Rathbone Unit Trust Management

Contact us 020 7399 0399 rutm@rathbones.com

Rathbones
Look forward

Rathbone Multi-Asset Strategic Income Portfolio

Monthly update August 2023

The Grand Old Duke of York is of course a tale of a man who rides his army up and down a hill. It has lived long in the British culture because of that delicious mix of farce and menace that we all tend to relish so much. When they're up, they're up, and when they're down, they're down. And when they're only halfway up, they're neither up nor down. Markets…

So far this year they have certainly been up, down and generally following the theme of to-ing and fro-ing. The market, if it were a man on a horse, seemingly has no idea what to do with his troops. Uncertainty among investors is palpable. After a strong July, stocks dipped in August, harassed by conflicting economic news and general unease about what the future will bring and how central bankers will react to it. And so stocks continue to bounce around from one month to the next, as we've seen several times already this year.

Still, even if it doesn't feel like it, many stock indices are up strongly in the first eight months of the year. A lot of this has been driven by big gains in the largest American stocks (dubbed the Magnificent Seven by big-bank analysts): Alphabet, Microsoft (both of which we own), Apple, Amazon, Nvidia, Meta and Tesla (all of which we don't).

Making the most of market moves

Prices for government bonds have been up and down the hill many times this year too, as investors chop and change their views on the path of interest rates as economic data rolls in. The US 10-year government bond yield hit a post-Global Financial Crisis high of 4.3% in mid-August as a slight rise in inflation and signs of a strong economy made its price slump. The yield on its UK counterpart also spiked to levels not seen in 15-odd years — its high was 4.7%. Both bond yields dropped back in the second half of August as investors started to question whether central banks will increase interest rates much further.

No hike is forecast for the US Federal Reserve (Fed) monetary policy meeting of 20 September; investors expect another 25-basis-point rise in the Fed Funds Rate to the 5.50%-5.75% band sometime in final quarter of the year. However, these sorts of expectations have been fluid so far in 2023 and will no doubt remain so for the rest of it. They swing dramatically on how strong the US economy looks. In late July, it was reported that US GDP growth accelerated to 2.4% in the second quarter, helping push global bond yields higher. At the very end of August the second estimate revised that growth to 2.1%, easing pressure on yields.

The more vibrant economies look, the more nervous investors become of inflation reaccelerating and central bankers hiking interest rates further. The more they appear to be fading, the more prevailing bond yields drop back and the more relaxed investors become about owning stocks. This dynamic isn't going anywhere. While investors rejoice on signs that labour markets are cooling, other pressures continue to bubble away. Strikes by Australian liquified natural gas plant workers have halted 5% of global supply and driven European gas prices more than 10% higher in a day. Wild weather all around the world has badly hit harvests of all manner of foodstuffs. Meanwhile, China's property market is still groaning under enormous debts and an ocean of unneeded (as well as unfinished) homes. To put this into some sort of context, one report from late 2021 estimated that China had 65 million empty units, or 20% of all its housing stock. That's enough to house everyone in France. And it's got worse since. This imbalance is dragging the economy down hard because so much of the nation's money is tied up in these millstones. That makes companies go pop, leaving workers unemployed, and terrible investment losses frighten households and discourage them from spending. This helps explain why China has this year slumped to deflation (a negative inflation rate, i.e. general prices are *falling*) even as the rest of the world battles rampant inflation.

As bond yields continued to rise in August, we bought the **UK Treasury 4.5% 2042** and **4.25% 2032** and added to our position in the **3.75% 2052**. The further into the future a bond matures and repays its capital, the more sensitive its price will be to changes in prevailing interest rates. That's because if market rates fall the value of earning more interest than anyone else can get today is factored into the price of the bond – and if you have that rate locked in for many years to come that's more valuable than if it's only for a few years. Similarly, if rates in the market rise your bond is earning less interest than you can get if you invested today, so the value of your bond will fall – and it will fall much more if you're locked into that poor rate for many years. With yields at multi-decade highs, we felt it made sense to increase our interest rate sensitivity (or 'duration' in the lexicon).

In late August the volatility of the US stock market dropped to quite a low level. Put options, which work like portfolio insurance in that you pay a premium upfront and receive protection if markets drop, become cheaper to buy when volatility is low and more expensive when it's high. The reason for this is that if volatility is high – if prices are yo-yoing all over the place – there's more chance that the option will be used, so it's more attractive. However, volatility isn't stagnant, so it's often best to buy insurance when the sun is shining, so we added to our put option exposure.

We sold alcoholic drinks conglomerate **Diageo** last month because we felt smaller, more artisanal brands were better able to challenge its premium labels. We added to our holding of UK housebuilder **Redrow** and American self-storage business **Public Storage**.

What is risk?

There is enough conflicting information out there to make an argument either that inflation and global economic growth are smoothly falling back to normal levels, or one that we're about to tip over into recession in the coming months. Whether you make the case for one or the other seems more illuminating of your innate disposition than it does about the economic prospects for the world.

We're trying to avoid banking on one or the other. When a stock or bond we own starts to look expensive, we trim or sell it and put the cash into something that has fallen back to more attractive levels. Our portfolio is usually tilted toward companies with less debt, higher profit margins and stronger growth rates than the average, and this is still the case today. You have to pay more to buy these sorts of assets, which is a risk, but we think they offer more security if a recession does arrive. That's because they don't have onerous interest payments and they tend to have strong business models that should weather a downturn and – crucially – not go bust. Because, in our view, that's the true measure of risk: a permanent loss of your money, as opposed to short-term fluctuations in value.

David Coombs
Head of Multi-Asset Investments

Will McIntosh-Whyte
Fund Manager

Rathbone Multi-Asset Strategic Income Portfolio

If you require further clarification on this commentary, then please contact your adviser or Rathbones at the contact details below.

Any views and opinions are those of the investment manager, 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 and the income from them may go down as well as up and you may not get back what you originally 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

Authorised and regulated by the Financial Conduct Authority

A member of the Investment Association

A member of the Rathbones Group. Registered No. 02376568

8562.09.23