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T. ROWE PRICE FIXED INCOME CREDIT SECTOR VIEWS

Sector Strategy Advisory Group (SSAG)* Insights – November 2022

	RISK REGIME	MAC RISK REGIME COMMENTS
Multi-Asset Credit (MAC) Risk Indicator	RISK OFF / **RISK ON**	▪ Our risk indicator switched—for now—to a risk-on state, driven by downward momentum for credit spreads following the fourth major sell-off this year. ▪ Conditions appeared conducive for a short-term relief rally aided by defensive investor positioning and seasonal factors. However, a sustained downward trend in inflation is needed to assuage the Fed's hawkishness and quell the unrelenting interest rate volatility that has fueled risk-asset volatility. ▪ We are very mindful that a risk-asset rally may be short-lived if the Fed pushes back against an easing of financial conditions that could negate its progress in containing inflation expectations. As such, we favored a balanced approach to risk-taking, utilizing liquid instruments and maintaining ample dry powder.

SSAG Tactical View: Positive (green) · Neutral (grey) · Negative (red)
Change vs. Prior Month: ▲ Upgraded · ■ Stable · ▼ Downgraded

SECTOR	SSAG VIEW AND CHANGE VS. PRIOR MONTH	SECTOR COMMENTS
High Yield (HY) Corporates	Neutral ■	▪ We maintained a neutral stance on the higher-beta sector, in line with our cautious optimism on credit in the near term. ▪ Based on our HY team's bottom-up analysis, we expect a roughly 2.7% default rate for the US market over the next 12 months. This is well below historical recessionary levels owing to robust sector fundamentals—especially in commodity sectors. We believe spread levels appropriately reflect this outlook. ▪ Despite difficult liquidity in other sectors, HY bond liquidity remained healthy. However, it is likely to decrease as we get closer to year-end. ▪ After a prolonged period of screening cheap, HY credit index derivatives (CDX) outperformed cash bonds and now appear only marginally inexpensive.
Bank Loans	Neutral ■	▪ We likewise maintained a neutral view on loans. Attractive, below-par, short-dated loan opportunities are balanced with growing concerns about loose underwriting standards, a deteriorating macroeconomic outlook, and the negative impact of higher rates on company fundamentals. ▪ Our analyst team expects a 3.9% loan default rate over the next 12 months, approximately in line with post-GFC market selloffs. ▪ Relatively weaker spread tightening momentum during the recent credit rally drove a decline in the sector's quantitative relative ranking.
EM USD Sovereign & Corporate Credit	Positive ▲	▪ We upgraded EM credit to the top of our rankings, driven largely by predictive factors that tend to be correlated with the asset class's spread movements. ▪ Our quantitative analysis favored sovereigns over corporate credit, aligning with our EM credit team's stronger fundamental conviction in the former sector. ▪ Amid a terrible year for the asset class, our EM team believes we are in a bottoming process and are optimistic on future returns despite tightening financial conditions. Valuations are historically attractive, with prices at deep discounts and yields providing a comfortable cushion to help counter duration risk. ▪ Increased differentiation between countries and numerous "special situations" have created unique opportunities for careful bond selectors, in our view.
Investment-Grade (IG) Corporates	Positive ▲	▪ Although the overall sector didn't screen particularly favorably, we upgraded our tactical view, reflecting opportunities seen in BBB rated US intermediate-term bonds. We viewed that specific segment as a relatively liquid and less-volatile source of attractive spread and yield. ▪ Our analysts also liked global banks, many of which are attractively valued relative to industrials. Banks stand to benefit from abating technical pressures, fundamental strength, and any relief measures the Fed takes to ensure that markets have adequate liquidity as tightening pulls reserves from the system. ▪ European credit offered attractive value—particularly on a USD-hedged basis—but we remained wary to chase value due to European macro headwinds.
Securitized Credit	Neutral ▼	▪ High-quality securitized segments with ample degrees of credit enhancement screened cheap vs. both IG and HY corporates, offering compelling long-term return potential. Our downgrade was tactical in nature, reflecting better excess return potential in higher-beta segments, as well as liquidity challenges. ▪ Our securitized team has few fundamental concerns outside of specific subsectors and deals, but abysmal liquidity has been the market's kryptonite. ▪ We continued to like areas of securitized offering shorter durations and high coupon carry to earn attractive yields while limiting spread volatility.
Agency MBS	Neutral ▼	▪ While longer-term valuations remained attractive, spreads tightened rapidly from their October wides and could be due for some consolidation. ▪ Excess returns have been beholden to rate directionality and volatility, and the Fed signaling a slower pace of tightening could be helpful in that regard. ▪ The technical backdrop is mixed; net supply has trended lower, but selling by REITs and outflows from bond funds industrywide have been challenges.
Taxable Municipals	Negative ▼	▪ Valuations cheapened vs. IG corporates in recent weeks as taxable muni spreads leaked wider while corporate spreads tightened, particularly for longer maturities. ▪ However, relative spread levels aren't overtly cheap, and the sector's longer duration profile is unappealing based on our view that long-term rates may rise further.

*See additional information on the next page for details about the SSAG.

The **T. Rowe Price Sector Strategy Advisory Group (SSAG)** is comprised of select Fixed Income investment professionals, specializing in a range of disciplines, who collaboratively generate investment ideas for use in portfolios across our platform. Views are based on SSAG research and discussions, combining fundamental analysis from sector specialists with insights from our quantitative research experts and proprietary tools. Views are intended to be tactical, are as of the date indicated, and are subject to change.

What is the MAC Risk Indicator?

The MAC Risk Indicator is a proprietary credit risk model based on an aggregation of five underlying risk signals including:

1. fundamental sector conviction ratings from T. Rowe Price's Fixed Income sector teams;
2. T. Rowe Price economics team's internal forecast for near-term global economic growth;
3. direction of credit spread momentum;
4. state of financial market volatility;
5. investor risk sentiment and positioning.

Applying an established set of rules, the combination of these inputs produces either an overall positive ("risk-on") or negative ("risk-off") view on the environment for credit risk, which influences the SSAG's tactical sector allocation views.

SECTOR STATISTICS AND RETURNS

As of 31 October 2022

			Credit Spreads (basis points)					Total Returns (%)[1]		
	Yield to Worst (%)	Duration (years)	Current Spread	M/M Change	1YR High	1YR Low	1YR Avg.	1M	YTD	1YR
HIGH YIELD CORPORATES										
Global HY	10.03	4.11	594	-57	682	373	504	1.98	-14.73	-14.54
US HY	9.12	3.97	464	-88	583	271	403	2.60	-12.53	-11.76
Euro HY[2]	11.90	3.27	605	-26	675	306	468	2.03	-11.6	-11.09
Asia HY	21.02	2.79	1580	268	1584	860	1122	-8.62	-32.48	-34.36
Loans[3]	10.28	0.25	596	-4	601	390	467	0.97	-1.72	-1.22
EMERGING MARKETS										
EM Sovereigns (USD)	9.66	6.53	543	-17	593	349	457	0.15	-23.83	-24.19
EM Corporates (USD)	8.53	4.14	462	54	468	306	369	-2.05	-17.93	-18.06
INVESTMENT GRADE CORPORATES										
Global IG	5.57	6.02	182	2	187	90	138	-0.58	-17.19	-17.09
US IG	5.93	6.91	158	-1	165	85	127	-1.03	-19.56	-19.57
Euro IG[2]	7.82	4.88	221	-4	237	90	156	0.93	-14.00	-13.80
Asia IG	6.31	4.83	192	43	192	116	144	-2.49	-15.62	-15.40
SECURITIZED CREDIT										
CLOs	7.61	3.55	332	5	334	205	258	0.33	-2.41	-2.30
CMBS	5.65	4.58	133	28	133	61	89	-1.60	-13.23	-13.44
ABS	5.46	2.08	95	42	95	29	58	-0.84	-5.85	-6.07
OTHER SPREAD SECTORS										
Agency MBS	5.11	5.92	73	4	88	18	39	-1.42	-14.89	-15.04
Taxable Munis	5.73	9.52	147	8	147	85	118	-3.26	-24.77	-24.91

COMMON BENCHMARKS

			Total Returns (%)[1]		
Index	Yield to Maturity (%)	Duration (years)	1M	YTD	1YR
Global Aggregate	3.82	6.63	-0.34	-12.39	-12.12
US Aggregate	5.01	6.05	-1.30	-15.72	-15.68

SOVEREIGN YIELDS

10-Year Rates	Yield to Maturity (%)	M/M Change (bps)	1YR High (%)	1YR Low (%)
U.S. Treasury	4.05	22	4.24	1.34
German bund[2]	5.46	18	5.84	0.61

Past performance is not a reliable indicator of future performance.

[1] Returns are hedged to USD.

[2] Yields are hedged to USD. As of 31 October 2022, currency hedges increased European sector yields by approximately 332 basis points for USD-based investors.

[3] Loan yields and spreads are forward to maturity.

Please see the following page for benchmark information.

ADDITIONAL INFORMATION RELATING TO THE MARKET INDICES ON THE PREVIOUS PAGE

Market indices shown on previous page represent the following:

Global HY: Bloomberg Global High Yield Bond Index USD-Hedged; US HY: Bloomberg US Corporate High Yield Bond Index; Euro HY: Bloomberg Pan-European High Yield Bond Index USD-Hedged; Asia HY: Bloomberg Asia USD High Yield Bond Index; Bank Loans: J.P. Morgan Leverage Loan Index; EM Sovereigns (USD): J.P. Morgan EMBI Global Diversified Index; EM Corporates: J.P. Morgan CEMBI Broad Diversified Index; Global IG: Bloomberg Global Aggregate – Corporate Index USD-Hedged; US IG: Bloomberg US Corporate Bond Index; Euro IG: Bloomberg Pan European Aggregate Corporate Index USD-Hedged; Asia IG: Bloomberg Asia USD Investment Grade Bond Index USD-Hedged; CLO: J.P. Morgan CLO Post-Crisis Index; CMBS: Bloomberg US CMBS ERISA Eligible Index; ABS: Bloomberg US ABS Index; Agency MBS: Bloomberg US MBS Index; Taxable Munis: Bloomberg Taxable Muni US Agg Eligible Index; Global Aggregate: Bloomberg Global Aggregate Bond Index USD-Hedged; US Aggregate: Bloomberg US Aggregate Bond Index.

Yields for European credit indices and German bunds are hedged using the EUR 3-month implied yield and 3-month USD LIBOR. Source: Bloomberg.

ADDITIONAL DISCLOSURES

IMPORTANT INFORMATION

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