Global Equities: Embracing Uncertainty

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Despite lackluster corporate earnings and continuing geopolitical uncertainty headlined by the U.S.-China trade war, 2019 was a great year for markets. We entered 2020 with positive and modestly improving growth expectations. Purchasing Managers' Indexes appeared to be bottoming, huge amounts of liquidity remained, and the prospects for corporate earnings were improving. But only a couple of months into the new year, financial markets have been hit by the rapidly spreading coronavirus outbreak and a monumental collapse in oil prices.

Recent volatility is certainly understandable given markets are fearful of the unknown, with the scale and longevity of the coronavirus impact being the definition of "unknown." However, while times like these are challenging for investors, we also believe they can help sharpen conviction in underlying investments, especially those that should sustainably emerge from this period.

Maintaining a Calm and Reflective Response

Since the global financial crisis, we have witnessed both volatility and opportunity on an unprecedented scale. This is the latest chapter in an extraordinary equity cycle, and while concentrating our current efforts on stock selection and risk control, we are viewing our decisions within a framework of four key big picture influences:

- Interest rates
- Oil
- U.S. presidential election
- Coronavirus

While recent interest rate cuts and monetary stimulus actions are generally positive for equities, they have their limits and are currently fighting the other key issues listed above that constitute real and uncertain risk factors.

While an oil supply surge would normally be positive for the global outlook, given that most economies are net energy importers, 2015–2016 highlighted that price declines this large and quick can do more harm than good, especially via credit markets if balance sheets in the sector are called into question.

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The coronavirus and oil price collapse has certainly accelerated the convergence of central bank interest rate expectations and long-end bond yields. All major central banks have slashed rates to close to zero and some have restarted quantitative easing to tackle the pending global recession. With monetary policy reaching its limits, we are also seeing renewed and coordinated fiscal response to help support economies, as we deal with the near-term crisis in economic activity levels.

At the same time, the unpredictability of a U.S. presidential election also needs to be monitored closely given the U.S. is the largest market represented in the portfolio.

In terms of the outlook for equities on a risk-adjusted basis, we have for some time viewed the world as a shade of gray as opposed to black or white. As we noted in our last T. Rowe Price Insights: *Why I Am Still Confident in Emerging Markets,* we had reduced the degree of risk within the portfolio coming into 2020, given the need to maintain a balanced portfolio and account for the mosaic of risk and return opportunities.

While volatility has been dramatic and we have not been able to fully avoid the recent equity sell-off, our ownership of quality and growth-oriented stocks helped on a relative basis. Our beta[1] was neutral heading into this period of instability, and we also benefited from a successful earnings season for many of the stocks we own. The market has rewarded companies that delivered strong earnings, while punishing those that were less robust, resulting in a wide dispersion of returns.

As we are comfortable with the durability and medium-term growth prospects for many of our holdings, we have not made any wholesale or strategic changes to the fund as a result of the recent spate of market volatility. Most of our recent trades have been repositioning the fund on the margin into high-quality businesses that were trading at much more reasonable valuations.

Tried and Tested

The strategy’s investment principles, which are centered on stock selection and a thoughtful approach to portfolio construction, have been tested in these more volatile times, just as they have been in other periods of crisis. Our ability to deliver alpha[2] in both up and down markets over more than 10 years of managing the fund gives us confidence in our approach.

Importantly, the depth of our research and scale of our global research platform give us an increased level of comfort that we have thoroughly tested and know the businesses we invest in.

Our focus remains on looking for durable, growing businesses in good industries that also offer a valuation opportunity that gives high-conviction upside potential. We therefore continue to concentrate on what we do well—finding stocks in which we have insights about cash flow and durable earnings growth where businesses have not been recognized and valued properly by the market.

Where Do We Go From Here?

While we certainly do not want to underestimate the near-term impact from the coronavirus outbreak, history shows that events like this tend to offer opportunities for investors that have a long-term orientation. We are likely to see more volatility in the coming weeks and months until we get more certainty around the outbreak’s economic impact, but it should not alter the long-term fundamental thesis of many of the companies we own.

[1] Beta is a measure of the volatility, or systematic risk, of an individual stock or fund in comparison to the unsystematic risk of the entire market. It is a numeric value that measures the fluctuations of a stock to changes in the overall stock market. Beta measures the responsiveness of a stock’s price to changes in the overall stock market.
[2] Alpha is a term used in investing to describe a strategy’s ability to beat the market (benchmark index). It is often referred to as “excess return.”

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If there's one silver lining to the recent volatility, it's that the conversation has quickly turned away from "extreme valuations" that investors raised as a barrier to investing. With a longer-term approach to investing, we believe the fear of others will continue to present us with attractive opportunities that simply weren't available two months ago across global markets.

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