

### PERFORMANCE

	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years
Fund Performance (B Class)	-2.8%	-1.9%	-4.8%	-10.5%	-3.2%	26.6%
R&S Sterling Bond Benchmark	-3.4%	-1.1%	-6.9%	-17.7%	-8.2%	17.3%
IA £ Strategic Bond	-1.0%	0.7%	-0.2%	-5.0%	2.9%	24.8%
Sector Quartile	3	3	4	3	4	2

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

### YIELDS

Distribution	4.33
Underlying	3.78
Historic	4.26

### MARKET REVIEW

Gilt yields were sharply higher, notably in May, as persistent consumer price inflation affirmed the case for further monetary policy tightening and reduced the probability of a dovish global central bank pivot. The Bank of England raised its base interest rate by 0.25% in May and by a larger-than-expected 0.50% in June to 5%, with shorter-dated gilt yields rising the most in response to these actions. The 10-year yield began the quarter at 3.49% and fell to 3.43% before rising to a high of 4.49% in June and ending the period at 4.39%.

The US Federal Reserve raised its benchmark interest rate by 0.25% at its May policy meeting but left it unchanged in June. Whilst the concerns around US regional banks appear to have subsided for now, policymakers remain wary of the cumulative effect of policy changes conducted thus far, notably on interest-rate sensitive segments of the economy. The European Central Bank increased its main interest rate by 0.25% at both its meetings in May and June. It was also keen to signal a higher terminal rate required to meet its price stability objective, with inflation uncomfortably high.

Credit spreads declined steadily over the quarter, with bank junior subordinated debt recouping some of its March underperformance and broader corporate debt benefitting from stable risk sentiment. Rising underlying gilt yields were the main drivers of total returns therefore, with corporate debt once again outperforming sovereign debt.

### PERFORMANCE & ACTIVITY

The Sterling Bond Fund's total return outperformed its iBoxx Sterling Non-Gilts Index benchmark over the period but lagged behind its IA Strategic bond sector. The Fund's added interest rate sensitivity adversely impacted performance. However, this was offset by a stronger contribution from credit selection in the financial sector that rebounded after March's selloff. Its larger allocation to long-dated gilts was beneficial in June, when longer maturity debt rallied as shorter-dated gilt values fell.

Credit spreads were marginally lower over the quarter, with underlying interest rates determining a large part of total returns. By the end of the period, risk sentiment had began to shift to reflect poorer economic prospects as the financial system adjusts to higher inflation and tighter financing costs. A more challenging outlook for companies that could result in higher default rates appears to have been delayed for now but would nonetheless see risk premia increase.

Over the quarter, the Fund initiated holdings in the newly issued United Utilities 5.125% 2038, Close Brothers Group 7.75% 2028 and UK Treasury 4.5% 2042. It added to positions in Phoenix 5.867% 2029, M&G plc 6.25% 2068 (2048 call) and Yorkshire Water 5.5% 2035. Along with redemptions of Bupa Finance 5% 2023 and Royal London 6.125% November 2043 (2023 call), the Fund also sold its UK Treasury 3.5% 2045, IBRD 0.5% 2023 and Kommunalbanken 0.25% 2025 to raise cash.

## OUTLOOK

Global central bankers remain steadfast in efforts to curb rising prices, with upward inflation surprises in Europe and the UK serving to remind market participants of the challenging path ahead. Whilst a policy pivot in the latter half of the year had been contemplated earlier, a higher for longer interest rate outlook is now expected, particularly given persistent price pressures on core goods and services.

Where some progress in tackling inflation is apparent, along with stronger than expected economic growth and or a more robust labour market, central banks may have scope to assess the cumulative effect of tightening conducted thus far by pausing interest rate hike campaigns. This explains the bifurcation in monetary policy stances of the US Federal Reserve and central banks in Europe. 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 as the Bank of England enacts further interest rate hikes. In the face of a weaker growth outlook coupled with tighter financing conditions, a focus on higher credit quality remains justified in a market that is yet to reflect higher corporate default potential. We retain a bias towards higher quality corporate bonds which offer attractive risk-adjusted yield, alongside an increasing allocation to gilts and supra-national debt, notably in longer-dated maturities.

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 rates are now just above neutral.

## 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.

# R&S Sterling Bond Fund

## Q2 2023 Commentary



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Firm Reference Number 527473.