

Rathbone SICAV Multi-Asset Strategic Growth Portfolio

Quarterly investment update, April to end June 2020



Hot topics – ‘Top-down’ (market and macroeconomic)

Whack-a-mole. It hasn't taken long for COVID-19 to pop back up in countries that thought it had the pandemic on the run. All over the world, from Australia to Europe and here at home, flare-ups have caused disquiet among people, businesses and governments. In many US states, politicians had declared victory



before the fight against the virus had even begun. The Sun Belt, from California right across the southern sweep of states to Florida, has suffered an explosion of new cases. Of these states, only New Mexico had implemented a proper lockdown and suspension of business by late July. If these states are going to get the virus under control this side of Christmas, they will have to institute some form of lockdown. Such pockets of rapid infection will continue to flare up for at least the rest of the year. And when they do, it will frighten investors by reminding them of the earnings black hole that was the second quarter. Yet we believe, short of an apocalyptic and widespread eruption of infections, governments all around the world won't go further than localised lockdowns from now on. The cost of shutting down people's lives and livelihoods, both in unemployment and cold hard taxpayers' cash, has been somewhere in the stratosphere. Political appetite – among governments and the people – for a reprise to this sledgehammer response seems low to us. How much new flare-ups will spook people who would otherwise go out and spend is another matter, however, and one we will be watching carefully.

Biden time. The American presidential election is fast approaching, yet the Democratic nominee is conspicuously quiet. Joe Biden – or “Hidin’ Biden” as the President has dubbed him – seems to be following the Boris Johnson playbook with his working-from-home campaign. With the economy in the soup, unemployment floating round 15% and Mr Trump botching the pandemic response, keeping a low profile is a strong strategy. The President is opponent enough for himself, Mr Biden really only risks making gaffes by pulling himself away from his trainsets to campaign actively. Given Mr Trump's abysmal polling, most models suggest Mr Biden will win the White House on 3 November. But there's still a long way to go. For investors, what matters most is whether the Democrats also sweep control of both chambers of Congress and who will be Mr Biden's running mate. These two factors will determine just how far to the left a Biden-led presidency will swing. The Democrats are set to easily retain control of the House of Representatives, yet the odds of them taking control of the Senate are long indeed. If they do manage it, businesses would



be in for a barrage of regulation and higher taxes. As for the running mate, if he picks a firebrand like Bernie Sanders or Elizabeth Warren, that would show he is preparing for an anti-business administration.



Stealth rally. The US stock market has become heavily skewed towards handful of gigantic companies that dwarf all the others. The index is getting as concentrated in its top-10 constituents as European indices get. The S&P 500 index is still a long way away from Nokia of Finland in 2000 though – it got as high as 70% of the index! Most of these super companies are the tech darlings that have been able to use network effects to grow inexorably across the globe over the past decade and more. If small and mid-sized US companies (which are still huge companies in their own right) enjoy a resurgence when the recovery gets into full swing, it could mean most companies do better than the index as a whole. This stealth rally would reward stock-pickers at the expense of index trackers who are inordinately exposed to the fortunes of the few large companies dominating the market. Of course, if the corona crisis does turn cataclysmic, the chances of any such upswing will be virtually nil.

Portfolio activity

Key purchases/additions	Key sales/trims
iShares Fallen Angels High Yield Corporate Bond ETF (new purchase)	Commonwealth of Australia 4.75% Bonds 2027 (sale)
US Treasury Inflation-Protected Securities (TIPS) 0.125% Bonds 2024 (new purchase)	Lloyds Banking Group (sale)
Thermo Fisher Scientific (new purchase)	Micro Focus International (sale)
Japanese Government 0.1% Bonds 2023 (new purchase)	iShares FTSE 100 and FTSE 250 ETFs (sale)
Ashmore Emerging Markets Short Duration Fund (addition)	

Source: Rathbones

As markets slumped early in the quarter, we added across the board to our stocks and to new assets that looked cheaper after the sell-off. We then took profits after the market's breakneck recovery.

Two of the new investments we made were the **iShares Fallen Angels High Yield Corporate Bond** and **Invesco US High Yield Fallen Angels ETFs**, adding to our equity-type risk through assets with lower valuations. Corporate bond prices have bounced around all over the place. Much of the dislocation is down to credit agencies downgrading hundreds of billions of dollars in debt as companies' sales dry up during lockdown. Some of these 'fallen angel' companies are in deep trouble, yet many of them have tapped plenty of cheap financing from governments and central banks, despite tumbling into junk territory.

We also added US laboratory equipment business **Thermo Fisher Scientific** to our portfolio. We believe this high-quality company will play an increasingly critical role in diagnostics and testing over the long term. It supplies everything from healthcare software and syringes to medical devices and chemicals.

To protect against inflation taking off in the shorter-term because of the sheer weight of fiscal and monetary stimulus, we decided to swap our fixed rate **UK Treasury 0.75% Bonds 2023** and **UK Treasury 0.5% Bonds 2022** for **US Treasury Inflation-Protected Securities (TIPS) 0.125% Bonds 2024**, which have coupons that rise in line with US CPI inflation.

We sold the last of our **Commonwealth of Australia 4.75% Bonds 2027**, which we bought back in 2017 as a more attractive risk-off hedge given the US was heading into an interest-rate-hiking cycle (remember those days?). This trade had done its job, so we replaced it with **Japanese Government 0.1% Bonds 2023**. The yen remains a safe-haven currency (the opposite of the pound, which plummets when markets run scared), so it should provide handy protection in the event of any sell-off.

We lost faith in the UK government's response to the pandemic and its ability to drum up a strong Brexit trade agreement before the year's end. We sold the **iShares FTSE 100** and **iShares FTSE 250 ETFs**. We used the cash to buy the **SPDR Russell 2000 US Small Cap ETF**, the **JP Morgan Japanese Investment Trust** and the **JP Morgan Japan Equity Fund**. We also added to emerging market debt funds, by adding to our holdings in the **Barings Emerging Markets Debt Blended Total Return Fund** and the **Ashmore Emerging Markets Short Duration Fund**.

We also sold the last of our **Lloyds Banking Group** and **Micro Focus International**, a legacy business computer systems provider that we have held for several years. We got this one completely wrong, as the company has gone from trouble to misery. We had hoped that it would right itself in time; however, the pandemic has changed the landscape and put paid to that.



Spotlight

In this quarter, the spotlight is on the **CME Group** and **First Republic Bank**.



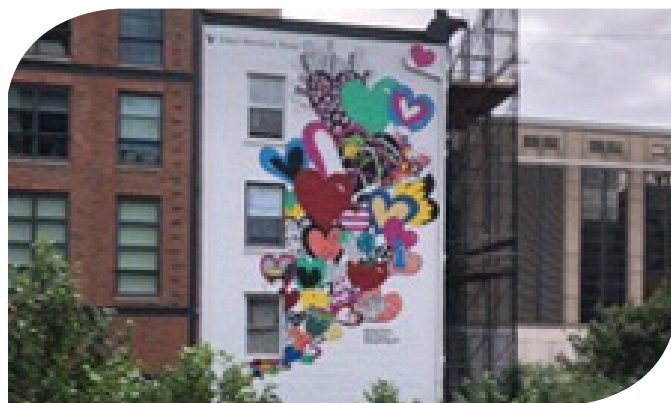
CME Group

- Global markets company with the largest financial derivatives exchange in the world – includes Chicago Mercantile Exchange, Chicago Board of Trade, New York Mercantile Exchange, and The Commodity Exchange
- Product suite includes a range of markets, including futures and options on rates, foreign exchange, equities, energy, and metals
- They have been able to step in and take advantage of the void left after banks left certain areas of the derivatives market after regulation meant capital requirements became too onerous – many banks are actually now becoming their customers and regulation is generally a positive for CME
- Business has been restructured and is now able to have a greater focus on customer demand driving the offering
- CME does not take capital risk as they only match buyers and sellers and with most of their revenue growth coming from trading and clearing
- Can be counter cyclical as volatility is their friend – higher volatility, outside a 2008 type scenario, typically means more trading



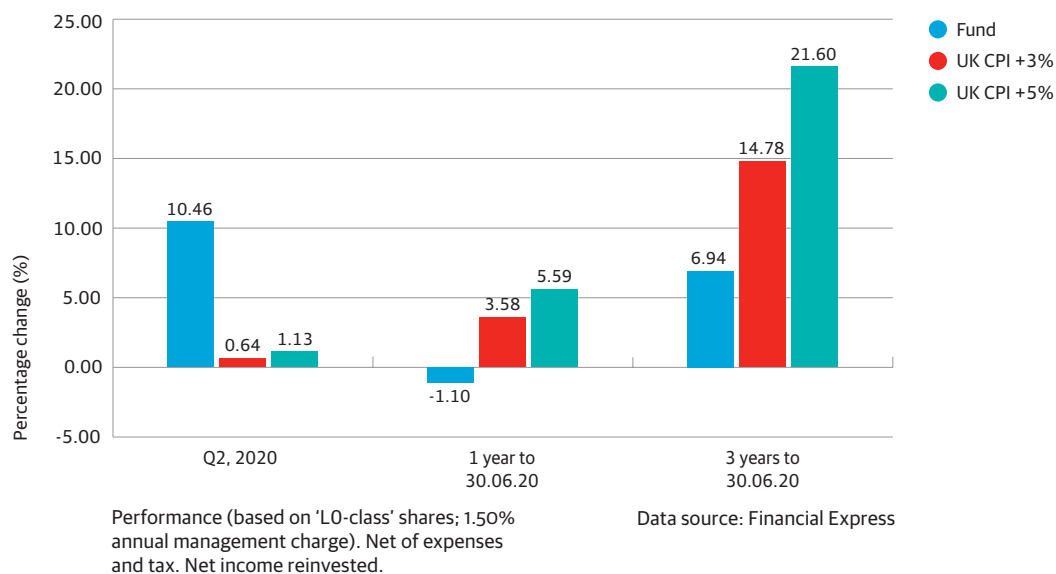
First Republic Bank

- US bank that defines itself primarily as a wealth management firm, but also offers personal banking, business banking, and trust services
- Growth has been fuelled by a very strong brand and unrivalled client service – they have been able to achieve market leading customer service scores consistently, and a large percentage of their new business comes from existing customers making recommendations to friends, colleagues, and family – they are seen as a premium service so less price orientated
- They are very targeted on lending with a focus high quality – they offer lending products such as jumbo mortgages, which tend to have lower loan to value, and consumer loans to those with liquidity and strong cashflows, for example loans to professionals looking to buy into their firms as a partner
- Their Relationship Managers take ownership of the loans they originated with compensation supporting high quality lending by including clawbacks to punish bad lending – very low non-performing loan book relative to other bank peers
- Targeted branch network with over 70 branches focused on seven bi-coastal hubs – they also have the only bank branch of Facebook's campus and Twitter's building



For those wondering, this is the view of back of the First Republic Bank branch from the High Line in New York

Fund performance



Our benchmarks are calculated on the rate of change of the CPI index, over different time periods (e.g. if we were calculating year to date figures in January 2019, we would look at the percentage change from December 2018 to the end of January 2019). So we take CPI to the current value, and add on the 3% to 5% respectively, prorated over a year (roughly 0.25% and 0.42% per month). If the CPI Index benchmark were to fall, more than the amount pro-rata, the benchmark year-to-date will be negative, even though inflation as reported by the media (calculated specifically as a 12M rate of change), remains positive.

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.

The investment objective of the sub-fund changed on 25 March 2019 due to the sub-fund ceasing to be part of a master feeder arrangement. Therefore, performance in the chart shown prior to this date was achieved under differing circumstances.

Top performers (%)			Bottom performers (%)		
Holding	Performance	Contribution	Holding	Performance	Contribution
Fevertree Drinks	+69.10	+0.25	JP Morgan 10109 95% Strike S&P Dec 20 Put Warrants	-61.23	-0.65
Invesco Markets US Energy Infrastructure ETF	+66.01	+0.17	BP	-8.53	-0.05
Aptiv	+58.80	+0.46	Royal Dutch Shell	-8.52	-0.05
Cadence Design Systems	+45.82	+0.30	CTS Eventim	-7.33	-0.04
Discover Financial Services	+44.40	+0.38	CME	-5.19	-0.02

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. Performance (table above only): Gross of charges.

Source: Rathbones

US Equities were a very strong contributor to returns as the US market powered ahead of others during the market recovery. A broad based recovery in sentiment towards the US was evident as their earlier reopening of the economy and subsequent swift recoveries in consumer spending spurred on risk appetite – some cold water was poured on this towards the end of the quarter though as rapid rises in infections in states like Texas, Arizona, Florida, and California caused a roll back or pausing of reopening in those states and resurgence in fears over what this means for the economy. Continued strength in names in the portfolio such as **Cadence, Amazon, Accenture, and Adobe**, were key contributors as investors sought quality companies where the structural trends supporting them have only been accelerated by the pandemic and lockdowns.

Our emerging market debt exposure via the **Ashmore** fund recovered well off its lows in Q2. In some of the darker days of Q1 this year we saw an opportunity to add to emerging market debt as we felt that at that price the potential returns on offer were certainly compensating us for the risk in those bonds. During the quarter we saw a very strong recovery from many of the underlying bonds, such as Argentina and Ecuador, which resulted in the fund being a material contributor to performance during Q2.

Companies such as **Aptiv** and **Discover Financial Services** all saw meaningful recoveries from their lows as markets moved to price in an economic recovery and these stocks, despite being high quality, have tended to behave more like cyclicals due to stresses in their end markets. Having exposure to companies that behaved in this way was very important from a portfolio construction standpoint as the market continued to rotate leadership back and forward during the quarter. Having some balance in the portfolio without needing to fish in those structurally challenged deep cyclical names was vital.

Fund performance (continued)

Gold was a helpful contributor to returns in Q2 and continues to have a positive correlation with the increase in money supply and zero or low interest rate policy around the globe.

The oil majors suffered another negative quarter given the uncertainty over the path from here for the oil market with some, such as **Royal Dutch Shell**, cutting their dividend. Finally, as you would expect in the recovery we saw in Q2, the put options that served us so well in Q1 were detractors from performance but we still believe that having these put options will be important as there may still be volatility ahead of us yet.

Asset allocation change and strategy

We reduced our UK equity exposure over the quarter because we felt the government had botched its pandemic response and the risks of a mistimed 'hard' Brexit had increased. We added to mid and small-cap stocks in the US and Japan.

Asset allocation split	31.03.20	30.06.20	% Change		12 month change	
Liquidity assets/lower volatility	23.06%	20.94%	-2.12%	▼	-8.19%	▼
Equity-type risk (economically sensitive assets)	66.87%	70.82%	+3.95%	▲	+4.79%	▲
Diversifiers	10.07%	8.24%	-1.83%	▼	+3.40%	▲
	100.00%	100.00%				

Asset class split	31.03.20	30.06.20	% Change		12 month change	
Equities	64.06%	63.82%	-0.24%	▼	+3.31%	▲
Index-linked bonds	0.90%	4.62%	+3.72%	▲	+3.82%	▲
Conventional government bonds	15.31%	8.10%	-7.21%	▼	+0.19%	▲
Corporate bonds	0.86%	3.58%	+2.72%	▲	+0.16%	▲
Emerging market debt	1.45%	2.92%	+1.47%	▲	+1.25%	▲
Private equity	0.50%	0.50%	0.00%	◀▶	+0.01%	▲
Alternative investment strategies	2.24%	0.67%	-1.57%	▼	+0.31%	▲
Property	0.00%	0.00%	0.00%	◀▶	0.00%	◀▶
Commodities	5.90%	5.78%	-0.12%	▼	+1.30%	▲
Cash	8.78%	10.01%	+1.23%	▲	-10.35%	▼
	100.00%	100.00%				

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Asset allocation ranges

Liquidity	Equity-type risk	Diversifiers
5% to 40%	40% to 80%	0% to 40%

Investment outlook

After the longest six months any of us will have experienced, we enter the next six. Will it be another time warp of uncertainty and fear? No-one can know. The only guess we hazard is that there will be nervous times and that getting back to normal will take much longer than you would hope. To rectify the hopeful boast of the Lost Generation, "You won't be home by Christmas."

There is one other assumption we are confident in making, however, and it's why we have been able to invest despite the pandemic and its fallout. We believe stock markets will be higher in five years' time than they are today; we believe the companies that we have bought over the past three months will thrive over the coming five, 10 years and longer. The pandemic will pass and the world will carry on. That's why we will continue to buy more shares in them when the opportunities present themselves.

Investment outlook (continued)

But that doesn't avoid the fact that the second half of 2020 has plenty of powder left in the keg. Both bond and stock prices are elevated, pushed higher by central banks buying eye-watering amounts of assets in order to keep borrowing costs for governments and companies low enough to get them through the most disruptive period for commerce in modern times. Stock prices are also supported by pretty optimistic estimates of next year's profits; a disappointment here could cause another market tumble. Electioneering ahead of November's US presidential vote, and the result itself, could frighten investors as well. As could the deteriorating relationships between the US, China and Europe.

COVID-19 is by no means in the world's rear-view. Developed nations managed to win the first battle, preventing their hospitals from being overwhelmed by the sheer number of infected. Emerging markets are still in the midst of that first fight. Here in the UK, we are still working to eradicate the virus even as we begin to reopen our shops and restaurants. It's sobering to remember that less than a tenth of the English population is estimated to have had the coronavirus, based on present antibodies or current infection. Most other countries will be in a similar situation. The chances of major flare-ups, especially as international travel resumes, is high.

Setting objective reality aside for a moment, we think perception and sentiment will matter more for the global recovery. This subjectivity is most crucial in two areas: household spending and business investment, and inflation expectations and people's faith in central banks' ability to keep prices stable.

Businesswise, it doesn't matter if the virus is rife or not. What matters is how a situation makes people feel. If people feel confident to go out and spend enough to give businesses the assurance they need to invest in more staff, stock or equipment, that's what kick-starts a struggling economy. As we said before, we believe the days of nationwide lockdowns are gone, so people will be making their own decisions about how much risk they are willing to take. That could be buying a home or a new fridge because you're safe in your job, or going to see friends at a restaurant because you feel like the health risk to you is low.

As for inflation, well, down the rabbit hole. A lot of research has been done by people much smarter than us (and probably with much worse chat) into how future inflation tends to be influenced most by our expectations of that future inflation. Put simply, if we all believe inflation is going to be much higher in a year's time, we will all make as many big purchases as we can now (before our money loses its value) and start bartering with our bosses to get double-digit pay rises. In doing so, we would bring about what we had feared. This is what we mean by 'perception' matters more than reality. The world has been inundated with cash from governments and central banks, yet inflation has fallen. This makes sense: Given the huge drop in economic demand, the extra money is tiding over the less fortunate and getting hoarded by the fortunate. However, as the global economy comes spluttering out of the corona crisis, people's beliefs about how inflation will react and their trust in the central banks will come to bear. People have taken a generally dim view of technocrats over the past few years, hopefully that doesn't influence their opinions about inflation!



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A member of the Investment Association

A member of the Rathbone Group.

Registered No. 02376568

Management company:
FundRock Management Company S.A.
Authorised in Luxembourg and regulated
by the Commission de Surveillance du
Secteur Financier

Rathbones
Look forward

When operating in the EEA, Rathbone Unit Trust Management works in partnership with a tied agent. In Europe we market our funds through Rathbone Funds Advisers, Unipessoal Lda. ("Rathbone Funds Advisers") a company acting as a tied agent to Carne Global Financial Services (Europe), Unipessoal Lda. ("Carne Global") which is an investment advisory firm authorised under MiFID II and supervised by the Portuguese Securities Market Commission – the CMVM (Comissão do Mercado de Valores Mobiliários). Rathbone Funds Advisers is registered in Portugal and has been appointed by Carne Global to provide investment advisory services on its behalf in relation to financial instruments, in particular units or shares in undertakings for collective investments.

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