Five fat years may be followed by five lean ones: T. Rowe Price

By Kerry Pechter *Fri, Dec 6, 2013*

"The U.S. bull market is aging," said Bill Stromberg, T. Rowe Price's head of equity. "International investments, especially in emerging markets, represent the best long-term value from here in fixed income and equity."

Be careful, investors. The global investment environment is approaching "an inflection point." So said T. Rowe Price investment pros at the company's Investment and Economic Outlook event in New York recently.

Given that what goes up must come down, they suspect that the gains of the last five years—U.S. stock indices are 160% of their lows in 2009 and touching new nominal highs—won't be matched over the next five.

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The taper caper. Expect the U.S. Federal Reserve to reduce its bond purchases in the next three to six months, they said. The Fed will move slowly while unemployment is high, but the tapering could "lead to volatile conditions in global equity and fixed income markets."

"The impact of political uncertainty in Washington should be less than it was this year, once we get past the January sequestration talks and the focus turns to elections," said Alan Levenson, T. Rowe Price chief economist.

Europe and beyond. Europe's economic recovery is still in its early stages, which could give European stocks more room to run than their U.S. counterparts. In Japan, ineffective corporate governance and dated labor and regulatory rules will hamper government reform efforts. In emerging markets, equity valuations appear to be below historical norms.

"The macroeconomic environment has transformed from an end-of-the-world scenario and fears of a Eurozone break-up to a story of improving confidence, modest recovery, and improving company fundamentals," said Dean Tenerelli, portfolio manager of T. Rowe Price European Stock Fund.

Munis on the mend. Global fixed income markets are vulnerable to interest rate increases, but emerging market debt has potential, they said. Credit fundamentals are rising for many states and municipalities, helping U.S. municipal bonds. Revenues are increasing, due to economic improvement and tax rate hikes, and budget gaps are shrinking.

T. Rowe Price favors revenue-backed municipal bonds, especially in areas such as public utilities, transportation authorities, and hospital systems, most of which operate as monopolies within their local markets.

"Despite headlines created by the situations in Detroit and Puerto Rico, municipal bonds still provide a high-quality, time-tested way to earn tax-free income," said Hugh McGuirk, head of municipal bonds.

"Munis have evolved away from being a predominantly interest-rate sensitive market to a more credit-driven market, which places a premium on strong internal credit research. Underfunded pensions continue to represent a critical challenge for state and local governments."