R&S Sterling Bond Fund

Q1 2023 Commentary

Performance with principles®

PERFORMANCE

	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years
Fund Performance (B Class)	0.9%	6.1%	-8.9%	-1.4%	-0.6%	23.5%
R&S Sterling Bond Benchmark	2.4%	8.3%	-10.2%	-8.9%	-4.8%	16.9%
IA £ Strategic Bond	1.7%	5.9%	-6.2%	3.5%	3.4%	23.3%
Sector Quartile	3	2	4	3	3	3

Source: Morningstar. Figures compared on a Bid to Bid basis with Net Income Reinvested.

YIELDS

Distribution	4.10%
Underlying	2.95%
Historic	4.00%

MARKET REVIEW

Gilt yields were marginally lower with global central banks moderating the pace of monetary policy tightening. An uncertain path lies ahead for interest rates, however. At its February meeting, the Bank of England raised its base interest rate by 0.5%, followed by a smaller 0.25% interest rate hike in March as fragilities around the global banking sector emerged. Increased market volatility thereafter favoured safe-haven assets. The 10-year yield began the quarter at 3.65% and fell to 3.01% before rising to a high of 3.88% in early March and ending the period at 3.49%.

At both its February and March policy meetings, the US Federal Reserve raised its benchmark interest rate by 0.25%, with policymakers still wary of elevated core price movements that are considerably higher than target levels. Concerns around US regional banks may well see policymakers pare back the magnitude of further hikes. The European Central Bank increased its main interest rate by 0.50% in February and by 0.50% in March, citing concerns around persistent inflation.

After tightening considerably at the start of the year, credit spreads then rose sharply in March on the account of risk aversion stemming from the financials sector. Bank subordinated debt bore the brunt of the sell-off, with Credit Suisse's junior debt written down entirely as part of its Swiss-led rescue package. Outside financials, corporate debt outperformed sovereign debt.

PERFORMANCE & ACTIVITY

The Sterling Bond Fund's total return lagged behind its IA Strategic bond sector and its iBoxx Sterling Non-Gilts benchmark over the period. Whilst the Fund has been adding to duration, its shorter relative duration position, notably in January, saw the Fund rally by less. There was some benefit from an increased allocation to longer-dated gilts and supra-nationals as safe-haven demand took hold in March. The latter was insufficient however in offsetting the adverse impact from its holdings in Financials whose performance suffered upon Credit Suisse's woes.

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Credit spreads on higher quality corporate debt end the quarter slightly lower, despite March's bout of risk aversion. The decision by central banks to avail liquidity support to the financial system, rather than outright monetary stimulus led to a broad re-assessment of credit risk. A more challenging outlook for companies that could well result in higher default rates warranted higher risk premia.

Over the quarter, the Fund invested cash inflows by purchasing the newly issued British Telecom 5.75% Feb 2041, Land Securities 4.875% 2032 and Yorkshire Water 5.25% 2030 sustainable bond. It also added to its gilts by purchasing UK Treasury 3.5% 2045 and switched from a near-cash EIB 0.875% 2023 holding to an EIB 3.875% 2037, thereby lengthening portfolio duration.

OUTLOOK

With central banks having moderated the pace of monetary policy tightening, guidance from global policymakers remains for higher rates, particularly as core inflation is uncomfortably higher than expected. Market participants are more dovish however, anticipating a looser stance by the end of the year and thereby making for greater volatility in asset prices.

Whereas the global economy has held up better than indicated by survey data at the turn of the year, recent concerns around the banking sector highlight fragilities in a financial system that has relied heavily on central bank stimulus until recently. A potential rise in defaults as debt is re-financed in tighter financial conditions appears increasingly likely. Also, higher inflation, particularly in the UK, continues to fuel labour market disquiet, which is impinging upon productivity. Whilst there is still scope to add to duration for instance via longer-dated government debt, a cautious stance towards credit has been maintained on the likelihood of a deteriorating economic environment. As such, we retain a bias towards higher quality corporate bonds which offer attractive risk-adjusted yield, alongside a higher allocation to gilts and supra-national debt. These should mitigate the adverse impact of higher risk premia as the global economy decelerates.

We remain vigilant in seeking out opportunities to add to high quality credits, scrutinising the robustness of business models and cash flows to ensure adequate compensation for risk. We have added further interest rate sensitivity with the view that the rate hike cycle is close to completion and are now just above neutral. Having reduced cash, we are also relying on higher credit quality to enhance overall portfolio liquidity whilst preserving capital.

YIELDS

The Distribution Yield reflects the amounts that may be expected to be distributed over the next 12 months as a percentage of the mid-market share price of the fund as at the date shown. The Underlying Yield reflects the annualised income net of expenses of the fund (calculated in accordance with relevant accounting standards) as a percentage of the midmarket share price of the fund as at the date shown. Both Yields are based on a snapshot of the portfolio on that day. The Yields do not include any preliminary charge and investors may be subject to tax on distributions. The Distribution Yield is higher than the Underlying Yield because the fund's expenses are charged to capital. This has the effect of increasing the distributions for the year and constraining the fund's capital performance to an equivalent extent.

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