Rathbone Unit Trust Management

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Rathbones
Look forward

Rathbone Multi-Asset Enhanced Growth Portfolio

Monthly update October 2023

Autumn is often a tough time for stock markets. The weather has turned pants, the days are shorter, the light fades and people's moods along with it. When all the technology, valuation measures and retrospective rationalisations are stripped away, the stock market is nothing but a barometer for the optimism and caution that battle themselves out in the minds of millions of investors. This year October was tough indeed.

While little, really, has changed in the big issues of the day – the paths of inflation, GDP growth and interest rates – the mood of investors definitely darkened. And it seems more for human reasons than cold, hard financial logic. There's comfort in that. It has seemed an especially dark couple of months, where every week brought another storm, where terrorism, war and worry have dominated our screens. There's solace in shared experience – in seeing humanity in even the most impersonal devices we've created.

Adding to beaten-up companies

Global stocks dropped about 2% over the month and almost 4% over the three months to 31 October – in sterling terms at least. A roughly 5% jump in the value of the dollar against its main trading partners actually cushioned losses for most foreign investors: in dollar terms, global stocks fell 9% in the past three months.

We used the weakness to add to some of our stocks that we felt have been unfairly punished for short-term dynamics. These included medical technology businesses **Dexcom**, **Abbott Laboratories**, **Smith & Nephew** and **Thermo Fisher Scientific**, which were hit hard by new weight loss drugs, and household retail brands **Estée Lauder**, **Coca-Cola** and **McDonald's**. We added to pest control company Rentokil Initial after it was sold aggressively because of a cautious outlook about the coming year and a slight decrease in expected 2023 profits.

We sold US logistics and warehouse supplier **Zebra Technologies** because we wanted to reduce our investments in industrial areas of the economy. We think that a mild recession is very possible in the coming year or so and Zebra, which supplies RFID gadgets and inventory management software to consumer-facing businesses, could be vulnerable.

In October we bought **Zoetis**, a pet and livestock health business based in New Jersey, US. The company has been in the game since the 1950s and has diversified into many different areas, including drench and medicines for preventing parasites, vaccines against common diseases, skin ointments, diagnostics and others. Zoetis has strong and reliable profits that generate a lot of cash, which is something that we prize in investments. If a business makes a lot of profits – and sees them quickly in cashflows as opposed to accounts receivable debts with customers – it has options and the flexibility to take advantage of opportunities that arise. It also has the tools and resources to deal with threats before they become a fatal spiral.

We added a significant amount to our holding of Japanese electronics and media powerhouse **Sony** this month. The business is a posterchild for the improvements in Japanese companies since the late Shinzo Abe's Three Arrows reforms of the mid-2010s. Sony is much more streamlined and focused on its strengths, while more attentive to shareholder returns and ensuring it's investing its money effectively. We took profits from internet search giant **Alphabet**, design software developer **Cadence Design Systems** and oil major **Shell**.

The mechanism for the sharp drop in stocks and the rise in the dollar was the same: a substantial rise in the prevailing yield of US Treasury bonds. Three months ago, a 10-year US Treasury bond yielded below 4%; in October the yield breached 5.0% and ended the month at 4.9%. And, of course, a rise in a bond's yield means its price must drop alongside, so bond markets dipped in value as well. Because the interest rate you get from investing in American bonds became more attractive, more investors sell other nations' assets – and their currencies – and buy dollars and US investments. As with anything, selling pressure pushes a currency lower, while buying demand makes it stronger. And so you get the ascendant dollar.

Why did bond yields suddenly rise? After a summer of growing confidence that the US central bank was going to pull off the mythical 'soft landing' – reining inflation in to the 2% target without causing a recession – many investors reconsidered their conviction. In October, after a few months of higher inflation in the US and a quarter of particularly strong GDP growth, people were spooked by the thought that the US Federal Reserve (Fed) may yet hike rates significantly more. The Fed itself actually dismissed the idea. It has kept open the option of one more 25-basis-point increase, but it has been pretty clear that it plans to wait and assess the effects of the medicine it has already administered to the economy. Regardless, bond investors ratchetted yields (borrowing costs, in English) higher in lieu of the Fed.

We're on the side of the Fed here. We think the already large uplift in the central bank's short-term benchmark rates has yet to be truly felt by households and businesses. But it is having an effect that is increasing with each passing month as debts roll over to higher interest rates, as businesses reassess the viability of projects now that financing is substantially more expensive, as people find less money left after the monthly bills. We think interest rates have now peaked – and if not, that only one more hike is on the cards.

Volatility is here to stay

Since month-end, bond investors have done an about-face: in the first fortnight of November the 10-year US Treasury bond yield slumped about 0.35bps to roughly 4.6%. This whiplash-inducing, post-month-end change in narrative sent share prices higher in early November too. The jittery, pessimistic sort of market mood in October made for a thorny set of quarterly company results. Companies that disappoint, even slightly – even only on throwaway comments about the outlook that no-one can predict – have been absolutely hammered by sellers. Businesses that deliver have been rewarded only modestly. Except for those that had already been completely written off by investors, which have bounced quite high indeed.

We expect this sort of jerky volatility – both up and down – to continue for the foreseeable future. As the year has worn on, geopolitical risks have remained in the forefront. The awful events in the Middle East appear unlikely to stop anytime soon. The financial effects pale in comparison to the human suffering, yet we do need to keep an eye on how worsening geopolitics could affect our portfolios. That mechanism will be through the oil price and the global price of energy. While Israel and Palestine don't have any meaningful oil industries, yet Iran and its neighbours do. For now, the oil price has stayed relatively calm, yet if the conflict spreads beyond Israel and the Palestinian territories the oil price could rise to account for sanctions, the threat of reduced production or disruption to supplies running through the neighbouring Strait of Hormuz.

There is continuing tension between the US and China over digital technology and AI, which has the capacity to fissure the intricate supply chains between East and West that helped deliver cheaper, better goods for global consumers over the past few decades. All sorts from cars and fridges to computer chips and clothing is manufactured in China or in its orbit using innovative designs, high-end manufacturing equipment and intellectual property delivered by Western nations. It's in the interests of both sides to continue – it keeps goods prices low and creates jobs for China. However, the leadership of both sides have seen it politically expedient to be bellicose about trade in recent years.

Added to this strain between East and West is the ongoing war in Ukraine. Russian oil and gas is flowing at a discount through emerging markets which are then using it or selling it on to Western nations that aren't allowed to buy it directly because of sanctions. This is creating a shadow market for oil and gas that's operating outside the sphere of developed markets. The ramifications of this are yet to be truly known, but as the Ukraine war has ground into what's looking like a long stalemate, these divisions in commodity markets may become entrenched.

There's a lot going on in today's world, both in public view and away from the headlines. We're trying to ensure we're keeping tabs on all risks – not just the ones, like interest rates and inflation, that everyone is currently fixated on.

David Coombs
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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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