Rathbone Unit Trust Management
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Rathbones
Look forward

Rathbone SICAV Ethical Bond Fund

Update, January 2020

Overview

Bond prices s surged in January over coronavirus-related global growth fears, sending yields tumbling. Yields on 10-year UK gilts started the month at 0.82%, falling to 0.52% by the end and 10-year US Treasury yields fell from 1.92% down to 1.51%. The outbreak really took hold in January, sharply shifting investors' focus away from any underlying US/Iran tensions. The virus weighed heavily on business sentiment and economists cut their growth forecasts; the longer the outbreak continues, the greater the disruption to economic activity.

The UK wasn't off to a great start anyway. Desperate UK retail sales of -0.9% (in November and December combined, to iron out Black Friday distortions) and stagnant annual growth lead to markets pricing in a 70% chance of a January rate cut. CPI inflation rose to 1.8% in January, up from 1.4% the previous month. A poor set of PMIs (business activity and confidence indices) could have pushed the Bank of England (BoE) into a rate cut, but in the end we saw a reasonable jump in the services PMI from 50 to 52.9, and manufacturing from 47.5 to 49.8, just shy of the 50 threshold that theoretically divides contraction from expansion. Outgoing BoE Governor Mark Carney decided against a parting gift and kept UK rates on hold.

Data was mixed in the US. The manufacturing ISM jumped to 50.9 in January from 47.8 in December, beating market expectations of 48.5. This was the first signal of expansion in factory activity for six months, with strong new orders and a slowing fall in employment helping nudge the index higher.

However, the flash estimate for the February composite PMI (services and manufacturing) showed a slowing pace of overall activity, falling from 52.4 to 51.7. The services component enjoyed a solid increase from 52.8 to 53.2 , a 10-month high, but this was offset by waning activity in the manufacturing sector, which slowed to an estimated 51.7.

Yet durable goods orders were strong at 2.4% versus 0.3% expected. This was the biggest increase since August of 2018, mostly due to a surge in military orders after Congress approved a higher budget for military spending. As broadly expected, the US Federal Reserve kept rates on hold at the end of the month.

Trades

As the fund continues to grow, we added to existing positions, while continuing to look for additional investment opportunities.

Collapsing gilt yields at the end of the month lead us to sell long-duration (high rate sensitivity) **European Investment Bank** debt. We used the funds to buy into a couple of new issues and some senior (higher in the capital structure and therefore relatively safer) bank debt.

We also holdings in a European 'green' issuer, the commercial real estate group **CPI**, and the logistics business **Logicor**, which should continue to play an integral role in adapting to changing consumption habits. We're all ordering more online which requires delivery distribution centres, not to mention very large boxes.

Outlook

The known unknown of the Coronavirus is at the forefront of investors' minds. Economic growth will be dampened, but we don't yet know by how much and for how long. We've already seen Chinese car sales for February down 90% and property sales in China have fallen off a cliff. How quickly is that likely to reverse?

We've had a lot of stimulus in China and the credit impulse had picked up prior to the outbreak. Historically, that leads to an increase in global growth. So, if the authorities inject more liquidity and manage to control the virus, then global growth could pick up.

Back home, the upcoming budget under the new Chancellor could put some pressure on gilt prices if plans for government borrowing are ramped up, adding more supply of gilts to the market. We've remained underweight duration given the risk. Gilts would be put under more pressure if plans for infrastructure spending and other fiscal stimulus measures lead to higher growth and inflation.

Strong demand for corporate bonds has pushed credit spreads (the additional yield you get from taking on the added risk of investing in corporate debt versus government bonds) to their lowest levels since the global financial crisis. With little new issuance in sterling debt markets, this adds to the imbalance in supply and demand, putting upward pressure on prices. There seems to be quite a lot of confidence in the future, despite the reasonable chance of disappointment in economics and individual company results. We're not expecting recession in the foreseeable future, but we reckon there could be a few stumbles and shocks. Meanwhile, we will look for opportunities to add to our holdings at more attractive yields.

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Source performance data, Financial Express, mid to mid, net income re-invested.

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