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Quarterly Outlook – Fixed Income

GROWTH EXPECTATIONS AND CENTRAL BANK STIMULUS GUIDE RISK SENTIMENT

OCTOBER 2019
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KEY INSIGHTS

- Global government bonds rallied for much of the third quarter amid growth concerns and expectations that major central banks will ease monetary policy.
- Investors recovered their risk appetite in September, looking through current economic weakness to position for a better macro environment in 2020.
- We believe that economic data is close to bottoming, but risk events remain on the horizon, including U.S.-China trade talks and the UK’s exit from the European Union.

CORE GOVERNMENT BOND YIELDS REFLECTING SHIFTS IN SENTIMENT

Global growth concerns and expectations that major central banks will ease monetary policy fueled demand for high-quality government bonds during the third quarter, driving yields lower and curves flatter. Toward the end of the period, there were signs of fatigue, however, as the easing of trade tariff concerns led to a pickup in long-dated core government bond yields.

CENTRAL BANK STIMULUS MEASURES TO SPUR GROWTH

After months of dovish rhetoric, several major central banks began delivering interest rate cuts in a bid to revive economic growth. Most notably, the Federal Open Market Committee lowered the fed funds rate in July for the first time since 2008. The committee then followed up with an additional 25- basis-point cut at its mid-September meeting, which moved the fed funds rate target range to 1.75%–2.00%.

The European Central Bank (ECB) was also in the spotlight as it announced new stimulus measures in September that included lowering the deposit rate deeper into negative territory and restarting its bond-buying programme.

Markets returned to a “risk-on” pattern in September, with both credit and equity markets outperforming despite weaker economic data and renewed geopolitical risk. At the same time, the rally in global government bonds came to a sudden stop as market participants were happy to look through the current economic weakness to position themselves for a better macro environment in 2020.

> “Overall, we believe the environment calls for a tactical approach, which should provide a tailwind for our strategy, as we have the flexibility to adapt quickly to changes in market conditions.”

ANTICIPATING MEDIUM-TERM IMPROVEMENT IN DATA

In our view, data is close to bottoming, and it’s possible we see some improvement over the medium term. Looser financial conditions should be supportive of growth, as should China pursuing more fiscal stimulus. Against this backdrop, it’s possible that some of the asset classes that have underperformed year-to-date, such as U.S. inflation-linked bonds and emerging market currencies, start to do better in an environment of stronger growth.

RISKS EVENTS REMAIN ON THE HORIZON

Looking ahead, there are a number of risk events on the horizon to monitor. This includes U.S.-China trade talks and the UK’s exit from the European Union. Economic data releases also need to be closely watched as we look for signs that the health of the global economy is improving.

Overall, we believe the environment calls for a tactical approach, which should provide a tailwind for our strategy, as we have the flexibility to adapt quickly to changes in market conditions. We will continue to follow our trusted investment process and strive to maintain a portfolio that strikes a balance between country, duration, and yield curve positioning to take advantage of relative value opportunities globally while also managing downside risks.

RISKS

The following risks are materially relevant to the portfolio.
ABS/MBS risk – These securities may be subject to greater liquidity, credit, default and interest ra te risk compared to other bonds. They are often exposed to extension and prepayment risk
Contingent convertible bond risk – contingent convertible bonds have similar characteristics to convertible bonds with the main exception that their conversion is subject to predetermined
conditions referred to as trigger events usually set to capital ratio and which vary from one issue to the other.
China Interbank Bond Market risk – market volatility and potential lack of liquidity due to low trading volume of certain debt securities in the China Interbank Bond Market may result in prices of certain debt securities traded on such market fluctuating significantly.
Country risk (China)- All investments in China are subject to risks similar to those for other emerging markets investments. In addition, investments that are purchased or held in connection with a QFII licenceor the Stock Connect programmay be subject to additional risks.
Country risk (Russia and Ukraine)- In these countries, risks associated with custody, counterparties and market volatility are higher than in developed countries.
Credit risk- A bond or money market security could lose value if the issuer's financial health deteriorates.
Currency risk- Changes in currency exchange rates could reduce investment gains or increase investment losses.
Default risk- The issuers of certain bonds could become unable to make payments on their bonds.
Derivatives risk- Derivatives may result in losses that are significantly greater than the cost of the derivative.
Emerging markets risk- Emerging markets are less established than developed markets and therefore involve higher risks.
High yield bond risk – a bond or debt security rated below BBB- by Standard & Poor's or an equivalent rating, also termed 'below investment grade', is generally subject to higher yields but to greater risks too.
Interest rate risk- When interest rates rise, bond values generally fall. This risk is generally greater the longer the maturity of a bond investment and the higher its credit quality.
Issuer concentration risk- To the extent that a portfolio invests a large portion of its assets in securities from a relatively small number of issuers, its performance will be more strongly affected by events affecting those issuers.
Liquidity risk- Any security could become hard to value or to sell at a desired time and price.
Prepayment and extension risk- With mortgage- and asset-backed securities, or any other securities whose market prices typically reflect the assumption that the securities will be paid off before maturity, any unexpected behaviour in interest rates could impact fund performance.
Sector concentration risk- The performance of a portfolio that invests a large portion of its assets in a particular economic sector (or, for bond funds, a particular market segment), will be more strongly affected by events affecting that sector or segment of the fixed income market

General Portfolio Risks

Capital risk- The value of your investment will vary and is not guaranteed. It will be affected by changes in the exchange rate between the base currency of the portfolio and the currency in which you subscribed, if different.
Counterparty risk – an entity with which the portfolio transacts may not meet its obligations to the portfolio.
Geographic concentration risk- To the extent that a portfolio invests a large portion of its assets in a particular geographic area, its performance will be more strongly affected by events within that area. **Hedging risk**- A portfolio's attempts to reduce or eliminate certain risks through hedging may not work as intended. **Investment portfolio risk**- Investing in portfolios involves certain risks an investor would not face if investing in markets directly. **Management risk**- The investment manager or its designees may at times find their obligations to a portfolio to be in conflict with their obligations to other investment portfolios they manage (although in such cases, all portfolios will be dealt with equitably). **Operational risk**- Operational failures could lead to disruptions of portfolio operations or financial losses.

201910-993701