R&S Short Dated Bond Fund

Q4 2022 Commentary

Performance with principles®

PERFORMANCE

	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years
Fund Performance (B Class)	2.7%	-1.7%	-5.2%	-4.3%	-2.0%	-
iBoxx Non-Gilts ex BBB 1-5 TR GBP	3.8%	-2.6%	-6.6%	-5.5%	-2.8%	-
IA £ Corporate Bond	5.7%	-4.1%	-16.3%	-11.5%	-5.2%	-
Sector Quartile	4	2	1	1	1	-

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

YIELDS

	Dec-22
Distribution	2.16%
Underlying	2.16%
Historic	0.95%

MARKET REVIEW

Shorter-dated gilt yields declined in the final quarter of the year as market participants contemplated a less hawkish outlook. The Bank of England delivered its first 'outsized' 0.75% interest rate hike in October and then raised its base rate by 0.5% in December in a bid to rein in inflation. UK fiscal policy concerns eased after 2022's second change in UK leadership, which also supported gilt markets. The FTSE UK Gilts under 5-year yield began the period at 4.36% and fell to a low of 3.07% in November before rising to 3.63% and ending the quarter at 3.59%.

The US Federal Reserve also raised its benchmark interest rate twice in the fourth quarter of 2022 by a combined 1.25%. Despite the downward shift in pace of rate hikes, elevated consumer prices led policymakers there to signal further tightening and emphasise commitment towards their price stability objective. The European Central Bank enacted interest rises of similar magnitude, increasing its policy rates by 0.75% in October and 0.5% in December.

Credit spreads tightened notably in October. Risky assets rebounded sharply as the debate over near-term peak benchmark interest rates gained traction. Corporate debt considerably outperformed government bonds over the period therefore, with lower-rated and higher-beta debt staging a significant rally, thereby recouping some of the relative underperformance registered in prior quarters of the year.

PERFORMANCE & ACTIVITY

The Short-Dated Bond Fund's total return of 2.7% lagged that of its iBoxx Non-Gilts 1-5 years ex BBB benchmark total return of 3.8% over the period under review. Its shorter duration positioning was the main adverse contributor to relative performance, with corporate bonds significantly rebounding after the Bank of England's targeted market intervention and the subsequent resolution to the UK's Liability Driven Investment crisis.

In addition, lower-quality bonds materially outperformed higher-rated credit and quasi-government debt. Whilst the Fund benefitted from its exposure to BBB-rated debt and its lower interest sensitivity when risk premia fell and yields rose into the year end, this was offset by its larger allocation to AAA-rated sub-sovereign debt which rallied less over the entire period.

Over the quarter, considerable cash inflows were used to establish new holdings in London & Quadrant 2.625% 2028, Assura Finance plc 3% 2028, Places for People 3.625% 2028, A2 Dominion 3.5% 2028, ING Groep 1.125% 2028 Green bond, Credit Agricole 5.75% 2027, Santander 4.75% 2028 and DNB Nor Bank 4% 2027. We also added to existing positions in Bazalgette Finance 2.375% 2027 Green Bond, Severn Trent 6.125% 2024, Anglian Water 1.625% 2025 Green bond and ING Groep 5% 2026 (2025 call), whilst reducing floating rate note exposure. We sold the Fund's holdings in Coventry Building Society Jan 2025 FRN, Yorkshire Building Society Jan 2027 FRN, Royal Bank of Canada Jan 2025 FRN as well as reducing s holding in Scottish Widows 5.5% 2023.

OUTLOOK

The market remains focused on the path for inflation in anticipating the terminal level of interest rates set by global central banks. Should consumer prices slow decisively, hiking cycles may peak. In restoring price stability, central banks are also likely to be wary of 'over-tightening' given the lag with which monetary policy effects materialise.

As such, global central banks have moderated the pace of hawkish policy action for the immediate future even while maintaining guidance that there is more work to do. In addition, a slowing global economy indicated by survey data dampens the outlook for demand, which could also have adverse implications on labour markets. For the UK in particular, labour market disquiet has been a growing theme. The latter could well persist through the year with core inflation proving stickier and as targeted temporary fiscal support on energy costs wears off, further hampering real wage growth. A cautious stance towards credit is warranted, given heightened recession risks that could well result in increased corporate default rates. We retain a bias towards higher quality corporate bonds, which now offer more attractive risk-adjusted yield, complemented by a larger allocation to government-backed debt to guard against wider 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. Whereas we are adding interest rate sensitivity, we continue to view the Fund's overall shorter relative duration profile as appropriate. Our investment approach continues to focus on good quality short-dated credits with attractive yields.