

# Rathbone SICAV Ethical Bond Fund

## Monthly update January 2022

Big central banks are showing greater urgency in their shift towards tighter monetary policy as they harden their stance on inflation.

Investors have scrambled to adjust to the new policy regime, sending government debt prices tumbling as investors sold these bonds whose low fixed returns look unattractive when inflation and/or interest rates are higher. The yield on US 10-year Treasuries (which moves in the opposite direction to prices) shot higher: it began the month at 1.51% and ended it at 1.78%. The yield on 10-year gilts also surged, rising from 0.97% to 1.31%.

It was an exceptionally volatile month in credit markets. Credit spreads – the extra return above government bond yields for taking on default risks – widened significantly amid worries that the higher borrowing costs that tighter policy brings may hurt borrowers' ability to repay their debts. The iTraxx Crossover began the month at 242 basis points (bps) and had widened to 288 bps by its end.

### Central banks harden their stance

This year has certainly got off to a tumultuous start. Investors have grown increasingly unnerved by the prospect of much more hawkish central bank policy than they'd expected and have rushed to try to price in aggressive interest rate-hiking and the reversal of big bond buying programmes. The US Federal Reserve (Fed) has opened the door to a rapid cycle of rate rises, with the first hike expected in March. The Bank of England (BoE) opted for a back-to-back 0.25% rate rise at the start of this month as expected; however, the revelation that four of the nine-strong committee wanted a 0.50% hike put the wind up many. Meanwhile BoE Governor Andrew Bailey's calls for workers not to ask for higher wages as they struggle to afford rising prices led to uncomfortable tabloid headlines about the "Plank of England"! The very same day that the BoE hiked, the European Central Bank signalled a hawkish policy pivot by refusing to rule out a rate rise this year.

Investors' big worry is that central bank efforts to bring down inflation will also slow demand, which, in turn, risks a policy-induced slowdown. This dynamic is causing the yield curve to flatten (the difference between yields of shorter and longer maturity bonds has decreased). In part, this is because investors seem to think tighter policy will prove too much to handle and central banks will be forced to cut rates again in the longer term. And it has increased strains in risk markets more broadly: many of the world's biggest equity markets had an awful January and their 'risk-off' mood has spilled over into corporate bond markets.

We expect yields to keep grinding higher for a while. But we think that investors are getting way ahead of themselves in terms of the number of rate hikes they're anticipating – Bank of America expects a whopping seven Fed hikes this year! In addition, growth is still powering ahead: US GDP grew by an annualised 6.9% in the last three months of 2021 despite the significant headwinds posed by Omicron, price inflation and supply-chain snarl-ups. And the jobs market is in rude health too. All this suggests that the global economy is not about to topple into a recession, forcing a big policy reversal.

### Keeping duration down and dialling down risk

Amid all this upheaval, we're sticking with our decision to dial down our duration (the sensitivity of a bond's value to changes in prevailing interest rates). Because we think the yield curve has probably flattened too much, the prices of some longer-duration bonds are looking a bit precipitous. As a result, we've continued to sell some of our longer-dated debt, including the **Metropolitan Housing Trust 1.875% Senior Secured 2036** bonds.

We still like bonds issued by select banks, insurers, building societies and investment firms that we believe will hold up well if life gets more difficult because they're well capitalised and manage their risk exposure carefully. But we've opted to pare back some of our financial bonds that rank lower down their issuers' capital structures (if the issuer were to default, these 'junior' or 'subordinated' bonds would be paid back only after the 'senior' bond holders had been repaid, so are higher risk). For example, we sold specialist insurer **Rothsay Life 6.875% Subordinated Perpetual-2028** bonds. We also sold **Coventry Building Society 6.875% Perpetual-2024** bonds.

Because we think bond markets will stay volatile for a while, we're holding on to some of the cash we have raised from sales like these until rates and spreads settle down a bit. But we're putting some to work by buying bonds that we think offer particularly compelling opportunities. When credit spreads were tighter, we felt that some of the new bonds being issued looked overly expensive. Because prices fell as spreads widened, we bought some newly issued bonds that we felt offered good value. For example, we bought the **Lloyds Banking Group 2% 2028** and **Santander UK 2.421% Senior 2029** bonds.

### Adding to housing association bonds

We snapped up the first ever bond linked explicitly to hard social and environmental targets that has been issued by a housing association. **London & Quadrant 2% Sustainability-Linked 2032** bonds are directly structured around achieving a set of ambitious social and environmental targets (like reducing its carbon emissions, improving the energy efficiency of its tenants')

homes and delivering new affordable housing). We expect to see more housing associations issuing bonds like these as they look to improve the energy efficiency of their existing housing stock.

In addition, we bought bonds issued by a couple of other housing associations that we believe are underpinned by strong fundamentals. We bought **Places for People 2.5% Senior 2036** bonds. Places for People is one of the UK's largest housing associations and its credit rating has benefited in the past from its decision to sharpen its focus on its core social housing lettings business. We also bought Southern England housing group **A2 Dominion 3.5% 2028** bonds.

Housing associations are carefully regulated and, as non-profit-making charitable organisations, they tend to be pretty risk-averse. As a result, we believe that investing in select long-duration housing association bonds can give us access to stable and secure cash flows far out into the future. In addition, we like housing associations' ethical credentials: they provide good quality homes for people with low incomes or special needs. And they're trying to address the UK's acute shortage of affordable housing by building new homes to rent and shared ownership properties.

### And finally...

The big bond market moves we've been seeing reflect investors' attempts to price in the impact of a new monetary policy regime before it's actually happened. We don't yet know exactly what policymakers are planning and how it will impact on financial markets or the 'real' economy (actual businesses and consumers).

For these reasons, we are continuing to favour investments in businesses and enterprises that look in good shape and which we expect to stay profitable and solvent.



**Bryn Jones**  
Fund Manager



**Noelle Cazalis**  
Fund Manager



**Stuart Chilvers**  
Assistant Fund Manager

Rathbone Funds Advisers, Unipessoal Lda. (or Rathbone Funds Advisers) is a company acting as a tied agent to Carne Global Financial Services (Europe), Unipessoal Lda. (or CGFSE). CGFSE is a MiFID II non-independent investment advisor. As a non-independent investment advisor, it will provide you recommendations only in relation to financial instruments issued or provided by entities having close links with it, such as a company belonging to the Carne Group, or by entities having legal or economic relationships with CGFSE, such as third-party fund managers or placement agents. CGFSE has contractual relationships with different third-party fund managers and placement agents, including issuers or providers of financial instruments that CGFSE may recommend to you, whereby it receives information on those financial instruments and on-going cash fees from them. This enables CGFSE to enhance the quality of its service, by considering in its analyses a wider range of financial instruments and providing you with additional services, such as assessing the continuing suitability of the financial instruments in recommended in which you have invested. CGFSE has received cash fees which it can disclose immediately upon request.

CGFSE is supervised by CMVM (Comissão do Mercado de Valores Mobiliários). Rathbone Funds Advisers is registered in Portugal and has been appointed by CGFSE to provide investment advisory services on its behalf in relation to financial instruments, in particular units or shares in undertakings for collective investments.

**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.**

This fund is actively managed. This is a marketing communication. Please refer to the prospectus of the UCITS and the KIID before making any final investment decisions.

Please note that the Rathbone Luxembourg SICAV may decide to terminate the agreements made for the marketing of the fund pursuant to Article 93a of Directive 2009/65/EC. For a summary of investor rights and guidelines regarding an individual or collective action for litigation on a financial product at European Union level and in the respective country of residence of the investor, please refer to the supplementary information document that can be found on [rathbonefunds.com/international](http://rathbonefunds.com/international). The summary is available in English or an authorised language in the investor's country of residence.