RATHBONES

RATHBONE STRATEGIC BOND FUND

QUARTERLY UPDATE SEPTEMBER 2026

Bond yields reset sharply higher as the war in the Middle East reignited inflation fears, central banks turned to rate hikes and governments kept borrowing heavily. A glut of debt from the AI giants added to the pressure, and credit markets finally began to show some strain.

The third quarter was a bruising one for bond markets. Worries about inflation and interest rates collided with concerns about rising government borrowing, while the flood of new debt from America's biggest tech companies stoked unease about how much supply investors can comfortably absorb. Together, these pressures drove a significant reset in yields across fixed income markets. During the quarter, the 10-year US Treasury yield rose from 4.42% to 5.29% to hit its highest level in almost 25 years. The 10-year UK government (gilt) yield rose only slightly less, increasing from 4.77% to 5.44%.

A BIG RESET IN BOND YIELDS

Source: Rathbones, FactSet as at 16 September 26.

The trouble began in July, when an escalation in the Iran war sent oil prices sharply higher and revived inflation fears. The price of Brent crude has risen from around $60 per barrel before the war began to roughly $100 as at the end of September, having touched $120 along the way. Diesel prices have risen even more steeply.

Central banks hit the brakes

Headline inflation is rising again as a result. In the UK, inflation hit 3.1% in August, its highest rate in five months, while US inflation jumped to 3.7% in September, rising for the first time since May. This resurgence in inflation has dramatically changed the outlook for interest rates. In late February, investors were pricing in two quarter-point rate cuts from both the US Federal Reserve (Fed) and the Bank of England (BoE) this year. By September, they were expecting several hikes, adding up to roughly a full percentage point of tightening over the next 12 months. In mid-September, the Fed voted unanimously to raise rates by a quarter-point to 3.75-4.00%, its first hike since 2023. The European Central Bank (ECB) is also tightening policy and the BoE is widely expected to hike rates by a quarter-point in November.

In our view, central banks are more likely to make one to two hikes over the coming year, depending on how the Middle East conflict proceeds and how it flows through to inflation via energy prices. That's roughly half the tightening that investors expect. Growth is holding up better than many had feared, but if energy prices stay high, the resulting economic drag will intensify, making successive rate rises less likely. Here in the UK especially, the risks seem skewed toward a slowdown rather than an overheating economy. Given our view that expectations of between three and four quarter-point hikes in total could prove overly aggressive, we added to our duration exposure (our sensitivity to the direction of interest rates) by buying more long-dated gilts, notably more **UK Treasury 4.25% 2040s** and **Green Gilt 1.5% 2053s**. Given the surge in inflation pressures as a result of the energy supply shock, we also bought more inflation-linked gilts, notably by buying more **UK Index-Linked Treasury Gilt 0.125% 2029s**. As their name suggests, linkers' income payments and face value are linked to the current rate of UK inflation, offering decent protection if it spikes. In a similar vein, we added to our **US Treasury Inflation-Protected Security (TIPS) 1.625% 2030s**.

Too many bonds, too few buyers?

Inflation has been the key catalyst for the big reset in bond yields, but other factors have come into play too. Longer-dated yields have been driven up by growing unease about many governments' massive borrowing and the rising cost of servicing that debt. Investors are paying more attention to the sustainability of government spending plans and demanding more compensation (via higher yields) to lend to some governments long term. Right now, France is very much in the hot seat as its plans for record bond issuance next year are fuelling concerns about its mighty fiscal deficit (the gap between what the government spends and what it brings in from taxes). Those concerns are intensified by opinion polls suggesting that Marine Le Pen's Rassemblement National, which has historically favoured economically populist, pro-spending policies, could well take control of the presidency in elections next spring. All this has driven investors to demand a much steeper premium for owning French government bonds (OATs) versus German Bunds (Europe's borrowing benchmark).

At the same time, investor demand for long-dated government bonds of all stripes seems less dependable. Governments used to count on a deep pool of price-insensitive buyers (such as central banks, pension funds and insurers) to absorb their longest-dated debt, but that pool is shrinking. Japan, the largest foreign holder of US Treasuries, is a good example: with 30-year Japanese government bond (JGB) yields above 4% and 10-year yields touching 3%, Japanese investors have far less reason to buy Treasuries in search of income.

Performance review

	3 months	6 months	1 year	3 years	5 years
Rathbone Strategic Bond Fund	-1.82%	0.62%	1.73%	19.32%	5.74%
IA UK Sterling Strategic Bond Sector	-2.06%	0.49%	1.24%	19.65%	6.57%

	30 Sep 25-30 Sep 26	30 Sep 24-30 Sep 25	30 Sep 23-30 Sep 24	30 Sep 22-30 Sep 23	30 Sep 21-30 Sep 22
Rathbone Strategic Bond Fund	1.73%	4.24%	12.53%	7.60%	-17.64%
IA UK Sterling Strategic Bond Sector	1.24%	5.16%	12.38%	5.21%	-15.34%

Source: Morningstar; data to 30 September, I-class, mid price to mid price.

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

The deluge of new debt from the AI hyperscalers complicates things further. Much of it is also long-dated and very highly rated (often AA to AAA), giving it some of the characteristics long-duration investors have traditionally sought in government bonds. Because the hyperscalers have issued so much debt so quickly (AI-related borrowing has rocketed from almost nothing in 2024 to an estimated $500 billion in the first nine months of 2026 alone), these firms have had to sweeten their yields to get deals away. That may be pushing up governments' borrowing costs as they compete for a limited pool of long-duration capital.

The supply squeeze and long-dated gilts

Gilts were more unsettled than some other major bond markets through July and into August, but steadied going into September. That coincided with efforts by new Prime Minister Andy Burnham's government to reassure investors that it's committed to fiscal discipline. The government is acutely aware of the risk that concerns over the UK's public finances could push gilt yields, and therefore its borrowing costs, still higher. The Autumn Budget will be an important test, with investors looking to Chancellor John Healey for evidence that the government can balance its spending ambitions with sustainable public finances.

We think a lot of the bad news is already priced into gilts, so we see scope for them to rally if the UK's fiscal outlook proves less dire than some fear. And the technical supply backdrop has grown more supportive too, especially at the long end. The Debt Management Office (DMO) has sharply cut back long-dated gilt issuance compared with previous years, while shifting issuance towards shorter and medium-dated bonds. Meanwhile, the BoE has scaled back quantitative tightening (QT) by cutting the pace of active gilt sales, pausing its auctions and planning to hold £120bn of its longest-dated gilts to maturity. Fewer new long gilts and less BoE selling could provide powerful technical support, reinforcing why we see value at the long end of the gilt curve in particular.

Credit's resilience cracks

After a long spell of resilience, credit spreads (the extra yield corporates offer over government debt) came under pressure in the final weeks of the quarter. The iTraxx European Crossover Index – a widely-watched gauge of high-yield credit risk – began the quarter at 245 basis points (bps) and had blown out to 301bps by its end. The key driver was broad bond market volatility, not worries about a deterioration in corporate fundamentals specifically. Rising bond yields, inflation worries and rate hikes from the Fed and the ECB set the tone, while political and fiscal uncertainty in France added extra pressure in Europe. The supply of new corporate debt slowed after a record-breaking first half of the year. The AI hyperscalers managed to get some big deals done, while outside the AI theme, there was ample investor demand for the massive Paramount Skydance deal to fund Paramount's takeover of Warner Brothers. Nevertheless, there were signs that pricing power was shifting more firmly towards investors, allowing them to demand higher yields from issuers.

Adding to insurers and French banks

We stayed highly selective in primary markets, buying some newly issued specialist lending and savings bank **Paragon 6.5% 2036s** that we felt offered particularly good value. We also increased our exposure to the insurance sector, adding bonds from insurers and insurer/asset managers, including some **Rothesay Life 6.9932% 2037s**, **Argentum (Swiss Re) 5.524% perpetuals**, **LV 7.625% 2046s**, **Admiral 8.5% 2034s** and **Aviva 4% 2034s**. Many insurers have substantial financial buffers and resilient business models, but their bonds can offer higher yields than comparable-quality companies in other sectors.

We bought some French bank **Crédit Agricole 5.5% 2033s**. French bank bond spreads have widened on concerns about the country's stretched public finances. We felt that created an opportunity: investors are worried about France's debt trajectory and deficit, not the financial resilience of its banks. Crédit Agricole remains in solid shape and, as a large, diversified global banking group, has significant operations beyond its domestic French market. That provides some insulation from France-specific political and fiscal risks, so these wider spreads looked like good value to us.

In July and August, longer-dated bond yields rose faster than shorter-dated ones. We responded by selling some of our shortest-dated bonds, including some Skipton Building Society 6.25% 2029s, **Coventry Building Society 5.579% 2028s** and **Investec 1.875% 2028s** to reinvest further along the curve where yields looked more attractive.

Putting the reset to work

For investors who look to bonds for stability, the volatility of recent months has been uncomfortable at times. But the sizeable reset in bond yields is also creating very attractive opportunities, particularly for active managers with the flexibility to choose where to take risk and which bonds to own, rather than simply following an index.

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

As yields have grown much more generous over the last four years, investors benefit from a meaningful income cushion against near-term price swings, particularly in higher-yielding markets such as the UK. As at the end of September, broad indices of sterling investment grade credit were yielding comfortably above 5.5%. That's up from roughly 5.1% at the start of this year and a major jump from just over 2% at the start of 2022.

Moreover, the mechanics of bond markets mean that when bond yields rise, bond duration falls. In simple terms, bonds get less sensitive to future changes in interest rates. That means that a bond market with higher yields is generally better positioned to absorb further rate moves than one where yields are meagre. And the more generous starting yields on offer from many government bonds bolster their ability to serve as safe-haven assets in the event of growth scares or a weakening in investor risk appetite.

After years of falling short on income, protection and diversification potential, bonds are beginning to behave like bonds again. Higher bond yields are transforming the fixed income opportunity set. But making the most of that transformation requires sharper choices about which risks to take, how to take them and, just as importantly, which ones to avoid.

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

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