Rathbone Unit Trust Management

Contact us 020 7399 0399 rutm@rathbones.com

Rathbones
Look forward

Rathbone Multi-Asset Strategic Growth Portfolio

Monthly update October 2021

Oh, the grand old duke of Threadneedle Street, he had 10,000 investors, he marched them up to the top of the hill, and he marched them down again. You hate to see that.

Bank of England (BoE) Governor Andrew Bailey had seemingly telegraphed to bondholders that his monetary policy committee would raise interest rates in early November to nip rising inflation expectations in the bud. Gilt yields shot higher, with the 10-year surpassing 1.20% for the first time since April 2019. But when the BoE's decision day rolled around, Mr Bailey had changed his tune, downplaying the need to raise rates and sending yields crashing back to earth. Obviously, Mr Bailey must be a fan of our The Sharpe End podcast – as he took our advice from October's episode that hiking rates would be a mistake...

Inflation fixation

Of course, inflation continues to push higher all around the world. But there's nothing that the BoE – or any central bank – can really do about it. Monetary policy's influence is focused on *demand* – on making consumers and businesses more or less willing to spend. It has few tools that can help when the problem is one of *supply*. Raising rates can't get fuel to the pumps quicker, make it rain for the soybean crops in Brazil, grease the export of raw materials from COVID-cagey Australia or open ports in China. If central bankers move too quickly, they could simply make things worse. It may even spark stagflation – putting the economy into reverse while persistent inflation eats away at people's spending power. So it's comforting that central banks appear to have accepted that fact, for now.

Prices for an all manner of things have been bouncing around for many months. There have been big price swings in lumber, computer chips, industrial metals, secondhand cars, energy and labour. These erratic moves will exaggerate inflation statistics at least into next year, so it's hard to get a handle on the true price level. Take wages – the area where most worry that persistent inflation would cement higher prices into the wider economy. Where have all the workers gone? The pandemic drove a sharp acceleration in the number of people retiring, driven no doubt by the boom in stock markets and house prices. But that doesn't fully explain why everyone from McDonald's to Amazon are struggling to fill low-skilled positions. Those people must be out there and they must need money, so we have an inkling that at some point in the near future they will return to the jobs market. This will all take a while to shake out.

The UK is likely to be most vulnerable to coming out of the last two years of sadness with a higher inflation rate. Tighter restrictions on immigration from Brexit and weaker sterling seem likely to make prices rise at a faster rate than before the pandemic.

Keeping balance

These reasons are why we're trying to keep our portfolio balanced. We have continued the work of the past few months: buying more 'quality cyclical' companies that should benefit from higher inflation, growth and interest rates. We have virtually no duration, or interest-rate sensitivity, in our sterling bond portfolio because we believe the risks are still skewed. In short, there's more to lose if rates rise rapidly than you could gain from bond yields slumping further.

We added to our **Japan Government 0.1% 2023** bonds because the yen exposure should protect us if sterling weakens due to stubbornly higher inflation. When yields spiked in October, we added to our holding of **US Treasury 1.5% 2030** bonds. Again, buying these bonds spreads our currency risk outside of the UK as well as offering a reasonable yield for a safe asset.

We trimmed some of our high-flying stocks, including US diabetes monitoring company **Dexcom**, cosmetics store chain **Ulta Beauty** and oil major **Royal Dutch Shell**. We used that cash to build our positions in more cyclical businesses with more attractive valuations, including American lorry maker **Paccar** and German electronics company **Siemens**. We added to copper and iron ore miner **Rio Tinto** and composite decking supplier **Trex** on weakness.

We also bought Japanese manufacturer **Shimano**, which makes gears, brakes, cranks and other components, along with returns on equity in the mid-teens. It has a reputation for quality among cyclists and is heavily embedded in the production of most bike manufacturers (it supplies between two-thirds and three-quarters of bike gears and brakes globally). That has translated to compound earnings growth of almost 20% over the past three years. With more of us hanging round the neighbourhood in the flexi-working age and lots of government money getting funnelled into cycleways, this should lend a strong global tailwind to cycle manufacturers and their suppliers.

Another new purchase was **UBS Nasdaq Put Options**, which give us the option to 'sell' a slug of exposure to the index at a level roughly 10% below the index level. They were a similar price to put options on the S&P 500, but the Nasdaq has more of the highly valued technology companies that are most at risk of their price-earnings multiples falling if prevailing interest rates rise. This is the risk that we most wanted to hedge.

Finally, we sold the last of our shares in distribution company **DCC** because we felt its price didn't account for the risk that its profit margins may be squeezed by higher costs.

Global company earnings, in the main, were very good in the past quarter, still flattered somewhat by easy comparisons. But all in all, companies have been doing well. The future is still murky, with shortages and margin difficulties aplenty. Not to mention the dogged persistence of COVID-19. Many managers are reluctant to make forecasts for their businesses, and I completely understand. If we've learnt anything at all over the last decade, it's that you never know what's around the corner. A bit of humility in this respect is sensible.

David Coombs
Head of Multi-Asset Investments

Will McIntosh-Whyte
Fund Manager

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.

Rathbone Unit Trust Management Limited
8 Finsbury Circus, London EC2M 7AZ
Tel 020 7399 0000

Information line
020 7399 0399
rutm@rathbones.com
rathbonefunds.com

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