

Rathbone Ethical Bond Fund

Update, August 2018

Overview

Ten-year gilt yields started the month at 1.33% and took a tumble to a low of 1.22% during the month, despite the Bank of England hiking interest rates to 0.75%. They finished August with a jump to 1.43% as the 10-year benchmark rolled over into a new bond.

UK industrial production easily outdid expectations, rising 1.1% in June compared with a year earlier. Inflation came in 10 basis points higher at 2.5%, right on analysts' forecasts. But the big surprise was retail sales growth, which posted a third consecutive strong month. Britons bought 3.5% more at the shops in July compared with a year earlier, easily eclipsing the 3% expected. Everything else has stayed relatively stable, especially considering the general Brexit fog. At one point, trade-weighted sterling had slumped 1.3% over the month, but it shot up as the month closed out to end effectively flat.

In the US, economic data continued its strong run. Small business optimism is at multi-decade highs, retail sales growth is north of 6% and personal income growth is running at roughly 5%. Trade talks continued throughout the month, with a deal struck between Mexico and the US. The concessions demanded to play with America seem too great for Canada, however. The talks are continuing, but it feels half-hearted. Both sides have heavily entrenched and coddled agricultural lobbies that make a deal pretty unlikely. As odd as it sounds, NAFTA – the vehicle of the North American boom of the 1990s and 2000s – is about to die with little more than a murmur.

One place where the mood has been a bit more feverish is emerging markets. For a while now, talking heads have been banging the drum about a dollar liquidity squeeze. Effectively, as the US Federal Reserve tightens rates, the better returns suck money out of higher-risk markets back to the safe haven of the US. We felt most developing markets were less susceptible to this risk than in the past. Some – like Argentina, Turkey and South Africa – were vulnerable and have been hit hard recently, but overall we thought many other nations should weather the storm relatively well. Of course sometimes the story itself is enough to start a stampede of investors that creates a self-fulfilling prophecy. Especially in today's increasingly passive world.

Trades

August was a quiet month for issuance. We added to a few of our existing holdings, mostly in financials. We sold the **Close Brothers Finance 2.75% 2026** because we felt its price had risen above its fair value.

Outlook

We still believe that US interest rates will rise steadily from here. Federal Reserve Chair Jay Powell has been pretty straight-up about his path. As long as the US's vital signs are strong, the central bank will continue to prudently normalise rates. And not just for the sake of it, but to ensure that the massive fiscal sugar rush unleashed by the government doesn't overheat the economy and lead to excessive inflation. US CPI has stepped up markedly this year to 2.9%, probably helped on its way by a significant fall in the dollar during 2017. In recent months, the dollar has surged upward, but it's still well off its peak. There could be a small rise in the UK too, but that's completely Brexit dependent. Markets seem to be priced for nothing less than a no-deal Brexit. Anything better than that could mean a rebound in sterling and a substantial repricing of risk in the UK. That goes for everything from property to stocks and bonds.

If Brexit turns out to be effectively in name only, the Bank of England may sneak in another rate hike during the relief rally that would be likely to sweep through the UK.

As September winds up, the new issuance season is getting underway. We're on the lookout for some new opportunities to put your cash to work.



Bryn Jones
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