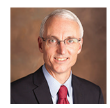
Finding Sustainable Sources of Excess Returns

Adopt a truly global approach, delve deeper, and have high conviction.

December 2019

KEY INSIGHTS

- Exploring the full opportunity set, including the best that emerging markets have to offer, can help alpha generation.
- Given diverging fundamentals across the world and especially the emerging world, it is crucial to focus on quality companies with the strongest and most durable earnings power.
- Determine the future economic potential of a company, its products, or services, but also focus on attractive industry structures. Have strong conviction and invest when valuation offers high upside potential.



Scott Berg
Portfolio Manager,
Global Growth Equity Strategy

We have enjoyed a remarkable period for equity investing since the global financial crisis, marked by both volatility and opportunity on an unprecedented scale. Since the launch of the Global Growth Equity Strategy, the financial landscape has been shaped by a range of events, forging one of the more remarkable periods in capital markets history. The strategy's investment principles, which are centered on stock selection and a thoughtful approach to portfolio construction, have been tested in this extraordinary environment. Throughout, the strategy has been able to navigate these more volatile times.

This would not be possible without the resources we have at T. Rowe Price. I firmly believe our global research platform provides me with a real advantage, given its breadth and consistency of results. This unique platform allows us to be truly global in nature, diversifying across sectors and geographies. It also enables the strategy to delve deeper into the opportunity set, including the best that emerging markets have to offer. This helps in the quest for durable and repeatable alpha.

Here are some of the key reasons why we believe this can be sustainable over the long term:

A Truly Global Approach

Many global equity managers limit their exposure primarily to developed markets, ignoring the full opportunity set available to them. We believe the ability to look beyond the index is crucial to producing a broader and potentially more rewarding opportunity set for a portfolio. Over the last few years, I have visited nearly 60 countries in the quest for new stock ideas. The result is that the representative

> "Our global research platform gives us coverage and an insight advantage over competitors.
>
> — **Scott Berg**
> *Portfolio Manager,*
> *Global Growth Equity Strategy*

We aim to capture the best of emerging markets through our bottom-up active management.

— Scott Berg
Portfolio Manager,
Global Growth Equity Strategy

portfolio[1] of the Global Growth Equity Strategy invested in 30 different countries, 13 of which are individual emerging markets.[2] By extending the opportunity set as wide as possible and leveraging the deep research resources of T. Rowe Price, I can discover more companies that meet the rigorous criteria for inclusion in the portfolio.

Extend Your Horizons and Delve Deeper

Casting the net wider is hugely advantageous. We believe that emerging markets have a range of growth characteristics that are not available in developed markets, allowing higher-quality companies in certain sectors to potentially generate sustainable earnings growth at a much higher rate than the global average. Banks are a great example, with the return on equity for emerging markets (EM) banks being far higher than their developed market counterparts (Fig. 1).

The growth profiles of countries like India, the Philippines, Indonesia, and Peru also offer up some great opportunities. India continues to grow at a fantastic rate, benefiting from a young population, low GDP per capita, and tremendous growth in the labor force. The rising urbanisation and growth of its middle class, along with dynamic new growth sectors, also offers great potential for investors.

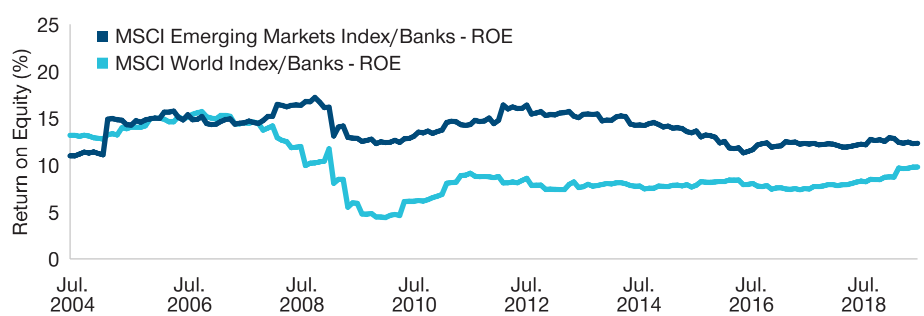
We would also point out the distorted view some global equity investors have of emerging markets. Many view them as a homogeneous asset class despite their substantial economic, political, and geographic differences. That view has led to periods of ebullience and despair for emerging markets with periods of outperformance and underperformance relative to developed markets.

Our strategy has always been to maintain a strong but selective exposure to emerging markets, marked by our nontraditional emerging markets exposure and little overlap with the MSCI Emerging Markets Index. Our active share of the Global Growth Equity representative portfolio's[1] emerging markets holdings is 84% compared with the MSCI Emerging Markets Index.[3]

The strategy also provides a good complement of emerging market exposure relative to many dedicated emerging market portfolios. This is because we often include peripheral and frontier emerging countries, and our sector orientation is often less diversified than dedicated EM managers due to our focus on long-term, secular growth opportunities in areas such as

(Fig. 1) Emerging Market Banks Offer Much Higher Return on Equity

Emerging Versus Developed Market Banks—Return on Equity (ROE)
As of 30 June 2019



Past performance is not a reliable indicator of future performance.
Source: MSCI via FactSet (see Additional Disclosures).

[1] The representative portfolio is an account in the composite we believe most closely reflects current portfolio management style for the strategy. Performance is not a consideration in the selection of the representative portfolio. The characteristics of the representative portfolio shown may differ from those of other accounts in the strategy.
[2] As of 31 December 2019.
[3] As of 30 September 2019.

> We strive to offer clients best-in-class stock picking across sectors and geographies.
>
> **— Scott Berg**
> *Portfolio Manager,*
> *Global Growth Equity Strategy*

financials and the consumer. This has served the strategy particularly well, with much of the outperformance coming from these areas.

We believe the EM index has areas where company quality is lower—areas we distinctly seek to avoid. Quality issues derive from a range of factors, including poor management, lack of governance (poor environmental, social, and governance practices), or the absence of positive drivers (sector disruption). Some state-owned enterprises (SOEs) fall into those categories.

High Conviction Is Crucial

Some argue that a highly concentrated portfolio is needed to generate alpha. We believe concentration does not equal conviction. Our research capabilities enable us to have actionable insights into every stock we own, facilitating a high degree of conviction about their potential to achieve our price targets.

Selectivity is key, however. Given diverging fundamentals across the world and especially the emerging world, we focus on quality companies with the strongest and most durable earnings power. Valuations are also integral to the process. We have a consistent price discipline with absolute and relative valuation considered versus history, the market, and industry.

Companies that demonstrate strong cash flow and durable earnings in the future and are yet to be recognised and valued properly by the market also come under the spotlight. Fertile industries conducive to sustainable growth, such as those demonstrating growth in market share and high barriers to entry, fall into that category. Understanding the mechanism and origins of market share gains for a company is imperative here, as it ultimately drives returns.

Conviction also extends to themes. When I identify a robust theme, I often have several holdings that align to that idea. For example, specific companies have been targeted for their potential to capitalize on the trend of the growing middle class within emerging markets. Rather than buy a multinational company with EM exposure, the strategy has distinctly focused on EM companies that offer products or services tailored to local tastes.

We believe that indirect exposure can, in some cases, be an incomplete substitute for direct EM investment and often doesn't allow the portfolio manager to capture the intended risk and return thesis. In less consolidated sectors, such as utilities, consumer discretionary, financials, and telecoms, direct investment is often crucial to capturing the premium growth stories.

The Connecting Thread—Bottom-Up, Fundamental Active Management

We believe that active management driven by bottom-up, fundamental research is best at uncovering and exploiting anomalies in equity markets. One of the core tenets of our investment philosophy is that quality growth stocks are frequently mispriced because the market underappreciates the durability of a long-term earnings stream. This is especially true in emerging markets where the demographic and secular drivers are very long term in nature. Another fundamental principle is that stock-specific factors are the key driver of stock prices over the long term. Ultimately, we look to invest in companies that offer high-quality, growing businesses in good industries, but that also offer a valuation opportunity that gives high-conviction upside potential.

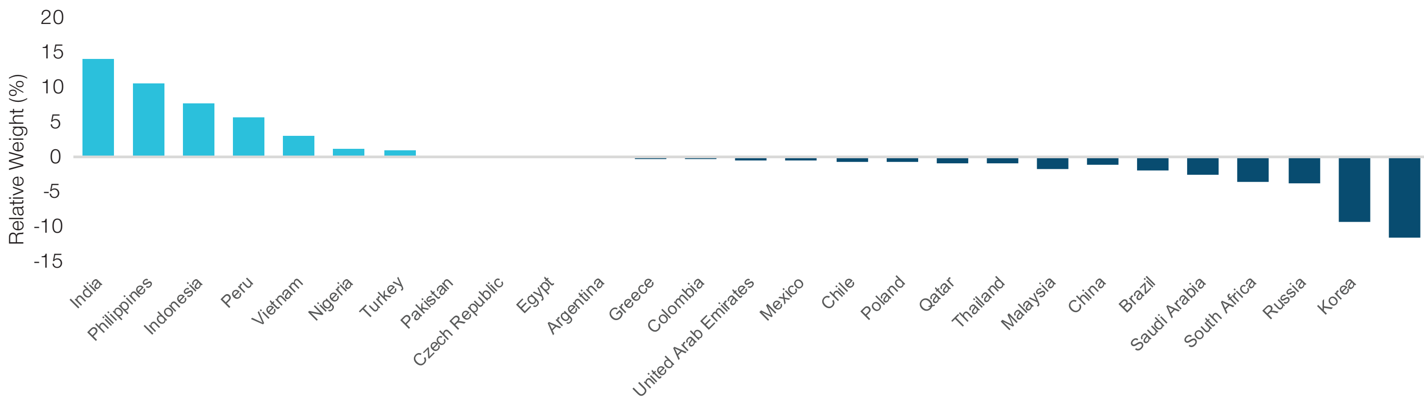
That goes to the core of active management—making difficult choices and systematically good decisions over long time horizons. The key is finding a sustainable source of excess return after fees, when pressures to reduce costs and avoid disappointment have become intense. We aim for the best-in-class set of returns, driven by what we do well over time—finding stocks where we have insights about cash flow and durable earnings that have not been recognised and valued properly by the market.

(Fig. 2a) Our Differentiated Approach to the Emerging World

Emerging Markets portion of Global Growth Equity Representative Portfolio versus EM Portion of MSCI All Country World Index

Country Weights

As of 31 December 2019



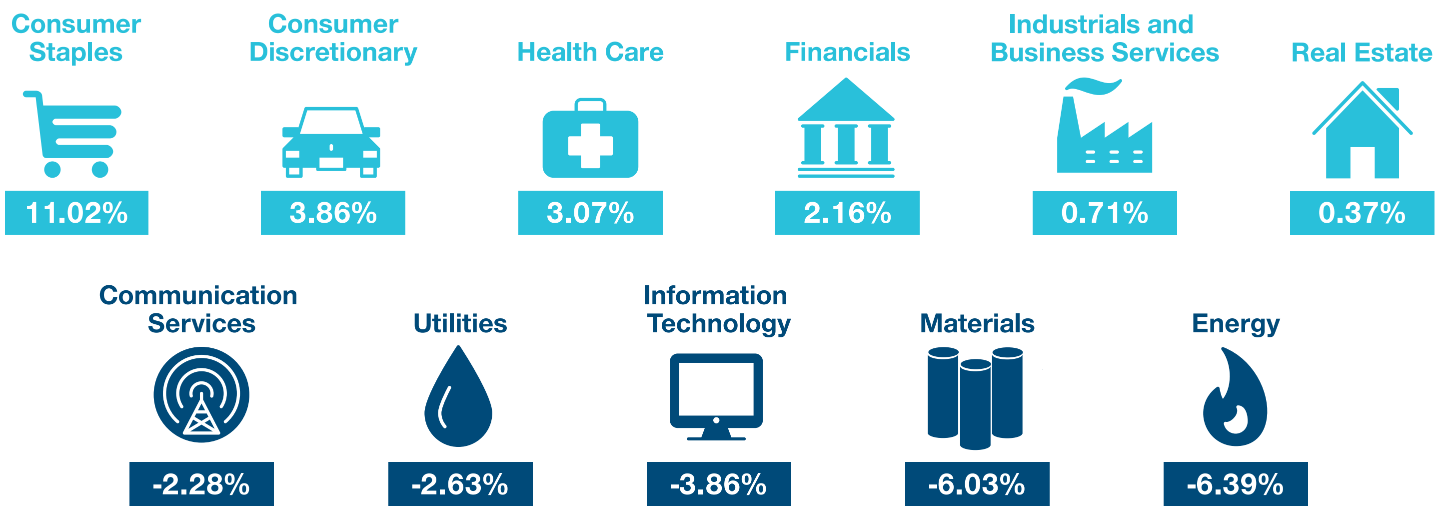
Source: MSCI via FactSet (see Additional Disclosures).
T. Rowe Price uses the current MSCI/S&P Global Industry Classification Standard (GICS) for sector and industry reporting. T. Rowe Price will adhere to all updates to GICS for prospective reporting.
The representative portfolio is an account in the composite we believe most closely reflects current portfolio management style for the strategy. Performance is not a consideration in the selection of the representative portfolio. The characteristics of the representative portfolio shown may differ from those of other accounts in the strategy.

(Fig. 2b) Our Differentiated Approach to the Emerging World

Emerging Markets portion of Global Growth Equity Representative Portfolio versus EM Portion of MSCI All Country World Index

Sector Weights

As of 31 December 2019



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Key Risks—Transactions in securities of foreign currencies may be subject to fluctuations of exchange rates which may affect the value of an investment. The portfolio is subject to the volatility inherent in equity investing, and its value may fluctuate more than a portfolio investing in income-oriented securities. The portfolio may include investments in the securities of companies listed on the stock exchanges of developing countries.

Additional Disclosures

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