Pilling & Co
Stockbrokers Limited

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The name's Bond...Corporate Bond! (licence to yield)

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Throughout 2022 and 2023, the Bank of England embarked on a cycle of raising interest rates to combat rampant inflation. A double-digit inflation print of approximately 11% forced the bank into drastic action, pushing through 14 successive interest rate hikes in an attempt to bring inflation back down to its 2% target.

Having peaked at 5.25%, the Bank of England finally pivoted in August this year with a 0.25% cut, feeling confident enough that the fight against inflation was being won. Although there remain concerns that inflation could creep higher, many economists and central bankers believe that it is sufficiently contained to potentially warrant further cuts to interest rates. Central banks around the world continue to balance the threat of inflation with the need to subtly stimulate their economies to ward off any recessionary threats.

The European Central Bank and the US Federal Reserve have also reacted and lowered their interest rates. Although many economists and market followers had expected interest rates to have fallen far sooner than they have, central banks have stated that they will maintain a cautious stance, favouring gradual, smaller cuts as the best way forward.

Although market consensus now seems to be for fewer interest rate cuts than had been hoped for at the start of the year, expectations are that more cuts are still on the way, possibly as soon as next month and into 2025.

There is still the potential for inflation to move higher, especially if the ongoing conflict in the Middle East were to cause a sharp spike in oil prices, but central banks have implied that they are comfortable that further loosening is possible. To pinch a phrase from the Federal Reserve playbook, all decisions do seem to be 'data dependent' and central banks will adapt to the changing economic environment.

As a result, if rates have now peaked then it could be a good time to consider adding some fixed interest investments to your portfolio.

Corporate bonds involve lending money to individual companies, who pay the holder a rate of interest, whilst paying back the capital on the bonds redemption date. They carry varying degrees of risk, depending upon factors such as the quality and size of the issuer. The rating agencies cover many of these bonds, assigning them a rating based on their credit worthiness.

The price of fixed interest investments move in an inverse direction to interest rates. When rates are moving higher, fixed interest prices move lower, so that their yield remains competitive against the base rate. Following the sharp move higher in the base interest rate over the past couple of years, bond prices are now looking far more attractive. Further cuts to central bank base rates could keep pushing the price of fixed interest prices higher. This offers the scope for some uplift in capital as well as locking in some attractive yields.

As interest rates moved higher, global stock markets have seen outflows, as investors were attracted to the risk-free returns being offered by bank accounts. However, the yields now being offered by corporate bonds remain very attractive, and as I highlight later in this article, there are bond funds paying higher yields than the best bank account rates.

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Bonds typically fall into two categories: investment grade (higher quality) and non-investment grade (lower quality/higher risk). The yield offered will usually be higher for non-investment grade, as holders will demand a higher yield in return for the increased risk they are taking.

I have picked out a handful of bond funds that we currently hold in our investment universe.

The Man GLG Sterling Corporate Bond seeks to provide income and capital growth by outperforming its benchmark index over 3 year rolling periods. At least 80% of the funds net assets will be invested in corporate bonds deemed investment grade. The Fund may invest in securities issued by corporate bodies, and those issued or guaranteed by governments or supranational bodies. It may also invest in other transferable securities, financial derivative instruments, money market instruments, deposits, cash or cash equivalents and other funds. An attractive yield of 6.1% is currently available.

The Twentyfour AM Dynamic Bond fund is actively managed and may invest in a wide range of fixed income assets including high yield bonds, investment grade bonds, government bonds and money market funds.

The largest weightings within the fund are to European, US and UK fixed interest investments which make up a combined 95% of the fund. Approximately 60% of the holdings have a maturity profile of up to 5 years, and the fund currently offers a yield of 6.7%.

L&G Strategic Bond invests in a range of bonds and related investments issued by both UK and overseas companies. Bonds issued by institutions such as Barclays, British American Tobacco and Warner Brothers are held. More than 300 different bonds are held in order to provide diversification, and the fund currently yields 6.5%.

The Rathbone Ethical Bond fund predominantly buys sterling bonds issued by companies, charities, the UK government and non-governmental organisations. It tries to avoid as much as possible investing in activities that make the planet or its inhabitants worse off and tries to support those projects that are doing good in the world.

The company has set up a separate ethical, sustainable and impact research division called Greenbank, that can't be influenced by the bond fund manager, to assess and screen all the potential qualifying investments on both their positive and negative social and environmental criteria. The fund yields a respectable 5.1%.

The key investor information document will need to be read prior to investing and these can be provided upon request.

Discrete Annualised Performance (%)	**Sep 24**	**Sep 23**	**Sep 22**	**Sep 21**	**Sep 20**
L&G Strategic Bond TR	16.7	5.6	-10.0	10.1	7.3
Man GLG Sterling Corporate Bond TR*	26.4	21.4	-16.9		
Rathbone Ethical Bond TR	13.1	9.5	-22.8	4.7	5.7
Twentyfour Dynamic Bond TR	16.5	8.2	-18.7	8.0	3.2
IA Sterling Corporate Bond TR	10.9	7.3	-20.5	1.3	4.2
IA Sterling Strategic Bond TR	11.8	4.9	-14.5	4.6	3.6

Source: FE Analytics

*Launch date 1st September 2021