Rathbone Income Fund

Quarterly update March 2021

At the risk of stating the blindingly obvious, we never know quite what is around the corner. I (Carl) ordered a new pair of trail shoes from Wiggle, but neglected to change the delivery address so they were sent to our London office. The result is that I am writing this investment letter on my lonesome, sharing an office floor with one other colleague and a lot of boxes. I have located my shoes and I have checked my desk for any errant foodstuff – luckily there are no fossilised remnants of bananas, though I guess the coconut green tea bags are probably a bit stale by now (don't mock, I liked them!).

The trip up to town was emotional. I've commuted to London almost every working day, bar holidays, since 1998. Notwithstanding the occasional office move, my day-to-day routine has remained remarkably consistent. I would leave the house at the same time, almost certainly park in the same spot at the station car park, stand in the same place on the platform and endeavour to sit in the same seat on the train, with the same polite nod to the travellers I'd see every day. Same route through London Bridge or Cannon Street. Same walk to work. Same coffee order from the same café – religiously not Starbucks. And I'd make the same decision to walk up the stairs rather than get the lift to the sixth floor. You get the drift.

But today was very different. I did get a coffee at the station, and my usual barista served me. She said that she was fine and that all was going well. We had time for a chat, muffled of course behind our face masks, because there was no queue. Just me. Luckily, she could remember my usual order because I couldn't! The train certainly wasn't empty, but there was no stress about getting a seat. London Bridge was extraordinarily quiet, with a bare trickle of human traffic rather than the torrent that I remember. Offices are stripped down to the essentials of agile working. When I looked through the windows of smart eateries, I saw tables and chairs stacked up. Road lay-outs have changed and there are fewer cars and more bike lanes. I found it very emotional, I tried not to feel anxious and to experience it all with fresh eyes; I know that my commute, to the extent that I will ever do it again, is forever changed.

Performance Review

This sense that irrevocable changes have occurred, but that it's still too early to be sure exactly what they mean, is inevitably impacting our investment decision-making. We question the wisdom of some market participants who claim they've got all the answers. We very much enjoy reading research from David Mortlock, head of investment banking at German bank Berenberg, especially his attempts to canvas broad opinion about what's happening across markets. These insights are always fascinating and provide a welcome reminder that many different points of view oil those markets. Vehement arguments are made both for and against inflation, commodity super-cycles, rotation trades, secular growth, re-opening trades and asset bubbles, etc., etc. Everyone seems to have a view to share and a position to defend. But is it wise to have this kind of conviction about how markets will behave? Let's be honest, at this juncture none of us really knows what the future is going to bring.

It's this sense of hesitancy that drives our 'safety-first' approach. For example, we participated in the rotation into value, but not by as much as if we had plunged in feet first, betting the house. Our approach was measured. In absolute terms, our performance since the stock market nadir at the onset of the pandemic has been very strong. In relative terms, progress has been less dynamic. But this trend started to change in the first quarter, with our fund buoyed by what we regard as steady positive news from several of our holdings.

	3 months	6 months	1 year	3 years	5 years
Rathbone Income Fund	7.4%	21.4%	30.1%	10.9%	24.5%
IA UK Equity Income Sector	6.8%	23.4%	32.6%	9.0%	25.9%
FTSE All-Share Index	5.2%	18.5%	26.7%	9.9%	35.7%

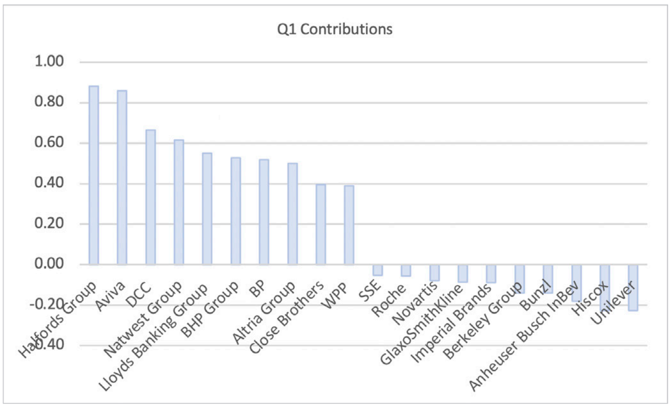
	31 Mar 20-31 Mar 21	31 Mar 19-31 Mar 20	31 Mar 18-31 Mar 19	31 Mar 17-31 Mar 18	31 Mar 16-31 Mar 17
Rathbone Income Fund	30.1%	-19.7%	6.1%	-4.3%	17.3%
IA UK Equity Income Sector	32.6%	-20.6%	3.6%	0.3%	15.1%
FTSE All-Share Index	26.7%	-18.5%	6.4%	1.3%	22.0%

Source: FE Analytics; data to 31 March 2021, I-class, mid price to mid price.

These figures refer to past performance, which isn't a reliable indicator of future performance.

Three-month Performance

As stated above, strong corporate news has pushed the fund marginally ahead of the IA UK Equity Income Sector and the FTSE All-Share Index in the first three months of the year.



Source: StatPro; Rathbones.

The stock market sector rotation that characterised much of the final six months of last year continued into the first quarter of 2021. By sector rotation, we mean an increased appetite for the shares of companies that might represent better value for investors, especially if they provide exposure to industries that may benefit from a global economic recovery. This trend is evidenced by the leading contributors to fund performance during this period, with financial companies (**Aviva**, **Lloyds**, **NatWest** and **Close Brothers**) and commodity plays (**BHP** and **BP**) maintaining the share price recovery first apparent in the latter half of last year.

Auto parts and bicycle retailer **Halfords** has enjoyed a very strong start to 2021, a far cry from its fortunes a year ago when we were first in lockdown and the prognosis for retail was very poor indeed. Management has done an excellent job in focusing the business and getting to grips with basic things like managing the supply chain. Crucially, it has taken advantage of the flexibility it's enjoyed in delivering its products to customers. Its stores have been able to remain open, online sales have been a boon and its fleet of mobile technicians have enabled it to get out to customers at home. In addition, Halfords has reaped the rewards of a cycling boom as people have had the time and the incentive to get on their bikes to enjoy the great outdoors. It expects growing demand for electric-enabled products to continue well after lockdown ends. (The electrification of transport in general – bikes, scooters, cars and vans – is a longer-term trend that we think is yet to be fully appreciated by the market.)

The flipside to the rotation into 'value' has been a devaluation of what has been labelled 'quality' businesses with highly predictable earnings. They performed relatively well at the height of pandemic as capital flew to 'safe-haven' stocks, but they've since slipped back as anxieties about economic shutdowns have eased. We would put **Unilever**, **Anheuser Busch InBev**, **Bunzl** and **Imperial Brands**, as well as the pharmaceutical giants **GlaxoSmithKline**, **Novartis** and **Roche** in this quality camp. We have sold **Imperial Brands** and have trimmed quite aggressively our position in Unilever. The latter has been a core holding in the fund for many years. However, we've grown increasingly uneasy about the way this business is allocating its capital and so have been keen to de-emphasise Unilever's importance in the fund. By contrast, we saw Bunzl's weakness in the first quarter as an opportunity to buy more of the shares at an attractive price.

The value of your investments and the income from them may go down as well as up, and you could get back less than you invested.

Outlook

One never knows what tomorrow will bring. This is why our 'margin of safety' concept is so important. We focus on value because it gives us a degree of 'insurance' against poor outcomes. Being too tolerant about price risks and owning businesses that are 'priced to perfection' can be a dangerous strategy if investors start dumping previously highly favoured sectors and shifting elsewhere. The rotation we've seen over the last six to nine months shows how dramatic share price moves can be when these shifts occur. We were fortunate to be positioned in such a way that we could reap some of the benefits of this rotation — which we believe has further to run.

Whether it's down to policy, bravery or chance (it's probably a combination of all three), the UK has made remarkable progress in its vaccine roll out. This means that our economy should restart more quickly than others. The fact that more people will need to stay in the UK for their holidays, combined with a healthier employment rate than we might have expected and a high savings ratio, all augur well for the domestic economy. Some analysts are already forecasting a bumper summer. Any spending rebound will be reflected in very easy comparatives this time last year.

However, we all know that there is one huge caveat to all this good news. That's clearly the realisation that COVID-19 is here to stay in some form or other. The faster the economy opens up, the greater the risk of another wave of infections. While we can invest to take advantage of any economic rebound, we must be mindful that things could change. We must always seek out a margin of safety. Currently, we're finding that margin through our belief that the UK market is very cheap relative to other geographies and asset classes. We regard this as our 'insurance' against less benign scenarios.

As we have written many times previously, cash in the bank is generating next to no return. What is the best fixed rate cash ISA you can buy — 1% at most? If investors want to supplement their incomes, where do they go? If UK companies are still paying decent dividends (and we are forecasting healthy dividend payments this year), we expect income-hungry investors to be attracted to this cash flow. Our fund yields 3.6% as of 31 March 2021. Not knowing what is around the corner, we contend that this level of dividend yield, alongside our value and risk-oriented approach, provide a degree of security in what remains a very uncertain world.

Carl Stick
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Any views and opinions are those of the investment manager, and coverage of any assets held must be taken in context of the constitution of the fund and in no way reflect an investment recommendation. Past performance should not be seen as an indication of future performance. The value of investments and the income from them may go down as well as up and you may not get back your original investment.

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