

Rathbone Multi-Asset Total Return Portfolio

Update, October 2019

Overview

Well, that was an exciting month. Sterling finished October like a rocket as the nation barrelled toward a Brexit deal before veering off toward a 'Brexit Election'.

Against all odds, Prime Minister Boris Johnson managed to hammer out a Brexit deal with the EU – one essentially reneging on inherited coalition partner the DUP. That deal's hefty drag on British household incomes, which according to King's College economists would be notably worse than his predecessor's, was lost in the din of his attempt to ram the legislation through the Commons in a matter of days. All that, in the end, turned out to be a feint: he used the kerfuffle as evidence of the country's need for a new Parliament to solve its deadlock. Mr Johnson managed to outflank his opponents on the public opinion front, getting them to agree to a 12 December election.

Sterling had already risen slightly from the multi-decade lows of mid-year, but it bounded 5.3% higher last month to just shy of \$1.30. Gilt yields went up with it. Both have continued to trade in a pretty tight range as polls come and go and UK economic data plods along uninspiringly.

More globally, markets got excited about the chances of a "phase one" trade agreement between the US and China. Both sides have flagged the high likelihood of sealing the deal before the end of the year, so we're cautiously optimistic of that good news coming (eventually). Donald Trump likes to make reality as dramatic as an episode of *The Apprentice*, so expect a few last-minute twists and turns.

Other investors seem more impatient, leading to a rotation from 'growth' companies to more economically sensitive 'value' firms. As you will probably have guessed, we're not chasing those value companies. There will be periods when the share prices of these sorts of businesses will do really well, but we feel like they will be few and fleeting. In a world of limited economic growth, we believe it's prudent to stick with companies that are taking profits from rivals because of their own merits. In that sort of world, relying on accelerating economies to increase the overall pool of earnings seems misguided.

This month's trades

As gilt yields rose we added slightly to 10-year UK government debt.

We added industrial gases company **Linde** to our portfolio. This company was formed by the merger of industry giants Praxair (American) and Linde (German) earlier this year. The combined operation is now the largest in its industry. This is the sort of business we love: supplying a crucial product (gas) to businesses in an industry that is hard for new competitors to enter. This has the sweetener of synergies from the merger that should help improve profitability further.

We took profits from quite a few companies during the month, including Dutch semi-conductor firm **ASML**, which makes the machines that print computer chips, and European private equity investor **HgCapital** after it soared 35% year to date. The UK-listed investment trust had even moved to a small premium as investor demand hotted up – it traded at an almost 10% discount throughout 2018.

We used the cash to buy **iShares FTSE 250 ETFs**, slightly increasing our exposure to the domestic UK economy (we've been light on our home market for quite a while).

Outlook

Some investors are eying Europe as the final frontier of this 10-year economic upswing, as a pure way to play global value. Added to that is the feeling that they should also benefit from a Brexit agreement. We agree that the Continent's stock markets are certainly pretty beaten down. But would we buy them? Not apart from a few great businesses that tend to be multinational and insulated from the most damning of Europe's structural issues. In a nutshell, we think Europe is stranded in no man's land holding a hand grenade. The EU is awkwardly halfway between full fiscal co-operation and siloed national interests that prevent it from addressing either national or shared problems. Deflation, immigration, high youth unemployment, poor entrepreneurial spirit, all of these enemies are attacking it right now. And the grenade? A dangerously lackadaisical attitude to the long-term distortions of negative interest rates.

Sweden's Riksbank was the first ever central bank to implement negative interest rates back in 2009, the European Central Bank (ECB) didn't follow its lead until five years later. Yet the Riksbank is now planning to exit the upside-down world because it worries that, "if negative nominal interest rates are perceived as a more permanent state, the behaviour of agents may change and negative effects may arise." When our in-house monetary policy expert recently went to listen to ECB advisers, they told him they had no intention of researching the potential long-term effects of negative rates ...

So with attitudes like that, it should come as no surprise to you that we prefer to invest elsewhere. The US has been a particular favourite of ours because it is the home to scores of world-beating companies of the kind that just don't exist anywhere else. But don't worry, we are trying to spread our risks. Which is why we've built up a basket of defensive assets such as commodity ETFs, overseas government and high-quality corporate bonds, put contracts that protect the value of our US equities and short-term UK gilts.



David Coombs
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Will McIntosh-Whyte
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