

Rathbone Multi-Asset Strategic Income Portfolio

Update, February 2019

Overview

US economic data are perplexing at the moment. Over the past year, the number of jobs and wages have been growing well, yet retail spending absolutely dived in December. The ISM PMI surveys – a mix of emotional data like confidence about the future and hard numbers like upcoming orders – were also simultaneously hot and not. The non-manufacturing ISM jumped much more than expected while the manufacturing measure slumped. A fall in housing starts accelerated, with concrete slabs poured for fewer homes than at any time since 2016.

Many other economic data have started to contradict each other too. For instance, Americans enjoy a booming labour market with decent pay rises, yet more than 7 million of them are at least three months late on their car repayments. That's the highest number since the global financial crisis. It's a headscratcher for sure. The longest government shutdown in history wouldn't have helped the average Joe's outlook. And an unexpected consequence of last year's US tax cuts means millions of people will end the year with a bill rather than the usual income tax refund.

Still, to us, these numbers don't paint a picture of imminent recession. The US has been growing steadily and its households are getting wealthier. There are areas of hardship and concern – some farms and businesses are no doubt suffering from the trade tangle with China – but these are isolated. In the case of American soybean growers, Uncle Sam has splashed the cash to support them as their crops rot in the fields. This isn't the *best* trade policy, but it does suggest that the US government intends to come to an agreement with China – and soon. Otherwise it may be doling out billions of dollars worth of corporate food stamps for the next two years at least (good luck winning an election if you leave farmers in the lurch).

As for the rest of the world, well ... it's not great, but we think it's not as dire as some would have you believe. Chinese growth is slowing, as expected, and that drop in demand for everything from metal and food to cars and industrial machines is hurting its largest trading partners. Again, nothing too surprising. One of these large suppliers, Europe, had problems already. Many, many times we've gone over how we see the EU as flawed and fundamentally difficult to invest in. Suffice to say, we have found better places to put your money to work.

Brexit tumbles ever onward. As we suspected, the sheer complexity and divisiveness of the issue has led politicians to keep delaying and obfuscating, creating a never-ending Brexit, if you will. That is no good for the UK, which will probably continue to leak capital like a broken bucket. Hopefully a compromise and a plan for the next decade can be reached soon; the country definitely needs it.

This month's trades

In mid-January, after the UK's GDP growth slowed even further, we began buying gilts. For a long while, we felt gilts offered little value to portfolios. More recently, we started buying because we felt poor economic growth makes it highly unlikely that the Bank of England will hike interest rates anytime soon (higher interest rates reduce the value of gilts). We think it is now prudent to hold a small amount of gilts at yields of roughly 1.20% to 1.30% as a portfolio buffer. We have also shifted some of our cash into gilts maturing in fewer than five years. They give a better return than leaving it in the bank and offer the chance of a fillip if interest rates are cut (which seems increasingly likely as the Brexit negotiations drag on).

We sold **Exxon Mobil**, an oil major that we have held for a very long time. We used the cash to buy **BP** instead, as it offers a more attractive yield as well as improving returns on capital.

We sold the last of our shares in the **Tritax Big Box Retail REIT**. We have held this distribution hub-focused property company since our fund was launched and it has been a great investment. However, with UK economic growth bleeding away and the company moving into developing properties – rather than simply buying and managing existing sites – we decided to use Tritax’s recent bounce back as a time to move on at a good price.

Another exit was **Marks & Spencer**. The company’s management says it is now focusing on improving its systems and processes to deal with the threat (and reap some of the rewards) of e-commerce. While we welcome this strategy, we feel a considerable amount of investment will be needed, which would damage the value of the stock.

Outlook

Global trade winds will continue to blow the way of US-China trade talks, while in the UK improved market weather will depend on some form of progress on Brexit negotiations.

We’re not expecting the world to fall into recession this year – it would take a large swing in several economies that just doesn’t look likely as things stand. Still, global growth is slowing down as the US comes off its tax-cut-fuelled peak and China struggles with over-indebtedness and export barriers. Because of this, we’re trying to stay as vigilant as possible, trying to take notice of the real issues in a world awash with information and emotion.

Italy is a particular area of suspicion for us. This debt-bomb of a country is bigger than you think, with the ability to upend the European debt market if it goes off. A tenth of the loans made by Italian banks have gone bad, according to the European Central Bank. Even worse is the absolute total of Italy’s bad debts: at €159bn it is easily the highest of any country in the bloc. Thankfully, up till now the Italian government – radical as it is – has shown itself to be very aware of the implications of going thermonuclear with its finances. Every time things come to a head, the Italian coalition has backed down. There’s always a risk that one day it stands its ground, however.

And, of course, there’s China. The nation has slowed significantly in the past few years, from 10% in 2010 to just more than 6.5% in 2018. This was always going to happen as the country grew to become a much larger share of the global economy. But there is a chance that this expected slowdown could spin out of control into a fully fledged slump. China is trying to move from a heavily industrial model to a more modern, services and hi-tech economy. To do this it needs to be deft, careful and have friends abroad. It will also have to resist the temptation to pour ever more debt on its problems and instead trust more in market dynamics.

So, lots of uncertainty out there? You bet. But that is nothing new. We are actually quite optimistic at the moment. The world isn’t perfect; it never is. But that isn’t what matters. What matters is how investors see the world – banally, we measure that by asset prices – and whether that matches up to the likely reality. At the moment, investors appear much more concerned than they should be: most assets are looking modestly priced. No bubbles are inflating that we can see, instead the global economy has been ticking over reasonably well as investors increasingly panic at the first sign of bad news.



David Coombs
Head of Multi-Asset Investments



Will McIntosh-Whyte
Assistant Fund Manager

This is a financial promotion relating to a specific fund. Any views and opinions are those of the investment manager, and coverage of any assets held must be taken in the context of the constitution of the fund and in no way reflects an investment recommendation. The information contained in this note is for use by investment advisers and journalists and must not be circulated to private clients or to the general public. Source performance data, Financial Express, bid to bid, net income re-invested.