Rathbone Unit Trust Management

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Rathbones
Look forward

Rathbone Multi-Asset Strategic Income Portfolio

Monthly update October 2020

By mid-November, the markets had priced in a Biden presidency and contested Congress. And that meant a big surge in stock and corporate bond markets.

The Associated Press declared Joe Biden the winner of a very close race. So close that it took the largest US voter turnout since the '60s and days of laboured counting. Yet it is not close enough to warrant Donald Trump's dogged refusal to concede the election: the margin of victory in most swing states was in the thousands; recounts tend to move results by less than 500 votes. The only way Mr Trump is getting a second term is if the Republican Party goes along with some extremely mendacious technical wrangling to essentially disregard the result in swing states and cast electoral college votes for their man instead. That's a can of worms we think the Republicans are unlikely to rip into.

As for the contested Congress, the Democrats are set to retain the House of Representatives with a greatly reduced majority while the Senate is balanced on the knife-edge of Georgia. Both of the state's Senators will be decided by a run-off in early January; the Democrats need two wins to wrest control from the Republicans. More pressing than that, there is another debt ceiling deadline looming in the coming weeks. In early December, the federal government will essentially run out of money unless Congress agrees on a Budget or on another delay bill. We have been here several times over the past few years, and more than once the US government has had to shut down because Congress and the President have been unable to agree to come to terms. If this happens once again – during the pandemic – the consequences could be more severe.

We business-minded people have, over the past few years, lamented the greater intrusion of politics into our world, and all the uncertainties, extra costs and distractions it has brought with it. Yet, you can't help feeling that politicians could well be upset by the intrusion of the business-mindset into their world. Politics has long been governed by conventions and gentlemen's agreements. Take the presidency: for career politicians, what Mr Trump is doing by refusing to concede the election is unthinkable and could irreparably damage American politics. Yet, Mr Trump is a businessman. And in business, making use of every legal avenue to achieve victory in a dispute is par for the course. In business, relying on a handshake and good faith is naïve at best and a breach of fiduciary duties at worst. This decade has perhaps shown the challenges that come with mixing politics and business.

So, with a centrist career politician back in the Oval Office from 20 January, for good or ill, it seems that we're heading into a couple of years of smoother governance. We'd be happy with that. We want to see less politics. We want to see four years' steady steering of the American juggernaut. We want to focus on companies themselves rather than having to continually worry about whether they will run foul of the White House or Capitol Hill. If Mr Biden steps down in four years with us all scratching our heads, thinking in vain for the big events of his administration, we'll be pleased.

During the campaign, Mr Trump, AKA the Apprentice President, dubbed Mr Biden "Sleepy Joe". We hope he lives up to the name – we could all do with some rest!

Because there's also Brexit, which is still tumbling on! We have long said that we believed the EU and UK would strike a deal, but that it would come at the very last possible minute. We are more convinced than ever that this will be hammered out and a deal put in place by the end of the year. There's just too much at stake for both sides, especially when you factor in the pandemic and its economic fallout. After that, Brexit seems likely to slide off the headlines as bureaucrats sort out all the details that civilians never think of. Again, we would be happy with such a result.

We generally added to our existing equity holdings during the month, including topping up some of our UK investments. We bought some **US Treasury 4.5% 2036** bonds as yields rose and sterling strengthened, taking on a slightly greater maturity than usual in return for a higher coupon.

We added to the **iShares S&P Small Cap 600 ETF** because we feel the US recovery will be better than most people expect, if a bit volatile. We wanted to get more exposure to the American main street, albeit the 'small-cap' companies in this tracker are still huge businesses.

Finally, we took profits from our investment in pest control business **Rentokil Initial** and internet search titan **Alphabet**.

Following the election, pharma giant Pfizer's big reveal of truly exciting results from its final trials – a 90% efficacy rate is extraordinary – sparked an almighty shift in markets. In stock markets around the world, long-bombed-out 'value' companies and 'cyclicals' – broadly those businesses that rely more on improving economic growth to boost their profits – soared as hope returned that they may soon get back to making a semblance of their normal earnings. To buy up these companies, many investors aggressively sold all those businesses that benefited from the pandemic – lots of digital enablers, online retailers and internet media companies.

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We expected this ‘style rotation’ to happen at some point, once a glimmer of light was spotted at the end of the pandemic’s tunnel. This was why we have been buying companies that, while still to our mind ‘quality’ businesses, are more sensitive to an economic recovery. These businesses, which we have been adding over past months, haven’t rocketed as high as some of the truly bedrock ‘value’ have done. Yet most have still gained considerably, ensuring that we have benefited from this rotation.

Investors’ full-throated embrace of ‘value’ may turn out to be a little overexuberant; although it may yet have further to run. Vaccines could soon start falling among us like snow — literally for Pfizer’s which requires deepfreeze transport and storage. There are about 10 vaccines in final stages so more results could appear in the coming weeks and months. More success stories could lend more credibility to the idea that inoculation against this virus will soon be widespread and the world will be able to get back to normal.

We hope the vaccines can help put the pandemic behind us, yet there are many distributional challenges that should be kept in mind. Getting so many hundreds of millions of doses dispatched to all the regions of the world and then jabbed in people’s arms will take time and a lot of money. Also, it’s important to keep perspective and remember that growth wasn’t so tickety-boo before we came to know COVID-19. The world is getting older, more indebted and more digital. Those trends will only accelerate because of the pandemic: hard-up people will put off having children; governments, companies and households are borrowing more to get through the dislocation; and everyone is embracing online and remote options.

All these trends are the reason why we believe it’s best to be biased toward ‘growth’ companies — those businesses whose profits are growing because of more than simply a recovery in the economy. They tend to be driven by the themes we outlined above. When there’s not much growth around, those businesses that can expand should be in high demand.

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