

Rathbone SICAV Income Fund

Quarterly update September 2020

As 2020 rumbles towards an uncertain, and perhaps volatile conclusion, we look back upon an extraordinary nine months in which markets have whipsawed back and forth. Although the story elsewhere on the globe has been markedly different, this period has not been kind to investors in the UK stock market. The relevance and justification for UK Equity Income mandates have been thrown into question, and the debate has been supercharged by the swathe of businesses whose dividend payouts have been postponed, cut, or cancelled altogether. The headlines of March and April have hung around the income sector like a bad smell,

scarcely dissipating as conditions improved for many companies over the summer. Furthermore, the combination of COVID-19, chaotic government, and the uncertainty over Brexit have combined into a heady mix that has made investors turn their collective backs on the UK market. When both UK and Income are dirty words, the environment is undoubtedly tough.

However, to bemoan the market, the pandemic, politics and the economy is not a solution. We have adopted a strategy that accommodates these new realities, while, crucially, remaining true to investors who rely upon the income philosophy that has been the bedrock of this fund for its 50-year existence. Our **"Rebase, Reallocate, Reward"** strategy is our response to these challenges.

Investment Review

	9 months	3 months	6 months	1 year	3 years	5 years
Rathbone SICAV Income Fund	-20.9%	-3.3%	7.2%	-17.5%	-13.2%	5.6%
IA UK Equity Income sector	-22.8%	-3.2%	7.4%	-17.2%	-14.5%	5.3%
FTSE All-Share Index	-19.9%	-2.9%	7.0%	-16.6%	-9.3%	18.6%

	30 Sep 19- 30 Sep 20	30 Sep 18- 30 Sep 19	30 Sep 17- 30 Sep 18	30 Sep 16- 30 Sep 17	30 Sep 15- 30 Sep 16
Rathbone SICAV Income Fund	-17.5%	2.5%	2.5%	9.5%	11.2%
IA UK Equity Income sector	-17.2%	-0.2%	3.4%	10.6%	11.4%
FTSE All-Share Index	-16.6%	2.7%	5.9%	11.9%	16.8%

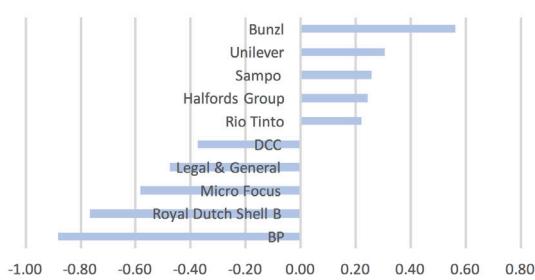
These figures refer to past performance, which isn't a reliable indicator of future returns.

Source: FE Analytics; data to 30 September, I-class, mid price to mid price.

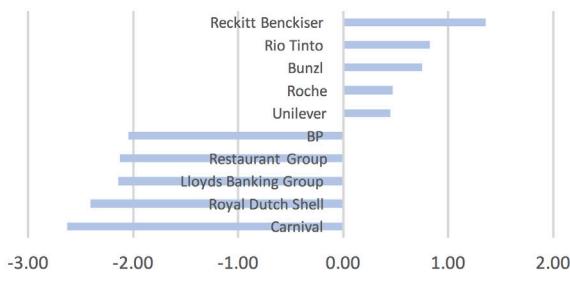
The year-to-date numbers certainly tell a story, down 21%, just behind the market, ahead of the sector average, but a severe reflection of the tumult that has been 2020. The winners this year have been the businesses and industries that have either been able to thrive due to their product mix – **Reckitt Benckiser** and **Unilever** selling cleaning products and wipes, and pharmaceutical companies – or others where industry dynamics have remained robust despite the turmoil. Here we think of miners such as **Rio Tinto**, benefiting from a resilient iron ore price and the robust cash flows that it empowers. The losers have been far more prevalent. Stocks within the consumer and leisure sectors, whose very existence has been placed under threat by COVID-19, we have sold; the energy sector has been pummelled, so our holdings in **BP** and **Royal Dutch Shell B** have hurt us; and financial stocks ranging from banks to life insurers and insurance businesses have all felt downward pressure, but here, on occasions, we have bought, believing that we can see both light at the end of the tunnel and very large margins of safety. Time will tell if we are correct.

If the first quarter of the year culminated in the initial violent reaction in markets to the emerging pandemic, and the second the dramatic spring back in line with concerted central bank and government action, the third quarter has been far less conclusive, far more schizophrenic, more meandering. On balance, however, the winners and losers of the summer months echoed those of the early year.

Q3 contributions



9 month contributions



Source: StatPro

Three tales

The quality play: The outstanding contributor to our performance through the summer was Bunzl, the global distributor of non-food consumable products. Its broad spread of clients has had wildly contrasting experiences this year: exposure to the leisure market has been disastrous – think disposables used in cafes and coffee houses; on the other hand, medical supplies have been very strong. Like-for-like sales have been volatile both up and down, but in Bunzl's latest results the netting out of big numbers resulted in a strong positive beat on sales and profit. Nevertheless, we are minded that the consumer downdraft may outlast the tailwind of the inventory build in healthcare, so we have trimmed. Importantly, however, Bunzl was able to reinstate its dividend.

There's value, then there's the UK, then there's the energy

sector: Our exposure to oil companies has been the obvious drag to performance this year. Royal Dutch Shell and BP have been hit with a triple whammy: demand slashed by COVID-19; unruly behaviour of the major oil nations (Saudi Arabia, Russia) has undermined the oil price; and the acceleration by consumers and producers alike towards a zero-carbon world, the fundamental change that is their energy transition. Oil majors have been the headliners of the dividend-cutting world, as we detailed in our August letter. We persist with them because we believe that they are part of the solution. The absolute opprobrium with which BP and Shell are viewed by many investors is an opportunity. However, thus far, it has been a painful ride, and we remain underweight the sector.

Chicken Licken can't believe his luck: Somewhat unfairly, the Financial Times jovially mocked Halfords CEO Graham Stapleton for his pessimistic outlook, after the company released an unscheduled trading statement following the period end. Throughout 2020, management have emphasised how difficult it is to predict future trading. They provided very cautious and wide ranges for future sales and hence earnings. And yet, they have beaten on every release. Yes, sales have benefited from the unexpected pandemic-induced resurgence in cycling, and government policy has been an additional fillip. The Autocentre division has seen an improvement in trade, and online is going great guns. Mr Stapleton is right to be cautious, because the future remains very uncertain, but analysts have had to elevate their estimates once more, and there are even whispers of a return to the dividend roster. Unlike many on the high street, the sky has certainly not fallen in on Halfords.

Outlook

Who knows what the final quarter will bring? Volatility is almost guaranteed. In the UK, we await the conclusion of the Brexit negotiations, and week by week we the economic ramifications of COVID-19 will be revealed as unemployment is sure to rise. How will the government react? In the US we will have the denouement, we hope, of the election cycle. Rumbling on in the background will be the evolving relationship of China with the rest of the world. And, of course, COVID-19 is here to stay.

However, from a market perspective, there are opportunities. There remains a bifurcation of views on interest rates and the best path for investors. Some argue that interest rates will stay lower for longer, and that the playbook remains to buy quality and to buy growth. Market leadership is narrowing, the argument runs, and you're foolish to fight this trend. On the flipside, others point to improving economic data, despite the trauma of 2020, and the sheer weight of monetary and fiscal impetus around the globe. They warn that inflationary pressures are building. Supporters of this stance advocate a shift towards value and cyclical.

We have tilted towards the latter view. We are positioned to benefit if economic news surprises on the upside; a cohort of stocks is pricing in such economic disaster that any incremental positive data will encourage some re-evaluation. Brexit anxiety is reflected in valuations. What happens if a deal is struck? What then happens to sterling, and conversely, what happens to our dollar earners, and possible investor complacency towards these businesses? We are not betting the house on positive outcomes, but we are judging that too little weight is being placed on the possibility that things do not turn out quite as badly as some valuations suggest.

Rebase, Reallocate, Reward

The world has changed, and our fund reflects many of these changes. As companies have cut, postponed or cancelled their dividend, we have had to rebase ours. It is frustrating, but the 20.5% reduction in our annual distribution is a long way ahead of the index, which is down an estimated 39-43%, according to the Link Asset Services Q2 UK Dividend Monitor. Importantly, we are now at a level where we believe that we have the foundations for future real income growth.

Our focus remains on comprehending the decisions that companies make around how they allocate capital, because decisions made today determine the earnings, and therefore the dividends, generated tomorrow. We are happy for companies to withhold cash from us, the shareholders, if that cash is being put to good use.

Finally, we want to remind investors of the reward from owning an equity income fund. Yes, we understand that investors may now choose to garner "income" by selling down capital, and therefore focus on total return. However, our focus is also on total return, we just recognise the validity and security of the tangible cash returns that dividends provide. At month end, the dividend yield of our fund stands at 4.4%. Despite the undoubtedly economic hardship that has been caused by COVID-19, and recognising that it has placed many households in dire financial straits, the truth is that the UK population has hoarded cash; the Bank of England forecasts the savings ratio will reach an eye-watering 17%. This money is generating no return in the bank, and alternatives are scarce: property funds, where exits may be restricted; bond funds, where you get less yield for similar risk? This has been a very difficult year, in a multitude of ways. But, as of today, we believe that we offer a viable choice for investors wanting both income and total returns.

Recent trading: We made very few changes to the portfolio during September. We increased our stake in new holding **Ferguson**, a global plumbing and heating products supplier. We then benefited from a subsequent strong set of results at month-end. We further trimmed our small position in flooring wholesaler **Headlam**.

Companies seen (virtually) this month: Bunzl, Relx, Dechra Pharmaceuticals, Jupiter Fund Management, Close Bros, Reckitt Benckiser, and Sandvik.



Carl Stick
Fund Manager



Alan Dobbie
Fund Manager

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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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