Rathbone Unit Trust Management

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Rathbones
Look forward

Rathbone Strategic Bond Fund

Quarterly update June 2021

Government bond markets have clawed back some of the big yield rises of early 2021.

The yield on US 10-year Treasuries fell from 1.74% on 31 March to reach 1.47% by quarter-end. Likewise, the yield on 10-year gilts nudged down to 0.72% after rising sharply to 0.85% in the preceding quarter (when yields fall, bond prices rise).

Credit markets benefited from the falling yield trend. Credit spreads – the extra return above government bond yields for taking on the risk of default – narrowed, with the iTraxx Crossover European high yield spread index ending the quarter at 232 basis points, down from 253 bps at the end of March.

	3 months	6 months	1 year	3 years	5 years
Rathbone Strategic Bond Fund	2.10%	0.88%	7.86%	14.46%	26.89%
IA Sterling Strategic Bond Sector	1.82%	0.56%	6.13%	16.02%	24.36%

	30 Jun 20-30 Jun 21	30 Jun 19-30 Jun 20	30 Jun 18-30 Jun 19	30 Jun 17-30 Jun 18	30 Jun 16-30 Jun 17
Rathbone Strategic Bond Fund	7.86%	2.83%	3.20%	1.91%	8.79%
IA Sterling Strategic Bond Sector	6.13%	3.79%	5.33%	0.33%	6.85%

Source: FE Analytics; data to 30 June, I-class, mid price to mid price.

These figures refer to past performance, which isn't a reliable indicator of future returns.

Bond markets stay (mostly) steady

The economic recovery from COVID-19 gathered considerable pace in the second quarter, while also broadening out to more countries and economic sectors.

It's estimated that US GDP may have grown by a blistering 9% annualised over the quarter as its economy continued to roar back to life. At the same time, the UK, Europe and Japan appeared to be starting to join in the big post-pandemic growth rebound.

As growth has picked up, inflation rates have been rising too. The US leads the way, with its 5% inflation rate the highest level since August 2008. Concerns over higher inflation generally coincide with higher bond yields. As a proxy for interest rates, bond yields tend to price in the expectation of interest rate hikes when inflation hots up. But recently bond yields have proved surprisingly steady (bar the odd few bouts of skittishness). The yield on 10-year US Treasuries settled into a narrowish range below 1.50% during the quarter, significantly below their yearly peak of 1.78% amid inflation collywobbles in February and March. The yield has fallen even as inflation data continues to hot up. Bond investors seem to be accepting the US Federal Reserve's (Fed) oft-repeated insistence that the current inflation spike is going to prove "transitory".

At its June policy-setting meeting, the Fed acknowledged that inflation and growth were coming in higher than it had expected. But it also stressed that it wanted to see clearer evidence of a firm jobs recovery before reining in its super-supportive policies. The recovery in US jobs has proved somewhat sluggish. June's payrolls report was a bit mixed. While more than 850,000 jobs were created (more than had been expected), the overall unemployment rate rose to 5.9% versus the previous month's 5.6%.

The Fed may remain patient about pencilling in interest rate rises until it sees substantial progress in repairing pandemic-inflicted labour market damage. But in June's meeting the Fed acknowledged that it's gearing up to kick off discussion on when to slow the pace of its quantitative easing (QE) bond purchases. This would be a first step in reining in its easy policies as QE helps keep a lid on bond yields.

For now, bond investors seem to be accepting that we're in a 'wait-and-see' world and it's just too early to tell whether the recovery rebound (and attendant inflationary pressures) will begin to ease back a bit or whether they'll stay on the boil. Whatever happens, bond investors appear more confident about the Fed's insistence that any eventual policy tightening is going to be slow, gradual, and signalled well ahead of time.

Against this outwardly calm backdrop, we've stayed focused on adding to bonds that we believe will benefit our fund's long-term return and income potential. We've allowed a little cash to build up so that we can swiftly put it to work when we find particularly compelling opportunities.

We've also been paring back our exposure to some longer-dated bonds. The prices of these long-duration assets are most sensitive to changes in yields/interest rates and may prove most vulnerable if more prolonged bouts of market volatility start to break out.

Adding to financials via floating rate notes

As has been the case since last year, we like many bonds issued by banks, insurers and other financial providers, like specialist lenders and investment firms. Many are thriving, well-capitalised businesses that should do well as economic healing continues. When economies are growing at a healthy clip, financials' earnings and profits tend to follow suit.

Over the quarter, we bought sterling-denominated floating rate notes issued by **Australia and New Zealand Banking Group** (usually known as **ANZ**) **1.809% LT2 2031**, as well as the euro-denominated **Credit Agricole 1.874% Floating Rate LT2 2020**. As their name suggests, floating rate notes are bonds whose coupons adjust as interest rates/yields move so their prices are less sensitive to higher rates/yields than traditional bonds. We think they offer attractive protection against the risk of capital erosion in a more uncertain rate/yield environment.

Rejigging global exposure

Many emerging market (EM) bonds had a challenging start to the year, in part due to concerns about their vaccination programmes. Since then, some of these bonds have performed strongly as investors have grown more confident about vaccination rollouts in the developing world and the reopening of global trade networks. Given this strong performance, we decided to rejig some of our EM exposure. In June, we sold the **Ashmore Emerging Markets Short Duration Fund** and bought the **Eaton Vance Emerging Markets Debt Opportunities Fund**.

We added to our holding in the **iShares China CNY Bond ETF**, which is invested in Chinese government and policy bank bonds (the latter are issued by government-controlled institutions that lend to official projects). The ETF provides an accessible way to gain exposure to these bonds, which are now included in one of the world's most important global bond indices. China is a highly rated sovereign and these bonds offer an attractive yield relative to high-quality alternatives.

Adding new strategies

We continue to seek out compelling 'best ideas' fixed income strategies with good track records. In May, we bought the **Raymond James Reams Unconstrained Bond** and the **Sturdza Strategic Bond Opportunities** funds. We financed these purchases by selling some existing exposure, including the **Pareto Nordic Corporate Bond Fund**.

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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 and the income from them may go down as well as up and you may not get back your original investment.

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