T. Rowe Price Group - Q2 2023

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Corporate Speakers:

- Rob Sharps; T. Rowe Price Group, Inc.; President, Chief Executive Officer & Director
- Jen Dardis; T. Rowe Price Group, Inc.; VP, Chief Financial Officer & Treasurer
- Linsley Carruth; T. Rowe Price Group, Inc.; Director of IR

Participants:

- Ken Worthington; JPMorgan Chase & Co; Managing Director
- Finian O'Shea; Wells Fargo Securities; Analyst
- Dan Fannon; Jefferies; Analyst
- Craig Siegenthaler; BofA Securities; Managing Director
- Glenn Schorr; Evercore ISI; Analyst
- Brian Bedell; Deutsche Bank AG; Director
- Brennan Hawken; UBS Investment Bank; Analyst
- Michael Brown; Keefe, Bruyette, & Woods, Inc.; Managing Director
- Patrick Davitt; Autonomous Research; Analyst
- Michael Cyprys; Morgan Stanley; Analyst

PRESENTATION

Operator: Good morning. My name is Gigi, and I will be your conference facilitator today. Welcome to T. Rowe Price's Second Quarter 2023 Earnings Conference Call. (Operator Instructions) As a reminder, this call is being recorded and will be available for replay on T. Rowe Price's website shortly after the call concludes.

I will now turn the call over to Linsley Carruth, T. Rowe Price's Director of Investor Relations.

Linsley Carruth: Hello, and thank you for joining us today for our second quarter earnings call. The press release and a supplemental materials document can be found on our IR website at investors.troweprice.com. Today's call will last approximately 45 minutes. Our CEO and President, Rob Sharps and CFO, Jen Dardis, will discuss the company's results for about 15 minutes, and then we'll open it up to your questions. We ask that you limit it to one question per participant.

I'd like to remind you that during the course of this call, we may make a number of forward-looking statements and reference certain non-GAAP financial measures. Please refer to the forward-looking statement language and the reconciliations to GAAP in the supplemental materials as well as in our press release and 10-Q.

Now I'll turn it over to Rob.

Rob Sharps: Thank you, Linsley, and thank you all for joining us today. While equity outflows continued in the second quarter, we saw improved performance in a number of important investment strategies. Stronger equity markets helped lift revenue from first quarter levels, and we identified substantial cost savings that will allow us to meaningfully slow expense growth while continuing to pursue our strategic initiatives.

On today's call, I'll give an overview of our investment performance, followed by a brief update on the key milestones we reached in advancing our strategic initiatives. Jen will then provide a detailed view of our financial results before we take your questions.

Overall, second quarter investment performance was encouraging, with reasonably solid results across asset classes and the percentage of funds outperforming their peers increasing from the prior quarter. The U.S. large cap growth franchise outperformed this quarter with Blue Chip Growth, Growth Stock, and Large-Cap Growth posting top quartile results versus peers and beating their benchmarks.

Our U.S. Equity Research and Mid-Cap Value strategies continued to deliver strong performance. In contrast, the Large-Cap Value franchise, a bright spot in 2022, gave back some of its relative outperformance in the first half of 2023. However, the long-term results remain favorable. Our target date franchise delivered another strong quarter of performance with all of our flagship retirement funds ranking in the top quartile.

Performance in fixed income and international equity was solid as well, with the majority of funds in both segments outperforming peer groups and a number of products, including Global Multi-Sector bond and U.S. High Yield in the top decile for the quarter. Our Global Stock, Overseas Stock and several of our Municipal Bond strategies were top quartile performers in the second quarter and all have strong 3-, 5- and 10-year performance track records.

Despite these gains, organic growth remains under pressure. As we reported, net outflows for the second quarter were $20 billion. The sales and redemption patterns that we saw in the first quarter largely continued in the second. U.S. equity outflows were primarily driven by U.S. large-cap growth strategies as market demand remained muted and we saw the lagging impact of past investment performance on sales and redemptions. International and global (equity) outflows slowed with improved market demand and better performance. Fixed income net flows declined from the prior quarter as rates rose and demand softened. Target Date products had net inflows of $2.4 billion for the quarter.

To protect our ability to invest in our corporate strategy and deliver for our clients, we are proactively managing expense growth. We are pursuing a number of efforts to manage expenses, drive efficiency and create a cost structure that's appropriate for the size and scale of our firm today. Jen will discuss these efforts in greater detail. But since the fourth quarter of 2022, we have taken steps to remove or reallocate over $200 million in run rate cost for 2024. This work partly reflects ongoing company and industry challenges, but also reflects a broader commitment to efficiency, process improvement and durability, driving a culture of continuous improvement and innovation with an agile mindset.

Institutionalizing this work will allow us to better invest in our corporate strategy and continue to deliver for our clients, even in challenging times.

Our corporate strategy is focused on areas where we believe we have the greatest opportunity for growth and long-term success. In the second quarter, we advanced efforts to deepen our client partnerships, expand our investment in operational capabilities and continue to broaden our global reach. We've made important hires and met some key milestones.

We are making steady progress in bolstering our USI wealth channel by fortifying partnerships with the largest intermediary firms in the industry. Clients expect compelling investment strategies offered in a variety of vehicles to meet their needs, and we made progress delivering on both this quarter.

On June 15, we launched 5 fully transparent active equity ETFs, which are already generating client interest and inflows. Our existing lineup of 15 ETFs now at $1.5 billion in AUM is steadily building momentum. We continue to fill out our roster of SMA strategies with the addition of 4 muni and 2 equity SMA strategies this quarter.

We finalized the seed commitment for our first joint co-branded product with OHA, T. Rowe Price OHA Select Private Credit Fund, or OCREDIT and closed for our business development company, or BDC, election filing on June 30. The filing is a key legal milestone for the launch, which is planned for later this year. We also hired a head of U.S. intermediary, alternative sales, and we'll continue to invest in resources and expertise to support this effort.

We closed on our acquisition of Retiree Inc., which will enhance our ability to expand and retain relationships with pre-retiree and retiree clients, by providing tax aware retirement income and social security claiming strategies. With this acquisition, we demonstrate our commitment to expanding and evolving our already strong retirement capabilities.

So while our flows continue to reflect lingering challenges, we are making clear progress. Our work on driving efficiencies and managing expenses will allow us to continue to invest to deliver for our clients and support future growth. I'm impressed by the resiliency and commitment of our associates, and I remain confident in the long-term fundamental value that a global active investment management firm like T. Rowe Price can deliver no matter the environment.

I'll now turn to Jen to cover our financial results for the second quarter.

Jen Dardis: Thank you, Rob, and hello, everyone. I will begin today by reviewing our financial results and will provide additional detail on our expense management efforts before we open the line for questions. As reported, our adjusted earnings per share was $2.02 for Q2 2023 versus $1.69 in Q1 2023. An increase from both higher revenues and carefully managed expense growth. Q2 2023 EPS was also favorably impacted by a lower quarterly effective tax rate. We ended the quarter with $1.4 trillion in AUM, an increase of $58 billion from March 31, 2023, driven by market appreciation and partially offset by net outflows.

Our average assets for the quarter were $1.36 trillion, up from Q1 2023, but down almost $50 billion from Q2 2022. As Rob mentioned, we posted $20 billion in net outflows for the quarter.

Across the entire complex, we continue to see clients taking longer to make decisions based on current market volatility, which is resulting in lower sales and net inflows than we've seen in prior years. Industry-wide, active equity and fixed income fund flows have been muted for over a year. We expect that this slowdown is cyclical and will revert to more normal patterns as the direction of interest rates, inflation and the likelihood of a recession become clearer.

Also consistent with last quarter, our U.S. large-cap growth equity products drove a majority of the outflows, and we are seeing performance-related lower sales and elevated redemptions from a range of clients. It will take some time for the recent performance improvement in these products to slow the outflows. Positive inflows for the quarter included U.S. Equity Research, Capital Appreciation, International Core and All-Cap Opportunities.

We also had net inflows to international fixed income driven by Global Investment Grade, Global Multi-Sector and Euro Corporate Bond. However, the inflows to international fixed income were more than offset by outflows from our U.S. fixed income Stable Value and Floating Rate products.

Our Target Date net inflows were $2.4 billion for the quarter. While this was down from Q1, keep in mind that first quarter flows are typically the strongest given that a higher proportion of planned decisions happen around year-end. In the first half of the year, we recorded $9.9 billion of net inflows to our Target Date products.

In response to changing market conditions and more available capacity, we have reopened to new investors some of our previously closed products, including Mid-Cap Growth, Small Cap Growth and Emerging Market Equity, which we expect will support future sales and net flows. We also continue to evaluate the capacity levels for other closed strategies, and we'll consider reopening these in the future.

Our Q2 adjusted net revenues were $1.6 billion, including $1.4 billion of investment advisory revenue that was up from Q1 2023 on equity market gains. Our effective fee rate was 42.3 basis points back to the same level it was in Q4 2022 after a slight uptick in the first quarter of 2023. Our adjusted operating expenses were a little over $1 billion, which was generally flat to the first quarter of this year, but up 8.3% from the second quarter of 2022. The year-over-year change was largely driven by the change in capital allocation-based income-related compensation. As a reminder, in the second quarter last year, there was negative capital allocation-based income, which created an expense offset. Excluding the compensation expense related to capital allocation-based income, adjusted operating expenses were up 1.8% over the same period last year, with compensation and related costs up less than 1% year-over-year.

We continue to forecast our 2023 adjusted operating expense growth, excluding capital allocation-based income-related compensation expense, will be in the range of 2% to 6% over the comparable full year 2022 amount of $4.1 billion. Based on current market conditions, we still expect to land at or below the midpoint of this range.

As Rob mentioned, we are pursuing a number of efforts to proactively manage our expense growth and drive efficiency. Last week, we internally communicated the difficult decision to eliminate approximately 2% of our existing positions globally. We have also slowed the pace of hiring and headcount growth by closing select open positions across the firm. All of these actions have been based on a careful review to make sure we are aligning our resources to best support our clients and drive long-term growth for the firm. Based on our current pace of hiring against our strategic initiatives, we expect head count at the end of 2023 to be modestly higher than the start of the year, even with the reductions I just mentioned.

Most of the costs related to the recent reduction in force will be incurred in the third quarter and are already included in our expense guidance. As we move forward, we remain committed to finding ways to be more efficient and drive a culture of continuous improvement.

For example, we are evaluating our current real estate use in light of our new hybrid work approach with the objective of slowing our occupancy and facilities expense growth. It will be some time, however, before any impact to expenses from real estate would be realized. In total, between the expense efforts we took last year and this year, we will have removed or reallocated over $200 million in operating expenses versus the run rate for 2024.

This financial discipline will allow us to continue investing in our strategic initiatives to support future growth while positioning us for low single-digit adjusted operating expense growth in 2024. Excluding the impact of capital allocation-based income-related compensation. We will refine these estimates as we get closer to year-end. As always, this estimate is based on current market levels and we could choose to adjust it if markets rise or fall significantly.

Shifting to capital management. We found some buying opportunities in May and June, bringing our year-to-date share repurchases to over 420,000 shares at an average price of just over $107 per share or $45 million total. We remain opportunistic in our approach to buybacks. However, given continued market uncertainty, we are being patient in the process. Supporting our recurring dividend remains a top priority. And in the first half of 2023, we returned over $600 million to stockholders. Our balance sheet remains strong, and we have ample liquidity to support both our seed capital program and potential M&A.

We are confident in the efforts we've identified to drive efficiency and slow our expense growth as we continue to manage the business to support our clients and return the firm to organic growth over time. As Rob said, institutionalizing this work will allow us to better invest in our corporate strategy and continue to deliver value for our clients, even in challenging times.

With that, I'll ask the operator to open the line for Q&A.

QUESTIONS AND ANSWERS

Operator: (Operator Instructions) Our first question comes from the line of Ken Worthington from JPMorgan.

Ken Worthington: Performance has improved in a number of your most prominent growth funds. And while outflows were still elevated in 2Q, are you seeing any early indications that the better near-term performance is starting to positively impact the net sales outlook? And if so, what distribution channels are benefiting? And if not, which channels would you expect to come back more quickly to reflect the improved performance given your comments that the time line for decision-making has been extended?

Rob Sharps: Yes, Ken. Thank you for the question. This is Rob. With regard to the large cap growth franchise, as you note, meaningfully better performance in the second quarter and year-to-date.

With regard to whether the improved performance is translating into better flows, the direct answer is, at the margin, but it's way too early to call this a trend. Our experience suggests that performance impacts flows with a lag that for institutional buyers, the 3- and 5-year numbers are important considerations and while we have very compelling performance on a year-to-date basis and attractive performance on a 1-year basis, we do have further work to do on the 3- and 5-year numbers. In terms of what channels you might pick the early signals up or where you would expect it to improve earliest. It would be in USI Wealth and in the individual investor business. I think, again, the more sizable institutional decision-making tends to more heavily weigh 3- and 5-year. I think the pattern we would expect to see is a lessening of redemptions and then eventually a more meaningful pickup in gross sales.

If I take a step back and talk about flows broadly, it's clearly the missing ingredient. Overall, I'm feeling better about things. I think we've been very front-footed in putting ourselves in a position where we can invest against our strategic initiatives, yet kind of have an appropriate level of expense growth. For now, at least, the market has given us a lift in revenues. And we're working really hard to put ourselves in a position where we can return to organic growth.

As it stands today, the industry conditions are challenging. There is a lot of money on the sidelines. I don't think that will last forever, but it's difficult to know when it will ultimately come back. We'll need to continue to drive improved performance and ultimately, we'll need to execute against our strategic initiatives to become more central with our existing clients and to reach more clients.

My sense is if you look at historical patterns, if we execute against those things and investors come off the sidelines and begin to invest with a more long-term orientation again, we should see meaningfully less in the way of outflows in 2024 and demonstrate that we can put the company on a path back to organic growth at some point in 2025. If I look at all of the leading indicators that I'm seeing right now, it suggests to me that we're experiencing the worst of the pressure on flows, which is another way of saying I wouldn't expect the run rate in the back half of the year to be greater than what we saw in the first half of the year.

And as we work our way through '24, we think we'll see, as I say, noticeably less in the way of net outflows. But again, there are some things that have to happen in terms of the industry backdrop, in terms of our investment performance, which we're deeply focused on, and I'm encouraged by. And again, with regard to execution against all of our strategic initiatives.

Operator: Our next question comes from the line of Finian O'Shea from Wells Fargo Securities.

Finian O’Shea: A question on the active ETF launches. Can you talk about the success so far there as to the extent that they capture the outflows, say, of their sister mutual funds? And also on a high level, are you encouraged by what you're seeing? Or are there roadblocks for that strategy to gain traction?

Rob Sharps: Look, at a high level, I am encouraged by what we've been seeing more recently. I think active strategies delivered in the ETF vehicle have really started to garner more attention and interest across the industry. And we've continued to expand our lineup. Kind of we now have a broader range across equity and fixed income. And as noted, launched a series of new ETFs this quarter, we have particular early traction in the Capital Appreciation Equity ETF offering, but kind of broadly, we're getting more and more engagement and are increasingly encouraged by interest in ETFs. With regard to whether it's just cannibalizing the open-ended 40 Act business, I think there's an element of that, but I also think we're attracting a lot of new investors.

What you find is that there are certain advisers that use ETFs exclusively. And until we had an ETF lineup, we weren't able to engage or deliver our strategies to those advisers. Tim Coyne and our USI wealth broker-dealer financial advisory team have done a really good job of getting out into the marketplace and ultimately, kind of giving people a sense for our strategies and why they could be appropriate in their clients' portfolios. And we're really pleased with how they're performing. We think there's a long way to go there. It's early days. And I would say, for us, the momentum has really just started to build, frankly, kind of over the course of the last several months.

Operator: Our next question comes from the line of Dan Fannon from Jefferies.

Dan Fannon: Jen, I was hoping to expand a bit upon the expense commentary. So at or below the midpoint of this year, I assume that's based on kind of June 30 AUM levels? And then also would be curious about what kind of onetime or severance might be included in 3Q as you think about the actions that have been taken and then further, just on the commentary for next year, low single digits at this point. Does that include some of the real estate and longer-term potential cost saving thing actions that you mentioned? Or would that be above and beyond as we think about '25 and further?

Jen Dardis: Thanks, Dan, I'll try to make sure I get all of those. So first, on the midpoint of the range -- at or below the midpoint of the range, as usual, we tend to look at an average of the month as you might have noticed in this particular quarter, the markets went straight up into the end of the quarter. So we tend to look at about a 30-day rolling average just to look at what the balance might be for the balance of the year. In terms of severance, there's about $15 million to $20 million worth of severance costs that would be reflected in Q3 and we would expect for the balance of the year, if you look at how things would roll into Q4, you would have that partially offset by some of the lower salaries based on the roles that departed in July.

Just remember, as we think about how that expense guidance would roll into the end of the year, fourth quarter typically has our long-term incentive plans where new LTI plans are issued, and that tends to create a bit of a pop along with ad promo that tends to be more seasonal in the fourth quarter.

And last, as we look into next year, that low single-digit guidance, it includes much of what I just mentioned, that includes the $200 million. The real estate savings would roll in over time. I would expect that would probably be more into the late '24 or early '25 time frame. But again, we're still going through planning for the year. We just wanted to give you a general sense for where next year might land.

Rob Sharps: Yes. I'll just say a few words with regard to expense management, we're trying to take an approach that really reflects our long-term priorities. We do want to invest against our strategic initiatives and invest for growth. We want to invest in our talent and maintain our culture, and have the ability to be central to our clients and reach more clients.

In order to do that and sustain profitability in various market environments, we're going to have to be more efficient. We're going to have to be better at prioritization. We're going to have to make space to invest in and acquire new skills. So we should be able to drive additional savings through process improvement and optimization over time, but we're going to want to be able to use that to invest in our business and to put the company in a position to be successful over the long term.

Operator: Our next question comes from the line of Craig Siegenthaler from Bank of America.

Craig Siegenthaler: We're coming up on the 2-year anniversary of the Oak Hill acquisition announcement. So maybe this is a good time to provide us an update on the M&A effort and also get your thoughts on potentially acquiring another private market manager. Maybe one with a focus on real estate or infrastructure.

Rob Sharps: Yes, Craig, thank you for the question. Look, our priorities with regard to M&A typically don't change quarter-to-quarter. We are constantly evaluating opportunities to add new capabilities that we don't currently offer and that are important to our clients. We typically evaluate that relative to developing something organically. So we're evaluating strategic opportunities. It's a stated goal of ours to build our alternatives business over time. So it's natural that as opportunities present themselves in areas like real estate and infrastructure, as you suggest, that we would evaluate them.

We're only going to do things that we believe are compelling. We're only going to do things where we believe there is real cultural fit. We want to associate ourselves with investors and teams that are performance oriented, that are client focused, and that have a long-term orientation. So when those opportunities present themselves, we're going to do work and ultimately feel like -- ultimately determine whether or not we should engage and do more work and whether it's something that we might move forward with.

There isn't anything that's imminent right now, but this is an active time in the industry from a consolidation perspective. With regard to OHA, the Board and I continue to be very happy with the acquisition overall. I think the market backdrop is a little more challenging with regard to capital raising and deployment across private markets, private credit and private equity, but it's a moment in time. I'm very enthusiastic about OHA's business in the long term. They are talented investors, with solid performance, and a very strong reputation, and great client relationships. I'm also encouraged by the work that our distribution teams are doing around the globe as they've spent time learning OHA's offering, and they are beginning to bring new opportunities from our client relationships to OHA.

Last thing I'd say about this is I'm really excited about our joint BDC, where we've noted, we've secured $600 million of seed capital and are building a pipeline of intermediaries to partner with for distribution. Again, demand is muted in this space right now, but we think it's a compelling product. It's an area that we didn't serve in the past, either to T. Rowe Price or OHA, so we feel like we can have a preeminent product on those platforms when demand for the private credit BDC type vehicle comes back.

Operator: Our next question comes from the line of Glenn Schorr from Evercore.

Glenn Schorr: So I want to take a step back on the intermediary channel because it's a little bit weird time where the markets go up a lot yet, you have a bunch of outflows. So the question I have is, is the same performance drives flows on a lag basis? Is that relationship still what's driving things in here and as your performance started to improve, we should see things slow. That would be what history would say. But is it bigger than that now? Is -- are you seeing like just a massive product preference change in the channel, hence, the ETFs and SMAs that you've been putting out? Maybe you could weave in what the responsibilities of your new head of intermediate distribution might be in charge of making happen?

Rob Sharps: Yes. Glenn, it's a good question. It is an unusual moment in time. If you look at where most of the inflows have come in the industry, it's been in passive, a lot of that in ETF and in money market. People are getting yields on money market funds that they haven't had in 15 years or more. And it's an uncertain environment. I think there are a lot of investors that are on the sidelines that are waiting for the Fed to get out of the way or waiting for a more attractive buying opportunity. I'd also say that it's been a narrow market. You note that the market is up quite a bit. It's been driven by kind of a very narrow portion of the market and a small number of overall names. So there hasn't been as broad participation, as you might expect.

Look, I still believe that good performance will drive flows across vehicles. And we saw this quarter inflows into a number of strategies, including funds where performance was good. Again, I think longer term, there is a shift away from open-ended 40-Act mutual funds in favor of other vehicles. You see that in fund to trust migration in our retirement business.

And as you noted, SMA and ETF are both growing more rapidly. But we're, I think, moving quickly to offer a broader range of strategies across those vehicles. So while the trends that you note are real, in terms of a shift to SMA with lower account minimums, more customization, tax loss optimization, a shift to ETF, to some extent, a shift to thematic, a shift to passive, I think those are things that we can navigate if we leverage our, I think, best-in-class global investment platform -- global research platform across equities and fixed income, all of those are opportunities that we should be able to address that I think we've made progress in building out our shelf space and availability, and we'll make further progress with going forward.

So look, I deeply believe that there will always be a market for active management, that excellent security selection will drive value. And I think it's incumbent on us to engage with our clients to understand kind of how we can deliver that value to them. So I think there's an element of this, Glenn, that is cyclical, that is kind of where we are today and kind of ultimately you'll see behavior change and money flow back to strategies where you have very good performance. But there's also an element of it that I think is likely to be more enduring, which is why we're working hard on SMA, ETF, things like the OCREDIT BDC. We want to be more present and better represented in areas where we've been less well represented in the past, because there are some changing demand trends.

Operator: Our next question comes from the line of Brian Bedell from Deutsche Bank.

Brian Bedell: Great. If I could just dive deeper in on 2 channels. The 401(k) channel, both DCIO and recordkeeping and then maybe contrasting that with the online brokerage platform channels like, for example, at Charles Schwab is just one of them. In the 401(k) channel, we saw elevated outflows in the institutional side of your business. So I assume that's concentrating in your 401(k). Maybe if you can just talk about whether there were any lumpy either mandate losses or something that drove that in the second quarter? And then are you seeing better potential trends in the DCIO versus the recordkeeping? And then on the online brokerage platforms, are you seeing better trends there? Are there more retail focused? They may be more performance sensitive not sure if it's a big enough contribution yet, but if you can just provide some color on those.

Rob Sharps: Yes. I'll start and ask Jen to offer her perspective as well. I'll start with our retirement plan services business, or our bundled 401(k) recordkeeping business. It's a business that, overall, I would characterize as healthy. We are growing in what we call the core market, which is below the large enterprise market. We are expanding our coverage of advisers that specialize in retirement and recordkeeping for small, medium-sized businesses.

And kind of overall, I think it's a business that is executing quite well for us, where we have some challenges in -- we often have plan deconversions when there is consolidation, where you have one of those large enterprises buy a mid-cap or more medium-sized company that's one of our clients. So that's pressured that business to some extent, but we've largely been able to offset that with growth in the core market. And I feel good about our momentum there. So I'll leave that for the 401(k) recordkeeping business.

In terms of the DC investment-only or institutional defined contribution business, I'd say it's more mixed. We continue to meet with success in the retirement date franchise there, but it's an area where we were very well represented in large-cap growth. And we have had some terminations from plans as a result of performance in that channel, and that has put some pressure on flows. It's part of the reason why we've called it out. I think it's been particularly elevated or acute in the first part of this year. I don't think we're out of the woods yet with regard to that. But I think if we continue to drive performance and get back to our historical standards, eventually that will run its course.

Jen Dardis: Yes. I'd add to that. I mean, if we think about -- we've been asked previously about trends in the DC, the defined contribution investment only versus our record-keeping business. Those are both important business lines for us, and we actually see the benefits of the work that we do, representing plan sponsors in that 401(k) recordkeeping business is able to help us think about plan design, it's able to help us think about product design, and it's really helped us to stay front of mind from an innovation perspective in both our target date products and in thinking about retirement income products going forward.

Operator: Our next question comes from the line of Brennan Hawken from UBS.

Brennan Hawken: So my understanding of T. Rowe's incentive comp is that you tend to skew to longer-term performance track records on the investment professional side. So just wanted to confirm if that's right and whether or not we -- number one, like what track records or which time periods are more important and have a bigger impact? And was the better-than-expected compensation expense this quarter beginning to reflect the fact that some of the longer-term track records have begun to deteriorate? And therefore, we could expect to see some continued tailwinds on the expense side from that dynamic.

Rob Sharps: Yes, I'm not going to comment on specifically what the underlying drivers are of the compensation accrual. I will say that our approach and philosophy around incentive compensation does emphasize longer-term track records. And kind of how you define that really depends on the tenure of the investment professional. But we look not only at the current year results, but at 3, 5 and even 10-year results for long-tenured portfolio managers. So our incentives are basically designed to reflect the long-term performance for investment professionals.

But you've got to remember, we have 8,000 associates. And we have people that are doing a lot of different things in the organization. We also have a very broad range of strategies. So, kind of while we might have delivered disappointing 3- and 5-year results in certain strategies, we have other strategies where you have excellent results. So at the end of the day, as I've said before, we're really focused on -- from an expense perspective overall, making sure that we have the capacity to attract and retain world-class, diverse talent and maintain our culture. And those are the things that I think are really essential for us to be able to deliver for our clients over time and to be able to deliver for our shareholders.

Jen Dardis: I think it is worth noting, as we talked about the steps that we've been taking from an expense perspective. We had the notable announcement where we took the actions with the 2% of existing roles. But in leading up to that, we've been working for the past several months at looking how we can actually slow down and close open roles, and that will have an impact on the expense growth rate in salaries. So, trying to manage that over a period of time allows us to do that through closing open roles, not necessarily having to eliminate roles that have people in them. So you would see that flowing through in the impact of salaries.

Operator: Our next question comes from the line of Mike Brown from KBW.

Mike Brown: So Jennifer, as you noted, the market rally was particularly strong at the end of the quarter. So just wanted to see if you had any color about the exit fee rate here relative to the second quarter? And any puts and takes we should really consider here for the second half?

Jen Dardis: No. I'd say, look, if you look at our trend over the last several years, 5 plus, we've had modest fee compression rates over the past several years in the range of 1% to 2%, depending on the actions that we've been taking to lower fees across different product lines and be competitive. So I would expect that wouldn't change. Obviously, in times of market rally, you'll see a little bit of an uptick as the business mix shifts, but nothing really specific to call out that's different from trends.

Operator: Our next question comes from the line of Patrick Davitt from Autonomous.

Patrick Davitt: So T. Rowe is widely known to be one of the best places to work in asset management and you've obviously been able to maintain that strong culture and strong pay packages through the last decades-plus bull market. But history would suggest that asset managers who start cutting more aggressively start to impact the investment management process and then ultimately, performance. So after now 2, I guess, waves of layoffs in a year, how are you balancing this new restraint on expenses with the risk that you negatively impact the investment franchise?

Rob Sharps: I think I've said this now maybe the third time. Our approach here is to have a balanced -- a balance between driving efficiency overall, and that's throughout the organization, making sure that we're getting value out of all of our roles, making sure that we are a company that is dynamic and in the long term has growth opportunity in a way that will allow us to sustain our culture and have the resources to compensate and attract top diverse talent throughout the organization, but particularly in investments.

Look, our retention is very strong. I think we have a very strong culture. Our compensation is, based on all of the market data that we have, very competitive, if not compelling. I expect it will remain the case. The vast majority of the head count initiatives did not impact investments. So it seems to be something that is very much top of mind for a handful of you all, but it's not something that I particularly am overly concerned with. It's something that we're always very, very focused on.

But there's no question in my mind that we have the capacity and intent to make sure that our compensation practices are very competitive and that we have appropriate incentives in place for people throughout the organization. Again, the proof's in the pudding there, if you look at our investment professional retention, I think it's excellent. Our retention throughout the organization is quite strong. What we're doing, I think, is very consistent with what you've seen throughout the organization in almost every one of our peers. So in that way, I would say I do not think that we are an outlier.

Jen, I don't know if you'd have anything to add.

JenDardis: Yes, I think it's also important to put it in context. If we look at the last 5 years, we were coming off a period of very rapid investment in the business. We've added a number of capabilities across investments, distribution, technology, operations, and globalization of the business over the -- again, over the past 5-plus years, to the tune of increasing operating expenses over $1 billion in run rate during that time frame. So these adjustments, I think these are nice moments in time to be able to take a look, make sure that we're doing things as efficiently as we can.

And if we look at the -- particularly on the role side of things, there were 3 things we were trying to do. One was increasing efficiency in the way we work. So trying to look at processes, rebalancing work, making sure that we have -- we're doing things in the right ways with the most beneficial technology that we can. The second is just looking at a need for changing skill sets. As we look at places that Rob mentioned, new vehicles, making sure that we have our skills decked against the places where the business is going.

And then the last thing is about pivoting and reprioritizing resources against these strategic priorities that we've been talking about. So, some of this is about expense reduction. Some of this is about expense reallocation. And to help put it into context for next year, as we started the baseline work, our expense growth next year would have been somewhere in the neighborhood of 300 to 400 basis points higher from an expense growth perspective, if we were just investing in all new things in the business. So we view this, again, not only as an expense cutting exercise, but also as a reallocation to make sure we're investing in the right spot.

Rob Sharps: Yes. And just to close the loop on this. For context, the role eliminations were roundly 2% of our global workforce and impacted multiple functions. The impact across investment divisions was minimal. You talk about dozens of people over a base of between 400 and 500 portfolio managers, associate portfolio managers, investment analysts across our -- all of our investment divisions. I think it's also important to understand that we've invested very steadily over time across our base of investment professionals. And we remain very confident in the strength of our global investment platform and our ability to deliver for clients. If you look back just to the -- since the end of 2013 *(correction since the end of 2018)* to June 30 this year, our total number of investors has grown by over 25%. So if there's any sense or concern that we're not investing in our platform or taking care of our investment talent, I think it's misplaced.

Operator: Our last question comes from the line of Michael Cyprys from Morgan Stanley.

Michael Cyprys: More of a big picture question for you. AI has been getting a lot of attention and focus across the world today. Just curious how you're thinking about the potential and opportunity from AI with respect to your business? Do you see this as more of a revenue or an expense play? What sort of impact could this have on the competitive landscape for the asset management industry? Maybe you could talk a little bit about how you're experimenting with this today or how you may experiment with that in the future.

Jen Dardis: Sure. Thanks for the question. I think it's important here that I know a lot of people are talking about generative AI and the capabilities that have been rapidly evolving over the past several quarters versus machine learning AI, I'd say we've been investing behind that in certain parts of our business for some time now in our investment data insight team as an example, to make sure that we're using the benefits of machine learning in all of our processes.

Specifically with regard to generative AI, we're looking at it across 2 fronts. One is from a risk perspective, just making sure that we have appropriate safeguards in place to protect data. And that's been one of the important things that we've been focused on in the early days. And then the second piece of that, we've been establishing pilots across the business just to evaluate what the capabilities are, to make sure that we can implement generative AI in ways that will improve our ability to generate insights for clients, the ability to reach and impact new clients, and also to drive efficiency across the business.

So I'd say we're looking at pilots across our investment organization, across our distribution channels, and within our technology organization specifically to look at how we can use that to drive efficiencies. So I think the opportunities are potentially significant over time, but it's early days, and we want to do it in a way that is durable.

Rob Sharps: All right. I think that was the last question. So I'll just close by thanking everyone for joining us and for their interest and good questions. As we noted, we're encouraged by investment performance. We continue to be deeply focused on it. And I think we believe that while there are some lingering issues that will impact flows, we have a path to improvement as we work our way through 2024. We believe deeply in our corporate strategic initiatives, and I'm really encouraged by the dedication and commitment of our associates and their focus on delivering for our clients. So thank you.

Operator: This concludes today's conference call. Thank you for participating. You may now disconnect.