RATHBONES

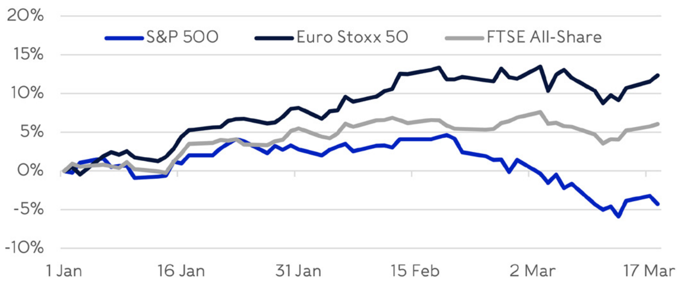
RATHBONE GREENBANK DYNAMIC GROWTH PORTFOLIO

MONTHLY UPDATE FEBRUARY 2025

The second coming of President Donald Trump was widely expected to boost US stocks at the expense of the rest of the world. Things haven't quite worked out that way.

Since Trump's election, European stocks have roared higher – even the FTSE All-Share has gained to a lesser degree – while their American counterparts have tumbled (check out the chart below). Since the S&P 500 started selling off in mid-February, the companies that posted the best returns over the past two years have been hit hardest. In contrast, the businesses that had the worst performance have fared well in the past month – in fact, on average they are up by double digits.

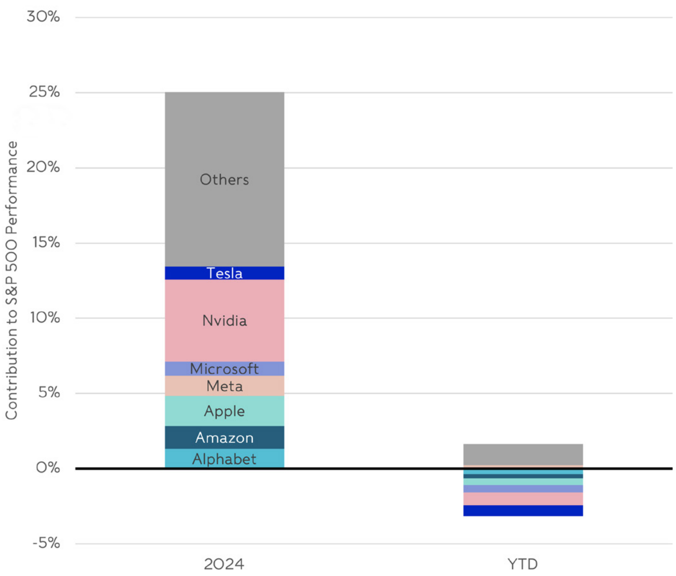
EUROPEAN STOCKS SURGE, US STOCKS SLUMP SO FAR THIS YEAR



Source: FactSet; local currency total return indexed to 100 at 28 Feb 2020, data to 18 Mar 2025

Over the past six months or so we've taken profits from our holdings of some US tech companies we hold that had become quite expensive and spread them into other, less pricey, companies both in the US and elsewhere. We'd become mindful that the ever-growing proportion of the US stock market devoted to the 'Magnificent Seven' tech companies was cannibalising the diversification of many investors. With America's trade and foreign policy causing waves, it seems that investors have taken profits from companies that have posted some truly extraordinary gains over the past year or two. With fully a fifth of the FTSE World stock market index invested in these seven companies as of the end of February, global indices have suffered as well.

THE MAG 7 DROVE RETURNS IN 2024, THEY'VE DRAGGED THE MARKET LOWER IN 2025



Source: Bloomberg, Rathbones; USD total return to 4 Mar 2025

For every action, a reaction

America's more aggressive, transactional foreign policy has caused massive shifts in geopolitics this year. Certain immutable facts and alliances, built up over decades, have fractured almost overnight.

The main one is NATO, a collective security pact that relies on its 32 members being adamant that any attack on one would trigger immediate retaliation by the rest. The US's equivocation on this point has badly damaged the alliance, perhaps irreparably. But Trump has done more than just put the sledgehammer to an ageing bulwark against the shadow of a Cold War superpower. He has also told the rest of the world, in no uncertain terms, that trade and security will be different from now on.

How the rest of the world reacts to these seismic shifts in geopolitics, trade, national objectives and government spending will have consequences reaching decades into the future. Take Germany, one of the main engines of Europe: It responded to Trump's equivocation on NATO with a proposal to amend its constitution and scrap its debt brake, allowing the creation of a 10-year €500 billion infrastructure fund and permitting essentially unlimited borrowing for defence budgets. If approved, this river of money could flow into a nation that has parched itself of infrastructure investment for years because of a commitment to straitened government finances.

Along with rearmament, it could help revitalise the German 'Mittelstand', a network of small industrial parts manufacturers that has faded since the Global Financial Crisis. That could give the whole Continent a much needed shot in the arm.

If passed, these German policies — along with EU-wide measures also in train — would amount to a complete change in direction for Europe, which has been saddled with underinvestment, anaemic economic growth and ultra-low interest rates relative to the rest of the world. Excitement about this pent-up growth potential is why European stocks have skyrocketed in the past couple of weeks. Expectations for greater government spending across the bloc — particularly in Germany — sent the 10-year German government bond yield, which is the benchmark for European borrowing costs, soaring from 2.39% to 2.80% in the first couple of weeks of March. It's hard to explain just how massive that move is.

This is a good example of how shocks and policy changes can have more dynamic effects than just 'good' or 'bad'. People and nations react and adapt, sometimes predictably, sometimes in ways that we can't foresee. This matters for businesses because it tends to widen or narrow the pool of partners you can work with, the regions you can operate in and the flows of investment you can capture or must contend with.

Sold US government bonds, adding to insurance

Trump's team has been vocal about wanting to reduce the yield of US government bonds, yet it's a difficult thing to do and not really in his control. Everyone would rather lower borrowing costs! While it's possible, his administration's mix of policies (and the uncertainty over whether it will succeed or fail on its goals) leaves plenty of chance that yields get stuck where they are for some time — or, worse, head higher led by stubborn inflation, rising tariffs and continued high government spending. Essentially, we were concerned that US interest rate markets were getting more volatile, something that could make these investments less helpful as a portfolio protection tool.

We don't invest in US government bonds because they don't meet our sustainability criteria. Instead, we invest in dollar-denominated bonds issued by the European Investment Bank, which is backed by European governments. The yields of these bonds closely track US treasuries. Because of the changing balance of risk we see in US interest rate markets, in February we sold our dollar-denominated **European Investment Bank 3.75% 2033** bonds. We replaced them with euro-denominated **European Investment Bank 2.625% 2034** bonds, which track closer to German government bond yields.

We bought the **Citi Commodity Curve Seasonally Adjusted Note 2026** structured product, which is a contract with an investment bank based on agricultural commodity prices, like grain and livestock. Typically, the value of a contract for future delivery of commodities is higher than the spot price (known as 'contango') because they tend to be bulky and costly to store. For instance, if you bought a few tonnes of wheat today you might need to borrow some money to pay upfront for the goods, and you would definitely need to pay for a truck to pick them up and to hire a barn to keep them in. If you simply agree to buy them in, say, six months' time (that's all a futures contract is), you don't have any of those costs. But the person selling them to you does and includes that in the future price you're offered.

Today, however, due to a range of bad harvests and supply shortages, many agricultural commodity markets are in 'backwardation': the spot prices are much higher than futures prices as people are clamouring to get hold of what they need now. We believe his unusual situation should correct itself in time, and if we are right our Citi Commodity Note should make money. Because this note's returns are related to the differences between spot prices and futures, it's unaffected by movements in the value of the commodities themselves. That means its returns are uncorrelated with global equities (they move in completely different ways), which makes it a good diversifier for our portfolio.

Last month, we sold long-time holding **Johnson Controls**, an Irish-American global supplier of fire safety, security and heating and ventilation systems for large buildings. We used recent weakness in the price of French engineering company **Schneider Electric** to swap the business into our portfolio. Schneider supplies the kit and know-how for maintaining and improving electrical circuits big and small. These range from site-specific needs for big power users, like hospitals, factories, data centres and the like to electricity generators and the power grid itself. As the use of electricity continues to increase, ageing grids around the world need serious investment. We think Schneider is well placed to help deliver these important improvements.

We trimmed our holdings in Canadian e-commerce platform **Shopify**, American GPS tools specialist **Trimble**, diabetes monitoring company **Dexcom** and US heart valve developer **Edwards Lifesciences**. We recycled that cash into US chip design specialist **Cadence**, laboratory equipment and services supplier **Thermofisher Scientific** US veterinary medicine maker **Zoetis** and digital office tools developer **Microsoft**.

The direction of America

Trump's 'America First' platform of fewer foreign entanglements, higher tariffs, tax cuts, public spending cuts and lessened regulation was widely signposted ahead of time. Most investors expected these measures to boost American workers, juice consumption, encourage business investment and drive the dollar and US stocks higher. However, there was always the other side of the coin. That these policies — along with a clampdown on immigration, both illegal and legal — could refire inflation, clog up supply chains and generally make it harder or more expensive to do business.

This messy mix of policies — where it's difficult to know which countervailing forces will prevail — leaves a lot of tinder around for people to create whichever campfire tale they want to tell. Some people make the case that inflation is about to rip higher, leading the US Federal Reserve to abandon any further interest rate cuts it had hoped to make. Others say America is on the cusp of recession. Some argue both: that 'stagflation' (stagnant growth along with higher inflation and unemployment) is approaching. We think all three are unlikely.

Inflation has drifted around between 2.5% and 3.5% since it descended from its post-COVID peaks in mid-2023. We've long thought it would probably stick slightly above the 2% central bank target once it calmed down after the upheaval of the post-pandemic period rather than scoot below it. It ticked down in February from 3.0% to 2.8%, so it seems well within benign levels to us. Of course, there's nothing like a national meltdown over the stratospheric rise in the price of eggs to make everyone in America think all prices are headed for the moon. This is standard fare for inflation: sudden spikes in low-value but everyday products tend to skew people's views of overall inflation. Food is the example par excellence.

US GDP growth, while it's slowed recently from its red-hot run, is still at the average of the 2010s, which is a healthy level. The economy would need to do the equivalent of a handbrake turn to start shrinking in the next 12 months. There are some signs that households are reining in their spending and cuts to government employees could be encouraging some of this. But there are plenty of opportunities for them to find other work, if rising private job openings are anything to go by. And while businesses are getting a little nervous about the erratic Trump administration, US profits are still expected to grow at a decent clip in the first quarter (7%), albeit not as much as analysts had hoped as the year dawned (12%).

Trump's blizzard of executive orders, attempts to cut back government staff and escalation of a trade war with virtually everyone has rattled allies, rivals and markets alike. It will take time for the effects to be felt in supply chains and economic data. Trump 2.0 could upend the US economy for sure. But we think it's not the most likely scenario and it would take much longer than markets are suggesting. Instead, we think it's more likely that the US economy continues to forge ahead, slower than in the recent past but at a reasonable clip. And if that accompanies a resurgent Europe after two decades of funk, that should support global demand for goods and services, which is what drives corporate profits in the long run. China's leaders also seem to have realised that they need to act decisively to help their nation break out of its property-bubble slump. If they continue to pour well-targeted support into their financial system, that adds yet another leg to underpin the world economy.

It's completely understandable to feel worried when markets start falling, especially when there's so much news and uncertainty flying around. But knee-jerk reactions can be harmful for long-term returns.

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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.

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