T.RowePrice®
INVEST WITH CONFIDENCE

June 2015

EQUITY MARKETS COMMENTARY

STOCKS CONTINUE TO RISE, WITH SOME SETTING NEW HIGHS

US equities advanced in May as investors focused on positive economic data. The Labour Department reported that the economy added 223,000 jobs in April and that the unemployment rate edged down to 5.4%. Other signs of a rebound from first-quarter economic weakness included a second consecutive monthly increase in capital goods orders and strong new home sales growth. April industrial production and retail sales data were disappointing, however, and a report by the University of Michigan and Reuters revealed a sharp decline in consumer sentiment.

In non-US markets, Japan led Asian markets with modest gains, while other developed markets in the region declined. Among European markets, Italy and Switzerland rose modestly, but most others posted losses. While emerging markets equities underperformed, Asian markets held up best, helped by gains in India and Indonesia. Data showed that India's gross domestic product expanded more than 7% during the fiscal year ended in March, marking the country's fastest annual growth rate in four years.

OUTLOOK

UNITED STATES: May's mixed economic data failed to establish a strong shift in sentiment. On the positive side, the start of the month brought news that payroll growth had rebounded in April, and the four-week average of weekly jobless claims reached its lowest level in 15 years. New home sales picked up, and the manufacturing sector generally seemed to be maintaining its footing despite the stronger US dollar. On the negative side, data showed sluggish growth in consumer spending, and consumer sentiment appeared to be weakening as gasoline prices crept upward.

A key question for both investors and economists was whether the economy was in fact accelerating out of its winter slump, as many had hoped. Revised figures from the Commerce Department at the end of May revealed that first-quarter gross domestic product contracted at an annualized rate of 0.7%—very similar to the previous year's winter chill. T. Rowe Price Chief US Economist Alan Levenson notes that, along with another bout of especially bad weather in much of the country, the strike-related disruption of West Coast port activity played a significant role in this year's slowdown. He expects a rebound in exports to spur growth in the current quarter, and he observes that fixed investment in housing and durable goods is picking up.

Another uncertainty for investors was how Federal Reserve officials would react to the economic signals—a special concern given policymakers' recent pledges to let the data drive their decision about when to begin raising short-term interest rates. Fed Chair Janet Yellen at the 17th June meeting stated that the Fed was still on track to begin raising rates in 2015, but data does not dictate a rise as yet. T. Rowe Price portfolio managers are concerned, however, that investors may have grown complacent about the support provided to valuations by near-zero interest rates and historically low bond yields.

More constructively, very low interest rates have helped to fortify corporate balance sheets, and managers note that this is likely to support the market in coming months. Stock prices can receive a boost not only when corporations deploy their ample cash for stock buybacks and dividends, but also from Mergers and acquisitions (M&A) activity.

Perspectives on current stock valuations vary among T. Rowe Price managers, with some reporting finding greater difficulty in locating stocks that meet their investment criteria. The exceptional length of the current bull market is also a concern, as is weakness in many non-US economies. Nevertheless, they note that healthy corporate balance sheets and cash flows offer companies the flexibility not only to return capital to shareholders through dividends and share buybacks, but also to increase hiring, pursue mergers and acquisitions, and increase capital expenditures. All of these factors are likely to provide support to both the market and the overall economy in coming months.

EUROPE: The European Central Bank's (ECB) quantitative easing (QE) program has been a driver for the market and should help to boost activity, but the underpinnings for a growth revival in the euro area were already in place even before January's announcement. European corporate management teams have largely avoided or deferred investment and acquisition decisions. However, with confidence increasing, and with an unavoidable build-up of deferred investment to renew aging fixed assets, we are beginning to see an increase in M&A activity and capital spending as the economic cycle strengthens. Meanwhile, with the primary balance of the eurozone in surplus, there is less fiscal drag across large parts of Europe. The weaker euro should also help eurozone companies.

We do, however, have to remember that Europe is a particularly open economy (50% of the revenues in the index comes from outside Europe), and therefore any slowdown in global trends will have implications. But, while many have talked about a slowdown in China, it is still growing at around 7% per annum. Meanwhile, the US economy, one of Europe's major trading partners continues to stand out versus peers for its economic improvement.

Importantly, corporate earnings are beginning to come through stronger again in Europe. In the latest earnings season, there have been more upgrades than downgrades, and the principal driver around the upgrades has been the European portion of companies' earnings.

While some would disagree, we believe valuations are best described as 'reasonable' for where we are in the economic cycle, although we would stress that this view is premised on the delivery of more broad-based earnings growth. On a cyclically adjusted basis, the Price-to-Earnings (P/E) ratio for the European market is currently around 15-times versus a longer-term average of closer to 20-times. As this measure utilizes the average of the last 10 years' earnings, we believe it is a useful indication to the market's attractiveness assuming a normalized level of earnings.

Additionally, a dividend yield of over 3% can reward those seeking yield in this low-rate environment. At the same time, we have witnessed some important structural changes in Europe since the financial crisis. Most encouraging for us though is that valuations do not yet reflect normalized earnings, so there still remains potential for stocks to move further ahead.

JAPAN: Much like Europe, Japanese equities have enjoyed a phenomenal ascent as QE (monetary policy delivery has continually surpassed expectations); an improving corporate earnings outlook and a weaker yen have all helped the market rise strongly. However, we believe that what is priced into the market is only the first order impact. We have seen stocks perform well due to a weaker yen, but also on an improving domestic outlook. What is not yet reflected in the market is the improved competitiveness of Japanese companies. We are witnessing this in technology, where Japanese companies have been taking share back from South Korean companies, but also in other areas of the market.

It is also worth noting that Japanese companies have suffered yen appreciation for a number of years, and it will take time for that to reverse. Therefore, if the currency remains stable over the next two to three years, we should see Japanese companies start gaining share of global demand again, which will lead to higher profits.

Of course, a slowdown in the global economy would have a detrimental impact on Japan as it is still the most cyclical of developed markets. There are concerns emerging about the first hike in interest rates in the US and what impact that will have on the global economy. However, even when the Fed does begin to hike rates, it is most likely to be at a measured pace in order to assess the potential reverberations through financial markets and the impact on domestic growth.

It is also important to highlight that when interest rates do begin to rise this will not necessarily be bad for stock prices. Higher rates often coincide with improved economic conditions, which typically bode well for equities. Additionally, it will probably mean that the yen weakens further, thereby providing a boost to Japanese companies.

For many, much of the Japanese government's "third arrow" of structural reform has yet to be delivered. We have been monitoring the pause in progress given the need to reform, but more recently, we have become encouraged. First, both Japan and the US have been making great progress in the Trans-Pacific Partnership negotiations, despite some challenges from the powerful agricultural lobby in Japan. We have also had some important labour law reforms passed in the Japanese Diet. Corporate governance in Japan is also sustainably changing. Encouragingly, much of this has been put into law, which gives it a much more powerful and secular force.

This is encouraging as we believe there is still upside potential for the market as a number of factors are supportive for further gains. Japan combines both a domestic and a later-cycle earnings growth story. Attach attractive valuations compared with other regions, along with some selective self-help reform that will structurally improve Japan's profitability and the result is a positive backdrop for further gains. However, at a stock level it is becoming increasingly harder to find good companies at cheap valuations. Therefore, it is important to do your research to focus on where companies' returns are going to improve as the structural and corporate improvements happen. This means investors will need to be selective, but as Japan begins to deliver on its promise, investors should continue to be rewarded.

EMERGING MARKETS: The backdrop for Emerging Markets (EM) equities remains favourable. With indications that most central banks plan to maintain interest rates at lower levels for longer, this means the search for capital appreciation will continue and EMs remain a great source for this.

Some will point to the sell-off in EMs in the summer of 2013 on the announcement that the US Federal Reserve's was 'tapering' it's QE programme, and many investors are now worrying over a repeat sell-off as we approach the long anticipated first hike in US interest rates.

When US interest rates do start to rise, EM stocks may indeed suffer a temporary pullback, but we do not expect the economic impact to be significant. Short term, it may create some uncertainty as the hunt for yield in EMs may start to look less attractive. However, much will depend on why rates are hiked, and at what pace. If rates rise at a moderate pace because the US economy is doing well, it would be a good sign for the global economy, and should be positive for emerging markets.

We expect dispersion and volatility within markets to continue, so careful stock selection will be important to long-term performance. Although valuations are not as compelling as they were a year ago, EMs overall are still trading at a discount relative to their history, and continue to look attractive versus their developed-market peers. However, investors will have to be much more granular in their approach. We are likely to see a much more uneven world going forward, with less correlation and more dispersion of returns at both a country and sector level.

IMPORTANT INFORMATION

These Materials are provided for informational purposes only and are not intended to be investment advice or a recommendation to take any particular investment action. They provide opinions and commentary that do not take into account the investment objectives or financial situation of any particular investor or class of investor. The information is based on sources we consider to be reliable. However, we do not guarantee its accuracy. The views contained herein are as of 31 May 2015 and may have changed since that time. Unless indicated otherwise the source of all market data is Thomson Datastream.

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.

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.

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 US Securities and Exchange Commission. For Institutional Investors only.

C12IP1Y54
2015-GL-2083