Rathbone Unit Trust Management

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Rathbones
Look forward

Rathbone Multi-Asset Enhanced Growth Portfolio

Monthly update February 2021

The momentum in markets has well and truly shifted. The US 10-year government bond yield has been rising steadily for months, yet it went into overdrive in late February and early March as investors prepare for a GDP growth slingshot when economies reopen.

The benchmark US borrowing rate jumped more than 50 basis points to 1.60% between January 31 and its peak in early March. To put last month's move into context, however, the yield is only now approaching the 1.60% to 2.00% band where it traded before the pandemic hit. Still, it's a big move in a small month and it has rattled markets.

Rising yields shake out stocks

The effect on stocks was as you would expect: 'growth' companies have generally tumbled because higher interest rates reduce the value of cash flows that are expected to arrive far out in the future. Growth companies tend to reinvest most of their profits in pursuit of becoming much bigger, dominant and valuable in five, 10, 20 years' time. This makes their share prices much more sensitive to changes in interest rates. As bond yields slumped during the pandemic, the values of many growth businesses were pumped up at the same time as many were enjoying increased earnings on top. Recent falls in growth company shares are simply the reversal of this phenomenon. Meanwhile, 'cyclical' companies – those that are heavily geared into wider economic growth – have enjoyed a sharp revival. This makes sense too, because investors are expecting them to make hay as economies reopen.

Now, as we've mentioned before, we're a little less sure about the longevity of any rebound in economic growth than other investors appear to be right now. While a few months of huge jumps in GDP and inflation are on the cards because of [the 'base effect'](), we believe there's still a whole bunch of long-term economic forces that should keep a lid on growth and inflation. Older demographics, way more debt and an ongoing technological revolution that is laser focused on reducing costs. Then add a significant increase in unemployment, which is likely the moment governments remove their pandemic support policies.

Yet markets are heavily influenced by emotion. People freak out and markets reflect that. Sometimes, if enough people worry enough about a thing happening, it can actually cause that thing to come about. What we're trying to get at is that we could be wrong so, as always, we try to hedge our portfolio against that risk. Typically, that involves buying when others are selling and selling when others are buying.

For example, we shave been taking profits in many of our growth companies over past months as markets and share prices kept hitting new highs. We have used that cash to add to companies we call 'quality cyclicals'. These businesses have the characteristics of growth companies (strong underlying customer bases, quality cash flow and advantageous market dominance) yet they should also benefit from economies reopening and recovering. This shift helped blunt the effect on our portfolio from the aggressive market rotation from growth to cyclicals.

We bought the **UBS CSI 500 Index** structured product during the month. This investment is an agreement with an investment bank that will give us the return of the CSI 500, a small and mid-cap Chinese A Share index. It also pays us an almost 10% income for allowing our shares to be lent out to other investors. The demand for borrowing these shares is large, as it helps stock dealers hedge their positions, yet few shareholders are willing to do so in this market because the volatility can be pretty high and local traders tend to buy and sell often. We believe this income stream more than compensates us for the risks involved.

We took profits in the **JPMorgan Japan Equity Fund** after an extraordinary year of outperformance for the manager.

We added Swiss carton-maker **SIG Combibloc** to our portfolio. SIG's cartons are aseptic, which means they don't have to be refrigerated to avoid spoiling their contents. This also means they are a higher-end product than you would first expect. The company sells its packaging lines to foodmakers and then supplies them with materials, a particularly sticky business model that means its average customer has been a partner for more than 20 years. The company is growing steadily, led mostly by the emerging markets of South America and Asia.

Another addition was **Vestas Wind Systems**, a Danish windfarm manufacturer and servicing company. Founded in 1945, it is one of the largest players in the global wind energy industry, with 77,000 windfarms across 83 nations. Wind is an ever-growing part of the energy mix as the world tries to decarbonise. Orders for Vestas turbines are particularly strong in Asia Pacific, an area that we believe is the most exciting growth region of the world.

We continued to build our positions in Japanese electric motors manufacturer **Nidec** and recycled plastic decking company **Trex**. We have also added carefully across other existing holdings where the price warrants it.

Make sure to know what you don't know

So where from here? We really don't know. As we said earlier, we have a hunch that inflation will be kept tamped down by strong economic forces, but we don't have a crystal ball.

The reopening surge could be explosive indeed. Take the UK: something like 90% of all self-catered holiday accommodation in the UK has been booked out for this summer. And that's before we know whether anyone will be able to travel further than the end of the drive! Restaurants and bars are similarly booked out months ahead despite the lack of certainty. At least in these sorts of sectors, such hefty demand coupled with reduced supply means short-term prices are headed one way: up. One of the major influences on longer-term inflation is people's expectations of inflation. If they think inflation will rise, they tend to agitate for greater wages, which has a significant effect on inflation. Who knows how people here in the UK – and those abroad who will be experiencing similar scenarios – will react. There is one impediment to widespread wage growth, which we mentioned earlier: it's hard to argue for a pay rise if unemployment is high. That is, unless your particular set of skills is in high demand (to paraphrase Liam Neeson).

Over in the US, which tends to create the global economic winds that blow through all other nations, lockdowns have been less total and commerce seems to be sharply rebounding already. This, combined with a humungous $1.9 trillion stimulus package that appears imminent, could redraw the economic landscape. It will do three things in particular: 1. Vastly increase households' ability to spend; 2. Massively increase the issuance of US government bonds (pushing yields even higher); 3. Boost unemployment benefits (potentially reducing people's desire to take a job paying less).

There's a lot of secondary and tertiary impacts that flow from just those three major phenomena. Over the coming months, as markets reopen and another round of stimulus kicks in, we feel like there's a reasonable chance of a rerun akin to the 'taper tantrum' of 2013 when the US Federal Reserve hinted that it couldn't hoover up bonds forever. Investors worried about rising yields, so started selling bonds aggressively, while the US Federal Reserve stepped in to buy them and calm things down. Another bout of this sort of thing wouldn't be great for any sort of asset in the short term.

Longer-term, we're optimistic about markets and the investments we hold, however we just feel like the reopening months could get a bit erratic as people's expectations mix with reality and evolving economic conditions. Like any transition! So we're keeping some of our powder dry to take advantage if it comes.

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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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