T.RowePrice®
INVEST WITH CONFIDENCE

September 2015

FIXED INCOME VIEWPOINTS

SUMMARY:

U.S. Treasury yields were volatile over the past month as China's surprise yuan devaluation exacerbated global growth concerns and triggered sell-offs in global equity and commodity markets. After falling sharply, Treasury yields reversed course in late August as risk assets stabilized somewhat and oil prices rebounded. Uncertainty about the timing of Fed rate liftoff added to financial market turbulence.

German bund yields followed a similar choppy trajectory as an improving European growth outlook was juxtaposed with worries about the health of China and other developing economies as the Fed prepares to potentially increase interest rates for the first time since 2006. Japanese government bond yields remained low and stable as a decelerating Chinese economy and disappointing domestic data increased the probability of additional Bank of Japan easing measures.

U.S. investment-grade corporate bond spreads finished August at their widest level in three years amid expectations of resumed heavy supply in September. Low oil prices and risk aversion weighed on the U.S. high yield market's performance, but issuers' balance sheets remain healthy away from distressed commodity producers. Although not spared from volatility, European corporates are supported by accommodative central bank policy and their earlier stage in the credit cycle.

Emerging markets (EM) credit spreads are near post-financial crisis wides, but myriad external and internal challenges warrant a high degree of selectivity. EM local rates are compelling versus developed market sovereigns, but currencies could see continued pressure until the macro backdrop appears less daunting.

SPREAD SECTORS:

U.S. INVESTMENT-GRADE CORPORATES: While non-financial credit fundamentals appear to have peaked for the cycle, valuations and steeper credit curves remain supportive of investor demand. At wider spread levels stemming from heavy issuance and the recent bout of risk aversion, U.S. investment-grade corporate bonds offer compelling value relative to many other credit sectors

EURO CORPORATES: Spreads reversed course after July's rally, which followed the latest Greek bailout deal. Concerns about China's economy, related weakness in emerging and developed equity markets, and a sharp decline in the price of oil and other commodities fuelled risk aversion. However, domestic factors remain supportive given low European default rates, an anticipated economic recovery in Europe, and the potential for further supportive European Central Bank (ECB) policy action.

U.S. HIGH YIELD: Overall valuations and market yields are getting more interesting but are heavily skewed by the energy and metals and mining industries. Volatility is still likely given energy's impact and equity market turbulence. In addition, we have entered a seasonally more volatile period of the year.

EURO HIGH YIELD: The market remains well-supported by strong technicals (especially industry inflows), accommodative monetary policy, improving eurozone macro indicators, and lower exposure than U.S. high yield to the energy and metals and mining sectors. Opportunities exist in single-name, higher-coupon bonds offering good diversification from the U.S. domestic market.

BANK LOANS: Spreads have widened in sympathy with the move in high yield bond spreads, and there are now a meaningful amount of loans trading below par. The asset class has benefited from a materially lower exposure to commodities than the U.S. high yield bond market, as well as lower CCC exposure. The sector also still provides some measure of protection against rising interest rates.

AGENCY MBS: Near-term uncertainty over supply and Fed policy may present a challenge to performance and limit further upside. But valuations versus Treasuries remain fair, liquidity is less challenged than other spread sectors, and positive carry in the belly of the mortgage curve should continue to provide protection against further spread widening.

EM DOLLAR SOVEREIGN: The sector remains exposed to both exogenous pressures and internal challenges. The former includes Fed policy action, China-related risks, liquidity challenges, commodity pressures, and tail risks from regional conflicts. The latter includes Brazil policy weakness, China growth concerns, and policy risks. Within the sector, we continue to look to upgrade liquidity.

EM CORPORATES: The recent sell-off is warranted by fundamental deterioration in some underlying credits, an uncertain macro backdrop, and weak commodity prices. Within the corporate space, we continue to be biased toward investment grade over high yield. Valuations for investment-grade quasi-sovereigns have cheapened relative to investment-grade emerging corporates and offer superior liquidity.

EM LOCAL: Valuations are cheap relative to shorter- and longer-term history as sector has underperformed global sovereigns and credit on a rolling basis. We still need to get past Fed liftoff or see stronger global growth to galvanize valuations, and we are awaiting a catalyst that could improve sentiment. In the meantime, China remains in focus, and slower emerging markets growth is keeping EM currencies under a cloud. From a rates perspective, there has been ongoing notable divergence in country performance.

DEVELOPED SOVEREIGN MARKETS:

U.S.: The Federal Open Market Committee (FOMC) appears eager to lift rates from zero even in the face of numerous global areas of weakness. This dynamic is leading to volatility and leaving the Treasury market largely trendless. The FOMC's rate decision on September 17 will dictate both duration and curve trends for the fourth quarter—and likely beyond.

EUROZONE: The ECB's aggressive program of sovereign quantitative easing (QE), through which it is buying two times expected net issuance in 2015 and 2016, is about a third complete. The growth and inflation outlooks are improving, but monetary policy will remain accommodative for the foreseeable future. QE is expected to end by late 2016. The market is pricing in a rate hike in late 2018, which seems appropriate if the outlook continues to improve.

JAPAN: Recent economic data has been disappointing, and the slowdown in China could further weigh on growth. Second-quarter economic growth was weaker than expected, and the bounceback in the current quarter appears muted. There is potential for additional fiscal or monetary easing, and the Bank of Japan may be forced to act more quickly if growth and inflation continue to undershoot.

UK: A conservative majority in the government allows tighter fiscal policy to be enacted over the next five years, which implies a shallower tightening of monetary policy. Economic data remains decent but has softened recently. Inflation pressures are muted due to a strong pound and lower oil prices. But with wages rising, the Bank of England is expected to raise rates in 2016 while emphasizing a slow and shallow tightening cycle.

CANADA: A negative second-quarter GDP reading marks a "technical" recession for Canada, with weakness concentrated in the commodities extraction sector. The Bank of Canada is likely to remain on hold for an extended period, looking for a delayed pick-up in growth in the second half of 2015. Renewed oil price declines pose downside risks to the outlook.

AUSTRALIA: The Reserve Bank appears comfortable with the current degree of monetary stimulus, with currency weakness also helping with the adjustment. However, another rate cut is possible given external threats to growth from China and renewed weakness in commodities.

IMPORTANT INFORMATION

This material, including any statements, information, data and content contained within it and any materials, information, images, links, graphics or recording provided in conjunction with this material are being furnished by T. Rowe Price for general informational purposes only. The material is not intended for use by persons in jurisdictions which prohibit or restrict the distribution of the material and in certain countries the material is provided upon specific request. It is not intended for distribution to retail investors in any jurisdiction. Under no circumstances should the material, in whole or in part, be copied or redistributed without consent from T. Rowe Price. The material does not constitute a distribution, an offer, an invitation, recommendation or solicitation to sell or buy any securities in any jurisdiction. The material has not been reviewed by any regulatory authority in any jurisdiction. The material does not constitute advice of any nature and prospective investors are recommended to seek independent legal, financial and tax advice before making any investment decision. Past performance is not a reliable indicator of future performance. The value of an investment and any income from it can go down as well as up. Investors may get back less than the amount invested.

The views contained herein are as of 8 September 2015 and may have changed since that time. Unless indicated otherwise the source of all market data is Thomson Datastream.

Australia - Issued in Australia by T. Rowe Price International Ltd (ABN 84 104 852 191), Level 50, Governor Phillip Tower, 1 Farrer Place, Suite 50B, Sydney, NSW 2000, Australia. T. Rowe Price International Ltd is exempt from the requirement to hold an Australian financial services licence in respect of the financial services it provides in Australia. T. Rowe Price International Ltd is authorised and regulated by the UK Financial Conduct Authority under UK laws, which differ from Australian laws. For Wholesale Clients only.

Canada - Issued in Canada by T. Rowe Price (Canada), Inc. T. Rowe Price (Canada), Inc. enters into written delegation agreements with affiliates to provide investment management services. T. Rowe Price (Canada), Inc. is not registered to provide investment management business in all Canadian provinces. The investment management services provided by T. Rowe Price (Canada), Inc. are only available for use by Accredited Investors as defined under National Instrument 45-106 in those provinces where it is able to provide such services.

DIFC - Issued in the Dubai International Financial Centre by T. Rowe Price International Ltd. This material is communicated on behalf of T. Rowe Price International Ltd by its representative office which is regulated by the Dubai Financial Services Authority. For Professional Clients only.

EEA - Issued in the European Economic Area by T. Rowe Price International Limited, 60 Queen Victoria Street, London EC4N 4TZ which is authorised and regulated by the UK Financial Conduct Authority. For Professional Clients only.

Hong Kong - Issued in Hong Kong by T. Rowe Price Hong Kong Limited, 21/F, Jardine House, 1 Connaught Place, Central, Hong Kong. T. Rowe Price Hong Kong Limited is licensed and regulated by the Securities & Futures Commission. For Professional Investors only.

Japan - Issued in Japan by T. Rowe Price International Ltd, Tokyo Branch (KLFB Registration No. 445 (Financial Instruments Service Provider), JIAA Membership No. 011-01162), located at GranTokyo South Tower 7F, 9-2, Marunouchi 1-chome, Chiyoda-ku, Tokyo 100-6607. This material is intended for use by Professional Investors only and may not be disseminated without the prior approval of T. Rowe Price International Ltd, Tokyo Branch.

Singapore - Issued in Singapore by T. Rowe Price Singapore Private Limited, No. 501 Orchard Rd, #10-02 Wheelock Place, Singapore 238880. T. Rowe Price Singapore Private Limited is licensed and regulated by the Monetary Authority of Singapore. For Institutional and Accredited Investors only.

Switzerland - Issued in Switzerland by T. Rowe Price (Switzerland) GmbH ("TRPSWISS"), Talstrasse 65, 6th Floor, 8001 Zurich, Switzerland. For Qualified Investors only.

USA - Issued in the USA by T. Rowe Price Associates, Inc., 100 East Pratt Street, Baltimore, MD, 21202, which is regulated by the U.S. Securities and Exchange Commission. For Institutional Investors only.

T. ROWE PRICE, INVEST WITH CONFIDENCE and the Bighorn Sheep design are, collectively and/or apart, trademarks or registered trademarks of T. Rowe Price Group, Inc. in the United States, European Union, and other countries. This material is intended for use only in select countries.