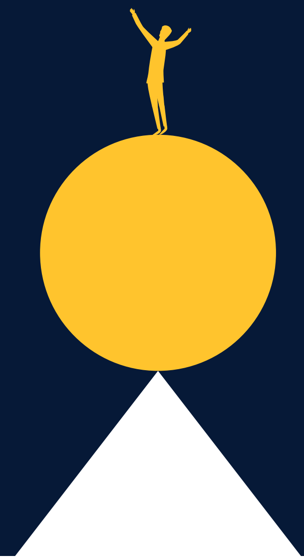
T. Rowe Price



Why balance is important amid equity market volatility

From the Field
July 2024

Key Insights

- A more challenging period seems likely for equity markets. Geopolitics, sticky inflation, and potentially peaking earnings growth are likely to generate some volatility.
- A small cohort of companies have dominated market performance this year, but the period ahead may be more complex and near-term earnings will likely drive sentiment.
- A more balanced portfolio with exposure to the best secular themes, coupled with areas that offer more defensive characteristics, will be important.

David Eiswert
Portfolio Manager, Global Focused Growth Equity Strategy

Nabil Hanano
Associate Portfolio Manager, Global Focused Growth Equity Strategy

Equity markets have performed well this year, but returns have been concentrated in a narrow subset of the market, namely artificial intelligence (AI) and artificial incretins (GLP-1s). However, we are entering a key earnings season in which many of the significant outperformers year-to-date may begin to see a slowing rate of returns improvement. In our experience, fundamental momentum tends to matter more in the short term for relative performance and valuation, and therefore the margin for error is smaller.

Two seismic developments: balancing exposure to artificial intelligence and artificial incretins (AI_2)

Corporate earnings for many large technology and health care companies have been strong over the past 18 months. However, in terms of the AI infrastructure buildout, we believe we are clearly past the early phase of adoption and most meaningful inflection in spending. It is wise at this point to question whether the current pace of capital expenditure growth can be sustained at these levels. The risk of an unexpected surprise in terms of earnings guidance could prompt a rotation out of AI names. That needs to be managed in a strategic manner, especially from a factor risk perspective.

> "The risk of an unexpected surprise...could prompt a rotation out of AI names.
>
> – David Eiswert
> Portfolio Manager, Global Focused Growth Equity Strategy

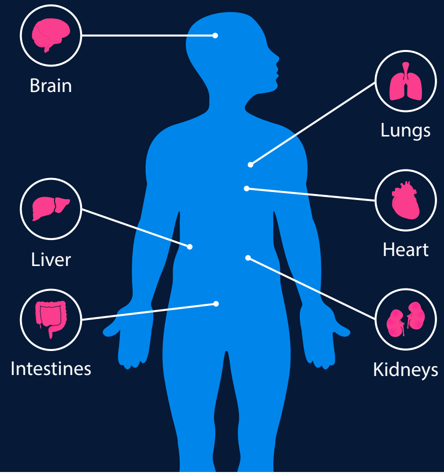
GLP-1 impacts beyond diabetes and obesity

While GLP-1 receptors are concentrated in the pancreas, they are spread throughout the body—and evidence is growing that GLP-1 drugs can interact directly with GLP-1 receptors found in other organs.

May reduce alcohol cravings, and early evidence suggests a possible role in avoiding neurodegenerative diseases such as Alzheimer's and Parkinson's.

May reduce fat buildup in those with fatty liver disease.

May speed the breakdown of fat cells to produce energy.



May reduce inflammation in the lungs and other organs, although it's unclear how much of this is due to weight loss.

May reduce inflammation in the heart and circulatory system.

May preserve kidney function in those with chronic kidney disease.

We have for some time treated our exposure to the so-called Magnificent Seven (Apple, Microsoft, Alphabet, Amazon, NVIDIA, Meta Platforms, and Tesla) as a separately defined sector. That allows more potential to govern the impact on portfolio returns versus the benchmark, particularly given the unusually high concentration of these stocks in market indices. The bar is now set extremely high for these companies in terms of earnings delivery—a risk that warrants due consideration.

While the initial infrastructure cycle for AI may be peaking, we are, however, only just beginning to see the potential benefits of AI in other areas. In the next few years, we expect to see an acceleration in terms of speed, productivity, and innovation as companies employ their AI capabilities. The potential is not limited to technology—it traverses nearly every sector and industry, some that may not be immediately obvious. Energy, industrials, and even real estate are all potential beneficiaries of the AI cycle.

The other seismic shift of recent years has been health care innovation, specifically the development of GLP-1s. We feel much more optimistic about the potential of this area in the near term. The benefits of these drugs keep expanding (see graphic). GLP-1s have been lauded, including claims that obesity could potentially be cured in the next 10 years. This has significant repercussions. The ability of the drugs to regulate body weight at a relatively low cost has huge potential benefits for both society and economies.

An oral version of GLP-1s is being developed and is likely to be available sooner rather than later. This would potentially see much greater adoption, and with it improved earnings for their manufacturers. Growth forecasts, however, will depend on constraints around capacity and the ability to deliver as demand increases.

Importance of building a balanced portfolio

Rising valuations and a stretched investment cycle demand consideration of the potential for market rotation. Building a portfolio that invests in technology and health care is important given the seismic shifts underway. But exposure here must be balanced with other areas such as energy, financials, industrials, and even consumer staples. These sectors have historically offered defensive qualities and steady growth that could potentially provide a buffer against market volatility.

> “While the infrastructure cycle for AI may be peaking, we are, however, only just beginning to see the potential benefits of AI in other areas.
>
> – Nabil Hanano
> Associate Portfolio Manager,
> Global Focused Growth Equity Strategy

The wider macroeconomic backdrop is also a key consideration. As we have conveyed previously, we believe we are in the early stages of an equilibrium shift. One where the economy has veered from abundance to scarcity. This will likely see inflation remain stickier and interest rates higher for longer. Geopolitical risks play into this dynamic. A more dangerous world means a higher risk premium put on natural resources and a greater importance on supply chain independence.

The U.S. presidential election cycle adds another level of complexity with different policy implications.

This mosaic of changes means that the playing field for investing is changing. Yet, this is where active management can take control. If the game has changed, it's important to change your strategy. But we believe this new equilibrium path offers new and broader opportunities, alongside a potential to build a better risk profile.

> "...we believe this new equilibrium path offers new and broader opportunities, alongside a potential to build a better risk profile.
>
> – David Eiswert
> Portfolio Manager, Global Focused Growth Equity Strategy

INVEST WITH CONFIDENCE™

T. Rowe Price identifies and actively invests in opportunities to help people thrive in an evolving world, bringing our dynamic perspective and meaningful partnership to clients so they can feel more confident.

The specific securities identified and described are for informational purposes only and do not represent recommendations. No assumptions should be made that investments in the securities identified and discussed were or will be profitable.

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. 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.

DISCLOSURE CONTINUES ON THE FOLLOWING PAGE.

ID0007243
202407-3738373