

# Rathbone Strategic Income Portfolio

Quarterly investment update, October to end December 2020



---

## Hot topics – ‘Top-down’ (market and macroeconomic)

**Viral evolution.** A proliferation of vaccines has been met with a proliferation of mutations in COVID-19. After slow wind-ups, most developed nations are steadily beginning to inoculate more and more of their people. However, the discovery of



two particularly noxious COVID variants – one spawned in South Africa and another right here in the south of England – dampen the success somewhat. Most scientists say existing vaccines should work for the UK strain, but the South African one may have changed in a way that makes it harder for the vaccine-induced antibodies to fight. Jabs can be tweaked, if required, to better fight new mutations, but that takes time and some people are already dubious about the safety of quickly developed new vaccines as it is. This concern about the vaccines is both a shame and understandable. Humans are conservative creatures and there is a chance that developers and regulators missed some problems in their haste. Yet the power of these new vaccines, especially the breakthrough mRNA type, is an incredible advance in our ability to fight viruses. So, with mutating viruses and gargantuan production and complicated roll-outs of vaccines all across the world, we feel there are quite a number of unknowns floating around that could pop up to shock investors. And markets, in the main, haven't left much margin for error in prices.

---

**Global Britain.** Now the deal is done, Brexit is out of the way. Except for the bureaucrats, though. They will be wrangling about the details and add-ons for decades. But, once the new environment has bedded in, the conversation will move on. This is welcome. The UK's protracted divorce with the European Union became all-consuming, preventing our nation from focusing on much else. Brexit certainly seemed like the only thing that global investors were focusing on – British markets have carried a substantial discount to other markets ever since the vote to leave. UK stocks – particularly small and mid-cap – have already done extremely well in the final months of 2020 and into 2021. We believe that this should continue once overseas money begins to return to our isles en masse. There's definitely room for optimism, so we will be carefully watching what the government does next: Does it experiment with free ports and reduced regulation or does it bind itself up in protectionism? We're not changing our stance on the UK just yet. We're also surprised that sterling didn't bounce back more on news of the deal. Because of this, we have kept our currency hedges in place.



These are agreements with an investment bank to fix the sterling value of a good portion of our overseas assets, protecting us from losses that would result from sharply higher sterling. They also mean we forego any benefit from a fall in the pound.

---

**Green new deal.** Big plans for investing in more sustainable energy and infrastructure, from the UK and Europe through to the US and China, are very welcome. These projects have the potential to cut global pollution and refine energy



usage, helping us face climate change and maybe even save many of us from hours stuck in traffic. Yet there is also the potential for investors to get burned in the hype. The hubbub of a goldrush already surrounds these industries, with some hucksters setting up their stalls. There will be some fantastic opportunities to invest in this once-in-a-lifetime shift, but there will also be a lot of fool's gold peddled. And that's before you think about most governments' track records on infrastructure projects: they tend to overpay for assets (because they use other people's money) and they tend to build the wrong things (because what looks good today is more valuable politically than what works best a decade hence). Whenever investing in these areas, we will be watching carefully for the chance of policy mistakes and misuse of capital. Where possible, we will also be cleaving close to that old adage: it's better to sell pickaxes than go prospecting for gold yourself. We believe it's usually best to invest in the technologies and equipment spurring this green drive, rather than punting on individual projects (or bundles of them).

## Portfolio activity

Key purchases/additions	Key sales/trims
US Treasury 4.5% 2036 bonds (new purchase)	ITV (sale)
iShares S&P Small Cap 600 ETF (addition)	M&G Global Macro Bond Fund (trim)
CME (addition)	Rentokil (trim)
Linde (addition)	Johnson Controls (trim)
GlaxoSmithKline (addition)	ASML (trim)

Source: Rathbones

In late October/early November we added US government bond exposure via the **US Treasury 4.5% 2036 bonds** as prices fell amid rising inflation expectations that we believe are overplayed. With the chance of volatility looming next year – given the lingering virus, Brexit uncertainty and the potential for investor disappointment with company reporting in the first half of next year – we felt it was prudent to top up our safe-haven assets.

We added significantly to our holdings of the **iShares S&P Small Cap 600 ETF** because of our belief that the US domestic economy should bounce back relatively well in 2021. We also increased our position in global financial exchange giant **CME**.

We sold the last of our shares in UK broadcaster **ITV**. The vaccine-inspired bounce back buoyed ITV as well, because a healthier environment for its advertisers bodes well for its profits. We believe there are better places to invest, however, especially as there is a mean band of deep-pocketed competitors arrayed against ITV: Netflix, Disney, Amazon, BBC and more besides.

Finally, in late October we trimmed our holding in the **M&G Global Macro Bond Fund**.

## Spotlight

In this quarter, the spotlight is on our **Ferguson** and **Aptiv**.

# FERGUSON

### Ferguson

- The world's leading specialist distributor of plumbing and heating products
- Despite being listed in the UK, the majority of the revenues and profits come from the US
- Their end markets remain fragmented but they are the number one or two player in most of them
- The service level and technical expertise Ferguson provide are their key advantages, and a significant way they can combat the threat of disruptors, such as Amazon, in their markets
- They recently sold their UK business, Wolseley, and returned money to shareholders via a special dividend – this will enable the company to focus on the US where management believe they have the best opportunities for growth



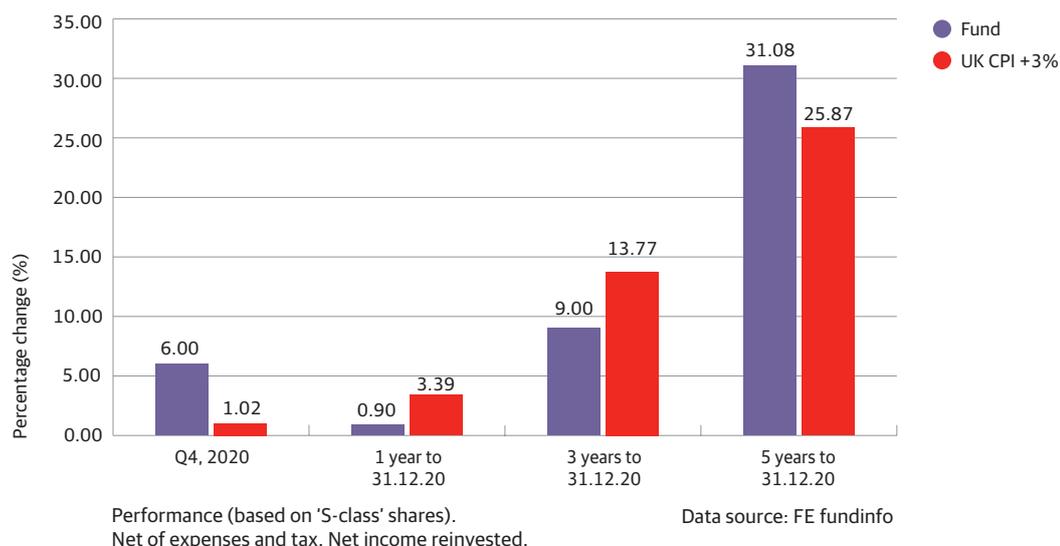
# • APTIV •

### Aptiv

- A global auto parts technology company with exposure to the key themes of vehicle electrification and connectivity, increasing infotainment, autonomous driving and active safety technology like sensors and automatic controls
- Their products are used in both commercial and consumer vehicles with increasing technology content being a key growth area in the autos space
- 25 of the world's largest auto manufacturers are customers, so it matters less to Aptiv which car company wins in the race for electric vehicles, autonomous driving, and other technological advances as they supply many of the key players
- Their long-standing presence and key customers in China help to broaden the growth opportunities
- Ongoing additional regulations support many key business areas for Aptiv, whether that be around quicker moves to electric vehicles, or the increasing safety standards requiring more safety software and sensors in cars



## Fund performance



The performance shown is for our 0.5% annual management charge share class. Some of our existing clients may be invested in a more expensive share class, the performance for which will therefore be lower. Factsheets for all share classes showing our charges and respective performance are available on request, free of charge or on our website [rathbonefunds.com](http://rathbonefunds.com).

Price performance based upon bid to bid prior to 21 January 2019 and single price (mid) thereafter. 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.

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 2020, we would look at the percentage change from December 2019 to the end of January 2020). So we take CPI to the current value, and add on 3%, prorated over a year (roughly 0.25% 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.

Top performers (%)			Bottom performers (%)		
Holding	Performance	Contribution	Holding	Performance	Contribution
Discover Financial Services	+48.99	+0.49	Amgen	-13.85	-0.14
Legal and General	+41.38	+0.47	DCC	-12.99	-0.09
Royal Dutch Shell	+35.85	+0.27	Christian Hansen	-12.42	-0.05
Aptiv	+34.57	+0.24	Lockheed Martin	-11.72	-0.13
JP Morgan Global Emerging Markets Fund	+27.92	+0.34	WEC Energy	-9.55	-0.09

Source: Rathbones

Note: Top and bottom performers are taken from the list of all holdings of 0.25% and above of the portfolio. Performance and contribution data shown above is based on unhedged GBP capital returns. Performance (table above only): Gross of charges.

The hedging we have of a large portion of our US dollars was a meaningful help to performance during the quarter. Over the period sterling experienced strength but also combined with broad US dollar weakness too. The rate of exchange moved from around 1.29 at the end of the third quarter of 2020 to around 1.37 at the end of the year. This is exactly the kind of move our hedging is designed to help protect against and it proved its worth during the quarter.

The rotation towards more cyclical areas of the market we saw during the quarter resulted in some of the companies and sectors which had performed very strongly throughout the earlier parts of the year faltering. Money flowed out of a number of those top performing areas as investors sought exposure that was more sensitive to an economic recovery. US small caps and more recovery-oriented stocks rallied significantly as the cyclical recovery began to take hold.

In Q4 2020, we saw a significant rally in the Russell 2000 index in which we have exposure via an exchange traded fund (ETF) as vaccines were announced and then rollout of vaccination programs began across the US. As you would expect given this environment supported the more cyclical names in the portfolio, broadly all of them had an excellent quarter. In addition to the **Russell 2000 ETF**, names such as **Discover Financial Services**, **Legal and General** and **Aptiv**, along with our exposure to certain banks and the oil majors, all saw a significant rally as market sentiment shifted and investors began to see the light at the end of the tunnel.

## Asset allocation change and strategy

There were no significant asset allocation changes during the quarter.

Asset allocation split	30.09.20	31.12.20	% Change		12 month change	
Liquidity assets/lower volatility	19.60%	22.82%	+3.22%	▲	-1.05%	▼
Equity-type risk (economically sensitive assets)	72.49%	70.97%	-1.52%	▼	+1.96%	▲
Diversifiers	7.91%	6.21%	-1.70%	▼	-0.91%	▼
	100.00%	100.00%				

Asset class split	30.09.20	31.12.20	% Change		12 month change	
Equities	56.49%	55.90%	-0.59%	▼	+1.39%	▲
Index-linked bonds	0.00%	0.00%	0.00%	◀▶	0.00%	◀▶
Conventional government bonds	16.87%	16.30%	-0.57%	▼	+0.03%	▲
Corporate bonds	14.62%	13.57%	-1.05%	▼	+0.59%	▲
Emerging market debt	3.96%	3.88%	-0.08%	▼	+0.56%	▲
Private equity	0.97%	0.91%	-0.06%	▼	-0.21%	▼
Alternative investment strategies	3.75%	2.53%	-1.22%	▼	-0.93%	▼
Property	0.00%	0.00%	0.00%	◀▶	0.00%	◀▶
Commodities	2.35%	2.06%	-0.29%	▼	-0.78%	▼
Cash	0.99%	4.85%	+3.86%	▲	-0.65%	▼
	100.00%	100.00%				

## Asset allocation ranges

Liquidity	Equity-type risk	Diversifiers
5% to 40%	40% to 80%	0% to 40%

## Investment outlook

The array of vaccines is definitely great for the prospects of 2021. Imagine how grim things would be if they didn't exist...

Yet we're trying not to get carried away. There's a long, bumpy path ahead and we have to stay alert to how our businesses are faring. And ensuring that they are adapting to the post-pandemic world that will arrive, one day. It will take a good few months to roll out the vaccines around the world, so inoculation and the change it should bring won't come on suddenly. When we start to emerge from this strange period, it seems ever more likely that it will be gradual, and perhaps in stages. It's been a long, dark year, but we are optimistic about the future.

One thing we aren't optimistic about is the potential for a sustained rise in inflation. With most of the world still battling the virus, GDP won't return to pre-pandemic levels until 2022/23. When inflation does return, we believe it will spike because of the "base effect" – a statistical quirk of recovery from extremely low levels – and then remain much as it has for years and years: muted.

There's just too much debt and too many unemployed workers for this to be any different, in our view. There are also massive changes in the global economy that make it harder for inflation to drive higher. If you think about the most profitable – the most successful – companies of today, they increasingly have little need of capital investment and physical materials. Compared with the past, at least. Most of the profitable growth is in intellectual property, ideas and software, not in tonnes of copper or hoppers of cement. We think that many of these companies are intrinsically deflationary, because they operate to offer more value for less money and to drive efficiency gains for households and businesses. As an example, think of how much you can do with the mobile in your pocket compared with 10 years ago. We doubt mobile prices have kept pace.

GDP growth seems unlikely to roar back in this environment, which is why we focus our investments on those businesses that should be able to increase their profits independently of stronger GDP growth.

**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

Authorised and regulated by the  
Financial Conduct Authority  
A member of the  
Investment Association  
A member of the Rathbone Group.  
Registered No. 02376568

**Rathbones**  
Look forward

**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.**