

Rathbone Multi-Asset Defensive 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.

Early in the month, we continued to bolster our portfolio protection by adding to our holdings in the **Legal & General All Commodities ETF**, which tracks a basket of raw materials, foodstuffs and metals, and **Canada Government 0.5% 2030** bonds because the Canadian dollar exposure should protect us if sterling weakens due to stubbornly higher inflation.

A 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.

We added to UK retailer **Next**, as it has weathered the pandemic and general decline in high street shopping more or less in one piece, unlike many of its rivals. We believe Next's solid online shopping channel and strong nationwide presence should help it dominate the premium economy area of UK retail in coming years.

We sold out of the **Ashmore Emerging Markets Short Duration Fund** because of the Pandemic continues to linger and disrupt developing nations. Meanwhile, the prospect of tighter US monetary policy is bad news for emerging assets, going off history.

We also 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. Finally, we trimmed **Royal Dutch Shell** after a strong run.

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.



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