Rathbone Unit Trust Management

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Rathbones
Look forward

Rathbone Multi-Asset Strategic Income Portfolio

Monthly update August 2021

Equity markets have risen pretty consistently since spring 2020, making valuations of COVID-19 friendly stocks look pretty lively.

In fact, we have had to come up with a new ratings system: 'lively', 'spicy' and 'eye-watering'. Two US software and computing hardware holdings in our fund, simulations company **Ansys** and computer chip optimiser **Cadence Design Systems** are trading at multiples of around 50 times forecast 2021 earnings. They have definitely gone from 'quite expensive' to 'spicy', whizzing right past the 'lively' category. And if you think it's just the US, think again. Dutch business **ASML**, another of our computer-chip positions, is also on 50 times 2021 earnings.

Now, we believe that high-PE stocks will sell off substantially if interest rates rise, so these eye-watering multiples make us a bit nervous. However, they are expensive because they are quality businesses, just the sort of businesses we want to own. And timing the market using PE multiples is extraordinarily difficult, if not impossible. The values of these stocks could go yet higher. We discuss this conundrum in episode three of our podcast **The Sharpe End**.

Hedging our bets

We don't want to sell these companies that boast reliable earnings growth and replace them with lower-quality or lower-growth names. We are long-term investors. We aren't buying highly indebted or unprofitable businesses valued on a price-to-sales basis. That tends to end badly when sentiment shifts.

To square this circle, we've followed our trademark strategy. That is, we've hedged our bets. We've been slowly but steadily reducing our exposure to technology and other highly valued stocks over the past 12 months. We still hold meaningful positions mind, as we reckon they have strong prospects for increasing their sales and implementing smarter cost cutting over coming years. But we are trying to prepare for the beginning of the (very long) end of Spinal Tap monetary easing ("turn it up to 11"). To do this, we've been buying quality companies that should benefit if the pandemic reopening really does take flight. Some of these businesses have had a more trying 2020, but they aren't airlines, restaurants and hotels. Instead, they are medical device businesses that should have lots of pent-up demand once hospitals are freed up from COVID-19 and well-capitalised events and ticketing companies, that sort of thing. We've catchily dubbed these companies 'lower-beta COVID reopening' stocks.

We also own a basket of sovereign bonds issued by several different governments. These bonds are mostly, but not all, short duration. This means they tend to have shorter lives before they mature and/or pay higher coupons, which makes their values less sensitive to changes in prevailing yields/interest rates. They should provide some insurance and, most importantly, liquidity if we get an equity market shock. In summary, our strategy is high(ish) growth and high liquidity. It's not the time to go all in.

Stacking sandbags

As another bit of defence for our portfolio we have been buying several bespoke structured products over the past 12 months. Because bond yields are so low, it makes stocks, bonds and property all expensive. This means it's harder to reduce the correlation of portfolio returns – to ensure that everything we hold isn't going up or down together – which is a key measure of our risk. Structured products are contract-based investments with banks, which means that if certain events happen or market measures hit certain targets we are paid a certain return, while if the opposite happens we lose the return and sometimes some of our capital. It depends on the product. Because their returns aren't based on the direction stock or bond markets take, they boost our diversification.

The most recent is the **Societe Generale VRR Index Structured Product**, which makes money if the volatility of US Treasury yields increases. So if yields rise rapidly because of an inflation scare or if they slump because of GDP growth concerns we make a return. Any increase in the size or frequency of moves in US treasury yields is good for this investment. However, if yields just amble along with little movement, we will lose money. And we would actually prefer the latter: if yields shoot up or down stocks are likely to be falling because of the fears driving the move. Whereas benign yields should be great for our stocks. Long story short, we view this product as an insurance policy for wobbly markets.

Don't get the wrong idea — we're not incredibly concerned about the future. On the contrary! We're quietly optimistic that the world will continue to grow steadily, taking markets with them. But asset prices have had a stellar run and people are casting round for worries, so we feel it's a good time to lock in some profits and make sure we're prepared for the unexpected. Always best to have the dykes ready before the flood.

David Coombs
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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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