



RATHBONES

RATHBONE HIGH QUALITY BOND FUND

QUARTERLY UPDATE JUNE 2025

It's a huge understatement to say the second quarter was eventful! But even though it began with a full-blown market panic, the worst volatility eased pretty quickly. Government bonds remained under pressure over mounting concerns about debt sustainability, but credit markets rallied over the quarter as a whole.

President Donald Trump's 'reciprocal' tariff policy unveiled on 'Liberation Day' (2 April) triggered a brutal market meltdown. Investors feared it could upend the global economy and disrupt deeply intertwined global trade, driving sharp sell-offs in risk assets (equities and credit). US Treasuries subsequently sold off too as investors worried about the potential inflationary impact of tariffs, as well as the reputational hit to Treasuries' 'safe-haven' status given Trump's avowed commitment to unpredictability ("I mean, nobody knows what I'm going to do").

Tariffs, tax cuts and U-turns

Extreme market volatility (especially the big spike in US Treasury yields) seemed to galvanise Trump into hastily calling for a 90-day pause in most tariffs and opening up trade negotiations with America's trading partners. The 10-year US Treasury yield, which had surged by well over 30 basis points (bps) from 4.21% at the start of the quarter to just below 4.60% in the week after Liberation Day, fell back sharply. But it then soared back above 4.60% in late May when investors were rattled by America's huge (and growing) debt load as Trump pressed ahead with his "One Big Beautiful Budget Bill Act" (OBBBA).

The OBBBA, which Congress approved on 3 July, includes sweeping tax cuts that will crank the US debt-to-GDP ratio up to extraordinary highs. Credit rating agency Moody's highlighted the increased burden of financing the ballooning US budget deficit when it announced in mid-May that it was stripping the US of its triple-A credit rating. The other two big rating agencies had already downgraded the US so none now give US sovereign debt top marks; S&P downgraded US sovereign debt 12 years ago and Fitch did likewise in 2023.

The 10-year Treasury yield retreated again when investors anticipated more interest rate cuts could be on the way from the US Federal Reserve (Fed) amid signs that the tariff saga isn't – so far – fuelling the surge in American inflation many had feared. So, with plenty of ups and downs along the way, the 10-year yield basically did a round-trip over the quarter, ending at about the same level as it had started, notwithstanding worries about spiking oil prices because of the Israel-Iran conflict. So far in 2025, the 10-year yield has dropped about a quarter of a percentage point.

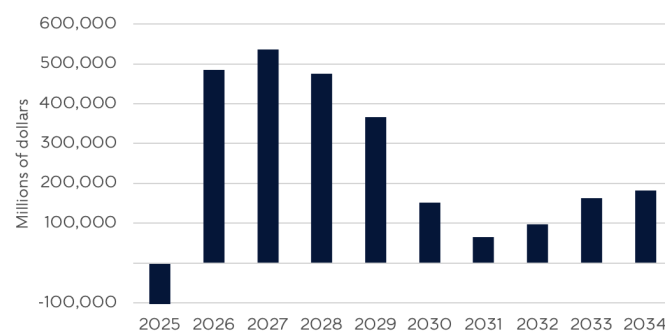
But longer-term Treasury yields have kept climbing consistently higher. The 30-year Treasury yield was just above 4% at the start of 2024, but it's been hovering around 5% for much of this year.

This steepening of the yield curve, where the gap between short and long-term yields widens as the latter rise more than the former, is a global trend. It reflects growing investor concerns about the huge debt and interest burdens borne by big borrowing countries. Investors fear that governments' huge debt loads will weigh on long-term economic growth, while also worrying that inflation could rise over the long term, or at least become more volatile. As a result, they're demanding more compensation (in the form of higher yields) to invest in sovereign debt further out the curve.

Short-term gilt yields have fallen this year as the Bank of England (BoE) has stuck with its pattern of cutting interest rates by 0.25% each quarter. The 10-year gilt yield was 4.68% at the start of April and briefly rose to as high as 4.79% during the height of tariff-driven market turbulence. But it had dropped to 4.50% by quarter-end as investors rooted for more forceful BoE rate cuts given signs that the UK economy is slowing. By contrast, the 30-year gilt yield ended the quarter higher than at the beginning of the year.

The softening in economic data in both the US and the UK over the last few months means investors now expect more Fed and BoE rate cuts than they did at the start of the year. That should ease some of the pressures on US and UK government bond yields as we move through the summer. Nevertheless, debt sustainability concerns may well resurface at various points since governments seem to lack the will to rein in spending. The OBBBA is expected to increase the projected US deficit by \$3.4 trillion over the next decade. And here in the UK, the Labour government's U-turns on pledges to reduce winter fuel payments and disability benefits mean that Chancellor Rachel Reeves' super-tight 'fiscal headroom' is shrinking by the day.

HOW THE OBBBA COULD SWELL THE DEFICIT



Source: Congressional Budget Office; estimated net impact of the bill per fiscal year

Investing in shorter-duration, less interest rate-sensitive bonds (as we do in this fund) can help insulate us from the volatility that can be triggered by aggressive swings in government bond yields.

Performance review

	3 months	6 months	1 year	3 years	5 years
Rathbone High Quality Bond Fund	2.05%	3.33%	5.86%	12.92%	5.59%
Bank of England Base Rate + 0.5%	1.19%	2.45%	5.28%	15.39%	17.13%

	30 Jun 24- 30 Jun 25	30 Jun 23- 30 Jun 24	30 Jun 22- 30 Jun 23	30 Jun 21- 30 Jun 22	30 Jun 20- 30 Jun 21
Rathbone High Quality Bond Fund	5.86%	8.40%	-1.60%	-7.82%	1.44%
Bank of England Base Rate + 0.5%	5.28%	5.73%	3.67%	0.90%	0.60%

Source: FE Analytics; data to 30 Jun, I-class, mid price to mid price.

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

Given our view that a weakening UK jobs market might drive the BoE to cut rates more forcefully, we decided slightly to increase our UK duration over the quarter. For example, we sold some **UK Treasury 4.5% 2028s** to buy some slightly longer-dated **4.375% 2030s**.

Credit rallies ahead of summer lull

While sovereign debt markets remained jittery, credit markets rallied sharply in May and June as investors grew increasingly confident that Trump's about-turn on tariffs would play out again. This is based on the belief that Trump's most outrageous policy announcements trigger market mayhem that forces him into big walk-backs, which, in turn, revive investor confidence once again.

Credit spreads – the extra yield investors get for lending to companies versus governments – began the quarter at 106bps and then blew out to as wide as 130bps immediately after Liberation Day. But that spread (as measured by the ICE Bank of America Sterling Corporate Bond Index) subsequently narrowed again, ending the quarter at 96bps.

That leaves credit spreads looking pretty tight relative to history. But, given very strong investor demand for credit, we think they could grind yet tighter over the summer as issuance levels dip during the holiday season. Against this backdrop, we bought some newly issued sterling-denominated Danish bank Danske Bank 5.25% 2031 bonds that we felt looked very attractive.

CREDIT SPREADS DROP SHARPLY WHILE GILT YIELDS TRADE FLAT



Source: FactSet; credit spread is ICE Bank of America Sterling Corporate Bond Index's option-adjusted yield above that of UK Government Bonds

While the BoE is suggesting it's ready to make larger rate cuts if the jobs market slows more significantly, the European Central Bank (ECB) has begun to signal it's nearing the end of rate-cutting for this cycle. Meanwhile, Germany is pressing ahead with big public spending plans that could drive up European inflation and so force the ECB to start *raising* rates again. As a result, we sold several of our European corporate bonds to buy UK credit instead. For example, we sold some of our German state-owned investment and development bank **KfW 0.75% 2027s** and some **European Investment Bank 3.875% 2028s**. We replaced them with some **Virgin Money 5.125% 2030s** and **4% 2027s** and some electric utility **London Power Networks 6.125% 2027s**.

The tariff saga rolls on... and on

Financial markets are undoubtedly calmer than they were at the height of April's full-blown panic. But the underlying drivers of that extreme volatility – trade policy uncertainty, concerns about slower US growth, heightened geopolitical risks and fiscal deficits – remain largely unresolved.

The Liberation Day tariff pause was initially due to end on 9 July, but the White House is now saying it'll keep tariffs on hold as it continues negotiations with its big trade partners that haven't already struck a deal. So far, it's reached limited deals only with the UK, China and Vietnam.

Estimates for where the average tariff rate will end up vary a lot, but are generally north of 15%. That's a huge increase from the end of 2024 when the rate was only around 2.5%! That kind of increase in US import taxes seems certain to impact on inflation, economic growth and supply chains right around the world, though it's hard right now to gauge the full fall-out.

We're staying cautious and braced for more bouts of market volatility. But, with many bonds offering very attractive yields and central banks in rate-cutting mode, we continue to believe that bonds are well positioned to deliver healthy returns in the months ahead. Moreover, our focus on short duration high quality credit should help bolster our fund's resilience in the event of further market turbulence.



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. When you invest, you could lose some or all of your investment.

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

Rathbones Asset Management Limited is authorised and regulated by the Financial Conduct Authority and a member of The Investment Association. A member of the Rathbones Group Plc. Registered office: 30 Gresham Street, London EC2V 7QN. Registered in England No. 02376568.