



September Bond Bulletin

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September saw bond markets consolidate after a very strong August; government yields rose marginally and there was little change in overall credit spreads. In the UK, government bonds returned -0.5% whilst sterling credit bonds returned -0.2%. Index-linked bonds performed well, giving a small positive return, as implied breakeven inflation rates rose in the month.

Within credit markets, the financial sectors were very strong. This reflects the positive interpretation given to the Basel III proposals. Basel III focuses on the capital structure of banks and, in particular, the requirement to hold certain levels of capital (particularly core tier 1) to support the business. The stronger a bank's capital base, the more able it will be to survive financial downturns and the greater protection the bank's depositors will have against possible losses. While Basel established a minimum level of capital that banks must hold, the Basel III proposals materially increase the minimum levels of capital required as well as establishing a timescale for the requirements to be achieved. Overall these proposals were seen as likely to increase the equity base of banks and to hasten balance sheet restructuring (increase the likelihood of further tier 1 repurchases).

Over the month we generally reduced the magnitude of our short duration stance, reflecting a more cautious economic outlook. In credit markets there were a few new issues and liquidity improved. We increased exposure to senior bank debt, participating in new issues by Co-Op Bank, Lloyds Banking Group and Coventry Building Society.

RLAM funds are generally positioned for a continued improvement in credit markets and we expect government bond yields will rise from present levels; we prefer index-linked to conventional gilts.

Source: rlam as at 11th October 2010 unless otherwise stated.

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