R&S Managed Income Fund

Q1 2023 Commentary

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PERFORMANCE

	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years
Fund Performance (B Class)	2.2%	11.6%	-3.3%	33.1%	17.5%	54.5%
FTSE All Share TR GBP	3.1%	12.3%	2.9%	47.4%	27.8%	75.9%
IA Mixed Investment 40-85% Shares	2.3%	5.3%	-4.6%	27.0%	22.3%	65.8%
Sector Quartile	3	1	2	2	3	4

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

MARKET REVIEW

Financial markets in the first three months of 2023 were driven by gyrations in inflation and interest rate expectations. For the latter part of 2022, the hope that inflation had peaked and central banks would therefore end their interest rate hiking cycle, drove risk assets higher. This carried on into the early part of 2023, with equities rising in most major markets and bond yields falling. Of note, US technology stocks, so often the barometer of risk appetite, rose sharply.

However, this process ground to a sudden halt in March, when SVB Financial, a bank that was a big lender to US tech start-ups, suddenly collapsed. The sharp rise in interest rates exposed gaping flaws in its risk management, prompting an exodus of deposits by concerned clients. Unlike bank runs of years past, in a digital world this process can now happen at lightning speed. SVB was wound up and then two more mid-sized US banks were rapidly closed in a flurry of activity reminiscent of 2008. This then precipitated the collapse of Credit Suisse, with a forced sale to its arch-rival UBS. While accident-prone Credit Suisse was a long-standing open wound in the banking system, this was an unusual event in that investors in their AT1 bonds – bonds issued after 2008 to act as shock absorbers in a crisis – were wiped out (as expected), while investors in the bank's equity were not, although they did make a significant loss. This turn of events prompted high volatility in financial markets and fears of a domino-effect cascade in the system, but (at the time of writing) it appeared that prompt action by central banks cauterised the damage and restored an element of confidence. With the dust settling, investors once more resumed their focus on lingering inflation and the likelihood of recession later this year.

PERFORMANCE & ACTIVITY

The EdenTree Responsible & Sustainable Managed Income fund made a positive return of 2.2% over the quarter, lagging the return of the FTSE All Share Index but performing in line with its peer group. The fund's exposure to more defensive sectors such as telecoms, food retail, healthcare and utilities was a tailwind in a volatile market. During the quarter, the managers reduced exposure to banks ahead of the SVB failure, which also helped. In contrast, the fund's remaining exposure to financials was a drag on performance, such as insurers, while the holdings in listed infrastructure companies were weak, given their sensitivity to interest rate movements.

On 1st March, a new team took over management of the EdenTree Responsible & Sustainable Managed Income Fund, consisting of Gregory Herbert and Michael Sheehan. While the new team fully expect to keep managing the fund in a similar way to before, with a high yield and low turnover, long-term approach to investing, there is a process of adjustment in the fund's holdings in this handover. The team made some changes, primarily by increasing the bond weighting of the portfolio. This was to capitalise on the ructions in bond markets following the SVB affair, where many bank bonds were offering higher yields, even at much more robust institutions and in securities ranked higher in seniority. This pushed up the portfolio's yield and allowed a bit more flexibility in terms of the equity exposure, giving the opportunity to add a few stocks with good

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dividend growth prospects but trading at slightly higher valuations and at lower yields. This included adding names such as RELX in the UK and Schneider Electric in France.

OUTLOOK

The SVB saga revived the oft-cited and entirely apt metaphor coined by Warren Buffett that you only find out who is swimming naked when the tide goes out. That is, the sharp rise in interest rates has permeated the financial system and we are only now seeing the second round effects: banks with bad risk management, financially stretched home-owners re-mortgaging at much higher rates, and so on. It seems reasonable to assume that we will see more of this process of unintended consequences unfurl. Also, there is currently an expectation priced into bond markets that central banks will rapidly reverse course as soon as they are done with interest rates rises. Equity markets however largely seem priced for some sort of slowdown and possible recession. The latter scenario seems more reasonable – rarely do central banks hike rates and then immediately start cutting them. There is a process of allowing the impact to take effect over a matter of months at least. Inflation also has a habit of being sticky, even if the headline rate might start to fall in the months ahead as the annualised comparisons with a year ago become more favourable. Tight labour markets and second round wage inflation will probably keep inflation at a higher rate than central bank targets. We are therefore minded to keep a fairly defensive positioning in our portfolio, with companies that are able to maintain margins amid input cost pressure. This includes green infrastructure stocks that offer both the attraction of continued spending on the energy transition and inflation-linked revenue streams. In terms of valuation, we regard the UK and Europe as still having attractive valuations and better yields relative to the US, although this gap has narrowed a little. We would also expect our bond exposure to continue to rise a little further, given the attractive yields available in higher quality credits, although these remain well within historic ranges.

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