Rathbone Unit Trust Management

Rathbone Luxembourg Funds SICAV
Contact us +44 (0)20 7399 0800 international@rathbones.com

Rathbones
Look forward

Rathbone SICAV Ethical Bond Fund

Quarterly update March 2022

Alongside its devastating humanitarian impact, the war in Ukraine is triggering a chain of consequences that have reverberated across financial markets and significantly added to the uncertainties weighing on the global economy.

	3 months	6 months	1 year	3 years	5 years
Rathbone SICAV Ethical Bond Fund	-6.07%	-6.60%	-4.30%	9.35%	18.34%
IA UK Sterling Corporate Bond Sector	-5.55%	-5.48%	-4.25%	5.20%	10.16%

	31 Mar 21-31 Mar 22	31 Mar 20-31 Mar 21	31 Mar 19-31 Mar 20	31 Mar 18-31 Mar 19	31 Mar 17-31 Mar 18
Rathbone SICAV Ethical Bond Fund	-4.30%	13.44%	0.72%	3.06%	5.02%
IA UK Sterling Corporate Bond Sector	-4.25%	9.02%	0.78%	2.96%	1.70%

Source: FE Analytics; data to 31 March, L-class, mid price to mid price.

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

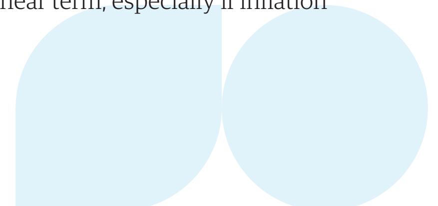
There was a short-lived rush to buy 'safe haven' government bonds when the war first began. But overall, investors have been preoccupied by high, and rising, inflation.

Because inflation eats into bonds' fixed returns, government bond yields rose sharply during the quarter (bond yields and prices move in opposite directions). Indeed, the US Treasury market experienced one of its toughest quarters on record: the yield on 10-year US Treasuries began the quarter at 1.51% and had reached 2.35% by its end. The yield on 10-year gilts surged too, up from 0.97% at the start of the quarter to 1.61% by its end.

Adding to the pain for investors, corporate debt also came under intense pressure. Credit spreads – the extra yield (or spread) offered relative to government bonds for taking on default risks – widened significantly amid worries that higher inflation and lower growth could make it harder for borrowers to repay their debts. The iTraxx European Crossover Index began the quarter at 242 basis points (bps) and had widened to 339bps by its end.

The inflation and growth outlook

Before Russia's invasion, the world's big central banks had made it clear they planned to wind down emergency monetary policies more quickly and aggressively than investors had initially expected to try to stem the rising tide of inflation driven by post-pandemic reopening. The Bank of England (BoE) was first to kick the process off, increasing rates in late 2021 and then again in February and March. Then the US Federal Reserve (Fed) lifted rates for the first time since 2018 in March. Markets are expecting at least seven further US rate rises this year. The BoE sounded a bit more cautious at its most recent policy-setting meeting, explaining it was worried about the growth outlook following the invasion of Ukraine. But BoE policymakers still believe that further rate hikes are warranted so UK rates are likely to rise further in the near term, especially if inflation continues to increase.



The value of investments and the income from them may go down as well as up and you may not get back what you originally invested.

Central banks can address the demand-side drivers of inflation by trying to curb consumption by raising borrowing costs. But they can't do much when it comes to inflation caused by curtailed supplies of goods and services. The war in Ukraine triggered a supply-side shock because it threatens to cut Russian energy and other vital Russian and Ukrainian resources out of global supply chains. This sent energy prices on a truly wild ride. And the UN Food and Agriculture Organisation reported that global food prices hit a record high in March as the war hit global supplies of grains and vegetable oils. Because central bank policy can't counter the impact of these new waves of inflation, the war has increased the risk that inflation goes even higher still. At the same time, it's increased the chance that global growth disappoints as higher prices squeeze businesses and households.

What's the US yield curve telling us?

At the start of the year, it seemed inconceivable that anyone would be worried about a looming recession. But even before the war began, economic growth was beginning to lose a bit of momentum and consumer and business confidence were dented by higher costs. The UK has been right in the eye of the storm given the huge cost of living squeeze exerted by April's whopping 54% increase in the cap on domestic energy prices and the simultaneous hike in national insurance contributions. Meanwhile, a closely watched recession indicator — the US Treasury yield curve — has flashed red on the other side of the pond. Typically, the yield on bonds increases with the time to maturity. That's because there's more time for things to go wrong before you get your money back, so you want a higher return for longer-dated bonds to compensate. A two-year bond should yield less than a 10-year bond. But, right at the end of quarter, the two-year US Treasury yield rose above that of 10-year Treasuries — or 'the curve inverted' — for the first time since 2019.

When yield curves invert, they typically spell trouble ahead for longer-term economic prospects: that's because shorter-term two-year yields move with interest rate expectations, while the 10-year yield moves in line with inflation and growth expectations. Yield curve inversion seems to be telling us that investors think Fed efforts to tame inflation with rate rises will stall economic growth. Inversions have preceded every US recession for the last 50 years. Some think it's a less reliable warning sign nowadays and the downturns predicted by past inversions have often taken quite a while to arrive.

Keeping duration down and sticking with carry

The question now is whether we agree with current market pricing. Markets imply that the current spike in inflation and interest rates will eventually subside and be followed — at some point — by an economic downturn. But there are huge uncertainties over how much further the current inflation shock has to run and how GDP growth will hold up.

Against this backdrop, we're not making big changes in the kinds of bonds we want to own. Given the intense volatility in interest rate markets, we're sticking with our decision to dial down our portfolio's duration (the sensitivity of a bond portfolio's value to changes in prevailing interest rates).

At the same time, we're balancing out our exposure to more defensive 'safe haven' bonds with exposure to bonds that we believe offer attractive 'carry'. Essentially, these bonds offer decent yields without us having to worry about big changes in their prices due to the volatility in the interest rate and inflation outlook.

We don't invest in mainstream UK government gilts as the government is involved in some areas prohibited by our screening criteria. Instead, we focus on the UK's green sovereign bonds ('Green Gilts') as an ethical alternative. Immediately after the invasion, we traded in and out of the **Green Gilt 1.5% 2053** to bolster our exposure to more defensive bonds and adjust our duration.

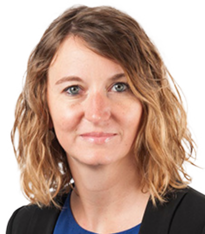
The outlook for corporate bonds has certainly got trickier over the last few months as worries about the risk of an economic downturn have grown, but we still like bonds issued by select banks, insurers, building societies and investment firms. We think these businesses are likely to hold up well if life gets more difficult because they're well capitalised and manage their risk exposure carefully. Immediately after the war began, not many firms were issuing new bonds. Later in the quarter, issuance began to pick up again and we opted to buy some newly issued bonds from lenders that we believed offered good value, including the **NatWest 3.8% 2029**, **Lloyds Bank 2% 2028** and **BNP Paribas 3% 2029**.

As we explained last month, we didn't have any direct exposure to Russian or Ukrainian bonds when the war broke out. We held a few bonds issued by companies that made a small proportion of their earnings in either Russia or Ukraine and have been scrutinising them very carefully over the last few weeks. We decided, for example, to sell Dutch bank **ING 1.125% 2028** bonds because we were concerned about the group's exposure to Russia.

(Nearly) 20 years on

When markets turn very volatile, as they did last quarter, it's easy to get panicked. We don't join short-term selling (or buying) stampedes just because that's what lots of other people are doing. We tune out market noise and instead stay focused on opportunities we believe will benefit our fund's long-term return and income. This can be painful in the short term. But, in the nearly 20 years since we launched our onshore fund (the official birthday is 14 May), we've learned that it's critical to stay disciplined and rational in turbulent times and to focus on long-term convictions rather than immediate uncertainties.

Bryn Jones
Fund Manager



Noelle Cazalis
Fund Manager

Stuart Chilvers
Assistant Fund Manager

Carne Global Financial Services (Europe), Unipessoal Lda. ("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. Between 1 January 2021 and 30 September 2021, CGFSE has received cash fees in the amount of EUR 841 210 from those entities.

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 what you originally invested.

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. The summary is available in English or an authorised language in the investor's country of residence.

Rathbone Unit Trust Management Limited
8 Finsbury Circus, London EC2M 7AZ

International information line
+44 (0)20 7399 0800
international@rathbones.com
rathbonefunds.com

Investment manager:
Rathbone Unit Trust Management Limited
Authorised and regulated by the Financial Conduct Authority

A member of the Investment Association

A member of the Rathbones Group. Registered No. 02376568

Management company:
FundRock Management Company S.A.
Authorised in Luxembourg and regulated by the Commission de Surveillance du Secteur Financier

7817.04.22