RATHBONES

RATHBONE MULTI-ASSET PORTFOLIOS

ENHANCED GROWTH FUND

Quarterly investment update
January to end March 2024

CONTENTS

HOT TOPICS

MARKETS HOT TOPICS (MACROECONOMIC)

SO NEAR, YET SO FAR

At the back end of last year, investors were confidently forecasting six or seven interest rate cuts from the US Federal Reserve (Fed) in 2024. They've since reined those bets in big time and currently think the Fed will deliver about three 0.25% cuts – if that – perhaps starting in the early summer.

That about-turn has driven big moves in government bond markets. Government bonds are the asset class most sensitive to rate expectations, so it's hardly surprising that their yields have risen, driving their prices down.

We think American rates will fall in time, but inflation and economic growth will need to moderate further first, and exactly when that will happen is anyone's guess. Ours, for what it's worth, is sometime in the second half of this year.

On this side of the Atlantic, however, we think there's a greater chance of rates falling faster and further. Given dire economic growth in the UK and a lot of Europe, the rates situation seems more favourable than in the US, where there's greater evidence that inflation mightn't yet be vanquished. The UK and EU seem more likely to cut sometime around the middle of the year.

WHO NEEDS RATE CUTS ANYWAY?

For much of 2023, investor confidence tracked central bank-speak slavishly. Stocks sold off in early autumn when investors expected the Fed to keep rates higher for longer in its ongoing fight against inflation and then surged towards year-end when the central bank seemed more confident about getting inflation down to its 2% target.

So why have stock markets hardly blinked this year as rate cut bets have been pared back so aggressively? It seems that as 2023's higher-rate-driven US bank failures fade from their collective memories, investors have got a lot more comfortable about higher-for-longer rates. Who needs cuts when America's economy keeps defying recession forecasts and is booming instead?

Providing company profits prove sustainable, stocks can probably keep rallying for a while longer. Stronger profitability would tend to imply a better economy and, therefore, less pressing need for those ever-elusive rate cuts. Stock market bulls also argue that gains are getting broader, and less alarmingly concentrated. In contrast to the first 10 months of 2023, when an unusually small number of stocks contributed to the gains of the entire US index and most underperformed, more global companies are participating in this year's rising markets.

Expectations for Fed interest rate cuts fall from six 0.25% cuts to three in just one quarter.

THE WORLD'S THIRD-LARGEST ECONOMY AND FIFTH-LARGEST STOCK MARKET ARE ONCE AGAIN BACK ON THE MENU.

CAN HOPE TRIUMPH OVER EXPERIENCE?

Since its stock market popped in 1990, Japan has had a long history of reliably disappointing investors. Every few years they're lured back by the promise of a new dawn, only to find little's changed, and so repeating the trauma. And yet, once again, the lure of Japan is calling.

The world's third-largest economy and fifth-largest stock market are once again back on the menu. The stock market has rallied handsomely, adding almost 50% since the start of 2023, and approaching levels not seen since the last Japanese market high in 1989 when Japan was all the rage, before the market burst spectacularly.

The Japanese economy has been plagued by low growth and deflation (falling prices), aided and abetted by terrible demographics. Often, the attraction of Japan was around valuation. Stocks trade cheap, with 30% of TOPIX stocks still trading below book value – this implies that investors believe almost a third of the index is likely to destroy capital in the future. However, we see several factors that should boost stock prices. One is the ratcheting up of the pressure on Japanese companies to do better for shareholder which is bringing genuine change. At the same time, Japan's economy is still relatively weak, but there have been some improvements. House prices have increased, and the country is finally experiencing positive inflation, helped by reasonable wage growth. International investors are returning to Japanese companies, reversing decades of outflows.

46%

Gain of the Japanese TOPIX stock market index since 1 January 2023.

PORTFOLIO ACTIVITY

Key purchases/additions	Key sales/trims
Credit Agricole TOPIX Callable Note 2029 (purchase)	Shimano (sale)
Deutsche Bank AG 7.5% (purchase)	Halma (sale)
SPDR Russell 2000 ETF (addition)	Tomra (trim)
Thales (purchase)	Nvidia (trim)
Salesforce (purchase)	ASML (trim)

Source: Rathbones

We bought a new diversifier to protect against exactly this. The BNP Paribas 10-Year US Rates Swaption May 2024 covers half the value of our US bond portfolio and makes money if 10-year yields rise. Usually, a swaption gives you the option to swap your fixed rate interest payments for floating ones; however, rather than giving us a series of floating cashflows into the future, ours is set up to simply pay us a lump sum when it's exercised. If rates remain flat or fall, all we lose is the small premium payment we made to buy the swaption.

While we don't allocate assets geographically, there are times when structural trends emerge that we'd like to gain exposure to. The 'three arrows' of former Japanese Prime Minister Shinzo Abe's reform agenda for corporate Japan, which began more than a decade ago, have started to bear fruit. Corporate governance changes have taken effect, further supported by changes implemented by the Tokyo Stock Exchange. This, alongside structural shifts in Japanese monetary policy and a more robust macroeconomic backdrop, have left Japan in a very different place to the last 30 years. This is reflected in the much stronger performance of Japanese equities over the last year or so. To gain exposure to this positive trend, we added a new structured product based on the TOPIX index which gives us the potential for some capped exposure to TOPIX gains plus conservative downside protection to any weakness.

In the last couple of years geopolitical stresses have escalated around the world, with the Russian invasion of Ukraine, tensions between the US and China, and the conflicts in the Middle East. Increasing belligerence between nations encourages investors to pay more attention to defence stocks as expectations for military spending rise. We've long owned aerospace and defence contractor Lockheed Martin to mitigate the risks of a more stressed geopolitical age, yet we increased our position this quarter and added French-listed rival Thales as well.

We think there are a few additional tailwinds which could drive long-term returns in the years ahead. The doctrine and needs of militaries are changing rapidly because of technological advances and the new fronts they open up. New threats require new solutions, and while large defence contractors are mostly known for the big machines they have produced in the past, a much more meaningful part of their business is now focused on cybersecurity and digital warfare. A kicker to this need for military investment is the potential for Donald Trump to win a second term as US President and the war in Ukraine, which both seem likely to push European members of NATO to spend more on defence.

Both Thales and US-listed Lockheed Martin have a comprehensive suite of cyber capabilities, supported by elements of AI, machine learning, and automation to deal with the complexities of today's deployments. These technologies also have civil uses, beyond the military ones that drive their creation. For example, Lockheed Martin is using its AI capabilities and hardware to support firefighters dealing with wildfires by connecting land, air, and space-based sensor and monitoring, which help predict and mitigate the spread of wildfires.

We bought more shares in the SPDR Russell 2000 ETF, which tracks the small-cap US index. Of course, 'small' is relative and the Russell 2000 constituents are still huge compared with companies in the rest of the world. We added to the Russell because we felt its companies are now better valued than the large-cap-denominated S&P 500 index after years of lagging performance. We also added to Japanese electronics manufacturer and digital entertainment giant Sony on weakness.

We sold UK safety systems engineer Halma this quarter. We still respect this business, however, given the level of markets and where we are in the business cycle, we felt it made sense to reduce some of our portfolio's 'cyclicality' (or its sensitivity to global economic growth).

As global stock markets continued to rise in 2024, we trimmed some of our better-performing shares, including AI computer chip designer Nvidia (check out our colleague David Harrison's explainer on what all the fuss is about), e-commerce platform Shopify and ASML, which designs equipment for making top-of-the-line computer chips.

SPOTLIGHT

IN THIS QUARTER, THE SPOTLIGHT IS ON OUR TSMC AND MERCK HOLDINGS.

TSMC

- TSMC is the world's largest semiconductor foundry, manufacturing chips for a variety of uses, including smartphones, computing, cars and data centres

- It has hundreds of customers across a diverse range of companies, technologies, and industries, all fundamental to the advancement of human progress

- Its advanced technology and capabilities provide TSMC with a strong competitive advantage and high barriers to entry as semiconductor production and design become increasingly complex

- Given its scale and strong technological expertise, TSMC is likely to benefit from favourable industry trends such as 5G, artificial intelligence (AI) expansion and rapid digitisation

MERCK

- Merck is a global health care company that offers health solutions through prescription medicines, vaccines, biologic therapies and animal health products. It operates through two main segments – pharmaceutical which is the vast majority, and it also has a small animal health segment

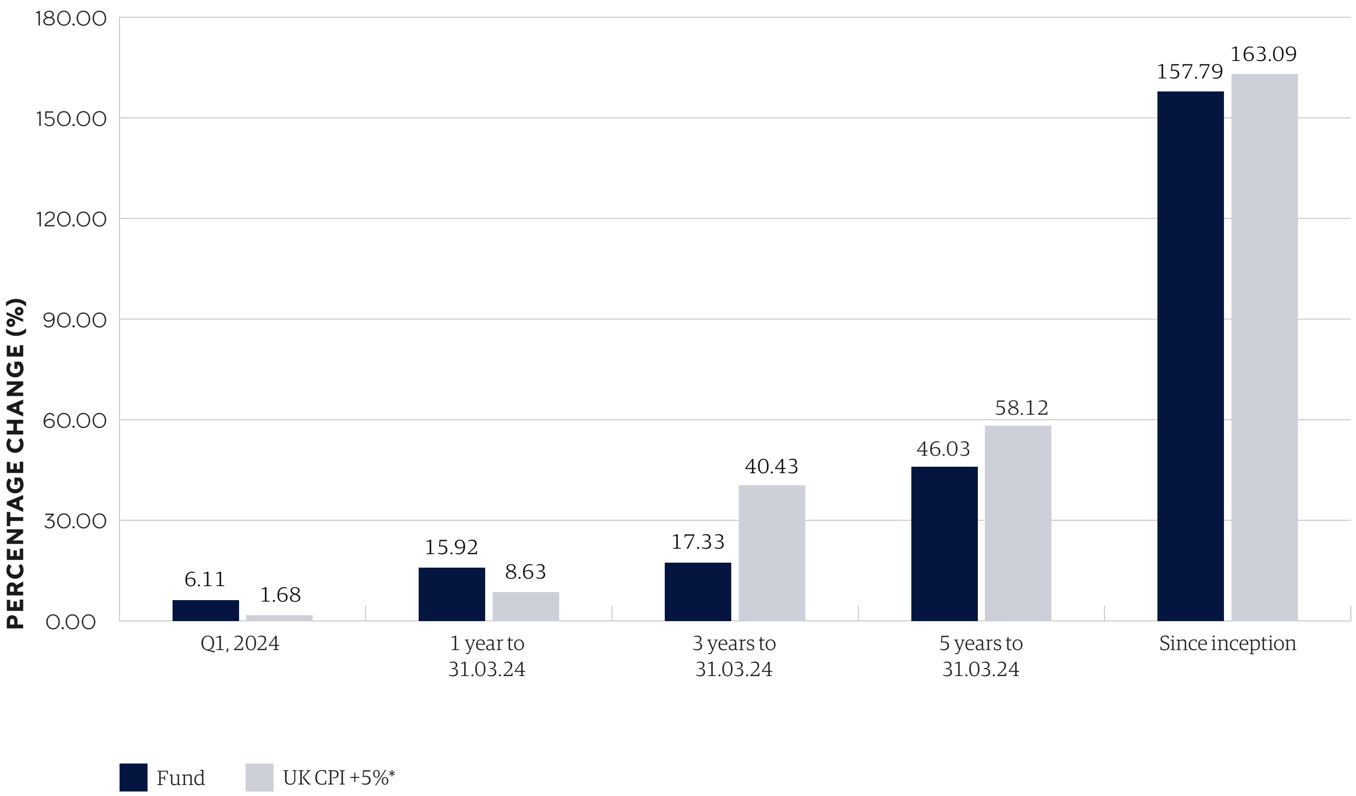
- It has a wide range of pharmaceutical products, including those for treating cancer, diabetes, and heart disease – its flagship drug is Keytruda a cancer immunotherapy drug

- This diversification helps mitigate risk, as the company is not overly reliant on any product or therapeutic area. Additionally, the company has a strong pipeline of new medicines to further drive future growth

- As a pharmaceutical business it should be less susceptible to rising costs from inflation compared to other sectors and should perform relative defensively if we enter a recessionary period

FUND PERFORMANCE

RATHBONE ENHANCED GROWTH FUND — QUARTER 1 2024



*At 1 October 2015, the benchmark measure changed to CPI+5%.

Performance (based on 'S-class' shares).
Net of expenses and tax.
Net income reinvested.
Data source: FE fundinfo

12-month rolling performance					
Year to:	**End Mar 2024**	**End Mar 2023**	**End Mar 2022**	**End Mar 2021**	**End Mar 2020**
Fund	+15.92%	-5.03%	+6.58%	+35.46%	-8.11%
UK CPI +5%*	+8.63%	+15.97%	+11.48%	+5.46%	+6.77%
Annual calendar performance					
Calendar year	**2023**	**2022**	**2021**	**2020**	**2019**
Fund	+12.30%	-12.53%	+15.86%	+10.70%	+20.00%
UK CPI +5%*	+9.14%	+16.19%	+10.40%	+5.40%	+6.46%

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**
Nvidia	+84.13	+0.87
TSMC	+32.45	+0.36
ASML	+29.35	+0.37
Edwards Lifesciences	+26.44	+0.29
Caterpillar	+25.58	+0.28

Bottom performers (%)		
Holding	**Performance**	**Contribution**
AIA Group	-21.88	-0.24
HDFC Bank	-15.79	-0.16
Adobe	-14.66	-0.16
Zoetis	-13.18	-0.12
Nike	-12.30	-0.12

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

AI chip designer Nvidia was the most significant contributor to performance as the stock continued its meteoric rise into 2024. In late February, it again reported very strong earnings as data centre demand for its chips continued to soar off the back of burgeoning artificial intelligence demand. Nvidia's quarterly revenues jumped 265% from a year earlier and the stock has rallied by more than 80% over the first three months of 2024.

Other chip-related stocks, such as ASML (which makes the machines that make chips) and Cadence Design Systems (whose software helps design and test chips) were also strong contributors.

Elsewhere in technology, cloud names such as Amazon, Alphabet and Microsoft had another good quarter and broadly backed this up with strong earnings and healthy outlooks. These businesses are also perceived as the leaders in the development of AI, helping to drive their share prices to at, or near, all-time highs.

Stock markets have continued to move higher as investors have grown more confident about the chances of a soft, or at least softer, economic landing. That's helped support industrials such as Kion (automated warehouse solutions) and Caterpillar (construction and mining equipment) which rallied sharply. US consumer-related stocks, such as home improvement retailer Home Depot and discount retailer Costco were also stronger off the back of a sunnier outlook for the US economy.

A key detractor from our performance for the quarter was Hong Kong insurer AIA, whose share price fell by around 20%, dragged lower after its management warned about weaker profit margins on its China business.

ASSET ALLOCATION CHANGES

THERE WERE NO SIGNIFICANT CHANGES DURING THE QUARTER.

Asset allocation split	31.12.23	31.03.24	% Change	12 month change
Liquidity (10%-20%)	5.3%	3.4%	-1.9%	-0.9%
Equity-type risk (70%-100%)	93.1%	95.0%	2.0%	1.6%
Diversifiers (0%-20%)	1.7%	1.6%	-0.1%	-0.7%

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

Asset class split	31.12.23	31.03.24	% Change	12 month change
Equities	88.4%	89.5%	1.1%	-1.2%
UK	12.0%	12.4%	0.4%	-1.8%
US	53.0%	53.9%	0.9%	-0.9%
Europe	13.9%	12.5%	-1.4%	-1.4%
Japan	2.9%	4.1%	1.1%	0.6%
Asia ex-Japan	4.0%	4.3%	0.3%	1.1%
Emerging Markets	0.0%	0.0%	0.0%	0.0%
Global	2.6%	2.5%	-0.2%	1.4%
Index-linked bonds	0.0%	0.0%	0.0%	0.0%
Conventional government bonds	0.0%	0.0%	0.0%	0.0%
Corporate bonds	3.4%	4.3%	0.9%	2.7%
Emerging market debt	0.0%	0.0%	0.0%	0.0%
Privite equity	1.3%	1.2%	0.0%	0.1%
Alternative investment strategies	1.7%	1.6%	-0.1%	-0.7%
Property	0.0%	0.0%	0.0%	0.0%
Infrastructure	0.0%	0.0%	0.0%	0.0%
Commodities	0.0%	0.0%	0.0%	0.0%
Cash	5.3%	3.4%	-1.9%	-0.9%

INVESTMENT OUTLOOK

THE YEARS-LONG WAIT FOR AMERICAN RATE CUTS THAT REMAIN ALWAYS JUST OVER THE HORIZON REMIND US OF ASYMPTOTES: CONSTANTLY APPROACHING AND NEVER ARRIVING.

The years-long wait for American rate cuts that remain always just over the horizon remind us of asymptotes: constantly approaching and never arriving. The last couple of months have done little to disabuse us of this notion. Businesses, households and investors are eagerly awaiting drops in benchmark rates, yet they keep floating on the horizon.

The big piece of the puzzle is inflation: will it continue to fall (we think it will), reassuring central banks that they can reduce borrowing costs without sparking another flare-up in prices? We have always suspected that the last mile of getting inflation back to 2% would be the hardest. And so it has been so far. To add another nuance to this point: all else equal, it's harder to get inflation lower when your economy is flying than when it's in the doldrums.

To avoid being burned by any shifts in expectations that arise as investors continually re-evaluate the likelihood of rate cuts and the strength of economies, we've continued trimming stocks whose valuations appear to have got a bit over-optimistic. We've used that money to add to equities and other assets that have fallen from favour. We don't want to sell outperforming businesses completely – lots of people want to buy them for a reason! – because over five years or more, we think they have the opportunity to grow well and become more valuable. Yet we try to minimise the short-term downdraughts that happen.

2% INFLATION

We have always suspected that the last mile of getting inflation back to normal would be the hardest.

WANT TO HEAR MORE FROM THE TEAM

THE SHARPE END PODCAST A MULTI-ASSET INVESTING PODCAST

The Sharpe End lets you be a fly on the wall for frank and informal conversations the team are having on the desk about recent events and how they impact their funds.

Available on all major podcasting platforms.
New episodes monthly.

Listen and subscribe here:
linktr.ee/thesharpeend

Scan to listen to
The Sharpe End podcast.

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.

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.

Any views and opinions are those of the investment manager, and coverage of any assets held must be taken in context of the constitution of the fund and in no way reflect an investment recommendation.

Call
020 7399 0399

Visit
rathbonesam.com

Email
ram@rathbones.com

Address
Rathbones Asset Management Limited
8 Finsbury Circus, London EC2M 7AZ

@RathbonesPlc

@RathbonesGroup

Rathbones Asset Management

8832.04.24