Rathbone Unit Trust Management

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Rathbones
Look forward

Rathbone SICAV Multi-Asset Strategic Growth Portfolio

Monthly update May 2021

What's that Michael Phelps quote? "It's not how you start, it's how you finish."

Boris Johnson doesn't strike us as a swimmer, despite the chlorinated tinge to his hair, but his government has most definitely adhered to that principle during the pandemic. Let's not forget that the UK's early response really was a botch-job – Dominic Cummings certainly made a concerted effort to remind everybody last month. It was so bad that it turned us off the UK. At the beginning of 2020 we had been starting to move more of our equity portfolio into the country, as we felt it was out of fashion and ripe for beating very low expectations. However, once the government's initial disorganisation became apparent, we immediately reversed our move.

But now, the UK has outdone itself with its vaccine rollout. The take-up among citizens has been really high too, especially compared with some other nations. This is just as important as the efficacy of the vaccines themselves, because they're no good if not in the arm of most people. Even as the UK has opened up wide for summer, the numbers of deaths and hospitalisations have stayed remarkably low. The magic of modern medicine. It feels like the endgame for the pandemic in the UK now (even if COVID itself may linger as a common but managed flu). If that's correct, we feel like we've returned to the situation of early 2020: an unloved market with the flexibility to shake things up, with the potential to beat the crowds of naysayers.

So last month we bought the **iShares Core FTSE 100 ETF** and added to a few of our direct stocks, including miner **Rio Tinto**, telco **Vodafone** and market operator **London Stock Exchange**. To raise the cash, we used the proceeds from a few lower-rated corporate bonds that matured. We also sold some other higher-yield bonds, which have had a very good run over 2020. These included the **Invesco Markets US High Yield Fallen Angels** and **iShares Fallen Angels high Yield Corporate Bond** ETFs.

Hotting up

We aren't the only investors who have started warming to the UK either. So far this year private equity firms have bought out 131 publicly traded companies in the UK, totaling £25.7 billion, greater than in the whole of 2020. That's according to investment data company PitchBook. And the crazy part is that last year's £17.5 billion of deals was a record for Britain. This avalanche of buyouts has got a few MPs worried about foreigners picking off our nation's economic crown jewels at an unjustified discount. However, the point remains: UK companies have been trading at large discounts to overseas rivals for a long time now.

There are still risks, of course. COVID-19 has thrown us all plenty of curveballs, so we can't rule out another. And if the virus really is under control, then there's a lot of unravelling of supply chain snarl-ups and labour dislocation to come. This could take a few months to shake out – perhaps a little longer for the labour market. But we're confident that the market will do its thing, no doubt with a bit of lobbying from labour-strapped businesses. We're seeing that already, ironically from arch-Brexiter and Wetherspoons boss Tim Martin. Bluntly, though, the UK does now have the ability to set rules to suit its needs, so this shouldn't be an issue. Particularly if the punters suffer a summer with 40-minute wait times for a pint...

Overall, we're feeling pretty good about the prospects for the UK and the US. Retail sales have really shot back in both nations. As an example, specialty beauty and fragrance chain **Ulta Beauty** absolutely smashed its first-quarter results. Sales rocketed 65% compared with Q1 2020 and easily eclipsed the same time in 2019 as well. As another proxy for getting back to normal, you can look at petrol demand and air travel. These have bounced back in the US. According to Atlantic Equities, daily American air passengers surpassed 1.9 million in May, the first time since March 2020. And US drivers were using roughly 97% of the fuel they were back in 2019.

Many people seem to be worried that the US is going to overheat, but we think we're just seeing the whiplash you should expect from such a massive dislocation to people's lives and businesses. After a summer of very spicy economic numbers, things should die down as things resettle. We're expecting a reasonably modest level of economic growth (and therefore inflation) over the coming years.

We bought UK retailer **Next** because we believe it should get through the pandemic and general decline in high street shopping more or less in one piece. The industry has been mauled over the past couple of years, yet Next has a good online shopping channel. Not something that all its rivals can boast. We think that Next could be the last man standing in the premium economy area of UK retail, which should be an attractive place to be over the coming years.

We bought **Taiwan Semiconductor Manufacturing Company** during the month. This is one of a handful of businesses that dominate production of the computer chips that seem to go into everything these days. The technology in this industry – and its progress from year to year – is blistering. The exponential growth in computing power we have all enjoyed is driven by the ability to accurately print components at ever-smaller scale on silicon wafers. This means huge outlay on research and development and new equipment, which discourages new rivals and keeps prices steadier. At the moment, there is a huge global

shortage of computer chips which has stopped gadget makers and vehicle production lines in their tracks. This is a short-term phenomenon, however, and the long-term case is underpinned by the Internet of Things – chips are going in everything nowadays, including your kettle.

Another purchase was **Tomra**. This Norwegian company takes recycling to the next level. It makes reverse vending machines that encourage the recycling of bottles, cans and newspapers. It also designs sensor systems that help resources companies sort ore and make mining more efficient and less burdensome on the environment. Similar technology is brought to bear on food supply chains as well, creating more effective processes that reduce waste and improve hygiene.

The risk pendulum

As economies roar back to life, investors' appetite to take risks – while a bit flighty depending on the daily news flow – has increased noticeably. Most markets are up, including those 'cyclical' ones that are more sensitive to improving (or deteriorating) economic growth. Stocks in the UK, Europe and Japan, which have cyclical biases, have done well recently.

Another sign of this change in appetite is a sustained fall in the value of the dollar. When things go pear-shaped – like during the pandemic – investors flock to safety, which tends to mean government bonds issued by the US, Japan, Germany and Switzerland. To buy those 'safe-haven' assets, investors need to buy the currency first, which is why a scramble for safe harbour tends to push up the value of those aforementioned nations' currencies. This works in reverse as well: when investors want to sell their safe assets and buy riskier stuff in search of better returns, they have to sell their dollars (or yen or Swiss francs) and buy other, riskier currencies. So the exchange rate pendulum swings back, as we have been seeing in recent months.

In keeping with our expectation for greater economic growth, potentially accompanied by inflation fears, we bought US investment bank **Morgan Stanley** last month. If bond yields continue to steepen (yields of longer-dated bonds rise more than shorter-term ones), then the bank should be able to make money off that. There has also been a raft of new listings, bond issues and M&A, which are the bread and butter of investment banks. Above all of these reasons to buy, however, is that Morgan Stanley has been expanding its wealth management business, significantly improving the quality of its earnings. By 'quality', we mean the fluctuations in its earnings are lessened by the smoother recurring wealth management fees. When this happens, it leads investors to put a higher value on the earnings, boosting a company's price-earnings multiple.

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