RATHBONES

RATHBONE GREENBANK GLOBAL SUSTAINABLE BOND FUND

QUARTERLY UPDATE MARCH 2024

This is our first update on the fund since its launch on 30 November so we're using this opportunity to fill you in on what's been happening in financial markets over the last few months, while also telling you about the bonds we've been buying and selling.

When we launched the fund, government bonds were starting to rally after selling off very sharply in October. Investors had feared that the US Federal Reserve (Fed) might be planning more interest rate rises given the stickiness of US inflation. Investors had also been rattled by concerns about just how much the US government was spending and whether investors were willing to fund it. Last year, the federal deficit was $1.7 trillion, or 6.3% of GDP, which must be funded by selling lots more bonds than usual.

Things began to turn around from late October, helped by an announcement that the extra bond issuance would be skewed towards shorter-term maturities, which helped ease upward pressure on the much-watched 10-year benchmark yield. Investors began to buy up government bonds in the hope that yields might have crested at their prevailing highs. US jobs data seemed to show that the once red-hot jobs market might be cooling a bit, which seemed to reinforce confidence that the Fed's work in raising rates might just about be done.

Many bond investors (ourselves included) thought the resulting spike in government bond prices might have gone too far and expected central banks to pour some cold water on hopes of looming rate cuts when they held their December rate-setting meetings. They'd been sticking with a clear 'higher for longer' message for ages so we felt they were unlikely to signal an imminent pivot to rate cutting.

In the event, the Fed astounded more or less everyone and delivered a very significant about-turn. Fed chairman Jerome Powell announced the central bank was now starting to consider when to cut rates and was predicting 0.75% worth of cuts in 2024. (By contrast, the Bank of England (BoE) and the European Central Bank (ECB) stayed hawkish and neither gave any hints about future rate cuts.)

The Fed's announcement drove a monster rally in government bond markets. By the beginning of this year, investors were confident that the Fed would deliver around six 0.25% rate cuts in 2024, perhaps starting as early as March.

Hopes of early US rate cuts wane

But persistently sticky inflation, alongside a roaring US jobs market, have subsequently forced them to rein those bets in big time. Investors no longer see much chance of the Fed cutting rates any time soon. Most expect around two 0.25% cuts in the second half of 2024, though a fair few think the Fed might not cut at all this year. Because government bonds are the asset class most sensitive to rate moves, this reassessment has driven bond yields up significantly this year, forcing down their prices.

When the fund launched, the benchmark 10-year US Treasury yield stood at 4.33% and it had dropped to 4.21% by the end of March. Those figures in isolation don't show just how hugely volatile the 10-year yield has been over the last four and a bit months. It fell as low as 3.85% at the end of 2023, for example, and at the time of writing it's now back above 4.70%. That's about as high-octane action as you're likely to see in bond markets! UK government bond (gilt) yields have followed a similar trajectory, with the 10-year gilt yield swinging wildly from 3.44% in late December to 4.00% at the end of March.

The big variation is in shorter-term bonds, which tend to be a better barometer of expected changes in central bank interest rates. The gap between the yield of the two-year US Treasury and the two-year gilt is double what it was at the start of the year, because many expect the BoE to cut rates well before the Fed. The BoE should be able to move earlier because the UK's economy is much weaker and inflation appears to be more under control this side of the Atlantic.

We don't invest in US Treasuries because the US government's heavy military spending means these bonds don't meet our screening criteria. Instead, we focus on US dollar-denominated debt issued by big supranational institutions, which behave in a similar way to Treasuries. We do invest in gilts, often favouring the UK's green sovereign bonds ('Green Gilts') in particular. We bought some US dollar **Inter-American Development Bank 3.5% 2033** and **International Bank of Reconstruction & Development 1.625% 2031** bonds and **UK Green Gilt 0.875% 2033s** in the fourth quarter of last year, selling some of the latter in mid-December. We continued to trade these bonds in the first three months of 2024, buying more when yields rose and selling some when yields fell. We didn't want to pare back our duration (interest rate) exposure too much because it's longer-duration government bonds that will rally most when rates do get cut.

Even though this has been an exceptionally turbulent few months for government bonds, corporate bond markets have kept powering ahead. That's because credit investors have grown increasingly confident that high interest rates don't seem likely to tip economies into harsh recessions that might result in a deluge of corporate defaults and downgrades.

Performance review

	3 months	Since launch 30 Nov 23
Rathbone Greenbank Global Sustainable Bond Fund	0.89%	3.90%
IA Sterling Strategic Bond Sector	0.98%	4.70%
Benchmark*	0.27%	3.85%

* The fund's benchmark consists of 70% ICE BofA Global Corporate Index, 15% ICE BofA Global Government ex Japan Index, 15% ICE BofA All Maturity Global High Yield Index (all GBP hedged).

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

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

With investors seeming to buy fully into hopes of a 'soft landing' for the global economy, the extra yield (or spread) that corporate debt offers over government bonds to compensate for default risks narrowed significantly. The iTraxx European Crossover Index, which measures this spread, began the period at 426 basis points (bps) and had plummeted to 297bps by its end.

This spread-tightening reversed in April as disappointments about the path of US rates (which are the global benchmark for borrowing costs), more trouble in the Middle East and stock market sell-offs have weighed on corporate bonds. At the time of writing, the spread had jumped to 328bps.

April credit spread wobbles aside, the outlook for economic growth certainly seems a bit more positive than it did at the beginning of the year. This has been particularly important in the UK and Europe, where things have been pretty dire for quite a while. There's more evidence each day that the UK and Europe are now emerging from last year's stagnation/mild recessions. Monthly GDP data showed that the UK grew again in February after an upwardly revised performance in January, so it's highly likely that the economy returned to growth in the first quarter as a whole. Yet UK inflation is expected to fall again in the next set of monthly figures, with Ofgem's energy price cap falling in April. UK headline inflation could very soon be well *below* the BoE's 2% target, as food inflation also falls a lot further.

Against this backdrop, we are finding plenty of attractive credit opportunities, particularly in shorter-dated investment grade (high-quality) corporate bonds. Many of these bonds' yields come close to those on offer from longer-term corporate bonds. This means they can deliver attractive carry (coupon income) alongside less credit and duration risk because of their shorter maturity (i.e. there's less time before maturity for rates to change and defaults to occur.) Last year, for example, we bought some euro-denominated Spanish multinational electric utility **Iberdrola 3.375% 2032** and Australian supply chain logistics firm **Brambles 4.25% 2031** bonds. (Brambles' circular business model offers companies the 'share and reuse' of the world's biggest pool of reusable pallets and containers.)

We also bought some bonds issued by vehicle-lease charity for the disabled **Motability Operations 4.875% 2043**. Over the last few months, we've been buying some of its shorter-dated **3.875% 2034** bonds too.

In the first quarter, we bought some **NatWest 4.699% 2028** euro-denominated bonds issued specifically to fund women-led enterprises, as well as some Finnish pulp, paper and wood firm **UPM-Kymmene 0.5% 2031** euro bonds. UPM-Kymmene is firmly focused on supplying renewable and recyclable alternatives to carbon-intensive fuels, fibres and packaging.

We got some good news in early March when Nationwide Building Society launched a bid to take over Virgin Money. We'd been buying **Virgin Money 5.125% 2030** bonds for several months as we felt they offered good value. The takeover bid drove the prices of these bonds much higher so we decided to sell them. Last year, we bought some US sustainable waste solutions provider **Waste Management 2% 2029** dollar bonds. We sold them in February as we found better opportunities elsewhere.

Income yields are at multi-year highs

The stickiness of US inflation is a salutary reminder that financial markets and big economies rarely glide along entirely smoothly. There are likely to be plenty more bumps in the road towards lower inflation and lower rates.

But the yields now available on both interest-rate sensitive government debt and more growth-sensitive investment grade credit are a lot more attractive than they've been for many years. That huge reset means bond yields offer very decent buffers against any further volatility in bond prices, while also offering investors a way to achieve their long term return objectives through income yields alone.

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For more info on our fund, including factsheets, performance and fund manager views, please click here.

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.

If you require further clarification on this commentary, then please contact your adviser or Rathbones at the contact details below.

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.

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