Contact us 020 7399 0399 rutm@rathbones.com

Rathbones
Look forward

Rathbone Strategic Bond Fund

Monthly update April 2020

Overview

The 10-year gilt yield remained well anchored in April. Starting the month at 0.36%, it bumped along in a range between 0.40% and 0.20%, ending at 0.23%.

With yields so low, even small moves can have punchy effects on the value of longer-duration bonds. Longer-duration bonds, which tend to be many years away from maturity and paying relatively low coupons or interest, are very sensitive to changes in yields and market interest rates.

The continued fall in gilt yields has benefited those investors who held these longer-duration assets, yet with yields now so phenomenally low, the risk you take in holding them is very high. Should yields begin to rise again – even to where they started the year (0.53%), investors in these assets would suffer hefty losses. This is why our fund has a shorter overall duration than its IA Sterling Strategic Bond sector peers.

Economic data has been pretty terrible all round – as you would expect given swathes of the world has been shut inside for months. For the most part, markets seem to be ignoring the numbers and focusing instead on the solvency of individual companies and the actions of central banks.

Credit markets have had a tough pandemic, with liquidity completely drying up in March. Liquidity returned in April after central banks stepped up their support of credit markets. This move was aimed to prevent companies from falling into a downward spiral of ever-increasing borrowing costs that weaken them further. Despite these measures, spreads above government debt are still significantly higher and many high yield companies have had to tap investors at interest rates close to 10% or even higher.

Lockdowns are affecting businesses and industries in massively different ways, so carefully choosing the risks you want to take will be key for coming out of the corona crisis in one piece. These difficult times have been stressful, yet they have also presented several opportunities for making both short and long-term trades that we believe offer a lot of value.

Trades

Last month we used some of the cash we had built up in the early days of the pandemic crisis to buy a newly issued **International Bank of Reconstruction & Development 0.5% Bonds 2023** (the World Bank), raising money to fight COVID-19 and help fund healthcare projects in the developing world.

We took part in several new subordinated issues for financial companies, as we felt the spreads being offered for the bonds were very attractive. These included the insurers **Legal & General Group 4.5% Floating Rate Note 2050** and **Phoenix New Issue 6% Bonds 2031**, and the **Jupiter Fund Management 8.875% Bonds 2030-25** issue that was used to complete the acquisition of Merian Global Investors. We believe the pandemic and accompanying economic disruption will reduce their earnings, yet won't get to the point where companies will need to raise extra capital to stay afloat. Also, you must remember that these financial companies are much better capitalised compared with when they faced the great financial crisis in 2008.

Finally, as spreads widened, we started buying up some riskier assets, such as emerging market debt and some high yield bonds. We bought the **Muzinich Americayield** and **Muzinich Asia Credit Opportunities** funds, the Investec **Emerging Markets Local Currency Debt Fund** and **Barings Emerging Markets Debt Blended Total Return Fund**.

Outlook

It's hard to see through the current crisis. No-one knows how long it will be before the pandemic is brought to heel and the world is returned to some sort of normalcy.

A number of the worst-hit sectors are areas that we must avoid due to ethical restraints or have zero exposure because we simply didn't like their prospects to start with. We won't buy autos, airlines or airports on ethical grounds. While retailers we have chosen to avoid because of the huge battle they are fighting against e-commerce giants such as Amazon. The "death of the high street" was a feature of our economy even before COVID-19 shuttered our cities, towns and villages.

Broadly, we are wary of any sector that has taken a direct body punch from the pandemic because there is no way for us to know just how long these businesses will have to survive with virtually no income. So tourism-related investments, travel companies and retailers are all off the table for us right now. Clearly, we need to consider secondary and tertiary impacts as well, and our focus here is on commercial real estate. These companies will struggle to gather all the rent due on their leases and with many companies likely to go to the wall, they may will be stuck with space they can't fill, too. And for how long is anyone's guess. There is a better than even chance that companies may use the lockdown as a pilot run for reducing their office footprints and becoming much more open to staff working from home. That would only exacerbate the problems property firms face.

It won't only affect companies that specialise in property, however. Many firms' balance sheets are bolstered by large property assets and leases that may not be as valuable as old financial reports suggest. Property-heavy companies may find themselves with an albatross round their necks that they can't shake.

Bryn Jones
Fund Manager

Noelle Cazalis
Fund Manager

Stuart Chilvers
Assistant Fund Manager

This is a financial promotion relating to a particular fund. Any views and opinions are those of the managers, 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 may go down as well as up and you may not get back your original investment. Source performance data, Financial Express, mid to mid, net income re-invested.

Rathbone Unit Trust Management Limited
8 Finsbury Circus, London EC2M 7AZ
Tel 020 7399 0000
Fax 020 7399 0057

Information line
020 7399 0399
rutm@rathbones.com
rathbonefunds.com

6890.05.20