



Positioning for the Future in Global Equities

How our investment framework is adapting to the challenge of change.

March 2022

The last few years have been particularly challenging for investing, with the Russia-Ukraine conflict the latest event for investors to negotiate. Aside from the very concerning humanitarian issues, the conflict also has ramifications for future energy policy and near-term inflation as energy prices spike. We are also managing the fading of two of the largest drivers of markets in recent years: the coronavirus pandemic and the liquidity provided by central banks to support economic growth. We anticipate these trends will drive a change in behavior from both consumers and markets. This represents an opportunity to position for the future and aim to put our clients on the right side of the changes we believe will occur. This includes investing in areas that are likely to benefit from a rising rate environment, the reopening of economies, and countries where we believe a new economic cycle is just beginning, particularly in emerging markets.

Two Huge Distortions From the Pandemic Are Starting to Fade

Two major distortions came from the pandemic: (1) the extreme liquidity provided by the U.S. Federal Reserve and other central banks (negative interest rates and quantitative easing)



David Eiswert

Portfolio Manager,
T. Rowe Price Global Stock Fund

and (2) the extreme behavior that people went through during the pandemic—whether that was working from home or the breakdown of supply chains, shortages, or a change in behavior. Those two distortions are likely to reverse in 2022 and 2023 as we are asked to live with COVID-19 and central banks tighten monetary policy to tackle higher inflation.

The market chased these two distortions to extremes. Bubbles are the mis- or over-allocation of capital to specific sectors, and we believe that this happened during the pandemic. The market became crowded and price momentum driven. COVID-winners, U.S. stocks, and large-cap stocks were the largest beneficiaries. As we expect that these two great distortions fade and reverse to some extent, new and different opportunities will present themselves, driven by fundamentals that the market may not expect and is not priced for.

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Focusing on the Future—Where We See Improving Economic Returns

We fully expect markets to continue to react in the short term to the current crisis in Ukraine, along with individual data points (inflation, wages, and unemployment). But we need to position our portfolio for where we believe the world is heading.

We don't believe that this is a growth versus value debate. Instead, we are focused on companies where we believe there will be improving economic returns over the next few years—whether that be in financials as the Fed removes liquidity and interest rates begin to rise, or in reopening sectors, such as airlines, travel, hotels, and services that have been so badly impacted by the pandemic. For many of these companies, the return to normality gives us an insight of improving economic returns due to a return in demand. We also have the added benefit that many of these companies have used the pandemic to create efficiencies by investing in technology and improving their cost structures. The risk and the opportunity are that markets are not focused on those ideas. The market remains focused on the past.

Our Investment Framework Can Work Even as Environments Change

Importantly, as the world changes, our investment framework is flexible enough to adapt to different environments. It is our framework that helps identify companies with the potential to deliver improving economic returns. We do not necessarily believe that the best returns will be found in the same areas that worked over the last two years. There were many large-scale changes during the pandemic, including the acceleration of digital payments, e-commerce, delivery, streaming video, and video games. These are long-term powerful trends.

We remain invested in some of those companies, but we appreciate the pandemic demand pull forward will moderate. The real focus should be on the removal of Fed disruption and the likely return of industries in the economy that have been in hibernation, such as travel and aerospace. Those are the areas where we believe the best opportunities are to be found right now.

Being a global strategy also allows us to search for the best ideas throughout the entire investment universe. This lends itself well to our belief in being “carefully contrarian.” For example, we have seen significant pressure in emerging markets and a wide gap form between international stocks and U.S. domestic stocks. We believe this offers an opportunity, both in overweighting international markets, but also in looking at markets like China or Brazil for specific opportunities. This is a key part of how we allocate assets in the portfolio. We move around the world to the places where we see the best opportunities, and we see solid opportunities outside of the U.S. right now.

Of course, one of the more recent trends has been the concentration of flows into several mega-cap tech companies, with investors almost on autopilot when investing in those companies. We are not looking to make our alpha (or excess returns) from those names. We own some of those mega-cap stocks and are selectively betting on one in particular, but we believe there is more alpha to be found in understanding companies that others don't understand as well or own as broadly. Pursuing those idiosyncratic ideas is what makes us difficult to imitate. This does mean that our active share¹ is higher and therefore we are unlikely to deliver index-like positions for clients, but that is the point. We aim to deliver unique alpha that comes from our research platform and our investment framework.

¹ Active share is the percentage of the fund's holdings that differ from those of the benchmark index.

Managing the Risks and Opportunities Ahead

We believe inflation will remain high in the near term, especially as the Russia-Ukraine conflict intensifies. However, we expect inflation rates to moderate in the second half of 2022 and beyond as the bottlenecks caused by the pandemic are removed. We are likely to have the very unusual situation where inflation is falling but interest rates are rising. This is counterintuitive and will be difficult for markets to understand. It is the function of extreme distortion imposed by the Fed and now being removed, not market fundamentals. Long term, we believe inflation will settle lower than in recent months, but still at higher levels than the period before the pandemic. The market remains mispriced for this environment.

We have no certainty on how the current crisis in Ukraine will ultimately play out, but we will continue to monitor the situation. We are also following closely the direction of global energy policy over time as we see an increased urgency to diversify from traditional energy sources.

We do not, however, believe that the conflict disrupts what we are predicting in the gradual fading of the two large distortions that have driven markets in recent times. We expect the Fed will continue on its tightening path, and we also expect to see the reopening of economies around the world as COVID-19 is increasingly treated as an endemic disease.

We recognize that times like these can be very volatile and unsettling for investors. However, our strategy has always been built around a world that is changing. We embrace this and the potential to discover new companies and new ideas that will deliver value for our clients. At the same time, we always want to stick to the fundamentals that have proved successful so far—identifying insights about improving economic returns in the future and being disciplined around what we pay for companies, while embracing change and having an imagination. Those are factors that we believe will continue to deliver strong long-term results for our clients.

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