RATHBONE INCOME FUND

QUARTERLY UPDATE DECEMBER 2023

This winter, the UK has been hit by a barrage of rain and high winds in a meteorologically extraordinary season. By way of contrast, equity and bond markets trundled effortlessly higher during a benign December.

The FTSE 100 celebrated its 40th birthday by hitting an all-time high at the end of the year, but this does not change the fact that the UK market has been in the relative doldrums for half its life, substantially lagging the S&P 500. We can evangelise all we like about the cheapness of the UK market, but the brutal reality is that it remains unloved and lacking vitality. We will inevitably, and unapologetically, address this topic once more in our outlook.

But for a tailing-off in relative performance as markets rallied in December, 2023 would have been a very good year for our fund. In the final quarter, the fund gained 5.0%, marginally ahead of the IA UK Equity Income sector, and beating the FTSE All-Share Index, which was up 3.2%. Our 12-month numbers were closer: the fund returned 7.6%, ahead of the sector, which was up 7.0%, but behind the index, which was up 7.9%.

Performance review

	3 months	6 months	1 year	3 years	5 years
Rathbone Income Fund	5.0%	6.6%	7.6%	29.8%	37.4%
IA UK Equity Income Sector	4.4%	6.8%	7.0%	24.6%	33.5%
FTSE All Share Index	3.2%	5.2%	7.9%	28.1%	37.7%

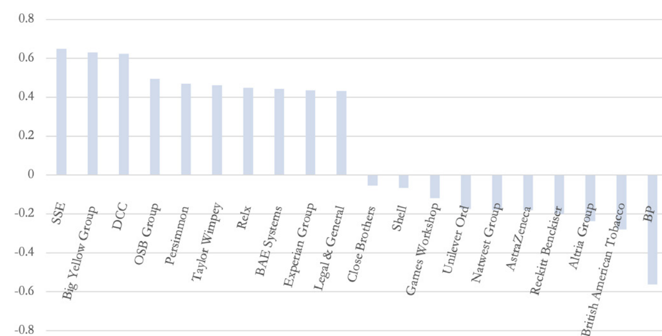
	31 Dec 22-31 Dec 23	31 Dec 21-31 Dec 22	31 Dec 20-31 Dec 21	31 Dec 19-31 Dec 20	31 Dec 18-31 Dec 19
Rathbone Income Fund	7.6%	0.1%	20.6%	-10.6%	18.5%
IA UK Equity Income Sector	7.0%	-1.7%	18.4%	-10.7%	20.1%
FTSE All Share Index	7.9%	0.3%	18.3%	-9.8%	19.2%

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

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

Fourth quarter 2023

Q4 STOCK CONTRIBUTIONS



Source: StatPro; Rathbones

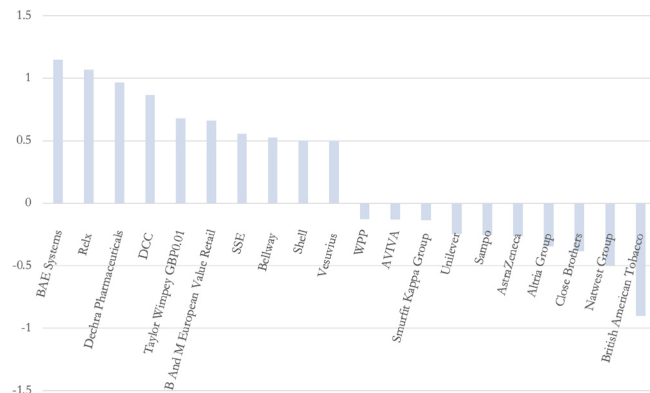
The principal laggards in the final quarter were the big beasts of the FTSE 100, with oil majors **BP** and **Shell**, pharmaceutical giant **AstraZeneca**, and key consumer staples like **British American Tobacco**, **Unilever** and **Reckitt Benckiser** (as well as US tobacco stock **Altria**) all weighing on performance. This was a rally that favoured risk appetite rather than hunkering down in the FTSE 100, with the mid and small-cap indices enjoying stronger runs into the year-end. Of course, there are idiosyncratic reasons for some of this weakness, especially within the consumer staples sector, but increased risk appetite was an important influence, as evidenced by our winners. Here, we observe greater reliance on UK domestic earnings. Self-storage company **Big Yellow Group** produced entirely predictable results in the period, but maybe investors were enthused by its debt refinancing news in conjunction with a share issue reflecting balance sheet conservatism, alongside incremental planning success. Global distributor **DCC** and UK utility **SSE** are key energy transition plays, whose results seem to satisfy investors of their crucial involvement

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.

in the road to lower carbon footprints for consumers and business alike. **Persimmon** and **Taylor Wimpey** played catch up as housebuilders in general had a good year, while financials **OSB** and **Legal & General** complete quite an eclectic mix of largely UK-facing outperformers.

Full-year review

FULL YEAR 2023 STOCK CONTRIBUTIONS



Source: StatPro; Rathbones

As we have written on many occasions over the last two years, **BAE Systems** continues to operate very well in an environment of increased defence expenditure. Investors who believe that **Relx** will benefit from new artificial intelligence technologies were edged ahead in the debate, as this quality compounder grew its fanbase. **Dechra Pharmaceuticals** proved a tremendous early fillip to our annual performance on account of buy-out group EQT's takeover offer in June. As highlighted above, DCC is winning over investors with regard to its role in the green energy transition, and **B&M European Value Retail** evidenced the strength of its discount offering in a highly competitive retail environment.

We can group the laggards into three distinct categories: those stocks we've sold, those that remain core holdings, and those we're keeping on watch. First, we've sold our positions in insurers **Aviva** and **Sampo** as part of a rebalancing of our financial exposure and reduction in our big overweight in life assurance. We also sold paper and packaging business **Smurfit Kappa** on news of its merger with WestRock — big deals make us very queasy. We've been burnt in the past when combinations prove very difficult and distracting. Secondly, while disappointed with their performance, we still see **NatWest**, **Close Brothers**, **AstraZeneca**, **Unilever** and **WPP** as core holdings.

But tobacco stocks BAT and Altria are causing us bigger headaches. The arguments about the merits of these shares are complicated and we can only touch the surface here. Some people will not like us owning the sector. The shares are very cheap, but they're cheap for a reason. Having benefited from a value rally in the first half of 2022, they were hammered in 2023. The traditional business remains in slow decline, while new technologies and products are heavily regulated and competitive. On the other hand, they throw off a lot of cash, the dividends are safe and they should also buy back a lot of their own shares in acts of gluttonous self-cannibalisation, such is the value. If equity markets are less robust in 2024, with the narrative around falling rates one of a response to weakening economics rather than successful inflation mitigation, and there is a persistent rotation back into defensives, then they could recover well. But they have, nonetheless, disappointed.

Outlook

Let us make two simple assumptions. The UK market is cheap, but it's likely to remain so without a catalyst for change. The UK economy is dragging its feet, and while it is perhaps not the disaster that many had forecast, future economic growth is widely expected to remain dull. But truth be told, we could have expressed these sentiments at any time over the last two or three years, so very little has changed in the general bad vibe surrounding UK plc. And yet, over the last three years your fund is up 29.8%, the FTSE All Share Index is up 28.1% and the Income sector is up 24.6%. By contrast, the IA Global sector average has lagged, up just 17.9%, and woe betide you if you didn't own a full weighting in a narrow cohort of mega-stocks.

These arguments should not deflect attention from the outstanding challenges to be faced in 2024, a year which one journalist has described as "Democracy's Superbowl". More than 40 countries, representing in excess of 40% of the world's population, are expected to hold national elections this year. The geopolitical landscape will evolve rapidly, with significant implications for domestic policies, global economics and international relations. The US presidential election will be pivotal. Throw France, Germany and India — and large municipal elections in Brazil and the Tokyo supercity mayoral race — into this heady mix and there are huge ramifications for the global political landscape.

Of course, we will likely have our own general election here in the UK. The announcement of an early Spring Budget in March suggests two things: the possibility of an early polling date in May, an idea subsequently played down by Prime Minister Rishi Sunak, and tax sweeteners to enthuse a largely disaffected electorate. What we can predict with some certainty is a deluge of policy discussion, most of which, while masquerading as strategy, will be short-term electioneering. However, the big positive is that the narrative on both sides of the political spectrum seems to be crystallising around two key areas, each crucial to economic and national recovery.

The first is planning reform. A bold revamp of our painfully slow and bureaucratic planning system would benefit not just the housing sector, but industry as well. The failure to build in its broadest sense impacts society, individual wealth, any notion of "levelling up", investment and growth. Bold policy is necessary, whoever is in power, and debate on what it should look like has begun.

The planning conundrum is just a piece of the second key challenge, one that's much harder to resolve. Successive governments over many decades have tried and failed to get to grips with under-investment in this country. However, there does seem to be a greater understanding today of the absolute need to deal with this challenge. One idea gaining traction is the comprehension that pension funds are a real potential source of long-term domestic capital. The shareholder lists of too many UK businesses are dominated by passive and international institutions that have no interest in investment and growth, only in maximising cash returns. In response, think-tanks like the Resolution Foundation

are proposing plans to amalgamate smaller defined benefit, defined contribution and local authority pension schemes into far larger pension funds that are incentivised to invest back into the UK through domestic share ownership. These ideas are proving attractive to both major parties.

Furthermore, amid all the stale, but understandable, talk of doom and gloom, there seems also to be a willingness to at least trumpet the things we are good at. The *Financial Times* listed them in one of its more optimistic op-eds at the start of the year: comparative advantages in financial and professional services; world class universities; London still the largest hub for start-ups in Europe; and specialisms in life-sciences, advanced manufacturing, renewable technologies and offshore wind. And policy is starting to move in the right direction: full expensing of capital investment, made permanent in the Autumn Statement, makes the UK's regime the most attractive in the OECD.

True to form, we must start the New Year with a clarion call for UK markets. The point is that we're at last starting to talk about what can be done, and we can keep our fingers crossed that change (or at least the hint of change) does seem to be afoot. Investors want a catalyst, but there is no magic wand, and this will all take a long time. But we hope there is a renewed will to change, and the UK market is cheap enough to reward us for our patience. Investment means playing the long game: this will be a long game.

Recent Trading: There were no trades in the fund in December.

CARL STICK
Fund Manager

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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.

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.

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