Vigilant Active Management

The “Chinese bamboo tree story” is a well-known parable about a plant that spends years developing a strong underground root system, showing no visible growth above ground, before suddenly shooting up 90 feet in just six weeks. This story powerfully illustrates the importance of patient perseverance. In the wake of the T. Rowe Price Fixed Income Division’s October Policy Week and recent capital market events, the story serves as a reminder that vigilant active management—grounded in a strong foundation—can help address the following two key considerations:

Maintaining credit selection discipline amid credit markets that are not providing much room for error and are beginning to rumble—Public and private credit markets have been wide open during the year-to-date period, which continues a trend of recent years that was only briefly interrupted this past spring. Corporate fundamentals have remained sound in conjunction with resilient U.S. and global economies. Meanwhile, fluidity between private and public credit markets has given companies access to the credit they need not only to sustain themselves, but also to expand organically or through mergers and acquisitions. As a result, investment-grade and high yield credit spreads had revisited historically low levels before most recently moving modestly wider; but spreads remain well below historical averages. Through this cycle of ever tighter credit spreads, the firm’s fixed income security selection process in credit has been not only prudently maintained but enhanced with the intent of ensuring credit exposure that could weather an eventual turn in the credit cycle. As a result, while the Fixed Income Division largely views the various global credit sectors that make up its opportunity set with “neutral” conviction coming out of Policy Week, the ongoing work of focusing on sourcing the best fundamental relative value from these various sectors continues.

It is against the backdrop of dedicated sector teams persistently scouring their markets to seek the best relative value while also not losing sight of fundamentals where the bamboo tree story comes into play. Consider, for example, just as the durable roots of the bamboo tree remain hidden in its early years, the ongoing credit selection process we referenced above also forms a strong—but largely invisible—foundation.

This is especially true in robust credit markets, where overall positive conditions can make it difficult to distinguish the impact of careful credit selection, as a rising tide tends to lift all boats. But just as a theoretical bamboo tree can suddenly powerfully appear as if out of nowhere, sound security selection also quickly becomes positively pronounced amid a turning point in the credit cycle.

It is yet to be determined whether the recent credit blowups that auto parts supplier First Brands and subprime auto lender Tricolor (no T. Rowe Price fixed income products have exposure to either credit) experienced represent a "canary in the coal mine" as being indicative of more broad-based trouble in credit overall and potentially a turn in the cycle. Whether it does or doesn't, certain private credit firms and banks have already been impacted by this news.

Away from the U.S., a heightened central bank policy rate of 15% in Brazil is suddenly acting as kryptonite for several heavily indebted companies in the country, with any refinancing or new bond issuance coming with significantly higher interest rates. Beyond Brazil, there is some room for pause more broadly in emerging market credit markets in recent weeks, in our view. Ultimately, whether the current moment in global credit markets turns for the better or worse from here, still stretched valuations in credit markets also mean that fixed income portfolios with "strong root structures" built on disciplined, thorough security selection—without shortcuts that could have been obscured during the recent bull market—are especially worth considering.

An earnest, yet methodical, approach toward incorporating generative AI into fixed income investment processes—As is the case with most corporations globally, T. Rowe Price and its Fixed Income Division are actively exploring and implementing AI-driven efficiencies into our investment process wherever productivity gains are to be made. While many now pursue such efficiency improvements, we believe few have a truth-based fundamental research platform at the foundation of this now urgent push to incorporate AI broadly into business practices and processes. The reference to "truth" is on purpose as many of us already know that not all content generated by AI is necessarily accurate. Ironically, an example of this is the idea that all bamboo trees spend several years developing underground root systems before suddenly experiencing rapid above-ground growth, which can be the depiction returned when posed to an AI chat application. However, this characterization is inaccurate or at least exaggerated, as bamboo can grow rapidly and consistently from the outset and often will be visible above ground relatively quickly. The widely cited narrative, which finds its way into AI-generated responses, more accurately describes the Chinese bamboo tree parable, but is not botanically precise. In this context, T. Rowe Price is committed to incorporating AI into select investment and business processes but will do so according to our own fundamentally clear standards.

Bottom Line—In an environment that's seeing increasing policy uncertainty, active management in global fixed income takes on heightened importance. Through a disciplined investment process, anchored by its Policy Week in conjunction with expanding quantitative capabilities and its rigorous and collaborative global bottom-up research effort, T. Rowe Price's Fixed Income Division is well positioned to actively manage the array of global strategies that compose its investment platform through the uncertain times ahead.

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Market risk – Market risk may subject the portfolio to experience losses caused by unexpected changes in a wide variety of factors.

Market Liquidity risk – In extreme market conditions it may be difficult to sell the portfolio's securities and it may not be possible to redeem at short notice.

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