



# RATHBONES

## RATHBONE HIGH QUALITY BOND FUND

QUARTERLY UPDATE DECEMBER 2025

**Government bond markets had a mixed end to 2025, while credit markets finished the year in fine fettle. Strong investor demand for corporate bonds' very attractive yields ensured that credit spreads (the extra yield offered over government bonds) ended the year at historically tight levels.**

### **Gilts rally as supply shifts and lower rates align**

Unsurprisingly, UK government bond (gilt) markets were very volatile ahead of the Autumn Budget on 26 November as endless leaks, rumours and policy false starts kept investors very jittery. In the event, the Budget proved more gilt-friendly than many investors had feared. The government announced a larger than-expected increase in its fiscal headroom, reassuring investors (for now at least) that it's serious about trying to plug the massive gap between what it spends and what it brings in from taxes. In addition, the Debt Management Office (DMO) announced the government will issue less new debt in the current fiscal year than investors had feared. Even more importantly, the DMO cut back the supply of long maturity gilts which should help support their prices.

Finally, unlike 2024's Budget, this one didn't include policies that might fuel inflation significantly. That paved the way for the Bank of England (BoE) to cut rates by 0.25% at its December meeting to 3.75%. All this aligned to drive a sharp rally in the 10-year gilt yield towards year-end, with the yield falling from 4.70% at the start of the quarter to 4.47% at its end. (Bond yields run in the opposite direction to their prices.)

### **What's on our watchlist for 2026?**

We think we'll now get a bit of a breather from the intense fiscal uncertainty that kept gilt yields so volatile for a lot of 2025. There was probably enough in the Budget to make the Spring Statement a non-event for gilts, but the local elections in May could be a different story. We think the weak employment picture will persuade the BoE to cut by more than the roughly two 25-basis-point cuts priced in for 2026 at the time of writing (we see scope for three cuts, which would take the base rate down to 3%). That should be particularly supportive for the shorter-dated (lower duration) bonds that this fund invests in.

While the BoE may cut more than investors currently expect, we think investors have probably fully priced in nearer-term rate easing from the US Federal Reserve (Fed). The Fed cut rates by 0.25% when it met in October and again in December, taking the federal funds rate to 3.50-3.75%. Inflation is still well above the central bank's 2% target, which would ordinarily call for keeping rates more or less where they are. But the US jobs market has been cooling (employers are creating far fewer new jobs), which typically points toward lower rates. Fed policymakers

appear increasingly divided about which of these problems is more urgent. For now, investors seem to be leaning towards a couple more Fed cuts during the course of 2026. Against this backdrop, the 10-year US Treasury yield had a choppy quarter and ended it at 4.15%, exactly the same level as at its start.

As ever, we're scrutinising the likely path of US rates (the global benchmark for borrowing costs) very carefully. That path may prove extra-twisty given President Donald Trump's very public spat with Fed Chair Jerome Powell. Ever since he won a second term, Trump has railed against cautious Fed rate-cutting. Much lower rates would fire up the economy, cut back the government's borrowing costs and be popular with many voters. But it could also fuel a big inflation spike, potentially forcing rates up further down the line. Trump's invective recently escalated into threats to instigate criminal proceedings against Powell, who claims the threats are a pretext to get rid of him given his resistance to pressure on the rates front. This is heightening investor concerns about the Fed's future independence, which may persuade them to demand higher risk premiums (in the form of higher yields) for holding long-term US government debt.

### **Can credit cope with more uncertainty?**

Credit markets proved remarkably resilient in 2025 given huge uncertainties on tariffs and global trade, inflationary pressures and pretty uneven global growth. Credit spreads nudged wider in October and November, but tightened again in December. As a result, spreads (as measured by the ICE Bank of America Sterling Corporate Bond Index) narrowed from 81 basis points (bps) to 80bps over the quarter as a whole. That leaves spreads at or near their tightest levels in almost 20 years.

Will credit markets manage to absorb further potential economic volatility and geopolitical shocks in 2026? The first few weeks of this year have already seen a massive surge in global geopolitical tensions. So far, this doesn't seem to have seriously dented investor demand for corporate bonds. For now, we see reasons to be (cautiously) optimistic that this demand is unlikely to collapse overnight.

First and foremost, starting yields are very attractive. High starting yields often predict stronger future returns since their generous income streams provide a nice cushion against interest rate risk, assuming the bonds are held to maturity and the issuer does not default. Coming into 2026 with a yield to worst of over 5% means the sterling investment grade corporate bond market offers a very decent buffer for absolute performance this year if credit spreads were to widen. That's helpful given the tightness in credit spreads.

**Performance review**

	3 months	6 months	1 year	3 years	5 years
<b>Rathbone High Quality Bond Fund</b>	1.57%	2.52%	5.94%	18.37%	6.10%
Bank of England Base Rate + 0.5%	1.14%	2.34%	4.93%	17.05%	20.12%

	31 Dec 24- 31 Dec 25	31 Dec 23- 31 Dec 24	31 Dec 22- 31 Dec 23	31 Dec 21- 31 Dec 22	31 Dec 20- 31 Dec 21
<b>Rathbone High Quality Bond Fund</b>	5.94%	3.83%	7.61%	-8.97%	-1.53%
Bank of England Base Rate + 0.5%	4.93%	5.86%	5.38%	2.00%	0.61%

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

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

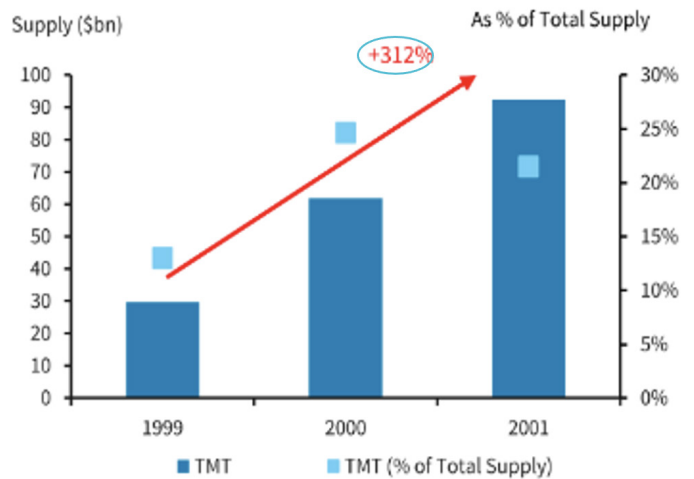
And, as we've explained, global investor appetite for corporate bonds is holding up. Indeed, investors have been rushing to snap up record-breaking levels of issuance. That enabled US investment grade borrowers to raise more than \$95 billion in the first full week of January in the busiest start to a year on record, while 7 January was the largest single day of issuance for European credit markets in history.

It feels like 2026 could be a bumper year for European credit markets in particular. The Netherlands is undergoing a big shake-up in its pensions system, with €1.5 trillion in pension investments moving out of defined benefit (DB) schemes to defined contribution (DC) ones over the next few years. That shift suggests Dutch DC schemes may significantly beef up their credit allocations as they seek to bolster investment returns. At the same time, Germany has scrapped its debt brake to allow for the creation of a 10-year €500bn infrastructure fund and permit essentially unlimited borrowing for defence budgets. That suggests we're likely to see a river of public money flowing into debt-funded investment projects in Europe's biggest economy.

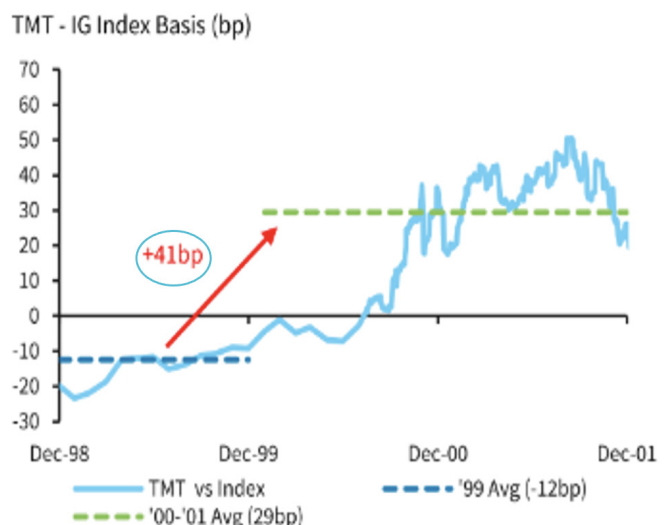
On to some potential negatives. Over and above the big picture economic and geopolitical uncertainties that might trigger volatility in credit markets, we're keeping a close watch on a couple of potential trouble-spots that emerged towards the end of 2025.

First up, some of the massive US tech firms at the forefront of AI have begun issuing huge amounts of investment grade bonds to fund their enormous AI-related capital expenditure (capex). To be clear, we're not generally worried at the issuer level given the huge capacity most of these firms have to service their debt given their low leverage and strong profitability. But we do think that the overall increase in already strong bond supply could weigh on credit spreads more generally. We saw this happen back in the early 2000s when a massive surge in issuance from telecom companies drove credit spreads much wider.

**TELECOM ISSUANCE SOARED DURING THE DOT.COM BUBBLE...**



**...DRIVING SPREADS WIDER**



Source: Bloomberg, Barclays Research as at 29 December 2025

### Is trouble brewing in private credit?

Another concern on our radar is the risk of further trouble brewing in the private credit industry after a couple of reasonably large American firms defaulted on private credit loans back in September.

Further defaults in the private credit space might stoke investor fears about the health of corporate borrowers, including those issuing publicly traded bonds. It's claimed that the high-profile defaults on private credit loans back in September may have involved fraud on the part of the borrowers, which would seem to suggest they weren't the result of more systemic risks. But if defaults on private credit loans do pick up, we wouldn't be surprised if that unnerved investors a bit and drove credit spreads wider.

Because several big US life insurers have sizeable investments in private credit, we dialled down our exposure to these issuers during the quarter as a precautionary move. As a result, we sold some of our **Met Life 4.75% 2031s** and **5% 2030s**, **Pacific Life 5.375% 2028s**, **Protective Life 4.8026% 2030s**, **Northwestern Mutual 4.7% 2030s** and **New York Life 4.875% 2031s**. We sold all our American insurer **MassMutual Global Funding 4.625% 2029s** because we had specific concerns about a US Securities and Exchange investigation into its accounting practices. This may not result in a formal allegation into wrongdoing at the firm, but we felt it best to exit.

We reinvested the money from the MassMutual sale into **Inter-American Development Bank 4.75% 2029s**. Given the very tight credit spreads on offer, we felt it was better to buy AAA-rated supranational debt.

We bought some newly issued UK building society **Nationwide 4.125% 2030** covered bonds. Covered bonds get their name because they're backed ('covered') by a pool of high quality assets on the issuer's balance sheet (like mortgages, for example). If the issuer were to run into trouble, these pools are protected from the claims of its other creditors. That puts covered bonds at the front of the queue to get paid back before other borrowings. This extra layer of credit protection means that covered bonds typically benefit from particularly strong credit ratings; the Nationwide bonds have an AAA rating.

We snapped up some **Telereal Securitised Property 1.3657% 2031s** towards year-end. Telereal manages a large-scale commercial property portfolio that's mainly leased to BT. The bonds are backed by the rental cash flows the firm earns from these long-term leases. We regard Telereal as a very high quality issuer: its bonds are very rarely available to buy as they're often held to maturity.

We also bought some sterling Munich-based **Bayerische Landesbank 5.25% 2029s**. As a publicly-owned, state-backed bank, **Bayerische** has a high investment-grade credit rating.

### Our sum-up

How does all the above leave us feeling for 2026? Cautiously optimistic.

As we've explained, we're keeping a close watch on a couple of potential trouble-spots going into 2026. When credit spreads widen, those of lower-rated, higher-yielding bonds, and bonds which mature a long way ahead, tend to widen most. We believe that our focus on high quality, shorter-duration bonds should help insulate us from possible outbreaks of credit spread volatility.



**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.

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