MARKET INSIGHT

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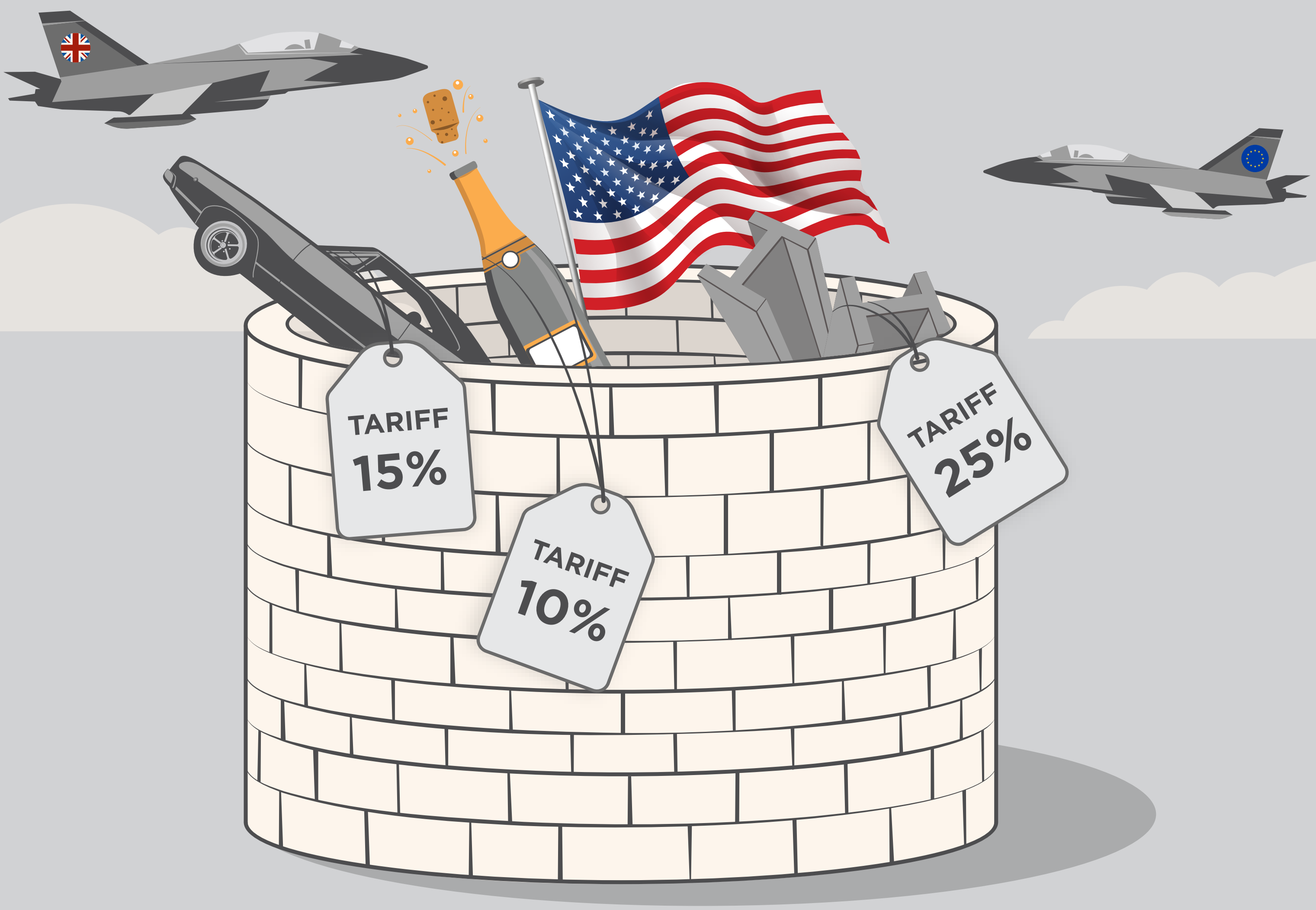
Redmayne Bentley

ISSUE 40 - MARCH 2025

Changing Priorities



IN THIS ISSUE

CHANGING PRIORITIES

ALASTAIR POWER | INVESTMENT RESEARCH MANAGER

IN THIS ISSUE

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2025 is a very special year for Redmayne Bentley as we will celebrate our 150th anniversary in December. As we look ahead to this significant milestone, we want to thank our clients, readers and listeners for your support.

In consistent fashion, events centred around the US have dominated headlines in recent weeks with the implementation of trade tariffs, alongside negotiations in Ukraine. Further tariffs against Canadian steel and aluminium imports have been announced and subsequently retracted, and financial markets are starting to digest the implications of potentially slower US economic growth. At the time of writing, 2025 returns for the US' S&P 500 index are -4.30%, with key names in the technology sector experiencing notable share price declines.

In Europe, there looks to be a realisation of the requirement for increased defence spending, pushing listed defence companies share prices higher, including Rolls Royce, Babcock and BAE Systems. German government bonds saw price declines as yields jumped on the back of increased spending on defence and infrastructure.

Meanwhile, the UK continues to lose both domestically-invested assets and listed companies. In its February fund flows report, analytics company Calastone highlighted UK-based investors withdrawing a further £1.22bn of assets from UK-focused funds during the month, preferring global and US sectors, which saw a further £2.9bn inflow. Perhaps the most eyebrow raising statistic from the report was that, since 2020, UK investors have added £100.88bn to the US and global sectors, which isn't far off the market capitalisation of the consumer goods company Unilever. As UK investors focus globally, our listed companies remain a target for acquisition, particularly in the Real Estate Investment Trust (REIT) sector where healthcare property owner Assura recently received a takeover bid from US private equity giant KKR and Care REIT was approached by US-listed CareTrust REIT. Together, the bids represent a further £2bn of equity leaving the UK's financial markets with more to come as the £626m residential-focused PRS REIT works through a sale process and Warehouse REIT rejected its fourth takeover approach from a private equity consortium.

In our Stock Focus article, Invesco Bond Income Plus (BIPS) takes centre stage. As a constituent of the Association of Investment Companies' Loans and Bonds sector, BIPS is one of a select few offerings for investors looking to buy fixed-income assets through the listed investment company structure. As it stands, the £355m market cap company is a result of the 2021 merger between City Merchants High Yield and Invesco Perpetual Enhanced Income Plus. The underlying portfolio consists of a mix of investment-grade and high-yield corporate bonds, enabling the board to pay investors dividends equivalent to a yield of 7%. While other listed investment companies are experiencing share prices trading below their Net Asset Values (NAV), BIPS is one of the few where the share price trades at a premium, enabling a consistent issuing of shares to both increase size and improve liquidity.

At the time of publication, focus will direct towards the potential outcomes of the upcoming Spring Forecast from Chancellor Reeves and updated economic forecasts from the Office for Budget Responsibility (OBR). Much will hinge on the outlook for economic growth and impact on the outlined fiscal rules.

STOCK FOCUS

INVESCO BOND INCOME PLUS

RUTH HARRIS | INVESTMENT RESEARCH ANALYST

High-yield is an area of the bond market involving investment in debt securities issued by companies which are generally considered riskier than those issued by higher-quality, investment-grade corporations. To compensate investors for the higher level of risk, they typically pay a higher return, or yield, on the debt. This higher level of yield is called the spread and can be measured relative to investment-grade corporate bonds or government bonds, which are generally considered credit-risk free. Rating agencies such as Standard & Poor, Fitch, and Moody's will categorise bonds according to the level of default risk, with BB+ from Standard & Poor and Fitch, or Ba1 or below from Moody's indicating a high-yield bond.

Invesco Bond Income Plus (BIPS) is a UK-listed fixed income investment trust allocating primarily to UK and European high-yield markets to generate a high level of income for shareholders. It is run by the Invesco Fixed Income team, which is well resourced by 250 investment professionals. Rhys Davies is lead manager of the fund, with 21 years of experience, including a decade in high-yield.

Within the high-yield market, BIPS offers diversified exposure across geographies and industries through three broad areas. The primary objective of the trust is providing investors an income and, consequently, most of the investment is in bonds issued by non-financial companies offering a high income to compensate for greater leverage on their balance sheets.

The fund also has exposure to banks and subordinated debt issued by financial companies which is paid back last in case of a default, generally offering a higher yield than broader market. Much of the remaining exposure is distressed debt, which is considered to have a high chance of default, issued by companies which the fund managers of BIPS believe have credible plans in place for recovery.

> *"The primary goal of BIPS is to provide a high level of dividend income for investors, with the investment trust structure allowing for the smoothing of distributions."*

While high-yield carries more credit risk than investment-grade, the Invesco team analyses both the company and debt issues to look for an attractive balance of risk and reward. Corporate hybrids, for example, are a type of junior bond that are considered riskier than the standard debt issue of a company. However, BIPS typically invests in corporate hybrids issued by large, investment-grade companies. While the bond is considered high-yield due to it being ranked lower for claims on assets in case of a default, the underlying issuer is investment-grade. This means the fund receives a higher yield but with exposure to a high-quality corporation.

Though BIPS typically focuses on high-yield issues, in recent years the fund managers have gradually increased exposure to lower-risk investment-grade bonds. By the end of 2024, 29% of the portfolio was invested in investment-grade bonds. This was partly driven by a higher interest rate environment offering better yields in higher-quality bonds, without taking additional credit risk. However, the fund has also reduced overall high-yield exposure due to increased refinancing risk in the area, as well as increasing the tilt to better-quality high-yield issues. For many years, companies operated in an ultra-low interest rate environment. This shifted in 2022 due to the lingering impact of the pandemic, the invasion of Ukraine and the subsequent energy crisis. Market participants have since shifted expectations to a 'higher for longer' interest rate environment. Many high-yield issuers, which are typically companies with a more uncertain outlook and lower-quality balance sheets, are having to refinance debt with higher coupon payments to attract investors. Many of these companies are expected to struggle with the subsequent higher interest payments. With spreads tight, the managers of BIPS are more selective about high-yield bond investments, looking to ensure that the pickup in yield relative to an investment-grade bond adequately compensates for the increased credit risk. In such environments, BIPS benefits from the analyst team's credit analysis and deep understanding of the issuing companies.

As mentioned, the primary goal of BIPS is to provide a high level of dividend income for investors, with the investment trust structure allowing for the smoothing of distributions. It successfully achieved its target 11.5p dividend per share for the 2024 financial year and currently offers a 7.0% yield at a 170.4p share price. Given that the return is driven by a high level of income, investors looking for capital growth will likely find the trust less attractive. Dividends are paid quarterly in February, May, August, and November.

Discounts are a much-debated feature of the investment trust sector at present, with many trusts' share prices trading well below Net Asset Value (NAV). While this can be an attractive entry point for investment, there is no guarantee that discounts will close, and a widening discount can heavily drag on returns. BIPS is one trust trading at a tight premium, with the share price trading at, or slightly above, NAV. This is due to the board's strict discount management, with an annual continuation vote ensuring a cash exit for investors preventing a large divergence of share price from NAV. Trading at a premium allows the trust to scale up through new share issuance, providing additional liquidity to shareholders. As of January 2025, total assets were £385.3m.

Market participants are facing a highly uncertain global macroeconomic environment, with potential implications for every asset class. For a high-yield focussed strategy, tight spreads prove challenging as any widening could result in a fall in capital values, as yields are inversely related to prices. This is also a risk if persistent inflation pushes interest rates up. Despite a challenging environment, BIPS benefits from the flexibility of the strategy allowing the fund managers to tilt away from the core high-yield exposure and into more attractive investment-grade issuers. With an experienced team, prudent board oversight, and attractive yield, BIPS may continue to interest income-seeking investors looking for diversified high-yield exposure. ■

INSIGHT

GROWTH ISSUES

ALASTAIR POWER | INVESTMENT RESEARCH MANAGER

Recent weeks have been challenging for financial markets. Global equities have moved lower following a positive start to the year, primarily driven by declines in the US, and government bond markets have seen further volatility, especially in Europe, and Germany in particular. President Trump's trade tariffs have taken centre stage and likely signal a shift in attitude away from free trade, leading to concerns over economic growth.

Following the imposition of trade tariffs on key trading partners, US markets have declined on market expectations of slower rates of economic growth and persistent inflation. The UK also faces a similar issue, with political leadership acutely aware of the problem but also the enormity of the challenge of reigniting growth and productivity rates. In Europe, Germany stands at a crossroads, having posted the lowest growth rate of G7 industrial nations last year while facing further issues of increasing requirements for defence spending and potentially increased trade tariffs given its trade surplus with the US.

Amid concerns around economic growth, government bond markets are usually fast to react. Following the recent elections, German government bonds, or Bunds, experienced sharp moves lower in prices as yields increased. This was triggered by the announcement of a plan to re-arm the Euro region alongside Germany's intention to boost fiscal spending on infrastructure and defence, which would constitute a violation of fiscal rules. Germany wasn't alone in experiencing lower government bond prices, the UK also experienced moves lower, but to a lesser extent and most likely as a spillover effect. Defence spending increases were also announced, with funding from cuts to overseas aid budgets, but the key event comes later in the month of March around the Office for Budget Responsibility (OBR) forecasts. Dubbed the 'Spring Forecast' the outcome of the projections could indicate the Chancellor either being on track to meet or break her outlined fiscal rules. In the case of the latter, there's a high chance of UK government bond yields moving higher should growth expectations underwhelm.

While European government bonds saw price declines, US treasuries were notably stable in their pricing and show positive returns in 2025 thus far despite slowdowns in economic growth given the effects of trade policies. Concern is clearly spreading, with US investment bank Goldman Sachs the latest to revise down expected US economic growth rates for 2025. Where the US benefits remains in the strength of capital markets and a highly innovative technology sector. Expectations remain positive for the latter, with software and artificial intelligence likely to be of significant importance in solving the issues of stagnating productivity growth in the face of ageing demographics.

While economic growth issues are clearly of concern to market participants, the pessimist's outlook is one of broad stagflation, or low rates of economic growth and a persistence of inflation. A more optimistic outlook is one in which the near-term challenges of inflation and slow growth abate, and economic growth broadens out beyond a US focus following increased spending on infrastructure and defence.

"As fiscal and geopolitical events unfold, there are still opportunities for investors, especially in fixed-income markets."

As fiscal and geopolitical events unfold, there are still opportunities for investors, especially in fixed-income markets. Government bond yields remain attractively priced, with UK ten-year bond yields of 4.67% positive on an inflation adjusted basis and offering tax efficiency when purchased at a price below face value. At the shorter five-year term, yields on offer are in the region of 4.26% while the yield on a broad UK corporate bond index is close to 5.8% despite the compensation for lending to a corporate over a government for a similar maturity being at near record low levels. At such levels, there is a continued expectation for fixed-income to once again return to operating as a ballast in portfolios. ■

Please note that this communication is for information only and does not constitute a recommendation to buy or sell the shares of the investments mentioned. Investments and income arising from them can fall as well as rise in value. Past performance and forecasts are not reliable indicators of future results and performance. The information and views were correct at time of publishing but may have changed at point of reading.

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