

Rathbone SICAV Ethical Bond Fund

Update, October 2019

Overview

Gilt yields rebounded slightly last month, with the 10-year rising to 0.63% from 0.49%.

This was driven by fairly positive news around Brexit. Against all odds, Prime Minister Boris Johnson managed to hammer out a Brexit deal with the EU – one essentially reneging on his legacy coalition partner the DUP. That deal's hefty drag on British household incomes, which according to King's College economists would be 50% more than his predecessor's, was lost in the din of his attempt to ram the legislation through the Commons in a matter of days. All that, in the end, turned out to be a feint: he used the kerfuffle as evidence of the country's need for a new Parliament to solve its deadlock. Mr Johnson managed to outflank his opponents on the public opinion front, getting them to agree to a 12 December election.

Sterling had already risen slightly from the multi-decade lows of mid-year, but it bounded 5.3% higher in October to just shy of \$1.30. It also sent gilt yields higher, as already noted. You would have thought that the overwhelming expectation of a Conservative victory would have sent sterling higher again, but perhaps once-burned investors are waiting for it to be bolted on before they move.

As for credit, it was a good month. The credit spread on five-year European subordinated financial bonds slipped yet lower, to 125 basis points from an already pretty squeezed 139bps. This suited our positioning, given we are light on duration and heavier on the riskier end of financial debt. It has boosted our performance on both ends – what we own went up and what we avoided went down. That's the job! Although it's often much harder than it sounds.

Trades

With gilt yields trading higher, we took the opportunity to, ever so slightly, increase our duration again. We bought the **Kreditanstalt für Wiederaufbau 5.75% 2032** and **European Investment Bank 5.625% Senior 2032**.

We used inflows to the fund to buy more insurers' debt, including **Liverpool Victoria 6.5% 2043-23** and **AXA 5.625% Floating Rate Subordinated 2054**. We also purchased the **Wrekin Housing Group 2.5% Senior Secured 2048** as well. We have also been buying perpetual bonds trading well below their face value. We believe they are inconvenient/inefficient for their issuers, so they may be bought back soon, which would benefit us. To that end, we purchased the **Lloyds Banking Group 2.3% Floating Rate Note Perpetual-2020**, **Lloyds Banking Group 2.14% Floating Rate Note Perpetual-2020**, **Royal Bank of Scotland Group 2.25% Floating Rate Note Perpetual-2019** and **Royal Bank of Scotland Group 2.25% Floating Rate Note Perpetual-2019**.

We continued to sell the **Marks & Spencer 7.125% 2037** because we think the company's business model is under pressure given the competitive UK retail market and the lack of decent real household spending growth. We reduced our holding of **JRP Group 9% 2026**, which are issued by retirement services specialist Just Group.

Outlook

For all the howling noise of the election, the UK seems becalmed at the moment. Like a ship with no wind left in the sails, carried forward by inertia, the nation continues forward into the fog at a so-so pace. Economic growth is ok – not great – and it has been slowing lately, but everyone is praying that the 12 December vote will finally sort the Brexit question once and for all. But what of all the policies that created

all the anger that brought about Brexit in the first place? Moody's has cut the outlook for the UK's debt rating because of the parties' spendthrift plans for running the nation. Not exactly a vote of confidence.

And so we float into the election with GDP muted, PMI surveys sedate and inflation benign. To be fair, the most likely force to change any of that in the next month or so is a change in circumstances for the US and/or Europe. Alterations to US monetary policy, fluctuations in global growth and developments (good or bad) are likely to flow through to our own nation's borrowing costs, currency and economic activity. Not for lack of effort by many, globalisation is still with us.

If the Conservatives manage to win a majority in next month, sterling will probably rise sharply, but the path of inflation, yields and economic expansion will be up to how it negotiates the coming years. Inking Boris Johnson's deal is only the first step in an extraordinarily long journey, regardless of his cavalier rhetoric. Still, we would be finally setting off, at least. And it would have taken us only three and a half years to put the boots on.

If Labour gets in, well ... The party's tax-and-spend plans are truly gargantuan. Nationalisation of virtually everything sold off since Margaret Thatcher, large tax hikes on the wealthy, a roll-back for all sorts of tax-based investment and savings incentives. Expect the bottom to fall out of sterling, investors to run screaming for the hills. We take heart because the chances of an outright Labour victory are extremely slim, and any coalition with the Liberal Democrats is likely to water down these policies enough to make them, while still bitter, at least safe to drink.



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Source performance data, Financial Express, mid to mid, net income re-invested.

Investment manager:
Rathbone Unit Trust Management Limited
Authorised and regulated by the Financial Conduct Authority
A member of the Investment Association
A member of the Rathbone Group.
Registered No. 02376568

Management company:
FundRock Management Company S.A.
Authorised in Luxembourg and regulated by the Commission de Surveillance du Secteur Financier