



Select portfolio update for  
clients of Saunderson House

Q4 2023 Report

**RATHBONES**



# KEY PERFORMANCE DRIVERS

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The latest quarterly updates for each of the Select portfolio funds is now available in the dedicated Multi-Asset Portfolio section of our website: [\*\*Rathbone Multi-Asset Portfolios\*\*](#)

Please also find some notes below covering the key aspects of the portfolio funds that have been driving returns over the last quarter.

## Bond yields

Government bond yields fell materially over the fourth quarter of the year, with falls accelerating in December after US Federal Reserve Chair Jay Powell told a press conference that monetary policy should be looser next year. Lower bond yields, which are driven by higher bond prices, gave our portfolio a substantial boost. Over the past year or so we had built up our holdings of government bonds and increased the length of time till they mature, which makes their values more sensitive to movements in interest rate expectations. We believe that these bonds are still attractive, with the US 10-year government bond especially offering an appealing return after accounting for inflation. Government bonds should also provide portfolio protection if an economic downturn arises.

## Valuation of corporate earnings

The sharp fall in bond yields helped stock markets as well because profits expected far into the future have a greater value when interest rates are lower. The biggest gains came from growthier stocks like e-commerce platform Shopify and more traditionally rate-sensitive stocks like telecommunication infrastructure company American Tower and data centre property company Equinix. The change in mood music also helped start a rally in US beauty retailer Ulta Beauty, which we own. Ulta went on to beat its quarterly earnings estimate and signal an improvement in its outlook for the coming year.

Other meaningful contributions came from cosmetics producer Estee Lauder, DIY chain Home Depot, and fast-food giant McDonald's.

## Medical technology

Our significant position in medical technology stocks held us back in the third quarter because of concerns that next-generation weight loss drugs, such as Ozempic, would badly damage many healthcare businesses. We used that share price weakness to add to our holdings and this was rewarded by a large reversal in November and December. As an example, one of our key holdings in this space, diabetes monitoring company Dexcom, rose from around \$75 a share at the height of the pain in mid-October to end the year around \$125.

## Rentokil

The key detractor from our quarterly performance was UK-listed pest control business Rentokil Initial, whose share price fell sharply after management cut forecasts for American sales growth and profitability. Tougher conditions have hurt demand in the US, which now accounts for around half of Rentokil's sales after it bought US firm Terminix in 2021. We believe there hasn't been a material change to the long-term investment case for Rentokil, so we used the share price weakness to add.



## The Sharpe End

The Sharpe End podcast lets you be a fly on the wall as our multi-asset portfolios team discuss recent events and how they impact their funds.

You can listen to the podcast on our website and also subscribe on all major platforms: Apple, Spotify, Google Podcasts, Amazon Music, Anchor, Breaker, Castbox, Pocket Casts and RadioPublic.

The link to the page for the podcast on the website is as follows: [\*\*sharpe-end-podcast\*\*](#) and the link to the linktree where you can be taken directly to The Sharpe End on your podcasting app of choice is as follows [\*\*linktr.ee/thesharpeend\*\*](https://linktr.ee/thesharpeend).

# MARKET HOT TOPICS

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## **Santa rally.**

Counterintuitively, a gruelling 2023 was a good year for investment returns. Stock markets soared (UK excepted), while corporate bond prices rose rapidly as well. Even government bonds made positive returns in a year of central bank tightening. The driver of this strong year was a large fall in prevailing bond yields towards the end of the year as investors first hoped for and then pre-emptively celebrated a 2024 of falling central bank interest rates, muted inflation and absent recession. It was an old-fashioned Santa rally: the returns came before the presents were handed out.

As far back as August we thought that global interest rates – as set by the world's most important central bank, the US Federal Reserve (Fed) – had peaked. Inflation, while bumpy, was clearly falling, even as global economic growth was holding up better than expected. The US economy was practically flying, though, and we felt that the Fed was unlikely to start cutting interest rates in 2023 or the first half of 2024 because it would risk putting the bellows to inflation. In December, Fed Chair Jay Powell seemed more disposed to cuts in the first half of 2024, as long as inflation fell back to the 2% target (it was 3.1% in November). While rate cuts are no doubt on the horizon, we still think investors may be getting overexcited about how quickly they will arrive. Perhaps the big variable now, rather than inflation, is US economic growth. If it continues to power ahead, the Fed will find it difficult to justify reducing borrowing costs. If it begins to falter, then the door to lower rates opens. Unfortunately, GDP growth is an extremely lagging number – you won't know it's slowing till months after it's started!

In the face of this watershed, we're trying to keep our portfolio balanced. We take profits from stocks and bond that have had particularly strong runs and recycle that money into holdings that have dipped yet still have exciting prospects over the next five years or more.

## **Global crossroads.**

The world is no longer as homogenous as it once was. While the US economy has boomed, the UK, Europe and Asia have faded. And while the economic fade hasn't been as bad as many expected, it's stark when compared with the US. These divergent paths – and the divergent central bank policies that are being applied – are causing some large swings in both stock and bond prices as investors weigh up the relative rates of return on offer in different regions.

Here in the UK, with inflation at 3.9%, the Bank of England is adamant that it won't be cutting interest rates anytime soon – in fact it's still leaning toward more hikes than cuts. That's despite the economy slipping into recession territory and many households struggling as they refinance mortgages at

treble the monthly payments and rents going stratospheric. Bond investors aren't buying it: UK government bond prices now imply a 25-basis-point cut to 5.0% by May and a roughly 1.4% drop in the BoE's bank rate over the whole of 2024. We are also sceptical, and think that the BoE will have to ease pressure on households and businesses if recession sets in during the first quarter and unemployment starts to rise.

Europe is in a similar position following the Fed's 'pivot' to more accommodative policy. Like the UK, its central bank is on a 'higher for longer' footing even as its economy struggles. And also like in the UK, investors are expecting the European Central Bank to fold and begin cutting rates in early 2024. China fell into deflation in the summer, i.e. general prices for goods and services are falling, rather than rising. China is struggling with a massive property bubble where developers, local governments and households have borrowed huge amounts to build and buy millions of speculative properties that no one needs. Some aren't even finished. Deflation makes those debts grow in real (inflation-adjusted) terms. The deflation is partly caused by the heavy overhang of debt, but it also makes the burden of those debts worse. In short, it starts a toxic feedback loop which hamstring economic growth.

China is still growing at an estimated 5%, however, and is actually convincingly overshooting what the IMF's World Economic Outlook had expected a year ago. No doubt aided by cheaper energy from, and increased commerce with, Russia in the aftermath of its invasion of Ukraine and subsequent sanctions by the West. However, many companies we see suggest the picture on the ground is far from as rosy as the headline numbers suggest. A heavily debt-laden Chinese trade partner is Japan. Its economic growth slumped unexpectedly in the third quarter as households and businesses abruptly stopped spending in the third quarter.



# MARKET HOT TOPICS

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More than ever, the US seems to be the sole engine of economic growth. This may well encourage investors to put yet more money into the sunny uplands over the Atlantic and shun the problematic, yet often heavily discounted, markets elsewhere.

## **Energy Converted.**

Even during gloomy times in the 21st century, it's worthwhile to take a moment to consider how lucky we are. Yes, things go wrong, problems can seem intractable and the world can seem to be going to hell in a handbasket. Yet globally, the number of people in poverty has fallen rapidly and the tools we have to live, work and keep in touch with each other are more powerful than ever before. These two facts are opposite ends of the same rope: the tools, technology and institutions that we've developed are why so many more of us enjoy better living standards, both in the developed and developing nations.

The amount of value that we can extract from a given hour of work, a pound of investment and a litre of fuel, is much higher than in the past. And this is acutely true in the developed world, where modern technology is deployed more fully. Because we need much less fuel for a given output than in the past, some argue that we're much less susceptible to rising energy costs than in the past. Yet that's disputed by others because energy becomes yet more crucial as technology improves – without it, our productivity tumbles drastically and we shuffle back toward the stone age.

For us, we look at the effect: when energy prices spike, households complain, businesses increase prices and governments rush to subsidise and support (as we saw in the aftermath of the pandemic and the invasion of Ukraine). It may be that higher energy prices affect developed world societies less than in the past. Yet when petrol is more expensive, punters feel less confident about the future. And when gas and electricity prices soar governments tremble. Changes in the price of energy cause changes in economic behaviour, so whether we're empirically more or less sensitive than in the past is sort of a moot point.

Because most of today's productivity boost comes from technology, which requires power, it's fair to say that economic activity today is simply energy converted. You can see echoes of that truth in the price of oil. When economic growth is expected to fall, demand for oil falls and the price of a barrel with it (supply expectations kept constant). That seems to have happened in the tail end of 2023, except with some added supply swings. From roughly \$90 a barrel in September and October when global economic demand was growing and

the emerging market OPEC oil cartel was squeezing supply, Brent oil is now trading around \$75 as America produces more barrels than expected and global growth eases. That's a significant drop which could help buoy consumers and businesses all around the world who have come through a tough 2023. Whether it continues is yet to be seen.

## **Investment outlook.**

The markets for bonds and locking in future interest rates imply that it's probable that the Fed will cut interest rates as soon as the first quarter. While anything is possible, we think it would require serious economic disintegration for the Fed to cut rates within the next four months or so. With current growth so high, that would be a breath-taking slump in economic activity. Instead, it seems more likely that the Fed will hold fast for a while yet. On a human level, we think central bankers' professional reputations and legacies are more at risk if they cut rates too early and let inflation flare up again. If they keep rates high and cause a minor recession, well, that's just the cost of prudent leadership...

Of course, that's not what the rest of the market hears when Fed voting members get to talking. We will have to wait and see. One of the main disconnects we see as 2024 kicks off is that many investors expect rates to follow a downward path that implies sharp economic deceleration, while simultaneously expecting chunky double-digit profit growth for companies that's rare in times of slowing (or falling) GDP.

To avoid being too badly burned by any disappointments, we've been trimming stocks whose valuations appear to have got a bit topky and using that cash to add to stocks and other assets that have fallen from favour. We don't want to sell these businesses completely – lots of people want to buy them for a reason! – because over five years or more, we think they have the opportunity to grow well and become more valuable. Yet we try to minimise the short-term downdraughts that happen.





Investment Insights – The Magnificent Seven

Our latest **Insights** publication starts the year with a look at the incredible concentration of returns in the 'Magnificent Seven' US tech giants, and what their influence might be like over the coming year. Topics covered in this quarter's edition include:

- 1. Will the tech superheroes ride to the rescue in 2024?
- 2. Bonds should benefit from the new 'higher-for-longer' rate regime
- 3. Why markets may be unmoved by a busy year for elections
- 4. Planning ahead for when economic recovery becomes more certain
- 5. How the transition to clean energy depends on market reforms

Investment Insight Webinars – 2024 Series

The Investment Insights webinars will be held from 12:00 – 12:30 on the following dates:  
16 January / 16 April / 2 July / 8 October

You can register for the January Webinar using the following link

[Register here](#)

If you would like more information or if you haven't received an invitation to the Investment Insight webinars from us already, please do let your adviser or a member of your investment team know.

Financial awareness course for young people

3 April 2024 – 6.00pm – 7.30pm - Virtual event

[Register here](#)

8 August 2024 – 6.00pm – 7.30pm - Virtual event

[Register here](#)

17 December 2024 – 6.00pm – 7.30pm - Virtual event

[Register here](#)

Financial awareness course for women

to enquire about future dates please email [Sharon Ryan](#).

Financial awareness course for all adults

to enquire about future dates please email [Sharon Ryan](#).





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