

# Rathbone Strategic Bond Fund

## Update, December 2018

### Overview

December was a torrid month for credit as a number of fears converged to panic investors.

Ten-year gilt yields started the month at 1.36% and ended at 1.28%. They bottomed out at 1.19% on 11 December. Despite the US Federal Reserve (Fed) pulling the trigger on another 25-basis-point hike last month, taking benchmark interest rates to the 2.25-2.50% band, US 10-year yields *fell* from 2.99% to 2.68%. That is the technical manifestation of what drove markets last month. In English, investors thought the Fed was being overly hasty with its monetary policy. That dampens inflation and growth expectations, which in turn sends longer-term bond yields lower. The worries about a Fed mistake were heightened by some poor economic news and disappointing company results which led people to believe that worldwide growth is weakening. A slowdown increases the chances of a global recession and therefore encourages people to sell equities and riskier bonds. Sprinkle a bit of US government shutdown, Trumpian bombast and “Brexit means Brexit” on top and you’ve made yourself a particularly foul version of market eggnog.

Credit spreads widened over the month, with the subordinated financials index jumping 16bps to 225bps and high yielders up 23bps to 353bps. Equities and credit markets were myopically focused on the few scary signals. There was plenty of good news out there too, including the ISM Non-Manufacturing PMI which defied analyst expectations of a fall by rising to an exceptional 60.7 in November. It did fall back following month-end, but it remains comfortably in expansionary territory. Another post-month data print was rosier: Nonfarm payrolls showed 312,000 net jobs were created in December – almost twice as many as forecast – while wage growth accelerated.

At bottom, it was a terrible month for anything other than the safest of assets. Any and all reassuring data was completely ignored as investors continued the late-2018 trend and took flight.

### Trades

UK retailers have had a tough time lately. We are generally steering clear of the industry, but that doesn’t mean we won’t pick up a bargain if we see one. We bought the short-dated **John Lewis 8.375% 2019** bonds because we felt the yield was attractive and the chance of the group going bankrupt in three months is extremely slim, given it has more than enough cash to service its debts.

We added to our medium-term gilts, specifically **Treasury ¾% 2023** and **Treasury 2½% Index-Linked 2024** bonds. Finally, we sold the **GAM Multibond Emerging Markets Bond Fund** after the manager left the company. We replaced it with the **Barings Emerging Markets Debt Blended Total Return Fund**.

### Outlook

We continue to deliver decent returns in varying markets, so we’re pleased with how your fund has been performing.

Despite reasonable data out of the UK and the US, investors are still fixated on the bum notes out there. Markets are fickle things and they have proved the rule again this time round. The reaction to recent events and Federal Reserve comments has been extreme. Yes, there are risks around the world: a heavily indebted China is slowing, most Western governments are inept and the tide of monetary policy is turning. But many of these risks have been hanging around for years.

Another risk we have been pondering is whether market volatility may upend refinancing for some companies. Weaker firms that need to roll over debts could find the market demands steeply higher rates or – even worse – takes a giant step back and refuses to buy the debt, leaving them with no cash and large balloon payments to make. Both scenarios would reverberate through to secondary credit markets. It could lead to dislocations in credit markets that make for rough times. We think that’s the next big risk for bond markets: if a big player struggles to refinance and it causes a panic.

### **Move to single-pricing**

As we’ve previously communicated, from 21 January our fund units will move to a single-price, dropping the current dual-price system. Rather than have a buy price and a marginally lower sell price, a single price will be issued for our funds at noon each day. Both purchases and sales of units will be based on this single price. In line with the industry, we intend to operate a ‘swinging’ single-pricing mechanism for our funds. This ensures the fair treatment of all unitholders by minimising the effects of the ‘dilution’ that occurs when stocks are bought and sold. The single price will swing in response to large purchases or sales in order to mitigate these effects. Once the single price of a unit has been determined, a ‘dilution adjustment’ will be applied to the price in accordance with the policy outlined in the prospectus for our funds. For example, when there are net inflows to a fund, a dilution adjustment increases the price (price swings up) and when there are net outflows from a fund, a dilution adjustment reduces the price (price swings down). However, regardless of whether the price is adjusted up or down, all investors buy and sell at the same price.



**Bryn Jones**  
Fund Manager



**David Coombs**  
Fund Manager

**This is a financial promotion relating to a particular fund. 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 may go down as well as up and you may not get back your original investment.**

**The information contained in this note is for use by investment advisers and journalists and must not be circulated to private clients or to the general public. Source performance data, Financial Express, bid to bid, net income re-invested.**