



Rathbone Ethical Bond Fund

Update for December 2011

The ten-year Gilt yield started December on 2.31%, ending the month – and a volatile year for credit – at 1.98%, close to an all-time low. Indeed, at one point, the 10-year hit 1.96%, driven by continued concerns about the euro sovereign debt crisis. Despite the obvious lack of value, Gilts continue to be perceived as a safe haven. Furthermore, quantitative easing, realised or anticipated, is suppressing yields in the short term.

The US provided something of a bright spot, with lead economic indicators showing signs of improvement. Manufacturing data were particularly positive, as was the employment picture. We are also seeing a relaxation of monetary policy in many emerging market economies, as well as the likelihood of easing from China. We are, therefore, positive in our outlook for credit in Q1 and Q2, although the potential for Europe to lurch from one disaster to another remains a worry for most investors. On a more positive note, the European LTRO (Long-Term Refinancing Operation) is offering unlimited three-year loans at 1% to European banks, which they can reinvest in credit, covered bonds or sovereign debt. This is QE by the back door, with a further auction in February likely to expand the ECB's balance sheet.

Over the month, we participated in several new issues such as *Morrisons*, and *Marks & Spencer*. We also added to an existing position in *ANZ Bank*, and also took a position in French bank *Credit Agricole*, a Tier 1 bond that had been beaten-up by the market amid European fears. We have taken the view that a tender might be in the offing. We also purchased some *UK Floating Rate Note's (FRN)*, yielding 6% and maturing next year – a compelling story.

We believe lower levels of inflation will effectively act as a policy tool, reducing the 'tax' on growth in the UK and the US whose economies remain heavily dependent on the consumer. We believe that the scene is set for risk assets to outperform during the first six months of the year, although the caveat has to be a European meltdown or an oil price shock, both of which could send markets reeling once again.

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