RATHBONES

# MANAGED CORE STRATEGIES INVESTMENT UPDATE FOR CLIENTS OF RATHBONES FINANCIAL PLANNING

## Q3 2024 REPORT

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# KEY PERFORMANCE DRIVERS

**THE LATEST QUARTERLY UPDATE FOR EACH OF THE MANAGED PORTFOLIO FUNDS IS NOW AVAILABLE IN THE DEDICATED MULTI ASSET PORTFOLIO SECTION OF THE RATHBONE ASSET MANAGEMENT WEBSITE, OR BY CLICKING HERE.**

Each Core strategy invests in one of our range of Rathbone Multi Asset Portfolio funds, and the notes below cover key aspects across the fund range. A separate investment update is available covering the Greenbank strategies.

## Positive returns from bonds

Developed world government bond yields dropped over the quarter in anticipation of the first US interest rate cut since the pandemic. Our collection of government bonds in the US, UK and elsewhere boosted returns as their prices rose on these lower yields. We had added to these bonds, particularly those whose prices are more sensitive to changes in prevailing yields, earlier this year when yields were higher. Towards the end of the quarter, we sold some of this government bond exposure to lock in profits. Having this higher level of rate-sensitive bond exposure hurt our performance at times over the year, but we felt confident that US inflation would keep falling, and that interest rates would follow, in time. We think government bonds remain attractive assets at current levels, given the returns above inflation that they now offer, with further returns likely as more rate cuts materialise. Equally, we expect bonds to provide important ballast to portfolios in the event of economic stress.

## China stimulus

China announced a raft of government spending, interest rate cuts and changes to banking regulations in September that led to an astonishing turnaround in its stock market. Stocks with significant exposure to China rallied along with those companies listed on the mainland. Many are quality companies that we believe should do well over coming years, yet a downbeat outlook for China had weighed heavily on them. These businesses include luxury conglomerate LVMH, cosmetics business Estee Lauder, and the much more directly linked pan-Asian insurer AIA Group and Chinese internet giant Tencent. We have consistently added to most of these on weakness, and they have since jumped higher, delivering a boost to performance.

## Utilities and Infrastructure provide ballast

As bond yields and interest rates have fallen, they have pushed up the share prices of our infrastructure and utilities stocks, including US power generator Wisconsin Energy, data centre operator Equinix and American Tower, which owns mobile network transmitters. These types of business look a little like bonds: they have relatively fixed returns stretching far into the future, so lower interest rates make those returns more attractive. Also, they tend to have quite a bit of debt to finance big upfront investments in land and equipment, so a reduction in financing costs can make a significant difference to their bottom lines.

## Technology weakness

US technology companies were generally weak this quarter, lagging the overall US stock market. Our technology holdings were not immune, with poor showings by search giant Alphabet, digital office supplier Microsoft, design software developer Cadence Design Systems and ASML, which makes the high-tech machines that print topflight computer chips. Some of our medical technology companies underperformed as well, including diabetes monitoring business Dexcom and heart-valve maker Edwards Lifesciences. Both share prices fell significantly after poor profit announcements. We used those falls to add to both names, as we still believe in their future opportunities, despite these short-term stumbles.

# MARKET HOT TOPICS (MACROECONOMIC)

## The long-awaited cut

Everyone has been waiting so long for US interest rates to fall that when they finally did it was almost an anti-climax. The first rate reduction by the US Federal Reserve (Fed) since the pandemic was a 'jumbo' cut of half a percentage point, taking the benchmark borrowing rate to the range of 4.75% to 5.00%. Since then, US stock prices and government bond yields are slightly higher.

A bit of a nonchalant shrug from investors then, albeit with several shifty looks at the horizon: how many more cuts are coming and how quickly will they arrive? Bond investors and the Fed's rate-setting committee were not seeing eye to eye on that question before the latest monetary policy meeting and they certainly haven't aligned themselves since. Despite the big first step in cutting rates, the Fed has outlined a relatively slow path from here. The latest iteration of the 'dot plot', which maps committee members' forecasts for interest rates, shows the average member expects the benchmark rate to be about 4.75% by the end of the year. Investors, as implied by interest rate markets, believe it will be 4.25%. There's a disparity further down the line too. The average Fed member thinks the rate will be somewhere around 3.25% by the end of next year; investors assume it will be comfortably below 3.0%. If investors are wrong, bond prices will need to fall; if the Fed is wrong bond prices should hold their gains and perhaps rally further.

That's a lot of detail. Big picture time: US inflation has ebbed as the year has progressed, the economy has cooled somewhat (judging by the labour market) and the Fed has started to cut rates in the second half of the year. In market shorthand, this scenario has typically been branded 'a soft landing'. That is broadly how we expected the year to go when it began, so we haven't been making any significant changes to our portfolios. That said, the market was noticeably more volatile in the past quarter. This was hair-raising in places, but we've tried to make use of it where we can to take profits during overexuberance and buy into overegged concerns.

While we expect the US economy will slow from here, we think a recession isn't the most likely outcome. If we're right, that should be good for stock prices, as rates fall and profits aren't upended by a contracting economy. This should benefit bonds as well, although they have already posted gains in anticipation of falling rates, so they may be a bit rockier in the coming months – at least until they come to an agreement with the Fed's view of the world.

The market's mood music will jive or trip in line with economic data and how the Fed interprets it. As long as the chance of recession appears slim, inflation stays in check and the central bank keeps lowering rates, we think markets will be supported. But there may be a few missed beats as monthly data drops occasional clangers. **We're trying to keep focused on the bigger picture and the direction of travel.**

## Labour's first Budget in 15 years

It hasn't been a smooth start to for the new Labour government. In fewer than three months, Prime Minister Keir Starmer's approval rating had fallen lower than his predecessor's. A raft of blockbuster public sector pay deals and 'unexpectedly high' spending by the previous government set the agenda as one of doom, gloom and diminishing chances of a British boom.

As the first UK autumn Budget approaches, the government has clamoured so loudly and relentlessly about the terrible state of UK finances and the inevitability of tax hikes that it's started to affect the confidence of households and businesses. That won't help the economy and it certainly won't encourage a badly needed resurgence of investment here. It's also driven many people to crystallise capital gains in anticipation of an increase in the tax rate. So the government's expected extra tax haul could be less effective than it hopes. That wouldn't go down well with bondholders, who may start to sell and send UK government borrowing rates (and therefore rates for all other Brits) higher.

All of which would crimp the money left over for boosting investment. The government has

Indexes are unmanaged, and it is not possible to invest directly in an index.

# MARKET HOT TOPICS (MACROECONOMIC)

rowed back on most of its investment plans and there are worrying rumours of plans to slash infrastructure projects by 10% across government departments. The nation has underinvested in its hospitals, roads, railways, prisons and ports for decades. Cutting deeper won't help boost the UK's dire productivity growth, which is the key to increasing long-term GDP growth and  people's living standards.

There are also whispers that Chancellor Rachel Reeves is mulling a 'definition change' that would change how government debt to GDP is calculated. This would allow her to stick to her fiscal rules that paint a picture of paying off the nation's debt, while also being able to invest for the future. This is both cynical and helpful: more debt, sure, but good investment in the UK's infrastructure should more than pay for itself in the long run. However, good is the operative word. Borrowing more cash to throw into money pits like HS-2 would leave us in a worse position. And making big changes that increase the government's ability to spend could spook bond markets.

We hope to be pleasantly surprised that the Budget won't as bad as many are expecting. That the government will take a moderate line: slightly higher taxes, a reasonable accounting fudge to allow greater investment and reform to planning laws to make investment easier. We will have to see...

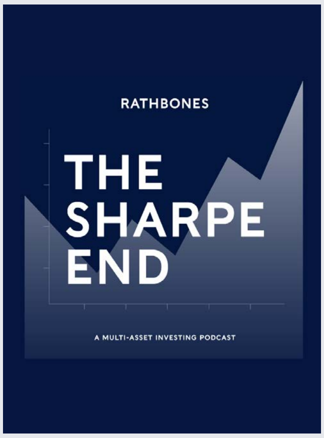
## Fuelling the dragon

It hasn't been an auspicious year of the dragon for the eastern giant. China's economic growth has steadily slowed in recent years as a huge, largely unaddressed, slow-motion property bubble disintegrates. After years of frenzied homebuilding and rampant speculation by businesses, local governments and households, billions of dollars are now locked up in property that isn't worth what it cost to buy. The lucky ones have the keys to empty apartments; the unlucky have had to swallow the loss of big deposits while looking at half-finished shells that will likely never be completed.

As China has continued to struggle with the fallout, its economic data has been continually 'refined' or 'improved' or just switched off to avoid annoying questions. But recently, it appears that the leadership has decided something must be done. The People's Bank of China cut its benchmark interest rate to 1.5% from 1.7%. It also reduced the reserves that banks must hold to protect against losses on the loans they have on their books. This frees up money that banks can then use to lend to businesses and households – estimated at 1 trillion renminbi ($142 billion), or 0.8% of GDP – boosting economic growth. Mortgage rates were also cut, giving a direct reprieve of roughly $21bn to many Chinese households.

Other parts of the Chinese government also got involved. The state could increase its borrowing by up to 1.5% of GDP, with half the cash to be used in propping up local governments groaning under unaffordable investments and the other half going direct to families and into consumer schemes that encourage people to replace old appliances and vehicles with better and greener alternatives ('cash for clunkers'). The government has also pledged to extend $114bn in low-cost loans to listed businesses so they can buy back their shares. And there's talk of large-scale bank recapitalisation – an essential ingredient of property crisis resolution in the past – and stimulus cheques direct to consumers.

The market response was phenomenal: mainland stocks rose 16% (in local currency) in only a few days, instantly erasing the cumulative sadness of a torrid 18 months for the market. This is a strong show by the Chinese government that has driven an enormous overnight recovery in its stock market. But the plans that matter are vague at the moment. The devil will be in the detail. Solving China's long-term economic issues will need more than just loans, however. It will take an acceptance of past mistakes, reform and time. But as they say, the first step is admitting you have a problem. The Chinese government has done that.




## 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-endpodcast** 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**.

# INVESTMENT OUTLOOK

**This information reflects our general views and should not be taken as a recommendation or advice as to how any specific market is likely to perform.**

We think the US economy – which has underpinned global growth of late – seems in relatively good shape. Recent data shows it's slowing from the red-hot growth of the past few years, but that was to be expected. The deceleration shouldn't be an issue unless the Fed keeps rates too high for too long, choking the economy into recession. It all comes down to the gradient of its path from here.

Another looming uncertainty is the US election. While the economic policies of both sides are actually more alike than either would wish to admit – protectionist and loose with government cash – there are stark differences that do matter for investors.

Republican Donald Trump's planned crackdown on immigration and his heavier hand on tariffs (he has floated a tax of at least 10% on every import) would be inflationary. The presence of fewer workers would bid up wages; more expensive imports would raise costs and reduce choice (and therefore price competition) for households and businesses alike. He also plans to deregulate business, particularly relating to the environment, and reduce subsidies for clean power. Democrat Kamala Harris would more than likely retain the status quo on all these issues, although lately she's talking tougher on immigration and Chinese imports.

Both sides offer similar messages for trade and business but the quantum makes a difference, especially in terms of tariffs. The starkest difference is the corporate tax rate. Trump's official platform says he intends to keep the rate at 21%, the rate he cut it to in 2017 when he was President. But he has mulled cutting it even further to 15%. Meanwhile, Harris has pledged to raise the rate to 28%. For an American company paying the headline rate of tax, a cut to 15% would boost profits by 8%, while an increase to 28% would reduce profits by 9%. That's roughly equivalent to an average year's earnings growth either gained or lost. This is a big swing for potential profits – and one depending on an uncertain election.

Whether Harris or Trump wins the White House is too close to call. As is the fight over Congress. It won't take much for Republicans to overwhelm the Democrats' razor-thin majority in the Senate, yet they their own hold on the House of Representatives is extremely slim. A switch in control of both chambers of a divided Congress has never happened before. It may just occur this November. A split Congress would make it difficult for whoever wins to implement their agenda. Often not necessarily a bad thing!

One thing both presidential candidates agree on is spending more money than they get in taxes. That means the amount of US Treasury bonds issued is likely to keep rising, which could put upward pressure on their yields. Any resurgence of inflation would have a similar effect. We think the chances of inflation heading higher are low, but it's something to keep an eye on.

Other investors are no doubt wary of disappointment as well. As we mentioned earlier, stock markets, government bonds and most commodities have lurched around extensively over the past year in reaction to unexpectedly variations in data from business surveys, to inflation, employment and central bank pronouncements. Markets go from calm in a flash. The oil market has remained relatively placid, however. That's despite a lot of uncertainty about the US economy and interest rates, escalating violence in the Middle East and continued deterioration in the vitality of China.

We're unsure whether this will continue, but we've got some investments in place that should protect us if the oil price does suddenly skyrocket.

**OIL PRICE SO FAR UNFAZED BY MIDDLE EAST CONFLICT**


Source: FactSet, Rathbones; Brent Crude spot price to 4 October

# KEEPING YOU UPDATED

## INVESTING FOR THE NEXT DECADE: MEET THE NEW NORMAL, SAME AS THE OLD NORMAL

The first few years of the 2020s have been characterised by huge shocks to the global economy – from the pandemic to the Ukraine war. When the dust settles, we think the global economy will have changed in significant ways, and the investment strategies that fared best over the past decade won't be the ones that serve us best for the next one. If the 2010s are gone for good, we'll need a different approach. **Read here**


## GENERAL FINANCIAL AWARENESS COURSE

Understanding investments can be like learning a different language. At Rathbones, we believe in education to enhance your understanding of the wealth management environment. Once you understand your money, you are better equipped to make informed decisions. **Register here**

## 16-25 FINANCIAL AWARENESS COURSSESS

Our financial awareness courses, delivered by Rathbones' investment managers, are designed to help young people take control of their finances, providing them with the knowledge and skills to build a secure financial future. **Register here**

## FEMALE FINANCIAL AWARENESS COURSESS

Our female financial awareness courses are designed to show women how to fulfil their financial goals through the power of investing, to better understand their money and to be better equipped to make informed decisions. To book your place please email **Sharon Ryan** at sharon.ryan@rathbones.com.


## RATHBONES INSPIRED MINDS

### What does inspiration mean to you? Do you need it? Where does it come from?

To find out, we invited some truly inspired minds to join broadcaster, cricket commentator and classics buff Daniel Norcross, on the Rathbones Inspired Minds podcast. Daniel talks to acclaimed writers, scientists, thinkers and entrepreneurs and asks what inspired them to pursue their fields of expertise. Listen to historians Tom and James Holland, Peter Frankopan, former England cricketer Ebony Rainford-Brent, comedian Andy Zaltzman and many more inspired minds in our fascinating new podcast series. **Listen here**

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