A Flexible Bond Approach to Help Navigate Volatile Markets

How the T. Rowe Price Funds SICAV–Dynamic Global Bond Fund[1] may help during this challenging environment.

May 2022

This year has been extremely challenging for bond investors, and volatility is set to continue as markets prepare for life without central bank support. We believe this environment will suit our absolute bond return approach, which is flexible, has a strong emphasis on active duration management, and employs defensive hedges to provide diversification against risk assets.

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Volatility Is Set to Continue

It has been a tumultuous few months in fixed income, with sovereign bond yields rising sharply and almost every segment of the asset class declining (see Figure 1). The unprecedented moves have left many investors questioning how much longer the rout can continue. Although it is difficult to envisage further moves of the same magnitude, particularly in sovereign bond markets, this turbulent period is far from over. If anything, it is only just beginning. We have entered a new fixed income regime as markets prepare for life without the support of central banks.

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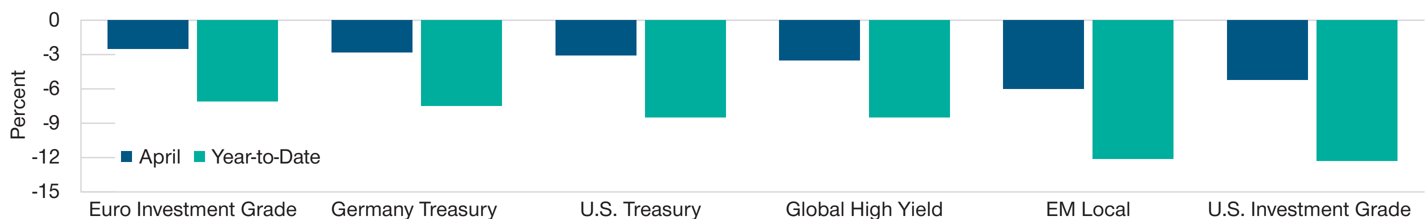
[1] The fund is actively managed, and the manager is not constrained by the fund's benchmark, which is used for performance comparison purposes only.

Tough Period for Global Bond Markets

(Fig. 1) Performance breakdown of major bond market segments



As of April 30, 2022. All Index returns are total returns.
Past performance is not a reliable indicator of future performance.
Euro Investment Grade: Bloomberg Global Aggregate Corporate–European Euro Index hedged to USD, Germany Treasury: Bloomberg Global Treasury: Germany Index hedged to USD, U.S. Treasury: Bloomberg U.S. Treasury Index, Global High Yield: Bloomberg Global High Yield Index hedged to USD, EM Local: J.P. Morgan Government Bond Index–Emerging Markets (GBI–EM) Global Diversified, U.S. Investment-Grade: Bloomberg Global Aggregate Corporate–United States Index hedged to USD.
Sources: Bloomberg and J.P. Morgan Chase & Co.; analysis by T. Rowe Price (see Additional Disclosures).

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Across developed markets, central banks are responding to multi-decade high inflation by withdrawing liquidity and hiking interest rates. Furthermore, some central banks, most notably the U.S. Federal Reserve, also plan to begin reducing their balance sheets. With quantitative tightening on the horizon, we believe that it's likely to be a lot faster and larger in scope than ever experienced, especially if multiple global central banks all do it in unison.

Against this backdrop, it is difficult to see how volatility in bond markets will ease anytime soon—on the contrary, we believe it is here for the long term. In the current climate, we feel that risk markets, such as credit, are particularly vulnerable as they have not fully priced in the prospect of quantitative tightening even after the recent sell-off. Therefore, we expect credit spreads to widen further as the market grapples with tighter liquidity conditions, slowing growth, and higher inflation. While this could be challenging, at some point there is likely to be an inflection point at which valuations become attractive again and strong potential buying opportunities emerge.

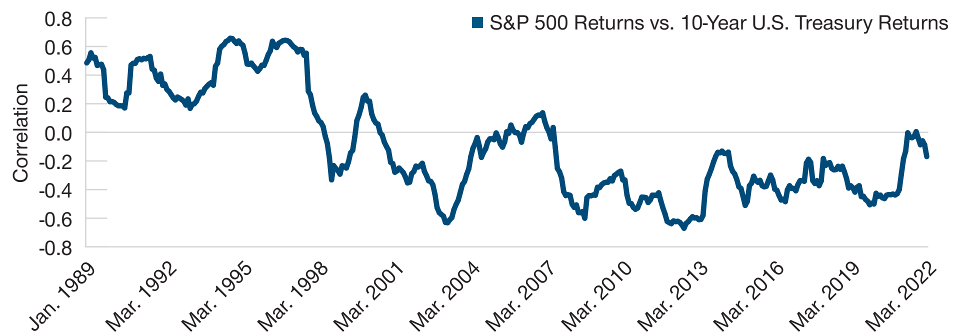
We believe that this new regime requires volatility management. In the Dynamic Global Bond Fund, we implement defensive hedging positions in seeking to help anchor performance during periods of risk aversion. Flexibility will also likely be essential in this environment. Heightened volatility may result in prices becoming dislocated, so our ability to be tactical can be beneficial. This proved to be the case in March 2020, when we responded to a huge sell-off in credit and added select corporate bond exposures that were dislocated from fundamentals and identified as attractive by our bottom-up research process.

Time to Rethink Risk Diversification

Fixed income markets are going through a period of strategic change as central banks retreat from supporting markets. This environment means that investors can no longer rely on the post-global financial crisis investment playbook and will need to think differently—particularly regarding diversification. At times this year, stocks and bonds have both sold off simultaneously, demonstrating that the stock/bond relationship is not always constant and can change, especially in the current climate where central banks are withdrawing liquidity support. Given this, we believe that it will be vital for portfolio managers to adapt to the changing nature of correlations to avoid suffering losses from both major asset classes at the same time.

What's Your Hedge?

(Fig. 2) Rolling 252-day correlation of the S&P 500 to 10-year U.S. Treasury return



As of March 31, 2022.

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Source: Bloomberg and analysis by T. Rowe Price (See Additional Disclosures).

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In the Dynamic Global Bond Fund, we do not assume that fixed income will always be a diversifier that typically performs well when risk markets such as equities sell off. Instead, we focus on actively managing the portfolio and maintaining a liquid profile. This provides us with the flexibility to adapt to changes in market conditions. We also consider the full toolkit available to help with diversification efforts, including using currency and derivatives markets alongside traditional interest rate management.

Why the Dynamic Global Bond Capability?

In the Dynamic Global Bond Fund, we seek to achieve three core goals:

- Provide a regular return;
- Act as a diversifier during times of market stress; and
- Manage downside risks such as rising interest rates.

The volatile market conditions experienced so far in 2022 have provided an important test of our approach, and we have delivered on these goals. The fund produced a positive return during the first four months of 2022 at a time of a deep bond market sell-off and heightened volatility across risk markets. Our use of active duration management was central to this achievement, as we dynamically managed exposures over the period. This approach helped us deliver gains from a variety of positions, including short positions in select developed market sovereigns, allocations to inflation-linked bonds, and occasional tactical long exposures.

Performance Table

(Fig. 3) T. Rowe Price Funds SICAV–Dynamic Global Bond Fund

	Cumulative				Annualized		
	One Month	Three Months	Year-to-Date	One Year	Last Three Years	Last Five Years	Since Inception June 10, 2015‡
T. Rowe Price Funds SICAV–Dynamic Global Bond Fund–Class I (USD)*	1.18%	3.62%	4.61%	1.69%	4.74%	2.68%	2.72%
Linked Benchmark in USD†	0.01	0.06	0.05	0.13	0.77	1.29	1.13

	2015‡	2016	2017	2018	2019	2020	2021
T. Rowe Price Funds SICAV–Dynamic Global Bond Fund–Class I (USD)*	2.10%	4.60%	-1.31%	0.47%	-0.28%	8.62%	0.26%
Linked Benchmark in USD†	-	0.75	1.28	2.34	2.36	0.66	0.14

As of April 30, 2022.

Past performance is not a reliable indicator of future performance.

Figures are calculated in U.S. dollars.

* Source for performance: T. Rowe Price. Fund performance is calculated using the official net asset value with dividends reinvested, if any. The value of the investment will vary and is not guaranteed. It will be affected by changes in the exchange rate between the base currency of the fund and the subscription currency, if different. Sales charges, taxes, and other locally applied costs have not been deducted, and, if applicable, they will reduce the performance figures. Where the base currency of the fund differs from the share class currency, exchange rate movements may affect returns.

† Effective November 2, 2021, the primary benchmark for the T. Rowe Price Funds SICAV–Dynamic Global Bond Fund changed to the ICE BofA U.S. 3-Month Treasury Bill Index. Prior to this change, the primary benchmark was the 3-Month USD LIBOR.

‡ Since inception June 10, 2015, through December 31, 2015.

The manager is not constrained by the fund's benchmark, which is used for performance comparison purposes only.

Benefits of Active Duration Management

(Fig. 4) Return analysis of the T. Rowe Price Funds SICAV–Dynamic Global Bond Fund during rising rate environments

During Periods of Interest Rate Rises >25 bps*		
	U.S. Treasury 10-Year Yield Move	T. Rowe Price Funds SICAV–Dynamic Global Bond Fund
September 30, 2016–November 30, 2016	0.79%	0.09%
August 31, 2017–October 31, 2017	0.26	0.12
December 31, 2017–February 28, 2018	0.46	1.54
August 31, 2018–October 31, 2018	0.28	1.28
January 31, 2021–March 31, 2021	0.67	1.99
July 31, 2021–September 30, 2021	0.27	0.22
December 31, 2021–January 31, 2022	0.27	1.10
February 28, 2022–March 31, 2022	0.51	2.02

As of March 31, 2022.

Past performance is not a reliable indicator of future performance.

Figures shown in U.S. dollars. Gross-of-fees cumulative returns. The index shown is not a formal benchmark. It is shown only for comparison purposes. Performance figures are shown gross of fees. Total returns would be lower as a result of the deduction of such fees.

*Periods selected represent accelerated increases greater than 25 bps in the yield of the generic U.S. 10-year Treasury note where bond markets have moved meaningfully in a short period of time (e.g., below 60 trading days).

Source: Bloomberg and analysis by T. Rowe Price (See Additional Disclosures).

This was not a one-off: Our track record of outperforming during periods of rising rates is strong. During the last bond market correction in January 2021, for example, the U.S. 10-year Treasury yield rose more than 25 basis points (bps), while the fund gained more than 1%. Indeed, the fund has consistently outperformed during some of the largest bond market corrections since its inception (Figure 2). Again, we have achieved this primarily through our active management of duration, which allows us to implement both long and short positions, including cutting overall duration to as low as minus one year. This gives us the flexibility to adapt to different market cycles and environments, including rising rates.

Benefits of Diversification

(Fig. 5) Return analysis of the T. Rowe Price Funds SICAV–Dynamic Global Bond Fund during equity market sell-offs

During Periods of Negative Equity Returns <-5%*		
	S&P 500 Index Performance	T. Rowe Price Funds SICAV–Dynamic Global Bond Fund
July 31, 2015–September 30, 2015	-8.36%	-0.37%
November 30, 2015–January 31, 2016	-6.47	0.47
January 31, 2018–March 31, 2018	-6.13	0.14
September 30, 2018–October 31, 2018	-6.84	0.53
November 30, 2018–December 31, 2018	-9.03	1.10
April 30, 2019–May 31, 2019	-6.35	2.43
January 31, 2020–March 31, 2020	-19.57	4.57
August 31, 2020–October 31, 2020	-6.36	-0.68
December 31, 2021–February 28, 2022	-8.02	1.48

As of March 31, 2022.

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*Periods selected represent accelerated negative moves greater than 5% in the S&P 500 Index (total return) where equity markets have fallen meaningfully in a short period of time (e.g., below 60 trading days).

Sources: © 2022 Refinitiv. All rights reserved, S&P and analysis by T. Rowe Price (See Additional Disclosures).

We have also consistently outperformed during periods of negative equity market returns, which demonstrates our ability to manage downside risk and act as performance anchor when risk markets correct. During February and March 2020, for example, when coronavirus pandemic fears triggered a major sell-off, the fund returned over 4.5% while the S&P 500 Index fell by almost 20%. Since inception, the fund has outperformed the S&P 500 Index in several of the largest equity market drawdowns (Figure 3). We achieved this not only by allocating to high-quality fixed income assets (which typically have a low correlation to equity markets), but also by implementing specific defensive strategies involving currency and credit markets to anchor performance during times of stress.

Looking ahead, we expect volatility to persist. The market environment remains highly uncertain, with worries continuing over geopolitics, stagnating growth, rising inflation, and tightening financial conditions.

While this is likely to be challenging, we expect great buying opportunities to emerge at some stage. Beyond simply navigating a new higher-volatility regime, it will be crucial to identify when a potential inflection point emerges. Overall, we believe these are the conditions the fund is designed for, with built-in flexibility, a broad approach, and a strong emphasis on volatility management.

T. Rowe Price Dynamic Global Bond Fund

Investment Parameters	
Country/Duration Management	▪ Active global interest rate and curve management. ▪ Duration range between -1 and +6 years.
Currency Management	▪ Automatically hedged with a limited currency overlay.
Sector Allocation/Security Selection	▪ Credit including investment-grade, high yield, emerging markets, and asset-backed securities. ▪ Maximum 30% in non-investment grade.
ISIN Code	▪ LU1216622214 (I USD)

As of March 31, 2022.
Source: T. Rowe Price.

Objective

To generate income while offering some protection against rising interest rates and a low correlation with equity markets.

Investment Process

The fund is actively managed and invests mainly in a portfolio of bonds of all types from issuers around the world, including emerging markets. The fund may use derivatives for hedging, efficient portfolio management, and investment purposes. The fund may also use derivatives to create synthetic short positions in currencies, debt securities, credit indices, and equities. For full investment objective and policy details, refer to the prospectus. The manager is not constrained by the fund's benchmark.

Risks—The following risks are materially relevant to the fund (refer to the prospectus for further details):

Asset-backed securities (ABS) and mortgage-backed securities (MBS)—ABS and MBS may be subject to greater liquidity, credit, default, and interest rate risk compared with other bonds. They are often exposed to extension and prepayment risk.

Contingent convertible bond—Contingent convertible bonds may be subject to additional risks linked to capital structure inversion, trigger levels, coupon cancellations, call extensions, yield/valuation, conversions, write downs, industry concentration, and liquidity, among others.

Credit—Credit risk arises when an issuer's financial health deteriorates and/or it fails to fulfill its financial obligations to the fund.

Currency—Currency exchange rate movements could reduce investment gains or increase investment losses.

Default—Default risk may occur if the issuers of certain bonds become unable or unwilling to make payments on their bonds.

Derivative—Derivatives may be used to create leverage, which could expose the fund to higher volatility and/or losses that are significantly greater than the cost of the derivative.

Emerging markets—Emerging markets are less established than developed markets and therefore involve higher risks.

High yield bond—High yield debt securities are generally subject to greater risk of issuer debt restructuring or default, higher liquidity risk, and greater sensitivity to market conditions.

Interest rate—Interest rate risk is the potential for losses in fixed income investments as a result of unexpected changes in interest rates.

Issuer concentration—Issuer concentration risk may result in performance being more strongly affected by any business, industry, economic, financial, or market conditions affecting those issuers in which the fund's assets are concentrated.

Liquidity—Liquidity risk may result in securities becoming hard to value or trade within a desired time frame at a fair price.

Prepayment and extension—Mortgage- and asset-backed securities could increase the fund's sensitivity to unexpected changes in interest rates.

Sector concentration—Sector concentration risk may result in performance being more strongly affected by any business, industry, economic, financial, or market conditions affecting a particular sector in which the fund's assets are concentrated.

Total return swap—Total return swap contracts may expose the fund to additional risks, including market, counterparty, and operational risks, as well as risks linked to the use of collateral arrangements.

General Fund Risks

Counterparty—Counterparty risk may materialize if an entity with which the fund does business becomes unwilling or unable to meet its obligations to the fund.

Environmental, social, and governance (ESG) and sustainability—ESG and sustainability risk may result in a material negative impact on the value of an investment and performance of the fund.

Geographic concentration—Geographic concentration risk may result in performance being more strongly affected by any social, political, economic, environmental, or market conditions affecting those countries or regions in which the fund's assets are concentrated.

Hedging—Hedging measures involve costs and may work imperfectly, may not be feasible at times, or may fail completely.

Investment fund—Investing in funds involves certain risks an investor would not face if investing in markets directly.

Management—Management risk may result in potential conflicts of interest relating to the obligations of the investment manager.

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

Operational—Operational risk may cause losses as a result of incidents caused by people, systems, and/or processes.

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