

Rathbone High Quality Bond Fund

Quarterly update March 2020

10-year gilt yield slumped to 0.36% on 31 March, down from 0.83% at the start of the year. Along the way the gilt yield posted a new all-time low, too: just 7 basis points during trading on 9 March.

Global markets have had a terrible time as the severity of the impact of COVID-19 on health as well as economies has become all too apparent. The first quarter of 2020 was one of the worst quarters in living memory and ended the 11-year bull market in stocks. Major equity markets around the world were down between 20% and 30% as investors try to work out the severity of the impact of Coronavirus on the short-term profitability of businesses. Credit spreads jumped higher as investors worried about widespread defaults and ratings agencies started downgrading pandemic-struck companies.

Thankfully, the spread of the COVID-19 pandemic across the world has been matched by truly speedy and enormous support packages from central banks and governments. The US, Europe and UK in particular have rolled out trillions of dollars of furlough schemes, bargain loans, grants, bolstered unemployment benefits and the obligatory quantitative easing (QE). This is a welcome response to a global health emergency, and a much more timely reaction than during the credit crunch a decade ago. But now we're into the crucial bit: execution.

One potential blind-spot of the authorities' response was that many sound investment grade businesses are dropping into high yield as revenues have dried up and balance sheets come under pressure. These companies would face significantly higher borrowing costs at the very time when they need to refinance. Helpfully, central banks have since stepped in to buy both investment grade credit and these 'fallen angels' which have recently found themselves reassessed as high yield.

Markets are unlikely to base out until the number of cases in Europe and the US show signs of peaking. Until then, fear and uncertainty will drive sentiment. We are bracing ourselves for some rather ugly economic data over the next few months.

In the first quarter, our fund fell 2.65%, compared with the 0.28% return of our benchmark, the Bank of England's Base Rate +0.50%.

Early in the quarter, we continued to buy new issue floating rate notes (FRNs) because they offered decent yields with little duration (sensitivity to interest rates). We believe you can also secure better yields by going direct to the source rather than buying in the secondary market. The most significant purchases here were the **Santander UK 0.7% FRN 2027** and **Nationwide Building Society FRN 2025**.

Mid-March was a very difficult time for credit, with spreads rising rapidly and liquidity leaking out of the market. Around this time we increased our cash allocation. These sales included **Lloyds Bank SONIA-Linked FRN 2022** and **Province of Alberta 1.5% 2022**.

Since that mid-March squeeze, credit markets have reacted well to central bank interventions. Liquidity has largely returned and spreads have recovered somewhat. We have used this improvement to adjust our fund's strategy. Now that UK interest rates have dropped to just 0.1%, interest payments from our FRNs have fallen in lockstep.

We now see more value in fixed-interest senior bank debt, which have been a victim of their own liquidity. As markets seized up in March, many large bond funds sold the reasonably liquid senior bank bonds to pay for redemptions. This caused a jump in yields, making for an attractive entry point for us. We picked up **Svenska Handelsbanken 1.625% 2022** and **Coventry Building Society 1% Senior 2020**, funded by steady sales of our FRNs.

We also purchased **LVMH Moet Hennessy 1% Senior 2023**. We believe this luxury brands conglomerate is at little risk of defaulting on its debts, given its very strong balance sheet and the resilience of luxury sales in recessions.

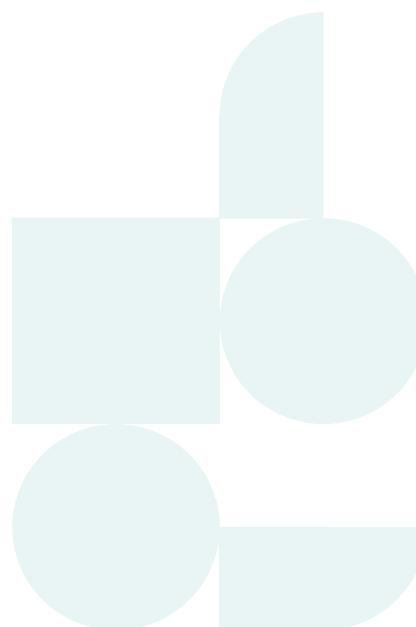


Since quarter-end, there have been huge dividend cuts across the board, which have presented equity income-seeking investors with a bit of a challenge. Property funds have closed, gilts don't generate yields, interest rates on cash are at rock bottom and equity dividends have gone to zero – so where can they go? Their next stop is fixed income credit. That, we believe, is the driving force behind the general improvement in investment grade debt markets in April. This hunt for income could be a positive for corporate credit over the next six to 12 months as investors continue to swap out of riskier asset classes.

In times like this, it's easy to get caught up in firefighting and panicked decisions. But we cannot chase the market around – that would be disastrous. We will remain disciplined, rational, and calmly follow our strategy.



Noelle Cazalis
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, mid to mid, net income re-invested.