Rathbone Unit Trust Management

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Rathbones
Look forward

Rathbone Income Fund

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"I acquired the book in a small town on the plains for a few rupees and a Bible. Its owner didn't know how to read ... He told me that his book is called the Book of Sand because neither the book nor sand possess a beginning or an end...
...If space is infinite, we are in no particular point in space. If time is infinite, we are in no particular point in time."
Jorge Luis Borges, *El Libro de Arenas (The Book of Sand)*, 1975

Frank: "...that's an example of assonance."
Rita: "Yeah, means getting the rhyme wrong."
Willy Russell, *Educating Rita*, 1983

Doesn't time fly?

Years ago, when I first started work, and I lived in staff digs on Inverness Terrace in Bayswater, I maintained a habit that I had begun in my teenage years. I'd save up until I could buy an album (by then we had only just evolved from vinyl to CDs) from the local Our Price. This treat was afforded maybe once every three or four weeks, and as I had always done, I listened to my latest purchase over and over again until the narrative of the music was cemented in my head, one track anticipated even before the prior one had concluded. Many years later that anticipation remains imprinted in my brain when I listen to these decades-old tracks.

These days, you're more likely to spot an apparently obsolete vinyl record than the CD that once consigned it to oblivion. Lines of CDs that I still have at home sit untouched in neat rows in a specially designed cabinet that keeps them from sight. My new minimalist self knows that I should get rid of them, but a mixture of nostalgia and a bad case of the "what ifs" stops me from decluttering this part of my life. I have all the music I need on the mobile phone in my pocket; Spotify can make me the equivalent of a new compilation tape (now that does age me!) every day. Yet there is no sense of narrative, of longevity. I can hear a song on my morning run and by the time I get home it has gone, never to be heard again. When the choice of tracks is virtually infinite, the experience of music can become ever more fleeting. One had better enjoy the moment, because in an instant it can be gone.

Equity markets move in ever-varying cycles

Short-lived knee-jerk reactions can be the immediate reflection of some shock, sometimes market related, often exogenous, and experience says that noise is rarely a principal driver of sustained market gains or losses. Noise is frequently just a creator of volatility. More relevant are the prolonged moves that are serious generators or destroyers of capital. Think of markets' grind upwards through to 2000 on the Technology Media Telecoms boom, steamrolling through the occasional emerging market debt crisis and hedge fund implosion to hit all-time highs; or the subsequent bear markets that we remember post-2000, and more recently, from 2007 through to 2009. However, in terms of longevity, the current bull market, into its tenth year from the lows of March 2009, is certainly a long player.

Market historians like to look back and measure previous bull and bear markets, to try to determine where we are today. But the reality is that every moment is a different world and, while certain universal truths may hold firm, investors' reactions are almost certainly going to be very different. The challenge for fund managers is to know not only which truths and behaviours from the past have weight today, but also to understand that this moment in time is inevitably different. Mark Twain's legendary aphorism, "History doesn't repeat itself but it often rhymes," is so frequently invoked because of the truth in the word rhyme. There are always little differences – it is never quite the same – and this is why trying to time market changes is so impossibly difficult. There is no blueprint that we can follow.

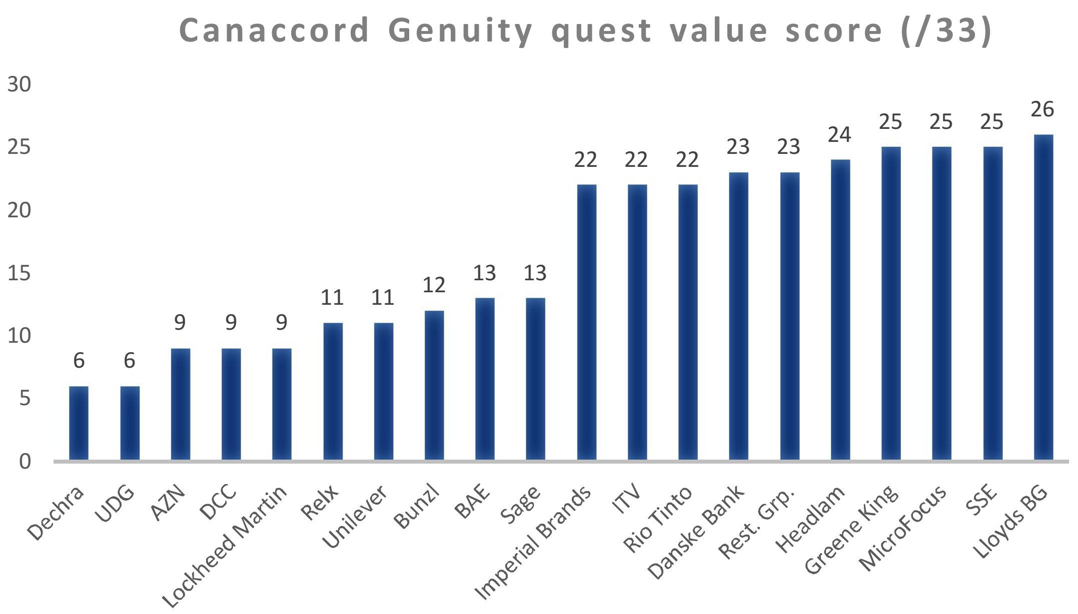
Fashions fade, but live again

There are markets within markets. In the first half of the noughties, consumer staples were loathed. I had to have my arm severely twisted to buy Diageo sometime after their disposals of the Pillsbury dough business (sold to General Mills in 2001) and Burger King (2002), and before they were feted as a purveyor of global brands. How many changes of strategy did Unilever have to go through before it became loved by long-term investors? Tobacco stocks were loathed and then loved and have now fallen from favour again. No-one wanted to own the newly privatised water stocks in the technology heyday of the late nineties, but woe betide income funds that were short of these names as they were picked off one by one in an M&A frenzy in the first half of the following decade.

Over the last few years, there has been a switch back in favour of growth companies, and very specifically technology-related growth. Seven of the 10 biggest stocks in the world today are technology names: Apple, Alphabet, Microsoft, Amazon, Tencent, Alibaba and Facebook. In March 2000, Microsoft was number one, but a large percentage of the technology and telecommunications names that empowered markets through that bull market are no more or have been superseded by better products and businesses. This technology and growth-driven bull market is different, and we are well aware of the dangers of predicting a change in the tide.

Nevertheless, we do have to take a position, and ours is one of extreme caution, although we admit that this is the wrong side of the prevailing market dynamic. However, while one can't anticipate the catalyst for a change in dynamic, we do worry about what will happen when we lose the status quo of low interest rates, low volatility and high asset prices.

But in the short term we have to take the pain, and it is too crude to hide behind a simplistic argument of value underperforming growth and momentum. Yes, we are very value oriented, but it would be wrong to say that we are dogmatically value investors. We like to understand the price risk inherent in any stock that we hold. Three of our most expensive stocks exhibit visible growth profiles and momentum has been very strong. Although the stories are intact we are disciplined in pruning positions in Dechra Pharmaceuticals and UDG Healthcare as the valuations become ever more stretched. We are also trimming AstraZeneca, where the strong price performance now belies the risk inherent in predicting future earnings. This is our process in action.



By contrast, greatest value is exhibited by some very UK-oriented names, including Lloyds Banking Group, SSE, Greene King, Headlam, and Restaurant Group. We have added to most of these names, fighting the prevailing winds, and the only sale has been Lloyds, where we have preferred the risk reward of Danske Bank as an alternative financial play. But is the climate now changing? Investors are beginning to recognise the value in the UK, and when shares like Greene King rebound after a trading statement elicits no new downgrades, one senses the start of a change in tide.

We have to be careful that we are not too inward looking, and ignore what is happening in the wider world. There are reasons why markets have recovered in the way that they have. In the modern world there is an awful lot of noise. However, our remit is to focus on the fundamental balance between the quality of a company's earnings and the price that we are willing to pay for those earnings. Nevertheless, our hunch is that the playbook that worked so well in 2000 may be relevant in 2018: Sustainable, visible cash earnings supporting meaningful dividend yields have a value; it remains to be seen whether the wider market will concurs – and if so, when.

Recent trading: We have taken profits from a number of positions, including **Rio Tinto**, **AstraZeneca**, **BAE Systems**, **Dechra Pharmaceuticals** and **UDG Healthcare**. We have continued to consolidate the new holding in **Imperial Brands**.
Companies met during the month: In a very quiet few weeks we met with **Lloyds Banking Group** and **Lockheed Martin**.

Carl Stick
Fund Manager

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