R&S Sterling Bond Fund

Q4 2023 Commentary

Performance with principles®

PERFORMANCE

	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years
Fund Performance (B Class)	7.8%	10.2%	8.0%	-7.0%	7.6%	31.4%
R&S Sterling Bond Benchmark	7.4%	9.8%	8.6%	-13.4%	0.7%	29.9%
IA £ Strategic Bond	6.9%	7.3%	8.0%	-3.7%	11.5%	29.7%
Sector Quartile	2	1	2	3	3	3

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

YIELDS

Distribution	*4.28%*
Underlying	*3.73%*
Historic	*4.19%*

MARKET REVIEW

Despite a weaker start, global bonds rallied sharply over the quarter as market participants not only priced in peak interest rates but also expected looser policy in the months ahead. While some central banks maintained higher-for-longer forward guidance, further declines in headline inflation were acknowledged with the Bank of England holding its benchmark interest rate at 5.25%, unchanged over the period. The 10-year yield began the quarter at 4.44% and rose to a high of 4.67% in October before falling to a low of 3.44% in December and ending the period at 3.54%.

The US Federal Reserve also maintained its benchmark interest rate at 5.5%, the level it had last raised it to in July. With economic data including growth and unemployment appearing robust, policymakers began to anticipate interest rate cuts over the forecasted horizon in a notable shift. While the European Central Bank's Governing Council also kept monetary policy unchanged, a hawkish stance prevailed on lingering concerns around elevated levels of inflation relative to its target. Reinvestments under the Pandemic Emergency Purchase Programme are to be discontinued at the end of 2024.

Credit spreads declined steadily over the quarter, in a similar manner to the previous months, with lower-rated debt gaining considerably more than higher-quality securities as risky assets rallied. Longer-dated debt registered the greatest gains and sovereign debt outperformed corporate bonds over the quarter.

PERFORMANCE & ACTIVITY

The Sterling Bond Fund's total return outperformed both its iBoxx Sterling Non-Gilts index benchmark and the IA Strategic Bond sector over the period. Having steadily increased the Fund's interest rate sensitivity, the larger allocation to longer-dated debt, notably gilts, contributed positively to performance as yields declined. With credit spreads also tighter, there was also a benefit from credit selection as subordinated debt including financials rallied in tandem with other risky assets.

Credit spreads tightened over the period under review. However, the effect from underlying interest rates dominated. Lower inflation outturns along with better than anticipated economic growth data supported risk sentiment, raised geopolitical risks

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notwithstanding. The risks associated with more challenging economic conditions in a restrictive financing environment such as higher default rates and increased risk premia have therefore taken longer to materialise but remain prevalent.

Over the quarter, the Fund initiated holdings in UK Treasury 1.5% 2053 and the newly issued Pension Insurance 8% 2033, while adding to positions in UK Treasury 4.25% 2046 and European Investment Bank 5% 2039. Its holdings in Alpha Plus 5% 2024 and Pension Insurance 8% 2026 were redeemed. It also sold Places for People 4.25% 2023, John Lewis 6.125% 2025, IBRD 0.75% 2026 and IFFIm 2.75% 2025 to raise cash.

OUTLOOK

The reluctance to tighten monetary policy further, with some central bankers even beginning to signal policy cuts, implies a 'peak interest rate' scenario following the latest global rate-hike campaign. Whereas upside risk to the prices of goods and services remains, with tight labour markets also warranting the need to retain optionality, continued inflation declines from post-pandemic highs are noteworthy. The market's focus has decidedly shifted, therefore, to the timing with which policymakers ease financial conditions from present more restrictive levels.

Global economic growth has, thus far, held up better than expected. Near-term price increases above desired longer-term targets may serve to limit the urgency with which interest rate cuts are implemented as well as their magnitude. This points towards the latter half of 2024 as a preferable commencement period for any such changes, which also allows more time to assess the cumulative effects of the policy actions delivered thus far. Ongoing quantitative tightening at a time of reduced fiscal headroom justifies caution vis-à-vis term premia. Policymakers are nonetheless keen on softening the economic impact of higher interest rates as growth is re-prioritised ahead of key elections. This policy pivot, in what has so far been a benign environment for corporate defaults, creates a favourable backdrop for bonds. We retain a bias towards high quality credits offering attractive risk-adjusted yields and an increased allocation to gilts and supra-national debt.

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. With the interest rate hike cycle largely complete, we have positioned for longer relative interest rate sensitivity. Having reduced cash, we continue to rely on higher credit quality to enhance overall portfolio liquidity whilst preserving capital.

YIELDS

The Distribution Yield reflects the amount that is 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 the Fund's expenses (calculated in accordance with the relevant accounting standards) as a percentage of the mid-market 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 charges 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.

PERFORMANCE DISCRETE	12 Months to 31/12/2019	12 Months to 31/12/2020	12 Months to 31/12/2021	12 Months to 31/12/2022	12 Months to 31/12/2023
Fund Performance (B Class)	8.8%	6.4%	-0.3%	-13.6%	8.0%
R&S Sterling Bond Benchmark	7.8%	7.8%	-3.1%	-17.7%	8.6%
IA £ Strategic Bond	9.2%	6.1%	0.9%	-11.7%	8.0%
Sector Quartile	2	3	3	3	2

Past performance is not necessarily a guide to future returns.

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