



2023 Global Market Outlook

The Need for Agility





Executive Summary

MACRO

Central banks and the delicate economic balancing act

There's never been a spike in inflation above 5% that didn't trigger a recession. Despite the high chances of an economic slowdown, there are still ways for investors to play offense in 2023.

EQUITIES

Now's the time to be selectively contrarian, we believe, in certain strategies

The trend toward higher inflation and interest rates has major implications for investors. In our view, significant equity opportunities still can be found in this shifting paradigm.

FIXED INCOME

Yield is back in fixed income markets (finally)

A brutal year for bond markets in 2022 ended with a silver lining: Fixed income yields rose to some of the most attractive levels since the global financial crisis. We see several ways to take advantage.

GLOBAL ECONOMICS

Deglobalization in a connected world

Recent events are causing a profound reconfiguration of supply chains across the globe. Adaption will create new winners and losers across industries—and new opportunities for skilled active managers.

MACRO

An Economic Balancing Act

Markets Are at a Turning Point

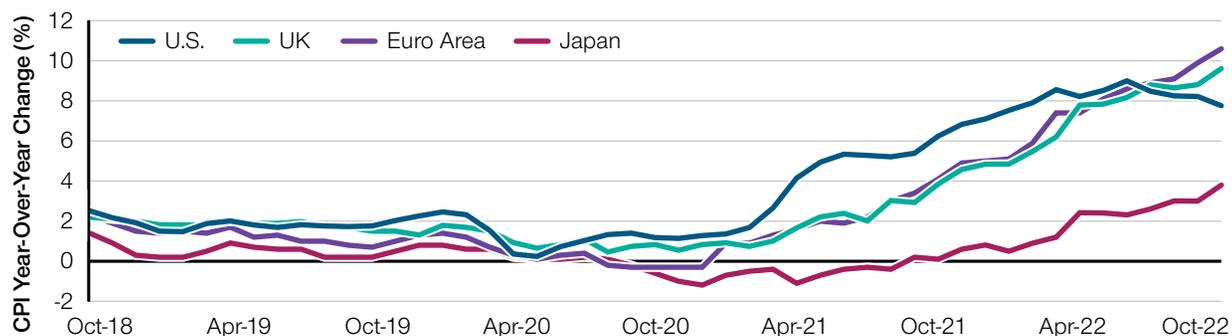
2022 was one of the most challenging years in capital markets history: We endured the worst stock market performance since the global financial crisis; the worst bear market on record for bonds; and the worst performance for a 60/40 (stock/bond) portfolio since 1929, as stock and bond markets collapsed simultaneously.

Entering 2023, investors stand at a major turning point. The global economy has shifted from decades of declining interest rates into a new regime, marked by the persistent pressure of inflation and interest rates that are being raised aggressively across the globe in response.

An Uncertain Path Forward: Inflation and Recession Risks

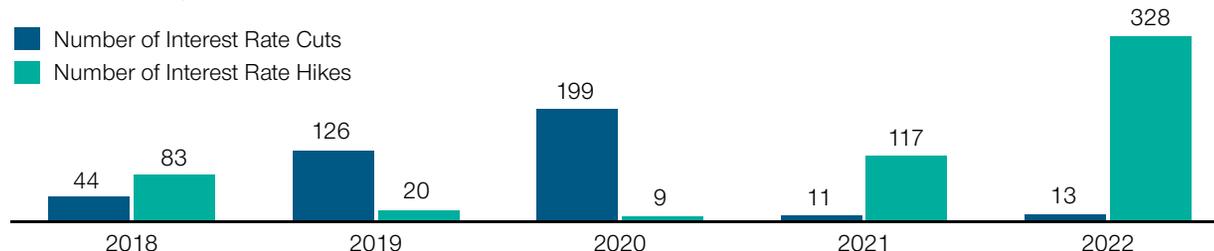
As of October 31, 2022

CONSUMER PRICE INFLATION (CPI)

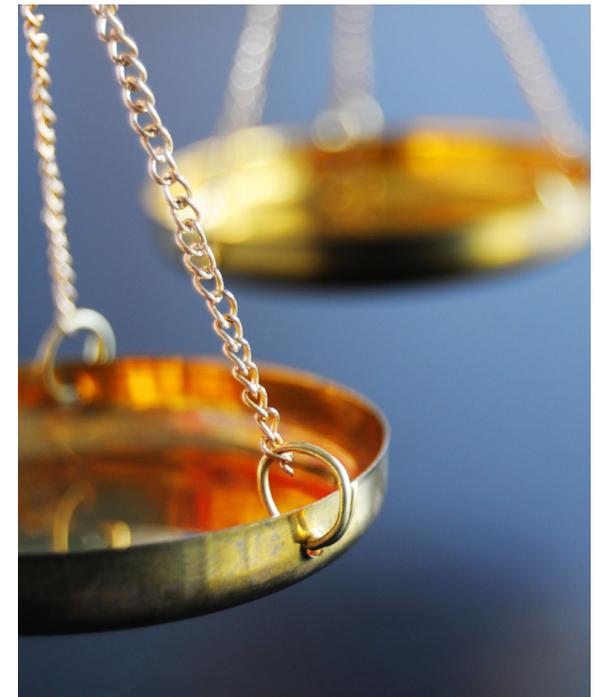


MONETARY ACTIONS

As of November 30, 2022



Sources: Bloomberg Finance L.P. and Bloomberg Index Services Limited, CB Rates (see Additional Disclosures).
Number of interest rate cuts and interest rate hikes made by all central banks globally.



So what happens next? The lag between central bank action and its impact on the economy means that this year the effects of past interest rate hikes will continue to be felt.

The outlook for inflation and interest rates will remain critical. Sticky inflation creates considerable uncertainty about where interest rates will peak in this U.S. Federal Reserve (Fed) tightening cycle. Fed policymakers hope to be able to pause at some point to allow the impact of previous rate hikes to work their way through the economy. Whether a pause turns into a pivot or is followed by additional hikes will depend on the balance between inflation and recession risks. But a quick turn to easing in 2023 appears unlikely.

EQUITIES

Leaning Against the Wind

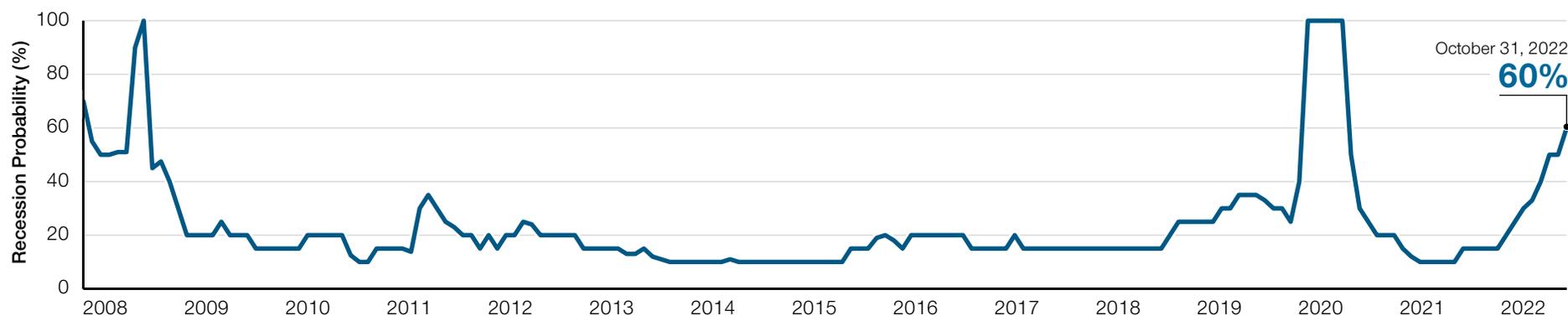
Recession in the Cards

Although an economic recession within the next 12 months is not a certainty, history is not on our side. Here are three statistics that illustrate the risk that the Fed's monetary tightening will end in recession:

1. 10 of the last 13 hiking cycles ended in recession in the United States.
2. The Fed has never lowered inflation by 4% or more without triggering a recession.
3. There has never been a spike in inflation above 5% that didn't result in a recession.

Bloomberg U.S. Recessions Probability Forecast

As of October 31, 2022



Sources: Institute for Supply Management/Haver Analytics, J.P. Morgan/IHS Markit, Bloomberg Financial L.P. (see Additional Disclosures). Data analysis by T. Rowe Price.

Earnings Estimates Are Falling

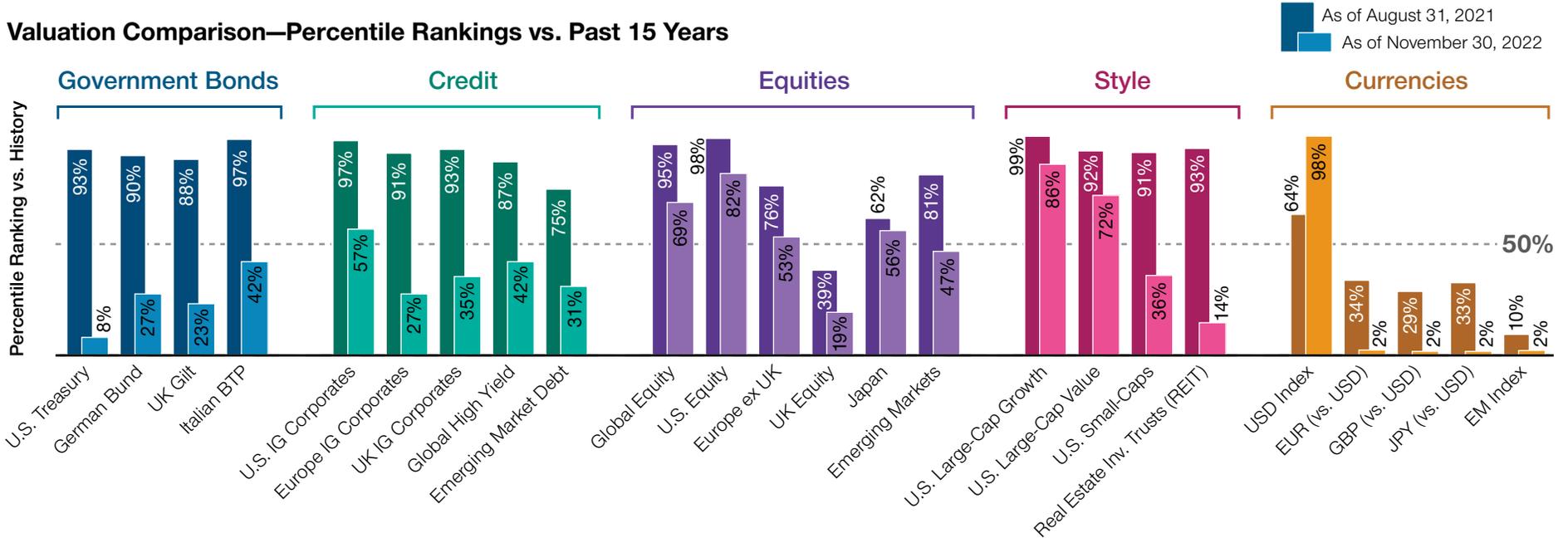
As of the end of November, forward consensus estimates predicted mid-single-digit growth in earnings per share (EPS) for the U.S. and Japan over the following 12 months, and even slower EPS growth in Europe and the emerging markets. Unfortunately, those estimates may be overly optimistic, as past U.S. recessions typically have resulted in 15% to 20% earnings declines for the S&P 500 Index. Consider these possible U.S. earnings scenarios ahead:

- **A soft landing**, in which case recent EPS assumptions for the S&P 500 Index appear reasonable.
- **A “normal” recession**, based on the last four U.S. recessions (not including the 2008–2009 global financial crisis), resulting in an EPS decline by 19% over the next 18 months.
- **A more bearish scenario**, with shrinking profit margins, that produces EPS losses somewhat worse than in a “normal” recession.



The Good News: Current Valuations Generally Appear Favorable

Fortunately for investors, the starting point in 2023 for most major asset classes is generally favorable. Any time valuations are below the dotted line shown in the chart below, it indicates an opportunity to invest at a discount relative to the historical 15-year average of the asset class.



Past performance cannot guarantee future results.

Indices listed in the order in which they appear above from left to right: U.S. 10-year Treasury, German 10-year bund, UK 10-year gilt, Italian 10-year BTP, Bloomberg U.S. Corporate Aggregate, Bloomberg EuroAgg Corporate, Bloomberg Global Aggregate Corporate—United Kingdom, Bloomberg Global High Yield, Bloomberg EM USD Aggregate, MSCI AC World, S&P 500, MSCI Europe ex UK, MSCI UK, MSCI Japan, MSCI EM, Russell 1000 Growth, Russell 1000 Value, Russell 2000, FTSE EPRA/NAREIT Developed, U.S. dollar, EUR spot, GBP spot, JPY spot, JPM EM currency index.

Sources: T. Rowe Price analysis using data from FactSet Research Systems Inc. All rights reserved. Source for Bloomberg index data: Bloomberg Index Services Limited, MSCI, Standard & Poor's.

Please see Additional Disclosures.

Value Exposure Could Be Even More Valuable in 2023

We know from history that regime changes nearly always bring changes in market leadership. We believe the value style should be a long-term beneficiary of this rotation. As a group, value stocks historically have outperformed growth stocks in high-inflation periods. Value also appears historically inexpensive relative to growth, even though U.S. value benchmarks significantly outperformed their growth counterparts in 2022. A selective approach will be key.

Small-Cap, Big Opportunity

U.S. small-cap stocks could offer relative performance advantages if the U.S. economy doesn't fall into a deep economic recession in 2023. On average, small-cap earnings have recovered more quickly than large-cap earnings in past economic recoveries. U.S. small-cap valuations also appear cheap, both in historical terms and relative to large-caps, as we see above. Again, selectivity will be key.

The Return of Yield

The Increasing Appeal of Bonds

Rising rates in 2022 pushed yields in many global fixed income sectors to the most attractive levels in decades, which could offer strong return potential in 2023. Higher yields were mirrored in greatly improved valuations for both sovereigns and private credits, with many sectors selling close to, or below, their 15-year historical medians as of late November. Higher-quality credits in the mortgage-backed and asset-backed sectors also are attracting inflows from investors who are looking to shift away from equity overallocations, put cash to work, or extend duration.*

High Yield Bonds in Focus

High yield bonds could offer particularly attractive return opportunities in 2023. Credit spreads—the yield difference between private credits and comparable U.S. Treasury maturities—have widened while default rates remain relatively low, enhancing their reward-for-risk proposition. Corporate balance sheets are in strong shape, generally. And the energy sector accounts for a smaller share of U.S. high yield debt than in the past, reducing default sensitivity. That said, if the U.S. economy slips into recession, default rates almost certainly will rise. But it would take a substantial leap to offset the return advantage built into current spreads.

High Yield Default Rate and Yield to Worst**

As of October 31, 2022



Past performance cannot guarantee future results.

*Duration refers to how long it takes for an investor to be repaid a given bond's price by that bond's total cash flows. It is often used as a way to measure the sensitivity of a bond's price to changes in interest rates.

**Yield to worst is a measure of the lowest possible yield that can be received on a bond without that bond defaulting on its payments.

U.S. Default Rate, based on par amount. Yield to Maturity and Default Rate correspond to the J.P. Morgan High Yield Index.

Source: J.P. Morgan Chase & Co. Please see Additional Disclosures for information about this J.P. Morgan information.



Deglobalization in a Connected World

Global Trade Reimagined

After decades of globalization, there is a growing narrative that peak globalization is now behind us. However, we believe the “deglobalization” trend has been exaggerated. Globalization has been defined by the fivefold rise in international trade as a percentage of world gross domestic product since the early 1950s. While that ratio has stopped rising, it also isn’t falling. That said, recent events have shown that globalization is profoundly changing. A number of economies have become dependent on critical imports from one specific part of the world.

European Energy: A Case Study

Europe’s heavy reliance on Russia for natural gas, for example, put its energy security at risk when the war in Ukraine sent gas prices soaring. Market forces can correct such imbalances if given time. Over the longer run, energy development could drive a massive global surge in capital spending on the transition from fossil fuels to renewable energy sources. Estimates on the amount of capital required to do so are as high as \$100 trillion. Capital expenditures on that scale should generate investment opportunities on an equally grand scale in the technology, materials, and capital goods sectors, as well as in alternative energy producers and efficiency innovators.

Four Drivers of Increased Capex Spending

As of October 31, 2022

NEAR TERM

-  **Inflation** will bring forward spending
-  **Fiscal Spending** on infrastructure

LONG TERM

-  **Deglobalization** leads companies to invest in more localized supply chains
-  **Green Transition** large-scale investment to meet net-zero targets



Is China Investable? We Think So, but There Are Several Factors to Consider

Investor anxiety about the economic and political future of China, the world's second-largest economy, weighed heavily on Chinese markets in 2022. Trade and technology conflicts added to investor unease, as the Biden administration unveiled new export controls designed to restrict China's access to advanced semiconductor technologies.

But pessimism may be overblown. China has taken demonstrable steps toward pivoting away from its zero-COVID policies, clearing the way for an acceleration in economic and earnings growth. Despite a turn toward stricter market regulation, China's political leaders, including President Xi Jinping, remain committed to a pro-growth agenda. Much of China's growth over the last three decades has come from property development, and that era is coming to an end. But different sectors should continue to drive a more moderate pace of economic growth. Furthermore, Washington and Beijing both have an interest in avoiding a major break, as that would likely cause a mutually assured economic depression.

Volatility Presents Opportunity for Those With the Knowledge and Skill to Take Advantage

Moving into 2023 and beyond, supply chains in some industries are likely to be reconfigured to limit disruptions such as those caused by war, the coronavirus pandemic, or a shifting geopolitical landscape. This could lead to stickier inflation and higher volatility. But adaption also will create potential opportunities for investors. The companies that can carve out important roles in the newer supply chains will be among the big winners—but skilled active management will likely be critical to take advantage of these opportunities.

Climbing the Great Wall of Worry

As of October 31, 2022



DOMESTIC POLICY RISKS

Key Risks:

- Data security
- Monetary deleveraging
- Environmental costs



GEOPOLITICAL RISKS

Key Risks:

- Russia-Ukraine spillover
- China-U.S. trade war
- Taiwan



ECONOMIC RISKS

Key Risks:

- Shifting COVID policies
- Lack of strong stimulus
- Property downturn



In a market defined by new normalities, **be active, look forward, and invest on the right side of change.**

“Change is the investor’s only certainty.”

Thomas Rowe Price, Jr.
(1898–1983)

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Risk Considerations:

Fixed income securities are subject to credit risk, liquidity risk, call risk, and interest rate risk. As interest rates rise, bond prices generally fall. Investments in high-yield bonds involve greater risk of price volatility, illiquidity, and default than higher-rated debt securities.

Small-cap stocks have generally been more volatile in price than large-cap stocks.

Investments concentrating in a specific sector can be more volatile than investments in a broader range of industries.

International investments can be riskier than U.S. investments due to the adverse effects of currency exchange rates, differences in market structure and liquidity, as well as specific country, regional, and economic developments. These risks are generally greater for investments in emerging markets.

Value and growth investing styles may fall out of favor, which may result in periods of underperformance. Investments in high yield bonds involve greater risk of price volatility, illiquidity, and default than higher-rated debt.

Diversification cannot assure a profit or protect against loss in a declining market.

Past performance is not a reliable indicator of future performance. The value of an investment and any income from it can go down as well as up. Investors may get back less than the amount invested.

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