

Rathbone Ethical Bond Fund

Update, January 2019

Overview

Ten-year gilt yields fell over the month, from 1.28% to 1.22%. Despite this fall, likely driven by lower inflation and growth in the UK, credit spreads tightened considerably as well. Equities, corporate debt and emerging markets all shot higher as investors swung from despair to optimism.

In short, investors sold risky assets so aggressively at the turn of 2019 that the market implied a strong possibility of recession in 2019. Economic data never really worsened enough to justify this belief, however. In the end, investors decided to jump back on the market bandwagon and indices shot higher. This was no doubt helped by an about-turn by the US Federal Reserve (Fed). The central bank ended January by implying that it may in fact *cut* interest rates this year, rather than increase them from their 2.25-2.50% level. Many have taken this message at face value, with derivative prices showing no expected Fed hikes for the next 12 months. The Fed's position was no doubt reinforced by US inflation continuing to fall, hitting 1.6% in January. However, the drop in CPI has mainly been the effect of lower petrol prices – core inflation (stripping out fuel and food) has been steady at 2.2% for five of the past six months. Central banks tend to ignore fluctuations in petrol prices, where possible, because it's not something they can control. Whether the Fed is simply trying to support the stock market or has seen some nasty, not-yet-public data in the pipeline is anyone's guess.

We stuck to our guns throughout the turmoil of the start of the year and benefited from the market bounce as the month wore on. As we've said many times before, this is classic Tom and Jerry markets: you've got to scurry around to pick up return on offer without getting walloped by sentiment turning conclusively against you.

Trades

When markets shot lower early in the month we took the chance to buy more senior credit in our favoured names: **Principality Building Society 2.375% Senior 2023**, **Coventry Building Society 1.875% 2023** and **Citigroup 2.75% 2024**.

We used the rally in corporate credit at the tail-end of January to cut our holdings in some of our higher-risk bonds, as well as those that we have cooled on over the past few months. These included the **TSB Banking Group 5.75% Floating Rate Note LT 2 2026-21**, **Metro Bank 5.5% 2028**, **John Lewis 4.25% 2034** and the **Intermediate Capital Group 5% 2023**.

We also added to bonds that have a high chance of being called early, such as the **Rothschild Continuation Finance 9% Variable Subordinated Perpetual-2024** and the **Rabobank Capital Funding (4) 5.556% Variable Perpetual-2019**.

Outlook

Worrywarts have a smorgasbord to feast on at the moment: the US and China keep battering each other over trade, the Fed is quickly eroding its credibility, Chinese growth is running low on steam and Europe is tottering because of it, and American households aren't quite the red-hot item they were in 2018. And then there's Brexit. Interminable Brexit.

Despite all this, sterling credit has held up well. Partly due to a lack of new debt being issued and partly because of strong UK company balance sheets. As for the pound itself, everything seems to be about Brexit. With one eye on the March Brexit deadline, we've been using the recent rally to cut back on some of the riskier areas of the portfolio.



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