

Rathbone Multi-Asset Enhanced Growth Portfolio

Update, October 2018

Overview

It was a difficult month for our fund, with a simultaneous rise in bond yields and sharp correction in equity markets. In English, this means the value of both bonds and stocks headed the same way: down.

However, we took this as an opportunity to buy assets at lower prices than we have for some time. We don't mean to sound blasé about this – we felt just as uncomfortable as you or the next person as markets roiled around us. But to us, despite the avalanche of red on our screens and thousands of earnest post-rationalisations from newspapers and analysts, little had changed by mid-October except that prices were roughly 5-7% cheaper. We thought growth would moderate as the year went on – the tax cut splurge had to fall out of the numbers at some point. And the fact that interest rates are rising isn't exactly a revelation. So we bought into the dip.

Many of the companies we own – and some we've been watching – fell significantly as the US 10-year yield, a reasonable proxy of the discount rate used to value stocks, stepped higher. This seemed to have been driven higher by fears that the Federal Reserve will keep raising rates apace, perhaps faster than the American economy can take. While we see that as the largest risk to global stock markets (because if the US boards the log ride, you can bet the rest of the world's markets will be right behind), we think it's more likely that the Fed will ease up as data dictate. In fact, economists we listen to say the attitude of Fed members has already started to swing toward a slower pace of tightening. That's because US inflation has slipped back toward the targeted 2% and there appears to be more people ready to enter the American labour force as jobs present themselves than people thought. That should keep a lid on wages as the economy rolls into the future.

We've been focusing on those companies that can post solid growth without leaning heavily on economic expansion or large debts. We think these businesses should be able to take higher borrowing costs in their stride without eroding margins, as well as delivering growth in a world where it's getting harder to find.

This month's trades

After equity markets took a dive in early October, we added to many of our holdings around the world. Rather than simply rebalancing our portfolio – buying more shares to return our holdings to the proportions they were before the falls – we went further and increased the amount of equities we hold. To do this, we used some of the cash we have been holding over the year.

Toward the end of the month, we sold cruise ship operator **Carnival**. Diesel is a significant expense for the business and the price of oil is now about 50% higher than when we first bought shares in the company. Added to that, Carnival is doubling down on its expansion into China. While we are fans of China in the long term, we think Chinese growth worries may create some rough waters for Carnival in the next couple of years. So we swapped the shares for **LVMH Moët Hennessy**. This is a holding company that owns a range of 70 high-quality luxury brands that we believe will prove a more resilient investment. It owns Louis Vuitton, TAG Heuer, Bulgari and Le Bon Marché Rive Gauche, a department store in Paris. It also owns several high-end alcohol producers, including Dom Perignon and Moët & Chandon, and the Glenmorangie distillery. LVMH has been on our bench for a while, but we couldn't justify the price.

Following the October sell-off, the share price looked much more attractive, allowing us to buy into the business.

We sold German chemicals and consumer goods firm **Henkel** because we were concerned about potential vulnerability of its household brands division. We have come to the conclusion that consumer brand companies are no longer the defensive bastions of metronomic sales and margin growth they have been in the past. It's easier for rivals to produce cheaper and better value substitutes, particularly after years of raising prices on customers. Even worse, we see signs that big brands companies are getting outfoxed by more nimble competitors in emerging markets and even at home. Products better suited to local tastes are quickly relegating traditional brands to a dangerous middle ground. If you're neither the best nor the cheapest, in today's world you're toast.

Outlook

We're cautiously optimistic about the final quarter of 2018.

At the beginning of October, the S&P 500 traded at almost 17x earnings forecast for the coming year. By the end of the month, the index was worth just 15.5x those earnings. Similarly, the FTSE All-Share fell from a forward PE of about 13x to 12x. This makes valuations easier to justify and takes some of the strain off growth worries – for us at least. We think investors are getting too nervy about 2019 growth; the US economy isn't as fragile as many people have come to think.

While there are some measures that have softened recently, most notably the housing market, virtually every measure of confidence, from consumers to businesses, is sky high. That matters because economies are, at bottom, driven by the confidence of people. Whether it's warranted or misplaced isn't really the point, what's important is that people spend and invest, because that's what creates the demand that ensures societies grow and progress. Of course that works both ways. If investors freak out, sell up and send financial markets slumping that can be enough to scare businesses to rein in spending which then leads their employees to worry about their jobs.

In the real world, that's called the tail wagging the dog.



David Coombs
Head of Multi-Asset Investments



Will McIntosh-Whyte
Assistant Fund Manager

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