T. Rowe Price

PANORAMA

QUARTERLY THOUGHT LEADERSHIP PUBLICATION FOR OUR CLIENTS

FIRST QUARTER, 2024

GLOBAL INVESTING
Investment Implications of Generative AI

GLOBAL MULTI ASSET
How dynamic credit can mitigate downside risk

US EQUITY
US Small Cap Stocks Look Like a Potentially Big Opportunity

GLOBAL FIXED INCOME
When Markets Twist and Turn, Flex Your Fixed Income

CHINA EQUITY
China: Charting the Course in 2024

T. ROWE PRICE
Introducing Our New Investor Website

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WELCOME……

.........to the first quarter 2024 edition of Panorama, T. Rowe Price's investment magazine for Asian investors.

While it is early days, most markets got off to a good start in January 2024 as the MSCI All Country World global equity index rose 0.5%. The macro set up for the world economy appears more favorable than twelve months ago when recession fears were at their peak. Today, the focus for many investors is on a rare 'soft landing' where inflation continues to fall, central banks cut interest rates, and economic growth holds up. A sunny-side-up scenario for markets may be partly priced in after the strong rally in stocks since October.

Our lead article again takes up the theme of artificial intelligence (AI) and how this might benefit investors. Global Equity portfolio specialist Rahul Ghosh sees Generative AI being adopted at a faster rate than previous core IT technologies across multiple sectors and industries. Substantial productivity gains are likely to follow, opening up many exciting opportunities for investors. T. Rowe Price believes there are compelling reasons why investors should embrace AI as a long-term investment theme.

Next, Wyatt Lee and Saurabh Sud recommend adding a flexible dynamic credit strategy to a target date retirement fund in order to provide investors with a smoother ride through credit cycles. As a leader in the U.S. target date marketplace, T. Rowe Price has a wealth of experience helping retirement investors to stay on the path to achieve their goals.

Curt Organt and Matt Mahon, who co-manage T. Rowe Price's US Smaller Companies Equity Strategy, see a potentially big investment opportunity. Consumer spending trends, the onshoring of U.S. industry, and improving pricing power are factors supporting a positive outlook for small cap stocks in 2024.

Fixed income managers Leonard Kwan and Saurabh Sud believe that in an environment where bond markets can twist and turn as in 2023, a more flexible approach in allocating to credit and emerging market debt could be a good choice for many investors. Yields in emerging markets are attractive while the wide universe offers scope to find opportunities that are less correlated to global cycles.

China's economy is clearly in transition and the current deleveraging process is a painful but necessary part of that journey. Portfolio analyst Clarence Li thinks the challenge for investors in 2024 is to carefully navigate this transition rather than withdraw from a market that is currently out of favour and historically cheap.

Lastly, in place of the Personal Profile interview, we are pleased to introduce T. Rowe Price's new website for investors. "Putting clients at the center of our best thinking" remains the number one goal for trowe.price.com. Please click on this link to visit the new website and gain access to our best investment thinking and learn more about T. Rowe Price investment products.

At Panorama, we very much appreciate your comments and feedback. Our contact details can be found on page 24 of this issue.

T. Rowe Price Australia

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Investment Implications of Generative Artificial Intelligence (AI)

Rahul Ghosh
Portfolio Specialist,
Global Equity Dividend Strategy

At T. Rowe Price, we believe there are compelling reasons why investors should embrace Artificial Intelligence (AI) as a long-term investment theme even if some popular AI stocks may appear a little frothy in the short term.

2023: An Exceptional Year for Global Tech

Looking back, twelve months ago our global equity managers held an optimistic view of global tech in 2023. We retain our positive view on the sector for 2024, not just for AI but for the broader technology sector in general. Many of the global tech stocks that our analysts cover are experiencing accelerating organic earnings growth and operating margin expansion which appears set to continue in 2024. AI has been and may continue to be cyclical, yet we also believe that its S-curve trajectory has likely been underestimated by the market.

> AI S-curve trajectory has likely been underestimated by the market.

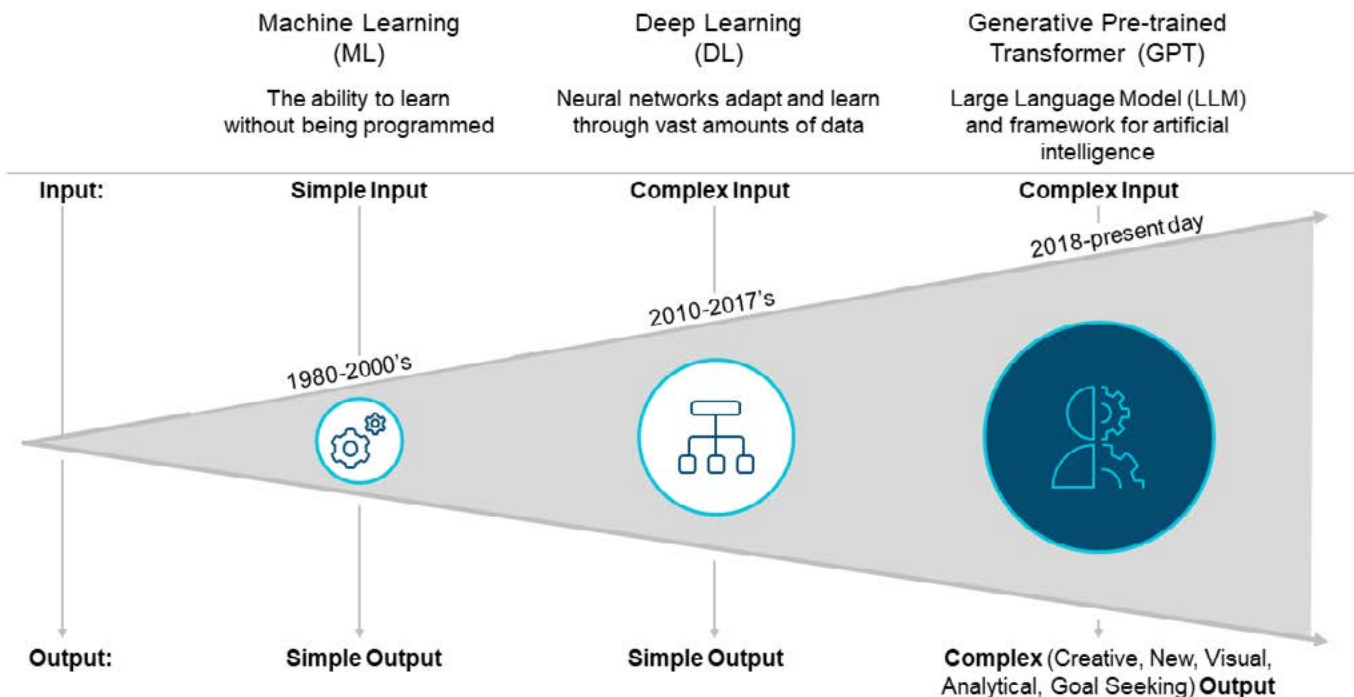
AI: Investing in the Future, today

Generative AI is incredibly semiconductor intensive due to its immense parallel processing requirements. One of the best ways to visualize the opportunities is in Figure 2 below, which represents AI beneficiaries graphically as a pyramid with four different levels. Among the first to benefit, forming the base of the pyramid, are the companies involved in the chip ecosystem for advanced semiconductors and semiconductor capex, such as NVIDIA, TSMC, ASML, Lam Research etc. One of the best ways to take advantage of Generative AI in this mega-trend has been via the "picks and shovels" and other parts of the infrastructure layer.

The second layer of the pyramid comprises the AI infrastructure providers (Amazon, Apple, Alibaba Cloud etc) and AI enablers (IT services companies such as Accenture, Microsoft Azure). At the third pyramid level are the foundational large language models

FIGURE 1: Generative AI Constitutes a Huge Breakthrough

Rapid jump from Machine Learning to Deep Learning to ChatGPT



As of 30 June 2023

like Open AI's GPT-4, or Meta's LLaMA. Finally, at the top of the pyramid are the customized AI applications, where currently there is less visibility as to who the eventual winners are likely to be.

While the adoption of AI is still in its early stages, it appears to be exceptionally rapid compared to previous IT booms such as PCs and smartphones, thanks in part to Generative AI and Large Language Models, which have encouraged tech and non-tech companies in many industries and sectors to experiment with early adoption, driven more by the recognition of potentially large efficiency gains than by FOMO (fear of missing out).

Global Tech Opportunities in 2024

Globally, the outlook for technology in 2024 appears quite robust, with continued growth in Generative AI and a cyclical rebound in the broader-based semiconductor market including PCs, smartphones, etc. Of course, this favorable view of tech has to be balanced against broader macro risks and concerns such as a potentially slowing in US consumer demand, the slow Chinese economic recovery, and escalating geo-political uncertainties in the Middle East, Ukraine and other regions.

We think it is likely, however, that the AI boom has enough momentum to continue in 2024, outweighing broader macroeconomic worries, many of which are not new but were also present throughout 2023. We continue to see many interesting areas of opportunity for global technology investors in 2024, including the following:

- Semiconductors overall could continue to be a source of strength. The demand for semiconductors is likely to stay strong, driven by accelerating AI demand, as exemplified by AMD's latest assessment of the global accelerator chip market being worth USD400 billion by 2027. The company increased their market growth outlook from a 50% CAGR to a 70% CAGR from 2023 to 2027. We could also see a bottoming in other areas such as industrial semiconductors by H2 2024.
- Cloud computing and enterprise software is expected to continue to grow due to the increasing demand for flexible and scalable IT solutions. AI development is poised to give a further boost to this and so we think the outlook for datacenter spending is likely to stay strong. In particular, companies need to get their data "ready" for AI. This means more companies investing in middle office and back-office

Three key facts that define the AI boom

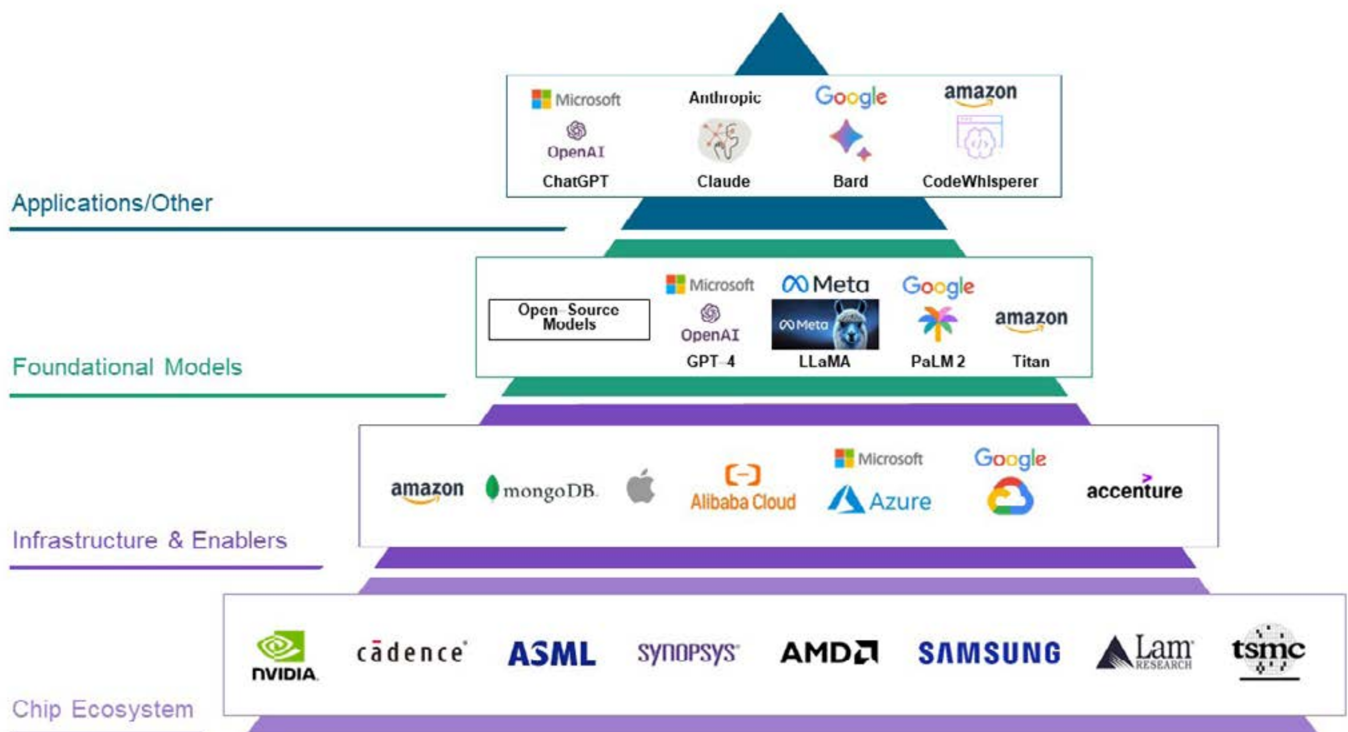
Generative AI is not a bubble. It is genuine breakthrough (as depicted in Fig 1) and a business upcycle due to AI is already underway.

It is the maturity of past IT innovation in terms of decentralized, superfast computing via the Cloud, powerful smartphones etc. that has enabled the great leap forward in AI that we are currently witnessing.

AI requires a robust combination of computing power, talented software and hardware engineers, vast troves of data, and hordes of new customers. In the IT sector, this benefits existing mega-scale internet platform companies. This means that AI, at least initially, is not a 'disruptive' technology.

FIGURE 2: Visualizing AI As a Pyramid

The Layers of AI



As of 30 June 2023

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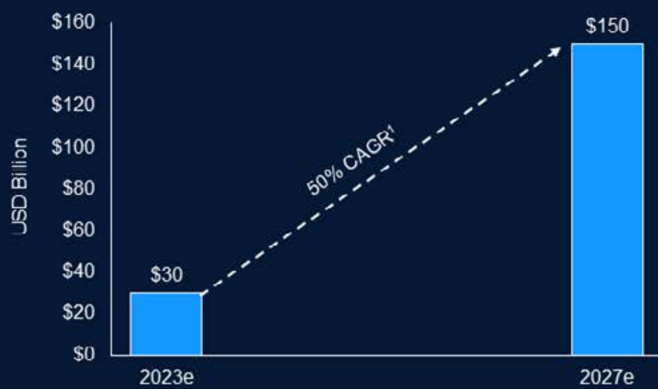
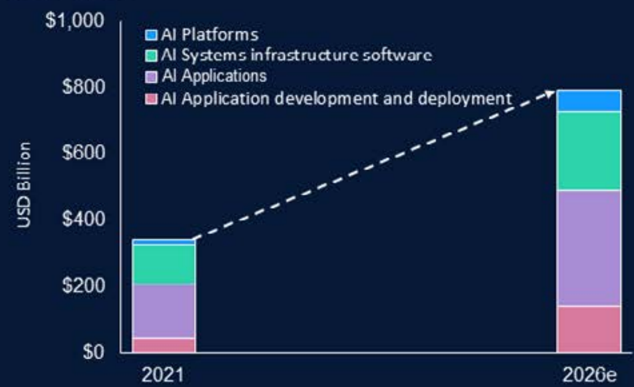
FIGURE 3: Rapidly Growing Global AI Markets
Global AI chip & software markets in USD billion.





Needs for AI compute and software – driving exponential growth

As of 30 June 2023
There is no guarantee that any forecasts made will come to pass.
1 Compound Annual Growth Rate.
Source: AI Chip Market—AMD Data Center and AI Technology Premier; Software Forecast—William Blair Research based on data from IDC; Worldwide Semiannual Artificial Intelligence Tracker, 2H21.

software such as Workday, SAP, and Service Now.

- Areas of Fintech could also be strong, hence our continuing involvement in the sector. E-commerce continues to accelerate post the COVID reflation and fintech companies are being more disciplined in their operating expenditure.

Balancing Risks and Opportunities

With such powerful dynamics, we are cognizant of the risks of a potential bubble forming, resulting in excessive valuations for popular AI stocks. As asset managers, we believe it is our job to navigate the rapidly changing AI environment responsibly, by adhering to T. Rowe Price's long-established bottom up investment framework and not overpaying for 'hot' AI stocks.

We have to balance the opportunities against potential risks, which currently we see being linked more to broader macro concerns than to sub-sector specific issues within the technology space.

- On the economic front, while the Fed seems to be managing a decent glide path in the US, there remains the risk of a slowdown, which combined with the current weakness in the Chinese economy could dampen global demand for technology products and services.
- On geopolitics, while there has been some recent easing in US-China tensions, we have to be alive to the possibility of it flaring up again, with potential impacts on demand as well as the IT supply-chain.
- Finally, regulatory risk also remains a challenge for the industry. As governments try to adapt to the increased adoption of AI, and the broader availability of data, the risk to AI remains of increased government regulations around data privacy, antitrust issues and national security concerns, as well as potential increases in compliance burdens and costs for technology companies.

Concluding Thoughts

We continue to believe the artificial intelligence (AI) story is bigger than many investors realize and could lead to exponentially greater returns and capital expenditures than the market is anticipating. We plan to navigate this mega trend responsibly, while also monitoring the wider technology landscape and look to pick up alpha where we can outside of AI. Above all this will always be done by staying true to our framework: finding companies that sell linchpin (or indispensable) technology, innovating in secular growth markets, with improving fundamentals and reasonable valuations.

How dynamic credit can mitigate downside risk

- We believe a more diversified fixed income profile can enhance outcomes for target date investors by helping to manage downside risk.
- Low correlation to other asset classes can help limit drawdowns when markets decline and preserve capital to participate more fully when markets advance.
- We believe the addition of Dynamic Credit will help provide a smoother ride through credit cycles, especially for investors approaching and in retirement.

Wyatt Lee, CFA
Portfolio Manager and
Head of Target Date Strategies

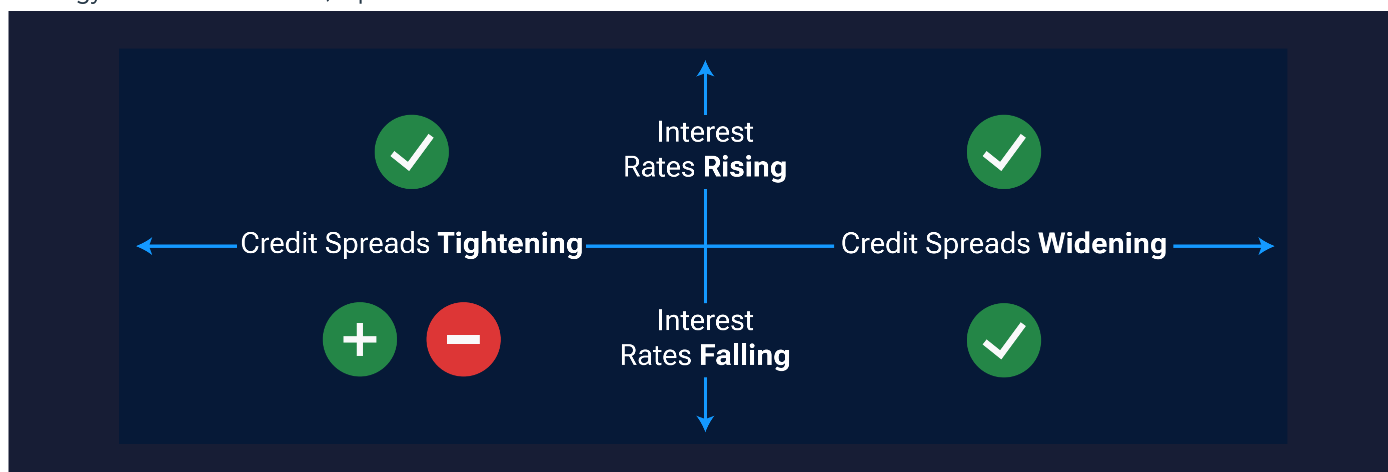
Saurabh Sud, CFA
Portfolio Manager, Dynamic Credit

Preparing for retirement can be a decades-long process for investors, spanning a full range of market environments, interest rate regimes, and ebbs and flows of volatility. For these investors, the need for growth of principal is considered alongside the desire for lower balance variability and lifetime income, especially as the duration of retirement continues to grow for many populations. As leaders in the U.S. target date marketplace, we have devoted significant resources to understanding how to deliver diversification that can help keep retirement investors on the path to achieve their goals.

Purposeful diversification

While many target date providers continue to offer comparatively basic allocations to fixed income that rely heavily on investment-grade bonds, our research has led us to a different conviction. We believe a more diversified fixed income profile can enhance outcomes for target date investors by helping to manage downside risk as well as providing exposure to securities with lower correlations to equities and U.S. interest rates. From this research, we arrived at a compelling case to include a Dynamic Credit strategy in our own target date solutions.

FIGURE 1: Diversifying performance drivers across market environments
Strategy seeks more flexible, alpha-oriented outcomes



Source: T. Rowe Price.
Green icons represent expected outperformance versus credit beta; red icon represents expected underperformance. For illustrative purposes only. The expected performance for Dynamic Credit is relative to alternative credit indices, such as investment-grade corporates, high yield corporates, or emerging market bonds. Market environments and expected performance are based on the general strategy structure but are not based on actual performance nor intended as forward-looking performance projections. As with any investment, performance may vary and is subject to potential loss. Actual performance may differ significantly.
As of September 4, 2023.
Source: Goldman Sachs Global Investment Research.

We think about our allocation to fixed income as the ballast in our glide paths, which are intended to mitigate different risks faced along the life cycle. Our fixed income profile includes allocations to yield-seeking sectors like high yield and emerging markets bonds, inflation focused allocations like inflation focused bonds, and exposures intended to preserve capital, like long duration bonds. Dynamic Credit is a new and differentiated allocation within our glide path that can make our risk management capabilities more robust and diversify performance drivers across a variety of markets.

Dynamic Credit

Dynamic Credit employs a flexible, cross-sector approach to source opportunities from our global research platform. Rather than narrowly focusing on a specific asset class, such as investment-grade debt or emerging markets bonds, this strategy can invest across all credit instruments to take advantage of pricing dislocations and compelling yield opportunities wherever they manifest.

The strategy seeks to generate excess returns primarily through a combination of high-conviction security selection and sector rotation. This rigorous approach to credit selection is reflected in the strategy's long positions, which, at a typical range of 100 to 200 names, is fairly concentrated among fixed income portfolios. These holdings include assets that our target date glide paths do not otherwise have dedicated allocations, including securitized credit, convertible securities, and municipal bonds.

The strategy also employs active credit shorting and duration management to both generate attractive returns and dampen volatility.

The value of low correlation

Dynamic Credit's alpha-seeking but risk-aware approach is well suited for a range of market conditions, and it may be even more valuable in the current unsettled credit environment. We believe that our fundamental credit analysis process that generates forward-looking insights from a global research platform with broad sector expertise can help us identify and capitalize on inefficiencies ahead of the market.

The strategy targets lower correlations with equities and traditional credit asset classes. Correlation measures the relationship between two asset classes. For example, two assets could be positively correlated, so that they move in the same direction, or negatively correlated, meaning they tend to move in opposite directions.

The tangible benefit of diversification through an allocation with lower correlation to other asset classes, such as Dynamic Credit, is that an unfavorable environment for other assets would not necessarily have a comparable effect on the strategy. This creates the potential to limit losses when markets decline and to preserve capital that can help investors participate more fully when markets advance.

Purpose in the glide path

Our research demonstrated how incorporating hedging strategies during the time when investors are most sensitive to market volatility can help improve risk-adjusted returns through reduced drawdowns from significant market events—which, ultimately, can lead to improved retirement outcomes. For retirement investors, we believe the addition of Dynamic Credit will help provide a smoother ride through credit cycles and differentiated sources of return, especially for investors approaching and in retirement.

As investors in our glide path portfolios approach retirement, their investment mix shifts away from equities and toward fixed income. As fixed income becomes a larger allocation within our glide paths, we layer in exposure to return-seeking fixed income, such as high yield bonds and emerging market debt. As part of this allocation, we also include exposure to Dynamic Credit. This exposure is phased in during the 10 years leading up to retirement, increasing to 20% of the return-seeking fixed income allocation at retirement. The Dynamic Credit allocation serves the purpose of providing exposure to the credit markets but doing so in a risk-aware way that can smooth returns around retirement and, importantly, can reduce the impact of significant market declines.

The addition of Dynamic Credit is part of the natural evolution of our target date solutions and a reflection of our research-based approach and long history of helping retirement investors navigate market volatility. This enhancement reflects our sharp focus on delivering consistent outcomes over a lifetime of investing. ■

U.S. small-cap stocks look like a potentially big opportunity

Curt Organt
Co-portfolio Manager, US Smaller Companies Equity Strategy

Matt Mahon
Co-portfolio Manager, US Smaller Companies Equity Strategy

- The ongoing resilience of the U.S. economy has increased the potential for a soft economic landing in 2024.
- U.S. smaller companies have borne the brunt of heightened risk aversion in recent years and are now trading at an historically wide relative valuation discount.
- Consumer spending trends, onshoring of U.S. industry, and potential pricing power are just some of the factors supporting a positive outlook for U.S. smaller companies.

Amid multi-decade high inflation, 18 months of interest rate rises, and ever-present fears of recession, the general resilience of the U.S. economy throughout this time has gone, if not unnoticed, then generally underappreciated by many investors. However, this resilience has been underscored recently with the economy posting strong third-quarter growth far exceeding expectations.

At the same time, inflation has declined, easing pressure on policymakers to hike rates further. The encouraging data raises the potential for an economic soft landing in 2024, defying gloomier predictions that have prevailed for much of the past two years.

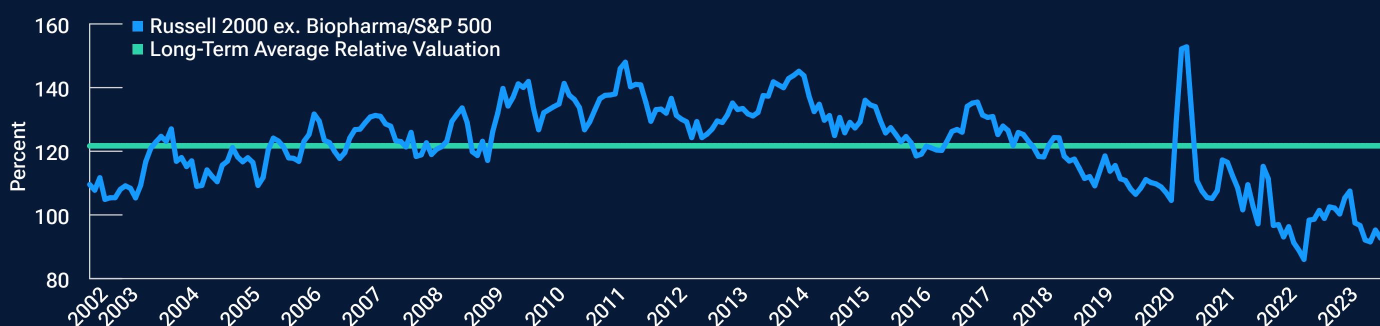
Historically wide valuation discount

For U.S. smaller companies—which have borne the brunt of heightened risk aversion in recent years—this marks a significant turning point. As risk appetite returns, and fundamentals once more prevail over sentiment, the extreme relative valuation discount of smaller companies looks increasingly attractive.

U.S. smaller company stocks have historically traded at a premium to large-caps, reflecting their higher relative risk/return profile. In recent years, however, this valuation trend has reversed—small-cap stocks are not only trading at a discount to their larger

FIGURE 1: U.S. small-cap relative valuations are at multi-decade lows

Relative forward (next 12 months) price/earnings ratio



As of September 30, 2023.

Sources: Furey Research Partners, S&P Indices, and LSE Group; analysis by T. Rowe Price (see Additional Disclosures)..

counterparts, but the differential has become extreme, widening to levels not seen in decades (Fig. 1).

Robust consumer spending

The U.S. economy expanded by an annualized 4.9% in the third quarter, the fastest pace in nearly two years. Meanwhile, inflation fell to 3.2% in October, marking a spectacular decline from the 40-year high of 9.1% recorded in June 2022.

One of the primary forces behind the economy's resilience has been the continuing strength of consumer spending. A strong jobs market with a high level of employment means U.S. wages are rising, while excess savings are also at historically high levels. Importantly, U.S. consumers are also less immediately exposed to the steep rise in interest rates than many other countries. Most U.S. household mortgages—around 90%—are fixed rate, with a large percentage secured at long-term interest rates well below the high rates available today. In short, individual balance sheets are in better shape than prior to the pandemic, giving consumers the confidence to keep spending.

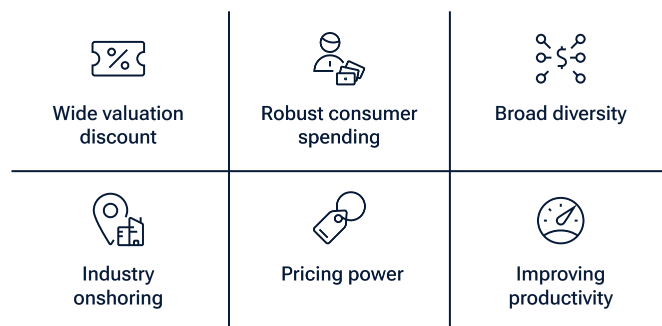
However, we are also seeing a shift in underlying spending trends, away from goods and into services. This traces back to the COVID pandemic, during which the goods economy remained robust while the services economy effectively shut down. We are now seeing this imbalance swing the other way, with evidence of a concerted catch-up in services spending. Importantly, with smaller company earnings much more geared to the services economy, this shift should help to fuel favorable relative earnings growth.

Similarly, U.S. companies, large and small alike, have also moved quickly to downsize or refinance their debt since the pandemic, resulting in generally healthier balance sheets, more cash, and less exposure to interest rate fluctuations.

Broad diversity in a highly concentrated market

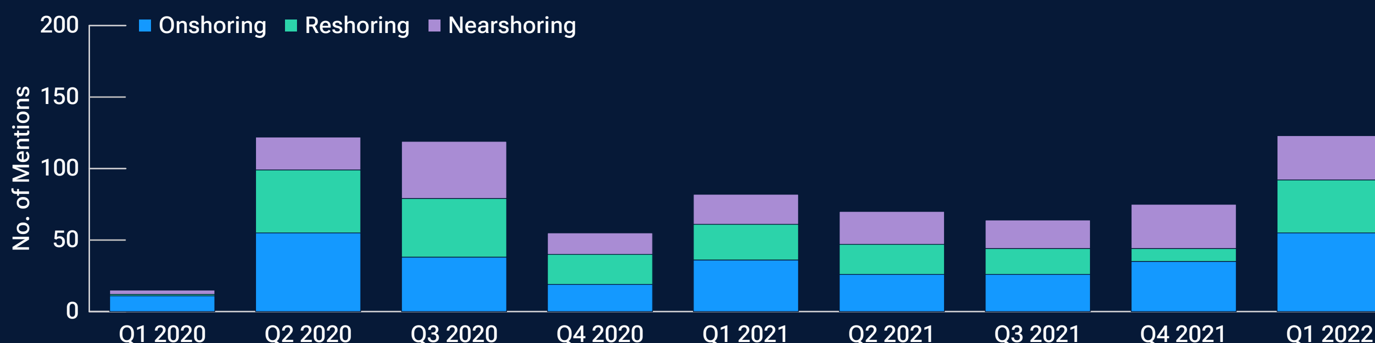
A great deal has been written about the highly concentrated top end of the U.S. equity market. The S&P 500 Index has become increasingly focused in a very small group of mega-cap companies. The so-called Magnificent Seven—Apple, Microsoft, Alphabet, Amazon, Nvidia, Tesla, and Meta—have become so highly priced that they now dwarf the value of many international equity markets.

AN UPBEAT OUTLOOK FOR U.S. SMALLER COMPANIES



Smaller companies offer a much more diversified exposure to the vitality of the U.S. economy and a different risk profile to large-cap investing. The domestic bias of smaller companies, and more balanced exposure at the sector level, means they are often better positioned to benefit from changing trends in the U.S. economy.

FIGURE 2: U.S. industry is coming home
Supply chain shifts are getting more attention from company management



As of June 30, 2022 (latest available).
Source: Bloomberg data; analysis by T. Rowe Price. U.S. executive mentions of the terms “Onshoring,” “Reshoring,” or “Nearshoring” during quarterly earnings calls and/or conference presentations.

Industry onshoring

The trend toward supply chain localization or “onshoring”/“reshoring” of U.S. industry is gathering pace. We have already seen a sharp rise in manufacturing and construction activity directly attributable to company onshoring/reshoring and this seismic shift is still only in the relatively early stages (Fig. 2). The full impact of new legislation, including the 2022 CHIPS and Science Act and the 2022 Inflation Reduction Act, offering big incentives for businesses to bring operations and personnel back to the U.S., is still yet to be felt. Each contains stipulations regarding the production and procurement of U.S.-made products and components designed to benefit companies that manufacture domestically. Smaller companies, which tend to be more geared to the domestic economy, stand to benefit from this concerted shift away from globalization in favor of more locally driven supply chains.

Smaller company pricing power

One of the main risks to the positive outlook in 2024 is that inflation recommences its upward trajectory, necessitating further rate increases. We acknowledge that there is secular upward pressure on costs in the energy sector, for example. Rising inflation and higher interest rates would certainly cloud the outlook for smaller companies. However, even if this transpires, there are many smaller companies that display that all-important attribute—pricing power.

Smaller companies are often assumed to be price takers, with limited ability to exert pricing power. In fact, many smaller businesses operate in underserved or niche industries, such as fintech,

> Smaller companies offer a much more diversified exposure to the vitality of the U.S. economy....
>
> – ***Matt Mahon***
> *Co-portfolio Manager,*
> *US Smaller Companies Equity Strategy*

computer gaming, e-commerce, and green energy, and so command more pricing power than their size might suggest. When these businesses begin to experience inflationary pressure, be it through supply chain bottlenecks, wage increases, or due to rising input costs, they are able to pass on these higher costs to customers, thereby helping to protect their profit margins.

Even if a smaller company cannot control the price of an end product, it is not necessarily powerless to influence its own revenues/profits. For example, many smaller companies can be critical components within more complicated processes or supply chains. As has been painfully clear in recent years, high demand and limited supply of any component along the supply chain gives pricing power to the component producer. Asset-light companies offering business-critical services/products, look particularly well placed to deliver recurring cash flows and potentially grow their revenues.

A premium for improving productivity

While a more positive economic outlook in 2024 is important for smaller companies at a broad level, improving productivity is likely to be a key driver of topline performance at a company level. With this in mind, there are many good opportunities to be found, often in less studied sectors, which are having a meaningful impact in terms of enabling improved productivity. Some of the most important aspects of our lives, in key areas like financial services, health care, and agriculture, for example, have not really been reimagined in the way that sectors like technology or communications have. We are seeing significant investment in these areas, and innovative smaller companies are frequently at the forefront of this advancement.

Looking ahead to 2024

The resilience of the U.S. economy, powered by U.S. consumers' confidence has bolstered hopes for a soft-landing scenario in 2024. If this transpires, and recession is avoided, there are many pieces in place to suggest smaller companies can perform well. Relative valuations, versus larger companies, have fallen to historically low levels, despite earnings remaining relatively resilient, and history tells us that small-caps tend to outperform strongly in an improving economic environment. With powerful onshoring trends and a strong dollar also providing tailwinds, investors may wish to consider adding small-cap exposure, focusing on those businesses driving productivity gains—and/or that command pricing power.

> Asset-light companies offering business-critical services/products, look particularly well placed to deliver recurring cash flows and potentially grow their revenues.
>
> **– Curt Organt**
>
> *Co-portfolio Manager, US Smaller Companies Equity Strategy*

When Markets Twist and Turn, Flex Your Fixed Income

During the past two years, investors have had to contend with periods when bonds and equities sold off at the same time. This went against the traditional function of fixed income as a diversifying asset class that tends to perform well when stock markets decline. High and sticky inflation, along with the sheer number of interest rate hikes aimed at taming it, were the main drivers of this unusual correlation.

However, inflation is now cooling, and central banks have likely finished their hiking cycles. With growth also expected to slow, bonds may potentially reassert their role as an effective diversifier for riskier assets. Furthermore, with bond yields now meaningfully higher, we think there is room for bonds to rally should fears of a deeper economic slowdown or a market shock dampen investors' risk sentiment.

That said, uncertainty is likely to remain high in 2024. The potential for larger-than-anticipated government debt issuance to fund fiscal deficits may result in supply/demand imbalances, which could contribute to volatility. But with no more interest rate hikes expected, rate volatility could shift to the long end of yield curves. This backdrop, combined with weaker growth and ongoing geopolitical risks, highlights the need for an active and flexible approach to fixed income investing. We believe this environment will be conducive for more dynamic strategies that can tactically adapt to the shifting macro and policy landscape.

Here to discuss more are Leonard Kwan, who manages the Dynamic Emerging Markets Bond Strategy, and Saurabh Sud, who manages the Dynamic Credit Strategy.

Leonard Kwan
Portfolio Manager,
Dynamic Emerging Markets Bond Strategy

Saurabh Sud
Portfolio Manager,
Dynamic Credit Strategy

What are the key features of your strategy and what role do you expect it to play in a global slowdown environment?

Leonard Kwan: The Dynamic Emerging Markets Bond Strategy seeks to capture the most attractive opportunities from the full spectrum of Emerging Markets (EM) debt, a broad opportunity set encompassing about 80 countries, more than 20 currencies, and over 800 corporate issuers. By focusing on the team's best ideas across sovereign, corporate, and local currency bonds, the strategy aims to capture EM's inherent growth potential while reducing drawdowns by actively managing the portfolio's volatility profile.

We take a forward-looking approach, underpinned by fundamental research and collaboration across asset classes and regions. Our process combines top-down macro analysis to inform asset allocation decisions among EM markets, corporates, interest rates, and currencies, with bottom-up country and issuer selection. We believe this approach is crucial to manage risk and mitigate losses in downturns.

In a weaker growth environment, we believe the strategy can be a useful source of income and diversification. All-in yields in EM are compelling, and the wide universe means there is potential to diversify by finding opportunities uncorrelated to global cycles. Although EM assets may come under pressure if broader risk appetite is impacted, our strategy has the tools to weather such a scenario by dynamically allocating to different sectors, countries, ratings, and companies. We can add duration to issuers we like, but in the same vein, we can choose to eschew segments we don't like even if it holds a weight in a traditional benchmark.

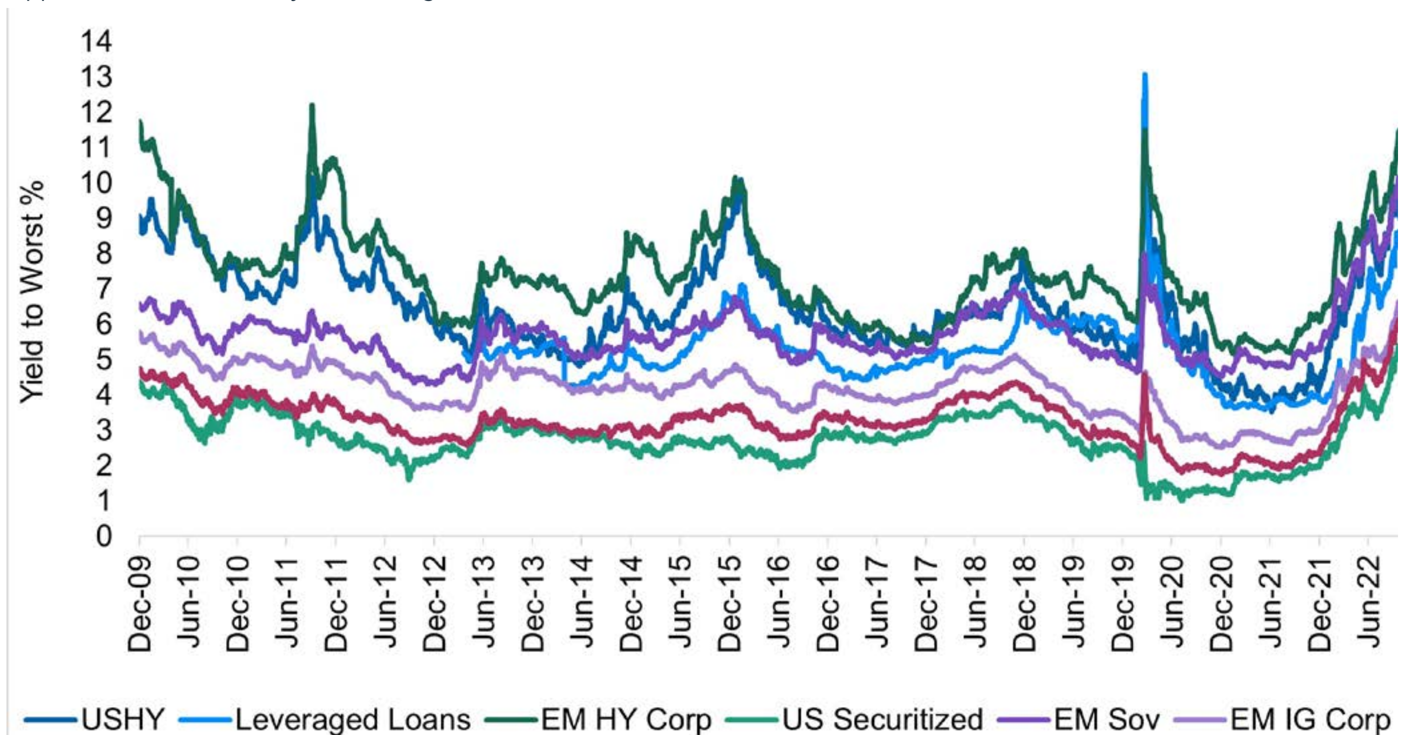
Overall, we believe that maintaining liquidity, with a focus on better-anchored countries and more defensive corporate ratings and sectors, is critical if a recession materializes. At the same time, we will look to leverage our deep EM expertise and extensive research capabilities to identify promising long-term opportunities. Ultimately, we believe our emphasis on fundamental research and active security selection will drive meaningful portfolio outcomes across cycles.

Saurabh Sud: The Dynamic Credit Strategy seeks to offer investors a "smoother ride" in credit investing by finding diverse alpha sources across the broad credit market (Fig.1). The strategy focuses on credit selection and sector rotation across the credit spectrum, including investment grade, high yield, emerging markets, securitized, distressed, municipals, convertibles, and bank loans. We have a long bias but employ active credit shorting and duration management to pursue alpha and dampen volatility during periods of weakness in credit markets.

The strategy aims to deliver attractive returns, source credit alpha flexibly, and diversify risk-asset returns. What we mean by the latter is targeting a lower beta to riskier asset classes, such as high yield credit and equities. To achieve these goals, the strategy harnesses expertise across T. Rowe Price's global research platform.

FIGURE 1: Global Credit Market Fluctuations

Opportunities consistently around in global credit markets



Past performance is not a reliable indicator of future performance.

Bloomberg: USHY: Bloomberg US Corporate High Yield Total Return Index Value Unhedged USD - Index Yield to Worst, Leveraged Loans: Morningstar/LSTA U.S. Leveraged Loan 100 Index (Wtd Average Yield) - Last Price, EM HY Corp: J.P. Morgan CEMBI Broad Div High Yield Yield to Worst - Last Price, US Securitized: Bloomberg U.S. Securitized: MBS/ABS/CMBS and Covered TR Index Value Unh - Index Yield to Worst, EM Sov: J.P. Morgan - EMBIG Diversified Yield to Worst - Last Price, EM IG Corp: J.P. Morgan CEMBI Broad Div High Grade Yield to Worst - Last Price, USIG: Bloomberg US Corporate Total Return Value Unhedged USD - Index Yield to Worst.

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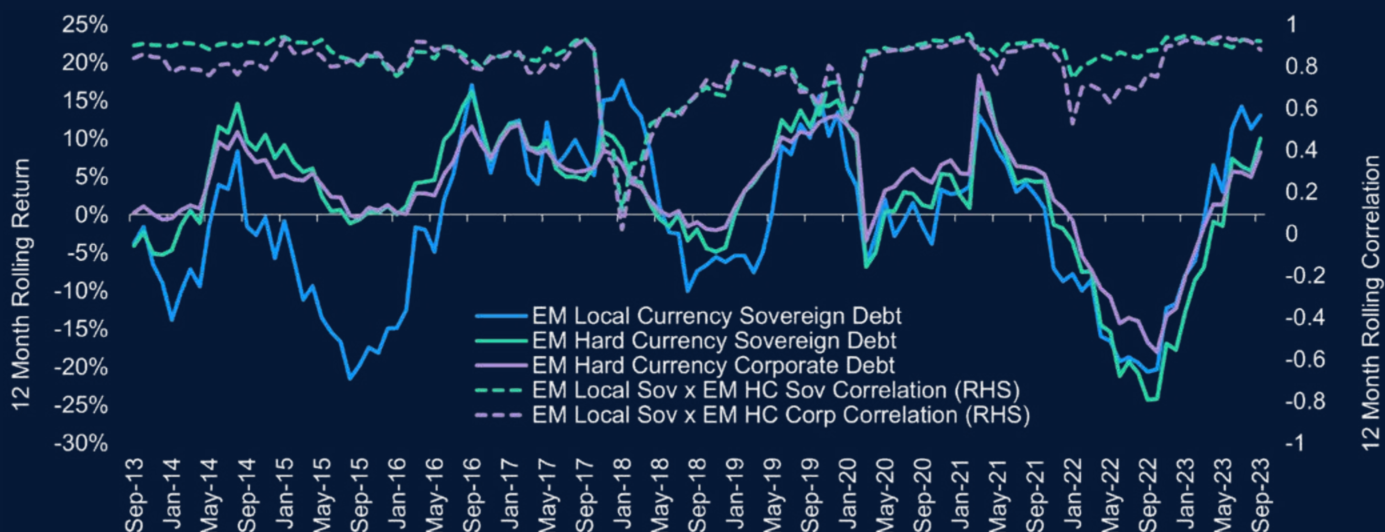
FIGURE 2: Emerging Markets Debt Sectors Returns and Correlations
12-months rolling returns and correlations



As of 30 September 2023. Figures are Calculated in U.S. Dollars.
Past performance is not a reliable indicator of future performance.
Indices: J.P. Morgan EMBI Global Diversified, J.P. Morgan CEMBI Broad Diversified, J.P. Morgan GBI-EM Global Diversified.
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We believe the strategy's alpha-seeking but risk aware approach is suitable for a range of market conditions, but may be more valuable in a slowing growth and uncertain credit environment. We believe that our fundamental credit analysis process, which generates forward-looking insights from a global research platform with broad sector expertise, can help the strategy identify and capitalize on inefficiencies ahead of the market.

How is your strategy different from traditional fixed income strategies? What solution does it aim to provide investors?

Leonard: Unlike traditional EM bond strategies, the Dynamic Emerging Markets Bond Strategy is a highly flexible solution offering unconstrained and diversified exposure to EM debt. Crucially, the team dynamically allocates across EM sovereign, corporate, and local currency debt sectors, investing in where we see the best opportunities (Fig.2).

This results in a concentrated portfolio that expresses our ideas via a mix of long-term core positions, high-conviction opportunities, and tactical hedges, with the flexibility to adjust exposures as market cycles shift.

The primary value proposition of the strategy is to provide a smoother EM experience by seeking to capture the bulk of the upside potential while limiting downside. This is particularly important as emerging markets and economies are less mature and typically involve higher risks. By focusing on our highest-conviction ideas, the strategy is designed to capitalize on sovereign and corporate growth in fast-expanding economies and capture emerging bonds' yield premium over their developed peers. This, combined with thoughtful diversification and tactical hedges, helps limit drawdowns, seeking for a more consistent return profile. Such an approach also alleviates the burden of investors having to make frequent reallocation decisions in response to changing market conditions and the evolving opportunity set.

Saurabh: What makes the Dynamic Credit Strategy unique is not just that it tactically invests across various credit sectors, but also our ability to flexibly manage duration and credit beta, as well as short individual credits. We believe our approach to portfolio construction makes the strategy a compelling and consistent credit allocation. The strategy's lower-beta profile helps it to weather conditions of widening credit spread, while actively managing duration positions it to adapt to different rate environments.

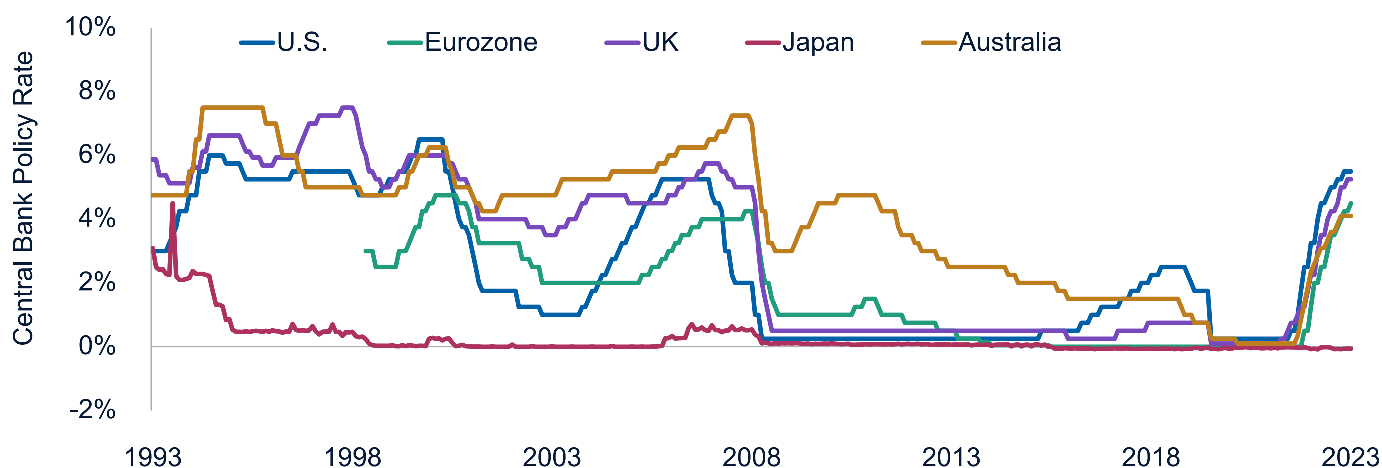
The strategy may suit investors who want to take advantage of credit opportunities while also managing drawdowns in volatile environments. It meets investors' search for yield, while managing undue credit beta and duration risk by using the full toolkit and capabilities on offer.

What is the outlook for bond markets for 2024?

Leonard: We believe we are at "peak everything" in terms of rates, inflation, liquidity, fiscal support, and credit. These factors supported the world economy's post-pandemic resilience but appear to be weakening toward longer-term trend levels. Our base case is for global growth to soften as governments taper fiscal

FIGURE 3: Short-term interest rates appear close to cyclical peaks

Central bank policy rates



As of September 30, 2023.

*U.S. = Federal Funds Rate Upper Limit, Eurozone = ECB Main Refinancing Rate, UK = Bank of England Official Bank Rate, Japan = BoJ Overnight Call Rate, Australia = Official Cash Rate, end of period.

Sources: Haver Analytics / Federal Reserve Board, European Central Bank, Bank of England, Bank of Japan, Reserve Bank of Australia. T. Rowe Price calculations using data from FactSet Research Systems Inc. All rights reserved.

accommodation and cumulative monetary policy tightening worldwide takes effect. Most economies are at a late stage of the economic cycle, though the prospect, timing, and depth of the slowdown remains difficult to forecast.

For EM, inflation is cooling in most countries, so central banks are expected to gradually ease policy. At the same time, the Federal Reserve (Fed) is likely at the end of its hiking cycle, which should reduce broader market uncertainty. Against this backdrop, our bias is for broadly lower yields and moderately wider spreads across the EM landscape in 2024. Nonetheless, we think all-in yields remain attractive, which should support above-trend returns and cushion against adverse macroeconomic events. We continue to expect attractive bottom-up opportunities due to the intrinsic differentiation and idiosyncratic nature of the EM asset class.

Saurabh: Most developed market central banks appear to have reached peak interest rates (Fig.3). The focus now is on sequencing—i.e., how long policymakers pause on rates before cutting. This will vary from country to country and depend on how economic growth and inflation evolves.

In the U.S., the economy is yet to show signs of significant weakness, but the Fed's recent dovish rhetoric points to likely easing in 2024. However, our economics team expects a sequential re-acceleration in growth data in the immediate term before moderating again, which may upset a market that has priced in aggressive interest rate cuts. Elsewhere, the BoJ is getting closer to achieving its price stability target. This combined with tight labor market conditions point to the potential removal of negative rates.

Broadly, the global economy is expected to weaken in 2024. While this could pose headwinds for credit markets, we continue to find appealing areas, such as secured parts of the U.S. high yield market. Overall, the asset class is supported by attractive yields, even though credit spreads—the yield differences between bonds with credit risk and high quality government bonds with similar maturities—appear less compelling at present. The overall improvement in quality of the high yield universe overall is another supportive factor, but selectivity remains key amid this tricky environment.

How will these market conditions suit the strategy that you manage?

Leonard: The multi-trillion-dollar EM bond market covers a multitude of companies and countries with distinct geopolitical and economic profiles. It is vast with plenty of differentiation and divergence, which is conducive for us as we can invest across the EM debt sphere. At present, we are watching Asian markets for signs of an activity upswing as China's economy stabilizes. Elsewhere, we see Latin America as potential beneficiaries of U.S. economic resilience. All these present potentially interesting alpha opportunities for astute investors to exploit.

In all, we believe our strategy is well suited for investors looking to stay invested in EM through the economic cycle. As mentioned, EM's diversity means there are likely always idiosyncratic opportunities to be found. Our flexible approach should not only enable us to find a range of less correlated exposures across sectors, but also supports diversification. The strategy's ability to tactically adjust duration and market beta is advantageous, relative to benchmark-aware strategies in periods characterized by volatility and uncertainty.

These features position it well to navigate through most economic environments.

Saurabh: Credit markets are currently priced for a soft economic landing. But a hard landing, or a tougher economic environment, is not out of the question, particularly if unemployment continue to rise. Even if a recession is avoided, we are likely to see economic growth concerns intermittently elevated. Therefore, we believe it's important to have a strategy that can flexibly navigate global credit markets. We can tactically shift allocations across sectors, which gives us the ability to streamline overall allocations. This should help improve overall diversification.

In an environment where growth is weakening, skilled security selection and sector allocation, informed by in-depth fundamental research, is vital. Harnessing the full breadth and depth of our global platform enables us to uncover great opportunities where prices have become dislocated from fundamentals, but also helps us to avoid issuers that might struggle in the more challenging macro conditions.

China: Charting the Course in 2024

China has long term structural economic issues, namely the '3 Ds' Debt, deflation, and demographics. These are topics that are well understood and frequently discussed, however it is worth remembering that they are not unique to China. Most Western governments are also having to manage these same issues. China's economy is clearly in transition and the current deleveraging process is a painful part of that journey.

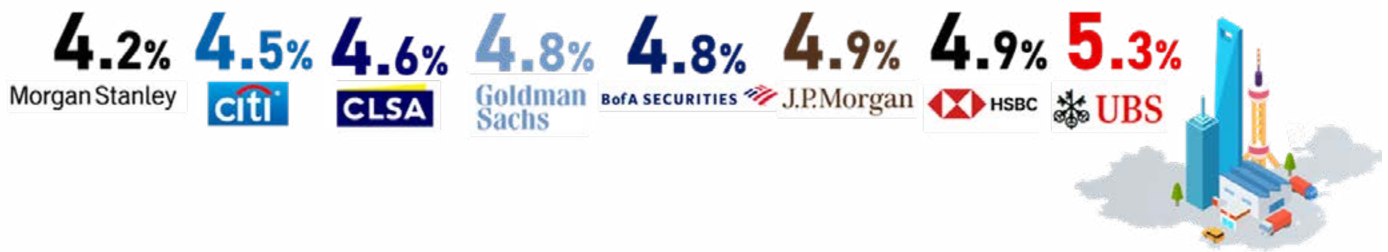
Clarence Li
Lead Portfolio Analyst

The government's challenge is to navigate this transition and strike a balance to achieve the goal of deleveraging the economy without destroying the economy. The economic recovery since the removal of the zero covid policies late last year has been underwhelming and in response we have seen a marked increase in policies aimed to support the economy. With the expectation of incremental policy support to continue, most sell-side outlooks for 2024 are cautiously optimistic, anticipating an improvement in GDP growth within a range of 4.2% to 5.3%.

> China's economy is clearly in transition...

To date, the government's response to the weak economy has fallen short of expectations but with every policy there will be a lag before their impact materializes. We feel that we are beginning to see an upturn in economic data and recent data points have beaten the, admittedly, modest consensus expectations. Stimulus efforts have intensified, particularly in regards to the property and capital markets. These measures include the easing of home purchase restrictions in several major cities, prime rates cut, and demands to banks to increase lending to private sectors.

FIGURE 1: 2024 Real GDP Growth Forecast



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Source: T. Rowe Price. As of 6 December 2023.

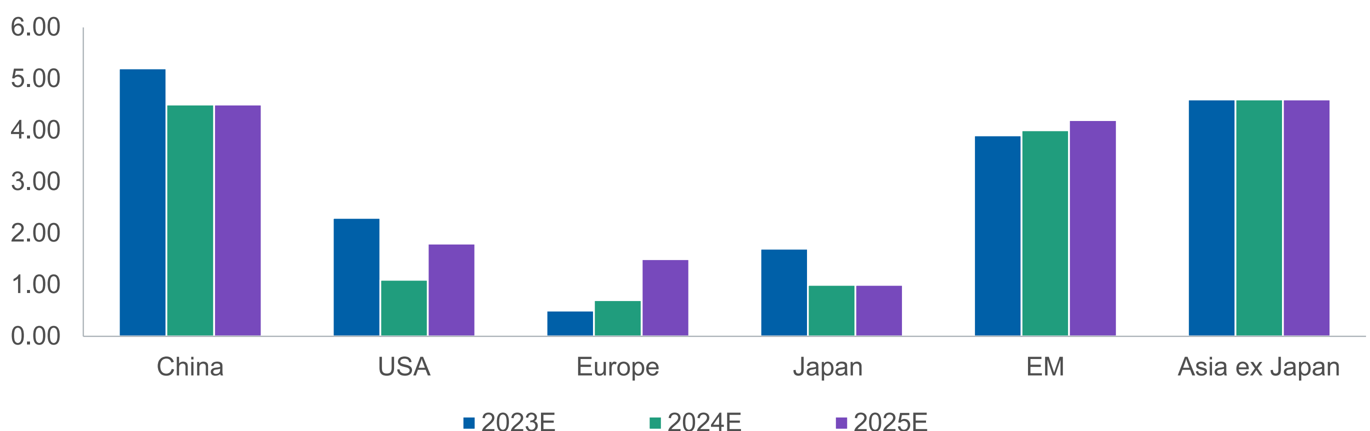
China's experience of the pandemic was unique and as a consequence their economic cycle has meaningfully diverged from the rest of the world. China's post-COVID reopening coinciding with a period where the majority of the world was struggling to contain inflation and avoid a recession which undoubtedly has impacted China's economic recovery through this year. Looking out, China's growth is projected to be higher compared to other global counterparts.

Chinese macro newsflow is closely followed and hard to ignore under the current environment, but over a longer term, the correlation between GDP growth and stock market performance tends to be very low, which is the case across most markets. As an equity investor, the focus is not about the entire economies; instead, we invest into individual companies. And what drive the returns in the equity market are fundamentally grounded in: Profits, Prospects and Price (valuations).

The expected earnings growth in China is stronger than developed markets, albeit below the broader emerging markets universe where a handful of heavyweight tech stocks are forecast to experience a significant upturn. The largest companies in China remain highly profitable. Recent years have been challenging for businesses with the twin headwinds of regulatory oversight and an economic slowdown, both of which have put pressure on their profitability. We see regulatory pressures easing in most sectors and a government clearly focused on economic growth. Furthermore, cyclicality in certain industries is showing signs of improvement. We also hear messages from company management teams that they are focusing heavily on capital discipline and profit maximisation. Certain industries that previously struggled with overcapacity are showing signs of recovery.

While market volatility may still lie ahead, sentiment towards China currently appears

FIGURE 2: GDP Growth YoY%



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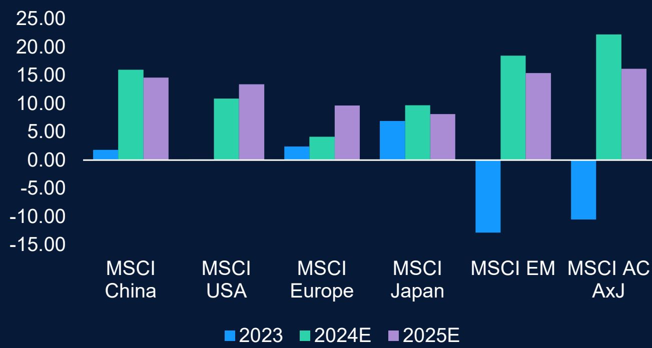
Source: Bloomberg Finance L.P. As of 6 December 2023

EPS Growth YoY%

(Fig. 3)



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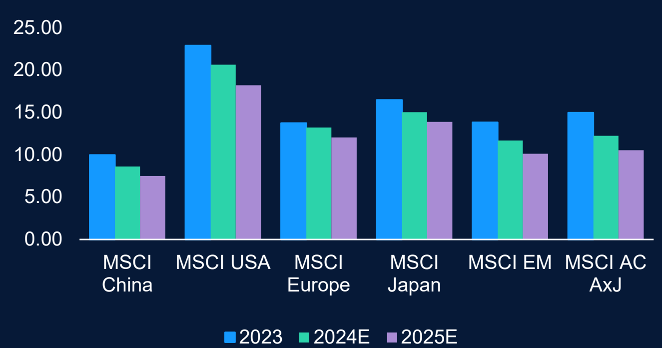
Source: Bloomberg Finance L.P. As of 31 January 2024.

EST P/E Ratio (x)

(Fig. 4)



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Source: Bloomberg Finance L.P. As of 31 January 2024.

predominantly pessimistic, causing a disconnection between fundamentals and subdued valuations. China's economy has moved in a different cycle to the rest of the world and it feels so too has its stock market. The overall index has pulled back to valuation levels last seen during the Zero-Covid lockdowns in the last summer, yet the situation in China has significantly improved since that point.

Our portfolio managers act cautiously and control our exposure to China market, but we do not share the view that the Chinese market is inherently uninvestable. There are many good companies generating significant earnings growth. The past few years have been entirely dominated by top-down macro factors; including the COVID on/off, QE/QT, and inventory de-stocking/re-stocking, all within the context of heightened geopolitical events. We believe that we have passed the moment of peak uncertainty for all of these events. Looking ahead to 2024, we foresee the influence of macro forces reducing and China moving back towards a stock picker's market.

Introducing T. Rowe Price's New Website for APAC Investors

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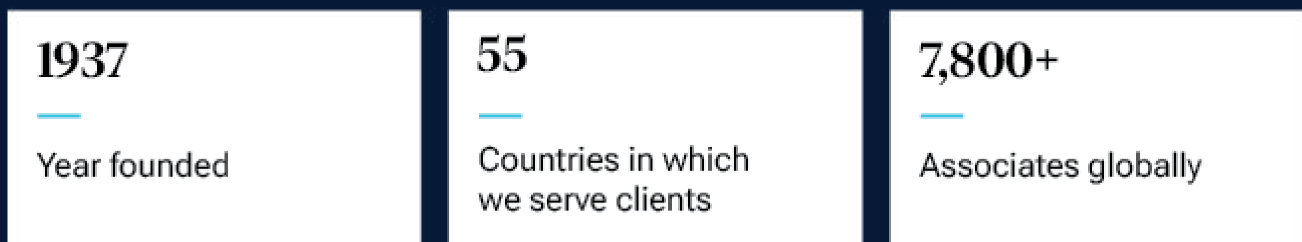

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We listen to understand our clients—and to learn. This helps us create deep partnerships. By understanding clients' needs and delivering timely, actionable insights and solutions, we help them navigate change and achieve better outcomes. We see partnership as a two-way street, a place where clients' goals meet T. Rowe Price expertise. From each insight to every investment, our singular focus is on our clients and their success.

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GLOBAL EXPERTISE
Continually growing global team of investment professionals

Founded in
Baltimore, USA in 1937

USD1.45
trillion in assets under management[1, 2]

812
investment professionals worldwide[3]

Local presence in
17
markets

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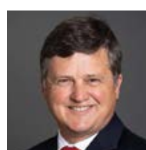

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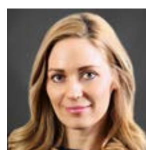

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[2] *As at 31 December 2023.*
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