RESPONSIBLE AND SUSTAINABLE STERLING BOND FUND

COMMENTARY FOR QUARTER TO END SEPTEMBER 2022

PERFORMANCE

	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years
Fund Performance (B Class)	-7.6%	-14.1%	-18.1%	-11.5%	-5.3%	24.2%
R&S Sterling Bond Benchmark	-11.0%	-17.0%	-21.9%	-19.3%	-10.1%	8.3%
IA £ Strategic Bond	-4.8%	-11.4%	-15.3%	-8.4%	-2.2%	22.0%
Sector Quartile	4	4	3	3	3	3

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

YIELDS

	Sep-22
Distribution	4.05%
Underlying	3.50%
Historic	3.99%

REVIEW

Gilt yields continued to rise as central banks delivered increasingly hawkish monetary policy in an attempt to mitigate surging consumer prices. At both its July and September meetings, the Bank of England raised its base interest rate by 0.5% with some policymakers voting for a larger hike in an attempt to re-anchor inflation expectations. Concerns around the UK's fiscal outlook also emerged. Such was the knock-on adverse impact on gilts in late September that the Bank of England saw targeted intervention necessary. The 10-year yield began the quarter at 2.23% and fell to a low of 1.81%, before rising to a high of 4.51% and ending at 4.09%.

The US Federal Reserve raised its benchmark interest rate by a combined 1.50% in the third quarter of 2022. It was keen to emphasize the likelihood of further hikes to drive inflation down sustainably towards target, implying a tolerance for weaker growth that would result from aggressive tightening to restore price stability. The European Central Bank enacted larger-than-expected benchmark interest rate increases of 0.50% in July and 0.75% in September.

Credit spreads, despite recording little relative change throughout the quarter, rose in the penultimate week in tandem with risk premia on sterling-denominated assets on the account of heightened fiscal concerns. Rising underlying gilt yields were the principal driver of returns, however.

PERFORMANCE & ACTIVITY

The Sterling Bond Fund's total return, despite lagging behind the IA Strategic bond sector, was significantly ahead of its iBoxx Sterling Non-Gilts benchmark over the period. This was largely as a result of the Fund's shorter relative duration positioning, which contributed positively towards performance. In particular, its underweight term structure position in longer-maturity debt, whose capital values declined to a greater extent as yield curves rose, proved beneficial to the Fund.

Risk sentiment deteriorated towards the end of the quarter, when it became apparent that central banks were willing to accept lower economic growth as a trade-off for restoring price stability. Credit spreads rose on lower-rated debt, as market participants began to price in a more challenging outlook for companies. Higher quality debt of shorter maturity continued to outperform, amidst the broader market sell-off that owed itself more to interest rates than to credit risk premia.

Over the quarter, trading activity was muted. The Fund reduced its holding in Travis Perkins 3.75% 2026. It also added the newly issued Church Commissioners 3.25% 2032 sustainable bond, International Finance Facility for Immunisation 2.75% 2025 and Hiscox Ltd 6% 2027, as well as purchasing UK Treasury 1.125% 2073 to add back a small amount of duration exposure.

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OUTLOOK

Global central banks are decisively hawkish. While their tolerance for slower growth as a price to rein back price expectations grows, risky assets are likely to face a more challenging outlook. Geo-political risks also remain elevated as Russia's invasion of Ukraine further disrupts energy supply to Europe ahead of the winter months.

Despite the speed of the decline in sovereign debt prices warranting intervention by the Bank of England, notably for longer-maturity gilts, global central banks elsewhere are thus far undeterred in their battle against inflation. Emerging signs that such price increases have become embedded for instance through higher core inflation, will only strengthen their policy tightening resolve. The US Federal Reserve continues to deliver outsized interest rate hikes, with the European Central Bank also guiding towards more restrictive monetary policy as inflation accelerates. Even though targeted fiscal support to ease the prevalent cost-of-living pressures are likely to lend support to consumer demand in the near term, the dampening effects of restrictive financial conditions on the prospects for growth are likely to dominate. A cautious stance towards lower-rated and 'higher-beta' assets is crucial, as is a bias towards higher quality corporate bonds and/or government-backed debt, particularly when central banks embark on quantitative tightening.

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 continue to view the Fund's overall shorter relative duration profile as appropriate, also relying on higher cash levels 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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