

Rathbone Strategic Bond Fund Bryn Jones – Lead Fund

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Positive returns in Strat Bond have been driven by a number of factors this year.

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We've had a rally in interest rate markets, which means that gilt yields and Treasury yields are for them, which means the prices have gone up in those bonds.

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But also we've seen credit spreads tighten quite a lot over the year and you know that also adds to a positive return.

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And I guess the other thing that's really been positive for us is that we've been able to generate excess returns and excess alpha from idiosyncratic risks within the market.

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And in particular things like Virgin Money where we had overweight, you know, that was taken out by Nationwide and you know that was a big positive as well as a lot of old legacy debt which continues to get taken out which no longer fit for regulatory purposes.

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And we see some significant upside from those.

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We've also performed quite well in our high yield bucket where we've been able to identify good active returns and good yielding assets with low levels of volatility and that's really added to the sharp in the portfolio this year.

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We've got a bit of overweight in the gilt market at the moment in terms of the the asset allocation, albeit that the duration of that is probably more neutral to the index.

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We we're underweight index linked.

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We've seen breakevens falling quite aggressively.

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At some point they might come quite attractive.

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We've got a little bit of TIPS in the portfolio because breakevens in the US we felt were too low, but we started to look to cut those recently as breakevens have continued to remain fairly low.

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And also we've got an underweight in global government bonds.

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We're relative to an overweight in gilts at the moment after the rally.

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What you've seen in Europe and the US, we feel that it's actually quite attractive to hold some, you know UK gilts because they have a higher yield.

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We've also got some Aussie 10 year in there because that yields more after the hedge in in sterling.

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So that's a nice little pick up in yield as well.

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My yields becoming a more and more of a difficult place to invest as we see credit spreads continue to grind in.

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You know, we've had a bit of an overweight in high yields, especially in special sits and hybrids of large corporates.

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In the last few weeks.

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We started to cut some of that because obviously as interest rates rise, it's going to be more difficult for these businesses to raise capital going forward.

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And so we've started to take a bit more of a defensive move in in high yield.

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We've been underway EM quite a lot this year, although we have got a little bit in South Africa where we thought rates look too high and the political situation was stabilising and inflation was falling.

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So, so we've done quite well out of our South African position.

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We think interest rates are likely to head down.

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In particular, we'd like to see more, you know, cut in the US.

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We're likely to see more cuts out of Europe.

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And you know, the Swiss and Canada have been cutting rates.

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The Bank of England are expected to cut rates, but not as aggressively as the US and Europe.

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But again, the direction for interest rates looks like it's downwards, albeit you know what's being priced into the Treasury and the gilt market perhaps is a little bit aggressive.

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This fund is different from its peers in the strategic sector by in a number of ways.

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I mean the strategic sector itself is full of different funds, short duration funds and global funds.

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You know this strategic bond funds, you know it can go anywhere funds, but also it has a specific risk budget.

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One of the things is about it is that we have a core strategy of weightings to different fixed income assets and we're only allowed to go a certain element outside of that core strategy.

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So the 10% either way and most apart from me and where we can drop it to 0 and that really does help the sort of risk adjusted returns that we're able to deliver this.

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So what we're really trying to do with this fund is not only generate good fixed income returns, but we're trying to do it with low levels of volatility and low correlation with the equity market.

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Well, refinancing risk is always a big concern.

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You know, there's been arguments about, you know, the US Treasury market and whether they can continue to increase their levels of debt.

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I don't think that's a major problem at the moment.

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In the short term anyway.

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Maybe in the next 60 years it would do.

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For corporates though, they have much shorter timeframes, in particular high yield market.

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And a lot of the high yield market look to refi during 2020 and 2021 at very low rates when we were coming out COVID, of course, most high yield bonds are normally issued with A5 to six year maturity.

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So as they roll off now they're going to have to refinance at higher rate.

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So it's definitely something to look out for, particularly in Europe where half the market needs to refinance over the next couple of years.

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Investment grade markets, less concerned, you know, you're kind of being compensated in a lot of the big sort of systematically important banks now got huge amounts of solvency, insurers huge amounts of solvency.

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But in particular areas where you know, you might not want to invest in, you know, for example, UK water sector's really, really tricky at the moment.

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You know, their refinance risk can be quite high.

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So you really have to pick each sector as it comes and really understand the fundamentals of those businesses.

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The outlook for the global bond markets over the next six months is tricky.

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We've had a lot of interest rate cuts priced into the US and UK curve and then Europe.

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So whilst rates might be coming down, they might not come down as aggressively as people expect.

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So perhaps, you know, where we are today might be about neutral where we need to be in rates.

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So we might see a little sell off.

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But yeah, wherever we see an aggressive rally from here, you would need to see something pretty nasty in the economy I think for rates to fall even more than where they have today.

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Credit spreads in the short term with interest rate cuts and policy, you know, easing are likely to perform quite well.

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That's good for credit, that's good for companies.

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However, at some point when you know, interest rates are being cut, they're being cut because things could be looking quite bad or recessionary.

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And in that environment, credit spirits might not behave particularly well.