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August 2018

MONTHLY MARKET REVIEW



Monthly Market Review

U.S. STOCKS

AUGUST 2018

TECHNOLOGY SHARES LEAD BENCHMARKS TO NEW HIGHS

The major benchmarks recorded solid gains in August, helping all but the narrowly focused Dow Jones Industrial Average reach record highs. The technology-heavy Nasdaq Composite Index performed best, building on its outperformance for the year to date, and the small-cap Russell 2000 Index was also particularly strong. Growth stocks handily outpaced value shares across all market capitalizations. Relatedly, technology shares performed best within the S&P 500 Index, followed by consumer discretionary stocks, while the value-oriented energy and materials segments recorded losses. Volatility remained generally contained and trading volumes were muted, as is typical of late summer.

At mid-month, many media reports noted that the S&P 500 Index had established a record for the longest-running bull market—the length of time since the last decline of 20% or more. Analysts debate whether the bull market that ended with the technology stock crash in 2000 began in 1990 or as early as 1987, however, as the 1990 decline fell just short of 20%. The “dot-com” bull market of the 1990s was also significantly larger in magnitude.

Total Returns

	August	Year-to-Date
Dow Jones Industrial Average	2.56%	6.73%
S&P 500 Index	3.26	9.94
Nasdaq Composite Index	5.71	17.47
S&P MidCap 400 Index	3.19	8.68
Russell 2000 Index	4.31	14.26

Past performance is not a reliable indicator of future performance.

Note: Returns are for the periods ended August 31, 2018. The returns include dividends based on data supplied by third-party provider RIMES and compiled by T. Rowe Price, except for the Nasdaq Composite, whose return is principal only. Frank Russell Company (“Russell”) is the source and owner of the Russell index data contained or reflected in these materials and all trademarks and copyrights related thereto. Russell[®] is a registered trademark of Russell. Russell is not responsible for the formatting or configuration of these materials or for any inaccuracy in T. Rowe Price Associates’ presentation thereof.

PROFIT GROWTH REACHES EIGHT-YEAR PEAK

Stock-specific factors helped drive the market higher in August, as the remaining flow of second-quarter earnings reports confirmed that tax cuts, continued global growth, and other factors were resulting in a surge in profit growth in 2018. Indeed, according to FactSet data, after setting a multiyear record in the first quarter, profit growth for the S&P 500 accelerated a bit, expanding by 25.0% on a year-over-year basis in the second quarter and reaching a new eight-year high. Leading technology and Internet-related companies continued to record some of

the best gains, with Apple drawing particular attention at the start of the month as healthy sales growth for its new line of iPhones helped it become the first company in history with a market capitalization exceeding USD \$1 trillion.

STRONG LABOR MARKET SUPPORTS CONSUMER SPENDING

The month's economic data also appeared to boost sentiment. Payroll growth in July slightly missed expectations when it was reported on August 3, but the Labor Department also revised previous months' gains higher. T. Rowe Price Chief U.S. Economist Alan Levenson noted that employment growth, which averaged 215,000 jobs a month for the year through July, has accelerated from 2017 and is nearly double the pace needed to absorb labor force entrants over the medium term.

The healthy job market supported a rise in the Conference Board's measure of consumer confidence, which jumped in August to its best level in nearly 18 years. The University of Michigan's gauge of consumer sentiment declined to its lowest level since the start of the year, however, as Americans grew a bit more concerned about rising inflation and interest rates. Indeed, consumer price inflation continued to run slightly ahead of average hourly wage gains on an annual basis. Nevertheless, Levenson notes that consumer spending fundamentals remain sound. Total wage income—which takes account of the growing workforce and longer average workweeks—is growing at an annualized pace of roughly 5%, while recent strength in the U.S. dollar is holding down import prices.

MOUNTING TRADE TENSIONS CAUSE PERIODIC SETBACKS

The uncertain and highly volatile policy environment weighed on sentiment at times and may have restrained the month's gains. On August 10, stocks pulled back following a tweet from President Donald Trump announcing that the U.S. was doubling tariffs on metal imports from Turkey in retaliation for the country's imprisonment of American pastor Andrew Brunson. The announcement added to existing downward pressure on the Turkish lira, contributing to a broader fall in emerging markets currencies that periodically weighed on Wall Street and other global markets throughout the month.

Investors worried most about the continued escalation of the trade dispute with China. At the start of the month, Beijing announced that it had prepared a list of USD \$60 billion worth of U.S. imports targeted for duties if the Trump administration followed through on its threat to hike tariffs on USD \$200 billion of Chinese products. Tensions appeared to ease a bit at mid-month, helping the S&P 500 record its best daily gain for the month after reports surfaced that China was sending a mid-level trade delegation to Washington. The two-day talks ended without any apparent progress, however, and on August 23 both countries began implementing previously announced tariffs on each other's products. The month ended with a threat from President Trump to apply the proposed USD \$200 billion round of tariffs as early as September 6.

Trade discussions between the U.S. and Mexico took a more favorable turn. Stocks had their second-best day for the month on August 27, following news that the two countries had negotiated a new trade deal including revised rules governing the crucial cross-border automotive supply chain. Investors hoped that Canada would soon join a revised (if perhaps renamed) North American Free Trade Agreement, but the month ended without a deal between Canadian and U.S. negotiators.

IMPRESSIVE EARNINGS GROWTH IS LIKELY TO SLOW

While tax cuts are partly responsible for the recent jump in U.S. corporate earnings growth, another key factor has been unusually robust topline revenue growth—FactSet estimates that revenues for the S&P 500 grew by 10.1% on a year-over-year basis in the second quarter, the biggest gain since 2011. However, revenue growth is likely to moderate in line with longer-term trends, and the year-over-year impact of tax cuts is set to fade in 2019. Profit margins are also likely to face headwinds from higher interest rates, wages, and input costs. As a result, the members of the T. Rowe Price Asset Allocation Committee caution that earnings growth is likely to slow over the intermediate term.



Monthly Market Review

INTERNATIONAL STOCKS

AUGUST 2018

INTERNATIONAL EQUITIES LOST GROUND

Most international stocks fell in August amid escalating trade tensions between the U.S. and China and Europe, with emerging markets suffering the steepest declines in U.S. dollar terms. Ongoing trade disputes also weakened business sentiment in Europe.

Within the MSCI EAFE Index, every sector but one—information technology—gained. Financials led declines, at 3.92%. Health care, industrials and business services, consumer discretionary, and consumer staples outperformed the broad EAFE index. Growth stocks in the EAFE Index lost ground but widely outperformed value shares.

Total Returns

MSCI Indexes	August	Year-to-Date
EAFE (Europe, Australasia, Far East)	-1.92%	-1.87%
All Country World ex USA	-2.07	-3.16
Europe	-2.78	-2.25
Japan	0.23	-1.23
All Country Asia ex Japan	-1.00	-4.73
EM (Emerging Markets)	-2.67	-6.93

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All data are in U.S. dollars as of August 31, 2018. This chart is shown for illustrative purposes only and does not represent the performance of any specific security.

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EUROPEAN STOCKS HIT BY TRADE TENSIONS, TURKEY FALLOUT, AND ITALIAN BUDGET WOES

Trade tensions, worries about Italy's ability to meet European Union (EU) fiscal mandates, and concerns of a "no-deal" Brexit pressured European equities in August. Financial stocks fell amid concerns about European banks' exposure to Turkey, whose currency, the lira, lost about 26% against the U.S. dollar. Spain's BBVA, Italy's UniCredit, and France's BNP Paribas are among Turkey's biggest lenders. Italy remained the regional risk epicenter as Fitch Ratings placed the country on downgrade watch and the new government struggled to produce a budget to meet funding needs. Investors grew concerned that a potential breach of the EU's budget deficit limit (3% of gross domestic product) could hurt the relationship between Italy and Brussels. The MSCI Italy Index fell 9.49% in U.S. dollar terms, and the yield on the 10-year Italian bond—seen as a key indicator of risk sentiment—rose to its highest level since March 2014.

TRADE WOES WEAKEN BUSINESS SENTIMENT

Business sentiment indicators underscored the toll that trade tensions are taking on confidence. August manufacturing purchasing managers' indexes (PMIs) in Germany and the eurozone overall showed a weakening expansion and corporate optimism at a 23-month low. Concerns about a possible stalemate over the terms of the UK's withdrawal from the EU also grew after the UK government released contingency plans for a no-deal Brexit, which would take effect if the UK and EU failed to agree on an exit deal before the scheduled March 2019 exit. The pound fell to an 11-month low against the U.S. dollar.

JAPANESE EQUITIES RISE...

Japanese equities outperformed the broad EAFE index in U.S. dollar terms, returning 0.23%, and the yen rose 0.95% versus the U.S. dollar, supported by a more active Bank of Japan, which adopted a wider trading band for 10-year government bonds. Japan's economy expanded in the second quarter as household and business spending picked up. Japan's Reuters Tankan poll showed manufacturing business confidence hit a seven-month high, thanks to the global expansion, while the services sector remained under pressure from tepid domestic demand.

...WHILE EMERGING MARKETS DECLINE

Emerging markets equities and currencies slumped in August as trade tensions and domestic political and economic concerns sparked risk-related selling. Stocks in emerging Asia were weak, led by a sell-off in Chinese A shares, which are stocks of mainland China-based companies. A shares fell 6.42% in U.S. dollar terms as investors remained cautious about the possibility of more U.S. trade tariffs on Chinese goods.

Latin American stocks lost ground and underperformed the broader MSCI EM Index. Argentine equities declined nearly 24% as the central bank raised rates and intervened in currency markets to defend the peso, which fell 28% during the month. Further unnerving investors were concerns about the country's ability to meet its financing needs, which prompted President Mauricio Macri to ask the International Monetary Fund to speed disbursement of its USD \$50 billion bailout package. Brazil's stocks lost 11%, and the real dropped nearly 9% as investors worried that the country's market-friendly presidential candidate was losing ground in the polls ahead of the October presidential election.

The Europe, Middle East, and Africa region lost almost 8%, led by a nearly 29% decline in stocks in Turkey, where President Recep Tayyip Erdogan continued to refuse to raise benchmark interest rates to cool an overheating economy and stop the lira's collapse. The central bank's more unconventional moves to deter currency speculation failed to stop the lira's sell-off. Turkey's unwillingness to release U.S. pastor Andrew Brunson, imprisoned on espionage and terror charges, added to the country's woes by inflaming tensions with Washington. In response, the Trump administration doubled steel and aluminum tariffs.

OUTLOOK: GLOBAL GROWTH REMAINS POSITIVE BUT LIKELY TO HAVE PEAKED

The outlook for global growth remains positive but is likely to have peaked, meaning trade-driven economies could slow. Ongoing trade tensions could exacerbate this slowdown, while a continued dialogue between the U.S. and China could improve the outlook, in our view. Idiosyncratic and political risks remain elevated in several key countries that have recently been labeled as the "BRATS"—Brazil, Russia, Argentina, Turkey, and South Africa. These countries' markets were at the center of risk-related selling in August. Other challenges to the outlook to global equities include a resurgence of geopolitical tensions, the possibility of central bank policy missteps, and the rising popularity of euroskeptic parties.



Monthly Market Review

FIXED INCOME MARKETS

AUGUST 2018

CONCERNS ABOUT TARIFFS, EMERGING MARKETS SPARK DEMAND FOR TREASURIES

The Treasury yield curve continued to flatten in August as the yield on the two-year note decreased less than longer-maturity Treasury yields. The closely watched yield differential between 2- and 10-year Treasuries compressed to 24 basis points (0.24 percentage point) by the end of the month, its tightest level since 2007. (Bond prices and yields move in opposite directions.)

The 10-year Treasury yield reached a monthly high of 3.00% on August 1—the first time it closed at or above the 3.00% threshold since late May—as news of increased borrowing by the U.S. government in the second half of the year seemed to dim investors' appetite for Treasuries. However, troubles in Turkey and Argentina and the potential that the Trump administration could soon impose tariffs on another USD \$200 billion of Chinese imports sparked demand for Treasuries and sent yields lower.

FED KEEPS BENCHMARK RATE UNCHANGED, BUT SEPTEMBER HIKE LOOKS LIKELY

As expected, the Fed kept its short-term interest rate benchmark in the 1.75% to 2.00% range at the conclusion of its two-day monetary policy meeting that ended on August 1. However, in their post-meeting statement, Fed policymakers changed their description of the economy from “solid” to “strong.” Minutes from the meeting that were released later in the month telegraphed that the central bank intends to raise rates at its September policy meeting and noted that while the labor market remains strong, potential trade disputes present a risk to economic growth.

Total Returns

Index	August	Year-to-Date
Bloomberg Barclays U.S. Aggregate Bond Index	0.64%	-0.96%
J.P. Morgan Global High Yield Index	0.15	0.91
Bloomberg Barclays Municipal Bond Index	0.26	0.25
Bloomberg Barclays Global Aggregate Ex-U.S. Dollar Bond Index	-0.31	-1.98
J.P. Morgan Emerging Markets Bond Index Global Diversified	-1.73	-4.49
Bloomberg Barclays U.S. Mortgage Backed Securities Index	0.61	-0.46

Figures as of August 31, 2018. **Past performance cannot guarantee future results.** This chart is shown for illustrative purposes only and does not represent the performance of any specific security.

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REPORTS SHOW HIGHER INFLATION

Investors seemed unfazed by reports of firming inflation. The July consumer price index showed core prices rising 2.4% over the past year, the biggest jump since 2008. T. Rowe Price Chief U.S. Economist Alan Levenson noted that core inflation has slowed to a 2.25% pace over the 6- and 12-month periods ended in July, and he believes the 12-month rate will rise more gradually in the coming months. The Fed's preferred inflation measure, the core personal consumption expenditures (PCE) price index, rose 2.0% for the 12-month period, in line with the central bank's target.

U.S. Treasury Yields

Maturity	July 31	August 31
3-Month	2.03%	2.11%
6-Month	2.21	2.28
2-Year	2.67	2.62
5-Year	2.85	2.74
10-Year	2.96	2.86
30-Year	3.08	3.02

Source: Federal Reserve Board.

TREASURIES, MORTGAGE-BACKED SECURITIES PRODUCE STRONG RESULTS

Lower yields contributed to generally positive results in the U.S. investment-grade bond market. Treasuries and mortgage-backed securities produced the strongest returns in the Bloomberg Barclays U.S. Aggregate Bond Index. Investment-grade corporate bonds recorded positive returns but were challenged by a heavy new issuance calendar.

High yield corporate bonds produced positive results. Below investment-grade bonds, which are more closely linked to equity performance, benefited as corporate earnings were strong and stock indexes reached record highs. Rising oil prices in the second half of the month supported high yield issuers in the energy sector. For only the second time this year, flows into high yield mutual funds were positive for the month. Bank loans also performed well.

DEMAND STRONG FOR HIGHER-YIELDING MUNIS; PUERTO RICO BONDS RALLY

Investment-grade municipal bonds produced positive returns but underperformed Treasuries as the market dealt with periods of heavy new issuance. Flows into the muni sector remained solid, though, and investor demand for higher-yielding securities was particularly strong. Puerto Rico bonds rallied after a couple of investor-friendly developments: A federal judge upheld the authority of the commonwealth's fiscal oversight board to impose budgetary restrictions on the island's government, and a deal was reached to restructure the island's COFINA bonds, which are backed by sales tax revenues.

GERMAN, ITALIAN BONDS HEAD IN DIVERGENT DIRECTIONS

The performance of developed market sovereign debt outside the United States varied. The yield on the 10-year German government bond decreased as investors sought out safer securities. The Italian 10-year bond yield, on the other hand, leaped from 2.73% to 3.23% amid concerns about the country's fiscal policies. The UK 10-year yield was little changed, although the Bank of England voted to raise its short-term benchmark rate by 25 basis points to 0.75%. Japanese government bond yields reached their highest level since 2016 in early August after the Bank of Japan adopted a wider trading band for the 10-year bond.

CURRENCY WEAKNESS PUTS EMERGING MARKETS DEBT UNDER PRESSURE

Emerging markets bonds declined amid significant currency weakness in Argentina and Turkey. Argentina's central bank hiked its benchmark interest rate to 60% in an attempt to defend the peso, which lost 28% against the U.S. dollar for the month. The country's government pledged to implement more aggressive fiscal measures to try to regain confidence in its ability to meet its financing needs. The Turkish lira declined 26% versus the U.S. dollar amid high inflation, a widening current account deficit, and U.S. sanctions. S&P Global Ratings and Moody's Investors Service downgraded Turkey's credit rating by one notch to B+ and Ba3, respectively.

OUTLOOK: DESPITE RECENT DECLINES, EMERGING MARKET FUNDAMENTALS APPEAR SOLID

In a recent Price Point article, T. Rowe Price Portfolio Manager Michael Conelius said that while emerging markets bonds have lost ground over the year-to-date period, he believes long-term fundamental and structural drivers in the sector remain solid, including stronger underlying economic growth, more controlled government spending, and significant political reforms in key markets. Conelius also noted that emerging markets bonds remain one of the highest-yielding opportunities in the fixed income market.



Monthly Market Review

GLOBAL CAPITAL MARKETS ENVIRONMENT

AUGUST 2018

Major U.S. stock indexes posted solid gains in August amid light trading volume. Some favorable economic data helped stocks edge higher early in the month, as the jobless rate ticked lower to 3.9% in July and employment growth remained strong. The Federal Reserve (Fed) voted to keep its short-term interest rate benchmark unchanged at the end of its two-day meeting on August 1. In its post-meeting statement, Fed policymakers elevated their description of the U.S. economy from “solid” to “strong,” raising expectations that the central bank will increase rates at its late-September meeting.

Trade relations between the U.S. and China dominated sentiment for much of the month. Optimism about a possible trade deal following a meeting between both countries in Washington faded as the negotiations yielded no progress toward ending the threats and implementation of tariffs. In response to the most recent U.S. tariffs on Chinese products, ranging from motorcycles to machinery, China responded by placing tariffs on U.S.-produced items, from coal to trucks.

On a positive note, the generally strong second-quarter earnings season, which wound down during the month, provided a boost to the U.S. equity market. U.S. stocks surged in the final week of the month—with both the Nasdaq Composite Index and the S&P 500 Index hitting all-time highs—after the announcement of a revised North American Free Trade Agreement (NAFTA) between the U.S. and Mexico. Shares received an additional boost when Canada rejoined the NAFTA talks. The month ended with no deal between the U.S. and Canada, but both parties are optimistic that one could be struck in the future.

Small-cap shares outperformed their larger peers. The small-cap Russell 2000 Index returned 4.31% versus 3.26% for the large-cap S&P 500 Index and 3.19% for the S&P MidCap 400 Index. As measured by various Russell indexes, growth stocks soundly outperformed value stocks across all market capitalizations.

	S&P 500 Index	S&P MidCap 400 Index	Russell 2000 Index
August	3.26%	3.19%	4.31%
Year-to-Date	9.94	8.68	14.26

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Source: Third-party vendor RIMES, as of August 31, 2018.

In the large-cap universe, as measured by the S&P 500 Index, most sectors advanced. Information technology fared best as the performance of a few industry bellwethers propelled the sector. Consumer discretionary shares also posted strong returns as the strong U.S. economy boosted consumer spending. Health care and telecommunication services also posted solid returns. Energy stocks declined, as the sector was weighed down by a rise in U.S. oil inventories. Materials was the only other sector to produce negative returns, albeit slight, for the month.

Domestic investment-grade bond returns were positive. The Bloomberg Barclays U.S. Aggregate Bond Index returned 0.64%. The Treasury yield curve flattened in August, as Treasury bill yields rose in anticipation of a September Fed rate hike, while longer-term yields decreased as overseas investors fled emerging markets in favor of safe-haven assets. In the investment-grade universe, Treasuries and mortgage-backed securities performed best. Corporate bonds and asset-backed securities also posted positive returns but lagged other investment-grade issues. Municipal bonds underperformed taxable bonds. High yield securities produced marginal gains.

	Bloomberg Barclays U.S. Aggregate Bond Index	Bloomberg Barclays Municipal Bond Index	J.P. Morgan Global High Yield Index
August	0.64%	0.26%	0.15%
Year-to-Date	-0.96	0.25	0.91

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Source: Third-party vendor RIMES, as of August 31, 2018.

Stocks in developed non-U.S. equity markets produced negative returns. The MSCI EAFE Index, which measures the performance of stocks in Europe, Australasia, and the Far East, returned -1.92%. Developed Asian markets were mixed, with escalating U.S.-China trade tensions undermining sentiment. Japanese shares ended relatively flat in dollar terms, as the yen appreciated roughly 1% versus the greenback, but shares in Hong Kong and Australia struggled. European shares were hit hard in August, as Italian shares performed the worst, dropping more than 9%. Italian economic concerns have been a common theme since a new populist coalition came to power in June. The coalition stated that it may breach the European Union's 3% of gross domestic product deficit limit, if needed, to increase investment spending to spur the Italian economy, news of which lifted Italian government bond yields to levels not seen since 2014. Shares in Austria and Spain also struggled, falling about 7% and 6%, respectively. Finland proved to be a bright spot, as Finnish shares advanced nearly 3% in dollar terms.

Emerging markets stocks underperformed developed non-U.S. markets. The MSCI Emerging Markets Index returned -2.67%. Turkish shares plunged about 29% for the month, as the lira routinely hit all-time lows versus the dollar. The lira, however, got a reprieve mid-month when Turkey's finance minister, Berat Albayrak, told investors that Turkey is committed to market-based economic policies and would use fiscal measures to slow the economy, reduce its current account deficit, and lower the inflation rate. However, the lira resumed its freefall in subsequent days and depreciated roughly 26% versus the dollar in August. In addition to Turkey's well-documented economic issues, political issues also weighed on stocks throughout the month. Turkey's refusal to release U.S. pastor Andrew Brunson from imprisonment has sparked tensions with the White House, as President Donald Trump doubled tariffs on Turkish aluminum and steel exports to the U.S. In response, Turkey imposed tariffs on American imports, including alcohol and cars. There were a few bright spots in emerging Europe, as Poland and Hungary posted modest positive returns. In dollar terms, emerging Asian markets were widely mixed. Chinese

stocks fell, while stocks in Thailand and the Philippines rose more than 2%. Latin American shares were hammered, with all countries posting negative returns. Mexican stocks held up best, thanks in part to a revised NAFTA deal with the U.S. at the end of the month, but shares still retreated about 3%. Brazilian markets posted steep losses of over 11%, thanks in part to uncertainty over the October presidential election and the real slipping to all-time lows versus the dollar.

	MSCI EAFE Index	MSCI Emerging Markets Index
August	-1.92%	-2.67%
Year-to-Date	-1.87	-6.93

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Source: Third-party vendor RIMES, as of August 31, 2018.

Bonds in developed non-U.S. markets were narrowly mixed in August. In Europe, core eurozone bond yields declined for most of the month, as many investors began to seek a safe haven due to deteriorating financial conditions in Turkey, concerns over global trade, and the volatile Italian political situation. The German 10-year bund yield dipped to 0.33% by the end of the month. Conversely, yields on Italian government bonds increased as government bonds sold off amid concerns over the country's fiscal agenda and the overall stability of Italy's ruling coalition. In the UK, the Bank of England raised short-term rates on August 2, as expected, while the pound fell almost 1% versus the greenback. In Japan, the yield curve steepened in the wake of the late-July announcement from the Bank of Japan that it would allow its 10-year government bond yield target to fluctuate in a wider range.

Emerging markets bonds posted negative returns in August. The Argentine peso and the Turkish lira were by far the two weakest currencies in the world, which had a significant negative impact on local bond returns in dollar terms. In South Africa, which recently slipped into a recession, according to data released in early September, the rand also depreciated significantly against the greenback. As a result, bonds denominated in local currencies significantly underperformed dollar-denominated emerging market issues.

	Bloomberg Barclays Global Aggregate ex USD Bond Index	J.P. Morgan Emerging Markets Bond Index Global Diversified	J.P. Morgan GBI-EM Global Diversified Index
August	-0.31%	-1.73%	-6.09%
Year-to-Date	-1.98	-4.49	-10.47

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Monthly Market Review

EMERGING MARKETS STOCKS

AUGUST 2018

EMERGING MARKETS STOCKS FALL AS TURKEY AND ARGENTINA FUEL GLOBAL CONTAGION FEARS

Emerging markets stocks fell in August as rising trade tensions and financial crises in Argentina and Turkey fueled a currency sell-off across the developing world, reducing the appeal of riskier assets. The U.S.-China trade battle intensified as each country imposed previously announced tariffs on the other's imports, dashing hopes for an agreement before the U.S. midterm elections. While Argentina's and Turkey's financial woes stemmed from domestic developments, their problems highlighted the dependency of many emerging markets governments and companies on overseas funding and their vulnerability to a stronger U.S. dollar. The MSCI Emerging Market Currency Index slid for the fifth straight month, its longest losing streak since 2015, according to Bloomberg. Ten of 11 sectors in the MSCI EM Index fell, led by utilities stocks. Health care was the sole advancing sector.

Total Returns

MSCI Index	August	Year-to-Date
Emerging Markets (EM)	-2.67%	-6.93%
EM Asia	-0.79	-4.94
EM Europe, Middle East, and Africa (EMEA)	-7.70	-13.64
EM Latin America	-8.33	-10.86

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Source: MSCI.

CHINESE STOCKS FALL AS U.S. TRADE RIFT DEEPENS; INDIAN STOCKS ADVANCE AS GDP BEATS EXPECTATIONS

- Chinese stocks fell as U.S. trade relations worsened, with yuan-denominated A shares lagging dollar-denominated shares. Hopes for a resolution in the U.S.-China trade dispute fizzled as each country began imposing previously announced tariffs on USD \$16 billion of the other's imports, low-level trade talks produced no breakthroughs, and President Donald Trump signaled he was ready to slap tariffs on USD \$200 billion more of Chinese goods in September.
- Indian stocks edged higher. India's economy grew a surprisingly strong 8.2% in the June quarter from a year ago, cementing India's status as the fastest-growing large economy. But August's emerging markets currency sell-off hit the rupee, which ended the month at a new low versus the dollar in its worst monthly retreat in three years.

- Southeast Asian stocks advanced. Indonesia's economy grew a better-than-expected 5.3% in the second quarter from a year ago—its fastest pace since 2013, but still below the official 7.0% target. Malaysia's economy expanded at a worse-than-forecast 4.5%, its third straight quarter of slower growth, and its central bank slashed its 2018 growth estimate. The Philippines' central bank raised its benchmark interest rate by 50 basis points (0.50%) to 4.0%, its biggest rate hike since 2008, to curb inflation. Thailand's central bank kept its benchmark rate at a record low but subsequently struck a hawkish tone after second-quarter gross domestic product (GDP) beat forecasts.

BRAZILIAN STOCKS SLUMP AS GDP DATA UNDERSCORE ANEMIC RECOVERY; ANDEAN STOCKS DECLINE

- Brazilian stocks sank roughly 11%. Brazil's economy expanded 0.2% in the second quarter from the prior quarter and 1.0% from a year earlier, reflecting a sluggish recovery after exiting its worst-ever recession last year. Beneath the quarterly gain, capital spending and industrial activity declined, and first-quarter GDP was revised downward, underscoring the economy's weakness.
- Mexican stocks declined. Mexico's economy shrank a worse than previously reported 0.2% in the second quarter from the prior quarter, according to the government's final estimate. The revised result translates into an annualized contraction of 0.6%, which was worse than a previously reported 0.3% annualized decline.
- Andean stock markets fell, paced by Chile's roughly 9% drop, amid worries that trade disruptions would hurt the region's commodity-driven economies by dampening global growth and raw materials demand.

TURKISH STOCKS LEAD DECLINES ACROSS EMEA AS LIRA CRATERS TO FRESH LOWS

- Turkish stocks plummeted 29% and the lira repeatedly hit record lows versus the dollar amid deteriorating relations with the U.S. and concerns about the central bank's independence under President Recep Tayyip Erdogan. The lira shed 26% in August and has lost more than 40% of its value against the dollar this year, increasing worries about the country's large dollar-denominated debt burden owed by companies and the government.
- Russian stocks and the ruble each slid about 7% as the prospect of more U.S. sanctions on Russia ahead of November's midterm elections weighed on the country's outlook. Russia's economy minister cut the official 2018 growth outlook to 1.8% from an earlier 1.9% forecast, citing the impact of U.S. sanctions and the emerging markets currency sell-off. The ruble hit its lowest level since 2016.
- South African stocks shed nearly 10% and its currency fell almost 11% as the country's economic outlook remained grim. In a report, Moody's wrote that weak growth and rising public wages were contributing to a slower-than-forecast pace of fiscal consolidation in South Africa. Plans by the government to press ahead with a controversial land reform measure that would allow expropriation without compensation increased the political risk attached to South African assets.

SOLID FUNDAMENTALS IN EMERGING MARKETS OFFSET NEAR-TERM RISKS

We are optimistic about the longer-term outlook for emerging markets. Most developing countries have smaller current account deficits, larger foreign exchange reserves, and more flexible currencies than they did in previous decades, reducing the risk of a financial crisis. Compared with developed markets, most emerging markets have more attractive demographics and a stronger tailwind from rising consumption. Emerging markets stocks remain attractively valued relative to developed markets stocks.

Near-term headwinds include a rise in U.S. protectionism and a faster-than-expected pace of rate hikes by the Federal Reserve. However, we believe that emerging markets will be able to withstand a gradual tightening of U.S. monetary policy given that their financial positions have broadly improved in recent years. Economic growth has slowed but remains stable in most emerging markets, and corporate earnings have begun to recover after

years of disappointing performance. Nevertheless, we believe that careful stock selection will be crucial for producing good long-term returns as emerging markets continue to show wide dispersion in the performance of individual countries and companies.

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Articles: 201809-597931; 201809-597925; 201809-597913; 201809-597920; 201809-597907

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201808-486585