

Rathbone Ethical Bond Fund

Update, July 2018

Overview

Ten-year gilt yields started the month at 1.28% and ended marginally higher at 1.33%. The slight rise in yields was likely driven by the expectation of a 25-basis-point hike in the Bank of England's interest rate in early August. Rates were duly raised to 0.75%, but yields have bled back below 1.30% since month-end.

Sleepy summer trading drove credit spreads a little tighter during July as the amount of trading slowed and supply fell away. Markets got more jittery as July wound down and, post-month-end, they became obsessed by the health of emerging market economies. Turkey has borne the brunt of this concern, with its currency slumping 35% year to date. The country has problems, for sure, and the market just made those problems a whole lot more pressing. But other developing nations appear to be in much better shape. We think they shouldn't be at risk of contagion from the Turkish meltdown. European banks, however, are a different story. Several big banks, particularly Spanish and Italian ones, have hefty exposure to Turkey. The quality of these assets is yet to be determined, so we will be watching extremely closely in case it creates another European debt crisis. These are becoming unnervingly common...

Trades

We bought the **Investec Bank New Issue 4.25% 2028**, while the **Old Mutual 8% 2021** was bought back by the company in a tender as we had expected. We added to some insurers with cheaper valuations too, including **Aviva 5.9021% Perpetual-2020**, **RSA Insurance Group 5.125% 2045-30**, **RL Finance 6.125% 2028** and **Standard Life 5.5% Subordinated 2042**.

Retailers are still having a tough time, so we've continued to reduce our holdings in the industry. That meant the **Marks & Spencer 7.125% 2037** and **Shaftesbury Chinatown 2.348% Senior 2027**, but also **3i Group 6.875% 2023**, a private equity company that has significant exposure to retail in Germany.

Outlook

The US yield curve remains extremely flat. While the spread between the 1-year and 10-year US Treasury started and ended the month at about 54bps, it got as low as 45bps mid-month. Since month-end it has slumped even lower to 42bps. If this spread goes negative – an inversion of the curve – it would almost certainly mean a recession is rolling into shore.

However, as spare as the spread is, we still don't believe this curve will invert in the coming months. US growth is strong and accelerating so markets should be able to shrug off the interest rate rises that are widely expected from the US Federal Reserve in the second half of the year. It is odd, though, that the US 10-year is struggling to break through 3.0%. The level of growth and inflation rate alone implies a higher long-term yield than current trading allows.

As for the UK, Brexit lends a tragic air to everything. But the country isn't in quite as dire shape as many make out. Economic data are ok, in the round, and beating people's dim expectations. The Citi Group UK

Economic Surprise Index turned positive again in July after an extremely glum second quarter. PMIs have been pretty good, especially manufacturing and construction. Property prices have been a bit lacklustre and retail sales were lower than expected but still 2.9% higher than last year.

It's not great out there, but it's certainly better than most give the country credit for. And any good news on Brexit (or any definite news for that matter) could lead to a wave of investors returning to the market. We're cautious, but we think there's a decent chance that investors are getting too pessimistic about the shape of the UK economy. The same could be said for parts of the global economy too!



Bryn Jones
Fund Manager



Noelle Cazalis
Assistant 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.