Fund Spy

T. Rowe Price Continues to Thrive

By Katie Rushkewicz Reichart, CFA | 12-03-15 | 06:00 AM | Email Article

Morningstar recently issued a new Stewardship Grade for T. Rowe Price. The firm's overall grade--which considers corporate culture, fund board quality, fund manager incentives, fees, and regulatory history--is an A. What follows is Morningstar's analysis of the firm's corporate culture, for which T. Rowe Price receives an A. This text, as well as analytical text on the other four Stewardship Grade criteria, is available to subscribers of Morningstar's software for advisors and institutions: Morningstar Advisor Workstation(SM), Morningstar Office(SM), and Morningstar Direct(SM).

T. Rowe Price excels at sticking to a disciplined investment process, one that's stayed consistent even as the firm has grown and experienced changes at the executive and portfolio manager levels over its 78-year history. Fueled by bottom-up, analyst-driven research, the funds are typically well diversified and constructed with an eye on risk, an approach that has reaped rewards: Over the trailing decade through September 2015, the average fund in its lineup has beaten 81% of its peers.

Strong, consistent fund performance has helped retain assets. Even as investors have gravitated to index funds in recent years, T. Rowe hasn't come under pressure; it has held on to assets and has seen significant asset growth through the bull market following the 2008 financial crisis. During a time when the active management style of investing that it is known for was largely out of favor with investors, T. Rowe continued to see inflows.

While leadership changes can cause a shift in strategic direction at some firms, that hasn't been the case here. T. Rowe has handled executive transitions well, including the upcoming retirement of CEO and president James Kennedy, who will step down at year-end. Successor Bill Stromberg fits the mold of T. Rowe's top leaders, which skews toward people who have come up through the firm's investment division. He joined T. Rowe in 1987 and has spent time as an analyst, portfolio manager, director of research, and, most recently, head of global equity. While his background makes him well-suited for the top role at the equity-heavy shop, Stromberg has gained broader exposure to firmwide issues by sitting on the management committee, a small group of senior leaders at the firm that serves as a sounding board for the CEO, since 2007. He's been groomed for this role and has had a long time to prepare following the official announcement in May 2015. No major changes in the firm's priorities are anticipated after the handoff, with Stromberg focused on fund performance and improving T. Rowe's global efforts and integration.

Despite a well-orchestrated CEO handoff, T. Rowe's upper ranks did experience a more abrupt change in leadership in early 2015 when head of fixed income Mike Gitlin unexpectedly left for Capital Group. Gitlin was a bit of an outlier for a top leader at T. Rowe in that he'd only been at the firm since 2007, having previously spent time at Citigroup and Credit Suisse. In that respect, his departure is less shocking

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than if a T. Rowe lifer had suddenly departed. However, Gitlin had done a good job in the role, overseeing a measured ramp-up in T. Rowe's global fixed-income staff and quantitative resources as well as the launch of several new strategies as the firm has tried to diversify its equity-heavy fund lineup. (T. Rowe Price Global High Income Bond (RPIHX) and T. Rowe Price Global Unconstrained Bond (RPIEX) both launched in January 2015.) While he didn't have money management experience himself, he proved to be an effective people manager, making efforts to develop career paths for analysts and encourage overseas assignments. On his watch, the fixed-income team generally had good analyst retention.

Successor Ted Wiese is a logical replacement. He's a 31-year veteran of the firm who's run T. Rowe Price Short-Term Bond (PRWBX) since 1995 (a new manager has already been named, and Wiese will eventually step down from that role). With his long tenure at the firm, he's a known entity. Given the huge buildup in resources and strategies that occurred under Gitlin, Wiese's top priority is helping the team digest those changes rather than embark on a bunch of new initiatives. He's also working closely with the technology and quantitative groups and hopes to improve analyst/manager communications, including better collaboration with the equity team.

T. Rowe is thoughtful when it comes to succession planning for key posts, typically mapping out scenarios for unexpected departures like Gitlin's as well as intermediate- and long-term plans. Most of its portfolio managers and executives retire by their mid-60s, which generally provides some clarity for roles that will need to be filled in the future. When a successful portfolio manager or group leader retires, as we've seen recently with Kennedy and managers Brian Rogers, Preston Athey, and Bob Smith, among others, it can bring some temporary uncertainty as to how a replacement might fare. From a cultural standpoint, though, T. Rowe's retirement track opens positions to up-and-comers and promotes a sense of developing the next generation of leaders.

Succession planning can also help the firm spot talent gaps. In mid-2015, the firm hired Sebastien Page from PIMCO to co-head the asset-allocation group, joining Rich Whitney, who's been at the firm for more than 30 years and is likely approaching retirement age. T. Rowe has a rich history in asset-allocation products, having launched various fund-of-funds strategies in the early 1990s and more recently becoming a leader in the target-date space. Despite its success in asset allocation, T. Rowe executives contend the firm could be doing more to better package solutions and create custom portfolios, particularly in the institutional space. As a result, it hired Page, who has experience in product development at PIMCO and State Street. Page also sits on T. Rowe's renowned asset-allocation committee, which is responsible for recommending tactical allocation shifts that feed into various funds.

It's unusual to see such a high-profile hire from outside the firm. Even Gitlin had been at T. Rowe for a couple of years before being promoted to head of fixed income. It's also surprising that Page has a seat on the asset-allocation committee, which primarily consists of top portfolio managers and division leaders who have demonstrated a long-standing commitment to T. Rowe's careful investment style. That's not to say Page plans to come in and shake things up, but it is a meaningful departure from the firm's tendency to promote from within. In the wake of Gitlin's departure, it also raises questions about whether outside hires are likely to stick around or plan only a short stop at the firm. Finally, it remains to be seen what type of product development will result. T. Rowe is known for being conservative in launching products and generally stays in its wheelhouse, but an outsider could bring a different perspective.

Beyond some key changes at the top, the investment team has been on steadier footing lately. Recent manager turnover has generally been because of retirements rather than the rash of unexpected departures that occurred in 2013-14, when three managers separately left, two of whom started hedge funds. Analyst turnover has also trended down on the U.S. equity team after clocking in at above average (relative to T. Rowe's history) a few years in a row. There has been some internal movement as analysts took on other roles as directors of research, portfolio managers, or associate portfolio managers, but the firm has been filling those roles and adjusting coverage assignments accordingly.

Meanwhile, T. Rowe has grown its associate analyst program, which currently has about 30 associate analysts, nearly triple the amount from five years ago. That doesn't necessarily result in more promotions from that group to full-scale analyst, given that the bar is still very high, but it does provide a wider group of talent to consider.

At both the analyst and manager level, T. Rowe has pushed for improved global collaboration. The international-equity team has come a long way since T. Rowe's joint venture with Robert Fleming Holdings ended in 2000, which resulted in a net gain of international portfolio managers but required the firm to hire new global analysts. Although it has a shorter history than the U.S. equity team, the overseas team has become more stable and experienced over time. It has also become increasingly global, with four managers based in Hong Kong compared with zero just a few years ago and with plans to add a few more analysts to cover Asia ex-Japan following the opening of the China market.

Still, T. Rowe recognizes there is more to be done in coordinating globally. Along those lines, head of international equity Chris Alderson took on an additional title of head of equity globalization, and U.S. director of research Jason Polun also now serves as global research coordinator. The intention isn't to micromanage interactions on the research team but to share best practices for research and hiring and better promote collaboration, particularly in sectors that are more regionally focused. As part of this effort, there could be more global sector funds in the future, with the idea that having a horse in the race helps keep analysts engaged and improves interactions across the team. (A few already exist, including Global Real Estate (TRGRX), Global Technology (PRGTX), and Global Industrials (RPGIX).)

While these niche funds may not be widely applicable to the average investor, T. Rowe more broadly has been careful about rolling out funds and monitoring asset growth. Beyond the push in fixed income, the focus has been on international equity (including T. Rowe Price Emerging Markets Value Stock (PRIJX), launched in September 2015), where the firm has more growth potential and fewer liquidity constraints. U.S. equity funds consumed more than 60% of the firm's mutual fund assets as of September, but several funds have reached capacity limits after years of solid performance and strong inflows. Indeed, seven of the firm's 25 biggest funds are closed, which is in the interests of shareholders who own them.

What's more, T. Rowe has had broad success across the board, indicating it has been thoughtful about its fund lineup and getting the right people in the right places. The firm's 10-year Morningstar Success Ratio through September 2015, or the percentage of funds that have survived and outperformed their category average during that span, was 81%--the second best of the top 10 fund companies by assets. That trend held steady for the three- and five-year periods, as well.

There have been a few weak spots: T. Rowe Price International Bond (RPIBX) has lagged and is trying to regain its footing under Arif Husain, who joined T. Rowe from AllianceBernstein in 2013 as the firm's new head of international fixed income. Some of the more conservatively run funds on the taxable-bond side have also looked sluggish in the intermediate term.

But overall, it's hard to go wrong with T. Rowe's fund lineup. The Retirement funds, which offer exposure to all asset classes, receive a Morningstar Analyst Rating of Gold, speaking to the strength of the firm as a whole. Target-date funds remain a key growth driver for the firm. The downside is that asset growth could have capacity implications down the line, particularly since several of the firm's marquee small- and mid-cap funds are closed. It is possible that passively managed small- and mid-cap funds may be incorporated in small doses in the future. (The target-date funds already use a large-cap index fund to keep costs down.) However, the firm's long history of success with active management in the less efficient small- and mid-cap space philosophically makes the inclusion of index funds anomalous, even if they end up being a small percentage of the series' overall assets.

On the whole, though, T. Rowe operates in a way that serves fund investors' interests well. Portfolio managers' shareholder letters do a good job showcasing a fund's strategy, positioning, and performance patterns. The firm remains in a strong financial position, with no debt and high margins positioning it well from a resources standpoint, and it hasn't compromised on its values despite the pressures of being a publicly traded company. Most important, T. Rowe has maintained a solid investment culture despite the company's huge growth and even in the wake of departures, both anticipated and unplanned. For these reasons, T. Rowe Price earns an A for Corporate Culture.

This article is the Corporate Culture portion of the Morningstar Stewardship Grade for funds for this fund family. Visit our corporate website to see Morningstar's Stewardship Grade methodology.

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