

RATHBONE GREENBANK GLOBAL SUSTAINABILITY FUND

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). 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

We didn't buy anything new in August or completely sell any of our stocks. Instead, we used market dips and spikes to add to and trim our existing holdings.

We bought more shares in our infrastructure companies because their prices should benefit from further falls in US interest rates. These types of business look a little like bonds: they have relatively fixed returns stretching far into the future, so lower prevailing interest rates make them more attractive. Also, they tend to have quite a bit of debt to finance big upfront investments in land and plant, so a reduction in financing costs can make a significant difference to the bottom line. We added to **American Tower**, which owns mobile network transmitters, and **Hannon Armstrong Sustainable Infrastructure**, which develops and operates a range of projects, from energy efficiency to renewable energy and sustainable infrastructure. We think the market is still undervaluing the potential of these companies.

We also added to vehicle electrification supplier **Aptiv**, which makes the sensors, wiring and safety measures that go in all types of car. Cars have become vastly more complex since the roll-down windows and manual chokes of yesteryear. Electrical components are doing these jobs – and also automatically calibrating engines and tyres and other parts of the car as we drive. All in the pursuit of making the journey more energy-efficient and comfortable. Aptiv isn't tied to any one type or brand of vehicle, which we see as a massive plus: this makes it less susceptible to the failure of a single customer. Aptiv's share price is trading at a large discount both to the wider US stock market and to where it has typically traded in the past. Its price is roughly 10x the profits analysts forecast for next year, the S&P 500 average is almost 22x.

This depressed mood could be down to concerns about a coming US recession, which would cut back the number of cars that people want to buy (when you're worried about your job, you tend to avoid making big purchases). Added to that, the take-up of electric cars has undershot expectations in the past couple of years, particularly in the US. However, it's important to remember that Aptiv products are suitable for all car types, regardless of what fuels their engines, so this should be less of an issue that you might think. Aptiv's leaders share our optimism about the company's long-term prospects: they've announced the business will buy back more than a fifth of its outstanding shares. All else being equal, share buybacks boost the value of the remaining shares as the same business's profits are spread across fewer owners.

We trimmed our holding in smart-grid designer **Schneider Electric** after it posted strong share price performance in the past year, to the point where its valuation looked a little full. We believe Schneider is well positioned to benefit from sustained global investment in electrification and power supply. The outlook for Schneider's profit growth in next few years looks strong to us.

Another slight reduction was in UK household brands business Unilever. We bought a significant position in **Unilever** earlier this year because we felt that there was a substantial change in strategy underway. The board had decided to slim down the number of products and brands that it holds to sharpen its focus and increase sales. This meant reorganising the business into new business groups and preparing for the sale of unwanted brands. Unilever’s managers have delivered on this so far – a £1.5 billion spin-off for its ice cream brands is in the works – and the shares have performed very well so far this year. We’re very confident in the continued improvement of this iconic British business, but we think it’s prudent to take some profits after a strong run.

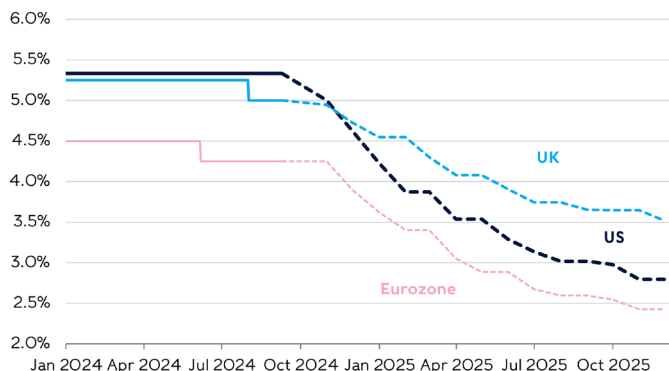
Finally, we pruned our holding of US stormwater pipe supplier **Advanced Drainage Systems (ADS)** ahead of its August results. Its share price has been trading at all-time highs after several bumper years driven by American government spending on infrastructure. With an election in the offing, we’re unsure whether this public spending will continue into the coming years, so we thought it was a good time to take profits. Longer term, we remain happy holders. ADS is expanding into sustainable building products to widen its product range and diversify its sales drivers to make it less dependent on highway and drainage projects. We think this is a sound strategy, which appears to be progressing well.

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.

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