RATHBONES

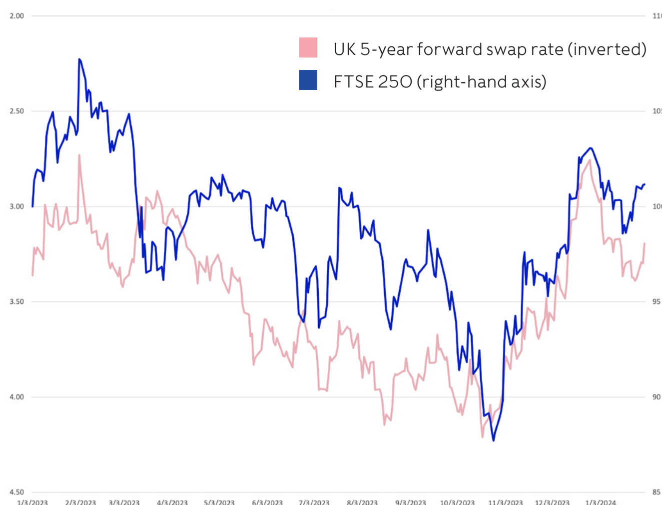
RATHBONE UK OPPORTUNITIES FUND

MONTHLY UPDATE JANUARY 2024

Following the punchy year-end rally, equities were more low key in January as investors once again readjusted their interest rate expectations. Therefore, rates remain the major driver of share prices.

Indeed, the FTSE 250 mid-cap index has become incredibly inversely correlated to the five-year forward swap curve. In plain English, that means mid-cap stocks rise when the average interest rate expected over the coming five years drops, and they fall when that rate rises. While we can't predict the path of rates, we do think the direction of travel is definitively downward, which offers broad support to our asset class.

EXPECTED CHANGES TO INTEREST RATES GREATLY INFLUENCING FTSE 250



Source: Bank of England, FactSet, Rathbones

We had one standout poor performer in January, while elsewhere our holdings reported solid results and shares were generally rewarded. UK-based clothing retailer **JD Sports** faced a nasty reality check when it admitted being overstocked with the overpriced £120 Nike Tech Fleece. Autumn was too warm and the price too high, so more discounts were needed to shift stock. Investors took this badly, as JD had been outperforming its competitors, particularly in North America where it's on a growth drive. This FTSE 100 name fell 30% over the period and now trades on 8.5 times next year's forecast profits. Retailers typically trough at 10x.

Sneaker seller stumbles

JD's key differentiator is that half its products are exclusive to it, but that still leaves the other half of sales vulnerable to needing to join the fray of discounting – or face not selling at all. We see this issue as largely a one-off, and largely outside its control. But it's reminded us why we are usually wary of retail businesses, or companies whose revenues and profit margins are so dependent on another company's (in this case, Nike's) pricing decisions. Interestingly, some of the high-end retailers, like Burberry and Watches of Switzerland, have issued big profits warnings blamed on weak Christmas trading, while those that target more cost-conscious consumers (think Next) are having a better time of it. We don't own any of these stocks.

JD alone explains all of your fund's slight underperformance in January. This took the shine off what was actually a very good month for the portfolio. For example, our tech holdings have joined in somewhat with the Magnificent Seven rally (the giant tech companies at the top of the US stock market index). Our AI play (but make it UK) **Bytes Technology** had another storming month. We are watching the multiples carefully in this space. **Team17**, the indie video game developer, bounced nearly 50% this month, recovering a great deal of ground it lost late last year. Management has been buying shares, perhaps that was sufficient to drive this move. One of our new tech holdings, San Francisco-based yet AIM-listed mobile payments provider **Boku**, issued superb numbers. Its newest division, 'local payments methods' posted 153% revenue growth. This venture helps businesses sell to customers using the countless new mobile-based, digital payment services that have popped up all over the world as alternatives to credit and debit cards. These payment methods, like PayPal and AliPay, are hyper-local to nations and regions and are a bigger market than bank cards.

Low values fuels growing enthusiasm about UK stocks

We've been trimming some of our larger more cyclical positions this month to retain portfolio balance and diversification. Looking at our benchmark, the FTSE All-Share, 40% is made up of the 10 largest stocks. We own only one of these (alcoholic drinks giant **Diageo**), because the rest currently do not fit our process. Our fund is much less concentrated in its largest holdings than the benchmark, which we like, but this can cause marked under- or out-performance over time.
Since the beginning of the year, we have detected a growing trend of positivity toward UK equity allocations. Sell-side firms, the big names who rarely need to stray beyond the halo of the Magnificent Seven, have begun assessing the opportunity in UK markets. Their view is that the combination of low starting valuations (the price-earnings ratio of the FTSE All-Share is around half that of the S&P 500) and current outlook for inflation and interest rates are suggestive of strong forward returns. As it becomes clearer that the UK is no longer an economic outlier, and in fact pulls away from the sogginess of the Eurozone, and we cycle through a pretty humdrum election, this country can start to regain its standing among global allocators.

Data tells us the speed of UK equity outflows is already starting to decline. We observe an interesting pattern whereby our holdings perform better during afternoon trading hours. As UK equity managers, we've been talking about this story for a while now. Now, it seems others are starting to agree.

ALEXANDRA JACKSON
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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