Rathbone Unit Trust Management

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Rathbones
Look forward

Rathbone UK Opportunities Fund

Quarterly update September 2023

The third quarter started with much promise for UK equities, thanks to a lower-than-expected inflation print back in July and a rebound in UK GDP data in August. The Bank of England has likely ended its rate hiking cycle. But September brought a sizeable pullback that left few places to hide, weighing on equities across geographies, sectors, sizes and styles. So what happened?

	3 months	6 months	1 year	3 years	5 years
Rathbone UK Opportunities Fund	-2.6%	-3.3%	13.5%	0.2%	-7.4%
IA UK All Companies Sector	0.9%	0.2%	12.8%	26.4%	10.2%
FTSE All-Share Index	1.9%	1.4%	13.8%	39.8%	19.7%

	30 Sep 22-30 Sep 23	30 Sep 21-30 Sep 22	30 Sep 20-30 Sep 21	30 Sep 19-30 Sep 20	30 Sep 18-30 Sep 19
Rathbone UK Opportunities Fund	13.5%	-35.7%	37.2%	3.7%	-10.9%
IA UK All Companies Sector	12.8%	-15.3%	32.4%	-12.8%	0.0%
FTSE All-Share Index	13.8%	-4.0%	27.9%	-16.6%	2.7%

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

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

Bond rout is spooking equity markets

The answer, of course, is the bond market, where Halloween came way too early. Bond yields (which run in the opposite direction to prices) continued to march higher. In the UK, the 10-year gilt is just *ahead* of where it spiked during the Truss mini-budget debacle. Investors are attempting to price in central bank instructions that rates will have to stay high for longer, even if they don't go higher from here. This has led to the yield curve starting to 'un-invert' (this means the spread between long-dated bond yields and shorter-dated bond yields is becoming less negative). The biggest spike came at the long end (reflecting 'high for longer'), while short-term rates have proved more anchored (reflecting rates not going up anymore).

While economists tell us that an inverted yield curve is a great predictor of recessions, it's actually when the curve starts to steepen like this that signals it's time to get more defensive. Corporates start to feel the pressure of higher interest costs (generally struck at the long end these days), while they're earning less on their cash positions (generally subject to the short end). This can start to weigh on earnings, and then on hiring/investment decisions, thus causing a generalised economic slowdown. Equity investors' best defence against this is usually to focus on quality factors such as low leverage levels and high profitability. In this fund, almost 40% of our holdings have net cash on their balance sheets. Not that this has protected performance enough so far.

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.

August and September have cancelled out July's sprint ahead, leaving us behind our benchmark and peers for the year so far. While the FTSE 100 is up 5.5% this year, the FTSE 250 is now down half a percent and AIM has dropped 11.4%, thanks to concerns over tax relief status. All headwinds given the asset allocation of this fund.

The other unhelpful dynamic was the sudden advance in the oil price (even ahead of early October's shocking events in the Middle East). The fund owns no oil majors; our exposure is in the energy services space, which is less directly correlated to the oil price. So we lag behind when oil is moving higher. Generally, being underweight large cap was a hindrance — sterling weakness boosts the large dollar earners listed in the UK. But the large cap positions we do own performed nicely, notably defensives such as **Tesco** and **Rightmove**, as well as building materials supplier **CRH** with its additional US listing.

Our biggest stock-specific drags were from some of our industrial names (**discoverIE**, **Oxford Instruments** and **Halma**), where generalised concerns around how fast new orders will arrive have damaged sentiment. The fact that the three major geographic regions have decoupled is clouding the outlook too: China's recovery has been very sub-par and stimulus isn't having the desired effect so far, while Europe bumps along the bottom and the US is still riding high, though forward-looking indicators are pointing sharply down. We've been trimming some of these industrial names to reduce our exposure while visibility is so poor.

Positive performance came from our infrastructure-exposed stocks that we have mentioned a lot of late! **Breedon**, a provider of cement and aggregates in building projects in the UK and Ireland, moved into the FTSE 250 during the quarter, which boosted buying interest. **Hill & Smith** largely faces into the swathe of US infrastructure spending and continues to trade extremely well. Our newest holding, **Ergomed**, a provider of clinical trials for drug development companies, was actually bid for during the month, rising 33% over the period. We were hoping a rival bidder might emerge to push the price a little higher, but the way management has structured the deal makes this a bit tricky. Once again, we are left feeling a little short-changed by swift acceptance of average bid prices for trophy assets trading on UK exchanges.

Cash in the fund remains at an elevated level as we trade through a seasonally weak period. The terrible situation in the Middle East could add to volatility. Our portfolio of high-quality UK companies is well placed to weather difficult times, but undoubtedly is suffering from the 'doom loop' that has engulfed UK markets. We welcome the myriad suggestions put forward so far aimed at reinvigorating equity culture in this country via simplified regulation and clearer tax treatment. There are plenty of gems to invest in here. The main problem is the lack of appetite, not the lack of opportunity.

Alexandra Jackson
Fund Manager

Rathbone UK Opportunities Fund

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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