RATHBONES

RATHBONE MULTI-ASSET PORTFOLIOS

STRATEGIC INCOME FUND

Quarterly investment update
October to end December 2024

CONTENTS

HOT TOPICS

MARKETS HOT TOPICS (MACROECONOMIC)

This information reflects our general views and should not be taken as a recommendation or advice as to how a specific market is likely to perform.

COMING UP TRUMP

Donald Trump's electoral win triggered a surge in American stocks, bonds and the currency as investors bought into the prospect for lower taxes, lessened regulation and a pro-growth agenda. This moderated somewhat in the final days of the year, likely because of people cashing in profits after another year of 25% gains in US stocks, but also as inflation concerns rose to the fore once again and government bond yields rebounded sharply.

There's a risk that Trump's touted policies (big tariffs on trade, big tax cuts for households and businesses, and a clampdown on both legal and illegal immigration) will send inflation higher. However, we think people are putting too much weight on these areas and ignoring his ambitions on slashing government spending. Trump often talks big at the outset, only to negotiate a compromise at the end. To that end, some of the tariffs may be much smaller or not happen at all. Similarly, tax cuts may not be as large as some hope. But if he and "First Buddy" Elon Musk's Department of Government Efficiency manage to slash a significant amount of federal spending, the tax-cuts' net effect on inflation may be negligible.

We're particularly impressed with nomination of billionaire hedge fund CEO and one-time Democrat Scott Bessent as Treasury Secretary (the job currently held by former US Federal Reserve Chair Janet Yellen). He's eminently qualified for the top finance job and many investors see him as a restraining force for the administration, one that could smooth the sharp edges of other members. Bessent has spoken of a "3-3-3" strategy: halving the federal budget deficit to 3% of GDP by 2028, growing the economy by 3% a year through deregulation and privatisation, and increasing US oil production by 3 million barrels a day.

Hitting these targets could be a tough ask, but the strategy seems positive for the US economy: a focus on growth, tighter finances, less bureaucracy, more private enterprise and cheaper energy. We think US inflation is likely to remain in its current band: between 2% and 3%. Not quite low enough for the central bank to claim victory and not high enough to cause serious panic. Just constant low-level anxiety throughout the year. But that would leave room for the Fed to cut rates.

We think this sort of situation should allow a broadening of American stock market performance beyond the handful of massive technology companies at the top of the index. Solid economic growth, steadily falling rates and a reduction in regulation should boost smaller US companies as well.

The US "3-3-3" strategy Government spending cut to 3% of GDP GDP Growth of 3% a year Increase US oil production by 3 million barrels a day.

BOND YIELDS

Right now, however, bond investors around the world are definitely rattled. After a short-lived and aggressive drop for most major government bond yields in November, a swift reversal sent prices lower and yields rocketing again. The concerns appear to centre on the spendthrift ways of most advanced nation governments, but particularly the US, which is the bellwether bond market. The rampant American economy, which continues to outdo forecasts, and stickier inflation of late, also haven't been good for bondholders' nerves.

The US and UK 10-year yields were 4.6% by the end of the year, up roughly a full percentage point from their recent lows. Even Germany, which shares none of its peers' fiscal imprudence, has suffered a substantial rise in its bond yields.

US 10-YEAR TREASURY YIELD SETS THE TREND FOR ALL

Source: FactSet; data to 10 January

The big question for 2025 is the same as it was in 2024: how much will central banks be able to cut interest rates in the face of strong economic growth in the US and stubborn inflation virtually everywhere? As 2025 dawns, the prevailing answer is just one quarter-percentage-point reduction by July – if that.

As Trump's inauguration has approached, hopes have steadily faded for cuts to the Fed's overnight interest rate. One thing to note is that this isn't a new thing: yields were very volatile for all of 2024 as expectations for rate cuts have ebbed and flowed. They surged higher in the first half of the year on concerns that the Fed's rate-cut plans would be upended by strong economic growth and rising inflation. They then sunk back significantly when the panic subsided. Sound familiar?

BRITISH EXCEPTIONALISM

The UK wasn't the only country to suffer a bond market sell-off in the past few months, but it was by far the hardest hit. Very long-dated 30-year government bonds jumped to heights not seen since the 1990s. The increased borrowing costs across all maturities may have vaporised the headroom between what the government expects to receive in taxes and how much it will spend. Yield spikes have caused angst about UK government finances several times over the past five years, only for the problem to melt away when panic and yields subsided.

If US central bank interest rates fall back, as most investors expect, then you would expect UK yields to recede with them. Let's hope the same happens this time as well. If not, greater borrowing costs may force the government to tighten policy to meet its fiscal rules. It's got until 26 March when the Office for Budget Responsibility gives its verdict on the rules – bond yields could easily move another half of a percentage point (in either direction!) between now and then.

Yet that's only one of Britain's pressing concerns: the other is a distinct lack of GDP growth. The economy has ebbed relentlessly since Labour took power, hitting 0% in the third quarter. We had been concerned about the increasing chance of a UK recession for some time and now it seems the chorus is growing broader. The major risk, as we see it, is stagnant economic growth and above target inflation and high unemployment. Some may call that stagflation. Inflation climbed back up to 2.6% in November as housing costs, utility bills and prices for package holidays, cinema tickets and pets all rose. The December figure, released after year-end, eased to 2.5%. Most helpful, however, was that it showed a big drop in services inflation – essentially anything that isn't a physical product. Persistently between 5% and 6%, the problem child is now closer to 4% than it is to 5%. If that trend continues it will help dampen those UK stagflation fears.

If inflation does remain above target despite an economic contraction, it would make it extremely difficult for the Bank of England to cut interest rates in support of the economy, because that would worsen inflation. It would also send government bond prices lower (so yields higher) because higher inflation would mean investors demanding a greater return to offset that reduction in the value of their coupons. This would make it even harder for the already cash-strapped government to boost the ailing economy too.

6%

The percentage of GDP that US government is spending more than it receives in taxes.

5.35%

The 30-year UK government bond yield is at its highest since July 1998.

PORTFOLIO ACTIVITY

Key purchases/additions
New Zealand Govt 4.5% 05/15/2030 (purchase)
UK Gilt 4.25% 07/31/2034 (purchase)
UK Gilt 3.75% 07/22/2052 (addition)
AstraZeneca (purchase)
Intermediate Capital Group (purchase)

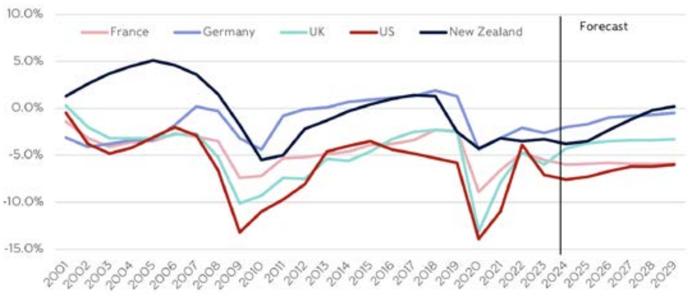
Key sales/trims
SPDR S&P 500 ETF (sale)
UK Gilt 3.25% 01/31/2033 (trim)
Ocado Group 3.875% 10/08/2026 (sale)
Accenture (trim)
Morgan Stanley (trim)

Source: Rathbones

Given investors' concerns about the large government deficits being run in the US and UK, early in the quarter we decided it was prudent to spread our government bond exposure a bit further afield. We looked for nations that have a better handle on their finances. Early in the quarter we swapped our UK Treasury 3.25% 2033 bonds for the New Zealand Government 4.5% 2030. We felt it was a good yield and the country is making strong strides to reduce its public spending deficit (as you can see from the chart). We also locked in the sterling value of our Kiwi and European bonds at October's exchange rate by 'hedging' the currency. This means that we won't suffer losses if the pound rises further against those currencies. The flipside of this hedge is that we won't make money if the opposite happens.

SPENDTHRIFT GOVERNMENTS ARE BECOMING MORE OF A RISK, BUT SOME BUCK THE TREND

Government deficit/surplus as percentage of GDP



Source: IMF; data is general government net lending/borrowing and doesn't include Trump policies

Following the UK Budget, which pushed yields higher, we added back to our UK Treasury 3.25% 2033 bonds. As yields continued to rise in the last couple of months, we bought the 4.25% 2034 and 3.75% 2052 as well.

We added several new companies to our portfolio over the quarter. The first was UK pharmaceutical AstraZeneca. The share price was beaten down by fears that its sales in China could slow, in part impacted by allegations of corruption in its Chinese division, but we think the impact of this is overdone. China accounts for about 13% of Astra's sales; its biggest market is actually the US, where it makes and researches drugs in 17 sites across several states. Astra is a truly global operator, with 28 manufacturing sites in 16 countries, so it should also be sheltered from Trump's tariffs.

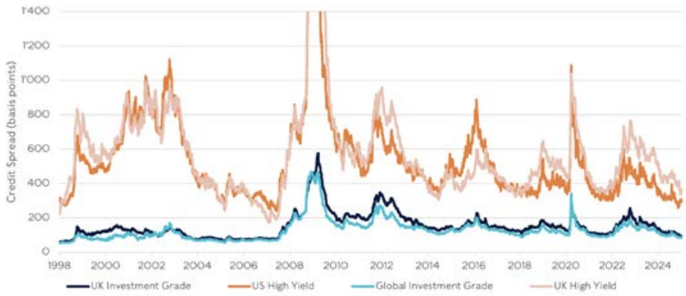
Another quality UK-listed global business that we added this quarter was Unilever. This business owns household brands that sell for a premium the world over. Well diversified in products, with ice cream, shampoo, cleaning products and food, it's also well diversified across the Americas, Europe and emerging markets. The business is partway through a push to streamline its product range, focusing its efforts to increase its profitability.

We got into private equity as well, although we decided it was better to buy the PE operator itself, rather than invest in one of their funds. Private equity funds are expensive! So where the opportunity exists to take a cut of those fees, along with investing alongside the fundholders, we thought it made sense. The company we chose was KKR & Co, which has a strong pedigree and is one of the largest listed PE firms. Private equity is another area that should benefit from a pro-business US administration and lower interest rates: it makes it easier for high-cashflow businesses to pull off lucrative leveraged buyouts and it increases the value of exits from successful start-ups. While best known for private equity, KKR actually has a much broader business, including insurance, infrastructure funding and capital markets work.

In November, after Trump's election win, we used the market strength to take some profits from US investment bank Morgan Stanley and digital-focused consultancy Accenture.

Finally, we sold our Ocado Group 3.845% 2026 corporate bonds. Optimism about the future and little concern that defaults may rise has left global corporate credit spreads at multi-decade lows. You can see from the chart that these spreads, or extra return above government bonds to compensate for the risk of default, are extremely low. Unlike stock prices, which theoretically can go as high as shareholders are willing to pay, bond prices have a ceiling. That's because there comes a point where you will be getting the same yield from a company as you do from a safe-haven nation. We're not at the ceiling yet, but we're very close, so we took the opportunity to sell.

CORPORATE BOND SPREADS ARE EXTREMELY LOW



Source: FactSet; data 1 Jan 1998 to 10 Jan 2024; US High Yield peaks at 2,147bps on 15 Dec 2008, UK HY peaks at 2,585 on 1 Apr 2009

SPOTLIGHT

IN THIS QUARTER, THE SPOTLIGHT IS ON OUR INTERMEDIATE CAPITAL GROUP AND UNILEVER HOLDINGS.

INTERMEDIATE CAPITAL GROUP

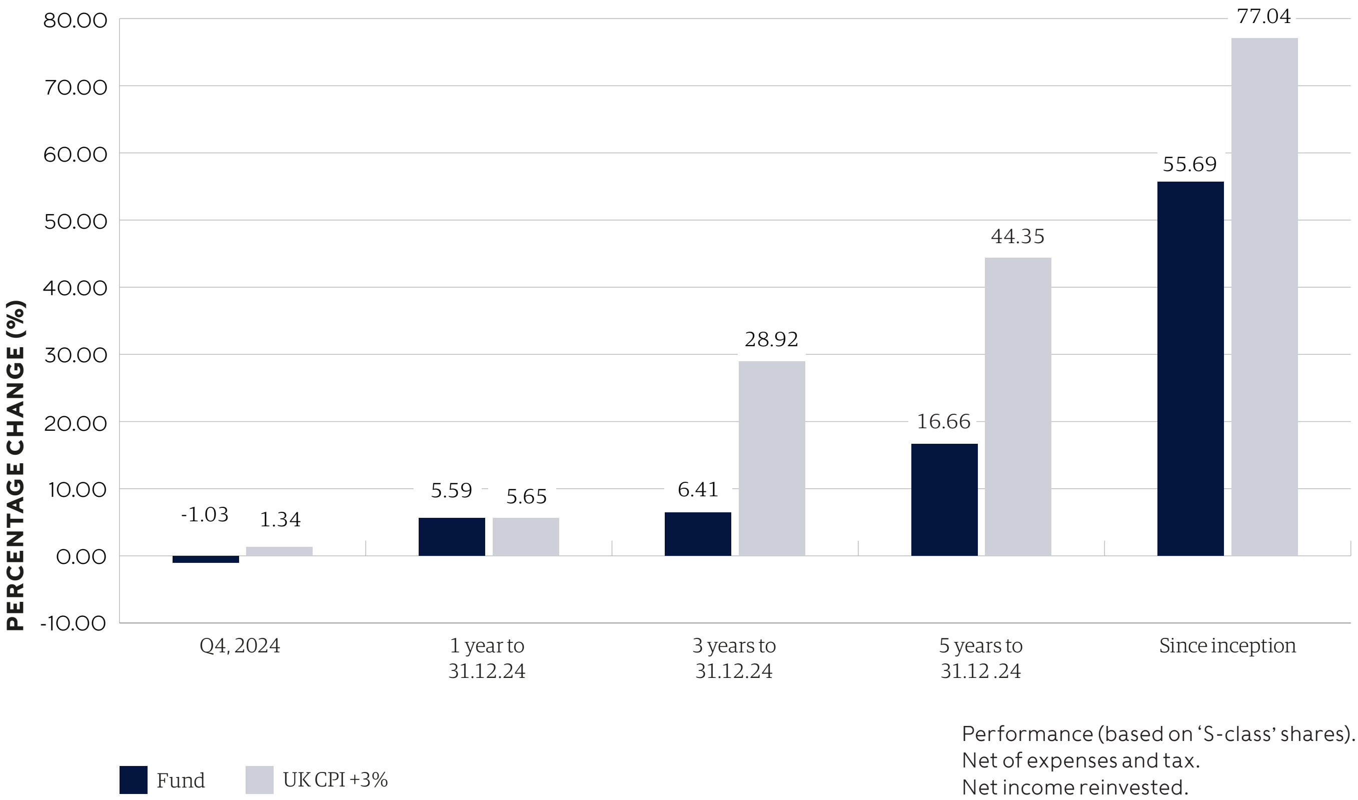
- ICG is an alternative asset manager, helping businesses secure funding and providing investment opportunities for investors
- They have carved out a niche in the market by offering customized and flexible solutions, tailored to each individual customers' needs
- It has a diversified portfolio of solutions, with strategies across four different asset classes – private equity, private debt, real assets, and credit
- Whilst most of their clients are based in Europe, their global presence is growing, and they serve a diverse range of clients including pension funds, insurance companies, asset managers and institutional investors. This growth will be further supported by the planned increase in marketing investment
- Over 90% of ICG's assets under management come from long-term, closed-end funds, ensuring steady and predictable fee income
- Growth opportunities include launching new versions of their successful flagship strategies and expanding newer ones. With a broad range of offerings, the focus is now on scaling up to achieve higher profitability

UNILEVER

- Largest global producer of household and personal products such as laundry detergents and deodorant, offering well-known iconic brands such as Dove, Hellmann's, Persil, and Vaseline
- Unilever has a well-diversified product-mix as well as geographic exposure, which includes a growing presence in emerging markets
- It is in the early stages of implementing a multi-year turnaround to unlock the growth potential of its portfolio, with the recently appointed new CEO well positioned to drive this change, bringing extensive experience in the consumer goods industry and a fresh perspective
- The business has undergone a reorganization to simplify and refocus the portfolio, with the opportunity to boost growth through more effective brand management. One example of this is the decision to sell its Ice Cream segment
- The stock has a defensive element to it, alongside predictable cashflow generation and an attractive return on capital

The specific securities identified and described do not represent all of the securities purchased, sold, or recommended for the portfolio, and no assumptions should be made that the securities identified and discussed were or will be profitable.

FUND PERFORMANCE



Performance (based on 'S-class' shares).
Net of expenses and tax.
Net income reinvested.
Data source: FE fundinfo

12-month rolling performance					
Year to:	**End Dec 2024**	**End Dec 2023**	**End Dec 2022**	**End Dec 2021**	**End Dec 2020**
Fund	+5.59%	+7.27%	-6.05%	+8.67%	+0.90%
UK CPI +3%	+5.65%	+7.06%	+13.97%	+8.30%	+3.39%
Annual calendar performance					
Calendar year	**2024**	**2023**	**2022**	**2021**	**2020**
Fund	+5.59%	+7.27%	-6.05%	+8.67%	+0.90%
UK CPI +3%	+5.65%	+7.06%	+13.97%	+8.30%	+3.39%

Price performance based upon bid to bid prior to 21 January 2019 and single price (mid) thereafter.
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 your original investment.

Top performers (%)		
Holding	**Performance**	**Contribution**
Morgan Stanley	+30.06	+0.29
Amazon	+26.11	+0.10
Visa	+23.34	+0.18
Alphabet	+22.12	+0.16
TSMC	+22.06	+0.12

Bottom performers (%)		
Holding	**Performance**	**Contribution**
Estée Lauder	-19.09	-0.09
Novonesis	-16.01	-0.09
Renewables Infrastructure Group (TRIG)	-15.92	-0.11
SSE	-14.63	-0.16
Ashtead	-14.19	-0.10

Note: Top and bottom performers are taken from the list of all holdings of 0.25% and above of the portfolio. Performance and contribution data shown above is based on unhedged GBP capital returns.

Source: Rathbones

In contrast to the third quarter, government bonds held back our returns in the final quarter of the year as yields in the US, Europe and UK surged. While the US Federal Reserve (Fed) cut its benchmark interest rate by a quarter of a percentage point to the range of 4.25-4.50% in December as expected, investors felt a mood change. The Fed's rate-setting committee signalled it expects to make just over half a percentage point of cuts in 2025; in September it thought it would make almost double that. If benchmark rates remain higher for longer, it reduces the value of bonds because their fixed returns become less attractive compared with cash in the bank that can be withdrawn at any time. We think government bonds offer an attractive yield along with providing portfolio insurance should stock markets and economic growth falter, so we added to them on weakness.

Here in the UK, government bond yields rose markedly before and after the October Budget, partly in sympathy with US bonds and partly because investors took the announcements poorly. In particular, the government's decision to issue more gilts than expected sent prices lower (and therefore pushed yields higher). We think the risk of a British recession has risen, which makes bonds a more attractive prospect, especially given yields are back near multi-decade highs. We bought and sold throughout the quarter as yields fluctuated, ending up with a slightly larger holding than when Q4 started.

A number of our companies reported strong results during quarter and rallied into the end of the year. These included American lender and investment bank Morgan Stanley, search giant Alphabet and e-commerce titan Amazon. It wasn't just American names either, with good performance coming from computer chip manufacturer Taiwan Semiconductor Manufacturing Company and Singaporean bank DBS Group.

A key detractor from our performance was US-listed cosmetics company Estée Lauder. Investors were already very negative on the company due to slowing Chinese economic growth (about a quarter of the business's sales are made there). Tepid results and cautious forecasts for 2025 sales drove a further sell-off. We think they — along with other names in our portfolio which have exposure to China — should benefit from a stabilisation in Chinese markets. While this may not be imminent, we now feel valuations have overly discounted this weakness. It's interesting to note that mainland-listed Chinese stocks posted the third-highest return of any major stock market in 2024 (behind the US and Japan) after a huge rally in the fourth quarter. Perhaps suggesting that the locals are more optimistic.

Our Diversifiers did a useful job for us in the quarter. These are investments whose prices tend to move very differently to stock markets yet are less easily traded than government and very high-quality corporate bonds (what we call Liquidity assets). One of these Diversifiers is the Société Générale US Rates Volatility structured product, a contract with an investment bank that benefits from increased price movement in US government bond yields. This perfectly summed up the quarter: big moves in both directions (mostly up). This meant we made good returns on this investment. Another volatility-based structured product that performed well was the JPMorgan 5.13% Dispersion contract which does well when the prices of an underlying basket of American stocks are more volatile than the price of the S&P 500.

ASSET ALLOCATION CHANGES

Asset allocation split	30.09.24	31.12.24	% Change	12 month change
Liquidity (5%-40%)	36.2%	34.8%	-1.4%	1.6%
Equity-type risk (40%-80%)	61.6%	63.0%	1.3%	-1.1%
Diversifiers (0%-40%)	2.1%	2.2%	0.1%	-0.5%

For more information on our liquidity, equity-type risk and diversifiers (LED) risk framework, please consult our investor brochure.

Asset class split	30.09.24	31.12.24	% Change	12 month change
Equities	51.1%	53.1%	2.0%	6.4%
UK	17.7%	19.5%	1.8%	3.4%
US	22.9%	23.0%	0.2%	2.2%
Europe	6.5%	6.3%	-0.2%	-1.4%
Japan	1.5%	1.5%	0.1%	1.5%
Asia ex-Japan	2.6%	2.8%	0.2%	0.7%
Emerging Markets	0.0%	0.0%	0.0%	0.0%
Global	0.0%	0.0%	0.0%	0.0%
Index-linked bonds	0.0%	0.0%	0.0%	0.0%
Conventional government bonds	23.3%	24.8%	1.6%	5.3%
Corporate bonds	13.3%	12.3%	-0.9%	-7.4%
Emerging market debt	0.9%	0.9%	0.0%	-0.8%
Private equity	0.5%	0.5%	0.0%	-0.2%
Alternative investment strategies	2.1%	2.2%	0.1%	-0.5%
Property	0.6%	0.5%	-0.1%	0.0%
Infrastructure	0.6%	0.8%	0.2%	-0.8%
Commodities	0.0%	0.0%	0.0%	0.0%
Cash	7.7%	4.8%	-2.8%	-1.8%

INVESTMENT OUTLOOK

THE US ECONOMY IS STEAMING AHEAD AND THIS SEEMS LIKELY TO CONTINUE INTO 2025, ALTHOUGH IT MAY START TO COOL AS THE YEAR WEARS ON.

The big question is whether inflation will remain low enough for the US central bank to cut its benchmark overnight interest rate by the half percentage point or so that investors want to see by the end of the year (which would take it to 4.0%).

As for everywhere else, the economic situation is far from rosy. This divergence in economic strength has already led to big shifts in currencies: a strong dollar versus virtually all other currencies. One outlier in 2024 was the pound, which actually held its own as investors became sceptical about the Bank of England's ability to cut rates as much as it suggested (see chart). But that strength unravelled quickly in the final quarter and continued in the early days of 2025, as sterling fell along with other big, advanced currencies. Will this dollar strength continue?

STERLING HELD ITS OWN AGAINST THE DOLLAR IN 2024, UNLIKE ITS PEERS

G-10 currencies against the US dollar

Source: FactSet; currencies' exchange rates against the US dollar, indexed to 100 at 31 Dec 2023, data to 10 Jan 2025

The dollar should remain strong if investors continue to assume that US interest rates will stay higher and fall more slowly than other major countries. That's because money tends to flow to places where the rate of return is highest for a given risk. At the moment, the US has a high risk-free rate and the strongest economy with the most opportunities for profits. That attracts cash from around the world, meaning people sell euros, pesos and pounds to buy dollars so they can get in on the action.

For the US, the big risk is that resurgent inflation and an economy that keeps growing at a pace that could be unsustainably fast prevents the Fed from cutting rates at all. Or, even worse, pushes the Fed to resume *increasing* rates. That would likely send the prices of bonds and stocks alike slumping — and not just in America — as investors decide that it's better to sell assets and keep their money in cash. But we are confident that inflation will remain in check without the Fed needing to step in with rate hikes.

If there are any of the commentaries you require further clarification on, then please contact your advisers or Rathbones Asset Management (RAM) at the contact details contained on the RAM website.

WANT TO HEAR MORE FROM THE TEAM

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