Berg: Go Beyond Global Developed Markets

October 2014



Scott Berg
Portfolio Manager, Global Growth Equity

EXECUTIVE SUMMARY

As manager of the Global Growth Equity Strategy at T. Rowe Price, Scott Berg is known for his frequent travels around the world to examine companies first-hand. Scott joined the firm as an analyst in 2002. He was then made associate portfolio manager of the Global Focused Growth Equity Strategy before launching the Global Growth Equity Strategy in 2008. In this interview, Scott outlines his current views on the global landscape and his strategy.

Looking globally, what's the current picture?

We remain in a low- interest, low- growth world, and that reduces investor expectations. Still, global equities remain good value on a relative basis, and I think could achieve a return between 6% and 8% a year over the next three to five years. Some say valuations are extended but they're not. It's true that US stock valuations are at the highs prior to the financial crisis, but US companies now earn 25% above their pre-crisis levels.

Also if you look through a dividend lens, you can argue that companies are actually cheap. Global equities yielded about 2.5% at the end of September, while the 10-year German Bund yielded 1.0% and 10-year Treasuries yielded 2.5%. In 2007, global equities yielded near 2%, when you could get 3% from Bunds and almost 5% from Treasuries. So you can now own real, growing, profitable businesses with dividend yields above those of fixed income alternatives.

What's your approach to managing a global strategy?

I'm trying to harness the best thoughts of T. Rowe Price analysts, sector, regional managers and fixed income managers, and put them into a high-conviction portfolio of large- and mid-cap companies that is truly global. I'm invested in about 30 countries, almost twice that of many global managers who tend to focus on developed markets. By contrast, I invest in 15 different emerging and frontier countries. Additionally, I have a clear preference for growth and quality. I'm not just looking for businesses that are exceptionally cheap but for ones that are more profitable, faster growing, gaining share, better run and that have higher returns, better balance sheets, and great management teams. Lastly, I want stock selection—not sector bets—to drive returns.

What about valuations?

Once you identify exceptional companies, the only way to win is to buy them for less than their intrinsic value. I want to acquire these companies at a discount so I can potentially make 40% to 60% over two to three years. I almost never buy stocks with anything less than a year time horizon because markets are relatively efficient over the short term. I also rarely buy companies for 10 years because the world changes more in a decade than most people can fathom. The nice thing

about a two- to three-year holding period is that it means I care about the fundamentals on a three- to five-year basis.

I'm always looking at a mosaic of valuation methods, but my preferred method is based on free cash flow [operating cash flow minus capital expenditures]. Cash is what really drives businesses. Cash doesn't lie.

Why is the strategy so focused on emerging markets?

One big reason I like emerging markets is because they are a less efficient part of the market, and I'm fortunate to have a lot of analytic resources at T. Rowe Price to generate returns from these inefficiencies. Second, just mathematically, for all the headlines about the US leading the global recovery, emerging markets are still driving approximately 70% of global growth. The final thing is the very broad way I'm able to access emerging markets. BRICs, with the exception of India, are relatively well known, but they are only half of the emerging market opportunity set. This is why we look deeper and ultimately seek to invest in stocks and markets that we believe will define the next ten years of the emerging world growth story.

Then who are the emerging market winners?

I like emerging markets that are domestically driven, that are starting from a low per capita GDP and that have low debt to GDP—economies like India, Indonesia, the Philippines, Peru, and Turkey. For all the talk of emerging market troubles, their underlying consumption and growth stories are unchanged. In frontier markets, there can be liquidity constraints so I focus on two of the biggest that could evolve into emerging markets, Vietnam and Nigeria.

Where are you particularly finding growth companies?

The internet is still a game changer for the way consumers interact and purchase products—not just search companies, but other internet business models like Priceline and Amazon. Priceline, in particular, is an online travel company with a very broad set of consumers globally, pretty high ticket purchases, and which has taken a lot of share from travel agents. There are also a lot of interesting software companies that are taking share.

Another really interesting area is financials. In the developed world, I own some well-run financials that could benefit when rates and volatility move higher, such as Morgan Stanley and State Street. I also like high quality, traditional banks in fast growing markets like India and Indonesia. They're not valued differently to developed world banks even though their markets' growth rates are much higher. Owning these is a broad play on their economies' faster growth.

Last word?

In a relatively low-return world, many investors may have portfolios that are a little too defensive. Many may also have too much invested in their home countries and are missing opportunities elsewhere that they may not appreciate. I think global equities today potentially still offer a very attractive return, and allow investors access to great businesses around the world.

IMPORTANT INFORMATION

This material is provided for informational purposes only and is not intended to be investment advice or a recommendation to take any particular investment action. The views contained herein are as of October 2014, and may have changed since then. The specific securities identified and described do not represent all of the securities purchased, sold, or recommended for clients in the composite and no assumptions should be made that the securities identified and discussed were or will be profitable.

This document, including any statements, information, data and content contained therein and any materials, information, images, links, sounds, graphics or video provided in conjunction with this document (collectively "Materials") are being furnished by T. Rowe Price for your general informational purposes only. The Materials are not intended for use by persons in jurisdictions which prohibit or restrict the distribution of the Materials and in certain countries these Materials are only provided upon specific request. It is not intended for distribution to retail investors in any jurisdiction. Under no circumstances should the Materials, in whole or in part, be copied, redistributed or shown to any person without consent from T. Rowe Price. The Materials do not constitute a distribution, an offer, an invitation, recommendation or solicitation to sell or buy any securities in any jurisdiction. The Materials have not been reviewed by any regulatory authority in any jurisdiction. The Materials do not constitute investment advice and should not be relied upon. Investors should seek independent legal and financial advice, including advice as to tax consequences, before making any investment decision.

Issued in Australia by T. Rowe Price International Ltd ("TRPIL") (ABN 84 104 852 191), Level 50, Governor Phillip Tower, 1 Farrer Place, Suite 50B, Sydney, NSW 2000, Australia. TRPIL is exempt from the requirement to hold an Australian Financial Services license ("AFSL") in respect of the financial services it provides in Australia. TRPIL is authorised and regulated by the UK Financial Conduct Authority (the "FCA") under UK laws, which differ from Australian laws. For Wholesale Clients only.

Issued in Canada by T. Rowe Price (Canada), Inc. T. Rowe Price (Canada), Inc. enters into written delegation agreements with affiliates to provide investment management services. T. Rowe Price (Canada), Inc. is not registered to provide investment management business in all Canadian provinces. Our investment management services are only available for use by Accredited Investors as defined under National Instrument 45-106 in those provinces where we are able to provide such services.

Issued in the Dubai International Financial Centre by TRPIL. This material is communicated on behalf of TRPIL by the TRPIL Representative Office which is regulated by the Dubai Financial Services Authority. For Professional Clients only.

Issued in the EEA by T. Rowe Price International Limited ("TRPIL"), 60 Queen Victoria Street, London EC4N 4TZ which is authorised and regulated by the Financial Conduct Authority. For Qualified Investors only.

Issued in Hong Kong by T. Rowe Price Hong Kong Limited ("TRPHK"), 21/F, Jardine House, 1 Connaught Place, Central, Hong Kong. TRPHK is licensed and regulated by the Securities & Futures Commission. For Professional Investors only.

Issued in Japan by T. Rowe Price International Ltd, Tokyo Branch ("TRPILTB") (KLFB Registration No. 445 (Financial Instruments Service Provider), JIAA Membership No. 011-01162), located at GranTokyo South Tower 7F, 9-2, Marunouchi 1-chome, Chiyoda-ku, Tokyo 100-6607. This material is intended for use by Professional Investors only and may not be disseminated without the prior approval of TRPILTB.

Issued in New Zealand by T. Rowe Price International Ltd ("TRPIL"). TRPIL is authorised and regulated by the UK Financial Conduct Authority under UK laws, which differ from New Zealand laws. This material is intended only for use by persons who are not members of the public, by virtue of section 3(2)(a)(ii) of the Securities Act 1978.

Issued in Singapore by T. Rowe Price Singapore Private Limited ("TRP Singapore"), No. 501 Orchard Rd, #10-02 Wheelock Place, Singapore 238880. TRP Singapore is licensed and regulated by the Monetary Authority of Singapore. For Institutional and Accredited Investors only.

Issued in Switzerland by T. Rowe Price (Switzerland) GmbH ("TRPSWISS"), Talstrasse 65, 6th Floor, 8001 Zurich, Switzerland. For Qualified Investors only.

Issued in the USA by T. Rowe Price Associates, Inc., 100 East Pratt Street, Baltimore, MD, 21202, which is regulated by the U.S. Securities and Exchange Commission. For Institutional Investors only.

T. ROWE PRICE, INVEST WITH CONFIDENCE and the Bighorn Sheep design are, collectively and/or apart, trademarks or registered trademarks of T. Rowe Price Group, Inc. in the United States, European Union, and other countries. This material is intended for use only in select countries.

2014-GL-959