



THE ROLE OF FIXED INCOME TODAY

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CIPFA
12 November 2014



Introduction: What Should be the Role of Fixed Income?



A source of stable income...



...a resource to enhance yield over cash...



...a source of liquidity...



...and a diversification tool to complement equities



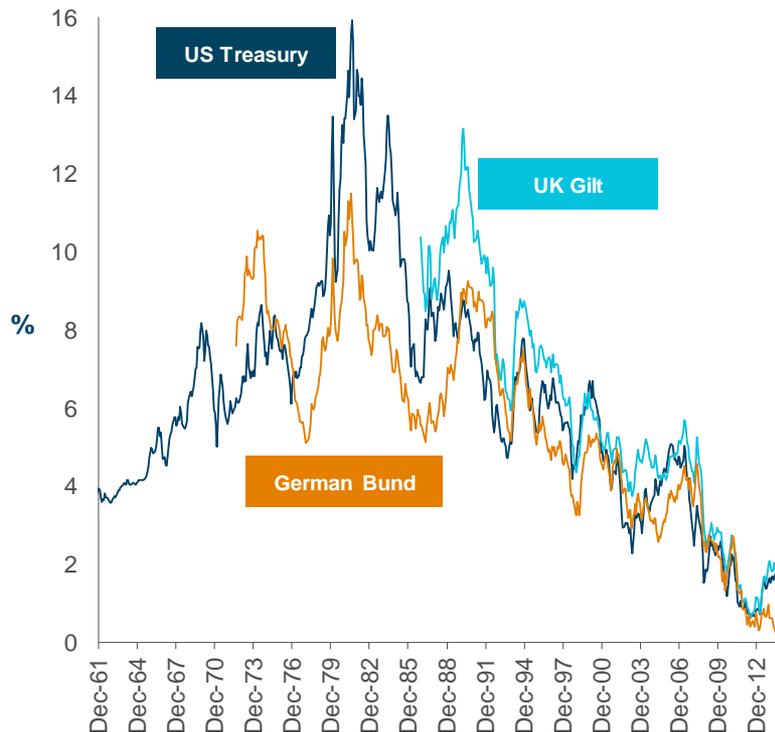
LET'S NOT FORGET THE TRUE ROLE OF FIXED INCOME

Fixed Income is Not What it Used to Be: The Zero Yield Boundary Issue

As of 30 Sep 2014

5-YEAR GOV'T BOND YIELD (%)

Since Dec 1961



POTENTIAL MAX. CUMULATIVE PERFORMANCE (%)

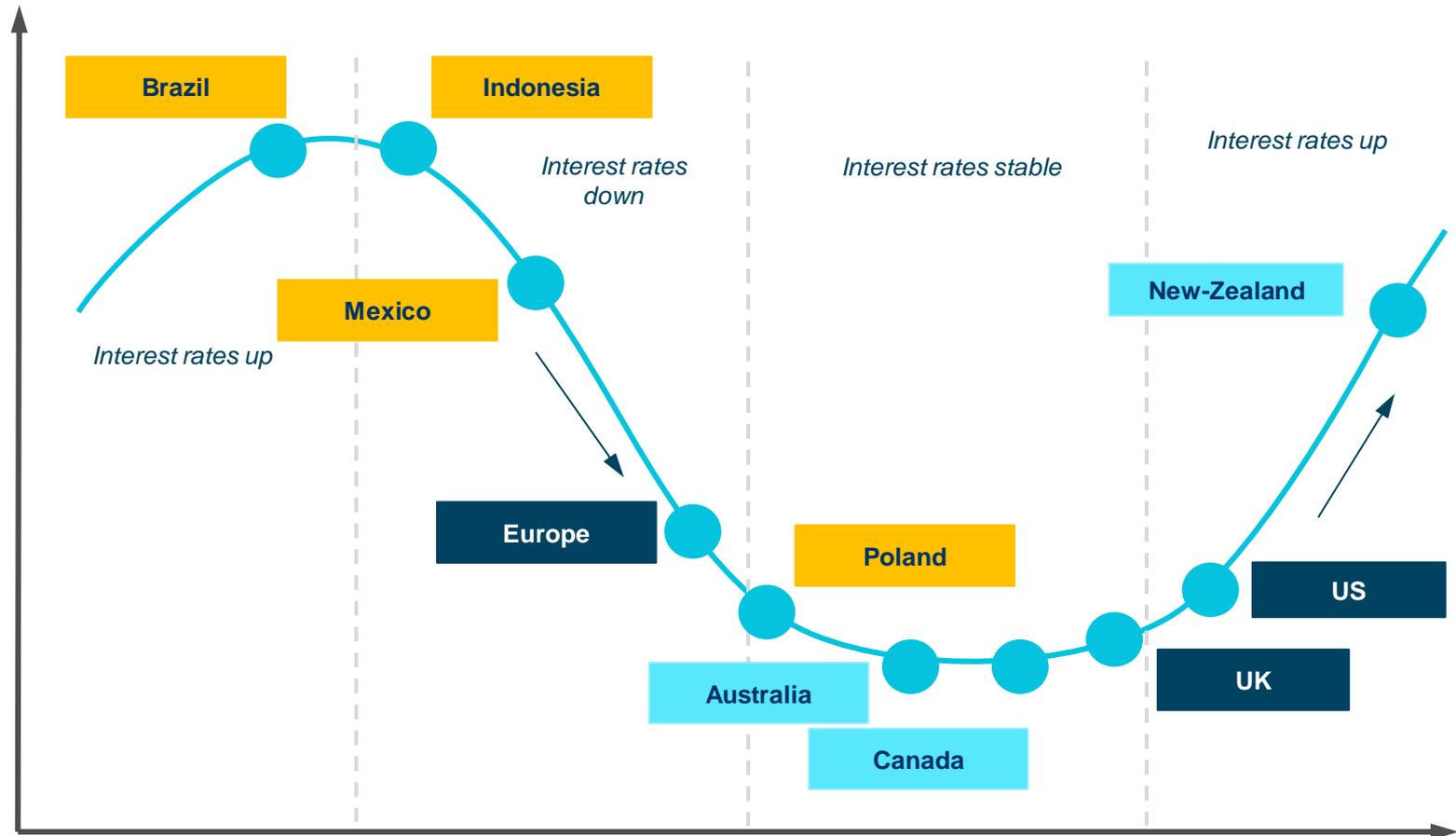
	If yields fall to ZERO within 2 years*	Compared to Recent Credit Crisis Period (02/22/2007 – 03/09/2009)
5-yr UK Gilt	9.74%	27.42%
5-yr US Treasury	9.63%	24.23%
5-yr German Bund	0.83%	18.63%

Sources: Reuters, Bank of England and T. Rowe Price

But All is Not Lost: Some Countries Still Offer Value

As of 30 Sep 2014

ILLUSTRATIVE INTEREST RATE CYCLE

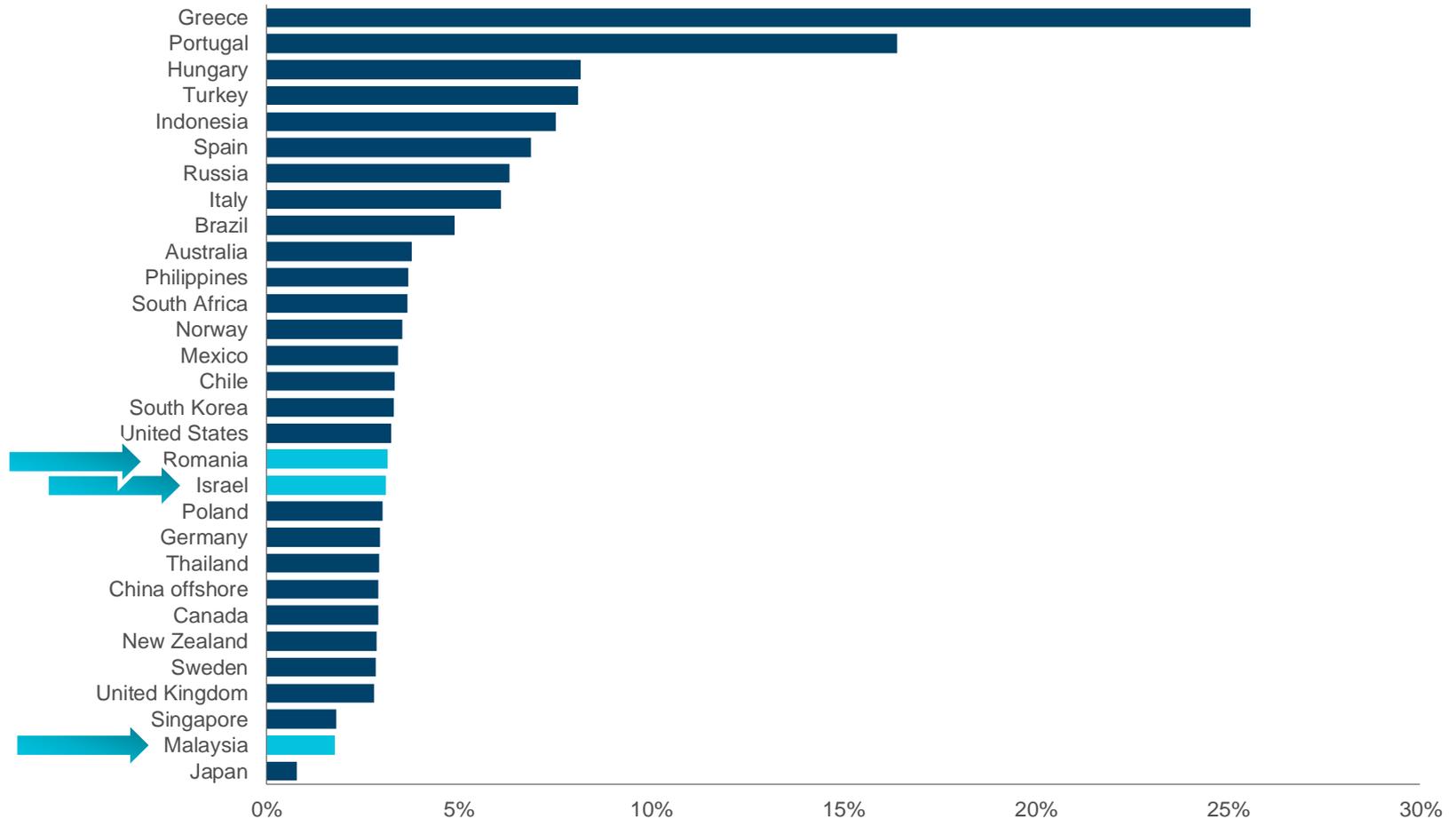


Source: T. Rowe Price

But All is Not Lost: Some Countries Have Stable Yield Structures

As of 30 Sep 2014

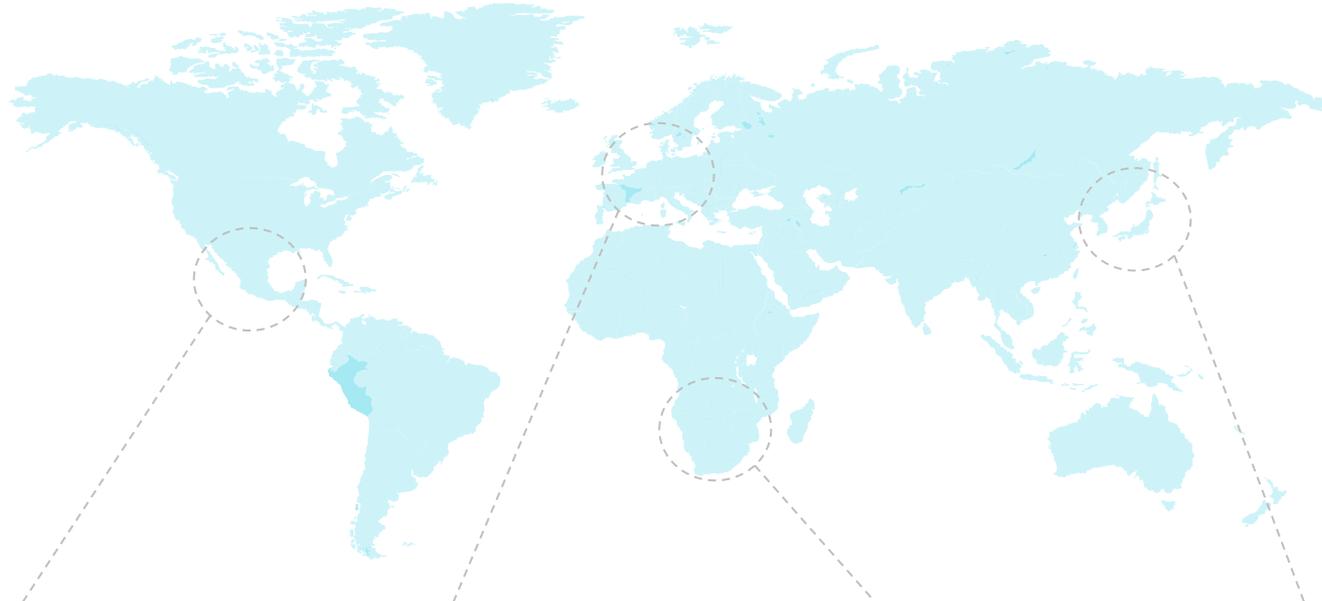
5-YEAR GOVERNMENT BOND PRICE VOLATILITY(%)



Sources: Reuters and T. Rowe Price

But All is Not Lost: Some Structural Improving Stories Are Worth Capturing

As of 30 Sep 2014



Overweight
Mexico Long Maturity Bond



Fiscal reform
Energy reform



Underweight
Italy vs. Slovenia



Slovenia better long-term
fundamentals



Overweight
South Africa Local Bond



Inflation trend rolling over
End of mining strike



Overweight
Japan Inflation Linked Bond



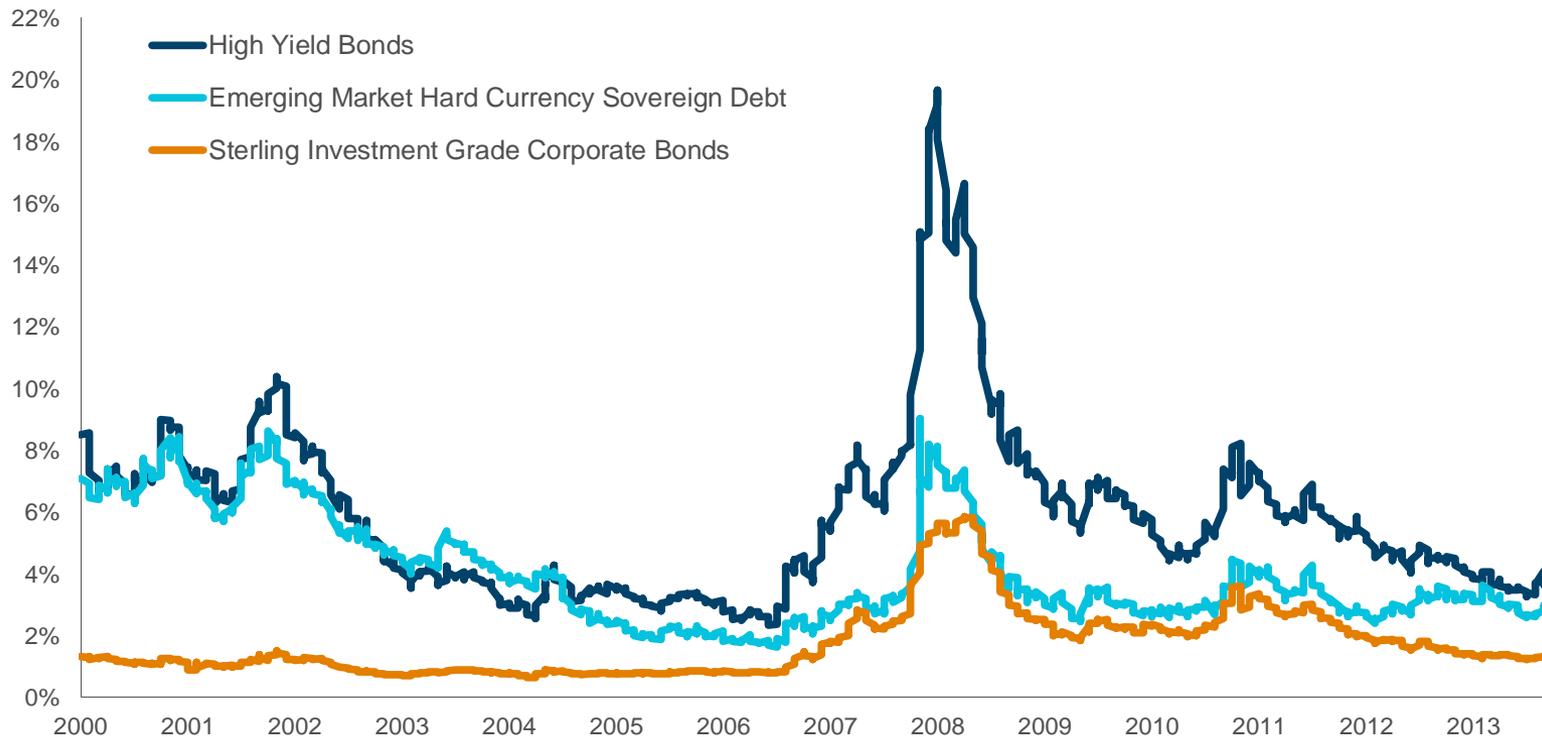
Abenomics' impact
Consumption tax

Let's Talk About Credit

As of 30 Sep 2014

HISTORICAL OPTION ADJUSTED SPREADS (%)

Since December 2000



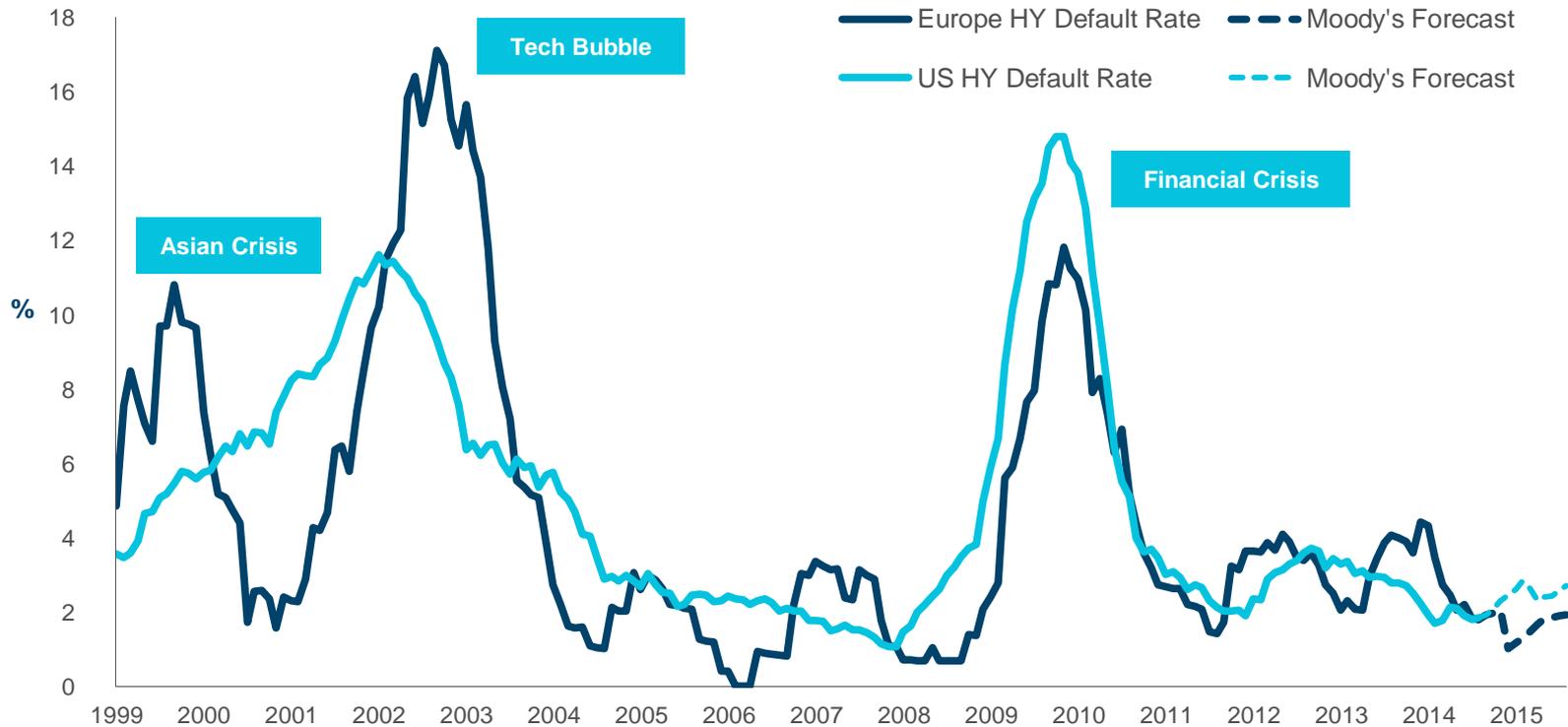
Sources: Barclays, JP Morgan, and T. Rowe Price.

Nothing Wrong on This Side

As of 30 Sep 2014

HIGH YIELD TRAILING 12-MONTH DEFAULT RATE (%)

From December 1998



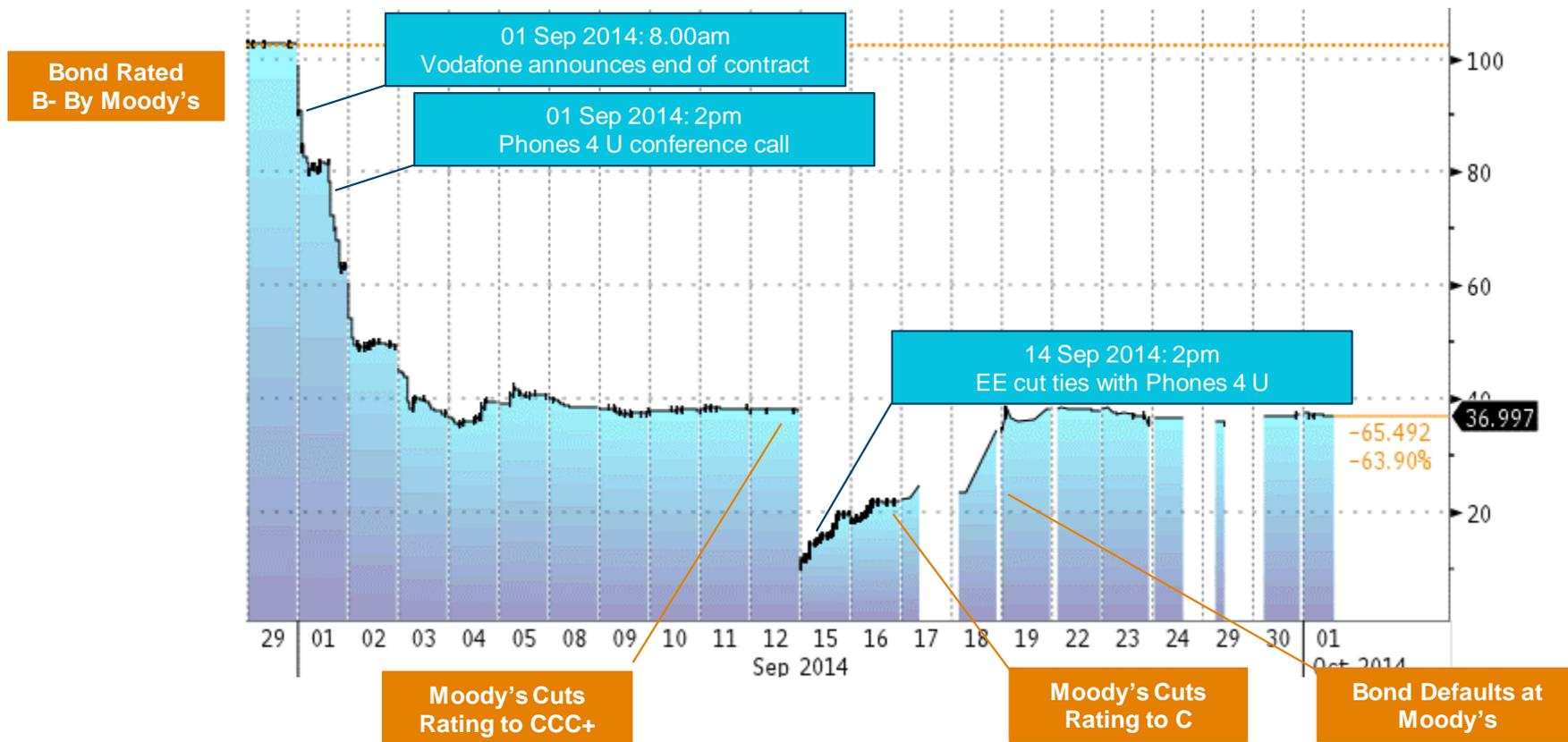
Sources: Moody's and T. Rowe Price

Security Selection Remains Key

As of 30 Sep 2014

PHONES 4 U 9.5% 01 APR 2018

Price Action 29 Aug 2014 – 30 Sep 2014



Source: T. Rowe Price

Examples and logos shown are for illustrative purposes only.

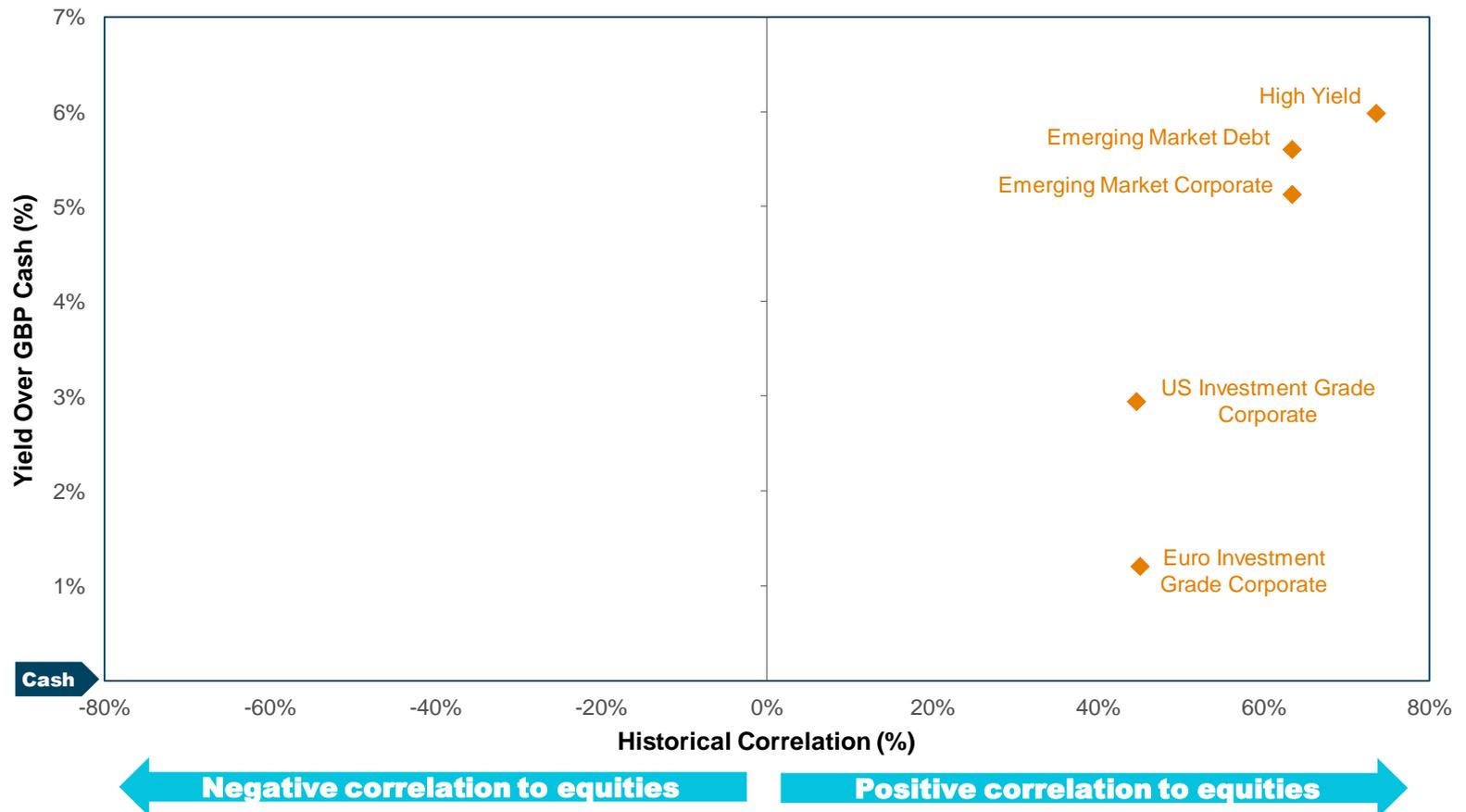
The specific securities identified and described above do not necessarily represent securities purchased, sold, or recommended, and no assumptions should be made that the securities identified and discussed will be profitable.

But This is the Issue: Credit Tends to Have High Correlation with Equities

As of 30 Sep 2014

CURRENT YIELD ABOVE GBP CASH VS. HISTORICAL CORRELATION

Last 10 years



Sources: UBS, Barclays, JPMorgan, BoA Merrill Lynch, S&P, MSCI, and T. Rowe Price.

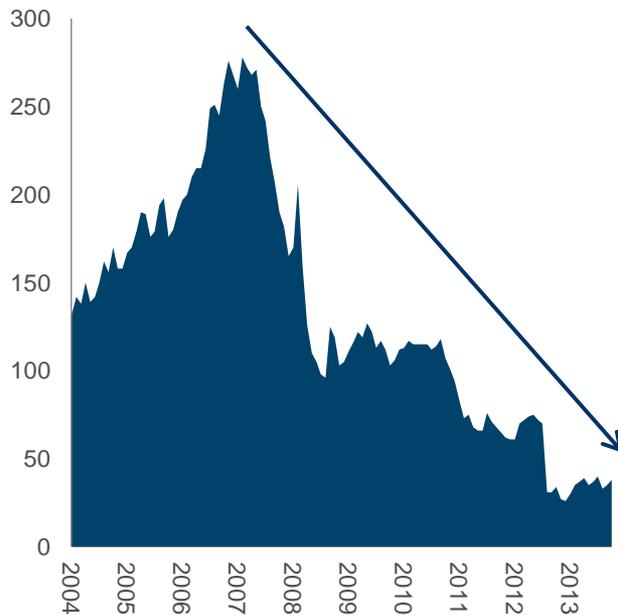
*Yield shown is on a hedged basis in UK Sterling. Volatility is based on the monthly returns each asset class hedged into UK Sterling

Liquidity has Deteriorated

As of 30 Sep 2014

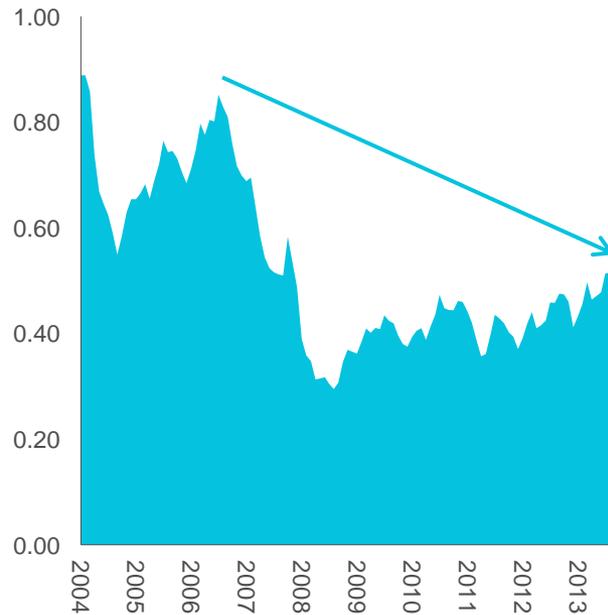
LIQUIDITY ON CORPORATE BOND MARKET

Dealer inventories
(US\$ billion)



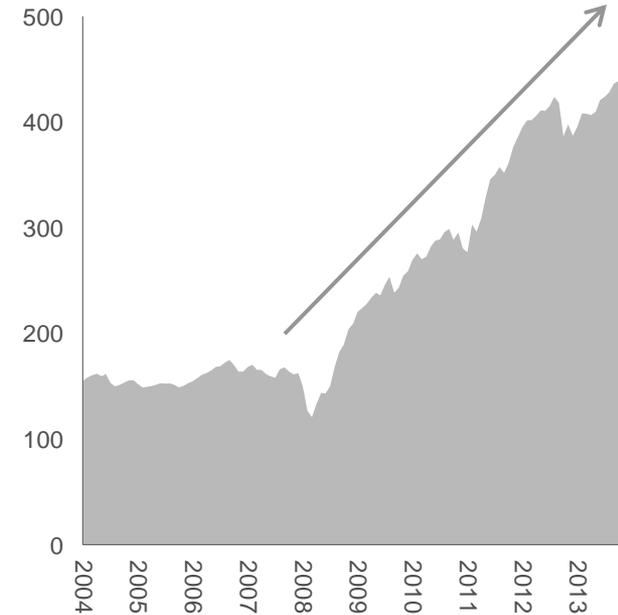
US Corporate Market Statistics
Primary Dealers Positions,
Federal Reserve Bank of New-York

Average Ticket Size
(US\$ million)



US Corporate Market Statistics
Market Access

Cumulative Market Size
(US\$ billion)



Morningstar US Corporate Bond and
Morningstar High Yield Bond categories

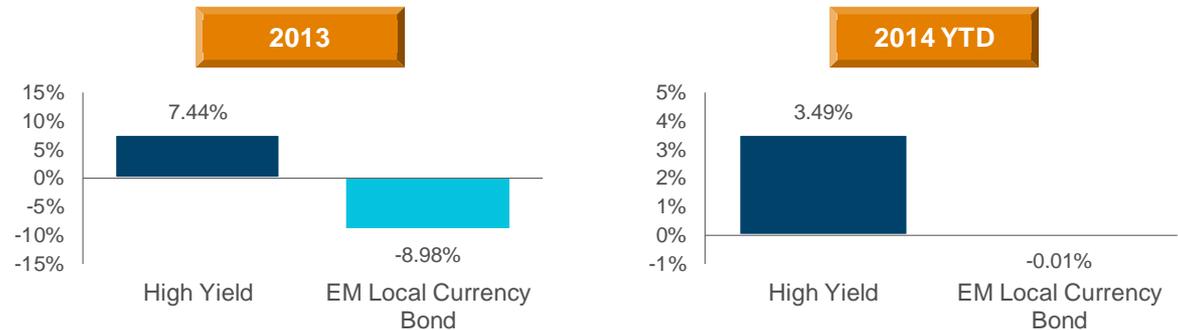
Sources: Federal Reserve Bank of New-York, MarketAxess, Morningstar and T. Rowe Price

Is There a Tradeoff Between Credit and Emerging Markets?

As of 30 Sep 2014

CUMULATIVE PERFORMANCE

Base 100 – 31 December 2012



Sources: UBS, Barclays, JPMorgan, BoA Merrill Lynch, S&P, MSCI, and T. Rowe Price.

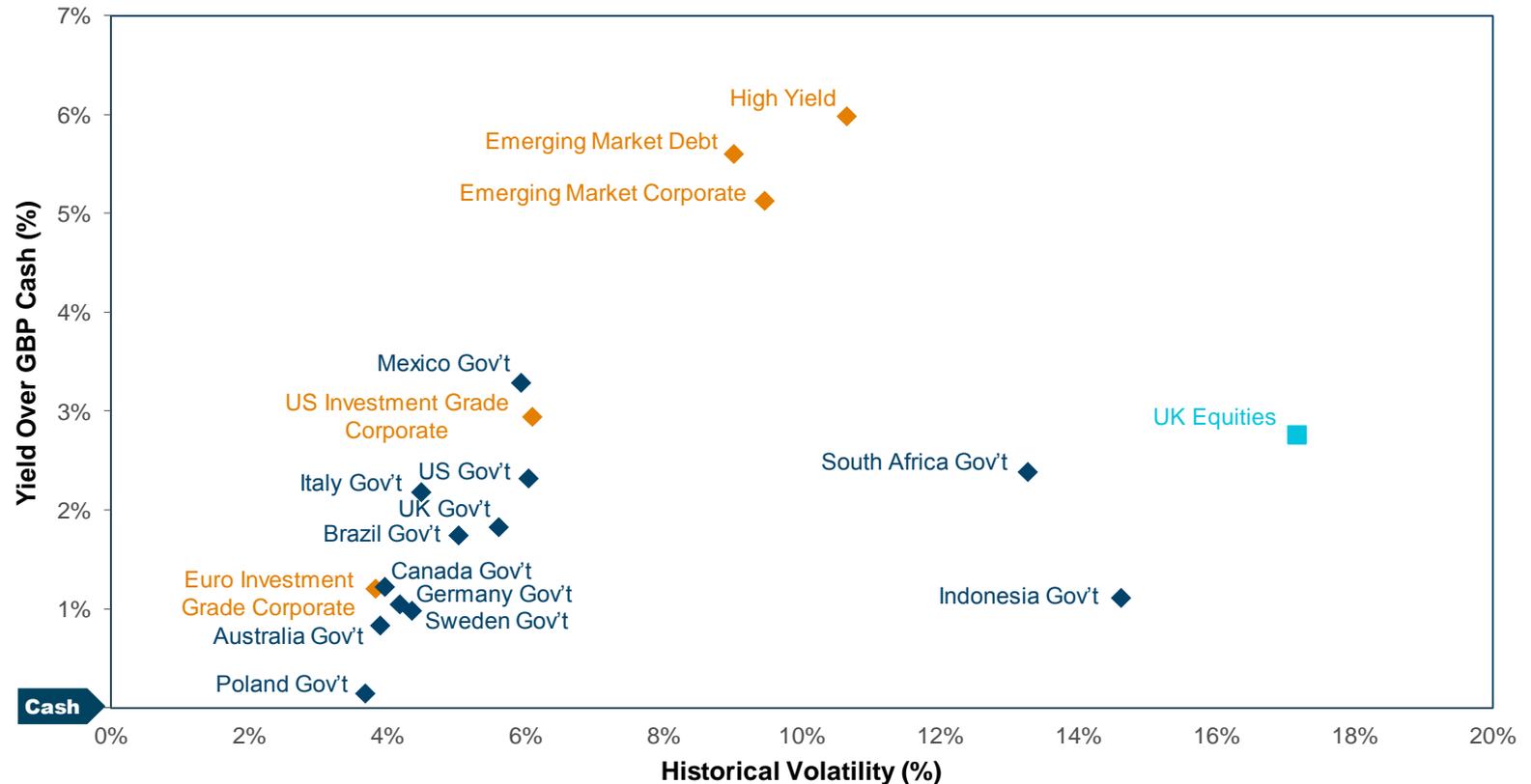
*Yield shown is on a hedged basis in Euros. Volatility is based on the monthly returns each asset class hedged into Euros

Selective Government Markets Can Offer Attractive Premiums to Cash...

As of 30 Sep 2014

CURRENT YIELD ABOVE EUR CASH VS. HISTORICAL VOLATILITY

Last 10 years



Sources: UBS, Barclays, JPMorgan, BoA Merrill Lynch, S&P, MSCI, and T. Rowe Price.

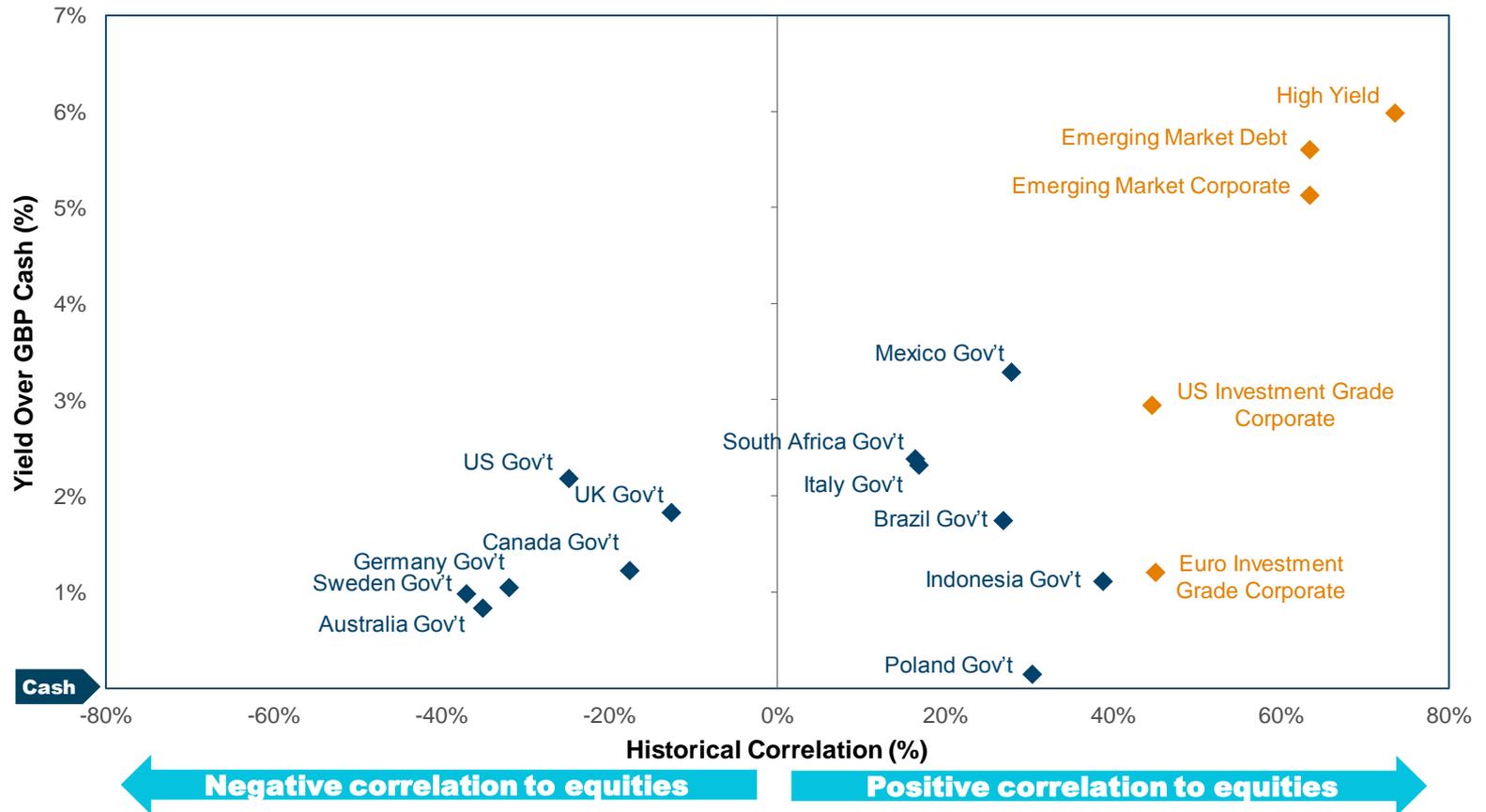
*Yield shown is on a hedged basis in UK Sterling. Volatility is based on the monthly returns each asset class hedged into UK Sterling

...And a Better Potential Hedge against Equity Movements

As of 30 Sep 2014

CURRENT YIELD ABOVE GBP CASH VS. HISTORICAL CORRELATION

Last 10 years



Sources: UBS, Barclays, JPMorgan, BoA Merrill Lynch, S&P, MSCI, and T. Rowe Price.

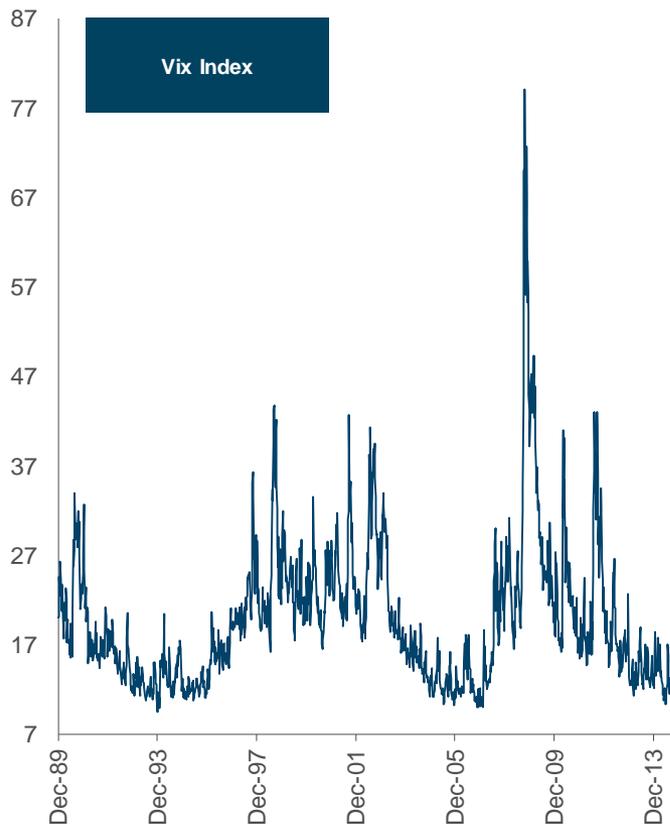
*Yield shown is on a hedged basis in UK Sterling. Volatility is based on the monthly returns each asset class hedged into UK Sterling

...Especially in a World of Low Volatility

As of 30 Sep 2014

VOLATILITY LEVELS

Last 25 Years

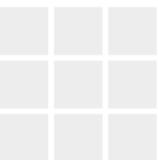


3-MONTH AT THE MONEY OPTION IMPLIED VOLATILITY

Last 10 Years

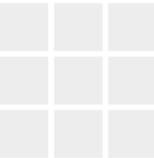


Sources: Reuters and T. Rowe Price.



Conclusion

WHAT DO YOU THINK?



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