

Rathbone SICAV Ethical Bond Fund

Monthly update November 2020

Once. Twice. Three times a vaccine. A raft of highly viable inoculations were announced in November, helping drive stock markets and corporate bond markets higher.

The prospect of widespread inoculation is like a shaft of light in the darkness of a very long year. The announcement of Joe Biden as President-Elect was another boost, as many investors decided they liked the idea of a more experienced hand on the tiller, especially if control of Congress remains split between Democrats and Republicans. A split Congress would keep the more radical wing of the Democratic Party in check, it's thought. To be honest, the Democrats seem a more raucous caucus than their opponents, and less likely to vote as a bloc. They have many different camps that may scupper overly radical reforms even if they do win the two Georgian Senate run-off races in early January and take control of both chambers. Why does American politics matter for a UK fund? Because that sets the tone for US markets and they set the tone for the rest of the world's markets.

And so, this whirlwind of news pushed the 10-year gilt yield much higher (because the price fell) during the month as many investors sold safer government bonds so they could buy riskier assets that offer the chance for greater returns (like stocks and corporate debt). Starting at 0.27%, the 10-year gilt yield got as high as 0.43% on the initial vaccine/election rally. As the month progressed, this reversed as optimism was tempered somewhat by the continued rapid spread of the virus. The 10-year yield finished the month at 0.31%.

For our part, we were surprised by the strength of the rally. It was common knowledge that several promising vaccines would be releasing final-stage test data sometime between November and February; more are yet to report, too. The market reaction seemed disproportionate, so we took advantage of the spike in yields to get buying in areas that we have avoided or kept only small holdings in because we thought prices were too steep. Namely, longer-dated safer government or quasi-government bonds and high-quality corporate bonds that are more sensitive to changes in yields/interest rates. We don't invest in gilts because of the government's involvement in arms deals, so we use sterling-denominated supranational (quasi-government) bonds as an ethical proxy. So when yields spiked we bought supranational **European Investment Bank 5.625% 2032** and Danish renewable energy giant **Orsted 4.875% Senior 2032**.

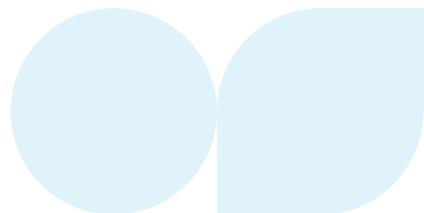
Another 'duration' trade (buying safer, longer-dated bonds that are more sensitive to changes in yields/interest rates) we made in November was purchasing the **Queensland Treasury 1.25% 2031**. Issued by the Australian territory, these high-quality government bonds offer a better yield than sterling issues, even after paying to lock in the Australian dollars to a set sterling exchange rate. This protects us from making losses if the pound strengthens against the Aussie dollar – it also means we won't gain if sterling falls.

We did a lot of steady buying across our portfolio in November, as money flowed in from new investors. Much of this cash went into buying more of the bonds that we already hold. Some examples include pensions insurer **Rothesay Life 3.375% Tier 3 2026** and Virgin Money bank holding company **CYBG 4.0% Floating Rate Senior 2026**.

Some of the cash went into the first green bond issued by a UK Real Estate Investment Trust (REIT): **Tritax Big Box REIT 1.5% Senior 2033**. Logistics warehouse company Tritax raised the £250 million from numerous investors to help pay for its pipeline of developments that should be built as best-in-class, sustainable, net-zero-carbon buildings. By using a green bond, the company gets a lower interest rate on its debt. Meanwhile, investors get lower risks from climate change and future regulation of carbon to meet national targets, while the nation gets more sustainable distribution networks. We believe ecommerce will only increase from here, so ensuring the delivery infrastructure behind that is environmentally conscious is extremely important.

We also added some bonds that we think should continue to perform well due to greater flexible working that's set to bed in once the pandemic is over. These included the sterling-denominated **Verizon Communications 1.125% Senior 2028** issued by the American telco giant.

We bought the retirement and insurance company **Just Group's JRP Group 9% 2026** because we think the company is solid and under-researched. This meant we could buy the bonds at an attractive price.



We sold some of the pandemic response bonds that we bought from issue several months ago. These included the **New Development Bank 0.625% Senior 2023, UNEDIC 0.25% 2029** and **Inter-America Development Bank 0.875% 2025**. We willingly stepped up to give these organisations the money they needed to help fight the pandemic itself and the fallout from it. We sold the bonds to other investors because the price had risen to the point where we felt it was prudent to take profits. Our sales don't affect the financing of these projects – they still have the cash and indeed are deploying it to help people in poorer nations all round the world.

As we approach the end of the year, the Brexit trade negotiations remain unresolved. We're used to the EU and UK leaving things to the last minute, but this is cutting it very fine indeed. Companies have to implement whatever they decide and now have less than a month to do so. Rumours are that a deal is in the offing, but we've heard that before. If a deal is signed, we will probably see a rise in sterling. If a deal falls through, we'll probably see a larger fall in the currency, given how it's strengthened somewhat over the final quarter of the year.

Bond yields – both for governments and companies – remain extremely low. Credit spreads, the extra return you get on corporate bonds to account for the risk of default, seem to grind lower every week. This is odd, given we're in the midst of a pandemic. However, it shows the optimism brewing among investors because they think vaccines considerably improve the outlook for 2021. And there is the prospect of less erratic US governance, and the belief that Western governments and central banks stand ready to spend yet more cash to prop up economies and markets should anything go further awry.

We've talked about this before, but it doesn't hurt to reiterate: we are trying to be as flexible as we can with our portfolio. We're trying to stay invested and ensure we get good returns for you, but we're also aware that, right now, the market is prone to turn sharper than a rhino on ice skates. We want to ensure that we aren't rooted in place if that happens. Because if we find ourselves in the path of the market, unable to move, it would be extremely painful for our investors.

So we are carefully selling some of our 'safer' government and quasi-government bonds when markets become worried and their prices rise. At the same time we use the cash from those sales to add carefully to our 'riskier' corporate bonds where prices have fallen. And then when markets get excited we sell our riskier assets and buy the safer stuff. This probably sounds basic: buy low, sell high – that's the game! But it takes a bit of discipline and the nous to know when to wait and avoid that pirouetting Rhino bearing down on you.



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