Rathbone Unit Trust Management

Contact us 020 7399 0399 rutm@rathbones.com

Rathbones
Look forward

Rathbone Heritage Fund

Quarterly update September 2021

Since the bottom of the market in March 2020, investors have benefited from a potent combination of fiscal and monetary stimulus, vaccine success and the release of pent-up consumer demand. These catalysts drove up the prices of virtually every kind of asset, ensuring that valuations soared. But a wobbly September suggests that investors have got more nervy about stretched valuations, cost pressures and tamer growth.

America's benchmark S&P 500 index suffered its biggest monthly loss since the March 2020 COVID 19-induced rout. Investor confidence faltered given a confluence of supply disruptions in labour and materials, fears that transitory inflation may be around for longer and that this, in turn, might pressurise central banks into raising interest rates earlier than investors had previously expected.

	3 months	6 months	1 year	3 years	5 years
Rathbone Heritage Fund	1.9%	7.0%	15.0%	19.7%	37.1%
CPI Inflation + 3%	1.9%	4.3%	6.3%	15.0%	28.8%
FTSE World Index (GBP)	2.0%	9.7%	24.0%	40.9%	85.6%

	30 Sep 20-30 Sep 21	30 Sep 19-30 Sep 20	30 Sep 18-30 Sep 19	30 Sep 17-30 Sep 18	30 Sep 16-30 Sep 17
Rathbone Heritage Fund	15.0%	2.1%	1.9%	4.6%	9.5%
CPI Inflation + 3%	6.3%	3.2%	4.8%	5.7%	6.0%
FTSE World Index (GBP)	24.0%	5.2%	7.9%	14.2%	15.4%

Source: FE Analytics; data to 30 September , I-class, mid price to mid price.

These figures refer to past performance, which isn't a reliable indicator of future returns.

The value of your investments and the income from them may go down as well as up, and you could get back less than you invested.

Losses in September were enough to erase many of the strong gains of July and August, leaving the FTSE World Index only modestly up over the quarter. Bond markets weren't immune to rising inflationary pressures either. Yields on 10-year US Treasuries (the global benchmark for borrowing costs) surged back above 1.50% for the first time since June and have since continued heading toward previous post-COVID highs above 1.70%.

Global supply and labour shortages should pass through the economy in time, but they won't be unwound immediately. Six months ago, it was commonly accepted that inflation would pop higher around the world as nations reopened after pandemic shutdowns. This would be due to snarled-up supply chains, altered spending habits and mismatched skilled labour for available jobs. And so it has come to pass.

So far, company earnings seem to have been holding up in more challenging conditions. Particularly in the US where third-quarter earnings announcements have been largely positive. But strong past performance gives us only so much comfort. We're scrutinising what businesses are saying about the future very carefully. We want to know how rising energy prices and supply chain tangles might affect profits in coming months.

Performance review

Our strongest performers were all companies that investors perceive as commanding dominant positions in economic sectors enjoying sustainable and longer-term structural growth and which, therefore, look well placed to withstand supply chain snarl-ups and cost pressures. Indeed, Dutch semiconductor giant **ASML** and US software designer **Cadence Design Systems** could arguably be viewed as benefiting from post-pandemic supply chain woes. Semiconductor chip manufacturers around the world are keen to ramp up production capacity to ease reliance on long semiconductor supply chains disrupted by COVID. Both ASML and Cadence enjoy virtually unique positions in the chip manufacturing process. ASML supplies high-end equipment to chip manufacturers, while Cadence provides the software design technologies required to design new chips. Both companies, therefore, benefit from burgeoning global demand that's creating huge, multi-year order books.

America's largest bank **JPMorgan Chase** also continued to prosper. Banks tend to be more profitable when yield curves are steeper because they can earn income from borrowing money at lower interest rates and lending it at higher rates. And JPMorgan's profits have been buttressed by the release of credit reserves set aside when the pandemic first hit to cover potential loan losses. In the event, these losses have proved much less severe than the bank had expected, enabling it to release huge loan loss reserves over several quarters.

The weakest performers over the quarter were hit by stock-specific negative news flow. Hong Kong-listed Chinese technology giant **Tencent** came under intense pressure as China's regulatory crackdown on its technology sector widened. Tencent's WeChat social networking and payments app was impacted by tougher data security protection initiatives. The crackdown then sought to impose curbs on gaming (one of Tencent's core business activities) aimed at safeguarding children, pressurising the company into restricting the amount of time children can spend on its gaming sites.

Belgian brewer **Anheuser-Busch InBev**, which makes Budweiser and Stella Artois, lagged amid concerns about the impact of higher costs (particularly more expensive can and distribution prices) on its profit margins. Anheuser-Busch has borrowed heavily to fund its acquisition-driven growth to date, raising concerns about whether it lacks the balance sheet strength to fund further growth initiatives from here.

Music streaming giant **Spotify** also came under pressure amid concerns about its profitability prospects. In particular, there are questions about its decision to invest heavily in podcasting, which has yet to prove a lucrative profit-generator.

Outlook

We have no more idea of what will happen in coming months and years than anyone else. Still, we remain hopeful that recent setbacks will end up being just a timely reminder that corrections are a normal function of markets and needn't send us into a panicked retreat. Some supply disruptions may be more pronounced and last longer than expected, and so may the higher inflation they bring. The global economy looks likely to stay on the road to recovery, even if that recovery won't prove as smooth and perfectly formed as valuations might have been suggesting earlier this year.

There's been considerable uncertainty about the kinds of stocks that are likely to perform most strongly. Earlier in the year, investors vacillated between 'quality' and 'growth' (i.e. earnings resilience potential) and 'value' and 'cyclicality' (earnings recovery potential). Growth-oriented markets and sectors have largely been in the ascendant since June. But their ever-higher valuations mean they could prove particularly vulnerable if their earnings start to disappoint.

We continue to balance our exposure, while noting that shares with cheaper valuations have a long way to go before regaining ground on more expensive growth companies. In addition, stocks that tend to do well in periods of rising inflation or bond yields are more likely to be found in sectors with a higher representation in value indices.

Because markets as a whole still look expensive, we are continuing to sit on a lot of cash, as dictated by our valuation-linked cash management mechanism. We continue to believe that the 'cost' of any shorter-term underperformance will be outweighed by our efforts to deliver attractive risk-adjusted returns over multi-year investment horizons.

The Rathbone Heritage Fund team

This is a financial promotion relating to a particular fund. Any views and opinions are those of the managers, and coverage of any assets held must be taken in context of the constitution of the fund and in no way reflect an investment recommendation. Past performance should not be seen as an indication of future performance. The value of investments may go down as well as up and you may not get back your original investment. Source performance data, Financial Express, mid to mid, net income re-invested.

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

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

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