

Rathbone SICAV Ethical Bond Fund

Update, February 2020

Overview

You won't need us to tell you that markets are being swept along by the Covid-19 pandemic right now. When the rapids will settle down – and what the world will look like afterwards – is anyone's guess right now. As the virus spread rapidly to scores of countries in February, investors took fright. Over February, the 10-year gilt sank from 0.53% to 0.45%.

Following month-end, the benchmark yield fell further to 0.16%. After the UK government unveiled a truly astonishing amount of stimulus worth roughly 15% of GDP, the yield has spiked to 0.70%. Corporate bonds have been particularly pressured, with liquidity nonexistent in many cases – even for bonds issued by solid companies and which are backed by strong assets. The traders just aren't there to buy what others are selling. This is leading government bonds to sell off as people sell the most liquid assets on their books in order to meet liabilities.

In short, it seems a lot of leveraged speculators are getting squeezed into selling at any price, which is showing some heavy falls in credit markets. This has been exacerbated – or perhaps driven – by the meltdown of fixed income exchange-traded funds (ETFs). Many of these passive portfolios are trading at 4-8% discounts to their underlying investments because of their inability to redeem investors without fire-selling their assets.

Thankfully, this isn't us. We have a good pot of cash that we can use to ensure the daily liquidity of our fund. We have sold some ultra-quality AAA floating rate corporate bonds to raise yet more cash as well. There are some truly ridiculous prices getting bandied about for credit risk at the moment. Soon, we hope to start buying up some bargains. However, for now, we believe it's best to shore up our fund and remain relatively defensive.

So far, we haven't fared too badly. We had reduced our exposure to risk before the abrupt falls. We have been – and remain – short duration (relatively insensitive to moves in government bond yields). Fortunately, we recently cut some of our credit risk because we felt prices had got pretty full. We had kept the proceeds in cash or close to it. About 20% of our fund is in cash or bonds that can easily be sold without discounts, so we believe we should be able to weather the storm. In fact, we would like to invest that pool, as we see some great opportunities to deliver for our investors over the next three to five years. That time is not quite yet, but we are monitoring an extensive shopping list for when the moment comes.

Trades

With markets looking so choppy we have focused on ensuring we have enough liquidity in our portfolio to react to opportunities as they arise.

In mid-February we sold some of our credit, including **Rothesay Life 6.875% Perpetual-2028**, **Nationwide Building Society 5.875% Floating Rate Perpetual 2024**, **Phoenix Group 5.75% Perpetual-2028** and **MORhomes 3.4% Senior Secured 2040**. At the beginning of the sell-off, towards the end of the month, we sold the German-state-backed development bank **Kreditanstalt fuer Wiederaufbau 5.75% 2032** and the **European Investment Bank 5.625% Senior 2032**.

Outlook

The path for markets over the coming weeks and months is hard to call. The credit spread (extra interest over government yields to justify risk of default) has blown out in the past few weeks. European

investment grade spreads have almost doubled to 170bps. European yield spreads peaked about 640bps in the first half of March and could yet go higher.

Central banks have unleashed a truly gargantuan amount of stimulus. The US Federal Reserve has slashed interest rates by 1.5 percentage points, unleashed \$700bn of quantitative easing and flooded other funding markets with hundreds more billions of dollars in an effort to keep the markets functioning. For now, it seems to be working.

Meanwhile, governments in Asia, Europe and the UK have unveiled huge fiscal support too. The UK plans to shore up everyone from companies to gig workers for months. Mortgage payments, business credit lines, foregone taxes and everything in between to the tune of £350bn. Some households and businesses face a cash flow crisis, others should be able to do really well – a friend of mine running a frozen foods business says orders have rocketed 80%, yet they are worried about being able to deliver. Supply chains are difficult and many workers are going into lockdown.

This is an unprecedented situation in modern times. Thankfully, governments and central bankers appear to have learned past lessons well. They have stepped up to the plate and swung with everything they have. With a bit of faith, calm heads and shared sacrifices (no more pubs or concerts for the foreseeable), we believe we can all get through this.



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When operating in the EEA, Rathbone Unit Trust Management works in partnership with a tied agent. In Europe we market our funds through Rathbone Funds Advisers, Unipessoal Lda. (“Rathbone Funds Advisers”) a company acting as a tied agent to Carne Global Financial Services (Europe), Unipessoal Lda. (“Carne Global”) which is an investment advisory firm authorised under MiFID II and supervised by the Portuguese Securities Market Commission - the CMVM (Comissão do Mercado de Valores Mobiliários). Rathbone Funds Advisers is registered in Portugal and has been appointed by Carne Global to provide investment advisory services on its behalf in relation to financial instruments, in particular units or shares in undertakings for collective investments.

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