R&S Short Dated Bond Fund

Q3 2023 Commentary

Performance with principles®

PERFORMANCE

	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years
Fund Performance (B Class)	2.8%	1.0%	4.8%	-3.8%	0.5%	-
iBoxx Non-Gilts ex BBB 1-5 TR GBP	3.2%	0.7%	5.9%	-5.5%	-0.7%	-
IA £ Corporate Bond	2.1%	-0.8%	7.1%	-14.1%	-2.3%	-
Sector Quartile	1	1	3	1	1	-

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

YIELDS

Distribution	3.06%
Underlying	3.06%
Historic	2.07%

MARKET REVIEW

Shorter-dated yields fell as market participants began to contemplate an end to interest rate hikes, even whilst central bankers continued to guide towards keeping policy settings restrictive for longer, with headline inflation having declined further. The Bank of England raised its benchmark interest rate by a further 0.25% in August and opted to maintain the base rate at that level in September by a narrow margin. The FTSE UK Gilts under 5-year yield began the period at 5.11% and rose to a high of 5.33% in July before falling to a low of 4.42% in September and ending the quarter at 4.53%.

The US Federal Reserve raised its benchmark interest rate by 0.25% to 5.5% in late July, which it then maintained at that level in September. Policymakers are currently assessing the impact of cumulative policy changes delivered and remain unanimous in pursuit of their price stability objective. The European Central Bank was perhaps most hawkish as it continued to raise its benchmark interest rate, albeit by 0.25% increments each time, at both its July and September meetings. Whilst progress on headline inflation was welcomed, upside risks such as to energy prices linger due to geopolitical uncertainty.

Credit spreads maintained a steady decline over the quarter, with lower rated debt rallying more than higher quality securities notably in shorter maturities as further rate hikes were perceived as less likely. This saw corporate debt outperform sovereign debt over the quarter.

PERFORMANCE & ACTIVITY

The Short-Dated Bond Fund's total return of 2.8% lagged that of its iBoxx Non-Gilts 1-5 years ex BBB Index benchmark (3.2%) over the period under review. Its shorter relative duration held back performance particularly in July when underlying gilt yields fell considerably.

The Fund's increased exposures to quasi-government debt rallied to a less extent as compared to lower quality debt. Its holdings in floating rate notes, despite benefitting from higher interest rates via higher coupons also underperformed fixed rate debt whose prices rose over the period with falling gilt yields. Higher beta credit such as subordinated financials also benefitted from credit spread tightening.

Over the quarter, the Fund initiated holdings in the newly issued European Investment Bank 3.875% 2028 and Nationwide Buildings Society 6.125%, whilst also establishing holdings in Kuntarahoitus 5.125% 2027. It added to positions in Places for People Homes 5.09% 2024, Siemens 2.75% 2025, Export Development Bank 4% 2026, Neder Waterchapsbank 0.25% 2025, Santander 4.75% 2028 and Bank Federative Credit Mutuel 5.375% 2028. In addition, there were sales of Bank of Nova Scotia 1.375% 2023, Fidelity International 7.125% 2024, HSBC Holdings plc 6.5% 2024, Severn Trent 3.625% 2026, Kommunalbanken 0.25% 2025 and redemptions of Segro plc 6.75% 2024, Anglian Water 6.875% 2023, International Bank of Reconstruction & Development 1.25% 2023.

OUTLOOK

Further moderation in the pace of interest rate hikes delivered by global central bankers has led market participants to anticipate that a peak is within view. Policymakers remain adamant, however, that more needs to be done to successfully return inflation to target levels and have therefore guided towards maintaining restrictive policy settings for longer than currently envisaged. Upside risks to the price of goods and services remain and have arguably been exacerbated by geopolitical uncertainty.

While interest rate hike campaigns are paused to enable the assessment of economies as further transmission of tighter monetary conditions takes place, central banks are reducing their balance sheets through quantitative tightening. The added supply of sovereign debt is likely to prompt a reassessment of risk, notably of term premia with the renewed focus on governments' fiscal plans. In the interim, better-than-expected growth has contrasted with slowing survey data, which has translated into delayed economic weakness. The UK's peculiar position of higher headline inflation and the re-acceleration of core price increases stands out from a global perspective and arguably increases the probability of a harsher economic downturn. The poorer growth prospects, coupled with restrictive financing conditions, justifies a focus on higher credit quality. Corporate default potential appears under-priced. We also consider a cautious stance towards lower-rated and 'higher-beta' assets as crucial, along with a bias towards higher quality debt, based on a deteriorating outlook.

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. Our investment approach continues to focus on good quality short-dated credits with attractive yields.