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Rathbones
Look forward

Rathbone SICAV Multi-Asset Enhanced Growth Portfolio

Monthly update May 2020

Overview

Stock markets continued to push higher in May. As many investors became more optimistic about the global economy bouncing back quickly, 'value' companies had an accelerating resurgence. Despite this late surge, in America these companies that are hugely dependent on better economic growth to increase profits still lagged 'growth' businesses over the month. 'Value' companies' share prices made big gains, but they have had – and continue to have – pretty hefty falls too.

It's important to keep share price moves in a wider context, especially today. Share prices are shifting much further much quicker than we have seen for many years. And the moves are both up and down. That can lead some to champion the return of certain stocks or to call the recovery of others that, when you zoom out just a little bit, looks a little less convincing.

Europe is perhaps the most conspicuous story of the recent value rotation, with its stock markets spiking higher. Yet many of the EU's export customers are in the emerging world. We all have a Western slant on the world, and that hasn't gone away during the pandemic. As COVID-19 starts to recede from the developed world many have been quick to claim global victory. Yet there are so many more billions of people in the emerging world who are entering the fight we are still now trying to finally win in the West. And they are doing it with vastly less of everything: technology, funding, savings and infrastructure.

We're as optimistic as we can be, yet we are realistic about the chances of a second wave of the virus. China has already had to shut down parts of Beijing because of a resurgence more than a month after they believed they had eradicated it. Last month, we noted that there was a very real risk of nations coming out of lockdown too fast without sufficient tracing systems starting to experience sharp spikes in new cases and deaths, forcing them to return to lockdown. China could not be accused of any of these mistakes, yet it succumbed. If a country with widespread testing, tracing and iron-clad quarantine laws can experience a second wave, the UK, US and Europe are also vulnerable. As is anywhere else.

If this comes to pass, we think it would be a massive shock for stock markets. They could test new lows. It would be havoc for businesses too, putting the fight back months could push many into bankruptcy and stress governments' finances to the limit. This is why we're reticent to jump on the value train. Instead, we're sticking first and foremost with solid companies with minimal debts, good cash flow and business models that should continue to grow (or hold up better than most) even if more economic disruption comes down the pipe. Yet we aren't perma-pessimists, we're not waiting for inevitable gloom. We've also built up our investments in companies that have a value edge to them. Companies with healthy balance sheets and reliable earnings, yet that should catch more of the economic upwind should the world defeat the virus and break out into the sunny uplands.

Trades

As part of our move towards quality companies with a value edge, we took profits from **ASML**, the Dutch company that designs the machines that make computer chips, and from laboratory and food safety business **Eurofins Scientific**. Both businesses have had a good pandemic, so we thought it best to cash in some of the gains and spread the money among other holdings that have a more cyclical leaning. These top-ups included metals behemoth **Rio Tinto** and oil majors **Shell**, **Total** and **BP**.

We also added a new quality stock with a cyclical bent: bulk store **CostCo**. In a way, this company is like a low-rent form of Amazon (which we also own). To shop at CostCo, you have to pay an annual membership fee. While this can put some people off, it also creates an interesting shopping dynamic for its customers. Because they have paid for the privilege, they tend to want to use it by buying from CostCo. The company's keen prices and membership perks help encourage that as well, obviously. This phenomenon is very similar to Amazon's Prime membership, which tends to rope people into using Amazon for virtually everything. Why is it low rent? Well, because the multiple you pay for CostCo is much, much lower than for Amazon. We think this lower premium (albeit much higher than rivals like Walmart) and the focus on supplying the typical American households and small businesses should deliver decent returns if the recovery continues to roll on.

We sold **Micro Focus International**, a legacy business computer systems provider that we have held for several years. We got this one completely wrong, as the company has gone from trouble to misery. We had hoped that it would right itself in time; however, the pandemic has changed the landscape. Now, it seems more likely that companies will be buying up brand new technology to aid flexible working than patching up the old, stable systems they have. That bodes ill for Micro Focus.

We sold some of our **iShares FTSE 250 ETF** to reduce our exposure to the UK. Earlier in the year we had increased our investments in the UK. However, following the UK's haphazard handling of the pandemic and the looming risk that Brexit is pushed through in an overly hard and very mistimed fashion we felt it prudent to cut our losses.

We bought Californian medical devices company **Dexcom**. This company makes high-end, minute-by-minute glucose monitoring systems for people with diabetes. The number of people living with this disease continues to grow, and this system is an unobtrusive way of dealing with it. The company is growing well and we believe its technology is far superior to its rivals.

Another Californian medical company we added to our portfolio was **Edwards Lifesciences**, which makes artificial heart valves and monitoring devices. Elective surgeries haven't been so hot during the pandemic, for obvious reasons. However, they will definitely jump back once COVID-19 fades. It should come back faster for heart surgery than rhinoplasty, at least. People tend not to mess around when it comes to recommended or required procedures for their heart.

Outlook

We're broadly positive about how things are shaping up at the moment – although it would be nice if some states in the US got a better handle on their infection rates.

As the world comes out of lockdown, shops, bars and restaurants are beginning to reopen in a reasonable fashion. Better yet, early signs show that quite a few people can't wait to get back out there and spend. This appetite is pivotal for the global recovery because it creates the demand for all the jobs needed to get people back to work. Then we will have to wait and see whether the precautions and safety measures work or whether the pandemic starts to surge once more.

Stock markets are high enough that it implies that everybody thinks the recovery is going to be tickety-boo. We truly hope so, but it seems unlikely to us. We believe it will be bumpy and halting, particularly when it gets to the point when the training wheels have to come off the economy. There has been a truly extraordinary tsunami of stimulus from government and central banks, yet that stimulus cannot be sustained indefinitely. Tapering it off and then hiking the taxes to pay for it without upending businesses and households will be the tough gig of 2021 and beyond.

Not only that, we believe there will be deep and lasting changes in how we live and work and also in supply chains and financial markets. During the long hours of lockdown we've been reading a lot, asking a lot of questions in virtual meetings and discussing how tomorrow will look different to today. We're putting together a short report on our ideas that we will share with you soon. In the meantime, stay safe and keep spending if you can! The economy depends on it.

David Coombs
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Fund Manager

When operating in the EEA, Rathbone Unit Trust Management works in partnership with a tied agent. In Europe we market our funds through Rathbone Funds Advisers, Unipessoal Lda. ("Rathbone Funds Advisers") a company acting as a tied agent to Carne Global Financial Services (Europe), Unipessoal Lda. ("Carne Global") which is an investment advisory firm authorised under MiFID II and supervised by the Portuguese Securities Market Commission — the CMVM (Comissão do Mercado de Valores Mobiliários). Rathbone Funds Advisers is registered in Portugal and has been appointed by Carne Global to provide investment advisory services on its behalf in relation to financial instruments, in particular units or shares in undertakings for collective investments.

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