T. Rowe Price
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China Downturn Rattles the World

It used to be said that if the United States sneezes, the rest of the world catches a cold. Now it's more like: If China gets a cold, the rest of the world catches pneumonia.

To be sure, the U.S. economy remains the world's largest and most innovative. But this summer's dramatic plunge in China's stock market and the unexpected devaluation of its currency quickly reverberated around the globe—triggering market volatility, dimming growth prospects for certain industries and countries, and exacerbating pressure on emerging markets.

Steep declines in Chinese markets are not new, of course. But past sell-offs have not roiled global markets as much.

The Chinese economic boom over the past decade has made its economy the world's second largest, accounting for a third of global gross domestic product (GDP) growth over the past three years, according to the International Monetary Fund.

As a result, China has become the world's largest market for autos and cell phones, the second-largest oil importer, and the most voracious consumer of many other commodities, particularly iron, steel, and copper—all now adversely impacted by the slowdown. Moreover, slower Chinese growth reduces growth prospects in other emerging markets, creating even more drag on global demand.

China's currency devaluation in mid-August stirred fears that its economy may be slowing even more than the official reported rate of 7% so far this year, compared with a double-digit growth rate just a few years ago. A fall in Chinese manufacturing activity last summer to a three-year low added to the growing concerns.

Chris Kushlis, a T. Rowe Price fixed income sovereign analyst for Asia, expects declining Chinese growth to continue or even accelerate, with the GDP growth rate potentially falling below 4% in a few years.

The devaluation, along with the government's unsuccessful intervention in its plunging stock market, also undermined confidence in China's leadership and, most important, in its ability to manage the transition of its economy from one led by investment and exports to one more driven by domestic services and consumption.

"One of the key tenets of investors' favorable views on China has been the belief that the government could manage this economic transition," says Chuck Knudsen, an emerging market portfolio specialist. "Now our confidence is shaken."

U.S. Exposure

Although the U.S. market suffered its first correction (a fall of at least 10%) since 2011 amid China's tumult, it has less direct exposure to China than many other developed, and certainly emerging, countries.

[Continued on page 2]

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China Downturn

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Exports account for just 8.9% of U.S. GDP, and exports to China are about 7.7% of all U.S. exports. So China exports account for only 0.7% of total U.S. GDP (compared with 2.5% for Germany, 2.7% for Japan, and 10.2% for South Korea).*

However, Alan Levenson, the firm's chief U.S. economist, says that China's economic slowdown has contributed to falling energy and industrial commodity prices and slowing growth in the rest of the emerging world, which accounts for about half of U.S. exports.

"If this were just China weakening but the rest of the world reasonably healthy, we might not be seeing the U.S. stock market plunging the way it did," Mr. Levenson says. "But we're not talking about an environment with otherwise healthy economies. China can't be seen in a vacuum. It's indicative of a broader trend, particularly among emerging economies that became overextended and now have to deleverage and reduce capacity."

Rob Sharps, a growth stock manager of institutional portfolios, agrees that China alone was not the principal cause of the sudden setback in U.S. markets.

"The collapse of the Shanghai stock market brought to the fore other issues that had been simmering," he says. "Some big emerging markets are in recession, overall global growth is slowing, S&P 500 operating profit growth this year will probably be zero, the stronger dollar makes U.S. goods more expensive overseas, the U.S. market had not had a correction in four years, and the Federal Reserve likely will be raising interest rates.

"So China may have been the catalyst, but you put it all together and it's not surprising we have run into turbulence."

In terms of earnings, companies in the S&P 500 Index derive about one-third of their revenue from overseas operations, based on FactSet data. But China only accounted for 4.5% of their total revenue last year, and 4.3% in 2013. However, some industries are significantly more affected than others—particularly industrial, machinery, and commodity producers that were big beneficiaries of the Chinese infrastructure boom.

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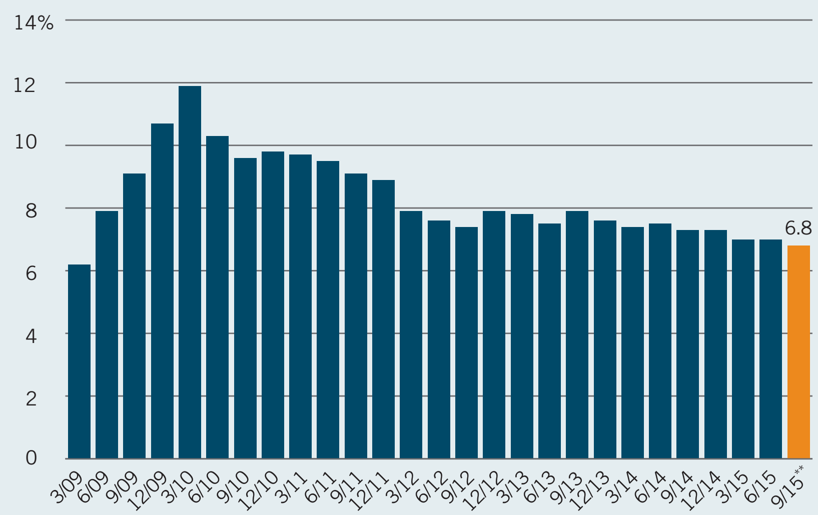
Peter Bates, manager of the Global Industrials Fund, says China has accounted for a disproportionate share of the organic growth of the average developed market industrial company the last several years. "So about 10% to 15% of the average industrial company's sales come from China," he says. "When China was growing at 10%, that would make it one-third of their organic growth. That's effectively gone—the Chinese industrial economy is not really growing."

So far, however, the growing Chinese consumer sector is holding up, with some consumer-oriented U.S. companies reporting strong China sales this year. But the Chinese stock market fall dimmed luxury goods makers' prospects, a corruption crackdown has hit U.S. gaming companies in Macau, and auto sales have plummeted. T. Rowe Price managers are concerned that the consumer sector in China eventually could suffer from the loss of jobs in the industrial economy.

China's Real GDP Rate* Has Fallen

Year-Over-Year Growth in Gross Domestic Product



*The real GDP rate is the GDP rate adjusted for inflation.
**Estimated.

Source: Strategas Research Partners and Bloomberg.

Emerging Markets

Emerging markets, dependent on Chinese demand, are now bearing the brunt of its travails.

With the collapse in commodity prices, energy, metals, and other commodity producers in Russia, Brazil, Chile, and South Africa have been hit hard, as well as such big exporters to China as Singapore and South Korea.

"China has been past its peak metals consumption for a few years, and its slowdown has had a dramatically negative effect on most metals prices," says Rick de los Reyes, a metals and mining sector manager. "It massively developed steel production and has been exporting excess steel to the rest of world, dragging down prices."

Until recently, China accounted for 70% of the demand for seaborne iron ore, but now its steel producers are cutting costs, hitting hard the global supply chain for iron and coal.

Mr. Knudsen says other exports among emerging markets also could be affected.

"While global trade has been falling, the one bright spot was China," he says. "Now investors have been forced to rethink global growth. You have this self-feeding loop where fears of China's slowdown have intensified, which affects growth prospects for other emerging markets and those who export to those markets."

But managers say Asia is not facing a financial crisis marked by currency devaluations and capital flight, as it did in 1997.

Debt levels have risen sharply across Asia, but debt is largely domestically owned and denominated in local currencies. Inflation is low, and most of the region runs current account surpluses. Currencies are at multiyear lows, but that helps support exports.

Meanwhile, capital flight from China and other emerging markets has accelerated, with the Federal Reserve moving toward rate normalization.

"In the past, emerging markets have been able to do relatively well when the Fed was gradually raising rates," Mr. Knudsen says. "But with all the crosscurrents going on now, the prospects of the Fed raising rates—even a quarter of a percentage point—adds another layer of uncertainty. That said, we believe most Asian economies should be able to successfully weather rising rates, especially if the Fed proceeds slowly as expected."

In the near term, they also anticipate more capital outflows from China and gradual depreciation in its currency in the coming months. This likely will put further downward pressure on regional currencies.

But Mr. Kushlis says, "I don't think there will be a major financial crisis in China anytime soon, although China has experienced a runup in domestic leverage and that has historically been correlated with financial problems and economic slowdowns in many countries. Because of the nature of China's economic transition, it's hard to predict how much the economy will slow. Until the new normal in Chinese growth becomes clearer over the next few years, investors will be jittery.

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Outlook

Mr. Knudsen says that the firm's global emerging market strategy has not made any major adjustments as a result of the China fallout, noting that one-third of its Chinese holdings are in Internet stocks.

"The secular outlook for these companies is very attractive whether China's economy is growing at 7% or 5%," he says. "We also have investments in well-managed Chinese consumer growth companies with high returns on equity and very attractive valuations and in some insurance companies that are benefiting from the shift in savings from property."

Anh Lu, manager of the New Asia Fund, says, "The China sell-off has given us the opportunity to buy other stocks in the region at much better valuations. I am optimistic that earnings for our consumer staples companies will improve in 2016."

Generally, T. Rowe Price managers expect China's economy to continue to downshift to a slower, higher-quality, and more sustainable level of growth.

"We've long believed that China's transition from a state-controlled to a more market-driven financial system would be a learning process. We should not be surprised to see pauses in this process or even periods in which the government reverts to prior policies to manage its financial system and the economy."

Funds that invest overseas generally carry more risk than funds that invest strictly in U.S. assets due to factors such as currency risk, geographic risk, and political risk. These risks are heightened for investments in emerging markets.

**Sources for export data: national governments, Haver Analytics, and T. Rowe Price calculations.*

Navigating Volatile Global Financial Markets Over Time

The recent rout in global markets is only the latest challenge faced by portfolio managers since the onset of the global financial crisis in 2008—a seven-year period that has been one of the more remarkable in capital markets history.

While global equity markets have staged a strong recovery since the spring of 2009, managers still have had to contend with a historically weak U.S. economic recovery and a persistently sluggish global economy, the eurozone debt crisis and recession, a deep crash in commodity demand and pricing, and the recent tremors from China that underscored fears of a hard economic landing there.

Navigating such an extraordinary environment, says Scott Berg, manager of the Global Growth Stock Fund, involves regularly striving to "separate facts from fear" and at times a strong willingness to take contrarian stances.

"There will always be crises and unexpected turbulence, but this is what creates opportunities to generate better returns in the future, if you can look beyond the near-term challenges to the long-term potential," he says.

Scott Berg

Along those lines, here's how Mr. Berg has maneuvered through this year's turbulence and three other recent periods of volatility: the broad equity sell-off in 2011, the severe underperformance of emerging markets in 2013, and the renewed concerns about Europe in the second half of 2014.

2015 Sell-Off

Emerging markets have been hit particularly hard this year as scrutiny of China's economy, currency, and leadership intensified and as energy and commodity prices plunged.

Mr. Berg says he has tried to take advantage of such indiscriminate selling, both in developed and emerging markets.

"We look for situations where the baby is effectively getting thrown out with the bath water," he says.

"So we have little or no exposure to markets tied to energy and the commodities. But the Philippines and India have very good fundamentals, and we are leaning into Indonesia, Peru, and Turkey.

"Investors are still painting very different emerging economies with the same brush, similar to what we saw in 2013. We are focusing on the faster-growing, demographically driven economies with a rising middle class, low debt, and increasing GDP [gross domestic product] per capita."

In China, Mr. Berg continues to favor certain Internet companies with solid fundamentals, but he says he is more concerned about China now than earlier in the year.

"I don't think China brings everything down, but the economic data have been weaker than expected, and the degree of uncertainty around the outcome has increased," he says. "China is really important not to just some stocks we own but to the world economy. There are bona fide scary concerns."

Looking back, Mr. Berg has faced somewhat similar crises before.

2011 Redux

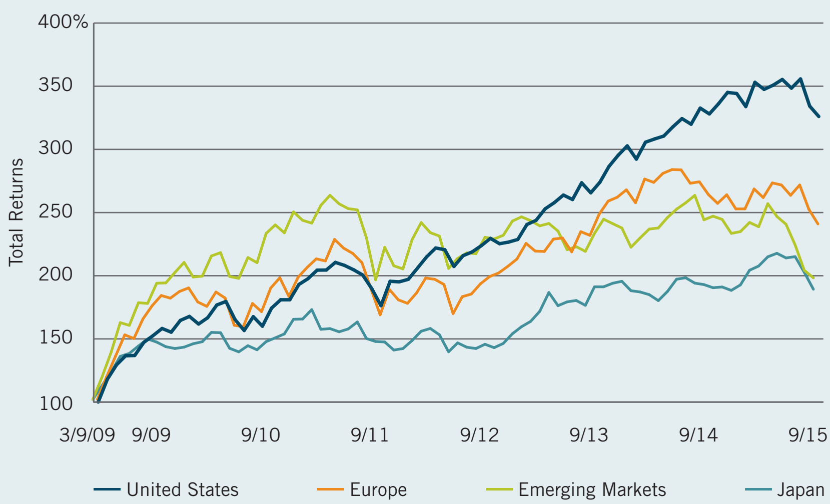
Just as the world was regaining confidence in global markets and economies, global stocks sold off in the second half of 2011.

Markets were buffeted by worsening financial conditions in the United States, Japan, and especially Europe, where its sovereign debt crisis reached new heights. Concerns over a hard landing for China's economy spiked, and there was uncertainty over the 2012 U.S. presidential election.

The MSCI EAFE Index of non-U.S. developed markets lost 16.2% in the second half of 2011, while emerging markets fell 19.0%. Investors focused

Uneven Recovery From Global Financial Crisis

Total Returns Indexed to 100 From March 9, 2009, Through September 30, 2015



Sources: U.S. performance is based on the S&P 500 Index, and performance of Europe, Japan, and emerging markets is based on the relevant MSCI index.

on defensive strategies and sectors, such as consumer staples and utility stocks, which performed well. Meanwhile, consumer discretionary and industrial stocks traded off significantly.

But by the end of 2011, the Global Growth Stock Fund had become more underweight in the consumer staples sector relative to the MSCI All Country Index than it had ever been and more overweight consumer discretionary and industrial stocks than ever.

This strategy was rewarded in 2012 as fears about Europe eased when the European Central Bank (ECB) committed to doing whatever it takes to spur economic recovery and fears of a China hard landing also subsided. Discretionary stocks significantly outperformed staples.

Performance in 2011 ended up below the fund's benchmark. (See chart this page.) "But that reflected our positions in growth-oriented and emerging market equities and our decision not to retrench in a risk-averse market, given the opportunities we were finding in attractively valued businesses," Mr. Berg says. These positions, he says, set up the fund for the strong rebound in 2012.

2013 Turmoil

Despite a second-half recovery, 2013 was a terrible year for emerging market investors. Fears rose that the Federal Reserve would start reducing its asset purchases, and emerging market currencies nosedived.

It was particularly distressful for countries with twin budget and current account deficits: Brazil, Indonesia, India, Turkey, and South Africa, collectively known as the "fragile five." By the end of 2013, the performance gap between developed and emerging markets had widened considerably.

Nevertheless, Mr. Berg maintained the fund's overweight position in emerging markets, believing that the entire asset class was being so tarnished that areas with strong fundamentals were too depressed.

So, for example, while trimming positions in commodity-producing nations, he increased investment in India, which had troubling deficits and was considered the weakest of the fragile five. "The following year, Narendra Modi was elected prime minister with an absolute majority that few pundits predicted," he says, "and India went from being one of the most unpopular markets to investors' favorite emerging market today."

The fund also increased its positions in Indonesia and the Philippines, an economy that did not have a current account deficit but was trading off due to contagion concerns. Both markets performed well the following year.

2014 Europe

As investors fled emerging markets in early 2013, they suddenly embraced Europe. The eurozone continued to recover slowly from the sovereign debt crisis, but many fiscal and structural challenges remained.

"I remained skeptical because Greece and other fundamental issues in Europe were not resolved, sentiment was extremely positive, and valuations were higher but there were few signs of economic growth emerging," Mr. Berg says. "Yet, by the end of the year, the euro was very strong."

When European stocks surged in the second half of 2013, Mr. Berg took profits and ended the year with about a 10% underweight position in Continental Europe.

As 2014 progressed, investors became increasingly concerned. Despite efforts by the ECB to stimulate the eurozone, growth hovered near zero and inflation remained unusually low, sparking deflation fears and investor flight. "Europe wasn't getting worse but it really wasn't getting better," Mr. Berg says.

As European stocks fell 11% during the back half of 2014 and remained weak early this year, he added investments in Continental Europe, particularly some high-quality industrial and consumer companies. This eradicated a large underweight position that had been established the year before, and it contributed to overall performance.

This fund is subject to the risks of international investing, including market, political, and currency risks. These risks are greater for investments in emerging and frontier markets. Because of the higher valuations and lower dividend yields of growth stocks, fund prices could decline further in down markets than non-growth-focused funds.

Global Growth Stock Fund Performance

Average Annual Total Returns Versus Its Benchmark Index*

	Year to Date as of 9/30/15	One Year	Three Year	Five Year	Since Inception*
Global Growth Stock Fund	-5.03%	-3.25%	8.57%	7.91%	16.06%
MSCI All County World Index	-6.65	-6.16	7.52	7.39	12.47

*The fund's inception date was October 27, 2008. *Current performance may be higher or lower than the quoted past performance, which cannot guarantee future results. Share price, principal value, and return will vary, and you may have a gain or loss when you sell your shares. For the most recent month-end performance, please contact a T. Rowe Price representative at 1-800-225-5132. The performance information shown does not reflect the deduction of a 2% redemption fee on shares held for 90 days or less. If it did, the performance would be lower. The fund's gross expense ratio as of its fiscal year ended 10/31/14 was* 1.16%. *Average annual total return figures include changes in principal value, reinvested dividends, and capital gain distributions.*

Source: MSCI.

Investing in Bonds and Stocks Amid Rising Rates

For the first time since 2004, the Federal Reserve likely will be ushering in an era of higher short-term interest rates, the beginning of a shift from an unprecedented period of monetary stimulation that fueled historic bull markets in stocks and bonds and buoyed an economic recovery.

Widely expected after six years of a near-zero federal funds rate, the Fed's potential move has been of concern to investors, contributing to a spike in market volatility this year. Rising rates historically have been associated with weaker equity and fixed income performance.

Before making significant portfolio changes, however, investors should note that the Fed has indicated that the path of rate increases will be unusually modest and gradual—in contrast to previous tightening cycles, including the last one (2004–2006) in which the central bank raised the Fed rate at 17 consecutive meetings.

Also, the end point in this rising-rate cycle is likely to be below levels reached in prior cycles, given that rates are starting at rock bottom and global economic growth is subpar.

"The Fed is likely to move more like a tortoise than a hare, taking a wait-and-see approach," says Hugh McGuirk, head of the firm's municipal bond department. "The end point for federal funds could be just 2%, and it will take longer to get there than in prior cycles."

Steve Huber, manager of the Global Multi-Sector Bond Fund, expects the Fed to pause and reassess after simply "getting off zero" with two rate hikes.

Nevertheless, "any increase will be a paradigm shift for the investment environment," says Arif Husain, head of international fixed income. "Market reaction will largely be determined by what is priced in at the time of the Fed move.

"Of more importance than the timing, though, is the subsequent path and ending rate. The Fed's path will be closely watched for evidence of a policy error—too much or too little, too early or too late."

During past rising-rate cycles, bonds have generally incurred principal declines, but fixed income investors ultimately have benefited from higher yields. And stock markets overall have proved resilient, at least until rates reached levels higher than expected in this cycle.

Comparisons with past cycles, however, may not hold up this time as this tightening cycle comes amid a slow U.S. economic recovery with inflation running substantially below the Fed's 2% target. (See article on page 9.) Also, despite the tightening, the Fed remains highly accommodative, and European and Asian central banks have expanded their monetary easing.

"I would probably dust off your investment playbook for Fed tightening, but I wouldn't memorize it," says John Linehan, a veteran equity manager who soon will take over the reins of the Equity Income Fund. "So much is already priced into the markets that investors should not overreact to it."

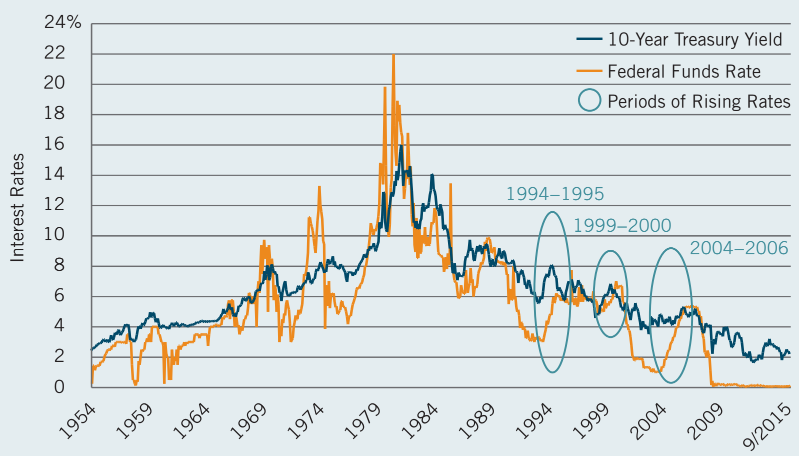
With that caveat, it still can be useful to examine past markets in rising-rate environments:

Bonds

Rising rates generally result in principal declines in bond securities, and that risk is exacerbated with rates so low because investors have less of a yield cushion to offset price declines.

Bonds: Silver Lining to Rising Rates?

A Long-Term View of Interest Rates, July 1954–September 2015



Bond Performance* in Recent Periods of Rising Rates

Positive Coupon Returns Have Offset Negative Price Returns

Recent Periods of Rising Rates	Price Return	Coupon Return	Total Return**
February 1994–February 1995	-7.46%	8.10%	0.01%
June 1999–May 2000	-4.58	6.92	2.11
June 2004–June 2006	-3.83	10.99	6.54

*Barclays U.S. Aggregate Bond Index.
**Paydown returns, which result from the early return of principal on mortgage-backed securities, are also a minor factor in total return and are not shown in the table.

Sources: Federal Reserve, Barclays, FactSet, and T. Rowe Price.

In the nine Fed tightening cycles since 1963, 10-year Treasury yields rose in each by a median of 62 basis points, according to Ned Davis Research (NDR). (100 basis points equal one percentage point.)

This cycle, T. Rowe Price managers expect the bulk of future rate increases to unfold in the short- to intermediate-term bond sectors, causing a flattening in the Treasury yield curve (with short-term rates rising more than long rates).

> **"If inflation and interest rates moved up dramatically, we would view that as very negative for the market. But a modest increase in rates is not necessarily a negative for stocks, especially if accompanied by continued improvement in economic growth and corporate profits. If short-term rates rise and intermediate- to longer-term rates remain relatively static, reflecting low expectations for embedded inflation, that historically has been supportive for stocks."**

In the last seven tightening cycles since 1980, NDR found bonds tended to underperform during months preceding the first rate hike but rebounded in the subsequent 12 months. Overall, though, the firm concluded that "since 1979, bonds have generally not done well during tightening cycles."

But various bond sectors and bonds of different quality and maturity respond differently to rising rates. Typically, shorter-term bonds are less sensitive to rising rates than longer-term bonds, so they have weathered periods of rising yields better than longer-term bonds.

However, shorter-term bonds offer lower yields than longer-term ones. Moreover, a rise in short-term rates does not mean longer-term rates will rise as well or as much.

In fact, that has been the pattern in every tightening cycle since 1963. In the last Fed tightening cycle from 2004–2006, when the Fed rate increased from a multi-decade low of 1.00% to 5.25%, longer-term yields barely budged.

"I expect rates to stay fairly low even after the Fed starts raising them," Mr. Huber says. "Longer-term rates should stay under control because they are driven by inflation and global growth expectations, which are very modest."

Mr. McGuirk adds, "We don't see any big move in long rates, and with the Fed moving gradually, you have a long time to earn the extra income to offset any principal loss."

If there is a silver lining to rising rates, it's the opportunity to earn more income after years of little or no yield. Investing at higher coupons can eventually offset any initial principal loss. (See chart page 6.)

Investors willing to accept more credit risk also might consider lower-quality but higher-yielding sectors, such as high yield corporate bonds and floating rate bank loans, both of which have historically performed relatively well in rising-rate environments.

This is because a rise in rates often reflects an improving economy, a positive for lower-quality debt issuers. Also, such bonds provide more yield cushion and on average have shorter durations.

T. Rowe Price examined six different 12-month periods (from 1994 to 2013) in which the 10-year Treasury saw the largest rate rises. High yield bonds provided a positive total return in each period, while U.S. investment-grade corporate bonds achieved a positive return in only one.

Floating rate loans—also known as bank loans or leveraged loans—offer attractive yields with less interest rate risk because their coupons reset every three months. "We think the historical performance of high yield and bank loan debt should be a good guide for this unfolding cycle," says Paul Massaro, manager of the T. Rowe Price Floating Rate Fund.

Although Mr. Huber says that "none of the credit sectors scream value," he also is favoring high yield bonds and bank loans in the global bond fund. "I think credit markets could generally perform well even with the Fed tightening."

Stocks

Thanks in part to the Fed's extraordinary easy monetary policies, equity investors have enjoyed a historic bull market. At the same time, a modest hike in rates from such low levels should not cause "significant disruption," Mr. Linehan says.

Larry Puglia, manager of the Blue Chip Growth Fund, adds, "If inflation and interest rates moved up dramatically, we would view that as very negative for the market. But a modest increase in rates is not necessarily a negative for stocks, especially if accompanied by continued improvement in economic growth and corporate profits.

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Rising Rates

Continued from page 7

expectations for embedded inflation, that historically has been supportive for stocks."

In the last six Fed tightening cycles since 1983, the S&P 500 Index had an average gain of 5.5% in the 12-month period following the first rate hike, and none of the periods produced negative returns, according to Strategas Research Partners. After two years, the average gain was 16.1%.

It's also encouraging that stocks have tended to perform better during slow Fed tightening cycles than fast ones in which most of the hike occurred in consecutive Fed meetings. (See chart this page.) While stocks have not performed as well when the Fed is tightening versus easing, they generally have still provided attractive returns—except for the 1973–1974 bear market and the 1987 market crash.

> **Some equity managers look forward to the day the Fed begins to distance itself from..."this grand and extraordinary monetary experiment in which the short-term, risk-free rate of return is nearly zero. Ultra-loose monetary policies encourage the mis-allocation of capital...and may have actually hindered economic growth."**

A separate T. Rowe Price analysis found that, in periods of rising U.S. rates going back to 1970, U.S. large-cap stocks were not adversely affected until 10-year U.S. Treasury yields rose to about 5% to 6%, though that inflection point could be lower this time given today's low interest rates.

As rates rise, one concern is that bonds become more competitive relative to income-oriented stocks in particular. At the same time, dividends can provide a cushion against downside risk if the market weakens as rates rise. NDR says that S&P 500 Index dividend payers have consistently outperformed non-dividend payers after the start of tightening cycles.

Because they provide relatively high levels of income, real estate investment trusts (REITs) particularly come under scrutiny in rising-rate environments. But David Lee, manager of the Real Estate Fund, says "returns in our sector are more affected in the long term by earnings growth rather than gyrations in interest rates."

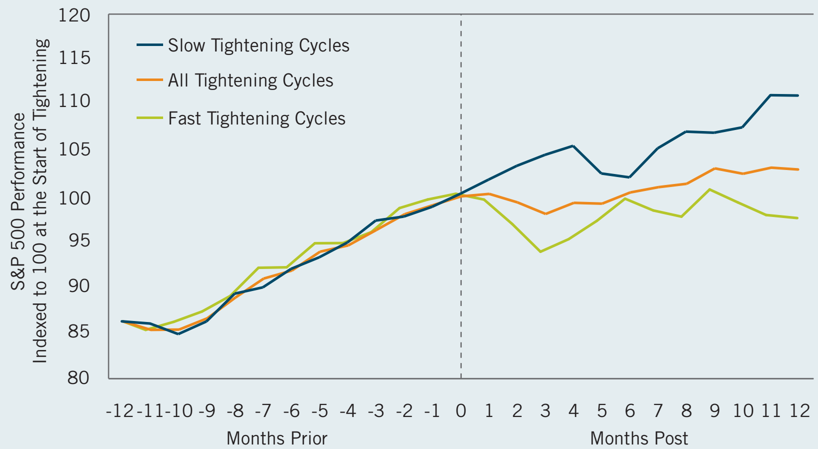
Some equity managers look forward to the day the Fed begins to distance itself from what Brian Berghuis, manager of the Mid-Cap Growth Fund, calls "this grand and extraordinary monetary experiment in which the short-term, risk-free rate of return is nearly zero.

"Ultra-loose monetary policies encourage the misallocation of capital by favoring slow-growth borrowers, such as large corporations and governments, over small business and may have actually hindered economic growth," he says.

Past performance cannot guarantee future results. Bond yields and share prices vary with interest rate changes. If interest rates rise from current levels, bond fund total returns will decline and may turn negative in the short term. Investments in lower-rated securities generally involve greater risk to principal than investments in higher-rated securities.

Stocks: Performance Before and After Fed Tightening Cycles

S&P 500 Index Performance for Fast and Slow Tightening Indexed to 100



Note: Twelve post-World War II cycles going back to 1946. Slow tightening cycles were those beginning 4/46, 4/55, 9/58, 7/63, and 8/77. Fast tightening cycles were those beginning 11/67, 1/73, 9/80, 9/87, 2/94, 6/99, and 6/04.

S&P 500 Performance in the Last Three Tightening Cycles

Date of First Raise	+1 Month	+6 Months	+1 Year	+2 Years
February 1994	-1.1%	-2.4%	1.9%	35.3%
June 1999	-3.2	7.0	6.0	-10.8
June 2004	-3.4	6.2	4.4	11.3
Average	-2.6	3.6	4.1	11.9

Sources: Ned Davis Research, Strategas Research Partners, and S&P Dow Jones Indices.

Anticipating a Patient and Slow Path of Fed Tightening

By Alan D. Levenson, chief U.S. economist

Federal Reserve deliberations indicate that the process of normalizing the highly accommodative monetary policy stance that has been in place since 2008 is likely to be patient, slow, and cautious.

While it is tempting to use past policy cycles for guidance, the sequence of rate hikes this cycle likely will differ from the cycles of February 1994 to January 1995 and June 2004 to June 2006 in at least three ways.

The first difference pertains to the current rate of inflation relative to the Fed's objective—2.0% for the personal consumption expenditures (PCE) price index. In the two earlier cycles, inflation was undesirably high when the Fed began policy normalization.

In January 1994, the 12-month inflation rate was 2.2% for the core (excluding food and energy) PCE and 2.9% for the core consumer price index (CPI), substantially above the Fed's objective. (The core CPI usually runs higher than the core PCE because of differences in measurement and weighting.)

And in May 2004, core PCE was 1.9% but on a sharp ascent from its 2003 cycle trough.

In contrast, core PCE inflation of 1.3% (1.8% in the core CPI) is now substantially below policymakers' medium-term goal of 2.0%.

While progress in reducing employment—one side of the Fed's dual mandate—suggests that a less accommodative policy stance is appropriate, the desire to see inflation rise implies a slower pace of rate hikes than would otherwise be the case.

The second difference: In the two earlier tightening cycles, the steady pace of rate increases reflected the Fed's implicit confidence that it knew the numerical value of the "equilibrium" federal funds rate—the level consistent over time with its objectives of full employment and low, stable inflation. In practice, Fed policy statements suggested that this "neutral" policy stance was reached at an inflation-adjusted federal funds rate of roughly 2.0%.

Now world trade is contracting and the dollar is on the rise. Market volatility—as seen lately in China—creates another channel of restraint on U.S. growth. The elevated uncertainty will encourage the Fed to be patient in assessing its steps.

> **...Fed officials have been openly debating the degree to which post-financial crisis "headwinds" have lowered the equilibrium policy rate, implying substantial uncertainty regarding policies for keeping the economy on a course to full recovery. This suggests that heightened caution will pervade the coming normalization of policy, with the Fed taking time to assess the impact of relatively small changes in rates before moving further along its charted course.**

Now, however, Fed officials have been openly debating the degree to which post-financial crisis "headwinds" have lowered the equilibrium policy rate, implying substantial uncertainty regarding policies for keeping the economy on a course to full recovery.

This suggests that heightened caution will pervade the normalization of policy, with the Fed taking time to assess the impact of relatively small changes in rates before moving further along its charted course.

Finally, there is the matter of those headwinds themselves. In particular, the unsettled international environment reflects delays in postcrisis restructuring and deleveraging, especially among emerging market and developing economies.

As the Fed was preparing to begin normalizing policies in 1994 and 2004, the secular expansion of world trade was a tailwind for U.S. growth. The foreign exchange value of the dollar was sliding, providing an additional growth boost and lifting inflation.

The Fed's latest interest rate forecasts center on a 1.25%–1.50% longer-run real (or inflation-adjusted) federal funds rate, 0.50% to 0.75% lower than in previous cycles.

A recent policy directive conveys the possibility that, even after employment and inflation reach the Fed's targets, "economic conditions may, for some time, warrant keeping the target federal funds rate below levels [viewed] as normal in the longer run."

As a result, the target range for the federal funds rate—currently 0.00%–0.25%—may rise by no more than 2.50 percentage points to 2.50% to 2.75% (0.50%–0.75% in real terms) by the end of 2017, more than two years from now. That's far lower than the three-percentage-point hike in the year to February 1995 and the 4.25-percentage-point rise in the 24 months to June 2006.

Fath: Searching for Growth When It's Become Scarce

Joe Fath

The Growth Stock Fund was the first U.S. mutual fund to focus on growth stocks. It is T. Rowe Price's oldest and largest mutual fund. Portfolio Manager Joseph Fath joined the firm in 2002, served as an equity analyst and associate portfolio manager, and began managing the fund in January 2014. He recently talked about growth stock investing:

Q. How do you define a growth stock?

A. A growth stock usually has earnings or free cash flow growth that's sustainable at a double-digit rate over time. This is hard to come by. The market tends to think a lot more companies grow faster than they really do or that the durability of that growth is longer. Only one in three companies average 10% or higher growth over time, and only one in five average 15% or higher.

Our goal is to find growth stocks that the market is undervaluing. If I had to pick one metric that really matters, it would be free cash flow growth. Profits can be manipulated through accounting, but cash is real—cash is king. For a company to be really powerful and sustainable, it has to generate cash that it can reinvest in its business.

Q. What's your approach to managing this fund?

A. Over time, we try to use bottom-up fundamental analysis to build an all-seasons growth portfolio that could perform well in up markets but also hold its own in down markets. At certain times, the fund does own some cyclical companies, such as financials that may benefit from rising interest rates. But we mainly focus on secular growers—innovative disruptors driving lasting changes in their industries and taking share or expanding their markets. Sometimes it's a big secular change as with Amazon, but sometimes it's industry structural change, such as the consolidation, pricing power, and greater fiscal discipline that have turned some airlines into growth stocks.

Q. Does the size of the portfolio—more than $42.23 billion at the end of September of this year—pose a challenge?

A. As dynamic growers mature, it's harder to sustain double-digit growth. For us, the sweet spot is not the largest companies but those valued at $10 billion to $50 billion. These can be the fast growers with big markets that over time have more room left to grow sustainably and for investors to appreciate that. We're trying to identify these stocks in advance of the market, stocks that could outperform over a three-year or greater time horizon. As a result, our annual turnover rate—about 35%—is relatively low.

Outlook

Q. Only a few large-cap stocks were strong even before the August market correction. Given slowing global growth, rising U.S. interest rates, and increased volatility, what's your outlook?

A. It's been a very tough market, a stock picker's market. Growth is scarce, and investors have been paying a premium for the big growth names. Earlier this year, growth stock valuations arguably reached fair levels. Accordingly, we became more sensitive to these valuations, even reducing the number of stocks in the portfolio to about 100 as it became harder to find compelling new ideas.

Going forward, events in China, of course, are a big wild card. For all the emotion about rising rates, rates might not matter so much. The headlines will change, but I see a continued slow grind in the markets. My guard definitely is up more. You've got to be very careful what you buy. In this type of market, we lean into stocks that can act a bit more defensive, like AutoZone or Microsoft, to add more ballast.

"It's been a very tough market, a stock picker's market. Growth is scarce, and investors have been paying a premium for the big growth names. Earlier this year, growth stock valuations arguably reached fair levels. Accordingly, we became more sensitive to these valuations, even reducing the number of stocks in the portfolio to about 100 as it became harder to find compelling new ideas....The headlines will change, but I see a continued slow grind in the markets. My guard definitely is up more. You've got to be very careful what you buy."

[Continued on page 12]

Finn: Searching for Value in Controversial Stocks

Mark Finn

A former accountant, Mark Finn closely scrutinizes companies' financial statements, as well as their managements, in hundreds of meetings a year at T. Rowe Price and on the road. At the firm since 1990, Mr. Finn has served as a fixed income analyst and an equity analyst before becoming manager of the Value Fund at the end of 2009. He recently talked about value stock investing:

Q. How do you define a value stock?

A. It's a relative high-quality company experiencing some controversy or uncertainty that has provoked market skepticism but that we believe can address its problems and grow into a bigger company. That's kind of the Holy Grail for a value investor.

Some sort of controversy has made these companies cheap. It might be from the bottoming of a cycle, such as we are seeing in the energy sector right now. It could be from self-inflicted wounds, such as the operational problems at the Carnival cruise line. Or it could be that the company is in an industry that has been not so well structured but now is improving, such as airlines.

Almost every company that interests me is going to have challenges, so I am looking for a sense that their management is being intellectually honest about facing these challenges—with a realistic plan that provides some confidence that the company can get back on its feet.

Of course, we also look to see if they are trading cheaply relative to their history, their sector, and the market on a number of metrics—particularly price-to-book values, net asset value, free cash flow, and a sum-of-the-parts analysis. I try to find the bottom for the stock, begin buying, and then increase the position with evidence that it is changing.

Q. What do you mean by a high-quality company?

A. These are companies with a reasonably strong brand, a strong suite of assets, and the ability to generate cash flow over the long term. High-quality companies tend to keep up in good markets but outperform in down markets. Take the energy companies Pioneer Natural Resources, Cimarex Energy, and Concho Resources, for example. It's been a horrific energy market, but they've held up relative to other energy companies—they're efficient drillers and have good acreage.

Sometimes, however, other factors can come into play. For example, for a while, we thought Avon, the beauty products company, could recover from its troubles. It was a relatively high-quality company with a strong brand, and we thought a new CEO would fix its self-inflicted issues. That didn't turn out to be the case because basically its model of selling through representatives could no longer compete with online and other competitors.

Q. What's your approach to managing this fund?

A. For a large fund, it's fairly concentrated. [The top 20 of 102 total holdings represented 47.5% of the portfolio as of the end of September 2015.] When I find a company that represents value, I take a pretty big position relative to the overall portfolio. As an active manager, that's what I am here to do.

Additionally, the average size of the companies in the fund can skew a bit lower than that for the Russell 1000 Value Index as a whole. I'm more opportunistic than the index, and often there's more opportunity in companies valued at $5 billion to $20 billion than in the mega-caps, though not always.

> **"Compared to a year ago, I'm finding less opportunity in the market. My caution progressively increased over this year as valuations rose. For the first time since I have run the fund, it is overweight in consumer staples, health care, and utilities, three traditionally defensive sectors. I wouldn't be surprised to see a flat market into 2016. But periods when the market kind of bumps along can be fine for us because we're focused on stock selection. It's still possible to make money. For one thing, U.S. growth may be more stable going forward than international growth, and the fund isn't that levered to revenues from outside the United States."**

[Continued on page 13]

Fath

Continued from page 10

At the same time, the correction allowed us to buy some companies with good fundamentals that went on sale. Those are times in the market when it's possible to position the fund for later potential outperformance.

Q. At the end of September of this year, 6.9% of your fund was in international stocks, particularly Chinese Internet stocks that had been hit by the correction. Have you remained committed?

A. I invest in international stocks when I can't find a U.S. company with exposure to the same unique growth area. The Chinese Internet market is much larger than its U.S. Internet market and is really dynamic. Chinese Internet companies are at an earlier stage than here, don't have a lot of off-line competition, and have moved rapidly into mobile. Before August, I had become more concerned about China and thus had been moderating exposure. But I am sticking with some blue chip names with good fundamentals and still attractive valuations, such as Tencent, Alibaba, and Vipshop Holdings.

Q. The fund is overweight the health-care, consumer discretionary, information technology, and industrials and business services sectors. How did you get there?

A. That's basically the outcome of stock picking. But I'm generally overweight areas in which there are innovative, dynamic companies. I've significantly raised the health-care weight, for example, for three primary reasons: Aging baby boomers will drive rising demand, disruption due to the Affordable Care Act creates opportunities, and drug discovery has become much more effective.

In pharmaceuticals and biotech, mapping the human genome has created powerful opportunities because it has enabled drug companies to go after bigger diseases and come up with more efficacious and safe treatments with a higher degree of success.

Overall, the biggest band of holdings is these secular growers, the middle band is cyclicals, and then there're special situations—value companies transitioning to growth and those benefiting from industry structural changes or consolidation in fragmented industries, which brings more talented management, greater scale, and better capital allocation.

Q. Let's talk about a holding with extreme growth potential.

A. Tesla. It's not among the fund's top holdings because I am managing risk, but I am pretty bullish. It may look expensive, but it could be very powerful in three to five years because of a number of catalysts: its new SUV, its new Model 3 mass market car that could be like an iPhone on wheels, and its battery packs for homes—home energy storage could be a lucrative market. The auto business can be tough until you get to a certain scale. Tesla is selling 50,000 cars a year but plans to get to 500,000 by 2020, and Uber has said it will take all those cars. So Tesla is a company at the epicenter of a potentially massive secular change that is still unproven. It's a green banana—not ripened yet and hotly debated—but the opportunity is massive.

Q. Last word?

A. Markets can be volatile, but over time if investors continue to take advantage of these dislocations, as we do, they can end up dollar cost averaging purchases of attractive stocks and value can compound for them. Discipline is critical to the most important rule, ignoring your emotions and staying the course.

As of September 30, 2015, securities mentioned by Mr. Fath made up 8.18% of the Growth Stock Fund. The fund is subject to market risk, including possible loss of principal. Because of the higher valuations/lower dividend yields of growth stocks, fund prices could decline further in down markets than non-growth-focused funds. Any foreign holdings are subject to risks inherent in non-U.S. securities, including currency fluctuations.

Growth Stock Fund
As of September 30, 2015

Sector Diversification

Sector	% Fund
Information Technology	28.7%
Consumer Discretionary	27.9
Health Care	21.1
Industrials and Business Services	10.5
Financials	5.6
Consumer Staples	3.1
Materials	1.2
Energy	0.6
Telecommunication Services	0.0
Utilities	0.0

Top Holdings

Holding	% Fund
1. Google	6.0%
2. Amazon.com	5.8
3. Priceline	3.7
4. Microsoft	2.9
5. Danaher	2.8
6. MasterCard	2.8
7. Facebook	2.7
8. Visa	2.7
9. Allergan	2.4
10. Apple	2.4

Source: T. Rowe Price.

Finn

Continued from page 11

Outlook

Q. With all the volatility this year, what's your market outlook?

A. Compared to a year ago, I'm finding less opportunity in the market. My caution progressively increased over this year as valuations rose. For the first time since I have run the fund, it is overweight in consumer staples, health care, and utilities, three traditionally defensive sectors.

I wouldn't be surprised to see a flat market into 2016. But periods when the market kind of bumps along can be fine for us because we're focused on stock selection. It's still possible to make money. For one thing, U.S. growth may be more stable going forward than international growth, and the fund isn't that levered to revenues from outside the United States.

Q. What about the impact of rising U.S. interest rates?

A. Financial stocks are almost 30% of the Russell 1000 Value Index, so I have a significant weighting of financials but am not overweight relative to the benchmark. As a result, I have positions that could benefit from rising rates, such as MetLife, Bank of New York, and State Street. Their valuations have been really reasonable. In general, the Value Fund welcomes higher interest rates.

Q. The fund's second-largest sector is health care. What do you like there?

A. Many health-care stocks have been trading at relatively cheap levels even though their long-term outlook is relatively bright. Some of these companies, such as Thermo Fisher Scientific, have become growth companies. And many of these stocks seem cheaper than they should be. Pfizer is a good example. I simply can't understand why it has been trading at a lower earnings multiple than, for example, Procter & Gamble [P&G]. It may be that the market can't figure out how durable Pfizer's drug pipeline is, while P&G has reliable products. But, frankly, the demographics for health-care companies simply couldn't look any better.

Q. What's a holding that really exemplifies value investing?

A. I'd say Tyson Foods. Historically, it's been a commodity chicken producer, and in 2009 it almost went bankrupt because chicken production was too high and prices sunk at a time when grain feed prices were high.

In 2011, Tyson decided it didn't want to be beholden to the chicken market any longer and started to make the company more about food brands and the stable, efficient production of chicken, beef, and pork—and less about the price of chicken. So about a year and half ago, Tyson bought Hillshire Farms, which has a lot of branded products.

It's in a transition from a commodity producer to a value-added consumer products company—yet the market has not yet given Tyson credit for that. As a result, it's trading much cheaper than, say, Hormel, the pork producer that made the same transition and that Tyson is modeling itself after.

Q. Last word?

A. Facing volatility and uncertainty, investors should focus on a longer time horizon. It's very hard to time the market. Our stock purchases this year are made with the idea that they may bear fruit in one to three years. And in many cases, volatility can provide an opportunity to buy stocks you've been watching at better prices.

As of September 30, 2015, securities mentioned by Mr. Finn made up 14.9% of the Value Fund. It did not own Avon Products or Hormel Foods. The fund is subject to market risk, including possible loss of principal. The fund's potential for price appreciation may be lower than one using a growth strategy, and there is the possibility that a stock judged to be undervalued is actually appropriately priced.

Value Fund
As of September 30, 2015

Sector Diversification

Sector	% Fund
Financials	23.8%
Health Care	21.4
Industrials and Business Services	14.7
Utilities	9.2
Consumer Staples	9.0
Information Technology	8.1
Consumer Discretionary	4.6
Materials	4.2
Energy	3.5
Telecommunication Services	1.3

Top Holdings

Holding	% Fund
1. GE	5.0%
2. Pfizer	4.0
3. American Airlines	3.2
4. Citigroup	3.0
5. MetLife	2.9
6. J.P. Morgan Chase	2.8
7. Boeing	2.4
8. Microsoft	2.4
9. Morgan Stanley	2.2
10. FirstEnergy	2.1

Source: T. Rowe Price.

Innovation Is Driving Strong Performance in the Biotech Sector

By Taymour Tamaddon, manager of the Health Sciences Fund, and Greg McCrickard, manager of the Small-Cap Stock Fund

More than a decade after scientists successfully decoded the entire human DNA sequence, that breakthrough is translating into a wave of innovation in the biotech and pharmaceutical industries—with spillover effects both inside and outside the health-care sector. Reflecting these advances, health-care stocks—biotechnology stocks in particular—have performed strongly over the past several years, outpacing the broad U.S. equity market by a wide margin.

The continued development of sequencing technology and the sharp reductions in its cost have made it possible to map DNA variations across larger groups of patients, allowing researchers to correlate those differences with disease phenotypes—genetic factors linked to particular illnesses. This, in turn, has made it possible to test the impact of drugs on patients with specific genetic factors or design new drugs that target those factors.

These innovations have resulted in a surge in new drug trials and sharply higher success rates in those programs. Meanwhile, the Food and Drug Administration has become more willing to accelerate the approval of new drugs, a number of which have gone on to become commercial, as well as medical, success stories, at a time when prescription drug spending overall has been rising rapidly.

Not surprisingly, new products, strong demand, and profit potential have attracted intense investor interest. Venture capital has poured into startup companies, and biotech initial public offering (IPO) activity has surged—from 40 offerings in 2013, to 72 last year, to 24 in the first half of 2015. Merger and acquisition activity also has accelerated.

Taymour Tamaddon

Heavy Fund Flows

Healthy revenue and profit growth have helped generate strong equity returns, with the biotech industry and the S&P 500 health-care sector both outperforming broader market averages over the past five years by significant margins.

> **"The current advances in genetic science are among the most exciting developments in medical history. It's natural that investors would react enthusiastically. Excessive optimism could certainly lead to volatile corrections. But these innovations are providing real, tangible benefits to patients, health-care providers, and the U.S. economy as a whole."**

The rise in biotech stocks—as measured by the Nasdaq Biotechnology Index—has been especially powerful, with the index rising almost 230% from the end of 2010 through September of this year.

These trends have created both opportunities and risks. On the opportunity side, innovation and product development provide a rich field for fundamental analysis and bottom-up stock selection. On the risk side, strong performance has attracted sizable fund flows into small- and mid-cap biotech companies, much of it from passively managed vehicles. These flows appear to be producing some historically extreme market characteristics not just in the biotech industry, but in the small-cap sector as a whole:

Greg McCrickard

- **Index weights:** As of the end of September, biotechnology stocks accounted for just over 6% of market capitalization in the Russell 2000 Index, a popular benchmark for U.S. small-cap equities, and almost 12% of the Russell 2000 Growth Index. At the industry's previous peak, in 2000, biotech reached less than 6% of the Russell 2000 Index.

  Likewise, as of the end of September, biotech composed almost 34% of the Lipper Health/Biotechnology Index—the benchmark for T. Rowe Price's Health Sciences Fund—up from 26.1% at the end of 2009.
- **New companies:** Following the Russell 2000 Index's most recent rebalancing, on June 26 of this year, more than 15% of the companies in the index (300 of 1,975) have been in existence for less than two years. Many are in biotech or related industries.
- **Valuations:** With the Russell 2000 Index priced at a bit less than 19 times forward 12-month earnings (P/E) at the end of September, small-cap valuations overall appear high but not at

unprecedented levels. However, stocks with negative earnings (many of them biotech stocks) are excluded from that P/E calculation.

Goldman Sachs recently estimated that negative earners now make up almost 35% of Russell 2000 Index market cap. Taking these companies into account—by dividing total index market cap by total earnings—the Russell 2000's true forward P/E may be close to 30, a historically extreme level.

Active Headwinds

The challenges these market dynamics pose is highlighted by the fact that stocks without earnings in the Russell 2000 Index actually have outperformed stocks with earnings since the end of 2012—a complete reversal of the normal historical pattern. (See chart below.)

A market environment in which stocks with negative earnings tend to outperform stocks with earnings almost automatically creates a headwind for risk-aware active managers who are typically reluctant to take such aggressive positions in speculative, momentum-driven stocks. Similarly, few prudently diversified active managers would allow a single industry to weigh as heavily in their portfolios as biotech currently does in the major U.S. small- and mid-cap indexes.

Managers of more specialized health-care sector strategies obviously have more leeway to concentrate on biotech stocks, if company fundamentals and growth prospects justify it. The Health Sciences Fund uses a bottom-up research process to identify and select stocks that appear to offer the highest return potential, based on risk and reward criteria. These decisions drive portfolio sector and industry weights—not the other way around.

That said, the biotech boom has had a strong impact on the Health Sciences Fund's benchmark, the Lipper Health/Biotechnology Index. Given that the fund's objective is to provide diversified exposure to the health-care sector—albeit with an emphasis on life sciences and medical technology—we are comfortable maintaining a weight in biotech stocks that is substantial but significantly lower than our benchmark.

We also continue to find attractive health-care investment opportunities. In part, this reflects spillover effects of the advances in genetic decoding, which are driving innovation in related sectors. These include the life sciences, such as companies that service and support clinical drug trials, and device manufacturers producing instruments used in environmental testing and pharmaceutical and industrial labs.

Finally, although fund flows have lifted small- and mid-cap biotech valuations to lofty levels, large-cap biotech stocks still appear reasonably valued. Although there are relatively few large-cap biotech stocks, several of them have either recently developed or acquired promising new drugs that we believe have high growth potential.

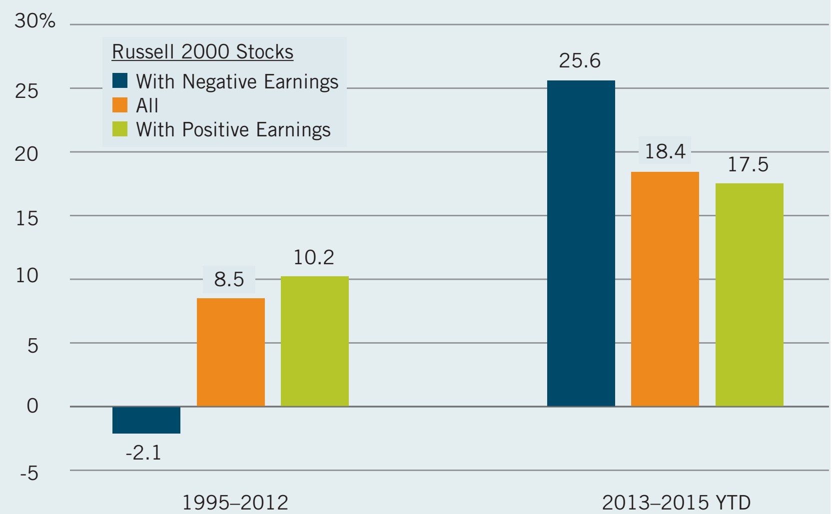
The current advances in genetic science are among the most exciting developments in medical history. It's natural that investors would react enthusiastically. Excessive optimism could certainly lead to additional volatility.

But these innovations are providing real, tangible benefits to patients, health-care providers, and the U.S. economy as a whole. This leads us to believe the benefits for investors will also prove durable over the long run.

Small companies tend to have less experienced managements, unpredictable earnings growth, and limited product lines, which can cause their share prices to fluctuate more than larger firms. A concentration in health sciences companies will be more volatile than that of more diversified funds. Further, these firms are often dependent on government funding and regulation and are vulnerable to product liability lawsuits and competition from low-cost generic products.

Small Companies Without Earnings Have Outperformed Recently

Total Annualized Returns, Russell 2000 Index by Earnings Category*



*Earnings before interest and taxes, referred to as EBIT. Year-to-date data are as of June 30, 2015.

Source: Furey Research Partners.

That Challenging Moment as You Turn From Saving to Spending

You've worked hard your whole life. You've lived within your means and saved. That—plus disciplined investing—has enabled you to accrue a considerable sum in your retirement account.

And now it's time to retire from work—and from saving—and to begin living off the fruits of all your long-term labors and market returns.

Now it's time to move from, as financial planners put it, the accumulation phase of the retirement planning cycle to the distribution phase.

For many new retirees, this may not be such a notable moment. Perhaps they haven't saved adequately for retirement and their significant source of retirement income may boil down to Social Security—in which case, T. Rowe Price financial planners say, they should aim to work longer if possible and delay taking Social Security benefits.

And some retirees—a dwindling number over time—may be relying on private pensions, not their savings.

But for those who have built up considerable retirement savings on which they will be depending to a great degree for post-work income, this moment of transition may prove psychologically challenging.

This may be particularly so because beginning to spend down their assets suddenly calls on them to go against a lifetime of disciplined savings habits.

"The psychology of this can be fascinating," says Stuart Ritter, CFP®, a T. Rowe Price senior financial planner. "People spend most of their lives accumulating assets for retirement, but the internal discipline and good financial habits that helped them save and accumulate can actually make it tough to begin spending—despite the fact that the ability to spend in retirement is why they were saving all along."

Viewed more broadly, the psychological challenge at the onset of taking withdrawals from savings is often just part of a broader process of "relinquishment" that many retirees undergo, Mr. Ritter says.

> **"The psychology of this can be fascinating. People spend most of their lives accumulating assets for retirement, but the internal discipline and good financial habits that helped them save and accumulate can actually make it tough to begin spending—despite the fact that the ability to spend in retirement is why they were saving all along....When people transition to retirement, they often are also consolidating their lives overtime—reducing work and perhaps some relationships, possessions, and activities, all of which have deep meaning for them. They're letting go, and that can be tough, particularly when they also are letting go of some of their savings as well."**

As he puts it: "When people transition to retirement, they often are also consolidating their lives over time—reducing work and perhaps some relationships, possessions, and activities, all of which may have deep meaning for them.

"They're letting go, and that can be tough, particularly when they also are letting go of some of their savings as well."

However, in reality, new retirees following a sustainable withdrawal plan should realize that they "tend not to spend down their assets that fast," he adds.

Withdrawal Study

To demonstrate, Mr. Ritter recently conducted a study examining the impact of withdrawals from a $1 million portfolio from ages 65 or 70 to age 95, using three different withdrawal methods. (See charts on the next page.)

In the study, the total lifetime withdrawals—over a 25- or 30-year retirement—exceeded $2 million in all three cases.

And the final account balances at age 95 exceeded $1 million in two cases and more than $860,000 in the third.

The three withdrawal methods are described atop the charts. One follows the "4% guideline" from age 65 on; a second follows the required minimum distribution (RMD) schedule from age 70 on; and the third is a combination of the two methods, following the "4% rule" from ages 65 to 70 and then withdrawing according to whichever method yields the greatest distribution.

The 4% guideline is widely recommended by retirement advisors—including T. Rowe Price financial planners. The RMD schedule is mandated by the Internal Revenue Service; it applies to tax-deferred accounts and starts at age 70 with a yearly withdrawal rate of less than 4%, which increases annually, eventually reaching more than 11%.

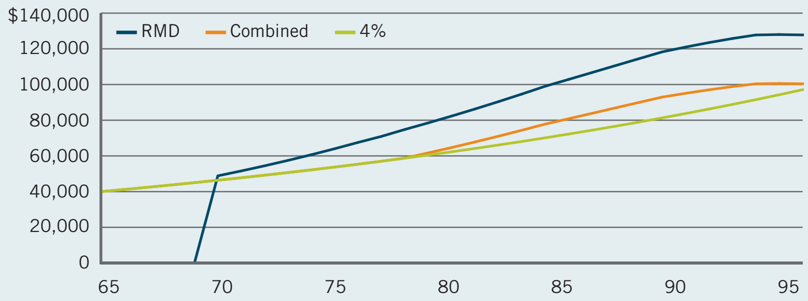
Retirement Withdrawals and Account Balances
Using Three Different Withdrawal Methods

This study is based on a $1 million retirement savings account to start. It shows that it's possible to withdraw increasing amounts annually from this account that could total $2 million or more over the course of a 25- or 30-year-long retirement, using three different withdrawal methods. The final account balances potentially total from $863,000 to more than $1 million, depending on the withdrawal method. The three different withdrawal methods are:

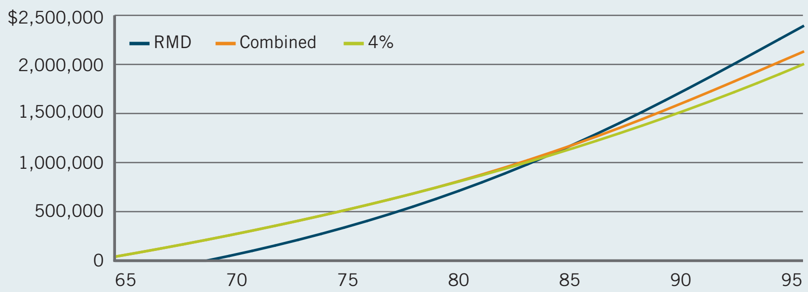
1) From ages 65 to 95, withdrawing 4% the first year and increasing that initial withdrawal by the rate of inflation each subsequent year.
2) From ages 70 to 95, withdrawing the required minimum distributions (RMDs) from a tax-deferred retirement account. (RMD withdrawals start at 3.65% at age 70 and increase to 11.63% at age 95.)
3) From ages 65–69, withdrawing 4% with subsequent inflation adjustments, and then from 70–95 withdrawing by whichever method (the inflation-adjusted 4% method or the RMD method) would yield the greatest yearly withdrawal, identified in the charts below as "Combined."

The assumed annual portfolio growth rate is 6%, which is T. Rowe Price's formal assumption regarding the potential return of retirees' portfolios. The assumed annual inflation rate is 3%.

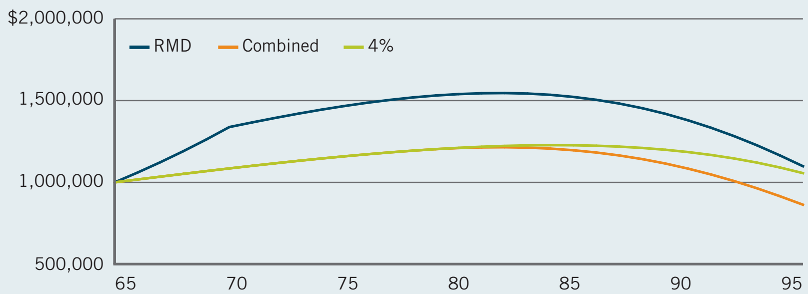
Yearly Withdrawal Amounts



Cumulative Withdrawal Totals



Account Balances



Source: T. Rowe Price.

One major caveat to Mr. Ritter's study is that it assumed a constant annual portfolio return of 6% in retirement. That is T. Rowe Price's formal assumption for the average performance of retirement portfolios.

While 6% is a useful performance assumption, actual market returns and their sequence, of course, may vary greatly. For example, retirees may experience down markets in their first years of retirement that could reduce their chances of sustaining a stream of income during their retirement.

However, Mr. Ritter notes that the 4% guideline takes into account a range of actual market returns and sequences and is designed to still provide a high probability of sustaining a rising stream of withdrawals over a 30-year retirement even with an early bear market.

That said, if investors experiencing a downturn want to improve their chances of sustaining a steady stream of income over the course of their retirement, they could aim to do so by not taking annual inflation increases for a while or by reducing the amount of their annual withdrawals.

Absent an early bear market, the study's relatively large final portfolio balances should suggest that retirees could end up with a sizable cushion to provide for later market downturns, emergencies, late-life medical costs, and perhaps even greater withdrawals or gifts, to name just a few expenses, Mr. Ritter says.

"In general," he says, "these potential final balances should give retirees some comfort as they face the challenge of letting go some of their savings—as hard as it might be."

Good News: Many Working Millennials Are Budgeting and Saving

Many working millennials are showing financial discipline that perhaps defies popular stereotypes of their generation, a T. Rowe Price survey shows.

The firm's "Retirement Saving & Spending Study," conducted last spring, shows that millennials (ages 18 to 33) working in firms where they participate in 401(k)s (workplace tax-deferred retirement savings plans) tend to be living within their means, tracking expenses and budgeting, and, not least, saving.

Significantly, they are saving for retirement at almost the same rate as baby boomers, the survey found. Moreover, a higher percentage of them reported budgeting than baby boomers (ages 50 to 68), and a majority said that they are better off financially than their parents were at the same age.

"We learned in this survey that many millennials appear to be very well intentioned when it comes to building their financial security, shattering a bit of the stereotype of younger workers," says Judith Ward, CFP®, a T. Rowe senior financial planner.

"Those who access a workplace savings plan are actually saving fairly well, and they see saving as an equal priority to paying down debt—which is significant because we know that many are saddled with student loans."

A caveat to these findings is that the survey generally was restricted to workers currently contributing or eligible to contribute to 401(k)s, which tend to be offered by larger firms.

Thus, in general, this sample of millennials was relatively well off, with a median personal income of $57,000 and an average job tenure of five years. (For more details on the survey, see the *note at the end of this article.)

Findings

The survey findings on millennials include:

- They are saving an average of 8% of their annual salaries in 401(k)s versus baby boomers' average of 9%. These savings rates do not include employer-provided matches. (T. Rowe Price recommends an annual savings rate of 15%, including employer matches.)
- They are more likely than baby boomers to track expenses and budget. Three-quarters track expenses carefully compared with 64% of baby boomers. Similarly, two-thirds say they stick to a spending budget versus 55% of baby boomers.
- Almost 90% report they are pretty good at living within their means, three-quarters say they are more comfortable saving than spending, and two-thirds say they save by any means necessary.
- They rank contributing to their 401(k)s as their top priority to virtually the same degree as they rank paying down debt.
- Almost three-quarters say they are somewhat or much better off than their parents at the same age.
- A majority (60%) expect Social Security to go bankrupt before they retire.

Overall, Ms. Ward says, these findings may reflect a degree of youthful optimism—though not when it comes to their dour view of the future of Social Security, which is typical of those under age 50.

But, she adds, the findings do go against the notion that millennials may not understand the importance of long-term saving and that they are so burdened by student debt that they really aren't able to do much saving.

"It's refreshing to see," she says.

**This research is based on an online survey of workers and retirees. It included responses from 3,026 working adults ages 18 or older currently contributing to a 401(k) plan or who are eligible to contribute and have a plan balance with their current employer of $1,000 or more.*

In addition, 255 millennials (ages 18 to 33) who are eligible for a 401(k) plan at their current employer but are not contributing and do not have a balance in that 401(k) were surveyed.

In all, 1,760 millennials, 1,007 generation X workers (ages 34 to 49), and 514 baby boomers (ages 50 to 68) were surveyed. Interviewing was conducted from February 19 to March 25, 2015. Survey samples have a margin of error of just under 3%.

"We learned in this survey that many millennials appear to be very well intentioned when it comes to building their financial security, shattering a bit of the stereotype of younger workers. Those who access a workplace savings plan are actually saving fairly well, and they see saving as an equal priority to paying down debt—which is significant because we know that many are saddled with student loans."

Chinese Economic and Stock Market Weakness Weigh on Global Equities

Despite generally favorable domestic economic data, U.S. stocks declined in the third quarter. During the period, large-cap indexes experienced their first "correction," which is a drop of at least 10% from recent highs, in four years. A steep drop in Chinese stock prices stemming from its decelerating economy and uncertainty regarding policy responses, including a small but unexpected currency devaluation in August, dragged global equity markets and commodity prices lower and fueled demand for safe-haven assets. The Federal Reserve kept short-term U.S. interest rates at all-time lows during the quarter, but following the central bank's mid-September policy meeting, Fed officials expressed concerns about adverse "global economic and financial developments." These concerns weighed on world markets as the quarter ended.

Equity Review

U.S. Shares Fall but Outperform Global Markets

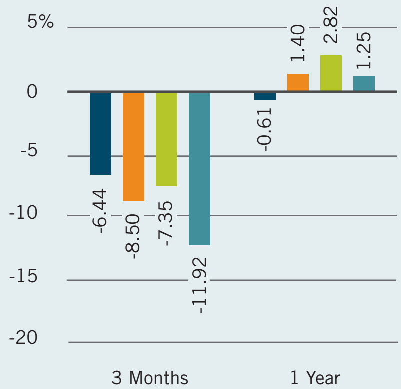
Large-cap U.S. shares held up better than mid- and small-caps. As measured by various Russell indexes, growth stocks held up better than value stocks among large-caps; the opposite was true among small-caps. Mid-cap growth and value shares fared about the same.

In the U.S. stock market, as measured by the Wilshire 5000 Total Market Index, energy and materials stocks posted steep losses, as commodity prices were pressured by expectations for weaker global demand. Health care stocks also fared poorly, especially biotechnology shares. Utilities stocks, which often behave like bonds because of their relatively high dividend yields, appreciated as long-term interest rates declined.

Stocks in developed non-U.S. markets fared worse than large-cap U.S. shares in dollar terms. Japanese stocks fell almost 12% but held up better than other Asian markets. In Europe, oil producer Norway's shares plunged 19%, while German shares dropped about 11% amid a Volkswagen auto emissions scandal.

Stocks in emerging markets fell sharply, in part because of generally weaker currencies. In Latin America, Brazilian stocks plunged more than 33% in dollar terms. In emerging Asia, Chinese stocks dropped more than 20%. In emerging Europe, Turkish shares tumbled more than 19% amid lira weakness and deep political uncertainty ahead of new elections scheduled for November 1. Russian shares skidded 14% in dollar terms as oil prices and the ruble declined.

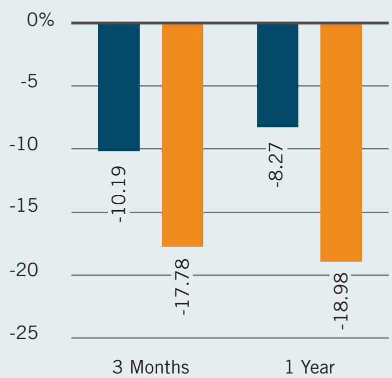
U.S. Stock Market Performance



Total Returns for Periods Ended September 30, 2015

- S&P 500 Index
- S&P MidCap 400 Index
- NASDAQ Composite Index (Principal Return)
- Russell 2000 Index

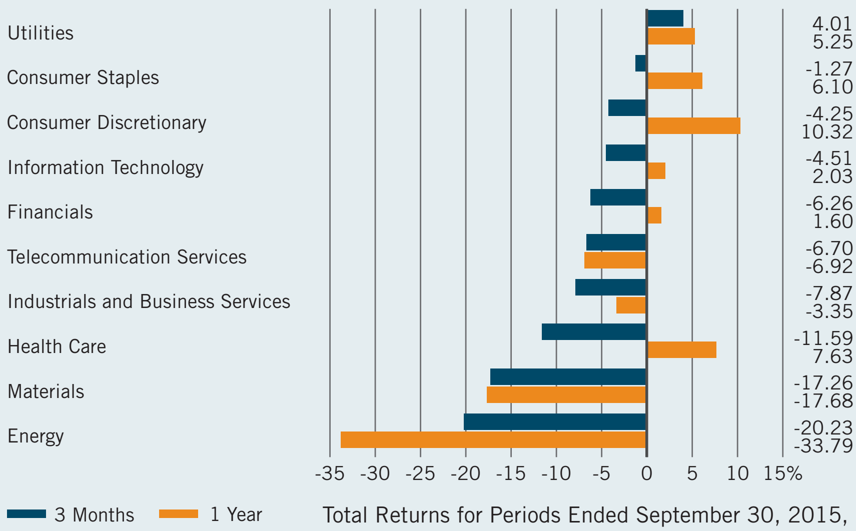
International Stock Market Performance



Total Returns for Periods Ended September 30, 2015

- MSCI EAFE Index (Europe, Australasia, Far East)
- MSCI Emerging Markets Index

Performance of Wilshire 5000 Series



Total Returns for Periods Ended September 30, 2015, Ranked by Highest to Lowest Quarterly Return

Global High-Quality Bonds Outperform

High-quality domestic bonds produced positive returns, benefiting from increased demand due to global equity market declines, global growth concerns, and the Fed's delay in raising short-term rates. The Fed, which kept the fed funds target rate in the 0.00% to 0.25% range established in late 2008, continues to anticipate that it will begin to raise short-term rates in the months ahead.

In the investment-grade universe, long-term Treasuries and municipal bonds performed best, as long-term rates declined. Mortgage-backed securities also did well, but corporate bonds lagged with slight gains. High yield bond prices fell amid weakness among energy and metals and mining companies and as investors generally favored lower-risk fixed income securities. Bank or "leveraged" loans, which have less exposure to commodities, held up better than high yield issues.

Bonds in developed non-U.S. countries were mostly flat in dollar terms. In local currency terms, many high-quality government bond markets performed well, as global growth concerns and deflation fears fueled demand for safe-haven bonds. However, a stronger dollar versus some currencies eroded gains stemming from bond price appreciation.

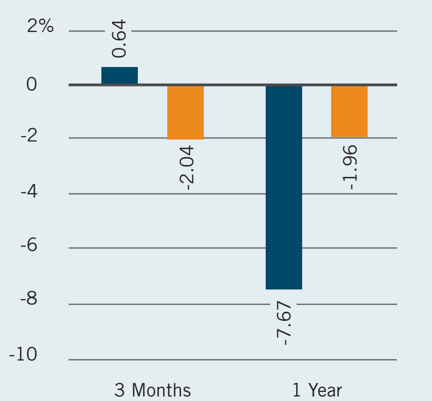
Dollar-denominated emerging markets bonds declined, as investor sentiment toward higher-risk assets soured. Bonds denominated in local currencies fell significantly as many developing market currencies fell sharply; some slumped to all-time lows against the dollar. China's decision to devalue its currency fueled fears that its economy is slowing sharply, which caused an abrupt increase in risk aversion.

U.S. Bond Market Performance

Total Returns for Periods Ended September 30, 2015

Barclays U.S. Aggregate Bond Index
Barclays Municipal Bond Index
Credit Suisse High Yield Index

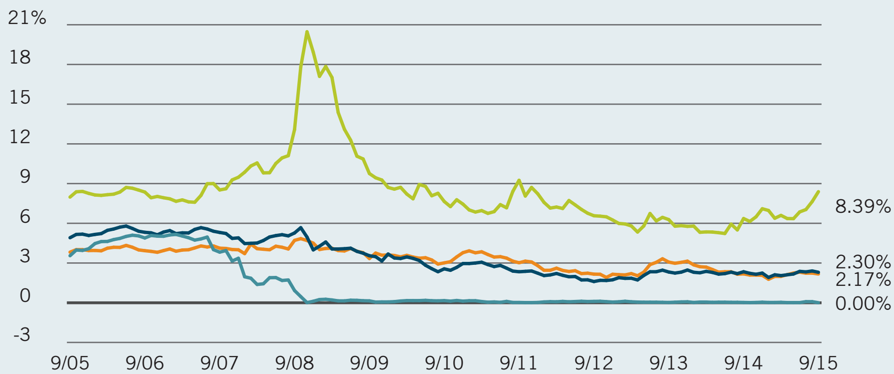
International Bond Market Performance



Total Returns for Periods Ended September 30, 2015

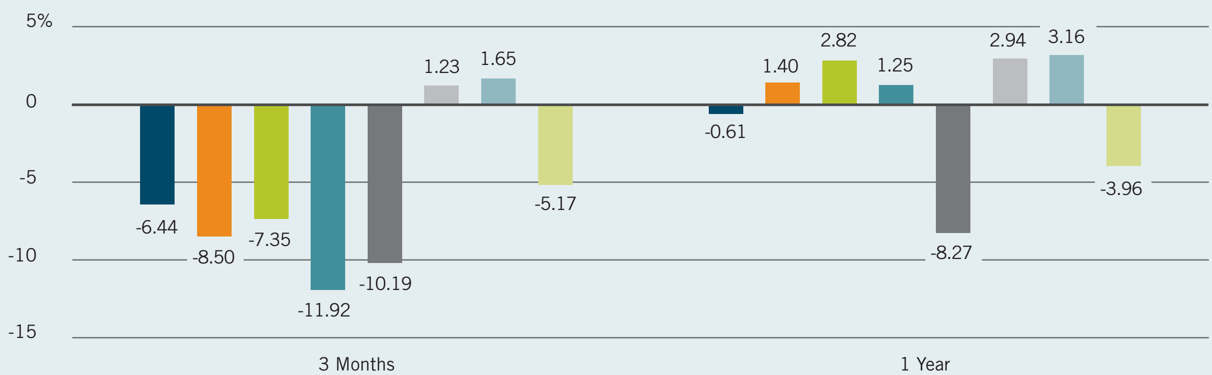
Barclays Global Aggregate ex USD Bond Index
J.P. Morgan Emerging Markets Bond Index Global

Trends in Interest Rates



[1]Yield-to-worst.

Stock and Bond Market Performance



Total Returns for Periods Ended September 30, 2015
Unlike stocks, U.S. government bonds are guaranteed as to the timely payment of interest and principal.

S&P 500 Index
S&P MidCap 400 Index
NASDAQ Composite Index (Principal Return)
Russell 2000 Index
MSCI EAFE Index
Barclays U.S. Aggregate Bond Index
Barclays Municipal Bond Index
Credit Suisse High Yield Index

Performance Summary

The performance information presented here includes changes in principal value, reinvested dividends, and capital gain distributions. *Current performance may be higher or lower than the quoted past performance, which cannot guarantee future results. Share price, principal value, yield, and return will vary, and you may have a gain or loss when you sell your shares. To obtain the most recent month-end performance, call us at 1-800-225-5132 or visit our website. The performance information shown does not reflect the deduction of redemption fees (if applicable); if it did, the performance would be lower. Call 1-800-225-5132 to request a prospectus or summary prospectus; each includes investment objectives, risks, fees, expenses, and other information that you should read and consider carefully before investing.* Funds are placed in alphabetical order in each category. To learn more about each fund's objective and risk/reward potential, visit troweprice.com/mutualfunds.

STOCK FUNDS	Ticker Symbol	3 Months	1 Year	3 Years	5 Years	10 Years or Since Inception[1]	Inception Date	Redemption Fee	Redemption Fee Period	Expense Ratio	Expense Ratio as of Date
Domestic											
Blue Chip Growth	TRBCX	-4.98%	5.50%	15.78%	16.03%	8.76%	6/30/93			**0.72%**	12/31/14
Capital Appreciation[2]	PRWCX	-2.77	5.70	12.16	12.28	8.28	6/30/86			**0.70**	12/31/14
Capital Opportunity	PRCOX	-6.31	0.08	12.29	13.12	6.87	11/30/94			**0.70**	12/31/14
Diversified Mid-Cap Growth	PRDMX	-8.39	4.02	13.98	13.21	8.25	12/31/03			**0.89**	12/31/14
Diversified Small-Cap Growth	PRDSX	-10.41	4.55	15.05	15.72	9.26	6/30/97	**1.0%**	**90 days**	**0.85**	12/31/14
Dividend Growth	PRDGX	-5.81	1.57	12.04	13.00	7.28	12/30/92			**0.65**	12/31/14
Equity Income	PRFDX	-10.24	-9.01	7.88	9.73	5.24	10/31/85			**0.66**	12/31/14
Equity Index 500	PREIX	-6.50	-0.85	12.11	13.04	6.54	3/30/90	**0.5**	**90 days**	**0.27**	12/31/14
Extended Equity Market Index	PEXMX	-10.45	0.06	13.04	13.10	7.82	1/30/98	**0.5**	**90 days**	**0.37**	8/1/15
Financial Services	PRISX	-8.31	4.84	15.53	12.26	4.55	9/30/96			**0.91**	12/31/14
Growth & Income	PRGIX	-4.42	2.69	13.18	12.93	6.91	12/21/82			**0.67**	12/31/14
Growth Stock	PRGFX	-4.71	6.47	15.24	15.19	8.73	4/11/50			**0.68**	12/31/14
Health Sciences[2]	PRHSX	-12.56	16.94	27.02	27.59	16.43	12/29/95			**0.77**	12/31/14
Media & Telecommunications	PRMTX	-5.24	1.92	13.15	15.01	13.08	10/13/93			**0.80**	12/31/14
Mid-Cap Growth[2]	RPMGX	-6.08	10.06	16.85	14.98	10.03	6/30/92			**0.77**	12/31/14
Mid-Cap Value[2]	TRMCX	-9.22	-3.05	11.70	11.33	8.10	6/28/96			**0.80**	12/31/14
New America Growth	PRWAX	-7.28	2.85	14.41	13.90	8.89	9/30/85			**0.79**	12/31/14
New Era	PRNEX	-17.29	-30.37	-5.17	-2.06	1.30	1/20/69			**0.65**	12/31/14
New Horizons[2]	PRNHX	-7.78	6.32	15.98	18.10	10.46	6/3/60			**0.79**	12/31/14
Real Assets	PRAFX	-12.44	-19.04	-4.92	-1.61	-0.21	7/28/10	**2.0**	**90 days**	**0.83**	12/31/14
Real Estate	TRREX	2.66	11.53	9.89	12.17	7.01	10/31/97	**1.0**	**90 days**	**0.76**	12/31/14
Science & Technology	PRSCX	-8.55	-1.72	15.76	12.12	8.00	9/30/87			**0.84**	12/31/14
Small-Cap Stock[2]	OTCFX	-10.31	0.92	11.44	13.50	8.42	6/1/56			**0.91**	12/31/14
Small-Cap Value	PRSVX	-8.14	-1.33	8.61	10.72	6.67	6/30/88	**1.0**	**90 days**	**0.96**	12/31/14
Tax-Efficient Equity[3]	PREFX						12/29/00	**1.0**	**365 days**	**0.87**	2/28/15
Returns before taxes		-6.34	5.98	14.04	13.86	7.66					
Returns after taxes on distributions		–	4.93	13.43	13.49	7.49					
Returns after taxes on distributions and sale of fund shares		–	4.23	10.98	11.13	6.24					
Total Equity Market Index	POMIX	-7.26	-0.77	12.40	13.07	6.89	1/30/98	**0.5**	**90 days**	**0.30**	8/1/15
U.S. Large-Cap Core	TRULX	-3.66	5.30	14.24	14.35	15.05	6/26/09			**1.15†**	12/31/14
Value	TRVLX	-9.81	-4.46	13.44	13.18	7.12	9/30/94			**0.82**	12/31/14

[1] If a fund has less than 10 years of performance history, its since-inception return is shown.

[2] Closed to new investors except for a direct rollover from a retirement plan into a T. Rowe Price IRA invested in this fund.

[3] The returns presented reflect the return before taxes; the return after taxes on dividends and capital gain distributions; and the return after taxes on dividends, capital gain distributions, and gains (or losses) from redemptions of shares held for 1-, 5-, and 10-year periods, as applicable. After-tax returns reflect the highest federal income tax rate but exclude state and local taxes. The after-tax returns reflect the rates applicable to ordinary and qualified dividends and capital gains effective in 2003. During periods when a fund incurs a loss, the post-liquidation after-tax return may exceed the fund's other returns because the loss generates a tax benefit that is factored into the result. An investor's actual after-tax return will likely differ from those shown and depend on his or her tax situation. Past before- and after-tax returns do not necessarily indicate future performance.

† This fund currently operates under a contractual expense limitation that may be lower than the expense ratio shown in the table above; for information about the expense limitation, including its expiration date, please see the fund's prospectus.

BENCHMARKS	3 Months	1 Year	3 Years	5 Years	10 Years
Domestic Stock					
S&P 500 Index	-6.44%	-0.61%	12.40%	13.34%	6.80%
S&P MidCap 400 Index	-8.50	1.40	13.12	12.93	8.25
NASDAQ Composite Index (Principal Return)	-7.35	2.82	14.03	14.30	7.94
Russell 2000 Index	-11.92	1.25	11.02	11.73	6.55
Lipper Indexes					
Large-Cap Core Funds	-7.15	-2.55	11.45	11.77	6.01
Equity Income Funds	-7.25	-4.24	9.74	10.94	5.63
Small-Cap Core Funds	-10.10	0.32	10.82	11.18	6.57

Performance Summary

Past Quarter, Year, and Average Annual Total Returns
Periods Ended September 30, 2015

		Ticker Symbol	3 Months	1 Year	3 Years	5 Years	10 Years or Since Inception[1]	Inception Date	Redemption Fee	Redemption Fee Period	Expense Ratio	Expense Ratio as of Date
STOCK FUNDS	International/Global											
	Africa & Middle East	TRAMX	-15.69%	-19.48%	6.88%	4.31%	0.16%	9/4/07	**2.0%**	**90 days**	**1.42%**	10/31/14
	Asia Opportunities	TRAOX	-14.36	-5.80	–	–	-1.71	5/21/14	**2.0**	**90 days**	**2.92†**	10/31/14
	Emerging Europe	TREMX	-13.34	-30.53	-14.37	-10.66	-4.21	8/31/00	**2.0**	**90 days**	**1.51**	10/31/14
	Emerging Markets Stock	PRMSX	-15.70	-15.26	-3.63	-2.69	3.66	3/31/95	**2.0**	**90 days**	**1.24**	10/31/14
	Emerging Markets Value Stock	PRIJX	–	–	–	–	-2.30	9/14/15	**2.0**	**90 days**	**1.55**	9/14/15
	European Stock	PRESX	-6.62	-0.95	10.25	8.80	6.11	2/28/90	**2.0**	**90 days**	**0.96**	10/31/14
	Global Growth Stock	RPGEX	-9.63	-3.25	8.57	7.91	16.06	10/27/08	**2.0**	**90 days**	**1.16†**	10/31/14
	Global Industrials	RPGIX	-10.79	-5.36	–	–	-2.31	10/24/13			**2.53†**	12/31/14
	Global Real Estate	TRGRX	-1.77	4.05	6.17	7.96	13.88	10/27/08	**2.0**	**90 days**	**1.07†**	12/31/14
	Global Stock	PRGSX	-8.16	-0.62	12.76	8.92	5.48	12/29/95	**2.0**	**90 days**	**0.89**	10/31/14
	Global Technology	PRGTX	-3.15	8.54	21.74	19.49	13.00	9/29/00			**0.91**	12/31/14
	International Concentrated Equity	PRCNX	-8.21	-7.52	–	–	-10.37	8/22/14	**2.0**	**90 days**	**11.13†**	10/31/14
	International Discovery	PRIDX	-7.29	1.75	10.18	8.39	7.50	12/30/88	**2.0**	**90 days**	**1.21**	10/31/14
	International Equity Index	PIEQX	-9.92	-8.36	5.19	3.70	3.04	11/30/00	**2.0**	**90 days**	**0.45**	8/1/15
	International Growth & Income	TRIGX	-11.22	-9.62	5.50	3.98	3.05	12/21/98	**2.0**	**90 days**	**0.85**	10/31/14
	International Stock	PRITX	-11.38	-6.04	4.46	3.81	3.82	5/9/80	**2.0**	**90 days**	**0.83**	10/31/14
	Japan	PRJPX	-9.29	-0.11	9.65	7.12	0.57	12/30/91	**2.0**	**90 days**	**1.05**	10/31/14
	Latin America	PRLAX	-22.50	-36.05	-16.97	-13.66	1.73	12/29/93	**2.0**	**90 days**	**1.31**	10/31/14
	New Asia	PRASX	-14.13	-11.21	0.08	0.94	8.92	9/28/90	**2.0**	**90 days**	**0.94**	10/31/14
	Overseas Stock	TROSX	-10.64	-7.48	5.60	4.89	0.83	12/29/06	**2.0**	**90 days**	**0.84**	10/31/14
BENCH-MARKS	International/Global Stock											
	MSCI EAFE Index		-10.19%	-8.27%	6.08%	4.45%	3.44%					
	Lipper Averages											
	Emerging Markets Funds		-16.02	-19.25	-4.38	-3.50	3.79					
	International Large-Cap Core Funds		-10.85	-9.72	3.76	2.83	2.92					
	International Large-Cap Growth Funds		-9.92	-6.47	4.62	3.80	3.96					
	International Small/Mid-Cap Growth Funds		-7.56	-2.11	8.12	6.98	5.92					
BOND FUNDS	Domestic Tax-Free[4]											
	California Tax-Free Bond	PRXCX	1.74%	3.25%	3.66%	4.85%	4.70%	9/15/86			**0.49%**	2/28/15
	Georgia Tax-Free Bond	GTFBX	1.69	3.42	2.90	4.09	4.23	3/31/93			**0.53**	2/28/15
	Intermediate Tax-Free High Yield	PRIHX	1.24	3.50	–	–	4.07	7/24/14	**2.0%**	**90 days**	**2.72†**	2/28/15
	Maryland Short-Term Tax-Free Bond	PRMDX	0.35	0.46	0.50	0.71	1.86	1/29/93			**0.53**	2/28/15
	Maryland Tax-Free Bond	MDXBX	1.55	3.35	2.87	4.17	4.45	3/31/87			**0.45**	2/28/15
	New Jersey Tax-Free Bond	NJTFX	1.52	2.78	2.80	4.15	4.31	4/30/91			**0.51**	2/28/15
	New York Tax-Free Bond	PRNYX	1.74	3.48	2.86	4.26	4.36	8/28/86			**0.49**	2/28/15
	Summit Municipal Income	PRINX	1.53	3.31	3.24	4.75	4.82	10/29/93			**0.50**	10/31/14
	Summit Municipal Intermediate	PRSMX	1.59	2.53	2.54	3.56	4.27	10/29/93			**0.50**	10/31/14
	Tax-Free High Yield	PRFHX	1.44	4.26	4.39	6.02	4.89	3/1/85	**2.0**	**90 days**	**0.69**	2/28/15
	Tax-Free Income	PRTAX	1.44	3.14	3.00	4.32	4.57	10/26/76			**0.51**	2/28/15
	Tax-Free Short-Intermediate	PRFSX	0.88	1.12	1.07	1.75	2.97	12/23/83			**0.49**	2/28/15
	Virginia Tax-Free Bond	PRVAX	1.53	3.20	2.70	4.02	4.37	4/30/91			**0.47**	2/28/15

All mutual funds are subject to market risk, including possible loss of principal. Funds that invest overseas generally carry more risk than funds that invest strictly in U.S. assets due to factors such as currency risk, geographic risk, and emerging markets risk. Funds that invest in fixed income securities are subject to credit risk and liquidity risk, with high yield securities having a greater risk of default than higher-quality securities. Such funds are also subject to the risk that a rise in interest rates will cause the price of a fixed rate debt security to fall. During periods of extremely low or negative interest rates, some funds may not be able to maintain a positive yield.

MSCI index returns are shown with gross dividends reinvested.

[4] Some income from the tax-free funds may be subject to state and local taxes and the federal alternative minimum tax.

[5] The market value of shares is not guaranteed by the U.S. government.

Performance Summary

Past Quarter, Year, and Average Annual Total Returns
Periods Ended September 30, 2015

	Ticker Symbol	3 Months	1 Year	3 Years	5 Years	10 Years or Since Inception[1]	Inception Date	Redemption Fee	Redemption Fee Period	Expense Ratio	Expense Ratio as of Date
BOND FUNDS — Domestic Taxable											
Corporate Income	PRPIX	0.15%	1.18%	2.56%	4.62%	5.35%	10/31/95			**0.62%**	5/31/15
Credit Opportunities	PRCPX	-6.05	-7.92	–	–	-6.84	4/29/14	**2.0%**	**90 days**	**1.89†**	5/31/15
Floating Rate	PRFRX	-0.82	2.13	3.08	–	3.47	7/29/11	**2.0**	**90 days**	**0.86†**	5/31/15
GNMA[5]	PRGMX	0.79	2.13	1.21	2.77	4.27	11/26/85			**0.59**	5/31/15
High Yield[2]	PRHYX	-5.19	-3.43	4.02	6.05	6.68	12/31/84	**2.0**	**90 days**	**0.74**	5/31/15
Inflation Protected Bond	PRIPX	-0.83	-0.82	-1.96	2.07	3.64	10/31/02			**0.58†**	5/31/15
Limited Duration Inflation Focused Bond	TRBFX	-0.60	-1.38	-0.82	0.38	2.14	9/29/06			**0.51**	9/1/15
New Income	PRCIX	0.77	1.93	1.51	3.00	4.76	8/31/73			**0.60**	5/31/15
Short-Term Bond	PRWBX	0.16	0.76	0.67	1.18	2.95	3/2/84			**0.52**	5/31/15
Ultra Short-Term Bond	TRBUX	0.01	0.58	–	–	0.41	12/3/12			**0.45†**	5/31/15
U.S. Bond Enhanced Index	PBDIX	1.09	2.63	1.58	3.03	4.60	11/30/00	**0.5**	**90 days**	**0.30**	10/31/14
U.S. Treasury Intermediate[5]	PRTIX	1.98	3.98	0.74	2.41	4.72	9/29/89			**0.51**	5/31/15
U.S. Treasury Long-Term[5]	PRULX	5.11	7.32	1.83	5.36	6.62	9/29/89			**0.51**	5/31/15
BENCHMARKS — Domestic Bond											
Barclays U.S. Aggregate Bond Index		1.23%	2.94%	1.71%	3.10%	4.64%					
Barclays Municipal Bond Index		1.65	3.16	2.88	4.14	4.64					
Credit Suisse High Yield Index		-5.17	-3.96	3.30	5.93	6.89					
Lipper Averages											
Short Investment Grade Debt Funds		-0.14	0.45	0.77	1.39	2.65					
Core Bond Funds		0.54	1.74	1.49	3.04	4.14					
GNMA Funds		0.43	1.92	0.91	2.49	4.30					
High Yield Funds		-4.48	-3.77	2.81	5.18	5.87					
Short Municipal Debt Funds		0.35	0.31	0.49	0.97	1.93					
Intermediate Municipal Debt Funds		1.05	1.38	1.55	2.96	3.59					
General & Insured Municipal Debt Funds		1.43	2.66	2.61	4.15	3.99					
BOND FUNDS — International/Global											
Emerging Markets Bond	PREMX	-2.58%	-3.58%	-0.54%	3.20%	6.01%	12/30/94	**2.0%**	**90 days**	**0.93%**	12/31/14
Emerging Markets Corporate Bond	TRECX	-4.25	-3.78	1.04	–	3.42	5/24/12	**2.0**	**90 days**	**1.21†**	12/31/14
Emerging Markets Local Currency Bond	PRELX	-11.36	-20.71	-9.29	–	-5.82	5/26/11	**2.0**	**90 days**	**1.35†**	12/31/14
Global High Income Bond	RPIHX	-5.33	–	–	–	-0.73	1/22/15	**2.0**	**90 days**	**1.03†**	1/22/15
Global Multi-Sector Bond[6]	PRSNX	-1.90	-2.00	1.86	3.45	7.15	12/15/08			**0.82**	5/31/15
Global Unconstrained Bond	RPIEX	-0.24	–	–	–	1.98	1/22/15			**0.93†**	1/22/15
International Bond	RPIBX	-0.81	-8.62	-4.21	-1.14	2.54	9/10/86	**2.0**	**90 days**	**0.83**	12/31/14
BENCHMARKS — International/Global Bond											
Barclays Global Aggregate ex USD Bond Index		0.64%	-7.67%	-4.00%	-0.85%	2.98%					
J.P. Morgan Emerging Markets Bond Index Global		-2.04	-1.96	0.51	4.40	6.76					
Lipper Averages											
Emerging Market Hard Currency Debt Funds		-4.75	-6.77	-1.38	2.59	5.57					
International Income Funds		-1.80	-6.24	-2.21	0.27	3.80					

	Ticker Symbol	7-Day Yield	7-Day Unsubsidized Yield	3 Months	1 Year	3 Years	5 Years	10 Years or Since Inception[1]	Inception Date	Expense Ratio	Expense Ratio as of Date
MONEY MARKET — Tax-Free[7]											
California Tax-Free Money	PCTXX	0.01%	-0.48%	0.00%	0.01%	0.01%	0.01%	0.83%	9/15/86	**0.69%†**	2/28/15
Maryland Tax-Free Money	TMDXX	0.01	-0.59	0.00	0.01	0.01	0.01	0.86	3/30/01	**0.58**	2/28/15
New York Tax-Free Money	NYTXX	0.01	-0.48	0.00	0.01	0.01	0.01	0.85	8/28/86	**0.70†**	2/28/15
Summit Municipal Money Market	TRSXX	0.01	-0.37	0.00	0.02	0.01	0.01	0.91	10/29/93	**0.45**	10/31/14
Tax-Exempt Money	PTEXX	0.01	-0.32	0.00	0.01	0.01	0.01	0.89	4/8/81	**0.51**	2/28/15
Taxable[7]											
Prime Reserve	PRRXX	0.01%	-0.29%	0.00%	0.01%	0.01%	0.01%	1.29%	1/26/76	**0.53%**	5/31/15
Summit Cash Reserves	TSCXX	0.01	-0.14	0.00	0.01	0.01	0.01	1.35	10/29/93	**0.45**	10/31/14
U.S. Treasury Money	PRTXX	0.01	-0.33	0.00	0.01	0.01	0.01	1.08	6/28/82	**0.44**	5/31/15

An investment in the money market funds is not insured or guaranteed by the FDIC or any other government agency. Although the funds seek to preserve the value of your investment at $1.00 per share, it is possible to lose money by investing in the funds. Money fund yields more closely reflect current earnings than do total returns.

6 Formerly T. Rowe Price Strategic Income Fund.

7 In an effort to maintain a zero or positive net yield for the fund, T. Rowe Price has voluntarily waived all or a portion of the management fee it is entitled to receive from the fund. A fee waiver has the effect of increasing the fund's net yield. The 7-day yield without waiver represents what the yield would have been if we were not waiving our management fee. This voluntary waiver is in addition to any contractual expense ratio limitation in effect for the fund and may be amended or terminated at any time without prior notice. Please see the prospectus for more details.

Performance Summary

Past Quarter, Year, and Average Annual Total Returns
Periods Ended September 30, 2015

	Ticker Symbol	3 Months	1 Year	3 Years	5 Years	10 Years or Since Inception[1]	Inception Date	Redemption Fee	Redemption Fee Period	Expense Ratio	Expense Ratio as of Date
ASSET ALLOCATION											
Balanced	RPBAX	-5.62%	-1.26%	7.61%	8.52%	6.07%	12/31/39			**0.68%**	12/31/14
Global Allocation	RPGAX	-6.32	-2.48	–	–	3.14	5/28/13			**1.88**†	10/31/14
Personal Strategy Balanced	TRPBX	-5.77	-1.86	7.11	8.22	6.19	7/29/94			**0.84**	5/31/15
Personal Strategy Growth	TRSGX	-7.50	-2.55	8.99	9.82	6.22	7/29/94			**0.89**	5/31/15
Personal Strategy Income	PRSIX	-4.05	-1.30	5.14	6.37	5.66	7/29/94			**0.72**	5/31/15
Retirement 2005	TRRFX	-3.79	-1.67	4.33	5.82	5.19	2/27/04			**0.58**	5/31/15
Retirement 2010	TRRAX	-4.22	-1.77	5.04	6.46	5.34	9/30/02			**0.58**	5/31/15
Retirement 2015	TRRGX	-5.01	-1.88	6.11	7.35	5.66	2/27/04			**0.62**	5/31/15
Retirement 2020	TRRBX	-5.84	-2.03	7.01	8.10	5.84	9/30/02			**0.66**	5/31/15
Retirement 2025	TRRHX	-6.55	-2.20	7.86	8.71	6.01	2/27/04			**0.69**	5/31/15
Retirement 2030	TRRCX	-7.15	-2.34	8.54	9.26	6.17	9/30/02			**0.72**	5/31/15
Retirement 2035	TRRJX	-7.70	-2.46	9.02	9.62	6.21	2/27/04			**0.74**	5/31/15
Retirement 2040	TRRDX	-8.13	-2.65	9.29	9.77	6.30	9/30/02			**0.75**	5/31/15
Retirement 2045	TRRKX	-8.12	-2.63	9.31	9.78	6.31	5/31/05			**0.75**	5/31/15
Retirement 2050	TRRMX	-8.11	-2.66	9.29	9.77	5.00	12/29/06			**0.75**	5/31/15
Retirement 2055	TRRNX	-8.10	-2.60	9.28	9.79	4.99	12/29/06			**0.75**	5/31/15
Retirement 2060	TRRLX	-8.10	-2.62	–	–	-3.38	6/23/14			**0.75**	5/31/15
Retirement Balanced	TRRIX	-3.79	-1.83	3.85	5.19	4.87	9/30/02			**0.56**	5/31/15
Spectrum Growth	PRSGX	-8.87	-3.09	9.76	10.28	6.38	6/29/90			**0.78**	12/31/14
Spectrum Income	RPSIX	-2.50	-2.37	1.93	4.01	5.19	6/29/90			**0.67**	12/31/14
Spectrum International	PSILX	-10.74	-7.11	4.94	4.24	4.33	12/31/96	**2.0%**	**90 days**	**0.94**	12/31/14
Target Retirement 2005	TRARX	-3.42	-1.52	–	–	3.36	8/20/13			**0.58**	5/31/15
Target Retirement 2010	TRROX	-3.50	-1.52	–	–	3.58	8/20/13			**0.58**	5/31/15
Target Retirement 2015	TRRTX	-3.99	-1.60	–	–	3.88	8/20/13			**0.61**	5/31/15
Target Retirement 2020	TRRUX	-4.65	-1.68	–	–	4.35	8/20/13			**0.64**	5/31/15
Target Retirement 2025	TRRVX	-5.37	-1.85	–	–	4.82	8/20/13			**0.67**	5/31/15
Target Retirement 2030	TRRWX	-5.98	-1.93	–	–	5.31	8/20/13			**0.70**	5/31/15
Target Retirement 2035	RPGRX	-6.60	-2.02	–	–	5.73	8/20/13			**0.72**	5/31/15
Target Retirement 2040	TRHRX	-7.04	-2.18	–	–	5.95	8/20/13			**0.74**	5/31/15
Target Retirement 2045	RPTFX	-7.50	-2.36	–	–	6.11	8/20/13			**0.74**	5/31/15
Target Retirement 2050	TRFOX	-7.80	-2.53	–	–	6.28	8/20/13			**0.75**	5/31/15
Target Retirement 2055	TRFFX	-8.12	-2.72	–	–	6.27	8/20/13			**0.75**	5/31/15
Target Retirement 2060	TRTFX	-8.10	-2.62	–	–	-3.38	6/23/14			**0.75**	5/31/15

Indexes included in this update track the following: S&P 500—500 large-company U.S. stocks; S&P MidCap 400—stocks of 400 mid-size U.S. companies; NASDAQ Composite (principal only)—U.S. stocks traded in the over-the-counter market; Russell 2000—stocks of 2,000 small U.S. companies; MSCI EAFE—stocks of about 1,000 companies in Europe, Australasia, and the Far East; MSCI Emerging Markets—more than 850 stocks traded in over 20 emerging markets; Barclays U.S. Aggregate Bond—investment-grade corporate and government bonds; Barclays Municipal Bond—tax-free investment-grade U.S. bonds; Credit Suisse High Yield—noninvestment-grade corporate U.S. bonds; Barclays Global Aggregate ex USD Bond—investment-grade government, corporate, agency, and mortgage-related bonds in markets outside the U.S.; J.P. Morgan Emerging Markets Bond–Global—U.S. dollar-denominated Brady Bonds, Eurobonds, traded loans, and local market debt instruments issued by sovereign and quasi-sovereign entities; Lipper averages—all funds in each investment objective category; and Lipper indexes—equally weighted indexes of typically the 30 largest mutual funds within their respective investment objective categories. It is not possible to invest directly in an index.

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