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ECONOMIC REVIEW

During the first quarter of 2025, sterling corporate bonds continued to outperform government bonds. The UK economy faced increased prospects of stagnant growth in the period, with the labour market and wages showing some strain. This, along with continued rising inflation caused by higher food and energy prices, caused the economic outlook to diminish.

In addition, the ascendance of Donald Trump to the US presidency – and his threats of trade wars and tariffs – caused greater uncertainty in markets, as did a breakdown of the western consensus on the ongoing war in Ukraine. This caused governments to explore reallocations of resources from social programmes to increased defence spending.

With inflation remaining closer to the Bank of England's 2% target, although still 'sticky', and with weak economic signals, we do see interest rates falling over the year. Further turmoil is expected from a backlash to Trump's tariffs.

FUND REVIEW

The fund only slightly outperformed the benchmark in the quarter. This was mainly due to our modest risk-facing position heading into the new year and our selective profit-taking over the quarter as markets became more volatile and tariff uncertainties came to the fore. However, the fund was negatively impacted by a number of longer-dated positions that we maintained early in the quarter.

We continued our overweight positions in the utilities, real estate and asset-backed sectors while reducing some of our higher-risk financials positions. Instead, we preferred to invest in sovereign government bonds to reduce risk in the near term with the option to add back at a more profitable level.

FUND TRANSACTIONS

Continued pension fund demand, low new issuance and strong fundamentals were the main reasons we maintained our favourable stance towards corporate credit in the first quarter. However, expensive valuations encouraged us to reduce some holdings, primarily in the financials sector.

We reduced a number of unfavoured positions in Notting Hill Housing Association, Brookfield Renewables, Scottish Widows and Motability. We also saw our long-held emerging markets position in Vena Energy mature. In financials, we rotated some of our more subordinated holdings into more senior names to reduce the level of risk in the fund.

OUTLOOK

We think market uncertainty will continue. The slowing inflation momentum we saw over 2024 has waned. The trade war instigated by the US is sure to result in retaliatory tariffs in the coming months. We are seeing the shock of higher inflation and stagnant economic growth in the US and global economy unfolding and don't expect it to clear up in the near term.

We believe it is prudent to remain conservative in our risk positions. We are switching to higher-quality bonds, where we see value. We are reducing positions that would be more adversely impacted by tariffs, economic slowdown and fiscal reallocation such as benefit cuts and government efficiency savings. We continue to believe that there is value in sterling bonds in the short term, especially versus US dollar and euro bonds. All-in yields (the yield considering both the underlying government benchmark and the yield for credit risk) for high-quality bonds remain historically attractive. However, we believe the fund is well-positioned to withstand possible weakness in credit markets and take advantage of opportunities if and when the tariff-related shocks dissipate.



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