RATHBONE GREENBANK GLOBAL SUSTAINABLE BOND FUND

QUARTERLY UPDATE DECEMBER 2024

This time last year, we were expecting a messy scramble as inflation and interest rates climbed down from their highs. Towards the end of 2024, the descent turned extra twisty as government bond yields (which move in the opposite direction to prices) spiked.

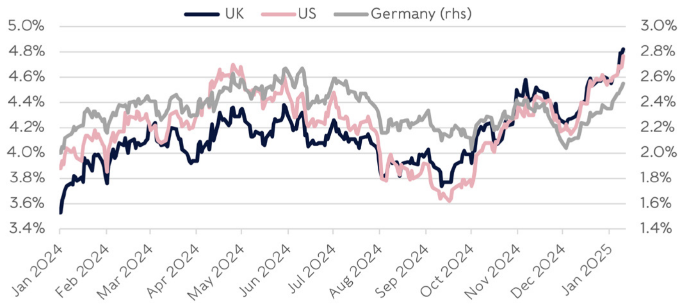
Ahead of the US Federal Reserve (Fed)'s jumbo 0.5% rate cut in September, many government bond yields had dropped to yearly lows. But since then, they've popped much higher. A lot of the selling pressure that's pushed yields up seems driven by nervousness that inflation is proving so sticky that it may not fall back to central banks' targets of around 2% anytime soon. That may force some central banks, especially the Fed, to stall further rate-cutting.

The sell-off also seems to have been fuelled by increasing investor unease about global levels of government debt. Many countries already have huge fiscal deficits (gaps between government revenues from taxes and their public spending). And some big borrowers are planning to up their fiscal spending and may issue more sovereign debt to pay for it. Investors have got spooked by the prospect of a big glut in the supply of government debt. When the supply of anything exceeds the demand to buy it, its price will drop. That's making big gilt investors more price-sensitive and demanding a 'fiscal risk premium' (via higher yields) to compensate them for the risks involved in lending to heavy-borrowing governments. Pressure is most intense at the long end of the yield curve because of the extra uncertainties involved in lending very long-term.

The trend higher in yields gained extra impetus when Donald Trump won the US presidential election in November. His promises of lower taxes and higher tariffs seemed like a recipe for more government borrowing and higher US inflation. Against this backdrop, the 10-year US Treasury yield rose from 3.79% at the start of the period to 4.57% at its end. By early January, it had hit 4.79% — one full percentage point higher than at the start of October. That's a really massive move in the usually relatively staid Treasury market!

The US 10-year yield is the bedrock for global borrowing costs, regardless of where you live or invest. When it moves, virtually all other bond yields do too. You can see from the chart below that even the German government bond (bund) yield rose in 2024 and early 2025 even though Germany's national debt to GDP ratio is much lower than that of the US.

US 10-YEAR TREASURY YIELD SETS THE TREND FOR ALL



Source: FactSet; data to 10 January

Gilt market turbulence

As we explain here, the global bond storm blasted the gilt market in the New Year. The 10-year gilt yield, which had risen from 4.01% to 4.57% in the final quarter of 2024, soared to as high as 4.90% in the first half of January. At the time of writing, the severe pressure on gilts had eased a bit (the yield had fallen to 4.65%). But we're braced for further bouts of volatility.

The gilt market turmoil was an uncomfortable start to 2025. But the rise in gilt yields since September does mean that longer-duration gilts in particular now offer a very generous yield. Even if the prices of long-dated gilts don't recover swiftly to their previous highs, they're offering very attractive 'carry' — the income you get from holding bonds even if their prices don't budge.

We bought the first-ever **Australian Federal Government Green Bond 4.25% 2034** in June because we felt it offered good value. Towards year-end, Australian government bond yields had drifted quite a bit lower than gilt yields, and their prices were correspondingly higher. We took this opportunity to take profits on these bonds and sold some to add to our long-dated **Green Gilt 1.5% 2053s**.

Performance review

	3 months	6 months	1 year	Since launch 30 Nov 23
Rathbone Greenbank Global Sustainable Bond Fund	-1.32%	3.23%	4.45%	7.56%
Benchmark*	-1.32%	3.36%	3.98%	7.69%

* The fund's benchmark consists of 70% ICE BofA Global Corporate Index, 15% ICE BofA Global Government ex Japan Index, 15% ICE BofA All Maturity Global High Yield Index (all GBP hedged).

Source: FE Analytics; data to 31 December, S-class, mid price to mid price.

These figures refer to past performance, which isn't a reliable indicator of future returns.

Duration deliberations

Given the volatility in government bond markets, we were very active in adjusting our exposure to duration (the sensitivity of a bond's value to changes in rates) throughout the quarter.

Among the big central banks, we think the European Central Bank (ECB) could be the most persistent in rate-cutting in 2025. Inflation isn't proving as sticky in the eurozone as in either the UK or the US and, across the region as whole, growth is painfully anaemic. In addition, the Trump administration's mooted universal tariffs on imports to the US could hit Europe particularly hard. The risk of that kind of growth hit could encourage the ECB to cut rates more than the Fed or the Bank of England (BoE). That could exert meaningful downward pressure on eurozone bond yields, bumping up their prices.

Against this backdrop, we increased our exposure to European duration and bought, for example, some euro-denominated **European Union 2.75% 2033s**. By contrast, we dialled down our exposure to US duration because we think US rates could plateau at their current levels for quite a while. We did this by selling some of our longest-dated US corporate bonds, including some US dollar **Microsoft 2.56% 2050s**.

A tougher backdrop for corporate borrowers?

At the start of 2024, there was quite a bit of scepticism about whether corporate bond markets could keep powering ahead given the volatility in government bond (rates) markets. But, bar a few short-lived blow-outs in credit spreads over the summer (around the time of France's fractious elections and August's 'manic Monday'), they narrowed for most of 2024. The ICE Bank of America Global Corporate Bond Index, which measures credit spreads, narrowed from 100 basis points (bps) to 88bps in the final quarter.

Going into year end, most measures of spreads were at multi-decade lows. When spreads get this tight, they can't tighten much more. But they can widen a lot if anything goes wrong.

What happens from here largely depends on the economy. So far, it's proved surprisingly resilient, especially in the US. If that continues, then corporate bonds should continue to hold up well. But that could change if it looks like the economy is weakening.

The growth outlook looks pretty patchy in most places apart from the US. When credit spreads widen, those of bonds with strong credit ratings and defensive characteristics (i.e. the bonds of issuers less likely to be impacted directly by a weaker economic backdrop) tend to widen least. Against this backdrop, we sold some of our high-yield bonds with lower credit ratings and added to our bonds issued by supranationals (big international organisations backed by the governments of two or more countries). For example, we bought some US dollar **European Investment Bank 4.125% 2034s**, **European Bank of Reconstruction and Development 4.25% 2034s** and **International Bank of Reconstruction and Development 1.625% 2031s**. All three issuers are super well-capitalised supranational development banks and benefit from the highest possible (AAA) credit rating.

As we explain here, very strong investor demand for so-called 'labelled' issuance (green, social and sustainability bonds) suggests it could be better shielded from any big credit spread blow-outs than some other parts of the broad fixed universe. We bought several new labelled bonds over the quarter. These included some Spanish electric power firm **Ibedrola 4.25% hybrid green** bonds (they are perpetual bonds but Ibedrola can call (redeem) them in 2030). Ibedrola plans to use the money raised to fund sustainable energy projects. We also bought some Brazil-based waste management firm **Ambipar 9.875% 2031 green** bonds. The firm has two arms: one focuses on environmentally friendly waste management and disposal; the second on environmental crisis management. The money raised is being used to restructure Ambipar's existing debt and also to fund projects intended to bring environmental benefits.

The value of investments and the income from them may go down as well as up and you may not get back what you originally invested.

Buckled up for a bumpy ride
We're still expecting global bond yields to edge lower this year, but it's likely to be a bumpy ride. The Fed seems likely to keep rates on hold for some time, while the ECB may press ahead with bolder rate cuts. We expect the BoE to trim rates cautiously for now, but that could change if the cracks appearing in the UK economy start to suggest a more serious slowdown is looming.

If government bond yields across short to very long maturities dip below their current 4.5-5.5% level at some point, they could offer very decent capital gains. In the meantime, they are paying very generous levels of income. And their juicy yields reinforce their ability to serve as a valuable counterweight if the prices of stocks and other 'risk assets' suddenly crater.

BRYN JONES
Fund Manager

STUART CHILVERS
Fund Manager

For more info on our fund, including factsheets, performance and fund manager views, please click here.

If you require further clarification on this commentary, then please contact your adviser or Rathbones at the contact details below.

Any views and opinions are those of the investment manager, and coverage of any assets held must be taken in context of the constitution of the fund and in no way reflect an investment recommendation. Past performance should not be seen as an indication of future performance. The value of investments and the income from them may go down as well as up and you may not get back what you originally invested.

Rathbones Asset Management

30 Gresham Street
London EC2V 7QN
+44 (0)20 7399 0000
Information line:
+44 (0)20 7399 0399
ram@rathbones.com
rathbonesam.com

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