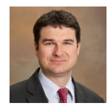
Five Rules for Investing During the Coronavirus Outbreak

Pitfalls to avoid and opportunities to seek.

April 2020



Justin Thomson
Chief Investment Officer, International Equities

KEY INSIGHTS

- Crises are a fact of life in financial markets, and although all crises are different, there are some common threads running through them.
- Lessons to learn from past crises include ensuring that you understand everything you own in your portfolio and avoiding the temptation of trying to call the bottom of the market.
- Other lessons include remaining invested, seeking out high-quality companies (which tend to recover strongly), and being on the lookout for fallen angels.

Crises are a fact of life in financial markets. Over the past 30 years alone, we have witnessed the early 1990s recession, the Asian financial crisis in 1997, the collapse of Long-Term Capital Management, the 2008–2009 global financial crisis, and the 2011–2012 European sovereign debt crisis, among others. Each of these crises was different, but there were also common threads running through them. As investors, what can we learn from them to help us navigate the coronavirus pandemic?

The current situation is particularly challenging because it is not just an economic crisis, but also a health and welfare one—governments are treading a fine line between avoiding an economic meltdown and trying to prevent health care systems from being overwhelmed. This crisis is also unusual because it is so acute: The descent from a record high of the S&P 500 Index to bear market territory has been extraordinarily swift and brutal. Further complicating the situation is the fact that the coronavirus has delivered an enormous, but as yet unquantifiable, dual demand and supply-side shock, with shortages of labor and medical supplies on the one hand and an excess supply of oil on the other. It's clearly a deeply worrying time.

Lessons From the Past

What common threads of previous crises can we see in the present one? Well, the process of de-risking has brought us the familiar pattern of sell-at-any-cost, disorderly markets and a breakdown in typically expected asset prices and correlation (shouldn't gold, for example, be going up at this point?). At the individual stock level, predicted betas have become unpredictable, as they usually do in a crisis (in other words, the mechanism of price discovery simply breaks down). This is both a

> …the process of de-risking has brought us the familiar pattern of sell-at-any-cost, disorderly markets…

source of frustration to investors (who cannot understand what they got wrong) and an opportunity as genuine mispricings occur. Above all, we are being reminded—as if we needed to be—that bear markets are intellectually and emotionally draining.

With all of this in mind, here are five suggestions to help you survive and ultimately thrive during this very difficult period:

1. **Be patient.** Do not try to solve for the whole world at once. In crisis markets like the ones mentioned above, it is natural to look at your entire portfolio or coverage list at once and think that getting market direction right is the only thing that matters—i.e., that fundamental security analysis is pointless. This is incorrect. The better you understand your companies, the more confidence you will have investing into air pockets. These moves should ultimately be rewarded when we get to the other side of this. Stay focused and break your workflow into manageable bites.

2. **Avoid predictions.** You cannot pick the bottom, so why beat yourself up about it? It is easy to start the day with optimism and get stuck in the market only to look foolish by midafternoon. Nobody, no matter what they claim, has the power of precognition—so avoid becoming obsessed with it.

3. **Stay invested.** Keep embracing risk, and remain allocated. When the reversal comes (and I am not calling the bottom here), we believe it will be powerful, and the majority of the potential upside will come in a limited number of sessions, so you will not be able to get invested in time. In all of the bear market cycles I alluded to previously, the inflection point only became apparent with the passage of time. No bell is ever rung to signify the bottom.

4. **Monitor quality.** Do not get anchored to the points that prices have fallen from. In security selection, we are always making a relative bet, but I recall from 2009 that it was "quality" (a subjective term, I know) that bounced hardest. The exercise is now one of selling low to buy low. Quality stocks now offer enough potential upside that you don't need to take existential risk with leveraged balance sheets. The pattern recognition from 2008–2009 was that stocks could be multi-baggers once they recapitalized, but the dilution to existing shareholders was painful.

5. **Be alert for fallen angels.** For those of you who operate in small-cap or high yield, the other pattern I remember from the 2008–2009 crisis is that of companies that were economically quite large and/or highly rated seeing their market caps (or ratings) compressed into small-cap or junk territory. These companies can present both opportunities and sources of index risk as they fall into benchmarks. After the global financial crisis, many of them soon recovered their mid- or even large-cap status.

So far, so tactical. But it is also important to be strategic. A new cycle is being set; there will be new trends and new market leadership. At this point, it is impossible to identify all of those trends, but at the very least, we appear to be in a new era of fiscal expansion. In the U.S., the fiscal stimulus announced so far amounts to around 7% of GDP and rising; in the UK, Robert Chote, the chairman of the UK Office of Budget Responsibility, recently said: "Now is not the time to be squeamish about public sector debt. We ran budget deficits in excess of 20% of GDP for five years during the second World War, and that was the right thing to do." For these reasons, I am going to hazard a guess that the era of ultralow rates might be coming to an end.

> You cannot pick the bottom, so why beat yourself up about it?

Finally, I should emphasize that truly great companies are rare. A 2016 study by Hendrik Bessembinder at Arizona State University, for example, found that from 1926 through 2015, just 86 stocks out of 26,000 examined accounted for 50% of the market's return. The top 1,000 companies (less than 4% of the total) accounted for 100% of the wealth creation during that time.

Opportunities to buy great companies at great prices are even rarer. We are currently at one of those moments.

WHAT WE'RE WATCHING NEXT

Like everybody else, we are closely monitoring the virus, the efforts of governments and health authorities to tackle it, and the response of markets to it. As it is impossible to predict when the bottom of the market will be reached, we continue to focus on remaining invested, keeping close tabs on everything we own, and looking for good-quality companies, including fallen angels, that should rebound strongly when markets recover.

Important Information

This material is being furnished for general informational and/or marketing purposes only. The material does not constitute or undertake to give advice of any nature, including fiduciary investment advice, nor is it intended to serve as the primary basis for an investment decision. 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.

Australia—Issued in Australia by T. Rowe Price Australia Limited (ABN: 13 620 668 895 and AFSL: 503741), Level 50, Governor Phillip Tower, 1 Farrer Place, Suite 50B, Sydney, NSW 2000, Australia. For Wholesale Clients only.

Brunei—This material can only be delivered to certain specific institutional investors for informational purpose upon request only. The strategy and/or any products associated with the strategy has not been authorised for distribution in Brunei. No distribution of this material to any member of the public in Brunei is permitted.

Canada—Issued in Canada by T. Rowe Price (Canada), Inc. T. Rowe Price (Canada), Inc.'s investment management services are only available to Accredited Investors as defined under National Instrument 45-106. T. Rowe Price (Canada), Inc. enters into written delegation agreements with affiliates to provide investment management services.

China—This material is provided to specific qualified domestic institutional investor or sovereign wealth fund on a one-on-one basis. No invitation to offer, or offer for, or sale of, the shares will be made in the People's Republic of China ("PRC") (which, for such purpose, does not include the Hong Kong or Macau Special Administrative Regions or Taiwan) or by any means that would be deemed public under the laws of the PRC. The information relating to the strategy contained in this material has not been submitted to or approved by the China Securities Regulatory Commission or any other relevant governmental authority in the PRC. The strategy and/or any product associated with the strategy may only be offered or sold to investors in the PRC that are expressly authorized under the laws and regulations of the PRC to buy and sell securities denominated in a currency other than the Renminbi (or RMB), which is the official currency of the PRC. Potential investors who are resident in the PRC are responsible for obtaining the required approvals from all relevant government authorities in the PRC, including, but not limited to, the State Administration of Foreign Exchange, before purchasing the shares. This document further does not constitute any securities or investment advice to citizens of the PRC, or nationals with permanent residence in the PRC, or to any corporation, partnership, or other entity incorporated or established in the PRC.

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.

Hong Kong—Issued in Hong Kong by T. Rowe Price Hong Kong Limited, 6/F, Chater House, 8 Connaught Road Central, Hong Kong. T. Rowe Price Hong Kong Limited is licensed and regulated by the Securities & Futures Commission. For Professional Investors only.

Indonesia—This material is intended to be used only by the designated recipient to whom T. Rowe Price delivered; it is for institutional use only. Under no circumstances should the material, in whole or in part, be copied, redistributed or shared, in any medium, without prior written consent from T. Rowe Price. No distribution of this material to members of the public in any jurisdiction is permitted.

Korea—This material is intended only to Qualified Professional Investors upon specific and unsolicited request and may not be reproduced in whole or in part nor can they be transmitted to any other person in the Republic of Korea.

Malaysia—This material can only be delivered to specific institutional investor upon specific and unsolicited request. The strategy and/or any products associated with the strategy has not been authorised for distribution in Malaysia. This material is solely for institutional use and for informational purposes only. This material does not provide investment advice or an offering to make, or an inducement or attempted inducement of any person to enter into or to offer to enter into, an agreement for or with a view to acquiring, disposing of, subscribing for or underwriting securities. Nothing in this material shall be considered a making available of, solicitation to buy, an offering for subscription or purchase or an invitation to subscribe for or purchase any securities, or any other product or service, to any person in any jurisdiction where such offer, solicitation, purchase or sale would be unlawful under the laws of Malaysia.

New Zealand—Issued in New Zealand by T. Rowe Price Australia Limited (ABN: 13 620 668 895 and AFSL: 503741), Level 50, Governor Phillip Tower, 1 Farrer Place, Suite 50B, Sydney, NSW 2000, Australia. No Interests are offered to the public. Accordingly, the Interests may not, directly or indirectly, be offered, sold or delivered in New Zealand, nor may any offering document or advertisement in relation to any offer of the Interests be distributed in New Zealand, other than in circumstances where there is no contravention of the Financial Markets Conduct Act 2013.

Philippines—THE STRATEGY AND/ OR ANY SECURITIES ASSOCIATED WITH THE STRATEGY BEING OFFERED OR SOLD HEREIN HAVE NOT BEEN REGISTERED WITH THE SECURITIES AND EXCHANGE COMMISSION UNDER THE SECURITIES REGULATION CODE. ANY FUTURE OFFER OR SALE OF THE STRATEGY AND/ OR ANY SECURITIES IS SUBJECT TO REGISTRATION REQUIREMENTS UNDER THE CODE, UNLESS SUCH OFFER OR SALE QUALIFIES AS AN EXEMPT TRANSACTION.

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

South Africa—T. Rowe Price International Ltd ("TRPIL") is an authorised financial services provider under the Financial Advisory and Intermediary Services Act, 2002 (FSP Licence Number 31935), authorised to provide "intermediary services" to South African investors.

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

Taiwan—This does not provide investment advice or recommendations. Nothing in this material shall be considered a solicitation to buy, or an offer to sell, a security, or any other product or service, to any person in the Republic of China.

Thailand—This material has not been and will not be filed with or approved by the Securities Exchange Commission of Thailand or any other regulatory authority in Thailand. The material is provided solely to "institutional investors" as defined under relevant Thai laws and regulations. No distribution of this material to any member of the public in Thailand is permitted. Nothing in this material shall be considered a provision of service, or a solicitation to buy, or an offer to sell, a security, or any other product or service, to any person where such provision, offer, solicitation, purchase or sale would be unlawful under relevant Thai laws and regulations.

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.

USA—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.

ID0003164 (04/2020)
202004-1138785