Rathbone Income Fund Carl Stick and Alan Dobbie – Co-Fund Managers

Autogenerated captions (may contain errors)

0:28
Well, in absolute terms, performance has been very good this year.

0:31
The funds up almost 9% to the end of August and we're on track for another year of dividend growth.

0:36
On a relative basis, 2024 has been more difficult, especially the first quarter.

0:42
We entered the new year with a view that global inflation and interest rates would gradually normalise, but that extended valuations, particularly in the US, meant that markets were vulnerable to shock.

0:52
So we tilted the fund towards lower beta, more defensive stocks.

0:56
As you remember, in the first quarter, inflation proved to be much stickier and the global economy much more robust than we and many others anticipated.

1:05
So as is often the case when markets are roaring ahead, the fund didn't quite keep up.

1:09
More recently, however, relative performance is much improved.

1:13
Inflation has come down and we're now starting to see some signs that the cumulative impact of the Fed's rate hiking cycle is hurting the US economy, the engine of global growth.

1:22
Over recent years, our fund still tilted towards lower beta defensive stocks, has benefited from this shifting macro picture.

1:29
And you can see that trend coming through when we look at those stocks that have been driving the fund's performance this year.

1:35

While the domestic banks took the top two positions, the rest of our top 10 contributors have a very defensive tilt.

1:42
We're pleased that the market is now recognising the changes being put in place behind Schumacher, Unilever's new CEO.

1:48
His mantra of fewer things done better with greater impact is really chiming with investors.

1:53
And the shares are up about 30% so far this year, the third year in a row BAE Systems has performed extremely well.

2:01
Operational improvements as well as an upward pressure on defence budgets coming from the escalating geopolitical risks have helped BAE deliver an astonishing 163% total return over the last three years.

2:14
On the negative side, the big miners BHP and Rio Tinto have struggled with a weaker Chinese economy and a falling iron ore price.

2:22
But we continue to think these businesses are well placed, particularly when it comes to the materials required for the energy transition.

2:29
I also want to highlight two stock specific issues.

2:32
Reckets is involved in some complex litigation cases regarding its US infant formula business.

2:38
Financial and reputational impacts have weighed in the share price this year.

2:42
Secondly, Close Brothers, like many other UK banks, is caught up in the FCA investigation into historic Motor Finance Commission arrangements.

2:50
In both of these situations, we think the companies have a strong case to make and that the share price falls have been overdone.

2:56
However, we do recognise the risk and that there could be further share price volatility ahead in either direction.

3:02
Our position sizes reflect this well.

3:11
Over recent years, investors have found many reasons to dislike the UK market and money's flowed away from UK equities towards shinier things across the pond.

3:20
But we're now seeing some signs that the mood music is changing.

3:24
We're not trying to claim that the tide has turned, but some optimism has certainly returned.

3:29
And to our mind, this positive sentiment is well justified.

3:32
The UK economy is performing better than most people expected at the start of the year.

3:38
The City Economic Surprise Index, which shows whether macro data points like employment growth and inflation have been coming in ahead or behind expectations, demonstrates that unlike China, the US and the Eurozone, UK economic data has been better than expected this year.

3:55
GDP growth has been revised higher, inflation is almost back to target, unemployment is stable around 4% and consumer and business confidence is much improved.

4:05
Add to that a greater degree of political stability than we've seen for many years and it's not hard to see why investors are warming to stocks exposed to the UK economy.

4:14
But as we know, the UK market is not simply a play in the UK economy.

4:19
The Footsie All share is dominated by multinationals who are on the vast bulk of their revenues overseas.

4:25
Over recent years, a common narrative has developed that these stocks are a problem for the UK market.

4:30
They're too old economy, they don't grow fast enough, they're on the wrong side of ESG.

4:34
There's not enough tech.

4:36
This chart, showing the total returns of the Magnificent 7 and seven largest stocks in the UK over the past three years demonstrates that you don't always need Big Tech to outperform.

4:46
While Nvidia's performance has been astonishing, elsewhere the big UK stocks have more than held their own.

4:52
Shell has outperformed Microsoft.

4:54
HSBC has done better than Apple.

4:57
Even Glaxo has beaten the returns of Alphabet, Amazon and Tesla.

5:01
Now, this is only one time period, but it does show that there's more to investing than simply identifying the best, fastest growing companies.

5:09
You also have to pay the right price.

5:11
Given the UK market's lowly valuation, it should be no surprise that it's companies can generate great returns from these levels.

5:23
Our positioning is designed to do 2 separate but complementary things.

5:28
The first one is reflected in our tilt towards defensive, globally focused businesses with resilient earnings.

5:34
We're a little nervous about the global economy, but this is amplified by the complacency reflected in the high valuations of many non UK stocks.

5:43
So we've tilted the fund towards those defensive stocks and sectors which should benefit the most from falling inflation, interest rates and bond yields.

5:51
So consumer staples, healthcare, property companies and utilities.

5:56
While this tilt didn't help as earlier in the year when inflation remains sticky and the global economy resilient, it's really come into its own over recent weeks as fears of US slowdown have risen.

6:07
You can see here that sector performance since the poor US labour data in early August has been exactly as you'd expect.

6:13
Banks, energy and basic resources have been weak, whilst the bond proxy sectors at the bottom of this chart have been strong.

6:21
We were too early with our positioning here but retain our conviction.

6:25
The second thing we're trying to do is exploit the relative strength of the UK economy so we have decent sized positions and UK house builders, domestic retailers and some specialist lenders.

6:36
In a nutshell, the portfolio is still reasonably balanced, but we're emphasising 2 conviction calls, one into defensive, globally focused businesses and the other into UK domestic earners.

6:48
By doing this, we hope to continue the fund's strong track record of protecting against downside risk while still generating an attractive and growing dividend.

7:02
If we have to champion one sector right now, it's got to be UK retail.

7:07
It presents both value and opportunity, exposure to AUK consumer that may now be feeling a little bit more confident, and a broad palette of different ideas.

7:18
This palette includes structural growth opportunities like discount store B&M and fantasy game specialist Games Workshop.

7:27
It includes more economically sensitive names like Halfords or businesses that offer a bit of both, like homeware store Dunelm.

7:36
Now we do acknowledge that the UK is still navigating a cost of living crisis.

7:42
However, consumer confidence has been rising, with the latest GfK Consumer Confidence Index indicating that people are feeling more positive about their financial prospects over the next 12 months.

7:55
This renewed sense of financial stability is likely to translate into increased spending on both essential and non essential items as we move towards the end of the year.

8:07
We've introduced 3 new names into the fund, the supermarkets Tesco and Sainsbury's as well as Dunelm.

8:15
Both Tesco and Sainsbury's have gained market share recently at the expense of Asda and Morrisons.

8:21
There's also less competition from the discounters as ALDI and Little are preoccupied with their US expansions.

8:28
Sainsbury's has the added benefit of owning Argos, which we think should get a boost from renewed spending on discretionary goods.

8:37
Dunelm offers something different.

8:39
As consumers resume spending on the living spaces, particularly as borrowing costs fall, there's ongoing appetite to spend on things that make life at home more comfortable at prices that don't break the bank.

8:52
Dunelm has successfully grown it's share of the UK homewares market and is now strategically ramping up his furniture offering.

8:59
Lower mortgage rates and a rebound in activity in the housing market should serve as an additional tailwind.

9:13
We think the opportunities outweigh the threats, but it's going to take months, maybe years for many of the proposed changes to work through.

9:22
So what are the positives?

9:23
We're thinking about hopefully a period of more stable government held in greater financial responsibility, the possibility of a more constructive relationship with Europe.

9:35
Kirstam has met with German Chancellor Olive Schultz five times as becoming Prime Minister.

9:40
And most challenging perhaps a commitment to invest in long term growth which goes hand in hand with much needed planning reform.

9:49
On the downside, well, we need to recognise that the growth agenda will be extraordinarily difficult to achieve and there is very little money in the coffers.

9:59
We've all read the headlines thinking ahead to the Autumn Budget.

10:03
What does this mean for taxation, on both the corporate and on a personal level?

10:08
High taxes and higher growth are not natural bedfellows.

10:13
So there's a promise of growth on the one hand, but a financial headache on the other.

10:18
Of course, we need to look beyond our own shores and at the fragile geopolitical state of the world for perhaps the greatest threats.

10:27
And our relationship with the US remains crucial.

10:30
Whilst the Labour government might desire a Harris presidency, they would need to have a relationship with Trump as well.

10:38
But all else being equal, the future does look a little brighter now.

10:42

Economic data have in general been constructive and the City has reacted with positivity since the election, which is in itself an interesting indication of mood.

10:53
And we have positioned the funds to reflect caution on the one hand, but also the UK economic opportunity on the other.

11:07
There are very specific opportunities for the UK equity income sector in general and our fund in particular.

11:14
Let us distil this down to three arguments.

11:17
Argument #1 The attractive combination of economic recovery, low valuations and the sheer breadth of opportunities make the UK market more attractive now than for many years.

11:31
But we guess that anyone choosing to watch or listen to this video may have a similarly constructive view on the UK economy and market.

11:39
Argument #2 Is the income mandate itself.

11:43
We've talked a lot over the last year and a half about longevity, older populations and the financial ramifications that go along with this, but the regulator is now also taking an interest.

11:56
We believe that investors and advisors are going to become increasingly motivated to think about the provision of income from their investments.

12:06
Income funds should be part of the suite of solutions because income in retirement is the central issue.

12:13
Our advocacy of income funds has always been based on the distributions we produce, whether through the powerful effect of compounding this interest over time by reinvesting back into a fund, or the flexibility of turning on the income tap by switching over to the appropriate income units.

12:34
And this leads us on to argument #3 the Rathbone Income Fund has an outstanding record of income generation.

12:43

This exemplary track record combines with a risk based investment framework and a long history of stable and consistent management.

12:53
Our focus on long term outcomes rather than maximising short term returns positions us very well as people start to think much more about their income and capital requirements in their retirement years.

13:07
Income funds have always been considered as good long term savings vehicles on account of the value component of the income yield requirement.

13:17
And to repeat, it's well worth the emphasis the compounding effect of reinvesting that income.

13:24
But as we are all thinking about the reality of living and working for longer, the flexibility of income mandates to provide both income and capital growth becomes even more attractive.

13:35
So we must be optimistic and therefore we conclude with this message.

13:40
We argue for justified improvement in UK sentiment in economic and market terms.

13:47
We expect greater focus to be placed on income provision, especially considering our ageing population and the probable requirement to extend our working lives.

13:57
And we have to be confident in our own track record to provide part of a meaningful solution to these challenges and opportunities.