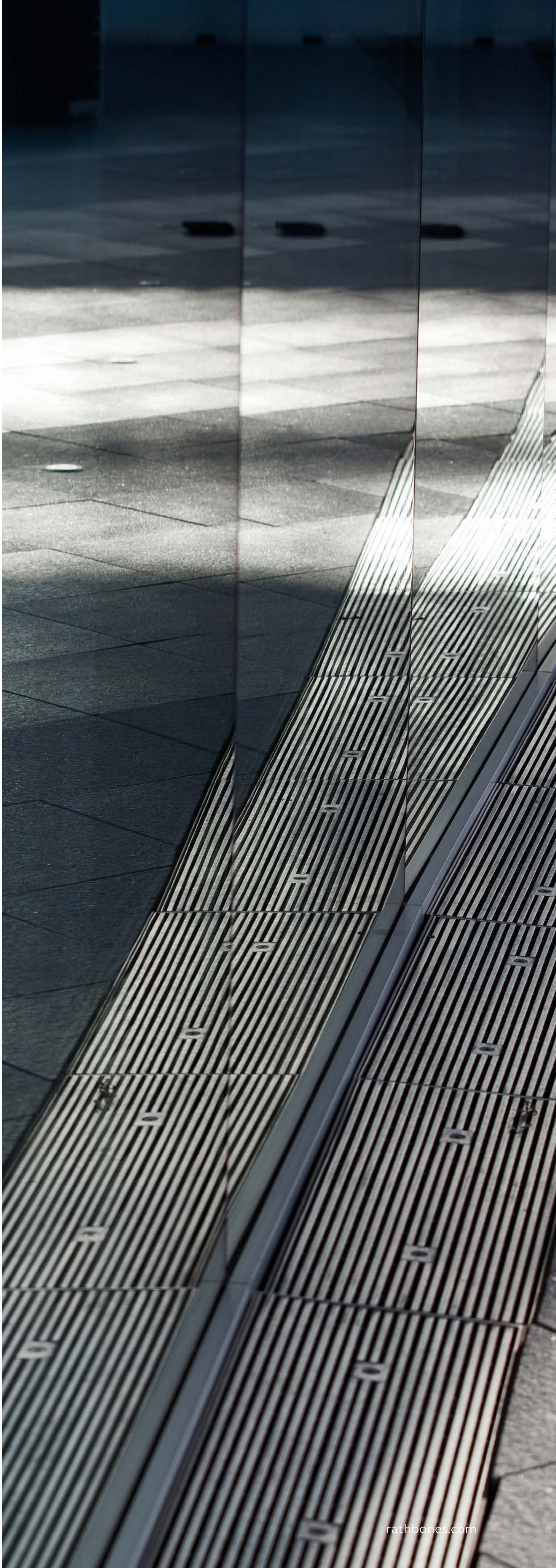
BESPOKE PORTFOLIO UPDATE FOR CLIENTS OF SAUNDERSON HOUSE

Q1 2024 REPORT

CONTENTS



QUARTERLY INVESTMENT UPDATE

THE MANY HAVE TAKEN OVER FROM THE FEW

Will it be a case of the tortoise versus the hare, with last year's stock market winners taking a breather while the laggards catch up?

Developed market equities have continued to do well this year as the likelihood of recession recedes, particularly US equities. In contrast to the first 10 months of 2023, when an unusually small number of stocks contributed to the gains of the entire US index, and most underperformed, more and more global companies are participating in this year's rising markets. The performance of the so-called Magnificent Seven mega-sized technology firms has been much closer to that of other large firms, as well as the returns of smaller and medium-sized companies.

It's notable that the performance within the Magnificent Seven (Apple, Microsoft, Alphabet, Amazon, Nvidia, Meta and Tesla)* has been mixed recently. Three have underperformed so far in 2024. The 'Seven' is arguably no longer a particularly coherent grouping, given the different drivers of those companies' businesses, which we wrote about in the January edition of our Investment Insights publication. It's also worth remembering that, looking back over many decades, the largest stocks in the index at any point in time — as indomitable as they may seem contemporaneously — usually underperform over five years or more. This is a strong argument against passive investing, which usually allocates more to the giants than other stocks.

While rising stock prices have been broadening out, substantial profit growth is still relatively rare and industry analysts have revised down forecasts for 2024 for all but the highest-quality and sector-leading companies — finding them remains a core focus for us. While we believe the outlook for the global economy and corporate profits has brightened significantly, the risks haven't vanished entirely and we are conscious that some stock prices have moved ahead of where the outlook for profits suggests. We have much more confidence than we did a few months ago that good returns can be achieved in the medium-term, but there may be another bump or two in the road ahead this year.

Slow off the mark

Advanced economies outside the US entered 2024 on a weak footing. In the second half of 2023, the UK joined 15 other advanced economies that have recently experienced a so-called technical recession — two consecutive quarters of contracting GDP. In most cases, there was only a marginal contraction in output and stagnation is probably a fairer categorisation. The US continued to be the exception. GDP growth did slow in the fourth quarter of 2023 but, at a 3.2% annualised pace, was still strong.

Outside of the US, there is a growing body of evidence suggesting the worst may now have passed. While low by past standards, there had been a noticeable jump in our own global leading economic indicator by January, and further data has pushed the indicator a touch higher since then. Parts of the equity market more sensitive to these indicators, such as eurozone equities, have been doing particularly well over recent weeks.

Business confidence surveys conducted around the world now stand at an eight-month high, as the service sector outlook remains stable, while the manufacturing outlook has improved. None of these indicators are strong in absolute terms and they have

Past performance is not a reliable indicator of future performance.

*The specific securities identified and described are for informational purposes only and do not represent recommendations.

not been a great guide to growth since the pandemic. But it is still good news that they have turned the corner, because that's what markets tend to respond to.

Emerging market equities have underperformed significantly over the past 12 months, led lower by China. We remain sceptical about China's ability to outperform sustainably over the next few years, which we highlighted in our China past its peak report last year. Several factors continue to bear down on China's trend growth rate, not least what will likely be a multi-year fallout from the bust of its overinflated property sector. But Chinese authorities appear to have done enough to stabilise the economy, with economic data improving over the past couple of months. This certainly helps the global economic outlook this year and should help broader investor sentiment.

Our analysis isn't unequivocally optimistic. Survey-based measures of firms' hiring plans have deteriorated and are consistent with an increase in unemployment. In the US, firms have already reduced the average worker's hours and are shedding staff on temporary contracts — both have tended to signal a worsening outlook for full-time employment. That said, they suggested a weaker outlook last year. It may be that with skilled workers in short supply, most of the adjustment comes from firms hiring fewer people rather than laying off existing staff.

A number of indicators that give us the longest lead on what lies ahead, such as the inflation-adjusted amount of money in the economy or commercial banks' willingness to lend among others, have ticked up too and that's encouraging. But because of the long look ahead they give us, this tells us more about the likelihood of a downturn continuing into 2025. The outlook for 2024 is indicated by last year's readings, which suggested recession, and it's important to acknowledge this risk.

In sum, more data is pointing up and we are more optimistic. Markets tend to respond more to the rate of change than they do to the level of these sorts of readings. But we think there is still about a one-third risk of recession across the developed economies in aggregate, and that makes us retain an element of defence in our investment strategy. The good news is that the traditional ballast in multi-asset portfolios, government bonds, are looking particularly attractive.

Tilting toward gilts

There's an asymmetry in the potential returns from UK government bonds (gilts). In our opinion, this makes them a relatively low-cost way of hedging against the risk of a setback in equities and other riskier assets, as well as a useful source of return for investors with a lower appetite for risk.

Following the shallow technical recession at the end of last year, UK GDP rose in January, recovering most of the ground lost already. Our analysis suggests activity has continued to recover in February and March. A popular business survey aggregating activity in all sectors of the economy reached a nine-month high, while there are fewer days being lost to strike action.

If this trend continues, UK interest rates are likely to fall by at least the three quarter-point cuts currently implied by market pricing, so bond returns (which tend to move inversely to interest rates) would likely be moderate. However, the lagged impact of past interest rate rises and tighter fiscal policy present powerful headwinds that mean growth is likely to be weak at best, and the economy is still vulnerable to a more typical recession. In this event, interest rates would likely fall by much more than is widely anticipated, causing gilt returns to be strong.

If inflation proved sticky, we may get another two or three interest rate rises, and gilts could suffer capital losses, though probably only mildly so. If held to maturity, we know that they would still earn a positive return over the life of the bond (in addition to the regular coupon payments, investors would get back the face value of the bond when it matures).

Sunnier days for UK inflation

Here in the UK, the inflation rate is on a downward trend. Energy price deflation should continue into the end of the year. Consumer food price inflation, which was adding around 1.5 percentage points (ppt) to headline inflation in January, is set to drop to zero (it follows producer food price inflation closely, with a six-month delay), bringing overall inflation to less than 2% in the spring. Services prices have been

Past performance is not a reliable indicator of future performance.

the most persistent component of inflation in advanced economies for some time now — they are the reason core inflation is still above target. In the UK, services inflation is still only around 1.5 ppt below last July's peak. But this year-on-year rate masks a sharper drop-off in the monthly price rises lately, and surveys that give a lead on the future are cause for optimism too.

One factor underpinning weaker inflationary pressure in the services sector is a downward trend in wage growth. Regular private earnings grew at only about a 3% annualised pace over the last two quarters of 2023. That's roughly consistent with inflation at target. Such short-run data can be volatile, but even so, this is clear progress.

Tortoise versus hare

In the UK and eurozone we're confident about the direction of travel. US inflation came down more quickly last year, but things are in danger of getting a little stuck there. The three-month rate of change of core inflation has been rising since the autumn and is above the 6- and 12-month rates of change. Again, the service sector is the culprit, with the annualised rate of three-month inflation spiking to 6% for two months in a row, which is a big reversal from having fallen back down to within a whisker of 2% in late summer 2023. It's not just a few prices behaving badly and having an unrepresentative influence: median inflation is far too strong too, again highlighting breadth.

We expect it to continue to come down, particularly because wage growth is a key element of US service sector inflation, like it is in the UK. There are many leading indicators suggesting this. Perhaps most compelling is the advertised wages taken from job posting websites like indeed.com. The hiring rate, the rate at which people are quitting and the rate at which people are staying on employment benefits all suggest an even great decline in wages in the months ahead.

However, if the past few years have taught us anything, it's that we must be humble about our ability to truly understand the inflation-forming process. Until we get to the finish line, we have to acknowledge there is still some upside risk.

Financial markets are pricing in more or less the same rate cuts in the US as the UK this year. Historically, that scale of cuts would be mild. We believe the risks to interest rates seem to be tilted to the downside, but much more so in the UK than the US where the risks appear most balanced. So for the moment we prefer UK bonds to US ones.

When small is beautiful

Given the improving outlook for growth and relative valuations, we see the long-term prospects of smaller and mid-market companies as particularly attractive. At the start of the year and for the first time since the 1988 inception of the Russell 2000 index of smaller US companies, the S&P 500 large company index achieved a new high, while the Russell was still in a bear market, off 20% from its highs. Small and mid-sized companies are still vulnerable to a pullback if we do get a deeper economic downturn, while relative valuations don't tell us much of anything about short-term performance prospects. But it does give us more confidence in the potential for medium-to-long-term returns.

We recognise that some other parts of the market may have moved ahead of where the outlook for profits suggests they should be. The leading economic indicators we discussed earlier tend to have a close correlation with market returns, but recent gains in global equities have been consistent with past periods when these indicators have been their most ebullient.

They are some way short of that today. The recent downward revisions to profit forecasts don't preclude decent returns from equities this year, but our analysis suggest that this environment does tend to favour higher-quality and possibly more defensive businesses. They did particularly well in January, and we'll continue to focus on selecting quality businesses with resilient returns as the broader investment outlook brightens.

Past performance is not a reliable indicator of future performance.

*Indexes are unmanaged, and it is not possible to invest directly in an index.

ASSET ALLOCATION

DIVERSIFSIERS

Commodities

There has been even more evidence that the key driver of gold prices has become buying by central banks and other official institutions (figure 1). Despite a further decline in holdings of gold in exchange-traded funds (ETFs), a steady rise in central bank holdings has supported its price. The increase in institutional demand has been most apparent in Turkey, China, and India recently, suggesting that countries not geopolitically aligned with the US continue to diversify their reserve assets away from the US dollar. Demand in China has been particularly strong, with local prices trading at a $50 (USD) premium to global prices. The desire of certain countries to diversify reserves away from the US dollar helps explain why the past relationship between the price of gold and US real (inflation-adjusted) yields (where higher real yields reduced the appeal of non-yielding gold) appears to have broken down.

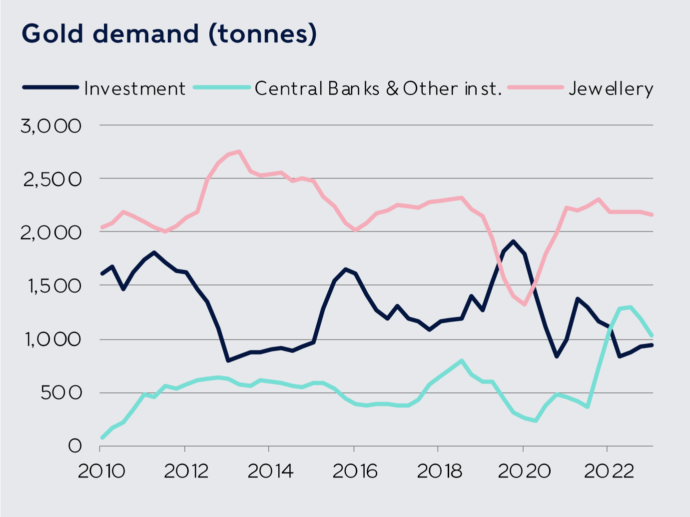


Figure 1

Central banks and other institutions have been buying more gold recently, which could explain why prices have risen this year.

Source: World Gold Council, LSEG, Rathbones, November 2023

Infrastructure trading at a discount

Infrastructure investment trusts have been subject to large discounts relative to their net asset values (NAVs), which have grown larger over the last quarter. A narrowing of these NAV discounts could provide significant returns and higher quality trusts could benefit if gilt yields fall in anticipation of rate cuts (making infrastructure trusts relatively more attractive as a source of income). However, the additional yield from infrastructure trusts over safer gilt yields is still quite low by past standards (figure 2).

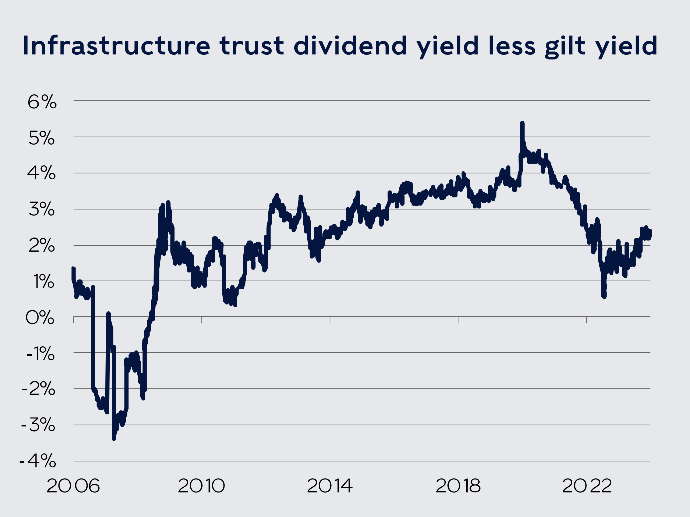


Figure 2

Infrastructure trusts offer higher yields than gilts but investors must decide whether it compensates them adequately for the additional risks involved.

Source: LSEG, Rathbones, March 2024

Past performance is not a reliable indicator of future performance. 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.

ASSET ALLOCATION

EQUITIES

Japan

Japanese equities have been the top performer recently and second only to the US when factoring in movements in exchange rates. However, valuations in Japan are still not especially high, despite the recent strength of the market, which has seen the Nikkei 225 finally exceed its 1989 peak (figure 3).

Improving corporate governance and increasing shareholder returns have continued in Japan. Under new rules last year, companies persistently trading below their book values (which account for more than half of the Topix index) now need to disclose plans to remedy that situation.

Japanese firms generally have very low borrowings by international standards, and many have lots of idle cash. There's evidence that firms are now starting to return some of this cash to shareholders, with buybacks surging to record levels. We expect this trend to continue, providing a long-term boost.

Japan's market is proving an indirect beneficiary of the additional geopolitical and regulatory uncertainty around Chinese equities, offering investors an alternative way to diversify away from the US and Europe, without substantial risks.

The direct revenue exposure of the Japanese equity index to China is also surprisingly low, and only fractionally higher than that of US or European equities (figure 4). Therefore, pessimism about China's economic prospects isn't necessarily a reason to be downbeat about Japanese equities.

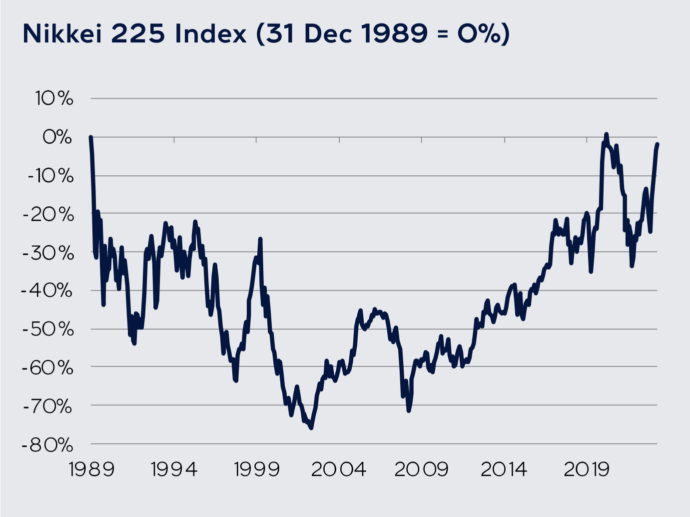


Figure 3

Japan's stock market has reached an all-time high after passing the previous record set in 1989.

Source: Factset, Rathbones, March 2024

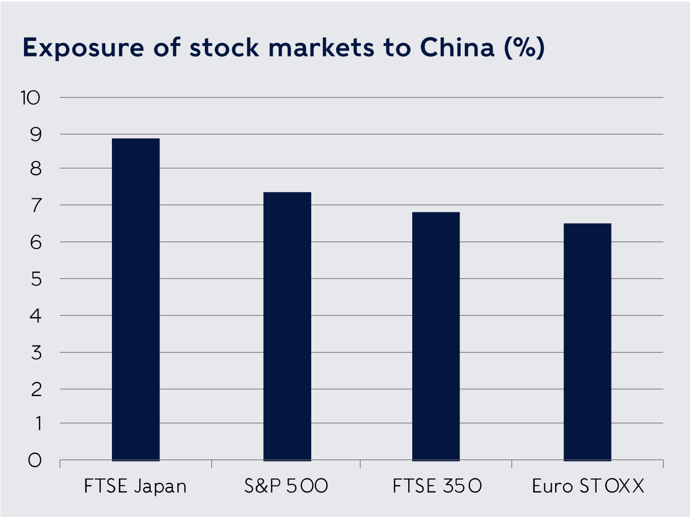


Figure 4

Japanese companies are only slightly more exposed to the Chinese economy than US firms, while UK and European companies are not that far behind.
Source: Factset, Rathbones, December 2023

*Indexes are unmanaged, and it is not possible to invest directly in an index.

Past performance is not a reliable indicator of future performance. 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.

HOLDINGS IN FOCUS

Siemens

Siemens is a German industrial conglomerate which has gone through a significant programme of divestment and simplification over the last decade to leave it focused on four business areas, each of which enjoys significant market share and structural growth potential via exposure to growth (and ESG) themes such as automation, electrification and clean energy, rail transport and healthcare spending.

Its four businesses areas are: Digital Industries (43% of 2023 group profit - automation and related software for industrial automation, particularly for discrete manufacturing customers ie automotive, aerospace and machine tool industries); smart infrastructure (27% of profit - products for electrical systems and building control e.g., fire safety and security, as well as power distribution systems for smart grids, distributed power, electricity storage and charging infrastructure); Mobility (8% of 2023 profit - rail rolling stock and infrastructure including digital signalling); and Healthcare Equipment (22% of profit via the 75% stake in separately listed Siemens Healthineers - world leader in medical imaging and radiation therapy, with strong positions in diagnostics and cardiology.

As it has restructured, Siemens has increased its earnings resilience, growth potential, margin profile and cash flow conversion, increasing the quality of the business.

Digital Industries remains a shorter cycle business and recent trading has been hampered by industry de-stocking following significant growth post-Covid. Expectations for recovery in this business are being pushed further out from H2 this year.

Valuation is low relative to other globally leading industrial businesses and in our view does not adequately reflect the transformation in quality and growth potential.

Spirax Sarco

Spirax is a UK-based engineering business operating in 66 countries across three divisions – steam systems, pumps (peristaltic or displacement pumps) and electric thermal solutions – all focused on industrial processes particularly in end markets like food and beverages and pharmaceuticals.

It is a high quality business, earning consistently high returns on invested capital and solid cash flow, and enjoying operating profit margins in excess of 20%. It is also a rare dividend aristocrat within the inherently cyclical industrials sector, with a 55 year track record of dividend growth and a dividend compound annual growth rate (CAGR) of 11% over that period.

It sells thousands of types of components such as steam traps, valves and pump tubing which are low-ticket (average invoice value is £3k) but mission-critical.

85% of revenue is from customers' operating (rather than capital) budgets and half of this is maintenance and replacement. The other half of this is 'self-generated' by Spirax's field force of 2100 sales engineers, who visit customers' industrial plants, maintain a dialogue with plant managers to understand the problems and challenges they face, and then present them with a series of solutions (incorporating Spirax components) which will deliver a demonstrable payback by saving cost or energy, reducing emissions or improving throughput.

Recent results for 2023 were relatively lacklustre for what is a defensive business. While the key steam division grew at 8% in 2023 (despite weaker industrial production figures), electrical thermal solutions grew at just 2%, while its pumps business, Watson-Marlow (which accounts for 23% of group revenue) saw revenues fall by 19%. This fall was exacerbated by de-stocking and came after strong years

The specific securities identified and described do not represent all of the securities purchased, sold, or recommended for the portfolio, and no assumptions should be made that the securities identified and discussed were or will be profitable.

in 2021 and 2022 driven by Covid vaccine production and overstocking to limit COVID supply-chain disruption. Biopharmaceutical customers still make up 50% of the pumps division's revenue and the long term growth in this end market for Spirax is still estimated to be c.10% once de-stocking ends, which management believe will occur this year, and they expect high single digit revenue growth particularly weighted to the second half.

Longer term Spirax's organic growth has averaged 7% over the last decade, c.2x the rate of industrial production growth.

The valuation looks expensive but this reflects the fact that we should see strong recovery in revenue and profits from the pumps business over the next couple of years, and the valuation falls quickly in outer years to be more comparable with other global leading and more defensive industrial names.

Hermes US SMID Equity Fund

This fund holds between 40-70 reasonable valued, high quality small and mid- sized businesses in the US, which can trade at much lower valuations than larger US stocks.

The experienced management team look for companies with stable, growing revenues coupled with high barriers to entry. Typically, 15-25% of the fund comprises cyclical stocks focusing on high quality and pricing power, 40-60% stable businesses with strong competitive power and lower cyclical exposure, and 15-25% high growth businesses in 'disruptive' niches. Existing holdings include the sports medicine and burn care therapy provider Vericel, construction materials manufacturer Eagle Materials and payments group Wex.

The team believe that the economic backdrop is improving and that there are signs of a broadening out in stock market gains. While the US Federal Reserve has signalled the end of the rate hiking cycle, Hermes does not believe that rates will return to the level experienced in the last cycle and this will prove supportive of the high quality, cashflow-generative and sensibly valued companies that the strategy invests in.

The specific securities identified and described do not represent all of the securities purchased, sold, or recommended for the portfolio, and no assumptions should be made that the securities identified and discussed were or will be profitable.

KEEPING YOU UPDATED

PLANNING FOR A CHANGE OF GOVERNMENT EVENT

With most polls projecting around a 20-point lead in the run-up to the general election, the Labour party is the odds-on favourite to form the next government. If these forecasts prove correct, what changes might be made to raise funds, how might these changes affect you and what can you do about it?Join us for our Planning for a change of government drinks reception on Thursday 2 May from 6.00pm at our London office at 8 Finsbury Circus, London, EC2M 7AZ. You'll hear directly from Randolph Churchill, investment director at Rathbones and great-grandson to former prime minister Winston Churchill, in addition to investment and financial planning experts from across the business.

The session will be followed by drinks and canapés and an opportunity to pose any further questions to our panel. Spaces are limited, but if you would like to attend then please click on the following link or get in touch with your financial planner to confirm availability.

INVESTMENT INSIGHTS – ON THE ROAD TO RECOVERY

In this 40th edition of **Investment Insights**, we consider how market gains have broadened out so far this year. We take a look at opportunities we're seeing outside of last year's narrow band of winners, the US tech titans known as the Magnificent Seven. We consider smaller companies and prospects for other regions outside of the US; and continuing our series of recent articles on developments in artificial intelligence, we look at the risks it poses for companies through the lens of environmental, social and governance factors. Topics in this quarter's edition include:

1. Big gains for big stocks obscure some hidden gems
2. The Magnificent Seven are not the only stock market stars
3. Can India meet optimistic growth expectations?
4. How to harness the power of artificial intelligence for good

FINANCIAL AWARENESS COURSE FOR WOMEN

Thursday 20 June 2024 – Virtual event. To confirm your registration, please email Sharon Ryan at **sharon.ryan@rathbones.com**

FINANCIAL AWARENESS COURSE FOR ALL ADULTS

Thursday 16 July 2024 – Virtual event. To confirm your registration, please email Sharon Ryan at **sharon.ryan@rathbones.com**

RATHBONES INSPIRED MINDS

We are delighted to announce our new series of podcast, **Rathbones Inspired Minds,** which launched in January 2024.

The Rathbones Inspired Minds podcast series, hosted by Daniel Norcross, features acclaimed writers, scientists, entrepreneurs and thinkers talking about what inspired them to follow their chosen careers and what continues to inspire them in their lives.

ADDITIONAL INFORMATION

Rathbones Investment Management Limited

8 Finsbury Circus, London EC2M 7AZ

020 7399 0399
ifaservices@rathbones.com
rathbones.com

Management of strategies is provided by Rathbones Investment Management. Funds are managed by Rathbone Unit Trust Management Limited.

Rathbones Asset Management is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

Registered office: Port of Liverpool Building, Pier Head, Liverpool L3 1NW. Registered in England No. 01448919.

Rathbones Asset Management is authorised and regulated by the Financial Conduct Authority and is a member of the Investment Association anda member of the Rathbones Group. Registered no. 0236568.

Nothing presented herein is intended to constitute investment advice and no investment decision should be made solely based on this information. Nothing presented should be construed as a recommendation to purchase or sell a particular type of security or follow any investment technique or strategy.

Information presented herein reflects views at a particular time. Such views are subject to change at any point and Rathbones shall not be obligated to provide any notice. Any forward-looking statements or forecasts are based on assumptions and actual results are expected to vary. While we have used reasonable efforts to obtain information from reliable sources, we make no representations or warranties as to the accuracy, reliability or completeness of third-party information presented herein. No guarantee of investment performance is being provided and no inference to the contrary should be made. The information has been provided independently to Rathbones by the listed third party providers.

RATHBONES