**Rathbone Unit Trust Management**

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Rathbones
Look forward

# Rathbone Strategic Bond Fund

## Monthly update February 2022

Investor confidence in the post-pandemic recovery is being severely tested by Russia's invasion of Ukraine.

We are deeply saddened by the events currently unfolding and our thoughts go out to all those impacted by the conflict. Alongside its devastating humanitarian consequences, we are keenly aware that the war could inflict meaningful economic damage and disrupt financial markets.

Fighting and retaliatory sanctions have the potential to cut the supply of energy and other vital resources from Russia and Ukraine to the rest of the world. This risks big price shocks at a time when many central banks have already been sounding the alarm about the possibility of high prices becoming entrenched. Ahead of the invasion, some were talking about tightening monetary policy and raising interest rates aggressively. If price shocks coincide with a forceful central bank pivot focused on inflation, this could further dampen investors' appetite for risk and sap economic growth momentum.

Government bond markets have proved erratic and volatile ever since the invasion began. Investor positioning has swung between two extremes. At one end, investors have scrambled to buy government bonds because they believe they offer 'safe haven' protection. At the other extreme, they've scrambled to sell these bonds because they fear their low fixed returns look unattractive as inflation and interest rates move higher.

Against this backdrop, the yield on US 10-year Treasuries (which moves in the opposite direction to prices) began the month at 1.78% and had reached 1.82% by its end. The yield on 10-year gilts rose too, up from 1.31% at the start of the month to reach 1.42%.

Corporate bond markets have been turbulent. Credit spreads – the extra return above government bond yields for taking on default risks – have widened significantly amid worries that the more challenging growth and inflation backdrop could see more borrowers struggling to repay their debts. The iTraxx European Crossover Index began February at 288 basis points (bps) and widened to 346 bps by month-end.

### The impact on the global economy and financial markets

Bond investors began this year focused on the global monetary policy outlook as inflation marched higher. Central banks are still a dominant theme in financial markets, but investors must now also contend with huge uncertainties resulting from the war in Ukraine.

Russia is the world's second-largest oil exporter and its top producer of natural gas. Europe gets nearly a third of its oil and around 40% of its gas from Russia, much of it via pipelines that flow across Ukraine. In addition, Russia is a major exporter of wood, coal, aluminium, copper, platinum, palladium and steel. Russia also sells the most wheat worldwide; Ukraine is also among the top five exporters of this crucial food staple and a huge supplier of corn as well.

Any disruption to these markets will have tremendous implications for the cost of virtually everything. Very simply, it will amplify global inflation that is already running red hot. Just the potential for disruption has sent the prices of all these commodities markedly higher. Inflation is now likely to be higher for longer than investors were expecting just a month ago.

It's not yet clear exactly how central banks will react to the war and its impact on global resource prices. But the risk of them making a mistake – either by tightening too much or by not tightening enough – has risen significantly.

### How we sought to protect the fund

We don't have any direct exposure to Russian or Ukrainian bonds. A few of the bonds we hold are issued by companies that make a small proportion of their earnings in either Russia or Ukraine and, before the invasion, we held some emerging market (EM) funds with exposure to lenders in either Russia or Ukraine. Please contact us if you would like further details.

Our key focus during the month was protecting our fund from the worst of the shockwaves in global financial markets. As a result, we increased our allocations to safer assets, including government bonds and cash.

We bought **UK Treasury 1½% 2047** early in February as we sought to bolster our exposure to more defensive bonds. Later in the month, we pared back our gilts, selling some **UK Treasury 4.75% 2030** bonds.

Ahead of the invasion, we sold emerging market bond funds with exposure in either Russia or Ukraine, including the **Ashmore Emerging Markets Short Duration** and the **Eaton Vance Emerging Market Debt Opportunities** funds. Soon after, we also sold the **Muzinich Emerging Markets Short Duration Fund**.

Until the extraordinary forces dominating financial markets begin to ease, there is huge uncertainty about what may lie ahead. We don't yet know what policymakers are planning and how it will impact on markets or the 'real' economy (actual businesses and consumers).

For these reasons, we continue 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

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Fund Manager

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Assistant Fund Manager

**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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