Rathbone Unit Trust Management

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Rathbones
Look forward

Rathbone Multi-Asset Enhanced Growth Portfolio

Monthly update January 2022

Venomous, slippery, at times difficult to breathe, January was like playing Twister with a bag of snakes.

Stock markets took sharp and violent tumbles, with American markets leading the plunge – the S&P 500 posted its worst start to the year since 2008. Worst hit were businesses with large price-earnings multiples, especially those that are still unprofitable, or which disappointed with recent results. The driver was a marked shift in the tone of the US Federal Reserve (Fed), the world's de facto central bank. Before Christmas, with inflation forecast to fade away on its own as 2022 progressed, the Fed was expected to raise interest rates just once over the year and start slowly unwinding the huge pile of Treasury bonds it has amassed from quantitative easing. In the space of weeks, Fed Chair Jay Powell put paid to that. A clutch of speeches, statements and minutes from the Fed's monetary policy committee suggested a much busier calendar. Now, derivative markets imply five 25-basis-point increases; one Fed Governor told a reporter that a 50-basis-point hike was also an option.

However, before we get too ahead of ourselves, we should remember to pay equal weight to the suffix for virtually every comment coming out of the Fed: it's always and forever dependent on the economic data. If the economy is doing well and inflation is trending upward, the Fed says it will raise rates. But if things look shaky, they say they will hold fire. When interest rates are rising, the perennial concern for investors is whether central banks will overdo it, causing a recession that punctures markets. As inflation rates continue to tick up, investors see a greater chance of the Fed moving faster and more forcefully. That would lead to a greater chance of recession and therefore a worse outlook for stocks.

Keeping a healthy perspective

Looking further out than a few months seems foolhardy these days. There are so many moving parts and scenarios that – thanks to the pandemic – we simply haven't seen before. But there are some trends that we think seem logical. First, fears about higher inflation stoking the Fed's wrath seem to have peaked. That's not to say inflation itself has peaked, there's probably a few more months of acceleration coming for most major economies, but by the second half of the year inflation should be fading as demand for goods continues to give way to more travel, restaurants, theme parks and other services. Unless there's a geopolitical shock that sends oil and gas prices soaring once again, that is, so this is based on Russia and the West cooling their aggression over Ukraine.

Meanwhile, most economies are actually looking in pretty good shape. Unemployment is low, wages are growing, property prices are rising. Most companies and households have saved a lot of cash over the past two years. And if they are anything like us, they are itching to get out and spend it after years of purgatory. All of this bodes well for future GDP growth, which should flow to profits, which is good for stocks, particularly those that are more cyclical. It was this broad logic that led us to add more balance to our equities throughout 2021. We didn't abandon the 'growth' companies that have been our mainstay for years, but we started taking profits and using the cash to buy businesses whose profits are more closely linked to the ebb and flow of economic growth. We still look for quality companies with limited debt, strong brands and reliable business models. Just in different industries and markets.

We used the month's stock market volatility to add back to some of our 'growth' companies that got hit hard in the rotation toward value. We had taken profits from most of these business over previous months, so we were happy to buy back in at more attractive prices. The largest of these purchases were digital-focused business consultancy **Accenture**, design software developer **Cadence Design Systems**, simulation software coder **Ansys** and **ASML**, a Dutch manufacturer of high-tech printers of computer chips.

We also used the turmoil to buy some new companies. The first is **Ashtead**, a construction equipment rental business – cherry pickers, drills, small diggers, compactors, chainsaws, that sort of thing. The company is listed in the UK, but 80% of its sales are made in North America. The outlook for construction is pretty bright, both in the UK and especially in the US. Housing is going up fast and infrastructure is in dire need of upgrade and replacement. Ashtead is growing well – an unfortunately unusual trait among British companies. We have been watching the business for some time, but it has always been a bit too expensive for us to start a position. We used the market falls of January to jump in at a decent price.

Another investment focused on the US housebuilding boom was in **Home Depot**. This business is the place to go for DIY warriors, with good value tools and materials, and well-skilled and knowledgeable staff who can give advice on getting the job done. But it is also one of the most popular suppliers for small and medium-sized trades businesses. Its professional sales relationships are thriving because of Home Depot's investment in its supply chain, delivery service and staff.

We also bought American stockbroker, ETF provider and wealth manager **Charles Schwab**. The company is growing well, driven by its compelling zero-fee approach to execution-only accounts. Charles Schwab makes most of its revenue from the interest earned on cash in client accounts, so it is actually an interest-rate beneficiary in disguise. It also makes commission on more complicated orders, and fees on guided investments and advice.

During a short bounce in the market we added to our **UBS Nasdaq Put Option**, which gives us the option to 'sell' a slug of exposure to the index at a level roughly 10% below where the market was when we bought.

We also took profits from a few of our more cyclical stocks, which have been boosted by recent market moves. They included oil majors **Shell** and **BP**, and engineering and services business for the industry **Schlumberger**.

Finally, we sold our holding in the **Ashmore Emerging Markets Short Duration Fund**.

Focus on profits

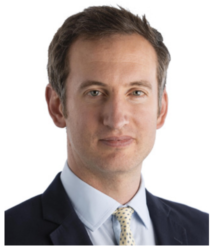
There are three major issues for the world right now: inflation is high, labour markets and supply chains are still untangling pandemic effects, and general uncertainty is running high.

Company earnings have been pretty good in the main, and have helped reassure investors throughout January and into February. Those that post so-so numbers have been absolutely clobbered, though.

Toward the end of 2021, stock markets – and some more alternative investments – had got a bit frothy, so a correction was arguably due. Some of that jubilance, and perhaps complacency, in the face of rapidly rising inflation has been firmly tamped down. Central banks are, lest we forget, tasked with keeping inflation in check. This should be a relatively healthy shake-up. We're feeling positive with how things stand. We've been able to use the volatility to adjust our portfolio, taking profits from those that have done well and topping up those that have had a rough month.

We finally seem to be coming out from under the shadow of the pandemic (yet we've been here before, haven't we!). Hopefully this time it really is good riddance to COVID-19. Exactly how people, businesses and governments will respond is yet to be seen though. While we think the future seems pretty bright, it's foolish to pretend that there aren't a few risks floating around. We're focusing on ensuring our businesses are masters of their own destiny, with good cash flow, low debt and all the flexibility those characteristics offer.

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.

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