Rathbone Unit Trust Management

Contact us 020 7399 0399 rutm@rathbones.com

Rathbone Total Return Portfolio

Quarterly investment report, October 2018 to end December 2018

Aim of the portfolio

The fund seeks to achieve a total return in excess of 2% above sterling six month LIBOR over a minimum three year period, and a targeted risk budget of one third of the volatility of global equities as measured by the MSCI World Equity index.

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 despatch 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)

When markets began to turn over in October, gilt yields were spiking sharply. We added to our holdings of the **Treasury 1.625% 2028** and **Treasury 0.5% 2022** bonds at more attractive prices. We feel these gilts should help protect the portfolio if the UK slips into recession.

We sold the **Jupiter Absolute Return Fund** early November because its performance during the first market downdraught, while positive, wasn't nearly as good as we thought it should be for the cost.

We offloaded the **Aspect Capital Diversified Trends Fund** in late December. Algorithmic traders struggled in 2018 because the mini-cycles and patterns they capitalise on have become more erratic and short-lived. We believe this phenomenon will continue into 2019, given the unpredictable political shenanigans and skittish market sentiment, so we have moved our money into more reliable safe havens. Meanwhile, we sold German chemicals and consumables company **Henkel** because we were worried about the competitiveness of its household brands division.

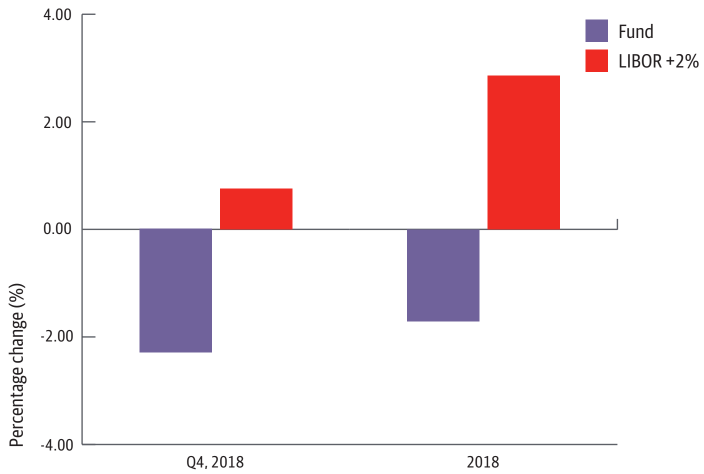
Fund charges

R-Class shares	Ongoing charges (UCITs)	Ongoing charges (PRIIPs)	Total MiFID II charges
Income shares	1.64%	1.70%	1.79%
Accumulation shares	1.64%	1.70%	1.79%
S-Class shares			
Income shares	0.64%	0.70%	0.79%
Accumulation shares	0.64%	0.70%	0.79%

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

Data source: Financial Express

Fund performance (continued)

Over the period, the Rathbone Total Return Portfolio returned -2.30%. The best underlying contributors to return were our holding in the RBC Capital Markets 95% Strike S&P Put (+0.80%); in iShares Physical Gold (+0.32%); in the RBC Capital Markets Leveraged 3-Year Steepener (+0.10%); in the BH Macro Fund (+0.09%); and in the Government of Japan 0.1% 20/06/2023 which added 0.09% to return over the period.

The worst underlying contributors to return were our holding in the Aspect Capital Diversified Trends Fund (-0.37%); in the Credit Suisse 1053 FTSE Call Lookback (-0.22%); in the Catco Reinsurance Opportunities Fund (-0.17%); in Eurofins Scientific (-0.16%); and in Schlumberger which shaved 0.15% off return over the period.

Performance: Gross of charges

Top performing holdings

	%
RBC Capital Markets 95% Strike S&P Put	+649.09
iShares Physical Gold	+10.09
Verizon Communications	+9.03
WEC Energy	+6.96
Government of Japan 0.1% 20/06/2023	+6.52

Performance: Gross of charges

Bottom performing holdings

	%
Catco Reinsurance Opportunities Fund	-57.00
Activision Blizzard	-42.37
Schlumberger	-38.51
Electronic Arts	-32.86
Eurofins Scientific	-32.77

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	44.92%	47.70%	+2.78%	▲	+4.96%	▲
Equity-type risk (economically sensitive assets)	40.65%	39.57%	-1.08%	▼	+2.47%	▲
Diversifiers	14.43%	12.73%	-1.70%	▼	-7.43%	▼
	100.00%	100.00%				

Asset class split	30.09.18	31.12.18	% Change		% Change, 31.12.18 compared to 31.12.17	
Equities	30.12%	29.40%	-0.72%	▼	+2.40%	▲
Index-linked bonds	5.25%	5.55%	+0.30%	▲	+0.50%	▲
Conventional government bonds	21.70%	25.14%	+3.44%	▲	+17.42%	▲
Corporate bonds	11.18%	10.91%	-0.27%	▼	-0.03%	▼
Emerging market debt	0.00%	0.00%	0.00%	◀▶	0.00%	◀▶
Private equity	0.33%	0.31%	-0.02%	▼	+0.04%	▲
Alternative investment strategies	9.49%	7.08%	-2.41%	▼	-9.74%	▼
Property	0.00%	0.00%	0.00%	◀▶	0.00%	◀▶
Commodities	4.94%	5.65%	+0.71%	▲	+2.31%	▲
Cash	16.99%	15.96%	-1.03%	▼	-12.90%	▼
	100.00%	100.00%				

Asset allocation ranges

Liquid	Equity-type risk	Diversifiers
10% to 50%	20% to 60%	10% to 60% (liquid: 10% to 40%; 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.

Rathbone Unit Trust Management Limited
8 Finsbury Circus, London EC2M 7AZ
Tel 020 7399 0000
Fax 020 7399 0057

Information line
020 7399 0399
rutm@rathbones.com
rathbonefunds.com

6230.01.19