

Rathbone Ethical Bond Fund

Update, September 2018

Overview

Ten-year gilt yields started the month at 1.43% and finished at 1.57%. Post-month end, they shot even higher to 1.70% after unexpectedly strong US jobs data sent the 10-year US Treasury soaring to 3.20%.

US economic data have been on a good run lately. Second-quarter GDP growth was an annualised 4.2%, PMIs were strong, particularly manufacturing, and consumer confidence increased from already elevated levels. Real wages were 0.5% higher than a year earlier, and inflation moderated more than expected to 2.7% from 2.9% the previous month. All of this led the Federal Reserve (Fed) to push ahead with its third 25bps interest rate hike of the year toward the end of September. There's a good chance that the Fed will add another in December, which would cement a much swifter tightening schedule than 2017.

The UK's macro numbers have been pretty constructive as well. Second-quarter GDP growth bounced back to 0.4%, or an annualised 1.2%. Consumer confidence remains a bit indifferent, but August retail sales were 3.4% higher than a year earlier. Inflation spiked unexpectedly to 2.7% – most economists had forecast a 10bps fall to 2.4%. This rise supports our decision to remain underweight duration. When inflation rises, bond yields tend to increase in line, which reduces the value of the bonds.

Trades

We have been reducing our floating rate notes and lower-yielding senior bank bonds in favour of the **Rothsay Life 6.875% Perpetual-28** and **Prudential 6.25% 2068** new issues. We felt the new bonds offer better yields.

Some great news came through for the fund last week. The portfolio's largest holding, **Standard Life 6¾% 2027**, will be bought back by the issuer at 50 over. We had been angling for this for a while, and it has now borne fruit.

We've been adding to some existing names that have dipped recently, but looked good value on our screens: the **AXA 5.43% Subordinated Perpetual-26** and the **WODS Transmission 3.446% 2034**.

Outlook

It's been a pretty punchy few weeks for interest rates. More US rate hikes are pencilled in over the coming six months, so this excitement is likely to linger.

Also hanging around is the bad smell caused by the new radical Italian coalition government. It's playing chicken with the EU over its first Budget and rattling Italian bond markets. The effects are mostly contained in the country, but big moves are creating small spill-overs into the wider European debt market. Meanwhile, all is not well in the UK retail space. Despite relatively strong UK retail sales growth, several stores have run into trouble lately. John Lewis's profits virtually vanished overnight and House of Fraser has been shuttering stores across the country in a bid to stay alive.

Quantitative tightening is well and truly underway, and it feels a lot like the effects are now starting to feed through to the economy and debt markets. Monetary policy takes a good few months – and sometimes years – to be felt in the real economy. For about a year now, the Fed has been reducing the huge stack of

bonds it bought up after the global financial crisis. And recently the European Central Bank has lessened the number of bond purchases it makes for its QE programme.

Brexit looms large, as much as we are all sick of hearing all the squabbling about it. One day – probably close to or soon after the 29 March deadline – a decision will be made. When it comes it will create waves in the currency markets, which will have big consequences for bond investors. So as dull and mind numbing as the back and forth of negotiations can be, we're stapling our eyes open to ensure we're as prepared as we can be.



Bryn Jones
Fund Manager



Noelle Cazalis
Assistant Fund Manager

This is a financial promotion relating to a particular fund. Any views and opinions are those of the investment manager, and coverage of any assets held must be taken in context of the constitution of the fund and in no way reflect an investment recommendation. Past performance should not be seen as an indication of future performance. The value of investments may go down as well as up and you may not get back your original investment.

The information contained in this note is for use by investment advisers and journalists and must not be circulated to private clients or to the general public. Source performance data, Financial Express, bid to bid, net income re-invested.