Rathbone Unit Trust Management

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Rathbones
Look forward

Rathbone Enhanced Growth Portfolio

Quarterly investment report, October 2018 to end December 2018

Aim of the portfolio

The fund seeks to achieve a long term total return in excess of the Consumer Price Index (CPI) +5% over a minimum five to ten year period, and a risk budget of 100% of the volatility of global equities as measured by the MSCI World Equity index. The income yield will at best be minimal.

Markets hot topics — 'top-down' (macroeconomic)

What happened? The fourth quarter was horrible for investors – all the more so because the capitulation was in response to things that were always on the cards. President Donald Trump was tweeting, but he's always tweeting; the US Federal Reserve (Fed) said it was continuing to wind down quantitative easing, but it's been doing that for more than a year. Combined with global growth ticking downward, you had the ingredients for US Treasury yields to shoot upward (they have since dropped below where they started the quarter) and equities to plummet. But it was common knowledge that China couldn't keep growing at the pace it has been. And after the sugar rush of tax cuts, the US economy was always going to come off the boil. All of this in no way means recession though! It's possible, sure, but most economic data in the US have remained strong. In fact, markets briefly reverted to the "good news is bad news" mantra of the past: any good data simply means the Fed will forge ahead with tightening monetary policy and trip up the American economy. What does that tell us? Essentially, investors were gloomy and could only see sadness; the AAII Bull Index slumped to its lowest point since mid-2016. We're not gung-ho optimistic that we'll see growth take off again in 2019, but we think the recent sell-off was an overreaction. We think the Fed gets it – it will be much more cautious this year.

UK recession. Big-ticket spending by both companies and households is weak, retail spending in general seems gloomy too. Consumer confidence is at its lowest ebb in more than five years and house prices have stagnated as a result. It's a bad time for business certainty to be hovering somewhere around zero. There is simply no saying what rules UK companies will have to play by when trading with the Continent post-Brexit, so they are understandably cautious and reluctant to invest. Money is being wasted or withheld everywhere, whether it's Whitehall paying people to plan the transformation of motorways into carparks, businesses stockpiling inventories, investors abandoning the UK for countries with brighter futures or 'Joan Bloggs' holding off on moving or making large purchases "till the Brexit thing blows over". Because much of the issue with the UK is a reluctance to spend and invest, there's a chance that a locked-in deal and signposted pathway to a new relationship will overcome these reservations and boost the economy and sterling. But at the time of writing the chance of that seemed slim to us. Any deal that does come seems destined to be delayed, disappointing and shy on the details. Instead, the Brexit purgatory seems set to continue, which will slowly strangle the economy. A recession looks ever more likely as one month rolls into the next, unless Theresa May pulls a 'rabbit' out of her dispatch box.

Once burned. Few sectors are more hated than telcos at the moment. It's one of those fascinating paradoxes: you can't go 30 seconds without seeing a mobile phone, yet mobile carriers have been dismal investments. Technological advances and a scramble for market share sent data prices spiralling lower as these companies made punchy investments in whizzy new technology. Upgrading your whole network doesn't come cheap – especially when the pace of progress makes your investments obsolete in less than a decade. Not only that, UK telcos fell over themselves to bid stonking amounts for 3G spectrum in the early 2000s. How long does it take to recoup £22.5 billion simply to use the airwaves? But here's the thing: 2018 was the 5G auction in the UK – a vintage that promises to be truly revolutionary – and the spectrum went for just £1.4 billion. It's not just self-driving cars and self-stocking fridges that can run on this technology either. It could create massive changes in how we use the internet. For instance, some say 5G will make home broadband irrelevant – we'll run everything from our phones instead. This new world will be years in the making, but it could have profound impacts on our lives and investments. By picking up this new spectrum relatively cheaply, it could prove to be much easier for telcos to make money in the future.

Hot topics — 'bottom-up' (direct and fund investment)

In October, we bought the **UBS 1218 FTSE 100 Accelerator** structured product as a hedge against any unexpected upturn in Brexit news. If Parliament agrees on a way forward, the FTSE 100 index could be boosted by foreign investors returning to the UK stockmarket after a long absence. We felt the accelerator also would do well if sterling remained weak because of the beneficial effect of converting foreign earnings at a depressed sterling exchange rate.

We sold cruise company **Carnival** because we were concerned about how decelerating global growth would affect its business. We used the proceeds to switch into **BP** in early November. The oil price had fallen below $75, so we took the chance to build a position in the oil major at a lower price.

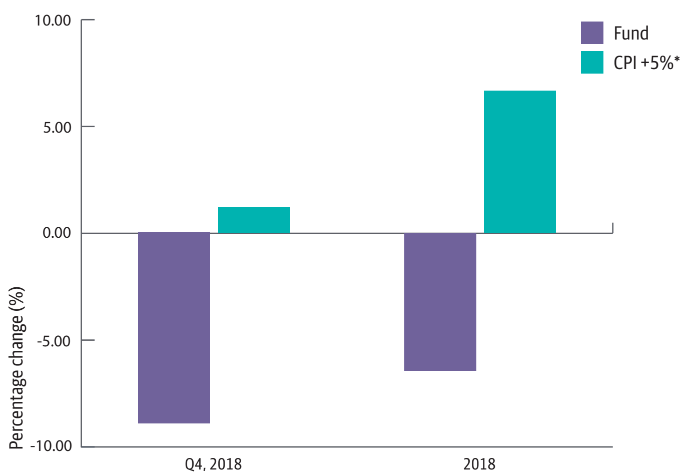
Fund charges

R-Class shares	Ongoing charges (UCITs)	Ongoing charges (PRIIPs)	Total MiFID II charges
Accumulation shares	1.81%	2.01%	2.18%
S-Class shares			
Accumulation shares	0.80%	0.99%	1.16%

The OCFs and MiFID II charges are as at 30 September 2018. The OCF includes the charges for the underlying funds held in the product.

OCF (UCITs) plus other underlying PRIIPs-related charges (i.e. Investment Trust charges) = OCF (PRIIPs). OCF (PRIIPs) plus transactions costs = Total MiFID II charges.

Fund performance



Performance (based on 'S-Class' shares), net of expenses and tax. Net income reinvested
*At 1 October 2015, the benchmark measure changed to CPI +5%.

Data source: Financial Express

Fund performance (continued)

Over the period, the Rathbone Enhanced Growth Portfolio returned -8.93%. The best underlying contributors to return were our holding in the RBC Capital Markets 95% Strike S&P Put (+1.68%); in iShares Physical Gold (+0.15%); in Verizon Communications (+0.07%); in Rentokil Initial (+0.06%); and in WEC Energy which added 0.06% to return over the period.

The worst underlying contributors to return were our holding in the Coupland Cardif Japan Alpha Fund (-0.73%); in the JP Morgan Japan Fund (-0.65%); in the Biotech Growth Trust (-0.44%); in iShares Core FTSE 100 Shares (-0.42%); and in Eurofins Scientific which shaved 0.36% off return over the period.

Performance: Gross of charges

Top performing holdings	%
RBC Capital Markets 95% Strike S&P Put	+636.42
iShares Physical Gold	+10.10
Verizon Communications	+9.15
WEC Energy	+7.03
Rentokil Initial	+6.24

Performance: Gross of charges

Bottom performing holdings	%
Catco Reinsurance Opportunities Fund	-57.00
Activision Blizzard	-42.43
Schlumberger	-38.51
Electronic Arts	-32.68
Eurofins Scientific	-32.43

Our benchmarks are calculated on the rate of change of the CPI index, over different time periods (e.g. if we were calculating year to date figures in January 2017, we would look at the percentage change from December 2016 to the end of January 2017). So we take CPI to the current value, and add on the 3% to 5% respectively, prorated over a year (roughly 0.25% and 0.42% per month). If the CPI Index benchmark were to fall, more than the amount pro-rata, the benchmark year-to-date will be negative, even though inflation as reported by the media (calculated specifically as a 12M rate of change), remains positive.

Asset allocation change and strategy

There were no significant asset allocation changes during the quarter.

Asset allocation split	30.09.18	31.12.18	% Change		% Change, 31.12.18 compared to 31.12.17	
Liquid assets/lower volatility	6.11%	4.43%	-1.68%	▼	-5.63%	▼
Equity-type risk (economically sensitive assets)	89.22%	89.77%	+0.55%	▲	+8.21%	▲
Diversifiers	4.67%	5.80%	-1.13%	▼	-2.58%	▼
	100.00%	100.00%				

Asset class split	30.09.18	31.12.18	% Change		% Change, 31.12.18 compared to 31.12.17	
Equities	80.02%	80.87%	+0.85%	▲	+6.59%	▲
Index-linked bonds	0.00%	0.00%	0.00%	◀▶	0.00%	◀▶
Conventional government bonds	0.00%	0.00%	0.00%	◀▶	0.00%	◀▶
Corporate bonds	1.90%	1.75%	-0.15%	▼	+0.08%	▲
Emerging market debt	4.79%	5.30%	+0.51%	▲	+2.64%	▲
Private equity	2.51%	1.85%	-0.66%	▼	-1.10%	▼
Alternative investment strategies	1.13%	2.11%	+0.98%	▲	-5.13%	▼
Property	0.00%	0.00%	0.00%	◀▶	0.00%	◀▶
Commodities	3.54%	3.69%	+0.15%	▲	+2.55%	▲
Cash	6.11%	4.43%	-1.68%	▼	-5.63%	▼
	100.00%	100.00%				

Asset allocation ranges

Liquid	Equity-type risk	Diversifiers
0% to 10%	70% to 100%	0% to 20% (liquid: 0% to 20%; less liquid: 0% to 20%)

Investment outlook

Many of us will feel a bit fatigued after 2018. Most asset classes fell to varying degrees and we saw the painful return of volatility. If you are a sterling investor, and most reading this are, then you had the added uncertainty of a currency buffeted by world opinion on the likely outcome of Brexit.

We don't know if markets will be positive in 2019 or whether we will see a repeat of last year. As we write this, US President Donald Trump is still tweeting and Brexit is still a mess. However, there has been a significant de-rating in equity markets, so as long as the world avoids recession – and we believe it will – we remain optimistic for the prospects of businesses that continue to evolve and improve themselves amid an ever faster pace of technological progress.

To this end we have been adding to our holdings in companies with strong franchises and reliable earnings growth. This doesn't mean buying 'growth' en bloc. Rather we have been backing businesses that we believe are well entrenched, with reliable cash flow and prudent amounts of debt. We think it's too early to give up equities and switch to bonds – there are some worrying signs out there, but there are arguably a greater number of encouraging ones. We are sticking with stocks, while continuing to build up a collection of safe-haven assets to cushion market setbacks and give us an insurance policy in the event that we're wrong about the state of the world. As gilt yields rise back to levels we think are decent (roughly 1.50%-1.60%) we will bring them back into our portfolios.

Past performance should not be seen as an indication of future performance. The value of investments and the income from them may go down as well as up and you may not get back your original investment.

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