RATHBONES

RATHBONE INCOME FUND

QUARTERLY UPDATE MARCH 2025

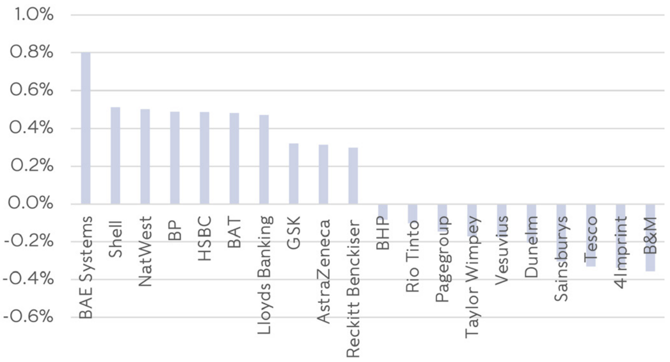
Trump 2.0 is markedly different from the original. There are too few adults in the room to soften, prevaricate or deflect. There's a President in the White House with a legacy to forge and the world is feeling the impact. Investors are reflecting and reacting and the mood is verging on panic. So-called 'Liberation Day' didn't feel particularly liberating.

Change was afoot in markets even before the tariff announcement and the subsequent market rout it sparked, which occurred after the quarter end. The S&P 500 lost 4.3%, and technology stocks were especially weak — the Magnificent Seven retreated 16%, making a 20% fall from the December peak. By contrast, the FTSE All-Share Index delivered 4.5%, one percentage point of which reflects the impact of dividends, very much our stock in trade.

We had a strong start to the year. Our fund was up 4.3%, a fraction behind the benchmark FTSE All-Share, but comfortably ahead of the IA UK Equity Income sector average of 1.2%. Yet again, aerospace and defence business **BAE Systems** has led the way in terms of stock-specific contributions to our returns. The impact of the Trump administration on Europe has been huge. The conclusion that the US is no longer a reliable ally has galvanised responses across Europe, and the defence industry will reap the reward. It's difficult to underestimate the importance of Germany amending its strict debt brake, effectively allowing unlimited borrowing for defence spending. The accompanying €500 billion of infrastructure investment over the next decade has the potential to be just as powerful. As we have stated many times, BAE is a very well-run business, and while it may face headwinds in the US if spending on security is reduced, the flip side is this inevitable increase not just in Europe, but beyond.

Other top-performers reflect our core positioning of several mainstays of the FTSE 100 in our fund, beneficiaries of what seems to be a nascent rotation of investors back towards the UK. Oil giants **BP** and **Shell**, domestic and international banks **NatWest**, **Lloyds** and **HSBC**, more defensive plays such as pharmaceuticals **GSK** and **AstraZeneca**, and consumer staples businesses, such as **British American Tobacco** and **Reckitt Benckiser**, have pushed ahead.

Q1 CONTRIBUTIONS



Source: StatPro, Rathbones

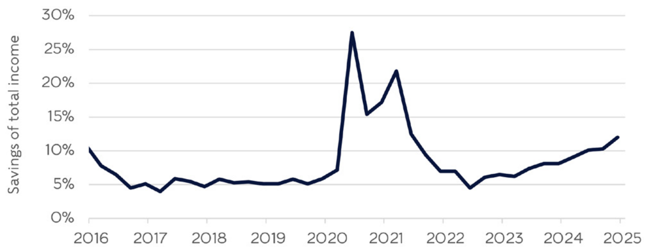
Commentary on the laggards makes perhaps more interesting reading. While the performance numbers show that we have been positioned well for current market conditions, we're perhaps only half right in that contention. Several domestic names have held us back, especially those exposed to UK households. Retail businesses **B&M European Value Retail**, **Tesco**, **Sainsburys** and **Dunelm**, alongside housebuilder **Taylor Wimpey**, have all dragged on our performance this year.

The retailers are worried about competitive pressure and the potential erosion of profit margins in an environment of continued strain for many consumers. However, the latest consumer confidence data is close to its highest in five years; real wage growth is still strong; and the UK household savings ratio has picked up. The latter data reflects nervousness, but it also reveals pent-up spending power if confidence is maintained.

UK REAL WAGE GROWTH STILL HIGH

Source: ONS, FactSet; 3-month year-on-year growth, data to 31 Jan 2025

A RISING SAVINGS RATIO SHOWS PENT-UP BRITISH SPENDING POWER



Source: ONS, FactSet; net of government transfers (includes pension contributions), data to end 2024

Separately, the weaknesses in US marketing group **4Imprint**, steel manufacturing technology business **Vesuvius**, and miners **Rio Tinto** and **BHP** illustrate broader concerns regarding global growth. These concerns are likely to persist, but we're reluctant to withdraw too far from these more cyclical businesses. They all have very strong balance sheets (little debt relative to the cash they receive and the equity in their businesses), as well as competitive positions that augur well for any recovery. We're particularly enthused by the firepower they all have to buy back their own shares if circumstances demand such a course of action.

Performance review

	3 months	6 months	1 year	3 years	5 years
Rathbone Income Fund	4.3%	0.3%	6.7%	16.0%	68.4%
IA UK Equity Income Sector	1.2%	-0.1%	7.4%	15.9%	70.3%
FTSE All Share Index	4.5%	4.1%	10.5%	23.3%	76.6%

	31 Mar 24-31 Mar 25	31 Mar 23-31 Mar 24	31 Mar 22-31 Mar 23	31 Mar 21-31 Mar 22	31 Mar 20-31 Mar 21
Rathbone Income Fund	6.7%	6.0%	2.6%	11.6%	30.1%
IA UK Equity Income Sector	7.4%	7.6%	0.2%	10.8%	32.6%
FTSE All Share Index	10.5%	8.4%	2.9%	13.0%	26.7%

Source: FE Analytics; data to 31 March, I-class, mid price to mid price.

These figures refer to past performance, which isn't a reliable indicator of future returns.

Outlook and positioning

"The issue is not which horse in the race is the most likely winner, but which horse is offering odds that exceed its actual chance of victory."

Steven Crist, horse racing journalist

Although this is a quarterly review, it's particularly important that we comment on what has happened subsequently in April.

We have frequently expressed our anxiety about investor complacency regarding the global equity market, and specifically any notion of US exceptionalism. We have also recognised that this could be interpreted as UK managers inevitably arguing their own book, unable to participate in the quality, high-growth, high-return, high-tech US equity space. We have been crying from the sidelines.

However, our argument was always established upon valuation and the mismatch between that afforded the US and that afforded the UK, despite the obvious disparity in growth potential. Buying growth for growth's sake is risky if valuation discipline is ignored.

The cracks were beginning to show early in the year. The Chinese AI app DeepSeek shook the technology world because it threatens to commoditise large language models (LLMs). If LLMs become ubiquitous and cheap, it would decimate the returns on the billions of dollars of investment already made by Western tech giants. Returns on invested capital are key to equity returns, and high share prices assume that they remain elevated.

Then we had the rebuke of the EU over defence budgets, and the Oval Office tantrum. Europe was shocked, the US cannot be relied upon in matters of defence, and the major European nations – Germany, France, Poland, and the UK, have had to react. Broader uncertainty over the future of Ukraine, the empowerment of Putin's Russia, and the safety of Europe's own borders, will continue to worry us all.

But the biggest impact on markets was the imposition of drastic trade tariffs by Donald Trump. He has started a global trade war – where we end is a lottery, but the cards have been thrown up in the air and the world will be a different place once they land. Notions of US exceptionalism are being dismantled and US assets are not the safe havens they once were. When US government bonds succumb to the volatility experienced in the days after 'Liberation Day', and the dollar weakens so substantially, global markets react, and the outcomes are messy.

Last year, as markets moved ahead strongly, our positioning hurt us. Anxiety about valuations and complacency around US exceptionalism informed our very defensive tilt. We preferred businesses with sustainable earnings – so-called 'bond proxies' that would benefit from falling interest rates. Think consumer staples, pharmaceuticals, quality growth businesses like media giant **Relx** and food service business **Compass**. However, persistent inflation kept interest rates higher, so this tactic was less effective than hoped.

We increased our exposure to UK domestic plays, on valuation, and a broadly accepted gloomy prognosis on the UK economy. These are our domestic banks, housebuilders and retailers. We owned businesses that are both defensive and UK oriented, like food retailers and utilities. Although we had individual stock success, the Autumn Budget scuppered the plan and any meaningful share price progression.

The net result was we underperformed, and we have asked the question: were we too early in our defensive positioning, or just plain wrong? The events of the last few weeks suggest the former rather than the latter.

As stated above, in relative terms, we have rebounded very strongly year to date but since 'Liberation Day' and the tariff tantrum, we have been propelled further up the rankings, reflecting this defensive mix.

As is our discipline, we are sticking to our process. Our intention is to make sure that the composition of our portfolio remains true to how it was before the increase in volatility.

By way of illustration, **National Grid** and **SSE** have held up very well. We have taken profit; we do not want our exposure to get too extreme because it opens us up to downside risk if markets whipsaw back up. That money has been reallocated back to other, smaller names that have been marked back in the turmoil, such as UK retailer **Dunelm** and IT service provider **Computacenter**. Nothing dramatic, just a light touch on the tiller.

The highlight from the start of the year is an increase, on valuation and fundamental terms, in our weighting towards UK small and mid-sized companies, which now currently stands at 23%, the highest in many years. Expect this position to be maintained, if not marginally increased.

We think that, when the dust settles, the UK may be regarded as a safe port in the storm. Stable and sensible government; fingers crossed, reasonably unaffected by tariffs, but Starmer and co need to keep their collective heads below the parapet. The possibility of closer trade relations with the EU and others (e.g. India) may be precipitated by the current shenanigans.

Although much mourned, regretted and commented upon, the UK's lack of manufacturing base and our reliance on services may act as insulation in the current environment.

The valuation of the UK market remains crucial. Other markets (read the US) have a lot further to fall. The S&P is only back to levels seen at the start of 2024. Earnings expectations arguably are yet to reflect the change in the global environment. If there is a major correction on the back of a global recession, things could get worse. Trump took a large step back from the brink on 9 April when he called off most of his 'reciprocal tariffs', but 10% universal tariffs are still in place (which is higher than it has been since the 1950s) and a deal with China seems some way off. In the meantime, tariffs on the US's biggest trade partner are near 150%, and investor confidence has been shaken.

AVERAGE US TARIFFS SET TO SOAR

Source: US Census Bureau, FRED Database, Rathbones

Recent trading reflects the decision to increase exposure to either smaller FTSE 100 stocks, or to the lower tier FTSE 250 Index, reflecting the valuation opportunity we can see. So we have trimmed a broad spread of names, including Shell, **HSBC** and **Unilever**. We have added to a variety of businesses – **Breedon**, 4Imprint, **IG Group**, Vesuvius, Taylor Wimpey, **Big Yellow Group**, **Sirius Real Estate** and **Hiscox**.

Companies seen in March: **Experian**, Breedon, Vesuvius, **Persimmon**, **Bodycote**, **Relx** and **Lloyds**.

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For more info on our fund, including factsheets, performance and fund manager views, please click here.

If you require further clarification on this commentary, then please contact your adviser or Rathbones at the contact details below.

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