Rathbone Unit Trust Management

Contact us 020 7399 0399 rutm@rathbones.com

Rathbones
Look forward

Rathbone UK Opportunities Fund

Monthly update April 2022

Reporting season has brought us largely strong results and no major torpedoes. But even decent results have been met with, at best, underwhelming share price moves. And if beating forecasts has resulted in lacklustre share prices, missing them has proved truly catastrophic. Pleasingly, your fund has largely sidestepped the torpedoes, even though this isn't evident in short-term underperformance.

This disconnect is frustrating, but it does show just how bearish investors have become (sentiment is at its weakest level in 13 years), which leaves the bar lower for any future upside surprises. We attribute super-bearishness to worries that, while backward-looking numbers might look fine, the outlook has become a lot more cloudy, thanks to the Ukraine invasion, China lockdowns and high inflation starting to hurt consumers.

Waiting for cost of living pressures to bite

As we write, the extremely uncertain outlook is reflected in consumer confidence, which has dipped to 2008 lows. There's no need to play the hero in markets like these. There are a lot of nuances to consider, not least how pernicious inflation will come to affect weary consumers. In the UK, we have the comfort blanket of a large savings pool built up during lockdowns. But, as always, the spread of these savings is extremely skewed towards the already wealthy. Low income consumers, those least able to withstand higher food and energy prices, have much less of a security net. But the spending habits of these poorer consumers tend to have relatively little impact on listed stocks. That's because their fortunes are more impacted by mid-to high-income consumers: for example, the richest 10% of UK households account for the same expenditure on restaurants and hotels as the poorest 50%. So some areas of spending will likely hold up. Similarly, we recall from the 2008-09 experience that 'little luxuries' or 'affordable treats' become sacrosanct during tough times, at the expense of larger non-discretionary items. We have very few retail stocks in the portfolio and no exposure to consumer electronics or home furnishings, but growing positions in non-discretionary spending (for example, supermarket retailer **Tesco**) and affordable treats (for example, bakery chain **Greggs**). Leisure exposure is also very light, consisting mainly of travel retailers **SSP** and **WH Smith**, which we expect to benefit from people's insistence that a summer family holiday is a non-negotiable annual ritual.

While there are many subtleties to parse, as well as the occasional hammer blow, the key risks are well known and constantly discussed. We may have to wait for clear evidence that the worst inflationary pressures are behind us, or at least that central banks have mastered the interest rate tightening cycle, before markets can make more headway. And while the current reporting season is not yet over, we probably won't know more about the full extent of softening consumer demand until the next round of results. It will be instructive to see if and when the current disconnect between macro and micro newsflow corrects itself: at the macro level, newsflow is very gloomy, but companies seem more sanguine.

Buying defensives and non-discretionary retailers, topping up some oversold stocks

We have been dripping our cash into defensive stocks, non-discretionary spending and some of our preferred franchises that have been sold off to attractive levels. At a market level, all the FTSE 250's previous valuation premium versus the FTSE 100 has now been wiped out, leaving some very interesting-looking opportunities within a market that already bakes in a significant discount to the US.

Staying the course and increasing the overall quality of the portfolio remains our goal.

Alexandra Jackson
Fund Manager

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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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