Contact us 020 7399 0399 rutm@rathbones.com

Rathbones
Look forward

Rathbone Global Opportunities Fund

Update, August 2019

In August, the Rathbone Global Opportunities Fund returned -1.4% versus a -2.5% average fall for the IA Global sector. Year to date your fund is up 27.3%.

August is often a month for fireworks in global stock markets, as if to torture investors for their trips to the beach.

The (very modest and fleeting) inversion of the US yield curve triggered a flurry of recession warnings. What does the inverted yield curve mean? Historically, when two-year US treasuries earn higher yields than 10-year ones, it has been a recession indicator and precondition for a bear market in stocks. But it is NOT a reliable recession indicator and not a sign that one is imminent. The timing of the inversion during a period of low August trading volumes may have also exacerbated the impact. According to JPMorgan interest rate research:

"… More than half of the recent move in interest rates and inversion of the yield curve was caused by technical drivers – i.e. convexity hedging of mortgages, bank portfolios, and variable annuities in poor liquidity conditions – and less than half of the move can be explained by fundamentals such as the growth, inflation and monetary policy outlook. This is an important data point for equity investors, as moves in rates (e.g. yield curve inversion) significantly impact investment sentiment. By looking at various systematic flows in equity markets, we find similar results – i.e. that more than half of equity moves were driven by systematic rather than fundamental trading."

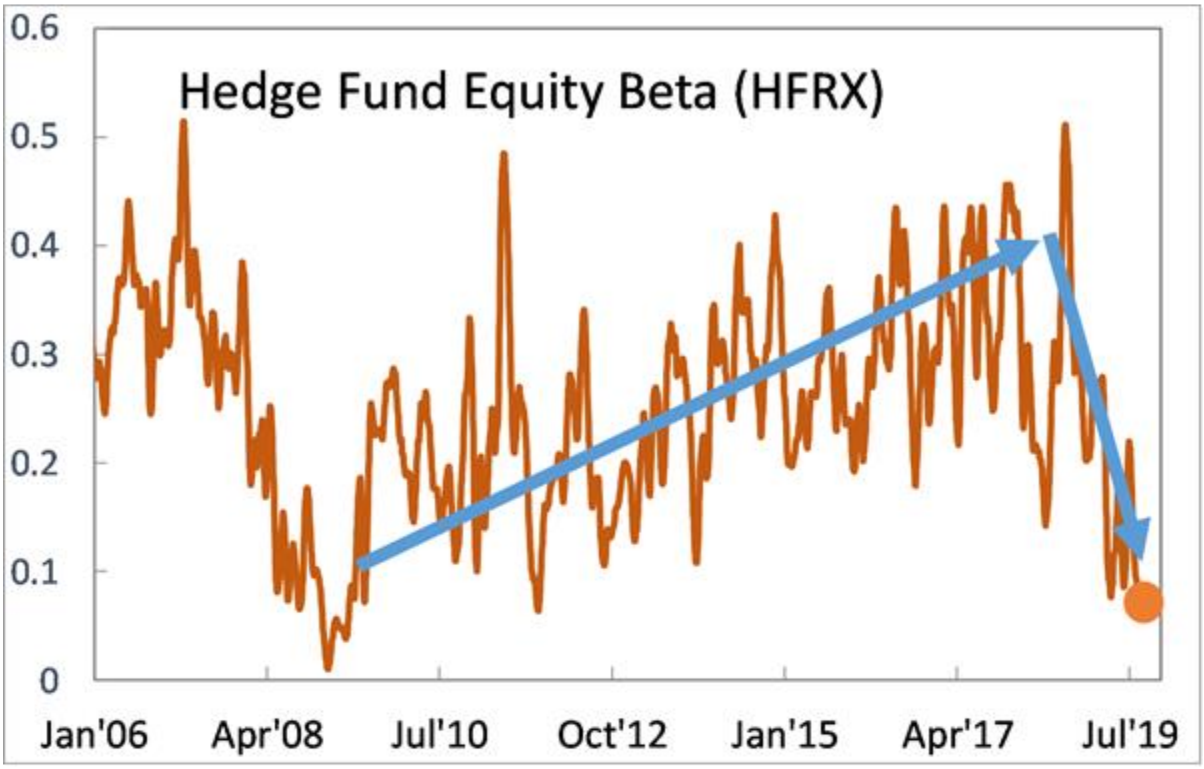
Perhaps this is just another symptom of a world starved of reliable growth. It doesn't take much of a slowdown, combined with the belief that this long period of expansion must be nearing an end, to send markets sharply downward. This is a normal behavioural reaction to the extreme market volatility and negative coverage we saw in the fourth quarter of last year and then again in May and August. As a result, we continue to see a sharp rotation into cash. Outflows from equity funds have amounted to a significant 3% of AUM just since the start of the year – almost half of the outflows seen during the last downturn.

For equity investors, this de-risking has caused further concentration of performance in reliable and resilient growth stocks, bond proxies and defensive equities. That's why we have seen such a dispersion of returns among industries. Areas like technology, specialist financials, staples, healthcare and 'growth' have massively outperformed, and more economically sensitive sectors, like oil & gas, mining, banks, industrials and other 'value' stocks have massively underperformed.

But just as investors pushed this concentration of performance to the limit, in early September there was a violent snapback that sent cyclicals soaring. This continues to be one of the most pressing short-term risks we face, which we highlighted in our 9 September webcast.

The reason for this surge in value and other long-time laggards is probably a more sanguine view of the global economy (up from deep despair just a few weeks ago) and expectations of further central bank interest rate cuts (and, in Europe, other monetary giveaways). The US election also encourages bullish behaviour as, historically, the S&P 500 has risen ahead of 18 out of the last 20 elections. The trade war remains a risk, but many believe that President Donald Trump will de-escalate because he is likely to be very sensitive to stock market and corporate sentiment ahead of a tight election. And the fastest way for hedge funds to express this more risk-on view is for them to close their shorts and increase their near-record low net positions (see chart below). Hence the five-standard-deviation rally of value vs momentum in a matter of days as investors bought names that have been beaten down in a prolonged period of concentrated underperformance.

Hedge funds' equity exposure was near the lowest since the global financial crisis...



Source: JPMorgan Equity Strategy

Do investors really need to reduce portfolio risk by adding cyclicality? That's exactly what's happening at the moment. It becomes a guessing game how long this trend reversal will last, but as long as it does, we will underperform. We have a long-standing aversion to the most economically dependent sectors of the market which have become value plays in recent years. They include energy, mining, autos and interest-rate-sensitive banks. Instead, we prefer companies with all-weather growth qualities and resilience. This technical snapback will cause us some further pain, but we won't chase trading performance to the detriment of long-term investing.

James Thomson
Fund Manager

Sammy Dow
Assistant Fund Manager

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Source performance data, Financial Express, mid to mid, net income re-invested.

Rathbone Unit Trust Management Limited
8 Finsbury Circus, London EC2M 7AZ
Tel 020 7399 0000
Fax 020 7399 0057

Information line
020 7399 0399
rutm@rathbones.com
rathbonefunds.com