Rathbone Unit Trust Management

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Rathbones
Look forward

Rathbone Income Fund

Quarterly update March 2022

Our message remains the same, resting as it does on three key points: the offer of a clear, coherent Plan B, important in a changing world; an income yield in excess of 4% and the prospect of real growth; and a management team with the experience of many economic and investment cycles.

In writing this quarterly investment review, we recognise from the outset the sheer horror of all that is unfolding in Ukraine. Our thoughts and prayers go out to all those affected by these events.

Performance review

Equity markets were, quite understandably, extraordinarily volatile during the period, but it reflects the substance of the UK market that the FTSE All-Share Index actually made a little ground while most other markets dropped significantly. This is a result of both its attractive valuation versus other markets — less froth to lose — and more importantly the weight of mining and energy stocks in the index.

It is unsurprising therefore to report that many of our biggest contributors to performance are part of the larger commodity space, with **Rio Tinto**, **Shell**, **BP** and **BHP** all in the top 10. We responded to the spike in commodity prices by introducing a new position in diversified natural resources company **Glencore**, and we also supplemented our holding in Shell. We are always likely to own less than the index, such is its overwhelming weighting towards commodity stocks, but we are comfortable now with our absolute positioning. We are especially mindful that this period of supernormal profitability will be transient, and these businesses still need to be disciplined in their capital allocation, a process more challenging now in a more volatile world.

	3 months	6 months	1 year	3 years	5 years
Rathbone Income Fund	-0.6%	4.7%	11.6%	16.7%	18.4%
IA UK Equity Income Sector	-0.1%	3.1%	10.8%	16.7%	21.2%
FTSE All-Share Index	0.5%	4.7%	13.0%	16.8%	25.8%

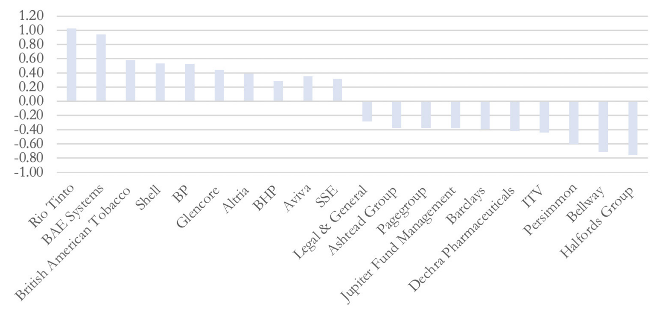
	31 Mar 21-31 Mar 22	31 Mar 20-31 Mar 21	31 Mar 19-31 Mar 20	31 Mar 18-31 Mar 19	31 Mar 17-31 Mar 18
Rathbone Income Fund	11.6%	30.1%	-19.7%	6.1%	-4.3%
IA UK Equity Income Sector	10.8%	32.6%	-20.6%	3.6%	0.3%
FTSE All-Share Index	13.0%	26.7%	-18.5%	6.4%	1.3%

Source: FE Analytics; data to 31 March, I-class, mid price to mid price.

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

The value of investments and the income from them may go down as well as up and you may not get back what you originally invested.

Q1 contributions



Source: StatPro; Rathbones

The other key contributor to performance was **BAE Systems**. It is inevitable that defence spending will increase in response to the Russian offensive, and we should expect to see a structural change in budget allocations to defence spending in NATO countries. Secondly, and you may view this as cynically as you choose, there is likely to be a softening of the ESG (environmental, social and governance) narratives pertaining to the aerospace and defence industries, which we believe will contribute to a further re-rating of the sector. We have owned BAE Systems on fundamental grounds, applauding management strategy and its focus on margin preservation, cash generation and balance sheet discipline. As we recognise, the share price performance this year has been driven by other factors.

Another controversial sector, tobacco, has also been strong. Not a lot has changed other than the industry represents a relative safe haven in difficult times.

The negative side of the performance equation was a sell-off in more economically sensitive, consumer-focused names. As we have commented on many times over the last two years, **Halfords** has been operating well in trying conditions. However, this year investors are clearly concerned about headwinds. Will there be a fall-off in consumer demand as inflation and rising costs start to bite? How easily will Halfords be able to navigate its own increased costs and supply-chain constraints? It is right to ask these questions. But we are comfortable that our limited exposure to UK retail is concentrated in this name.

The housebuilders screen very cheap, even more so after a difficult first quarter. We are advocates of the sector on account of the structural support that businesses like **Persimmon**, **Bellway** and **Taylor Wimpey** are afforded by the unique supply/demand dynamics in the UK market. However, the housing market is cyclical and susceptible to a downturn in the economy; furthermore, the threat of government fines relating to historic cladding issues casts a shadow over the whole industry. Events post-period end suggest that this particular period of uncertainty may be coming to an end. We argue that the value in the sector compensates us for the economic risk that currently prevails.

Finally, we should comment on **ITV**. The company has been doing all the right things, and advertising revenues were very robust in 2021, leading to great results in the autumn. However, buoyed by this improvement in fortunes, the company is planning a substantial investment in its digital platform. This is probably the right thing to do, but it does substantially increase the financial and business risk inherent in the business. With the economic environment uncertain, the return on capital is by no means secure. We applaud their boldness, but we have sold.

Outlook

We run a balanced portfolio because we never overstate our ability to predict the future. However, at the start of the year, we had hoped that the upcoming 12 months would deliver on a promise of controlled inflation, global growth and a gently steepening yield curve that together would encourage investor appetite for economically sensitive stocks, and thereby maintain a rotation towards value and cyclicality. The events of the last two months damage that prognosis. On the one hand, having positioned for economic rotation, your fund has benefited from its commodity exposure. However, it goes without saying that the events in Ukraine will have profound and long-lasting geopolitical, economic and commercial consequences. At the moment, there are as many predictions in the market as there are strategists. We don't have to make predictions, we just have to make sure we are taking the correct risks across a balanced portfolio. Fortunately, your fund has come through a volatile first quarter in good, if not stellar, shape, as shown by the estimated 4.2% increase in our interim distribution. Importantly, we are confident that the increase in our full-year distribution will exceed this.

Our message remains the same, resting as it does on three key points. Markets have changed: the comfortable low-inflation, low-rate environment to which investors had become very used, is behind us. This fund offers a clear, coherent Plan B. Inflation is rising, yet savers continue to get paltry returns on their cash. This fund offers an income yield in excess of 4% and the prospect of real growth. Finally, none of us has ever experienced two years like those just passed. But your fund is managed by a team with the experience of many economic and investment cycles, not just the prolonged ascent from the lows of 2009. At the very least, this gives us a humility that accepts that no one knows what is around the corner.

Here's hoping for a better second quarter, in oh so many ways.

Recent trading: Having added to BAE Systems back in the summer of 2021, we did trim a bit on the back of the recent strength. We also reduced our position in **Jupiter Asset Management**.

We created a new holding in Glencore, and added to BP and Shell, only partially funded by a small reduction in Rio Tinto.

Finally, we sold ITV and **Micro Focus International**, the exit of the latter completed after the period end.

Companies seen during the month: **Relx**, **DCC**, **Bunzl**, **WPP**, Jupiter, **Legal & General**, **Vesuvius**, **Breedon** and **Tate & Lyle**.

Carl Stick
Fund Manager

Alan Dobbie
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 what you originally invested.

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