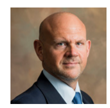
Tenerelli's Stock-Driven Approach Proves Its Mettle in a Challenging Europe

Skilled stock picking and a keen valuation discipline are key to generating excess returns.

June 2019



Dean Tenerelli
Portfolio Manager,
T. Rowe Price Funds SICAV
Continental European Equity Fund

KEY INSIGHTS

- A focus on fundamental research and a realistic approach to valuations have provided a solid foundation for navigating challenging markets.
- Higher-quality companies have shown to be more reliable generators of operational performance and better placed to respond to change.
- Looking ahead, selective cyclicals hold some appeal as Brexit uncertainty, trade disputes, and autos create interesting opportunities.

Dean Tenerelli has navigated a tumultuous decade in financial markets since he began managing the Continental European Equity Fund in May 2009. The period encompassed the bumpy recovery from the Global Financial Crisis (GFC), additional financial crises within Europe, and the increasing influence of central bank policy. On the recent 10-year anniversary of the fund, Dean reflected on the influence of past events and how they have reinforced the conviction in his approach.

The European market has enjoyed an annualized gain of almost 10% over the 10-year period I've managed the fund—although at times it never felt like it! The starting point was particularly fragile, with markets close to the troughs reached in the wake of the GFC. There were also several changes in market regimes to contend with, with investor sentiment swinging sporadically between the extremes of greed and fear as they reacted to changing investment fundamentals, national politics, and associated policy responses.

This is not to mention challenges associated with individual stocks. At times, I felt quite isolated investing in areas that were often dismissed by others. But I was also determined not to be complacent about investments that I believed were at risk of becoming crowded.

High-Quality Names Stand the Test of Time

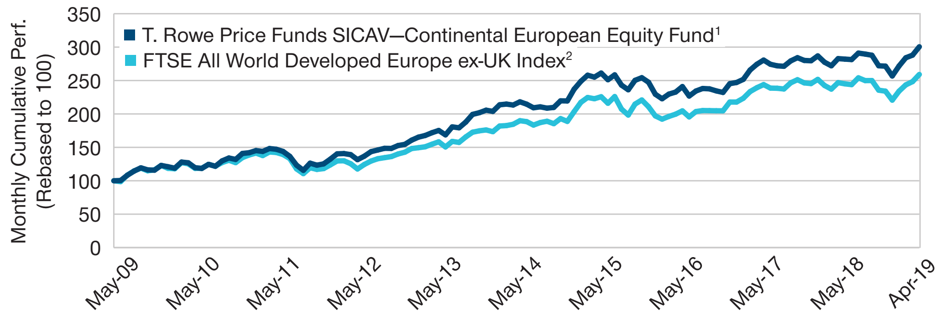
As the saying goes, "What doesn't kill you makes you stronger." On the whole, the past 10 years have featured a range of environments in which I've been able to test and validate my investment beliefs and process. Three key attributes, I believe, have helped me to establish an appropriate margin of safety that has assisted many of my investments.

> ...stock selection has almost exclusively been the source of excess returns...
>
> **— Dean Tenerelli**
> *Portfolio Manager,*
> *T. Rowe Price Funds SICAV*
> *Continental European Equity Fund*

(Fig. 1) Sustained Generation of Cumulative Returns Exceeding the Benchmark

Cumulative returns (in euros) for both the fund and the benchmark since manager inception

As of April 30, 2019



Past Performance is not a reliable indicator of future performance

[1] T. Rowe Price Funds SICAV–Continental European Equity Fund. Source for performance: T. Rowe Price. Fund performance is calculated using the official net asset value with dividends reinvested, if any. The value of the investment will vary and is not guaranteed. It will be affected by changes in the exchange rate between the base currency of the fund and the subscription currency, if different. Sales charges (up to a maximum of 5% for the A Class), taxes, and other locally applied costs have not been deducted, and, if applicable, they will reduce the performance figures. Where the base currency of the fund differs from the share class currency, exchange rate movements may affect returns.

[2] FTSE All World Developed Europe ex-UK Index. Returns shown with gross dividends reinvested. Performance is computed in U.S. dollars and converted to the currency shown using an exchange rate determined by an independent third party. The index shown is not an official benchmark. It is shown only for comparison purposes.

First, irrespective of headline and macroeconomic developments, experience served to strengthen my core conviction—that at the individual stock level, fundamental research and a realistic approach to valuation are essential foundations for navigating challenging markets.

Second, the benefits of investing in higher-quality companies have been repeatedly demonstrated. Operational performance has shown to be more predictable time after time, and when environments change, they have typically been well-placed to respond, particularly compared with those that have not shared the same competitive advantages.

And last, my valuation approach—which consciously guards against too much hope being discounted—has been a reliable anchor.

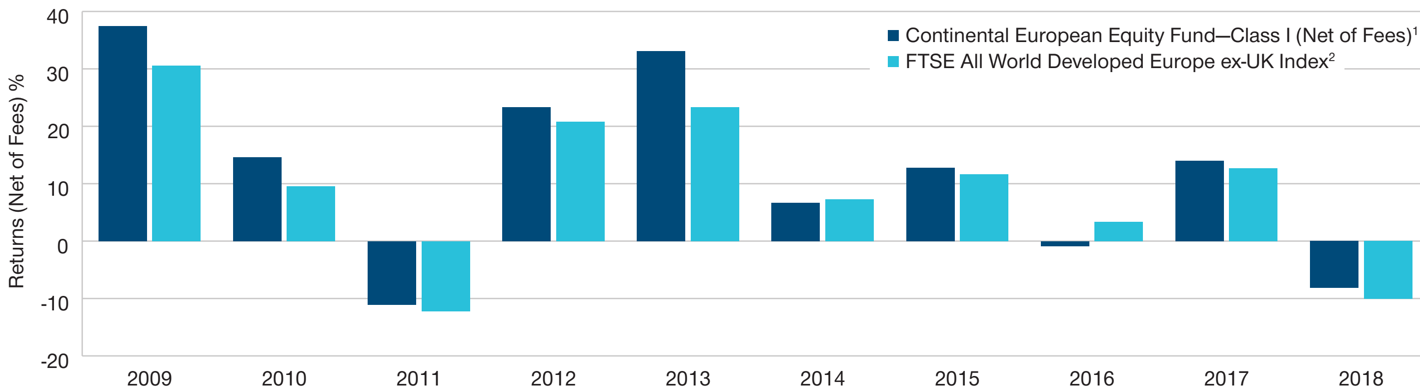
Skilled Stock Picking the Key to Excess Returns

What else have I learned? It has been a fascinating time to observe how economies, political systems, and policymakers develop and adapt. From an investment perspective, these dynamics create a distinct challenge: How does one optimally combine stock-specific insights with portfolio exposure considerations, be they stylistic, geographic, or policy instruments? Ultimately, there are no easy solutions. However, this has reinforced the need for continual vigilance of a range of potential performance influences as markets and the environment change—not always as one expects.

The attribution of performance since I began managing the fund, in my view, is a true reflection of how I manage investors' money. Over the 10-year period, stock selection has been one

(Fig. 2) A Consistent Record of Outperformance

The Continental European Equity Fund has outperformed its benchmark in eight of the last 10 years (returns in euros)
As of 2018



Past performance is not a reliable indicator of future performance.

[1] Source for performance: T. Rowe Price. Fund performance is calculated using the official net asset value with dividends reinvested, if any.

[2] Returns shown with gross dividends reinvested.

Performance is computed in U.S. dollars and converted to the currency shown using an exchange rate determined by an independent third party.
The index shown is not an official benchmark. It is shown only for comparison purposes.

8 years

The fund has outperformed its benchmark in eight of the last 10 years.*

* As of 2018.

of the main sources of excess returns, rather than sector or country allocations. Moreover, stock picking has been positive in a clear majority of sectors and countries.

In terms of stocks, some of the biggest contributors to returns were in information technology. They included Simcorp, a provider of software to fund managers (bought in 2010; sold this year). This investment illustrates that attractive long-term opportunities can be found in growth areas of the market, especially if valuation is restrained by an underappreciation of the medium-term growth opportunity. By contrast, another strong contributor, Spanish lender Bankinter showed that good-quality companies can also be found closer to the value end of the spectrum.

Spain, in particular, was an attractive source of alpha in most years. A memorable highlight was the incredible opportunities we found there amid the depths of the 2012 eurozone crisis.

While there will always be variations in shorter-term periods, I believe stock selection will continue to be the principle source of excess performance and, therefore, enable me to serve my investors well.

10 Years on—A Portfolio Balanced Between Cyclicals and Defensives

As ever, my portfolio is best understood from a "bottom up" perspective, built upon individual investment opportunities. Apart from a quality bias and a recognition that some of the best ideas can often be found among mid-cap stocks, there is rarely a theme to be found in the portfolio. This is not how I invest. The presence of a theme may even be a warning sign of an insufficient diversification of exposures.

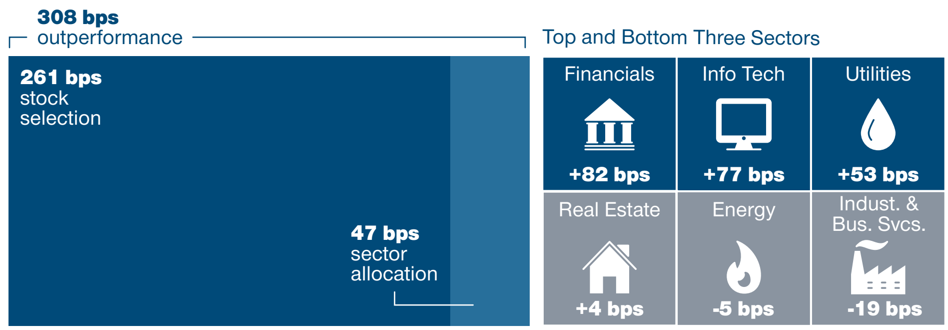
From an economic perspective, in my view, I feel that the portfolio is currently quite finely balanced at neutral, between the respective cyclical and defensive exposures. For much of last year it was tilted slightly more toward the latter, but the sell-off in the second half provided an opportunity to introduce greater

> One of the great attractions of investing in Europe is the breadth of opportunity across countries and regions.
>
> — **Dean Tenerelli**
> *Portfolio Manager,*
> *T. Rowe Price Funds SICAV*
> *Continental European Equity Fund*

(Fig. 3) Stock Selection the Main Source of Excess Returns in Past 10 Years

Contributions from stock selection and sector allocation to performance

As of April 30, 2019



Past Performance is not a reliable indicator of future performance.

Source: T. Rowe Price calculations using data from FactSet Research Systems Inc.

sensitivity to the economic cycle at far lower valuations.

From a sector perspective, the largest active exposures in the fund currently are to communication services (mainly media and entertainment) and utilities (primarily regulated). Neither of these are too pronounced, which serves to illustrate the balance in the portfolio. In terms of countries, relative to the benchmark, I am finding most opportunities across a range of industries in Sweden, Austria, Spain, and Italy. I struggle to see any overriding top-level theme here.

A Look to the Future—Watching European Banks, Automotives

Where could the most attractive opportunities emerge from in the coming months? One of the great attractions of investing in Europe is the breadth of opportunity across countries and regions. The analyst team and I must stay vigilant to capitalize upon emerging opportunities. European banks are an intriguing area. While there are structural challenges, valuations are low and investor sentiment may have swung too far. In the past six months or so, I have also added exposure to the automotive sector, which had underperformed materially. Additional opportunities could also emerge from the uncertainty in the UK caused by Brexit. Although the fund does not invest directly in UK-domiciled companies, that market is still important to many Continental companies and, indeed, economies.

European Growth Is Likely to Be Modest

I am not defying consensus when I say that the investing outlook in Europe is uncertain. In the shorter to medium term, economic momentum in Europe is slowing, although at this stage I do not expect a recession. One of the most pronounced developments in recent decades—the emergence of China as a major trading partner and source of economic and earnings growth—is proving to be a shorter-term impediment as negative influences emanating from there have quickly spread across the Continent, not least to Germany. Whether this proves to be longer-lasting will depend upon both national and international policies.

For this reason and others, I believe that earnings growth in Europe is probably going to be, at best, modest over the next two to three years. In this context, the recovery seen in the year to date could prove to be short-lived. A more positive development over recent quarters has been the greater variety of performance and valuation across and within sectors and markets. As a result, the ability to generate alpha could well become even more important, and market dynamics may be assisting active managers in doing this.

Confident We Can Find Strong European Companies

It has been a fascinating and rewarding decade at the helm of the fund. There have been many challenges, and there are problems that will need to be addressed in Europe this year and beyond. But I am continually reminded of the strengths of many European companies, both domestically oriented or leaders on a global scale.

Although I cannot predict how headline and macroeconomic factors will play out, I am confident in our ability to find great companies that can generate strong returns for investors in a range of market environments.

WHAT WE'RE WATCHING NEXT

European banks are an intriguing area. There are clearly structural challenges, but valuations are low and investor sentiment may potentially have swung too far. In the past six months or so, I have been adding exposure to the automotive sector as it underperformed materially. Uncertainty in the UK may also lead to opportunities among Continental companies for which the UK is an end market.

The specific securities identified and described do not represent all of the securities purchased, sold, or recommended for the portfolio, and no assumptions should be made that the securities identified and discussed were or will be profitable.

INVEST WITH CONFIDENCE℠

T. Rowe Price focuses on delivering investment management excellence that investors can rely on—now and over the long term.

T.RowePrice®

Risks—The following risks are materially relevant to the fund (refer to prospectus for further details):

Country risk (Russia and Ukraine)—In these countries, risks associated with custody, counterparties and market volatility are higher than in developed countries.
Currency risk—Changes in currency exchange rates could reduce investment gains or increase investment losses.
Small and mid-cap risk—Stocks of small and mid-size companies can be more volatile than stocks of larger companies.

General Fund Risks

Capital risk—The value of your investment will vary and is not guaranteed. It will be affected by changes in the exchange rate between thebase currency of the fund and the currency in which you subscribed, if different.
Equity risk—In general, equities involve higher risks than bonds or money market instruments.
Geographic concentration risk—To the extent that a fund invests a large portion of its assets in a particular geographic area, its performance will be morestrongly affected by events within that area.
Hedging risk—A fund's attempts to reduce or eliminate certain risks through hedging may not work as intended.
Investment fund risk—Investing in funds involves certain risks an investor would not face if investing in markets directly.
Management risk—The investment manager or its designees may at times find their obligations to a fund to be in conflict with their obligationsto other investment portfolios they manage (although in such cases, all portfolios will be dealt with equitably).
Operational risk—Operational failures could lead to disruptions of fund operations or financial losses.

Important Information

The Funds are sub-funds of the T. Rowe Price Funds SICAV, a Luxembourg investment company with variable capital which is registered with Commission de Surveillance du Secteur Financier and which qualifies as an undertaking for collective investment in transferable securities ("UCITS"). Full details of the objectives, investment policies and risks are located in the prospectus which is available with the key investor information documents in English and in an official language of the jurisdictions in which the Funds are registered for public sale, together with the articles of incorporation and the annual and semi-annual reports (together "Fund Documents"). Any decision to invest should be made on the basis of the Fund Documents which are available free of charge from the local representative, local information/paying agent or from authorised distributors and via www.troweprice.com

This material is being furnished for general informational purposes only. The material does not constitute or undertake to give advice of any nature, including fiduciary investment advice, and prospective investors are recommended to seek independent legal, financial and tax advice before making any investment decision. T. Rowe Price group of companies including T. Rowe Price Associates, Inc. and/or its affiliates receive revenue from T. Rowe Price investment products and services. **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.

The material does not constitute a distribution, an offer, an invitation, a personal or general recommendation or solicitation to sell or buy any securities in any jurisdiction or to conduct any particular investment activity. The material has not been reviewed by any regulatory authority in any jurisdiction.

Information and opinions presented have been obtained or derived from sources believed to be reliable and current; however, we cannot guarantee the sources' accuracy or completeness. There is no guarantee that any forecasts made will come to pass. The views contained herein are as of the date written and are subject to change without notice; these views may differ from those of other T. Rowe Price group companies and/or associates. Under no circumstances should the material, in whole or in part, be copied or redistributed without consent from T. Rowe Price.

The material is not intended for use by persons in jurisdictions which prohibit or restrict the distribution of the material and in certain countries the material is provided upon specific request.

It is not intended for distribution to retail investors in any jurisdiction.

DIFC—Issued in the Dubai International Financial Centre by T. Rowe Price International Ltd. This material is communicated on behalf of T. Rowe Price International Ltd. by its representative office which is regulated by the Dubai Financial Services Authority. For Professional Clients only.

EEA ex-UK—Unless indicated otherwise this material is issued and approved by T. Rowe Price (Luxembourg) Management S.à r.l. 35 Boulevard du Prince Henri L-1724 Luxembourg which is authorised and regulated by the Luxembourg Commission de Surveillance du Secteur Financier. For Professional Clients only.

UK—This material is issued and approved by T. Rowe Price International Ltd, 60 Queen Victoria Street, London, EC4N 4TZ which is authorised and regulated by the UK Financial Conduct Authority. For Professional Clients only.

Switzerland—Issued in Switzerland by T. Rowe Price (Switzerland) GmbH, Talstrasse 65, 6th Floor, 8001 Zurich, Switzerland. First Independent Fund Services Ltd, Klausstrasse 33, CH-8008 Zurich is Representative in Switzerland. Helvetische Bank AG, Seefeldstrasse 215, CH-8008 Zurich is the Paying Agent in Switzerland. For Qualified Investors only.

ID0002290 (06/2019)
201906-866630