RATHBONES

RATHBONE SICAV MULTI-ASSET PORTFOLIOS

TOTAL RETURN FUND

Quarterly investment update
July to end September 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.

THE LONG-AWAITED CUT

Everyone has been waiting so long for US interest rates to fall that when they finally did it was almost an anti-climax. The first rate reduction by the US Federal Reserve (Fed) since the pandemic was a 'jumbo' cut of half a percentage point, taking the benchmark borrowing rate to the range of 4.75% to 5.00%. Since then, US stock prices and government bond yields are slightly higher.

A bit of a nonchalant shrug from investors then, albeit with several shifty looks at the horizon: how many more cuts are coming and how quickly will they arrive? Bond investors and the Fed's rate-setting committee were not seeing eye to eye on that question before the latest monetary policy meeting and they certainly haven't aligned themselves since. Despite the big first step in cutting rates, the Fed has outlined a relatively slow path from here. The latest iteration of the 'dot plot', which maps committee members' forecasts for interest rates, shows the average member expects the benchmark rate to be about 4.75% by the end of the year. Investors, as implied by interest rate markets, believe it will be 4.25%. There's a disparity further down the line too. The average Fed member thinks the rate will be somewhere around 3.25% by the end of next year; investors assume it will be comfortably below 3.0%. If investors are wrong, bond prices will need to fall; if the Fed is wrong bond prices should hold their gains and perhaps rally further.

That's a lot of detail. Big picture time: US inflation has ebbed as the year has progressed, the economy has cooled somewhat (judging by the labour market) and the Fed has started to cut rates in the second half of the year. In market shorthand, this scenario has typically been branded 'a soft landing'. That is broadly how we expected the year to go when it began, so we haven't been making any significant changes to our portfolios. That said, the market was noticeably more volatile in the past quarter. This was hair-raising in places, but we've tried to make use of it where we can to take profits during overexuberance and buy into overegged concerns.

While we expect the US economy will slow from here, we think a recession isn't the most likely outcome. If we're right, that should be good for stock prices, as rates fall and profits aren't upended by a contracting economy. This should benefit bonds as well, although they have already posted gains in anticipation of falling rates, so they may be a bit rockier in the coming months – at least until they come to an agreement with the Fed's view of the world.

The market's mood music will jive or trip in line with economic data and how the Fed interprets it. As long as the chance of recession appears slim, inflation stays in check and the central bank keeps lowering rates, we think markets will be supported. But there may be a few missed beats as monthly data drops occasional clangers. We're trying to keep focused on the bigger picture and the direction of travel.

0.5%

The size of the US Federal Reserve's first interest rate cut.

LABOUR'S FIRST BUDGET IN 15 YEARS

It hasn't been a smooth start to for the new Labour government. In fewer than three months, Prime Minister Keir Starmer's approval rating had fallen lower than his predecessor's. A raft of blockbuster public sector pay deals and 'unexpectedly high' spending by the previous government set the agenda as one of doom, gloom and diminishing chances of a British boom.

As the first UK autumn Budget approaches, the government has clamoured so loudly and relentlessly about the terrible state of UK finances and the inevitability of tax hikes that it's started to affect the confidence of households and businesses. That won't help the economy and it certainly won't encourage a badly needed resurgence of investment here. It's also driven many people to crystallise capital gains in anticipation of an increase in the tax rate. So the government's expected extra tax haul could be less effective than it hopes. That wouldn't go down well with bondholders, who may start to sell and send UK government borrowing rates (and therefore rates for all other Brits) higher.

All of which would crimp the money left over for boosting investment. The government has rowed back on most of its investment plans and there are worrying rumours of plans to slash infrastructure projects by 10% across government departments. The nation has underinvested in its hospitals, roads, railways, prisons and ports for decades. Cutting deeper won't help boost the UK's dire productivity growth, which is the key to increasing long-term GDP growth and people's living standards.

There are also whispers that Chancellor Rachel Reeves is mulling a 'definition change' that would change how government debt to GDP is calculated. This would allow her to stick to her fiscal rules that paint a picture of paying off the nation's debt, while also being able to invest for the future. This is both cynical and helpful: more debt, sure, but good investment in the UK's infrastructure should more than pay for itself in the long run. However, *good* is the operative word. Borrowing more cash to throw into money pits like HS-2 would leave us in a worse position. And making big changes that increase the government's ability to spend could spook bond markets.

We hope to be pleasantly surprised that the Budget won't be as bad as many are expecting. That the government will take a moderate line: slightly higher taxes, a reasonable accounting fudge to allow greater investment and reform to planning laws to make investment easier. We will have to see …

FUELLING THE DRAGON

It hasn't been an auspicious year of the dragon for the eastern giant. China's economic growth has steadily slowed in recent years as a huge, largely unaddressed, slow-motion property bubble disintegrates. After years of frenzied homebuilding and rampant speculation by businesses, local governments and households, billions of dollars are now locked up in property that isn't worth what it cost to buy. The lucky ones have the keys to empty apartments; the unlucky have had to swallow the loss of big deposits while looking at half-finished shells that will likely never be completed.

As China has continued to struggle with the fallout, its economic data has been continually 'refined' or 'improved' or just switched off to avoid annoying questions. But recently, it appears that the leadership has decided something must be done. The People's Bank of China cut its benchmark interest rate to 1.5% from 1.7%. It also reduced the reserves that banks must hold to protect against losses on the loans they have on their books. This frees up money that banks can then use to lend to businesses and households – estimated at 1 trillion renminbi ($142 billion), or 0.8% of GDP – boosting economic growth. Mortgage rates were also cut, giving a direct reprieve of roughly $21bn to many Chinese households.

Other parts of the Chinese government also got involved. The state could increase its borrowing by up to 1.5% of GDP, with half the cash to be used in propping up local governments groaning under unaffordable investments and the other half going direct to families and into consumer schemes that encourage people to replace old appliances and vehicles with better and greener alternatives ('cash for clunkers'). The government has also pledged to extend $114bn in low-cost loans to listed businesses so they can buy back their shares. And there's talk of large-scale bank recapitalisation – an essential ingredient of property crisis resolution in the past – and stimulus cheques direct to consumers.

The market response was phenomenal: mainland stocks rose 16% (in local currency) in only a few days, instantly erasing the cumulative sadness of a torrid 18 months for the market. This is a strong show by the Chinese government that has driven an enormous overnight recovery in its stock market. But the plans that matter are vague at the moment. The devil will be in the detail. Solving China's long-term economic issues will need more than just loans, however. It will take an acceptance of past mistakes, reform and time. But as they say, the first step is admitting you have a problem. The Chinese government has done that.

10%

Rumoured incoming cuts to government capital investment.

$21 billion

Savings on Chinese mortgage payments after central bank action.

PORTFOLIO ACTIVITY

Key purchases/additions	Key sales/trims
Citi FTSE/Russell 9.85% Autocall Aug 2029 (purchase)	US Treasury 1.875% 02/15/2032 (trim)
Soc Gen Rates Volatility Note (addition)	US Treasury 2.25% 05/15/2041 (trim)
M&G (purchase)	Australian Govt 1% 11/21/2031 (trim)
Equinix (addition)	Soc Gen Rates Volatility Trend Note (sale)
Public Storage (purchase)	Co-op Group 7.5% 07/08/2026 (sale)

Source: Rathbones

US oil major Chevron had a tough quarter, with its share price pushed down by difficulties getting a proposed merger with smaller rival Hess over the line and recent weakness in the oil price. We took advantage to buy Chevron, as we felt it was unfairly valued and the merger wasn't going to blocked as investors seemed to expect. At the very end of the quarter, US anti-trust regulators approved the tie-up, as long as the Hess CEO doesn't join the board of Chevron (it was concerned that he was improperly discussing 'market stability' with the OPEC cartel in the past).

Chevron joins our existing investments in French oil major Total and UK rival Shell. We like having this spread of oil businesses headquartered in different regions because it should protect us somewhat from increasing trade tensions and the potential for higher taxes (whether on profits made in the home nation or in tariffs abroad) in any one country. We own a reasonable slug of oil companies because we think they are relatively cheap and deliver reliable cashflow-backed profits. They should also offer ballast in the event of higher-than-expected global growth or inflation, or if further unrest in the Middle East makes the oil price spike.

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. We used the cash from the sale to top up other holdings with Chinese exposure that we felt were better placed to benefit from any improvement in China's economy. These included cosmetics maker Estée Lauder and luxury conglomerate LVMH. We also added to beauty retailer Ulta Beauty.

We used weak patches to add to our holdings in pest controller Rentokil Initial, diabetes monitoring business Dexcom, heart valve manufacturer Edwards Lifesciences and ASML, which makes the high-tech machines that print top-flight computer chips.

We've built up a sizeable holding of government bonds from home and abroad as a hedge against any possible economic deterioration. In early August, as stock markets were roiling and bond yields were falling, we took the opportunity to sell down the US Treasury 2.25% 2041 and lock in some profits.

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 index 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.

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. We decided to trim our position, given its rapid rise. Discount retailer Costco is another holding we trimmed after a strong share price rise.

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.

A new addition to our fund 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.

SPOTLIGHT

IN THIS QUARTER, THE SPOTLIGHT IS ON OUR MCDONALD'S AND AIA GROUP HOLDINGS.

MCDONALD'S

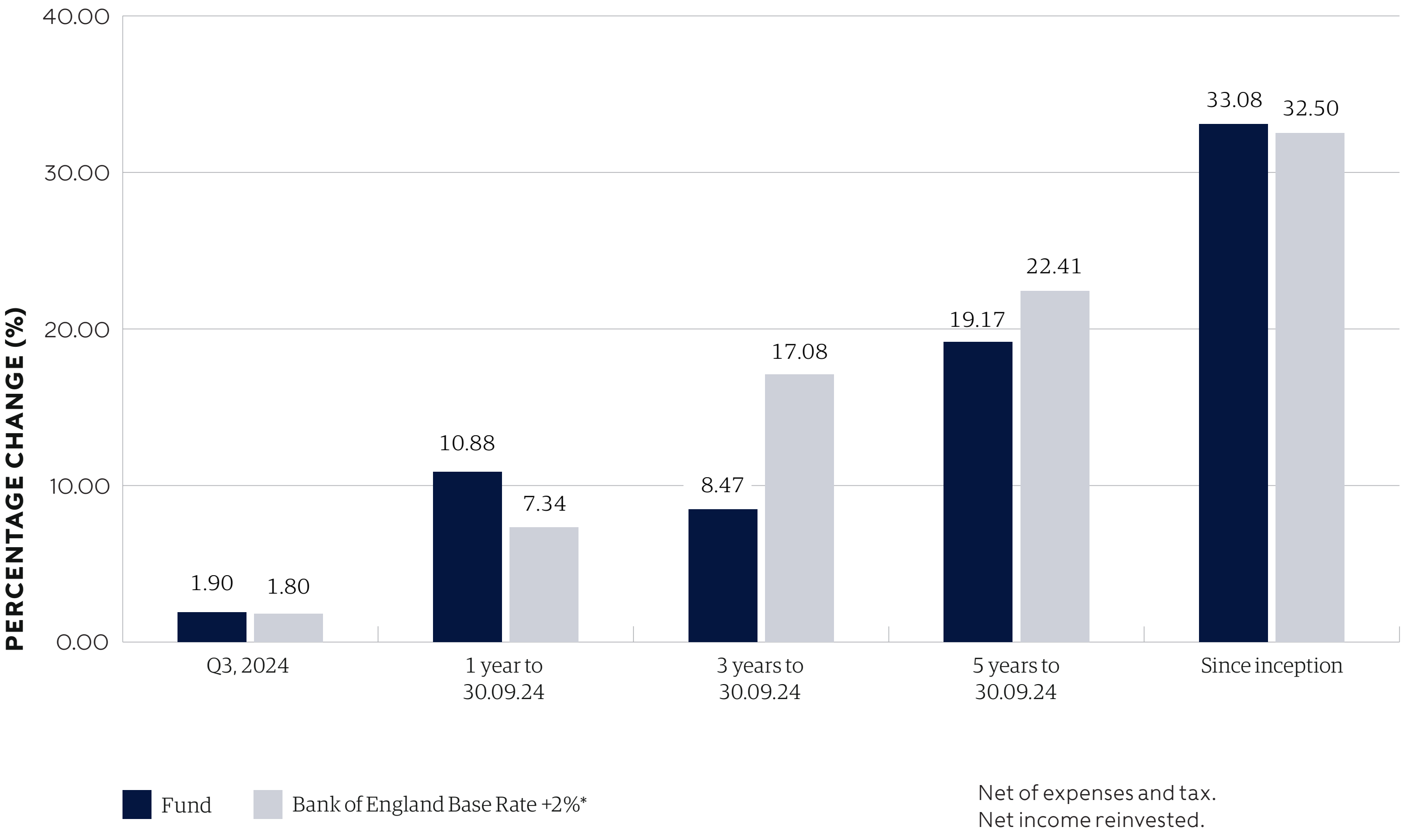
- World leading fast food chain, operating in more than 100 countries, and instantly recognised by its Golden Arches
- Operates through a franchise model, with more than 35,000 of its restaurants being operated by a franchisee. This number has been increasing, helping drive higher margins and achieve an attractive degree of diversification vs peers who tend to work with a more concentrated base of larger partners
- Has refocused on its core menu, reducing its extensive menu down to the most popular items in order to drive efficiency and growth in sales, as well as customer satisfaction
- Has seen a large uptake in its new loyalty programme and app, which have both been used to specifically target customers with marketing efforts and promotions to drive footfall
- McDonald's delivery has been a significant growth driver, as it has been scaled up across markets both through the McDonald's app and third party platforms

AIA GROUP

- The largest Pan-Asian insurer for households and businesses, offering a range of life, health and retirement protection, as well as savings plans
- AIA operates and has dominant market share in some of the fastest growing economies in Asia, including China, Thailand, Singapore, Hong Kong and Malaysia, but where insurance penetration remains low, and therefore providing substantial growth opportunities
- Benefits from increasing household income, alongside favourable demographic changes such as a growing yet aging population, and a rising middle class. These all contribute to a growing demand for the insurance products offered by AIA
- Double-digit sales growth is supported by excellent and durable returns on capital, as well as strong cash flows

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



Net of expenses and tax.
Net income reinvested.
Data source: FE fundinfo

*At 14 December 2021, the benchmark measure changed to Bank of England Base Rate + 2%.

12-month rolling performance					
Year to:	**End Sep 2024**	**End Sep 2023**	**End Sep 2022**	**End Sep 2021**	**End Sep 2020**
Fund	+10.88%	+3.26%	-5.27%	+8.12%	+1.62%
Bank of England Base Rate +2%*	+7.34%	+6.11%	+2.79%	+2.10%	+2.40%
Annual calendar performance					
Calendar year	**2023**	**2022**	**2021**	**2020**	**2019**
Fund	+7.06%	-4.86%	+6.74%	+4.51%	+9.42%
Bank of England Base Rate +2%	+6.73%	+3.47%	+2.11%	+2.23%	+2.76%

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**
AIA Group	+25.40	+0.12
Eurofins Scientific	+21.61	+0.08
Lockheed Martin	+18.58	+0.09
Smith & Nephew	+18.13	+0.09
WEC Energy Group	+16.56	+0.07

Bottom performers (%)		
Holding	**Performance**	**Contribution**
Dexcom	-44.58	-0.22
Edwards Lifesciences	-30.61	-0.15
ASML	-23.85	-0.15
Rentokil	-18.93	-0.08
Cadence Design Systems	-17.57	-0.09

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

Developed world government bond yields dropped over the quarter in anticipation of the first US interest rate cut since the pandemic. Our collection of government bonds in the US, UK and elsewhere boosted our returns as their prices rose on these lower yields. We had added to these bonds, particularly those whose prices are more sensitive to changes in prevailing yields, earlier this year when yields were higher. Towards the end of the quarter, we sold some of this government bond exposure to lock in profits. Having this higher level of rate-sensitive bond exposure hurt our performance at times over the year, but we felt confident that US inflation would keep falling, and that interest rates would follow, in time. We think government bonds remain attractive assets at current levels, given the returns above inflation that they now offer, with further returns likely as more rate cuts materialise. Equally, we expect bonds to provide important ballast to our portfolio in the event of economic stress, rather than the source of pain they were in 2022.

China announced a raft of government spending, interest rate cuts and changes to banking regulations in September that led to an astonishing turnaround in its stock market. Our stocks with significant exposure to China rallied along with those companies listed on the mainland. Many are quality companies that we believe should do well over coming years, yet a downbeat outlook for China had weighed heavily on them. These businesses include luxury conglomerate LVMH, cosmetics business Estee Lauder, and the much more directly linked pan-Asian insurer AIA Group. We have consistently added to most of these companies on weakness, and they have since jumped higher, delivering a boost to our portfolio.

As bond yields and interest rates have fallen, they have pushed up the share prices of our infrastructure and utilities stocks, including US power generator Wisconsin Energy, data centre operator Equinix and American Tower, which owns mobile network transmitters. These types of business look a little like bonds: they have relatively fixed returns stretching far into the future, so lower interest rates make those returns more attractive. Also, they tend to have quite a bit of debt to finance big upfront investments in land and equipment, so a reduction in financing costs can make a significant difference to their bottom lines.

US technology companies were generally weak this quarter, lagging the overall US stock market. Our tech holdings were not immune, with poor showings by search giant Alphabet, digital office supplier Microsoft, design software developer Cadence Design Systems and ASML, which makes the high-tech machines that print top-flight computer chips. Some of our medical technology companies underperformed as well, including diabetes monitoring business Dexcom and heart-valve maker Edwards Lifesciences. Both share prices fell significantly after poor profit announcements. We used those falls to add to both names, as we still believe in their future opportunities, despite these short-term stumbles.

ASSET ALLOCATION CHANGES

Asset allocation split	30.06.24	30.09.24	% Change	12 month change
Liquidity (10%-50%)	37.2%	40.6%	3.4%	4.4%
Equity-type risk (20%-60%)	46.7%	44.7%	-2.0%	-1.4%
Diversifiers (10%-60%)	16.1%	14.8%	-1.4%	-3.0%

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

Asset class split	30.06.24	30.09.24	% Change	12 month change
Equities	34.0%	34.2%	0.2%	0.8%
UK	6.2%	6.1%	-0.1%	0.4%
US	21.3%	20.9%	-0.4%	-0.8%
Europe	4.2%	4.0%	-0.2%	-0.7%
Japan	0.9%	1.0%	0.1%	1.0%
Asia ex-Japan	0.9%	1.1%	0.2%	0.3%
Emerging Markets	0.0%	0.0%	0.0%	0.0%
Global	0.4%	1.0%	0.5%	0.6%
Index-linked bonds	0.0%	0.0%	0.0%	0.0%
Conventional government bonds	29.6%	21.9%	-7.7%	-3.0%
Corporate bonds	13.6%	11.1%	-2.5%	-7.4%
Emerging market debt	0.6%	0.5%	0.0%	0.5%
Private equity	0.6%	0.6%	0.0%	0.1%
Alternative investment strategies	11.9%	10.6%	-1.3%	-2.1%
Property	0.0%	0.0%	0.0%	0.0%
Infrastructure	0.6%	0.5%	0.0%	0.5%
Commodities	4.3%	4.2%	-0.1%	-0.9%
Cash	5.0%	16.4%	11.4%	11.6%

INVESTMENT OUTLOOK

WE THINK THE US ECONOMY — WHICH HAS UNDERPINNED GLOBAL GROWTH OF LATE — SEEMS IN RELATIVELY GOOD SHAPE.

Recent data shows it's slowing from the red-hot growth of the past few years, but that was to be expected. The deceleration shouldn't be an issue unless the Fed keeps rates too high for too long, choking the economy into recession. It all comes down to the gradient of its path from here.

Another looming uncertainty is the US election. While the economic policies of both sides are actually more alike than either would wish to admit – protectionist and loose with government cash – there are stark differences that do matter for investors.

Republican Donald Trump's planned crackdown on immigration and his heavier hand on tariffs (he has floated a tax of at least 10% on every import) would be inflationary. The presence of fewer workers would bid up wages; more expensive imports would raise costs and reduce choice (and therefore price competition) for households and businesses alike. He also plans to deregulate business, particularly relating to the environment, and reduce subsidies for clean power. Democrat Kamala Harris would more than likely retain the status quo on all these issues, although lately she's talking tougher on immigration and Chinese imports.

Both sides offer similar messages for trade and business but the quantum makes a difference, especially in terms of tariffs. The starkest difference is the corporate tax rate. Trump's official platform says he intends to keep the rate at 21%, the rate he cut it to in 2017 when he was President. But he has mulled cutting it even further to 15%. Meanwhile, Harris has pledged to raise the rate to 28%. For an American company paying the headline rate of tax, a cut to 15% would boost profits by 8%, while an increase to 28% would reduce profits by 9%. That's roughly equivalent to an average year's earnings growth either gained or lost. This is a big swing for potential profits – and one depending on an uncertain election.

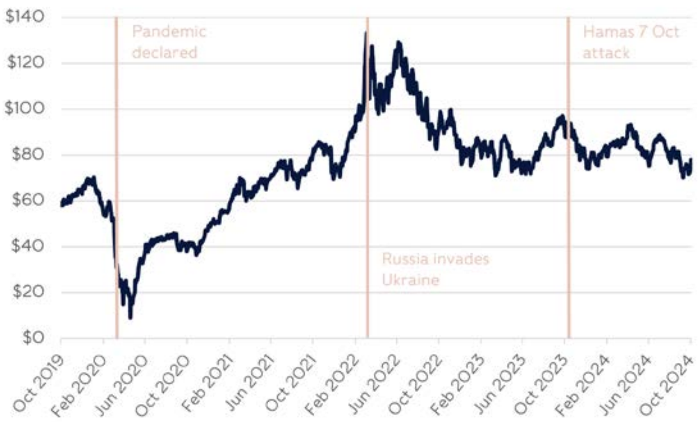
Whether Harris or Trump wins the White House is too close to call. As is the fight over Congress. It won't take much for Republicans to overwhelm the Democrats' razor-thin majority in the Senate, yet they their own hold on the House of Representatives is extremely slim. A switch in control of both chambers of a divided Congress has never happened before. It may just occur this November. A split Congress would make it difficult for whoever wins to implement their agenda. Often not necessarily a bad thing!

One thing both presidential candidates agree on is spending more money than they get in taxes. That means the amount of US Treasury bonds issued is likely to keep rising, which could put upward pressure on their yields. Any resurgence of inflation would have a similar effect. We think the chances of inflation heading higher are low, but it's something to keep an eye on.

Other investors are no doubt wary of disappointment as well. As we mentioned earlier, stock markets, government bonds and most commodities have lurched around extensively over the past year in reaction to unexpectedly variations in data from business surveys, to inflation, employment and central bank pronouncements. Markets go from calm to high alert in a flash. The oil market has remained relatively placid, however. That's despite a lot of uncertainty about the US economy and interest rates, escalating violence in the Middle East and continued deterioration in the vitality of China.

We're unsure whether this will continue, but we've got some investments in place that should protect us if the oil price does suddenly skyrocket.

OIL PRICE SO FAR UNFAZED BY MIDDLE EAST CONFLICT



Source: FactSet, Rathbones, Brent Crude spot price to 4 October 2024

Past performance should not be seen as an indication of future performance.

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.

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