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Rathbones
Look forward

Rathbone Heritage Fund

Update, Q1 2020

Our fund's performance suffered along with global equity markets in the first quarter. We lost 13.9%, compared with our CPI+3% benchmark which delivered 0.8% over this period. However, our portfolio fell less than the FTSE World Index, which was down 16.1%.*

The spread of the COVID-19 pandemic across the world has been matched by truly enormous support packages from central banks and governments. The US, Europe and UK in particular have rolled out trillions of dollars of furlough schemes, bargain loans, grants, bolstered unemployment benefits and the obligatory quantitative easing (QE). This is a welcome response to a global health emergency, and a much more timely reaction than during the credit crunch a decade ago. But now we're into the crucial bit: execution.

The hare-like speed of the virus's spread and the unprecedented economic lockdowns and policy support have sent markets on a crazy run. The three months to 31 March was the worst quarter since 1987, with the FTSE All-Share falling 25% and the S&P 500 dropping 20% (in dollars). Markets rallied sharply in April, roughly halving their losses since the initial sell-off. Yet oil remains fragile.

Oil companies have been particularly hard hit by the crisis, thankfully this is an area where we have zero exposure. Our holdings have suffered in other industries, however. At first, we concentrated on our portfolio holdings. We reassessed all of them to decide whether they are companies that are likely to survive the current crisis and whether we want to hold them for the long term.

Consumer-focused industries are obviously feeling the strain. Cruise operator **Carnival** is one example. We have sold our shares as we were concerned about Carnival's ability to survive this crisis. We are trying to ensure our holdings are highly likely to make it through several months with little to no trading. While some of their share prices and earnings could be hard hit in the short term, we are focusing on the longer-term business models and an ability to remain solvent.

Our US financial stocks, led by **JPMorgan**, **Discover Financial Services** and **US Bancorp**, have been hurt by US interest rate cuts, as well as expectations of widespread consumer credit losses. At this juncture we think quality is key, so we have kept hold of market leader JPMorgan and one of the strongest US mid-cap banks, US Bancorp. We have halved our position in Discover Financial Services.

In the autos space we have sold suspension and hydraulics supplier **Stabilus**, yet kept hold of vehicle electrification specialist **Aptiv**. Car manufacturing is falling off a cliff right now, but we believe greater use of technology in vehicles will continue to grow rapidly in the coming years, regardless of the current crisis. Our staples exposure, through companies such as packaged food maker **JM Smucker** and household brands multinational **Reckitt Benckiser**, served us well in the quarter. These companies provide the essentials for our lives, even in these troubled times. Pharmaceutical companies **Roche**, **Novartis** and **GlaxoSmithKline** helped us as well.

We have used market dislocation to search for opportunities as well. To that end we added specialty gases business **Linde** during March, a business that has long been on our watchlist. This business is the result of a 2018 merger between German business Linde and US business Praxair, with the management of Praxair taking control. The merger added a lot of uncertainty, and that together with a high valuation meant this stock was kept firmly on our watchlist. The merger has gone well, the integration risks have reduced and the recent sell-off gave us the opportunity to initiate a holding at a more attractive price. We have other companies in our sights for the coming months too.

*We aim to deliver a greater total return than the CPI measure of inflation + 3%, after fees, over any rolling 10-year period by investing with our valuation-linked cash management mechanism. Total return means the return we receive from the value of our investments increasing (capital growth) plus the income we receive from our investments (dividend payments). We use the CPI + 3% as a target for our fund's return because we aim to grow your investment above inflation.
We also compare our fund against the FTSE World Index so that you can see how global stock markets have performed.

Another key change for our portfolio is a significant reduction in our cash position, driven by the correction in markets. As you know, our fund's cash level is set by the cyclically adjusted PE ratio (CAPE) of global equities. As the PE valuation of global stocks rises, so does our cash level; when the PE falls so does our cash as we buy more equities. At the beginning of the year, our portfolio was about 25% cash as CAPE also hovered in the mid-twenties. Since mid-February, CAPE has fallen abruptly along with markets. That led to our cash level dropping to about 18% at the end of the quarter. We used this cash in a mixture of ways. Part of it was used to rebalance our holdings. Where we believed opportunities were thrown up, we used the cash to increase specific holdings. The rest of it was spread proportionately across the portfolio.

We have been careful to avoid over-trading, as volatility remains elevated and the global CAPE is fluctuating significantly with market moves. Our cash and CAPE bands allow us flexibility to do this, as well as staggering switches we may wish to make to ensure our cash-level discipline doesn't bleed into nonsense.

We are continuing to monitor our portfolio, and we have made sure our bench has a good range of stocks. This will help us to take advantage of opportunities, as and when they are presented, in what continue to be volatile and uncertain markets. As we enter the second quarter, we are all finding ourselves in a very different world to the one we expected just three months ago. I'm sitting writing this in surprisingly sunny North London suburbia, reflecting on the rapid and wholesale changes in life as we used to know it.

Amongst the struggles of staying healthy and stocked up with food, we are also working, both individually and as a team, in new ways. We have rapidly embraced technologies that didn't seem to have the same import mere weeks ago. With team video conferences on Zoom every morning and the constant ping of WhatsApp, it feels like we are more connected than when we were sat three feet apart. The real tell will be how we all manage as the novelty and adrenaline wear off, when the transition is complete. When this stuff feels natural and everyday, that's when we should get some idea about how much this worldwide shock could change the working culture of hundreds of millions of people. That gives us all something incredibly important to ponder as we while away the hours in our homes.

The Rathbone Heritage Fund team

Source performance data, Financial Express, mid to mid, net income re-invested.

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