**Rathbone Unit Trust Management**

**Contact us** 020 7399 0399 rutm@rathbones.com

Rathbones
Look forward

# Rathbone Income Fund

## Quarterly update September 2022

In our August letter we argued for the futility of trying to predict the future. How apt therefore that a few delays meant the letter went out a week late, and therefore with an ironic predictability pre-dated the Chancellor's 'fiscal event' by a mere couple of days. In the intervening week it seems that all bets (if not wheels) were off. In this quarterly review, we reflect on a period that, in relative terms at least, was very satisfactory indeed, but in absolute terms – which is what really matters to investors – was difficult once more. As one American commentator wrote, "Good riddance to the third quarter … there were few places to hide."

The market reaction to the mini-budget was violent, especially in the gilt market, and the situation remains very fluid. The Bank of England was forced to restore order in long-dated government bonds by promising to buy up to £65 billion of them, if required, over just 13 days. This meant, extraordinarily, enacting quantitative easing measures while strategically involved with monetary tightening at the short end of the yield curve to fight inflation. Having been unsuccessful in its initial attempts to allay concerns both here and abroad, the Government was forced to U-turn on the removal of the 45p tax rate ahead of the Conservative Party conference. As things stand, after the political vacuum of the summer, we must wait until 23 November for further clarification of the fiscal framework, but even this timetable is now up for change.

### Performance review

However painful in absolute terms the last month has been, in relative terms our fund has held up well against peers in September, and we had a very good quarter compared with the sector too. Our fund slipped back 2.8%, considerably ahead of the sector, and a better performance than that achieved by the broader FTSE All-Share Index. However, a very difficult last six months for all investors has cast an inevitable pall across all markets, and UK Equity Income has not been immune.

| | 3 months | 6 months | 1 year | 3 years | 5 years |
|---|---|---|---|---|---|
| **Rathbone Income Fund** | -2.8% | -9.5% | -5.3% | 1.2% | 6.4% |
| IA UK Equity Income Sector | -6.1% | -11.2% | -8.5% | 0.5% | 3.8% |
| FTSE All-Share Index | -3.5% | -8.3% | -4.0% | 2.4% | 11.3% |

| | 30 Sep 21-30 Sep 22 | 30 Sep 20-30 Sep 21 | 30 Sep 19-30 Sep 20 | 30 Sep 18-30 Sep 19 | 30 Sep 17-30 Sep 18 |
|---|---|---|---|---|---|
| **Rathbone Income Fund** | -5.3% | 29.4% | -17.5% | 2.5% | 2.5% |
| IA UK Equity Income Sector | -8.5% | 32.7% | -17.2% | -0.2% | 3.4% |
| FTSE All-Share Index | -4.0% | 27.9% | -16.6% | 2.7% | 5.9% |

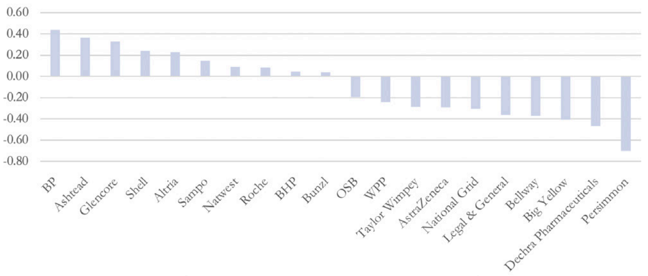
Source: FE Analytics; data to 30 September, I-class, mid price to mid price.

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

**The value of investments and the income from them may go down as well as up and you may not get back what you originally invested.**

We do have meaningful exposure to sectors that have been materially hurt, at least in share price terms, by the budget: financials, especially banks and life assurers, and house builders. On the other hand, stability has been provided by the balance that we have within our broader portfolio. By way of example, **BAE Systems** rose almost 5% in the week immediately after the mini-budget, and we are also benefiting from the large number of dollar earners in our fund, beneficiaries in sterling terms as our currency weakens.

### Q3 contributions




Source: StatPro; Rathbones

However, over the quarter, it is much harder to come to any granular conclusions or clear trends, other than to relate in an uncomplicated way the major contributors and detractors to our return. Commodity stocks continue to be robust. Despite a drift in the oil price, on fears of falling demand in an economic slowdown, and the persistent threat of windfall taxes, **BP** and **Shell** have performed well. This has been complemented by our exposures to the miners: **Glencore**, **Rio Tinto** and **BHP**. These businesses are all economically sensitive, but they also act as good inflation hedges. Two of our industrial names made important contributions – equipment hire business **Ashtead** and global distributor **Bunzl**. Tobacco business **Altria** has also proved its historic reputation for defensiveness – the strengthened dollar also helped our sterling returns for the US-listed business.

In the financial space, Scandinavian insurance giant **Sampo** and UK high street bank **NatWest** have been positive contributors; but life assurer **Legal & General** and specialist lender **OSB Group** have been on the negative side of the score sheet, both badly hit by sentiment after the budget. In the pharmaceutical space, **Roche** was supported by a rival announcing success in treating Alzheimer's with a drug called Gantenerumab – it uses similar science to Roche's in-development treatment. On the other hand, **Dechra Pharmaceuticals** and **AstraZeneca** slipped back.

The most significant negative in the quarter was the performance of the housebuilders. We are frustrated. The sector represents out and out value, and we believe in the long-term structural growth story supporting the industry. But this hasn't been enough to counter a barrage of negative noise throughout the year, whether the cladding issue at the start, ongoing angst about the future despite consistently good numbers from the sector (as well as M&A – Vistry and Countryside properties joined forces in September), and latterly the not-inconsiderable hit from rising mortgage rates and banks withdrawing mortgage deals in light of spiking yields. Of course, this is painful for the sector, but so much of this pain has already been priced into the shares. The best builders have very strong balance sheets which should defend them against the inevitable turbulence, and weaker players may offer up cheap prey. **Persimmon** is on an absurd yield, including a special dividend, of almost 18% – the market doesn't believe they will maintain the special, and nor should they in our opinion. They should use this cash aggressively, to buy cheap assets or even better, their own shares.

### Outlook

So what are we doing? We have put a small fraction of our cash to work, buying recruitment company **Hays**, paper and packaging business **Smurfit Kappa** and retailer **Games Workshop**. Our cash position is relatively high, at over 5.5%. One major bright spot in an increasingly cloudy sky is the fact that we expect to post an increase in pay-out that is pretty close to inflation. Finally, our analytical work has pivoted to reviewing the levels of debt that our businesses have, assessing how well they can cope with refinancing at higher rates, and re-evaluating their pension liabilities. This work is always ongoing, but gains greater relevance now. Our initial feeling is positive, but not complacent.

This is a difficult market and is likely to remain so for several weeks. However, you should always look forward because markets change. Sterling will remain in the doldrums for as long as uncertainty abounds, but there will be a point when it bottoms out (hopefully days or weeks, rather than months away) and any subsequent recovery will be a boost for UK markets. In the short term the pound is horribly over-sold. The fourth quarter's pain may be the first quarter of 2023's gain. UK stocks came into this crisis already cheap, and valuation does provide some insurance. Finally, we must hope that constructive policy decisions are forthcoming that will help to stabilise the situation; once we start to get incremental positives, the UK market will begin to look attractive again.

We must be positive. Despite the political shenanigans, the argument for UK Equity Income remains valid, and the attractiveness of a growing income stream in an inflationary environment – a return today rather than tomorrow, the arguments that we have been making all year – still hold. Notwithstanding the political noise, there are some great businesses in the UK, and they are currently 'on sale'. This remains our massive opportunity.

**Recent trading:** As mentioned, we have added to Hays, Smurfit Kappa and Games Workshop.

**Companies seen in the month:** Dechra Pharmaceuticals, AstraZeneca, **WPP**, **B&M European Retail** and **Diageo**.

**Carl Stick**
Fund Manager

**Alan Dobbie**
Fund Manager

**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 what you originally invested.**

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

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



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