Rathbone Unit Trust Management

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Rathbones
Look forward

Rathbone Income Fund

Quarterly update June 2021

The first six months of 2021 delivered further progress in the fortunes of equity investors. It has not all been plain sailing, with the narrative of 2021 twisting and turning. COVID-19 is with us still, and the optimism engendered by the promise of inoculated societies opening up, is tempered by the threat of more virulent strains of the virus.

Economic data has generally improved, with PMI (purchasing managers index) numbers across the US, UK and Europe strongly suggesting economic revival. But the mood music continues to be determined by the actions of central banks, and the debate around future levels of interest rates and inflation. These numbers are as crucial for the valuation of assets, future earnings streams and forecasting returns on your investment as they are impossible to predict. And so, inevitably, there has been no clear consensus among investors about the best way to position themselves.

From autumn last year through to spring this year, there was a rotation of money away from areas of the market that offered either earnings predictability ('quality') or reliable 'growth', into more cyclical industries, offering greater 'value'. The promise of an uptick in earnings now became more highly prized than the possibility of earnings upon the distant horizon. Latterly, the tide has swung in the other direction, with growth and quality in the ascendant. Rest assured, what happens in the second half of the year is being hotly debated.

	3 months	6 months	1 year	3 years	5 years
Rathbone Income Fund	5.1%	12.9%	23.4%	8.2%	31.5%
IA UK Equity Income Sector	5.0%	12.1%	25.4%	5.7%	33.7%
FTSE All-Share Index	5.6%	11.1%	21.5%	6.3%	36.9%

	30 Jun 20-30 Jun 21	30 Jun 19-30 Jun 20	30 Jun 18-30 Jun 19	30 Jun 17-30 Jun 18	30 Jun 16-30 Jun 17
Rathbone Income Fund	23.4%	-13.1%	0.9%	1.1%	20.2%
IA UK Equity Income Sector	25.4%	-13.6%	-2.5%	6.0%	19.3%
FTSE All-Share Index	21.5%	-13.0%	0.6%	9.0%	18.1%

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

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

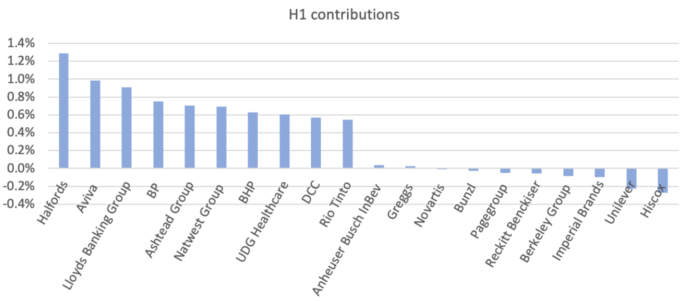
The value of your investments and the income from them may go down as well as up, and you could get back less than you invested.

Six-month performance review

Your fund has started 2021 well, rallying 12.9% in the first six months, ahead of the sector average and the benchmark FTSE All-Share Index. We have benefitted from market trends, but, more importantly, corporate news has been good. If our companies are trading well, we rely on share prices to eventually reflect this health.

Investors' greater appetite for cyclical risk certainly shows up in the principal contributors to our performance. Retailer and auto service provider **Halfords** maintained its 12-month resurgence. A vindicated business strategy combined with strong tailwinds energising its dominant market position, especially in bicycles and e-vehicles (bikes, scooters and cars), have propelled the company to rude health and a return to a stable dividend. The share price performance has reflected this, up 184% in the year ended 30 June, versus the market up 18%, and the retail sector up 37% (both also in price terms).

Style rotation (investors switching allegiance from quality/growth to value/cyclicality) is further reflected by the heavy representation of financials (**Aviva**, **Lloyds**, **NatWest**) and commodity stocks (**BP**, **BHP**) in our top 10. We introduced construction and industrial equipment leasing business **Ashtead Group** into the fund in February as a play on US economic recovery and growth. We said goodbye to **UDG Healthcare**, which we sold on news of the recommended offer for the shares in the company by a private equity bidder.



Source: StatPro, Rathbones

The positive market meant there were very few detractors to our performance in absolute terms. Insurance company **Hiscox** is the stand-out, entangled as it is in a dispute over COVID insurance claims. We do like the industry – in a rising rate environment insurers earn greater returns on premia held for the length of the insurance terms – and Hiscox is now one of a dwindling number of listed insurance names, with a strong if perhaps latterly tainted brand. Without doubt the last 12 months have been difficult.

Rotation is also reflected in our laggards, with **Unilever**, **Reckitt Benckiser**, **Bunzl** and **Novartis** all drifting in a strong market. We used the weakness to add to the latter three, but we sold Unilever in April. We had been fretting about its capital discipline, unconvinced that the many brands acquired by the company over the last few years justify the prices paid. We chose to exit the game and watch from the side-lines.

Employment agency **PageGroup** and high street baker and sandwich retailer **Greggs** are new additions to the portfolio. Both are economically sensitive plays on the revival of economies. PageGroup is a natural choice for our fund because it has very few capital needs and no debt to speak of. We've danced around it in the past, but why would you buy an employment agency when employment is very high and unlikely to get much higher? The pandemic gave us our opportunity. Frustratingly, our position in Greggs remains small, as its share price has moved ahead on outstanding trading this year, but we remain patient.

Outlook

There is a fine balance between conviction and pragmatism. We want all our holdings to reflect conviction: an understanding of the income we are going to receive from that business, a reason why we believe it will outperform the market, a solid idea of the upside. On the other hand, we know we cannot predict the future, so our portfolio construction reflects pragmatism. We don't put all of chips on red or black, rather we want the best possible result from the greatest number of possible futures. We believe it is this discipline that generates secure returns in the long run and a dependable rising dividend stream for you, our unitholders.

Although the rotation into cyclical value has paused over the final weeks of the period, we believe that it will resume in the second half of the year. Arguments around whether inflation is transitory or more structurally established are sideshows, in our view; any increase in inflation and rates from the very low levels that we have gotten used to over the last decade will have an impact. The investment playbook has changed.

Our positioning reflects three themes. We are planning for a recovery in the UK economy, empowered by an increase in consumption and fuelled by very high savings ratios unleashing pent-up demand. Globally, we believe that there will be a second rotation into value and cyclicality, reflecting broader economic revival. And nowhere is value more inherent than the long-neglected UK market.

This third point deserves further comment. On the one hand, this value is evidenced by the extraordinary level of M&A activity already experienced so far this year. Private equity can see a bargain. Corporate raiders may raise our hackles at the thought of losing the best of corporate UK, but if the market doesn't recognise the value, aggressive suitors will.

However, that misses the point. Our aim is to provide rising income and a competitive total return to UK investors, especially those with excess savings in the bank generating no real return. That reasoning has not changed. This year we expect to post a healthy rise in distribution, and we are already confident of next year. If the UK market looks good value, then UK equity income looks even better.

Recent trading: In a quiet June, we took a little profit from Halfords and Ashtead, and added to PageGroup. We also added to **Roche** and **Novartis**. We feel the pharmaceutical sector has been left behind a little and adding to these two Swiss pharmaceutical giants also helps our dividend planning for next year.

Companies seen (still virtually, sometimes in conference) in June: **Intertek**, **Rio Tinto**, **Smurfit Kappa**, Bunzl, **AB InBev**, **Clorox**, Halfords, Ashtead, and **GlaxoSmithKline**.

Carl Stick
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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 your original investment.

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