RATHBONES

RATHBONE GREENBANK DEFENSIVE GROWTH PORTFOLIO

MONTHLY UPDATE AUGUST 2024

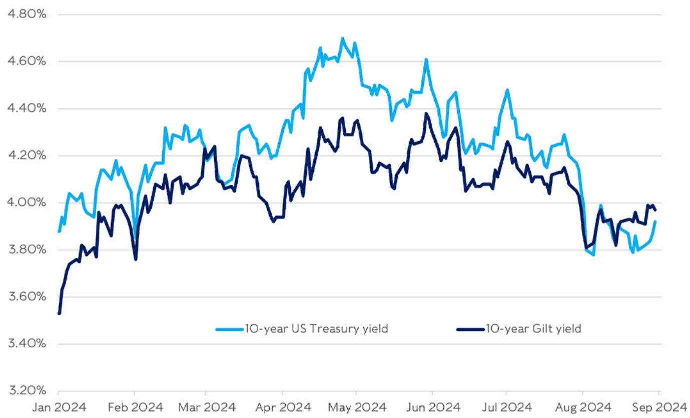
Summer is often a tough period for financial markets because low trading volumes increase the risk of big drawdowns if investors suddenly get spooked. But the stock sell-off in early August was exceptionally ferocious even by summer standards.

Investors had been getting edgy for a while that the US economy might be weakening. Early in the month, a couple of bad economic data releases really played into those fears. In particular, July's labour market report was a lot worse than had been expected, with surprisingly few new jobs added to the US economy and the unemployment rate rising to 4.3%. That increase in unemployment triggered the ominous 'Sahm Rule', unnerving some investors. According to the rule, when the three-month average US employment rate rises by 0.5% or more from its 12-month low a recession is probably under way.

On the first Monday of the month, investors started to panic about the risk of a US recession, sending stocks of all stripes into a tailspin. The biggest equity moves were in Japan, where the central bank had surprised investors by hiking interest rates on 31 July. That triggered the unwinding of massive yen 'carry trades' underpinned by Japan's very low borrowing costs. (For some time, global investors have borrowed money cheaply in yen and then invested it elsewhere to earn a nice easy 'carry'.) The unwinding of these trades as investors everywhere went into 'risk off' mode meant Japanese stocks got hammered and fell by around 15% in the first three trading days of August .The tech-heavy US Nasdaq index dropped by about 8% and the more diversified US S&P 500 by 5%, while UK stocks slipped slightly less. The VIX index, which measures the volatility of US equities and is widely known as the 'fear gauge', had been hovering at around 12 for several months, but briefly spiked to well above 60 at one point (that's as high as it's been since the onset of the COVID-19 pandemic).

While stock markets fell markedly on fears that the US economy would melt down, government bond yields also dropped considerably (meaning their prices rose). We've built up a sizeable holding of government and quasi-government bonds from home and abroad as a hedge against any possible economic deterioration from here.

BONDS HOLD ON TO THEIR GAINS



Source: FactSet, Rathbones

In the event, the stock market sell-off was short-lived. Only a few days after it kicked off, equity markets bounced back on the release of a contradictory jobs report (which showed jobless claims falling) and very positive services sector data. That was soon followed by the news that US inflation had in July dipped below 3% for the first time in more than three years. Evidence that the US economy wasn't about to keel over, alongside heartening inflation data, bolstered investor confidence in a 'soft landing' for the US economy. And that scenario is bullish for stocks. By month-end, many stock markets were back to pushing at all-time highs.

The big question now is whether they can sustain the pretty sizeable gains they've chalked up so far this year. September and October are notoriously tough for equity markets. US election uncertainty is likely to loom large over the next couple of months, while there are plenty of geopolitical tensions simmering away that could suddenly knock investor confidence and trigger bouts of market volatility.

Making the most of volatility

Over the past year or so, we've bought different structured products to boost our diversification. These products are contract-based investments with banks that pay specified returns if certain events happen or market measures hit certain targets. But if the opposite happens, we lose the return and sometimes a portion of our capital. It all depends on the product.

Since we feel that bond markets could prove volatile from here, we adjusted some of these diversifiers in August. We had owned two types of **Société Générale VRR Index (Rates Volatility)** structured product that made money if volatility increased in the US Treasury yield: a vanilla one solely reliant on increased volatility, and another that also made money if the rates trended up or down. While we think US rates will continue to leap around on investor sentiment, there's less clarity about whether the rates will trend downward or upward from here. Therefore we sold the trend-following version and put that money into the vanilla version, so we should make money if rates continue to move erratically and a lot.

The inexorable rise of AI chip designer **Nvidia** is a remarkable success story. As the dominant provider of the chips needed to power AI, it's benefited from massive demand for its products at increasing prices and profit margins. That means the company now accounts for about 6% of the entire S&P 500! And, in turn, this means that it's viewed as a critical market driver, with its results getting as much scrutiny as big macro events like jobs reports. The shares were exceptionally volatile in August. We added to our position early in the month as it sold off aggressively. Nvidia rebounded before tumbling again at month-end when its second-quarter results disappointed. It has since rallied again … We expect this sort of a hectic ride to continue given the hopes and fears baked into this stock. It is, however, a fantastic company for the long run, in our view. It's a normal part of our process to add to stocks on share price weakness and to pare back when we think prices could be getting a bit toppy.

We sold generator manufacturer **Generac** because its valuation had become quite inflated – especially as its profits were already boosted by generator sales on the back of a bad hurricane season. This should subside in the future, so it appears more overvalued that it would seem on first look. Also, we were concerned about the strength of competition in the energy storage market. Technology here is evolving so fast that the risk of your product becoming obsolete is high. Investors expect a decent slug of future profits to come from this area, but we're unsure whether that will come through. Because of these concerns, we decided to exit.

Another sale was enzymes and nutrition laboratory **DSM-Firmenich**, which we had held since the launch of our fund. We used the cash to buy a new tie-up in the same industry that we think is a higher-quality and slightly less cyclical option. Danish-listed **Novonesis** is the product of Chr Hansen and Novozymes, which merged earlier this year. It boasts an almost 50% market share and has clout across myriad industries. This means everything from better animal feed and longer-lasting food to the yeast in bread and beer, enzymes in diagnostic tools and good bacteria in dietary supplements.

Bank of America (BoA) is one of the largest high street lenders in the US, with a huge book of loans helping finance households and businesses improve their lot. This massive reach means it can have a big influence on global emissions by lending more to cleaner businesses and moving away from carbon-intensive operations. When we bought BoA it had a clear strategy to achieve net-zero and offered good jobs to its staff. However, the lender has recently weakened these climate policies and hasn't implemented the cutbacks to fossil fuel financing that it had promised. Given the change in direction, it no longer met our sustainability criteria, so we sold.

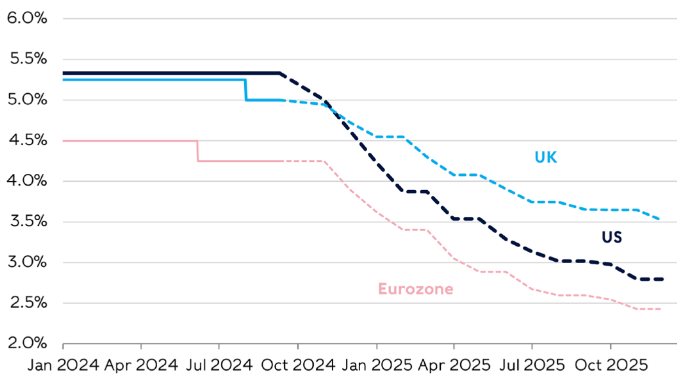
Meanwhile, we added on weakness to diabetes monitoring company **Dexcom**, cosmetics maker **L'Oréal**, vehicle electrification supplier **Aptiv** and customer relationship management software developer **Salesforce**. We trimmed our holding in medical technology business **Smith & Nephew** after its share price gained noticeably.

How far will the Fed go?

The most important factor influencing all markets is the trajectory of US interest rates. The US Federal Reserve (Fed) fired the starting gun on rate cuts with a 50-basis-point move in September.

What may matter more than the size of this first cut is how the Fed follows it up over the rest of this year and into 2025. Before the Fed's conference and update, futures markets were pricing in around nine 25bps of Fed cuts by the middle of next year. That hasn't changed much since the Fed weighed in. That sounds pretty aggressive within the context of the 'soft landing' being priced in by equity markets. We could be in for more volatility in equity or bond markets (or maybe both?) if they conclude that their pricing is out of sync with the Fed's direction of travel.

AGGRESSIVE RATE CUTS ARE PRICED IN FOR NEXT YEAR



Source: DataStream, Rathbones; the dashed lines are future rates implied by bond markets as of 31 August 2024

We'll be providing more detail on our investment outlook in our upcoming In Conversation video which will be available at the end of September. (You can sign up here.)

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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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