



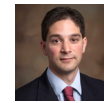
Market Uncertainty— Never Comfortable But Potentially Profitable

Bouts of uncertainty have historically created opportunities to generate alpha.

November 2019

KEY INSIGHTS

- A range of factors, both at a broad market level as well as company-specific concerns, are contributing to a general sense of market uncertainty. And with uncertainty comes weakening investor confidence.
- However, for U.S. large-cap growth investors, these periods of market uncertainty have historically provided some of the best opportunities to generate alpha.
- Beyond any short-term uncertainty, U.S. large-cap companies are driving much of the innovation that we are seeing in the market today. This remains an ongoing attraction.



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Large-Cap Growth Equity Strategy*

Any number of factors can combine to generate a broader sense of market or stock-specific uncertainty for investors. These can be macroeconomic or geopolitical concerns, such as the current U.S.-China trade tensions, the moderating growth environment, or a shift in central bank policy. Or they can be more stock specific, with disruptive industry trends as well as operational, regulatory, and competitive factors all coming into play. Ultimately, any uncertainty can lead to an erosion of confidence and weigh on stock market performance.

However, in the U.S. large-cap space—the most efficient part of the most efficient market in the world—these periods of uncertainty have historically provided strong alpha-generating potential. While never exactly comfortable, we see uncertainty as an opportunity.

Seizing Opportunity From Uncertainty

Market uncertainty creates potential pricing dislocation opportunities, as investors will frequently overreact in response to bad news. Whether it is at a broad market level, or specific to certain stocks, uncertainty creates short-term opportunities for long-term investors to potentially take advantage of this dislocation.

Importantly, for the T. Rowe Price US Large-Cap Growth Equity Strategy, we are constantly trying to identify and invest in innovative businesses—companies that, by virtue of their novel ideas, services, or products, have the potential to deliver long-term, compounded growth. These types of companies create potentially industry-disruptive uncertainty, and this is the kind we rush toward.

USD 8 billion+

Market cap of
companies included
within the U.S.

Large-Cap Growth
Equity universe—
equating to roughly
500 stocks.¹

Identifying companies that have these capabilities and potential demands research that goes beyond the day-to-day headlines. News stories create pockets of opportunity; however, it is difficult to make a lot of money from this kind of approach in the large-cap arena. It might be possible to achieve a 1% or 2% gain following a major news story. However, rarely is anything significant gleaned from this short-term “noise” that is ultimately useful in gaining a deeper insight into the company’s long-term growth or profit profile. In our experience, the only way to consistently try to capitalize on uncertainty in the U.S. large-cap sector, is by having a deep understanding of companies’ fundamental businesses and the distinctiveness of proposition they offer.

Looking Beyond the Short-Term Market “Noise”

Facebook is a great example of our approach. The stock fell from USD 210 in mid-2018, to USD 125 over the next six months, largely due to concerns about its approach to data privacy. Poor decision-making in the first instance and a distinct lack of transparency in communications once the issue arose weighed heavily on the stock.

However, looking beyond the immediate negative market reaction, we sought to revisit and retest our initial investment thesis. This involved further analysis into why so many companies use Facebook for their advertising, its principal revenue source. During a series of visits to companies across the country, most confirmed that advertising with Facebook represented the first or second most significant return on their investment. Understanding this, it became clear that the data privacy breach would not, of itself, see companies withdraw what is

effectively their most profitable avenue for growth.

As a long-term investor in Facebook, we also had a good understanding of the potential impact of major issues on daily/monthly average users. In this instance, despite the very public backlash, we observed only a relatively small negative impact on average user numbers.

The combination of these two factors meant that, when the stock price fell sharply, not only were we comfortable holding, but we added to our position during this period of weakness.

Dedicated, Fundamental Research Underpins Conviction Decision-Making

Boeing is another example where we have backed our conviction view through a period of heightened uncertainty for the company. Boeing faced a crisis in the wake of tragic incidents involving its new 737 MAX model aircraft. Through comprehensive research and insights into the sector, we were confident that Boeing could withstand the impact of the crisis.

Our dedicated sector analysts have a deep understanding of the aerospace industry, which is effectively structured as a duopoly. Our research highlighted that a heavy order backlog faces its main competitor, which is unlikely to be able to deliver on any new aircraft orders until around 2024/25. As a result, we felt confident to build our position in Boeing through the period of weakness.

Innovation Remains a Compelling Theme

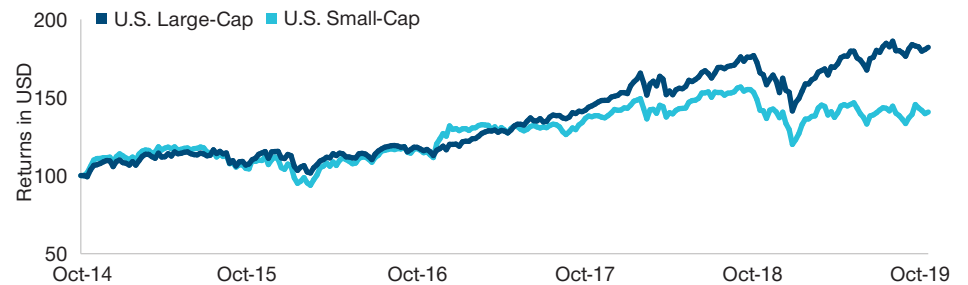
We continue to field questions from investors and prospects alike, essentially asking if we still feel the U.S. large-cap growth environment is a good place to invest right now. All bias aside, one of the ongoing attractions is the innovation

¹ Source: FTSE/Russell (see Additional Disclosure), as of 30 September 2019. Universe is represented by the Russell 1000 Growth Net 30% Index.

(Fig. 1) U.S. Large-Cap Companies are Driving Innovation

This trend has been reflected in market returns

As of October 11, 2019



Past performance is not a reliable indicator of future performance.

U.S. large-cap growth versus U.S. small-cap cumulative 5-year index performance. Indexes rebased to 100. U.S. Large-Cap = Russell 1000 (EOD) Growth - Price Index, U.S. Small-Cap = Russell RAFI US Small Co - Price Index. Price returns are shown and do not reflect reinvestment of dividends and income. Source: Refinitiv, © 2019 Refinitiv. All rights reserved, analysis by T. Rowe Price.

“...it is predominantly larger companies that are driving today’s market innovation.”

and potential market disruption that is coming from the large-cap area of the U.S. equity market, particularly from companies that are utilizing large data sets to their advantage. And we are not talking about any potential data privacy issues here but rather the analysis of vast sets of accumulated data to improve the consumer experience, for example.

Historically, market disruption has generally started with smaller companies leveraging a new and innovative product or service. However, today data is driving much of the innovation in the market. It takes very large data sets to drive the kind of disruption we are seeing. Given that this volume of data tends to be less available to smaller companies, it is predominantly larger companies that are driving today’s market innovation. This is a trend that has played out significantly over the last five years, with the influence reflected in relative market performance (Fig. 1).

Any use of data must be appropriate and within regulations, but the ability to beneficially utilize data is driving better targeting of advertising, leading to happier customers and improved revenues.

Market uncertainty is likely to remain prominent for the foreseeable future. Macroeconomic and political risks represent potential headwinds to negotiate, while at a company level, disruptive innovation as well as operational, regulatory, and competitive challenges will all continue to be impactful, creating stock-specific uncertainty. Nevertheless, we believe that there are sufficient market drivers in place to continue to support U.S. equities, while any increase in volatility could present attractive buying opportunities as investors will often overreact in this environment, both on the downside and the upside. For strategic, long-term investors, we believe this is a rich landscape.

WHAT WE’RE WATCHING NEXT

The U.S.-China trade dispute continues to weigh on investor sentiment, erode business confidence, and constrain capital spending. In our view, how this dispute evolves over the coming year will play a large part in determining the near-term performance of the U.S. equity market.

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