RATHBONES

RATHBONE INCOME FUND

MONTHLY UPDATE JANUARY 2024

What's the difference between an outcome and a solution? For fund managers, an outcome may be interpreted as the consequence of the collision between infinitely variable real-life events and the contrastingly limiting application of an investment process. As managers of the Rathbone Income Fund, the outcome that matters to us most is a total return that beats a benchmark alongside an income that grows by a real amount – what we like to call a 'pay-rise every year'.

We operate in an extraordinarily competitive marketplace. Investors can consider many alternatives to income-generating UK equities: global equities, with a healthy dollop of US exposure; passives, a cost-effective option, at least when shares go up; cash, now that rates are much more attractive; and multi-asset solutions, that are themselves generally outcome-based. This competition matters because of the well-documented flight of investment from UK markets. The returns (outcomes by another name) delivered by UK equities, and by extension the UK Equity Income sector, have disappointed. This malaise has continued despite our contention that the value in the UK market is compelling. Instead of focusing solely on outcomes, we want to present your fund as a potential solution to a very specific problem.

What is that problem? And can it really be solved?

The demographic challenge to our pensions

The UK's demographic landscape is changing significantly, catalysed by an aging population and declining birthrates. These shifts exert immense pressure on pension systems and threaten their long-term viability. The broader problem is how to preserve pension schemes' viability for future generations.

This is why raising the state pension age, not just in the UK but further afield, is viewed as a pragmatic solution. By way of example, it's being raised to 68 years in Ireland by 2028 and 67 in Germany by 2031. By extending the retirement age, the burden on pension funds is mitigated, allowing for better allocation of resources and fiscal sustainability. Furthermore, you can argue that a higher pension age aligns with the goal of promoting workforce participation among older individuals, harnessing their skills and experience to drive economic growth.

A recent report by the International Longevity Centre opens with the argument that "the UK and other ageing populations will have to increase their state pension age to 71 by 2050 to maintain the number of workers per retiree." This warning is made even starker by the admission that this recommendation falls short by failing to consider factors like preventable ill-health. Once you do that and recognise the many reasons why people can't work beyond 65, the situation gets even more critical. The report acknowledges that any solution that depends on people working a lot longer will prove flawed as research shows that "by age 70, only 50% of adults are disability-free and able to work."

The inequality challenge

Inequality remains a pressing issue within the UK. The current pension system exacerbates disparities that hit women, ethnic minorities and low-income individuals hardest. Raising the pension age could present an opportunity to address systemic inequalities. However, measures will need to be implemented that mitigate any adverse impact on vulnerable groups. This may involve targeted support mechanisms, such as enhanced access to education and training, and addressing barriers to workforce participation. But it is so more complicated than this. Research by the Institute for Fiscal Studies argues that raising the pension age from 65 to just 66 would encourage only eight in every hundred 65-year-olds to stay in work, barely achieving a balance between recovering the loss of pension they'd have received in exchange for a relinquished year of retirement. More importantly, the remaining 92% suffer financial loss, with a quarter of 65-year-olds ending up in poverty,

Health considerations clearly play a pivotal role in shaping retirement decisions and pension policies. Preventable ill-health poses a significant challenge as it's a big contributor to premature exits from the workforce. We must recognise the interplay between health outcomes and retirement age, advocating for policies that promote healthy aging and workforce participation.

It would be naïve to assume that simply extending our working lives is going to be enough to incentivise people to maintain their health and wellbeing, leading to increased productivity and reduced healthcare costs. Furthermore, while we may hope that a higher retirement age fosters a culture of active aging, in which people stay engaged in meaningful work and social activities and so enhance their quality of life overall, it would be foolish to imagine this is going to be a universal outcome.

Why are we discussing this?

We've recently been thinking a lot about income mandates as a tool to help ageing populations deal with the challenges and opportunities of a world where it will be necessary to consider a more 'malleable' approach to working lives. You could argue that this somewhat 'Pollyanna-ish' view fails to recognise the clear discrepancies between what some people are able to do in later life, and what will be years of increasing hardship for others. We must recognise an inconvenient truth: many people just won't be able to work for significantly longer. And this raises some more deeply entrenched and intractable problems.

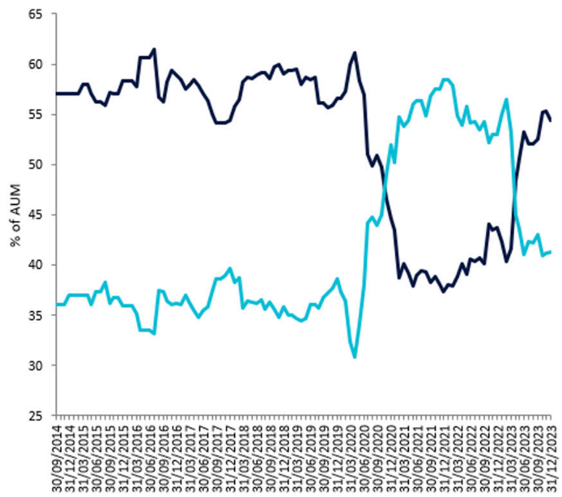
However, we still need to contemplate what we have referred to as the malleability of old age, the power of longer health spans, and the importance of being able to contribute to society well beyond traditional pension ages. That's because all this will demand taking on greater risk exposure in our savings and investments at an older age. It also highlights the advantages of being able to draw on an additional income stream when appropriate or necessary.

In a piece this short we can barely scratch the surface of a very complex and emotive topic. But that shouldn't mean we don't think about your fund as a solution to a problem, while also considering the investment opportunities that demographic change, longevity and extended health spans may well present. You can find our more about our thinking in our Longevity Matters video.

Outlook and recent activity

We continue to err on the side of caution. We don't buy into the argument that global markets will continue to grind higher, irrespective of valuations on the one hand, and severe economic and geopolitical risks on the other. This makes us circumspect and laser-focused on valuations as a way of mitigating risk. We may have been a little early in our shift towards defensive earnings, but we're happy with our increased exposure to 'core compounders' like **Unilever**, as well as our constructive positioning in pharmaceuticals. Relative predictability combined with careful calibration of price risks remain key.

OUR FUND IS NO LONGER OVERWEIGHT CYCLICALS/VALUE



Compounders + cash cows

Quality cyclicals + turnarounds

Source: Rathbones. Data as at 31 December 2023

Recent activity reflects our focus on valuations. We have trimmed UK utility **SSE** and global steel technology business **Vesuvius**. Both remain core holdings, but prudence encouraged a trim. On the other hand, buoyed by more encouraging housing data, we have added to **Persimmon** and **Taylor Wimpey**, as well as **Lloyds Banking Group**. We also bought more shares in **Games Workshop**, following an encouraging end of year statement.

But our watchword remains caution. The world is likely to become more, and not less, volatile over the next 12 months. We want to make sure that the price we pay for assets that we hold on your behalf recognises this reality.

Companies seen in January: IG Group

CARL STICK
Fund Manager

ALAN DOBBIE
Fund Manager

For more info on our fund, including factsheets, performance and fund manager views, please click here.

If you require further clarification on this commentary, then please contact your adviser or Rathbones at the contact details below.

Rathbones Asset Management

8 Finsbury Circus
London EC2M 7AZ
+44 (0)20 7399 0000
Information line:
+44 (0)20 7399 0399
ram@rathbones.com
rathbonesam.com

8779.02.24