

RATHBONE MULTI-ASSET TOTAL RETURN PORTFOLIO

MONTHLY UPDATE AUGUST 2024

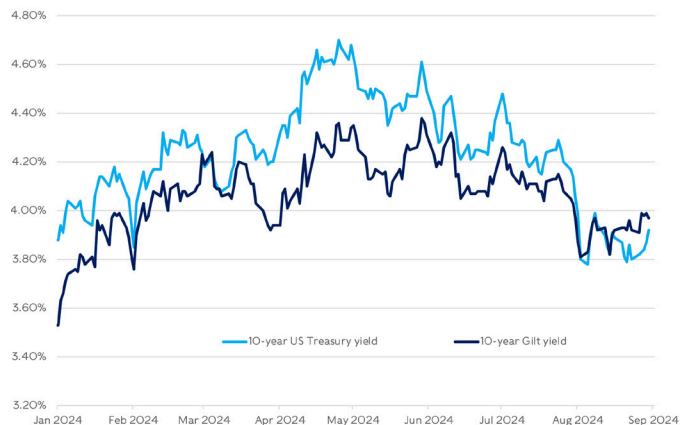
Summer is often a tough period for financial markets because low trading volumes increase the risk of big drawdowns if investors suddenly get spooked. But the stock sell-off in early August was exceptionally ferocious even by summer standards.

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 bonds from home and abroad as a hedge against any possible economic deterioration from here, but in early August, as stock markets were roiling, we took the opportunity to sell the **US Treasury 2.25% 2041** and lock in some profits.

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 after the release of a contradictory jobs report (which showed jobless claims falling) and very positive services sector data, soon followed by the news that US inflation in July had dipped below 3% for the first time in more than three years. Evidence that the US economy wasn't about to keel over, alongside positive 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 through 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.

Adding to autocalls

In the current rates environment, the returns on offer on certain structured products look attractive. 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 some of our capital. It all depends on the product.

In August we bought a new structured product – the **Citigroup FTSE/Russell 9.85% Autocall 2029**. It's a contract that pays a 9.85% coupon and gives us our capital back in a year's time if both the FTSE 100 and the Russell 2000 US small cap indices are above the level at which we bought in. If either index is in the red, the autocall doesn't pay out, but rolls the coupon payment into the next year. This continues until both indices finish a year above their trigger levels or the contract reaches its final maturity in 2029. The point of the investment is that it locks in a high annualised return if markets don't fall precipitously and stay there. In return, we give up any stock market returns above our 9.85% payoff. We believe this is a good way to make returns while reducing risk.

Trading Nvidia, trimming Apple

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, selling off at its start before rebounding and then tumbling again at month-end when its second-quarter results disappointed.

Given these big price swings, we traded our Nvidia shares throughout the month, trimming our exposure and adding back when prices dipped and then trimming once again. We weren't trying to 'time' the market, but it's part of our normal process to add to stocks on share price weakness and to pare back when we think prices could be getting a bit toppy.

Gadget king **Apple** has performed strongly so far this year and we remain confident in its prospects over the long term. But it's facing some shorter-term headwinds, including tougher competition and, we believe, less ability to keep pushing up prices and growing volumes as consumers cut back on discretionary purchases. Therefore, we decided to take some profits and trim back our holding.

We sold out of our holding in global sportswear behemoth **Nike**. We've owned the shares for a long time, but had begun to worry that Nike's dominance in sportswear might be starting to slip. Other brands have been grabbing more market share, with Nike falling behind on innovations and product launches that are a hit with consumers. China is an important market for Nike so it's suffered from the drop in Chinese consumer spending as the country's economy continues to slow.

Accelerating demand for auto parts

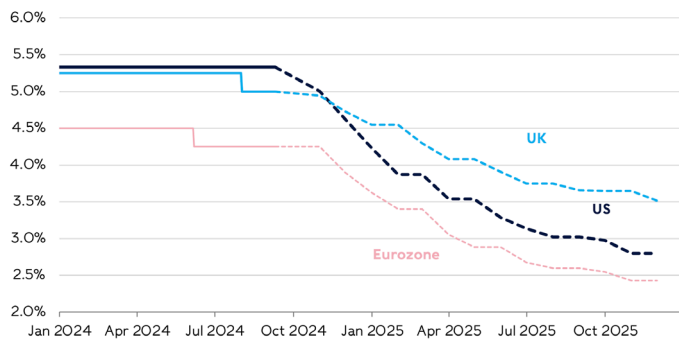
A new addition was US auto parts retailer **O'Reilly Automotive**. The age of the petrol-powered fleet seems to be growing year-by-year – not least because today's better-built vehicles last a long time (today's cars can last more than twice as long as they did in the 1970s.) This is proving a boon for auto parts retailers, particularly the larger outfits with the scale to hold big inventories of parts for replacement and service, and the distribution networks to get parts out quickly to DIY consumers and 'do-it-for-me' customers (garages and repair shops). As one of the country's four biggest auto parts retailers, O'Reilly has a huge footprint in the US. But we believe it has bags of room to grow and take market share from smaller retailers that are still clinging on to around two-thirds of the thriving auto parts market.

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 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 at 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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