Thame Town Council

Rathbones
Look forward

Investment portfolio review

01 November 2022

Portfolio Summary

Portfolio mandate

Fund name	Service Level	Investment Objective	Risk Level
Thame Town Council	Discretionary	Capital Growth	2

Portfolio valuation summary (as at 25 October 2022)

Fund name	Fund value	Est. income	Est. yield %
Thame Town Council	£1,805,955	£32,176	1.8%

Thame Town Council
Performance Table

Consolidated portfolio performance during periods to 25 October 2022 (after Rathbone fees)

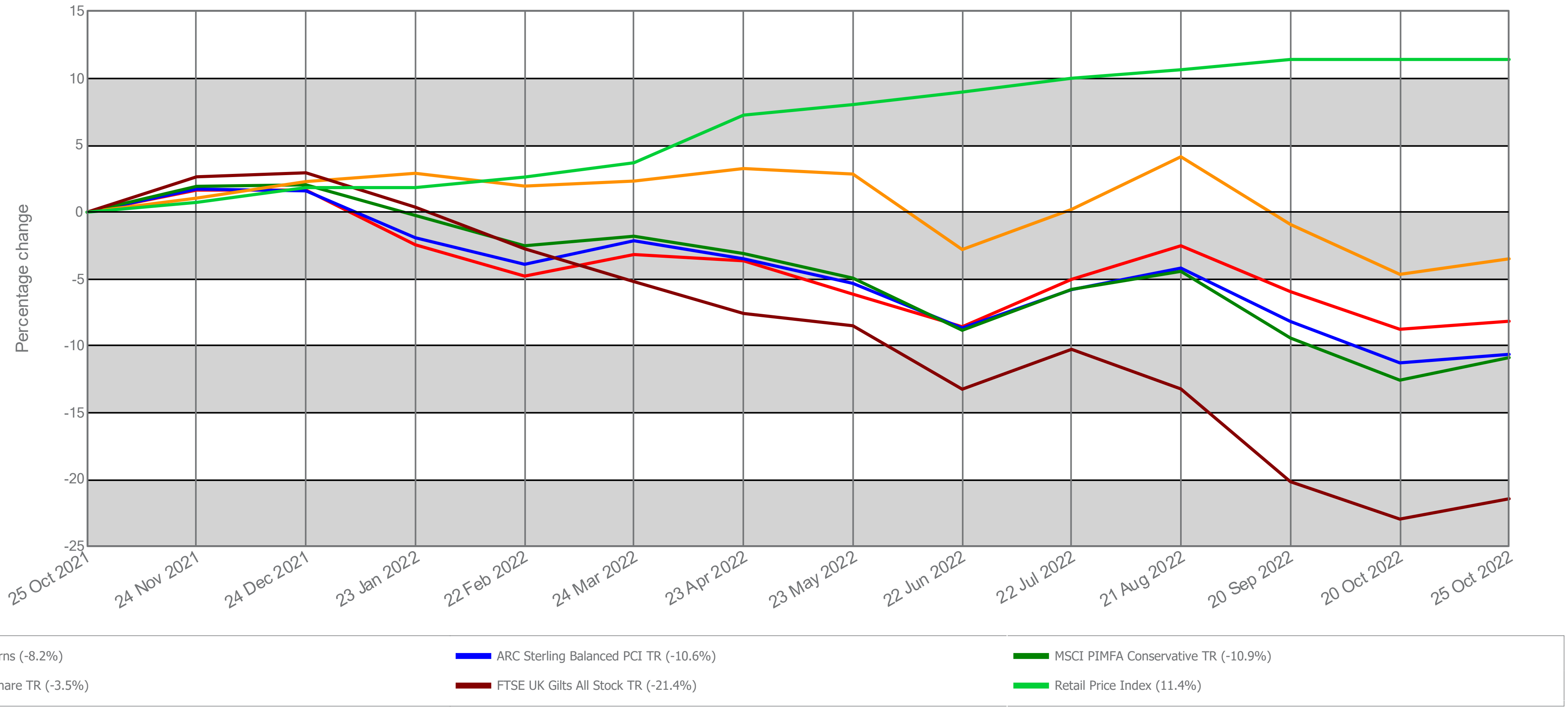
Portfolio	1 Year	3 Years	5 Years
Thame Town Council - Total Returns	-8.2%	6.5%	13.0%
ARC Sterling Balanced PCI TR	-10.6%	1.2%	6.2%
MSCI PIMFA Conservative TR	-10.9%	-2.6%	7.3%
FTSE All-Share TR	-3.5%	5.1%	12.3%
FTSE UK Gilts All Stock TR	-21.4%	-22.7%	-13.4%
Retail Price Index	11.4%	19.7%	26.3%

These performance figures are calculated on a fully time weighted basis, incorporating any cash flows or stock movements in or out of the portfolio as at the date of the transaction. It is noted above whether performance is calculated prior to, or after the deduction of any management fees

Thame Town Council

Performance Graph

Consolidated Portfolio performance one year ending 25 October 2022 (after Rathbone fees)



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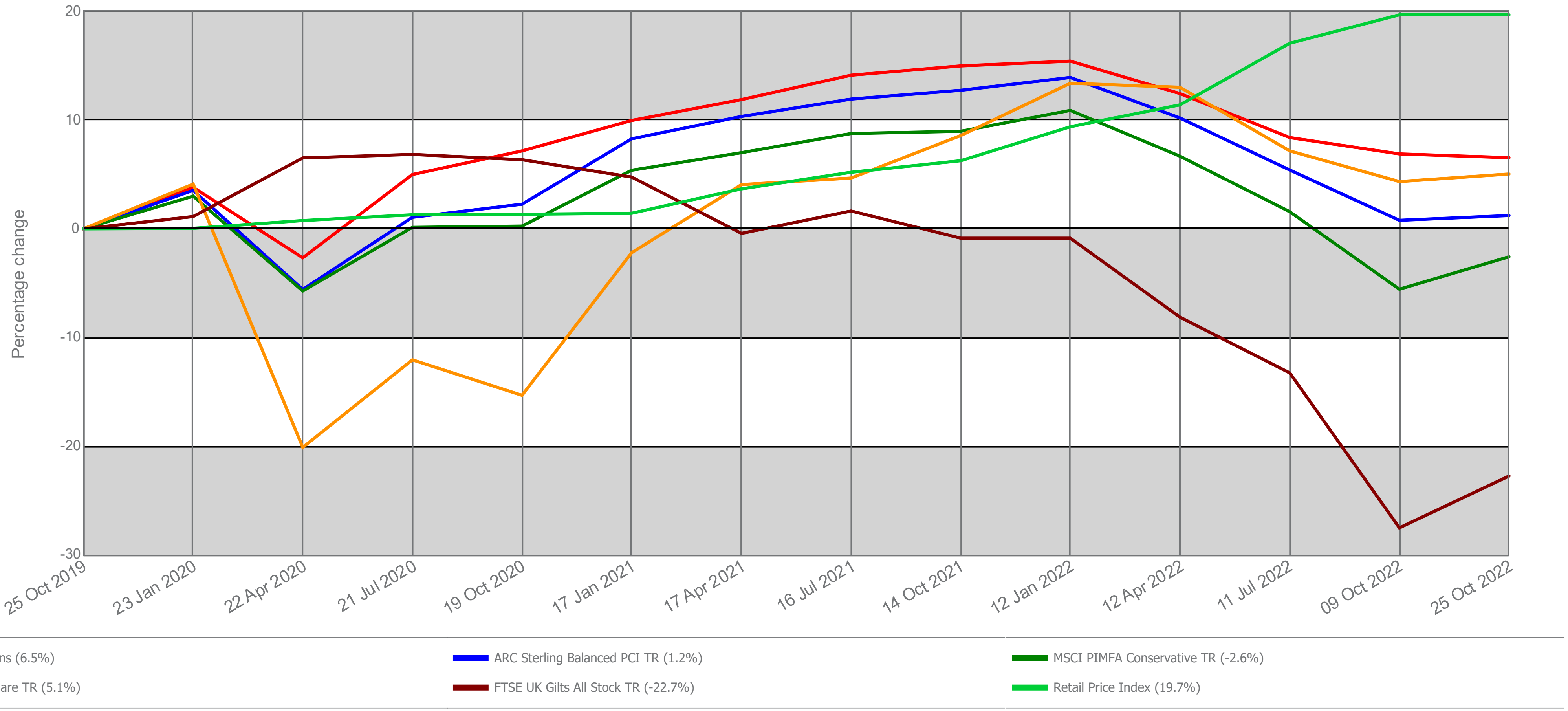
Thame Town Council
Performance Graph

Consolidated Portfolio performance three years ending 25 October 2022 (after Rathbone fees)



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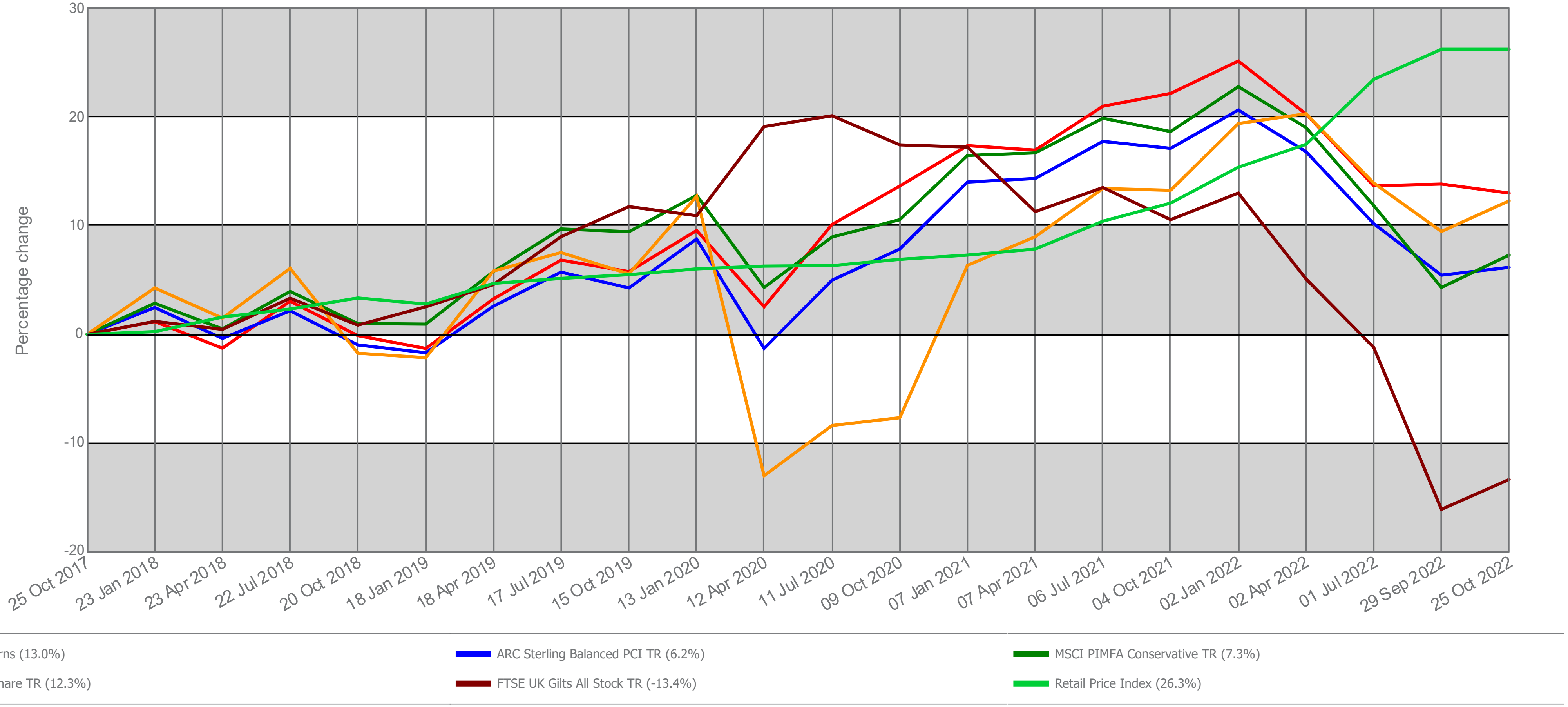
Thame Town Council
Performance Graph

Consolidated Portfolio performance five years ending 25 October 2022 (after Rathbone fees)



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Thame Town Council

Performance review & metrics

From 25 Oct 2017 to 25 Oct 2022
After All Fees

Performance	Period	Total Returns (Case)	MSCI PIMFA Conservative TR	Income Returns (Case)
Current year	To date	-9.72%	-12.64%	1.32%
Calendar year	2021	7.35%	6.89%	1.17%
	2020	7.35%	2.97%	0.96%
	2019	11.61%	12.86%	0.80%
	2018	-3.67%	-3.42%	1.68%
	2017	8.32%	7.46%	1.76%
Cumulative	Selected period	13.00%	7.30%	6.22%
	1 Yr to end date	-8.16%	-10.87%	1.57%
	3 Yrs to end date	6.54%	-2.56%	3.70%
	5 Yrs to end date	13.00%	7.30%	6.22%
Annualised	Selected period	2.47%	1.42%	1.21%
	3 Yrs to end date	2.13%	-0.86%	1.22%
	5 Yrs to end date	2.47%	1.42%	1.21%
1,000 invested	Selected period	1,130.00	1,073.00	

Risk	Period	Case	MSCI PIMFA Conservative TR
Annualised Volatility	Selected period	6.92%	7.63%
	3 Yrs to end date	7.92%	8.88%
Max Drawdown	Selected period	9.76%	14.90%
	3 Yrs to end date	9.76%	14.90%

Market Comparators	Period	Case	MSCI PIMFA Conservative TR
Annualised Alpha	Selected period	1.76%	
	3 Yrs to end date	3.53%	
Beta	Selected period	0.83	
	3 Yrs to end date	0.83	
Sharpe Ratio	Selected period	0.30	0.07
	3 Yrs to end date	0.21	-0.24

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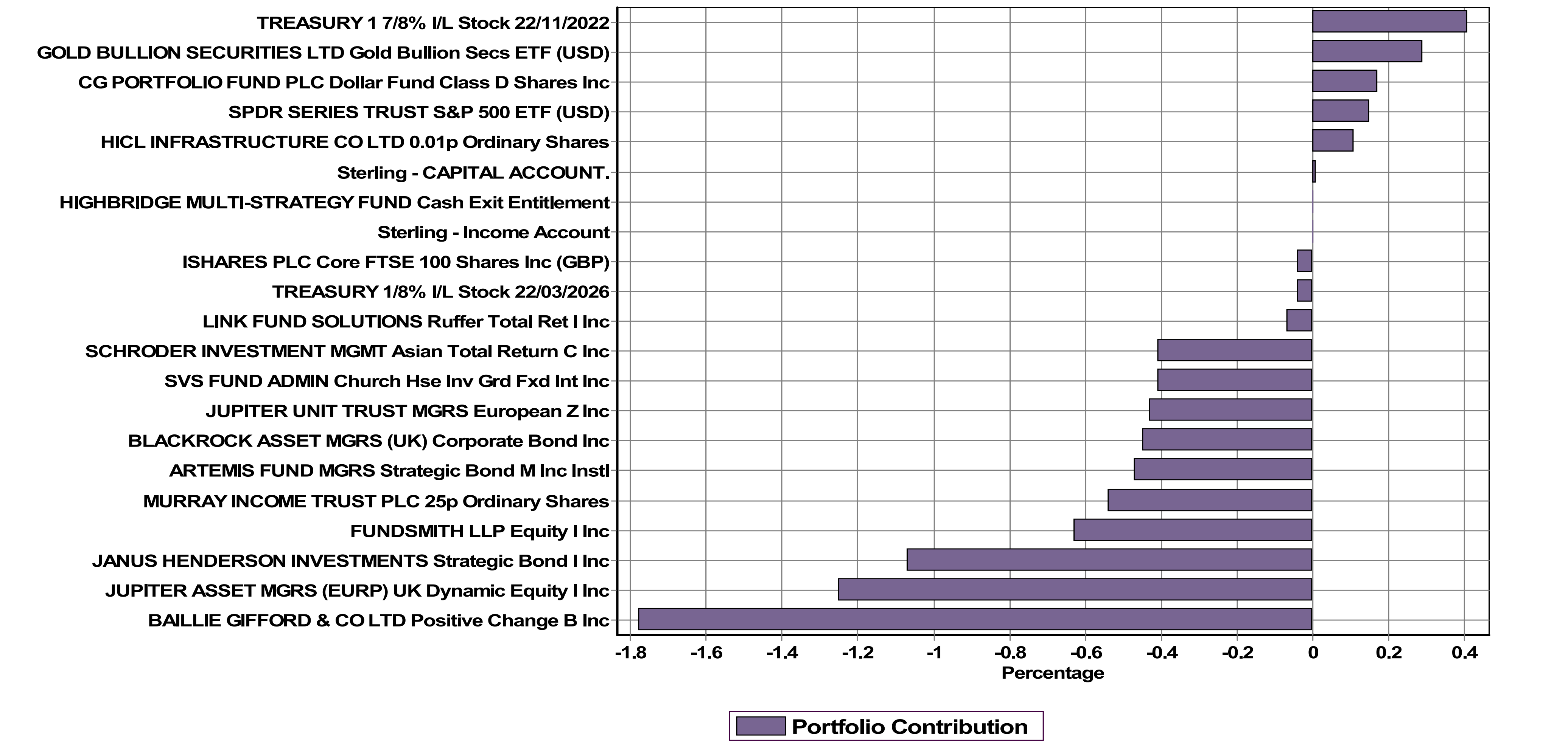
Rathbones
Look forward

Thame Town Council

Investment performance analysis

From 25 Oct 2021 To 25 Oct 2022
Before All Fees

Total Returns Using Model Weights



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Rathbone Investment Management Limited is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.
Registered office: Port of Liverpool Building, Pier Head, Liverpool L3 1NW. Registered in England No. 01448919. VAT Registration No. GB 241 6893 49.

A focus on Correlation is Key to Managing Risk

Building an investment strategy

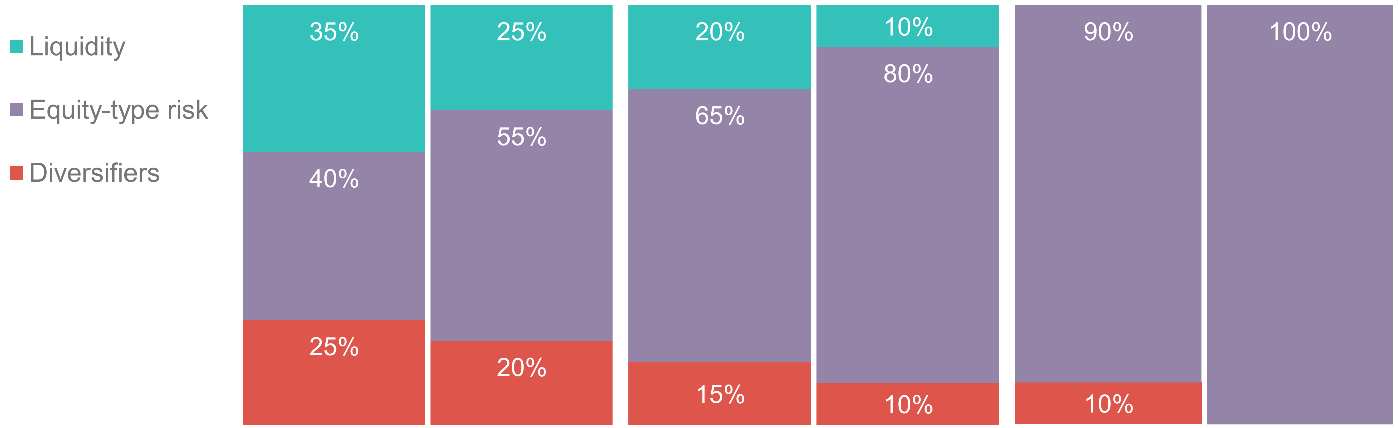
Grouping asset classes according to characteristics

Liquidity	**Assets that can be sold easily, low credit risk but may carry interest rate and currency risk**	— cash: £/$/€/¥
		— government bonds:
		  — conventional
		  — index linked
		  — UK and overseas
		— high-quality investment grade

Equity-type risk	**Equities and all assets highly correlated with equities**	— corporate bonds: investment grade, high yield — emerging market debt — equities: UK, US/Europe/Japan/Asia/emerging markets, private equity — property equities: UK and overseas — commodities sensitive to the economic cycle, i.e. industrial metals/energy
Diversifiers	**Assets with diversification potential demonstrated by low correlation to equities**	— commodities: precious metals, agriculture — macro/trading: discretionary, systematic — targeted return strategies — infrastructure — bricks and mortar property funds

Risk-adjusted asset allocation strategies

Risk strategy	1	2	3	4	5	6
Suggested time horizon (years)	3-5		6-10		10+	



Return and risk guidelines

	1	2	3	4	5	6
Inflation+ reference			Inflation + [2%+]	Inflation + [3%+]	Inflation + [4%+]	Inflation + [5%+]
Cash+ reference	Cash + [1%+]	Cash + [2%+]				
Risk measure/maximum drawdown (%)*	-9.6%	-15.9%	-21.2%	-28.6%	-35.1%	-41.8%
Benchmark	Rathbones benchmark 1	Rathbones benchmark 2	Rathbones benchmark 3	Rathbones benchmark 4	Rathbones benchmark 5	Rathbones benchmark 6

Lower risk **Higher risk**

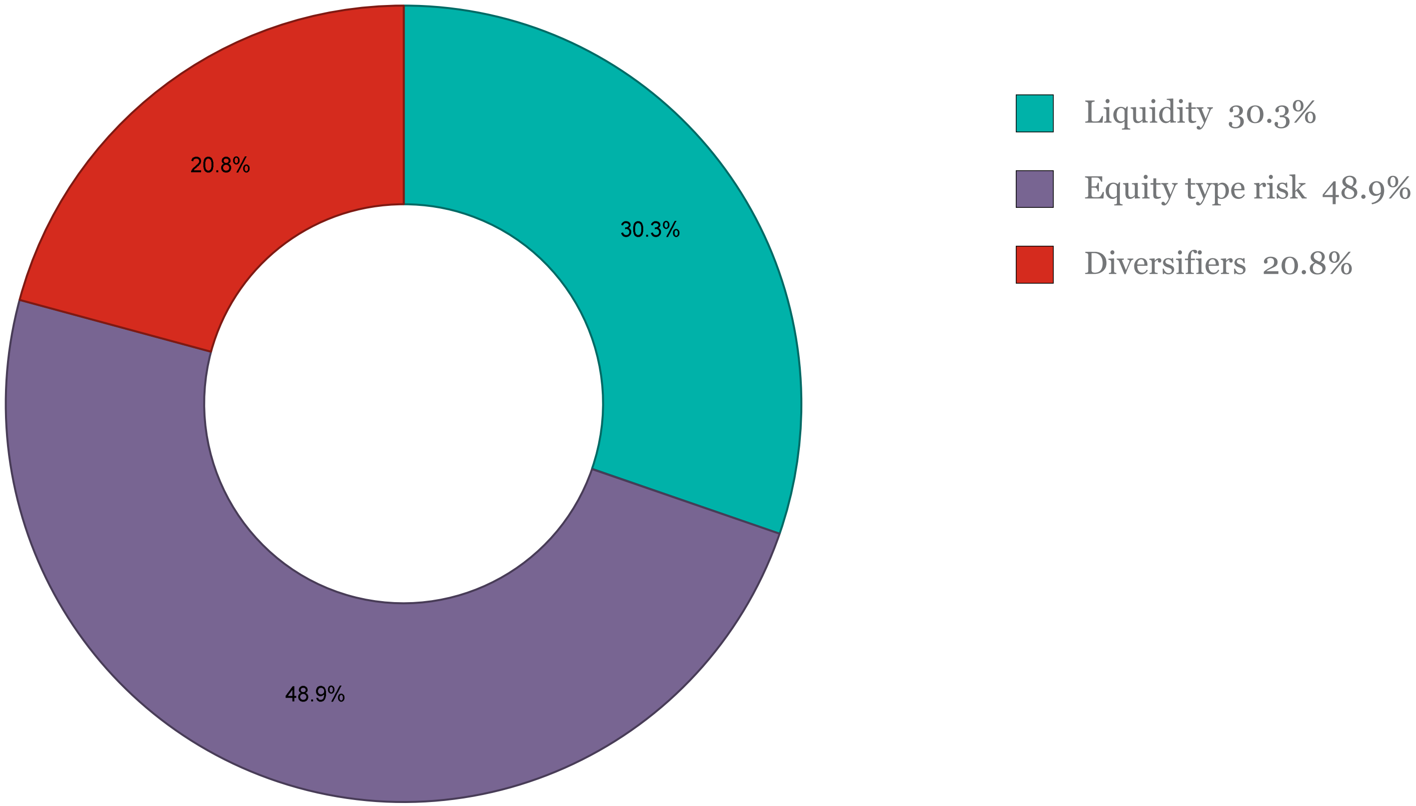
A wide range of objectives can be met: income or regular cash flow, total return and capital growth

* Drawdown shows the largest cumulative loss experienced by each strategy between the highest point and subsequent lowest point measured from 30 June 2002 to 30 June 2021. For a more detailed description of our investment strategies, please request a copy of 'Our investment strategies' document from your investment manager. These will be subject to ongoing review and therefore may change over time.

Thame Town Council

Asset Class Breakdown

Consolidated asset class breakdown as at 25 October 2022



Thame Town Council
Valuation

Sterling

Consolidated valuation as at 25 October 2022

Holding	Security description	Middle price	Market value	% of portfolio	Book cost	Estimated income	Estimated yield %
Liquidity			**547,586**	**30.3**	**517,698**	**8,200**	**1.5**
	Cash		**71,458**	**4.0**	**71,458**	**893**	**1.2**
71,458	£ CAPITAL ACCOUNT.		71,458	4.0	71,458	893	1.2
	UK Index Linked Government Bonds		**217,962**	**12.1**	**168,824**	**3,105**	**1.4**
39,000	TREASURY 1/8% I/L Stock 22/03/2026	£137.648079 Plus 33 Days	53,689	3.0	51,513	65	0.1
96,715	TREASURY 1 7/8% I/L Stock 22/11/2022	£168.520248 Plus 156 Days	164,273	9.1	117,311	3,040	1.9
	Overseas Index Linked Govt Bonds		**157,549**	**8.7**	**161,217**	**2,233**	**1.4**
140,000	ABRDN OEIC V Sht Dur Gbl I/L Bd Instl S Inc	£0.5026	70,364	3.9	72,765	1,013	1.4
500	CG PORTFOLIO FUND PLC Dollar Fund Class D Shares Inc	£174.37	87,185	4.8	88,452	1,220	1.4
	UK Inv Grade Bonds - Higher Quality		**47,223**	**2.6**	**55,833**	**1,359**	**2.9**
55,000	RATHBONE UNIT TRUST MGMT High Quality Bond S Dist	£0.8586	47,223	2.6	55,833	1,359	2.9

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Thame Town Council
Valuation

Sterling

Consolidated valuation as at 25 October 2022

Holding	Security description	Middle price	Market value	% of portfolio	Book cost	Estimated income	Estimated yield %
Liquidity			**547,586**	**30.3**	**517,698**	**8,200**	**1.5**
	O'seas Inv Gr Bds - Higher Quality		**53,394**	**3.0**	**60,366**	**611**	**1.1**
600	LEGG MASON GLOBAL FUNDS WA Sht Dur Blue Chip S + Hgd	£88.99	53,394	3.0	60,366	611	1.1
Equity			**883,411**	**48.9**	**607,489**	**18,309**	**2.1**
	UK Investment Grade Bonds		**102,126**	**5.7**	**117,721**	**2,563**	**2.5**
37,000	BLACKROCK ASSET MGRS (UK) Corporate Bond Inc	£0.94103	34,818	1.9	44,282	772	2.2
65,000	SVS FUND ADMIN Church Hse Inv Grd Fxd Int Inc	£1.0355	67,308	3.7	73,439	1,790	2.7
	Active Mgd Fixed Inc - Directional		**126,980**	**7.0**	**130,039**	**5,170**	**4.1**
100,000	ARTEMIS FUND MGRS Strategic Bond M Inc Instl	£0.4817	48,170	2.7	57,226	2,095	4.4
71,000	JANUS HENDERSON INVESTMENTS Strategic Bond I Inc	£1.11	78,810	4.4	72,813	3,074	3.9
	UK Investment Companies		**109,756**	**6.1**	**91,074**	**5,024**	**4.6**
2,600	ISHARES PLC Core FTSE 100 Shares Inc (GBP)	£6.86	17,836	1.0	19,297	704	3.9

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Consolidated valuation as at 25 October 2022

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Equity			**883,411**	**48.9**	**607,489**	**18,309**	**2.1**
	UK Investment Companies		**109,756**	**6.1**	**91,074**	**5,024**	**4.6**
12,000	MURRAY INCOME TRUST PLC 25p Ordinary Shares	£7.66	91,920	5.1	71,777	4,320	4.7
	UK Equity Long/ Short		**38,701**	**2.1**	**9,355**	**2,823**	**7.3**
9,000	JUPITER ASSET MGRS (EURP) UK Dynamic Equity I Inc	£4.3001	38,701	2.1	9,355	2,823	7.3
	North American Investments		**235,636**	**13.0**	**64,112**	**1,248**	**0.5**
999.996	FINDLAY PARK FUNDS ICAV American Unhedged Inc (GBP)	£136.3	136,299	7.5	23,796	0	0.0
300	SPDR SERIES TRUST S&P 500 ETF (USD)	USD379.4988	99,337	5.5	40,316	1,248	1.3
	European Investments		**36,838**	**2.0**	**39,567**	**180**	**0.5**
1,400	JUPITER UNIT TRUST MGRS European Z Inc	£26.3128	36,838	2.0	39,567	180	0.5
	Japanese Investments		**14,965**	**0.8**	**11,351**	**0**	**0.0**
1,600	COUPLAND CARDIFF FUNDS Japan Alpha T Acc (GBP)	£9.353	14,965	0.8	11,351	0	0.0

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Thame Town Council
Valuation

Sterling

Consolidated valuation as at 25 October 2022

Holding	Security description	Middle price	Market value	% of portfolio	Book cost	Estimated income	Estimated yield %
Equity			**883,411**	**48.9**	**607,489**	**18,309**	**2.1**
	Asia Pacific Investments		**29,457**	**1.6**	**27,919**	**812**	**2.8**
80	SCHRODER INVESTMENT MGMT Asian Total Return C Inc	£368.2106	29,457	1.6	27,919	812	2.8
	Global Investments		**188,952**	**10.5**	**116,351**	**489**	**0.3**
31,000	BAILLIE GIFFORD & CO LTD Positive Change B Inc	£2.778	86,118	4.8	91,977	297	0.3
20,000	FUNDSMITH LLP Equity I Inc	£5.1417	102,834	5.7	24,374	192	0.2
Diversifiers			**374,958**	**20.8**	**288,235**	**5,667**	**1.5**
	Infrastructure Funds		**57,610**	**3.2**	**59,953**	**2,888**	**5.0**
35,000	HICL INFRASTRUCTURE CO LTD 0.01p Ordinary Shares	£1.646	57,610	3.2	59,953	2,888	5.0
	Commodities (Non-cyclical)		**67,014**	**3.7**	**40,270**	**0**	**0.0**
500	GOLD BULLION SECURITIES LTD Gold Bullion Secs ETF (USD)	USD153.61	67,014	3.7	40,270	0	0.0

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Thame Town Council
Valuation

Sterling

Consolidated valuation as at 25 October 2022

Holding	Security description	Middle price	Market value	% of portfolio	Book cost	Estimated income	Estimated yield %
Diversifiers			**374,958**	**20.8**	**288,235**	**5,667**	**1.5**
	Actively Managed Strategies		**250,334**	**13.9**	**188,012**	**2,779**	**1.1**
21,422	HIGHBRIDGE MULTI-STRATEGY FUND Cash Exit Entitlement	£0.125	2,678	0.1	0	0	0.0
15,000	LINK FUND SOLUTIONS Ruffer Total Ret I Inc	£3.6759	55,139	3.1	57,673	1,027	1.9
92,144.799	LINK FUND SOLUTIONS Trojan X Inc	£1.2313	113,458	6.3	57,036	113	0.1
89,080.447	M&G SECURITIES LTD Global Macro Bond PP Inc	£0.8875	79,059	4.4	73,303	1,639	2.1
Total for portfolio:			**1,805,955**	**100.0**	**1,413,422**	**32,176**	**1.8**

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Thame Town Council
Market Transactions

Market transactions during period 25 October 2021 to 25 October 2022

Sales

Trade date	Security description	Quantity	Dealing price	Total proceeds
15/12/21	SPDR SERIES TRUST S&P 500 ETF (USD)	100	USD464.40	£34,912.13
19/01/22	JUPITER ASSET MGRS (EURP) UK Dynamic Equity I Inc	4,000	£5.74	£22,964.40
01/03/22	ARTEMIS FUND MGRS Strategic Bond M Inc Instl	71,000	£0.56	£39,490.20
27/05/22	SCHRODER INVESTMENT MGMT Asian Total Return C Inc	20	£407.06	£8,141.21
18/10/22	JUPITER ASSET MGRS (EURP) UK Dynamic Equity I Inc	4,000	£4.29	£17,160.80

Purchases

Trade date	Security description	Quantity	Dealing price	Total cost
16/12/21	HICL INFRASTRUCTURE CO LTD 0.01p Ordinary Shares	10,000	£1.75	£17,564.08
19/01/22	ISHARES PLC Core FTSE 100 Shares Inc (GBP)	2,600	£7.42	£19,296.77

Thame Town Council
Market Transactions

Market transactions during period 25 October 2021 to 25 October 2022

Purchases

Trade date	Security description	Quantity	Dealing price	Total cost
16/02/22	LINK FUND SOLUTIONS Ruffer Total Ret I Inc	10,000	£3.86	£38,615.00
01/03/22	ABRDN OEIC V Sht Dur Gbl I/L Bd Instl S Inc	30,000	£0.55	£16,515.00
02/03/22	LINK FUND SOLUTIONS Ruffer Total Ret I Inc	5,000	£3.88	£19,377.00

Five key issues shaping current investment strategy

1. Taking the global economy's pulse
   Different degrees of risk for the US and Europe
2. Qualities to look for in a stock
   Recession resilience at a reasonable price
3. In the policy wilderness
   Searching for perspective on the plunging pound
4. Investing in cybersecurity
   A golden age for digital locksmiths
5. Striking a balance
   What does the labour movement mean to ESG?

1. Taking the global economy's pulse

Different degrees of risk for the US and Europe

- the economic outlook has deteriorated around the world recently, but there are some key differences between the challenges facing each of the world's largest regions. Understanding them can help us adapt our investment strategy in the face of an increasingly difficult backdrop.
- an energy supply shock of historic proportions is squeezing the UK and Eurozone. Policies like the UK's freeze on household and business energy prices should help cushion the blow in the short term, limiting the hit to real incomes. France has a similar 'tariff shield' policy. Even so, recession seems highly likely.
- the UK economy has already begun to shrink, while the latest business surveys from the Eurozone are also consistent with contraction. Energy bills will still be high by past standards, although they won't hit the stratospheric levels they might have.
- the economic outlook in the US isn't quite as bad. In contrast to Europe, it has a much greater degree of energy independence, and US wholesale gas prices have risen by far less.
- on a more positive note, we've probably already seen the peak in US inflation. The decline in global oil prices meant that energy inflation there was in retreat. Goods inflation has been falling too, as last year's pandemic-induced disruption to global supply chains has continued to unwind (figure 2). Nonetheless, it's still too early to declare victory.

Inflation, recession scenarios and probabilities

	Inflation <4% by end-2023	Inflation >4% by end-2023
Recession in 2023	*Typical recession*	*Stagflation*
No recession in 2023	*Soft landing*	*Inflation resilience*
US probabilities		
Recession in 2023	*60%*	*15%*
No recession in 2023	*25%*	*0%*
Europe (inc. UK) probabilities		
Recession in 2023	*55%*	*35%*
No recession in 2023	*5%*	*5%*

Figure 1

We find it helpful to think in terms of four key economic scenarios.

Source: Rathbones

US goods inflation has been falling

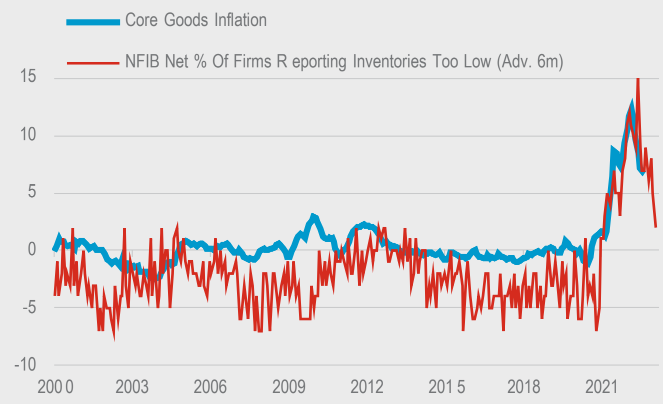

Figure 2

US core goods inflation (excluding more volatile items) has been falling as supply chain disruptions have unwound, allowing firms to replace depleted inventories and relieving pressure on prices for consumers. The figures on inventories have been advanced by 6 months to account for the lagged effect of changes to inventories on consumer prices.

Source: Refinitiv, National Federation of Independent Business (NFIB), Rathbones

2. Qualities to look for in a stock

Recession resilience at a reasonable price

— ‘quality’ in equity investing generally relates to companies that have a greater degree of stability and profitability, thereby leading to an expectation of higher or more predictable investment returns.

— a company’s business model can exhibit quality characteristics such as strong competitive advantages and a market-leading position (from uniqueness of product or offering, through barriers to entry such as knowhow, patents or brands), which in turn leads to pricing power.

— So why have some quality stocks underperformed during this year’s steep falls? This stems from the fact that many quality stocks are also associated with the ‘growth’ factor, which has strongly outperformed for many years (figure 3). Sharply rising interest-rate expectations (figure 4) have weighed and continue to weigh heavily on growth stocks, as the value today of those higher expected future earnings are discounted at higher rates.

— fortunately, there are pockets of quality companies that have defensive characteristics and resilient earnings in such sectors as consumer staples, defence (benefiting from increasing NATO defence budgets post-Ukraine) and healthcare. These are also more reasonably valued and less susceptible to rising rates.

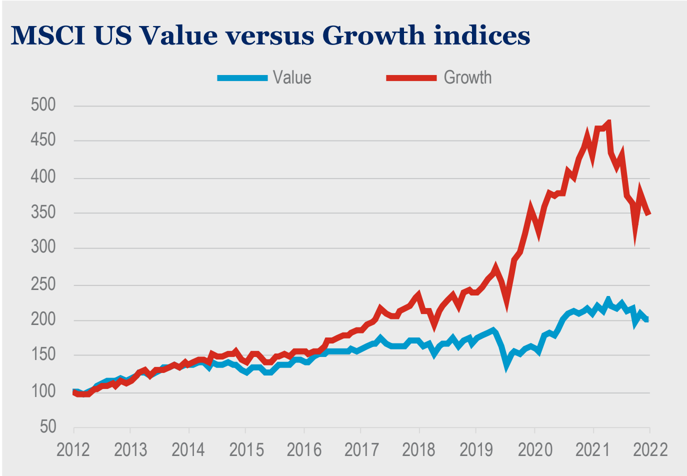

Figure 3

Growth stocks have underperformed value stocks this year, which makes us cautious about having too much exposure to the growth factor.

Source: Factset

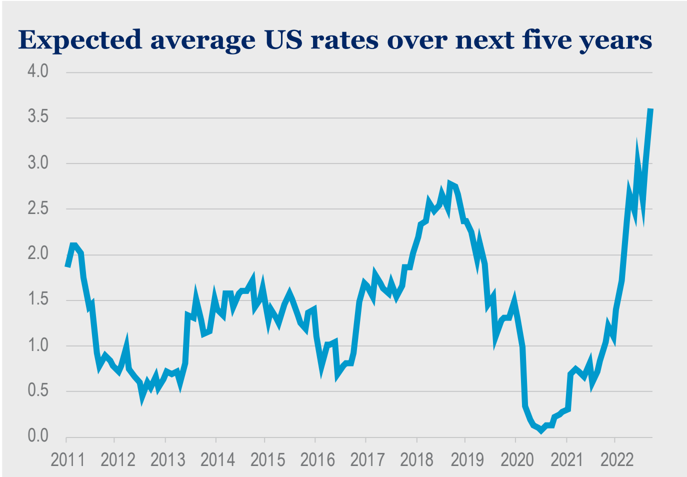

Figure 4

This chart shows the market’s expectations for average US interest rates over the next five years based on five-year overnight index swaps.

Source: Refinitiv; Rathbones

Past performance should not be seen as an indication of future performance.

3. In the policy wilderness

Searching for a perspective on the plunging pound

— the dramatic slide in the value of the pound this year has raised lots of questions. How does the latest fall compare with previous crisis periods? How much harder does exchange rate weakness make the Bank of England's fight against elevated inflation?

— two distinct factors have weighed on the pound this year. The first has been the global strength of the dollar, which has benefited from its status as the premier safe-haven currency, plus the relative resilience of the US economy. The second factor has been UK-specific concerns about the direction of policy, especially in the wake of Chancellor Kwarteng's 'fiscal event'.

— to put the pound's decline into perspective, figure 5 shows past falls in the currency versus a basket of its peers, weighted by their relative importance to UK trade. Its recent drop of just over 10% is large, but not yet in the same league as previous crises.

— whatever the cause, the weaker pound has only added to the UK's inflation problem. Falls in the currency typically increase the sterling prices of the goods and services that the UK imports (figure 6). This inflationary impact arguably matters more than usual, because price pressures are already too strong and the government's tax cuts will inject more demand into the economy.

— forecasting currencies over short time periods is notoriously difficult. Over the long run the pound still appears undervalued versus the dollar.

Charting the pound's fall

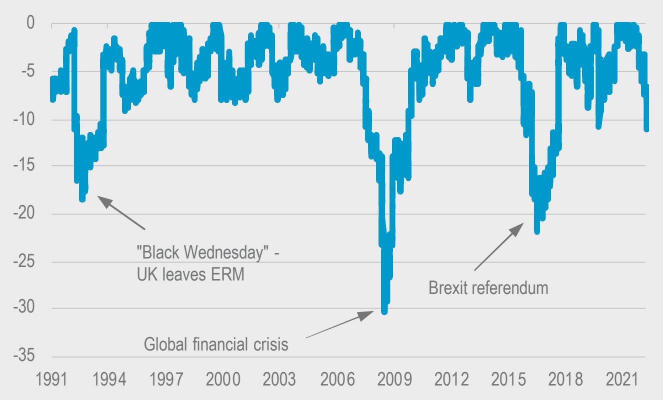

Figure 5

Bloomberg Sterling Aggregate Corporate Yield to Worst (lowest possible yield an investor would receive barring default).

Source: Bloomberg, Rathbones

Proportion of consumption from imports (%)

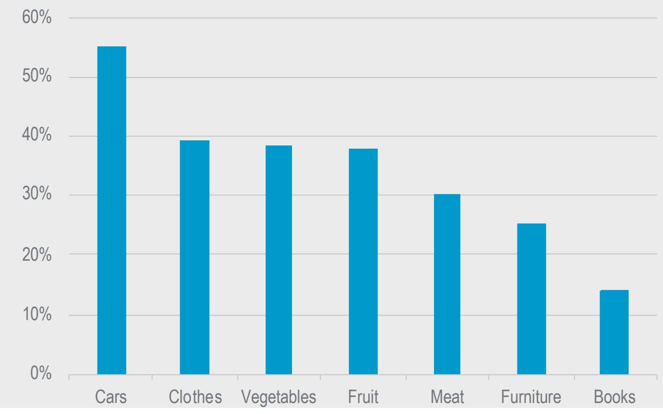

Figure 6

The value of sterling can affect what we buy.

Source: Refinitiv, Rathbones

Past performance should not be seen as an indication of future performance.

4. Investing in cybersecurity

A golden age for digital locksmiths

— with crime moving online and nation states conducting cyber warfare with impunity, the need for cybersecurity has never been greater. Despite enjoying booming demand, this is a complex sector to invest in owing to the ever-evolving threats and rapid changes in market leadership.

— according to the Center for Strategic and International Studies, the global cost of cybercrime leapt from $523 billion to $945 billion between 2018 and 2020.

— total spending on cyber software accounts for just 2% of overall spending on IT. But that proportion will rise according to research by management consultancy Gartner, as companies shift their budgets from hardware support and services to automated cloud based solutions. (Figure 7 shows the forecast for resulting growth in security software revenues.)

— competition in cyber is notoriously fragmented (figure 8). No single company has achieved more than 20% share of any subsector for long, as new solutions are rapidly cloned, better ones come along or new hacking methods make them obsolete.

— For now we see a lack of clear combinations of profitability, clear product differentiation versus peers and an attractive valuation for security software companies. However, it's an area we are monitoring with growing interest.

Security software revenue forecast ($ billions)*

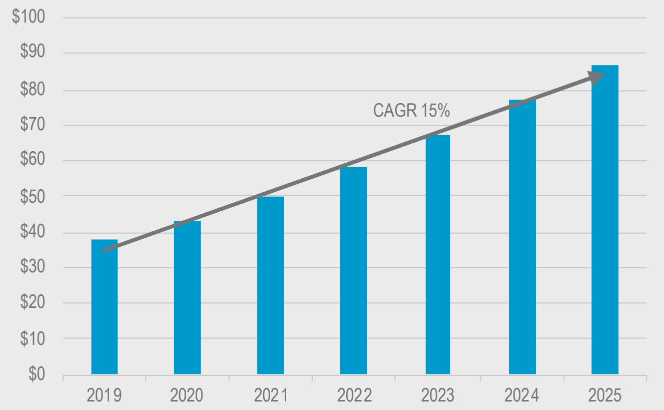

Figure 7

As spending on cyber security takes on a larger proportion of overall IT budgets, revenue for security software sellers is *forecast to have a 15% compound annual growth rate (CAGR); figures prior to 2022 are actual.

Source: Gartner

Security software market by vendor

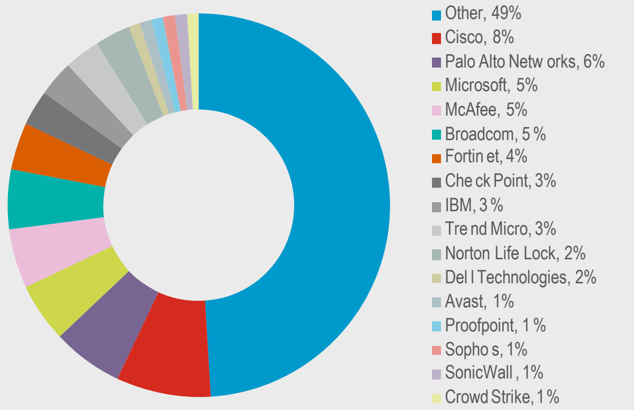

Figure 8

The security software market is notoriously fragmented, with no single company currently holding more than an 8% market share.

Source: Citi

Past performance should not be seen as an indication of future performance.

5. Striking a balance

What does the labour movement mean to ESG?

— spiralling inflation, wage stagnation, rising income inequality and a sense of injustice felt by those that put their health at risk during the pandemic to keep the economy ticking seem to have built momentum among workers to organise. Pressure is mounting on employers for better pay, benefits and working conditions.

— we believe a healthy tension — and respect — between unions and businesses is best for both sides. Yet to many corporations, union busting may be seen as a cost of doing business.

— one ESG ratings firm says it looks at workforce unionisation as a "proxy for the presence of basic employee rights and benefits" when assigning ESG scores. while companies with low or no unionisation can still score strongly on labour management measures under this assessment, typically companies with higher rates of unionisation are scored more favourably.

— for all the talk of a renaissance, trade union membership in both the UK and the US is at multi-decade lows (figure 9). But the tide may be turning — polling by Gallup suggests public perception of unionisation, particularly in the US, has been steadily turning more positive since reaching a low in 2010 (figure 10).

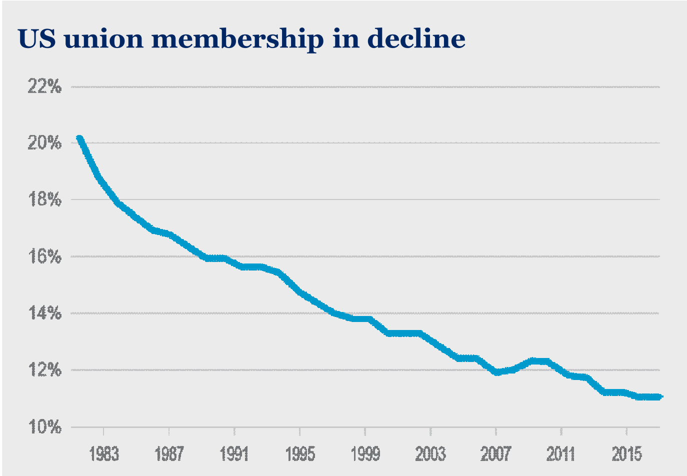

Figure 9

Trade union membership has been in decline since the 1980s, but the tide may be turning.

Source: US Bureau of Labor Statistics

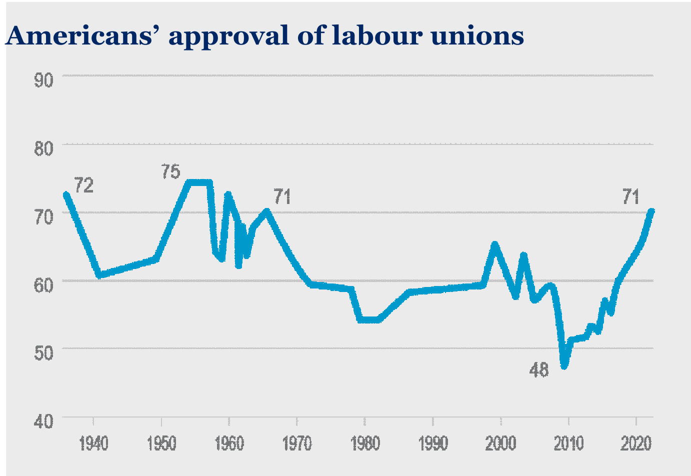

Figure 10

A US survey asking whether respondents "approve or disapprove" of labour unions has shown an increase in approval in recent years.

Source: Gallup

Past performance should not be seen as an indication of future performance.

Overview: the pace of growth is slowing

— **energy costs keep rising.** The UK and euro area are suffering an energy supply shock similar to those of the 1970s. Russia is stopping gas deliveries to Europe through the (now damaged) Nord Stream pipelines indefinitely, and wholesale prices are currently about nine times their average between 2015 and 2021. As a result, a recession now seems increasingly likely as both consumers and businesses take the strain.

— **the US is more insulated.** The economic outlook is less gloomy in the US, which does not rely on Russian energy imports. Wholesale gas prices have not risen by nearly as much and American consumers remain relatively resilient. However, a US recession still appears more likely than not, with interest rates already having risen and additional hikes yet to come.

— **China's economy is also struggling.** A major revival in the pace of Chinese economic growth does not look likely any time soon. Coronavirus cases are rising again after a summer lull, which has resulted in new lockdowns as the country persists with its zero-COVID policy. At the same time, China is experiencing its deepest housing downturn in decades, caused by attempts to rein in overleveraged developers.

— **inflation is finally peaking.** Inflation in the US may already be past its peak and should continue to fall from here but probably not by as much as the market expects over the next 12 months. In the UK, the decision to freeze household energy prices for the next two years means we will probably avoid the huge surge in utility bill-driven inflation that had previously seemed likely. However, historically large fiscal stimulus announced in the new Government's 'mini budget' could lead to inflation staying higher for longer.

— **interest rates are set to increase.** Central banks in many of the largest advanced economies have changed their approach over the past few months. Notably, they are placing more emphasis on bringing down inflation over supporting growth. As a result, they are likely to continue to raise rates for as long as inflation is above their targets, even if their economies fall into recession.

— **weighing up the investment environment.** Despite the gloomy economic outlook, consensus earnings forecasts are still for growth in 2023, even in Europe. With valuations under pressure from higher interest rates, this makes us defensive. A sustained rally in risky assets may not occur until leading indicators of global growth pass their trough. That in turn may not happen until monetary tightening slows significantly or stops, and Europe passes the worst of its energy crisis.

Fixed income

Government bonds

— UK gilt yields have risen sharply (meaning prices have fallen) as markets are expecting very aggressive near-term interest rate rises by the Bank of England (BoE). Following the mini budget, the two-year gilt yield topped 4% for the first time since 2008, up from about 1.6% in early August. The BoE stepped in to buy gilts the following week, stemming the selling for the time being.

— the decision to freeze UK energy prices removes some upward pressure on inflation (figure 1). But with lots of uncertainty about how quickly inflation will fall, particularly given the large dose of stimulus in the mini budget, yields on longer-dated bonds could continue to rise for some time.

Contribution of utility bills to UK CPI inflation (pp*)

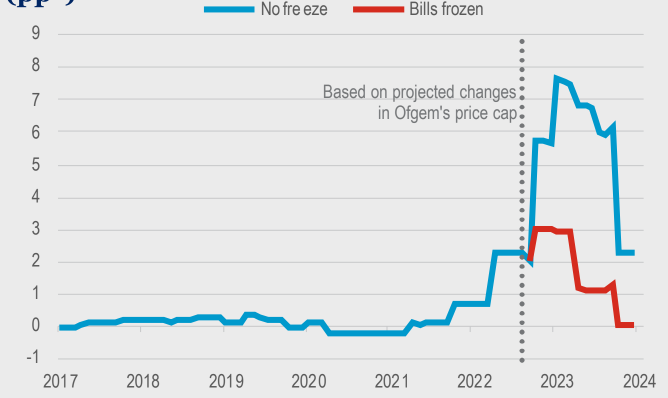

Figure 1

The government's decision to freeze energy prices is likely to take some of the heat out of inflation.

Source: Refinitiv, Rathbones; *pp=percentage points

Corporate bonds

— the performance of investment grade corporate bonds tends to be less volatile than equities, and can offer more defensive characteristics. In the UK and euro area, spreads (the additional yield over government bonds) are relatively high compared with the past (figure 2), which means prices have less room to fall.

— high-yield bonds look less attractive, while the economic outlook is unfavourable for emerging market debt amid a global slowdown, higher US interest rates and a rising dollar.

Yields spreads (ranking relative to history*)

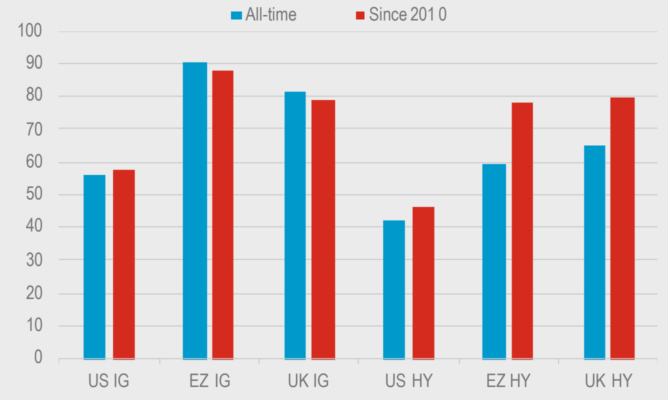

Figure 2

*This chart shows percentile rankings relative to historical norms (>50 indicating abnormally wide spreads) for investment grade (IG) and lower-rated high yield (HY) bonds, the latter being particularly elevated in both the UK and Eurozone (EZ).

Source: Refinitiv, Rathbones

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Equities – UK

— the UK economic growth outlook still appears worse than in the US. This may not be an issue for the largest listed firms, which earn only a small fraction of their revenues in the UK. But it could be a significant headwind for smaller, more domestically focused companies. This has been evident in the outperformance of the FTSE 100 versus indices of smaller UK stocks (figure 3), which could continue for a while longer.

— the FTSE 100 has also delivered a strong performance this year relative to other major global indices. Its defensive sectoral composition includes a large weighting in consumer staples (figure 4), which should continue to stand it in good stead as the global economic outlook deteriorates.

— there is a risk that the FTSE 100's substantial exposure to the energy sector could become a drag, particularly in the event of another round of widespread lockdowns in China and prolonged weakness in the global economy, as slowing demand puts further downward pressure on the price of oil. But the fundamentals of the oil market could provide some offsetting support to prices.

— the share prices of the UK oil majors already reflect a pessimistic outlook. Meanwhile, the mining sector has already come under pressure from Chinese weakness in the third quarter but the FTSE 100 has still outperformed given its defensive sectoral composition mentioned above.

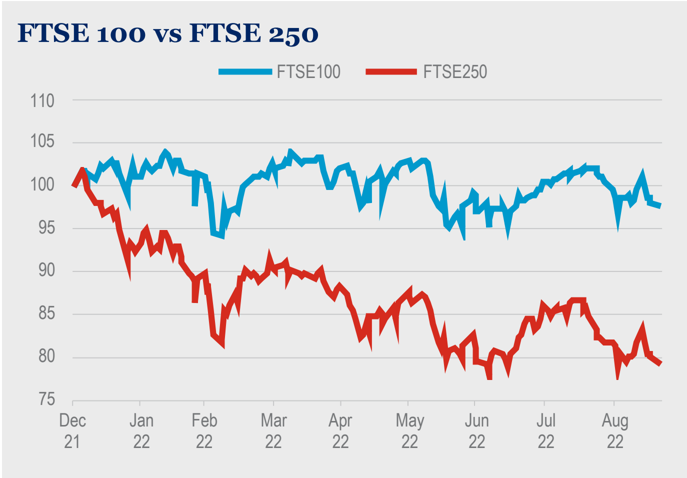

Figure 3

Many of the companies in the FTSE 250 index are sensitive to the domestic UK economy, which has been weaker than other global regions this year.

Source: FactSet, Rathbones; rebased to 100 as of 31 December 2021

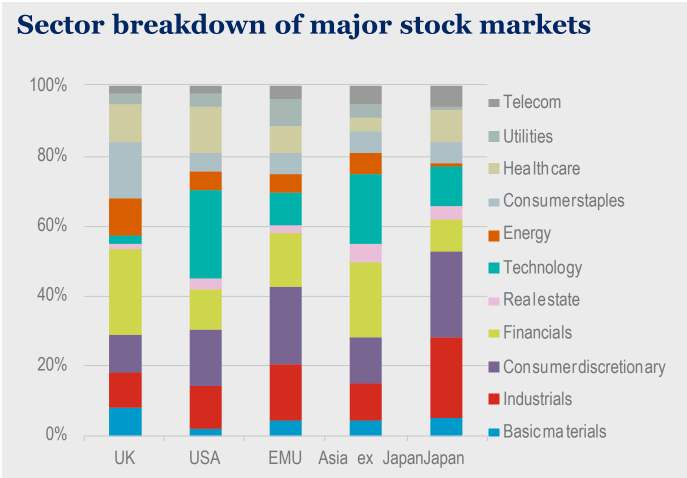

Figure 4

The UK stock market has a relatively large proportion of defensive sectors, which is part of the reason why it has outperformed many other regions this year.

Source: Refinitiv, Rathbones

Past performance should not be seen as an indication of future performance.

Equities – US

— the US market has not provided the defensive outperformance we had expected so far this year in local currency terms. This is in part because high-quality stocks, which dominate the US market, have fallen as interest rates have risen. Performance has been much better in sterling terms, given a circa 15% surge in the dollar (figure 5).

— however, we believe the relative performance of companies with higher-quality earnings may improve significantly over the next few quarters. These stocks tend to outperform when earnings expectations are falling. While earnings downgrades around the world have been very limited so far this year, we believe much larger downward revisions are likely before long.

— stocks with quality earnings have been highly correlated with growth stocks this year, and higher-growth shares have struggled against the backdrop of surging bond yields. The outlook for US bonds yields is now less one-sided. Meanwhile, the economic outlook in the US, while not great in absolute terms, appears better than in Europe.

— we remain cautious about having too much exposure to the growth factor. The MSCI US Value Index is down 9% this year in dollar terms compared with 22% for the MSCI US Growth Index (figure 6). The improvement in the relative performance of the growth index from late May has since come to an end.

Sterling versus the dollar

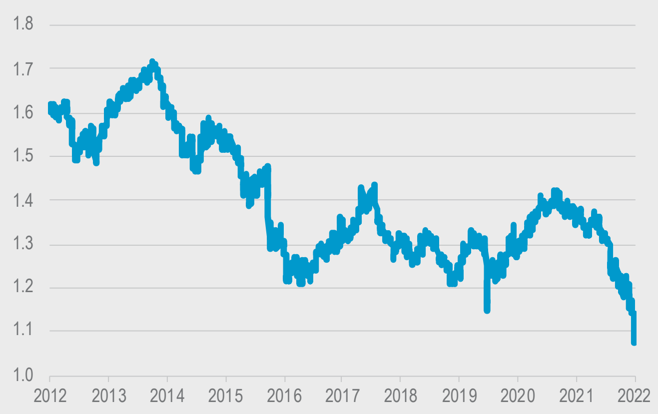

Figure 5

The US dollar has strengthened significantly against the pound this year, which boosts the performance of dollar-denominated assets for sterling-based investors.

Source: Factset

MSCI US Growth vs Value indices

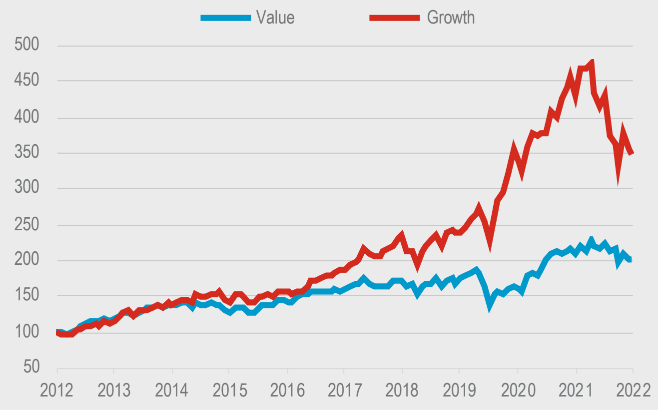

Figure 6

Growth stocks have underperformed value stocks this year, and we remain cautious about growth stocks given the scope for continued interest rate increases, which erode the present value of future earnings.

Source: Factset

Past performance should not be seen as an indication of future performance.

Equities – Europe

— company earnings in Europe in general tend to be fairly linked to the economic cycle, and the economic outlook is particularly poor as the region struggles with the impact of Russia cutting gas supplies indefinitely ahead of the winter (figure 7).

— we believe a deep recession is one of the possibilities, which the market may not have fully discounted yet (figure 8). Consensus forecasts are still for percentage earnings growth in the low single digits next year, for example, whereas in nominal terms they would probably fall sharply if the economy contracts substantially.

— we think it makes sense in the current environment to reduce exposure to the most economically sensitive assets, and particularly companies with exposure to Europe's economy. However, there is scope to gain exposure to defensive companies with large non-European revenues and strong pricing power despite being listed in Europe

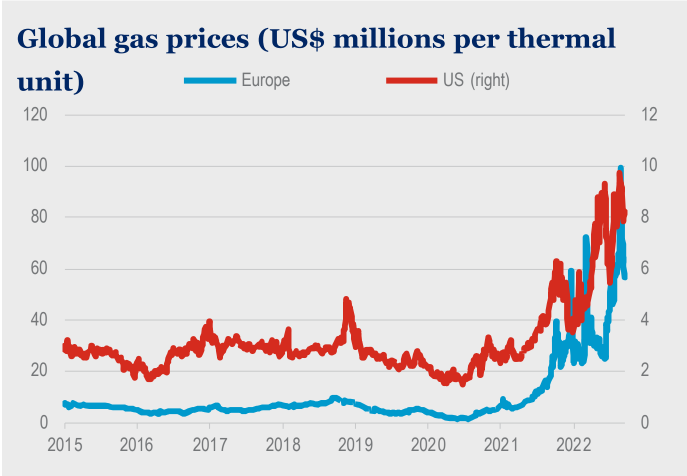

Figure 7

Gas prices have risen sharply recently owing to the disruption to supplies caused by the Russia-Ukraine war.

Source: Refinitiv, Rathbones

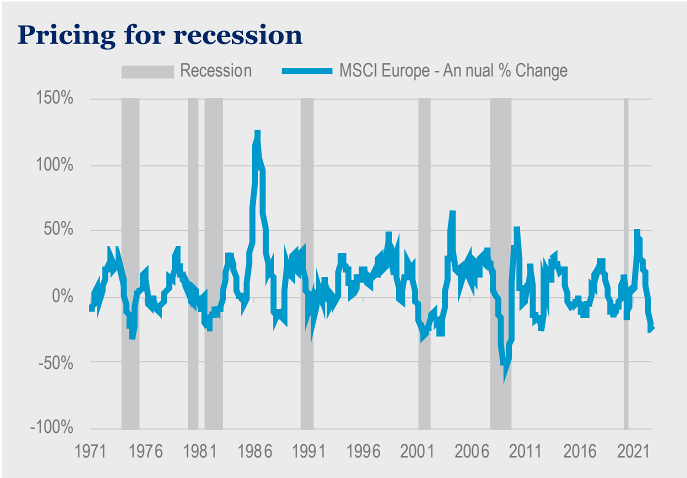

Figure 8

Europe's stock markets have a large proportion of companies in cyclical sectors, which would be vulnerable to any further slowdown in economic activity.

Source: Refinitiv, Rathbones

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Equities – Asia and emerging markets

— Developing market equities tend to be fairly sensitive to underlying economic conditions, and the outlook remains uncertain. Notably, the chances of a strong economic rebound in China – typically the key driver of the relative performance of developing equities – appear slim.

— coronavirus cases in China are on the rise again, a deep housing downturn is under way (figure 11) and policymakers appear unwilling to provide support on the same scale as in the past.

— meanwhile, the ongoing geopolitical tensions between China and the West, highlighted by China's renewed assertiveness towards Taiwan, may add to the risks of longer-term financial decoupling.

— the outlook for other emerging economies also appears poor given the backdrop of sharp increases in US interest rates and the US dollar (figure 12), which makes it harder for them to service their dollar-denominated debts.

China housing starts and sales (volume, % y/y)

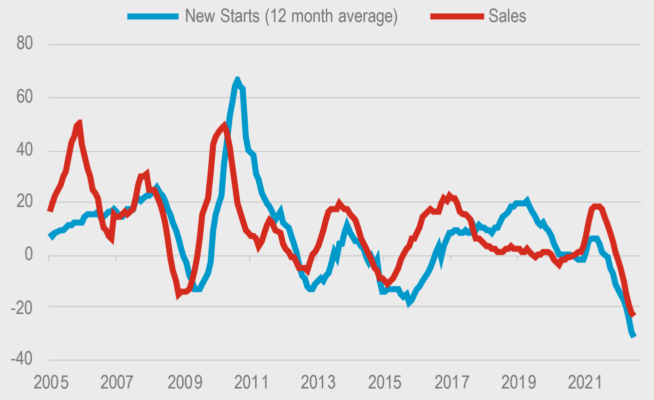

Figure 11

China's property market is a key factor in the country's economy, which is suffering from a period of weakness.

Source: Refinitiv, Rathbones

Trade-weighted US dollar index

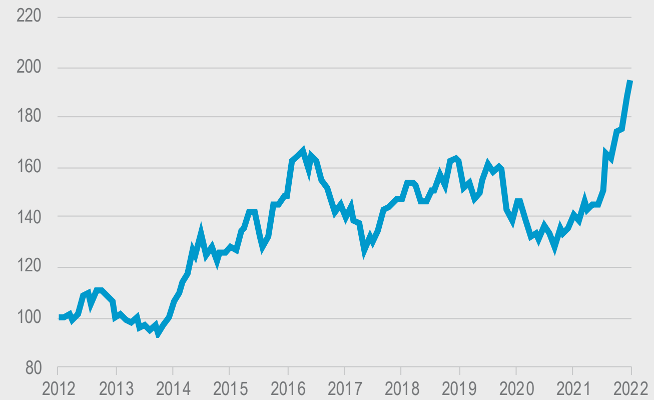

Figure 12

The US dollar has risen strongly this year, making it harder for many emerging-market governments and companies to service their debts.

Source: Factset

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Equities – Japan

— the outlook for Japanese equities is more favourable than for Europe or emerging markets even though the market is biased towards companies that depend on a strong economy. While Japanese firms also have significant supply-chain exposure to disruption in China, Japanese equities have held up better than their US (figure 9) and European counterparts this year.

— this is partly because the weakness in the global economy has been most apparent in Europe and China, and because the weakness of the yen (figure 10) has been a positive for Japanese exporters, as it boosts their price-competitiveness.

— over the longer term, valuation risks also appear relatively low in Japan, and the market appears less exposed to interest-rate volatility than others. Inflation in Japan is still below 3% and the Bank of Japan remains committed to its ultra-loose policy.

— the ongoing structural trend of improving corporate governance since the 'Abenomics' era (previously a major weakness of the Japanese market), coupled with improved return on equity, does not yet appear to be fully reflected in Japanese share prices.

Stock market performance

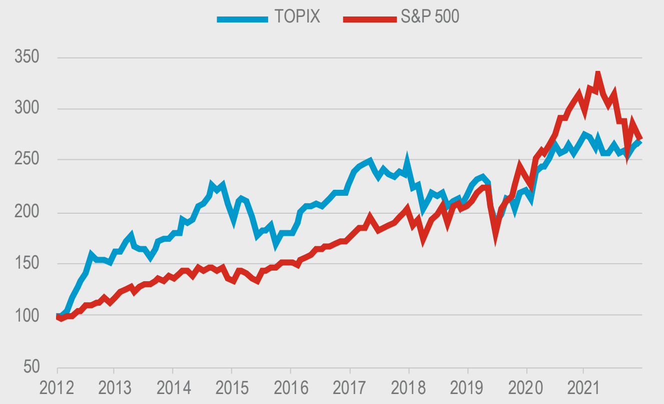

Figure 9

The 10-year performance of Japan's stock market has caught up with US equities this year, following the recent correction in America.

Source: Factset, Rathbones

Yen per dollar

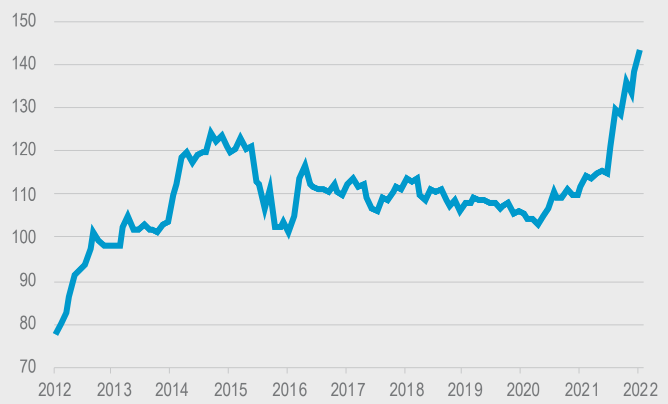

Figure 10

The yen has been weakening against the US dollar recently (a dollar buys more yen), which makes Japanese exporters more competitive, but raises the costs of imported goods.

Source: Factset

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Diversifiers

Commodities

— while gold appears overvalued on various fundamental measures, we believe it still plays an important diversifying role in portfolios and its correlation to equities remains low (figure 13). It has also performed much better in 2022 than justified by the World Gold Council's return attribution model, which accounts for a range of factors including US yields, inflation expectations, the dollar and ETF flows.

Diversifying investment strategies

— in uncertain times, actively managed strategies can provide additional sources of return and diversification. Those that seek exposure to market trends (often called CTAs or managed futures funds) are one of the few categories capable of delivering strong returns when equities and bonds are selling off together, as we have seen for much of 2022. They may be particularly useful over the next few years, given the possibility of further supply shocks and prolonged inflation volatility.

— infrastructure funds, across both core and renewable sectors, have seen significantly positive returns in 2022 (figure 14). The key driver across all funds has been rising inflation and subsequent increases in inflation assumptions for 2022 and the years ahead.

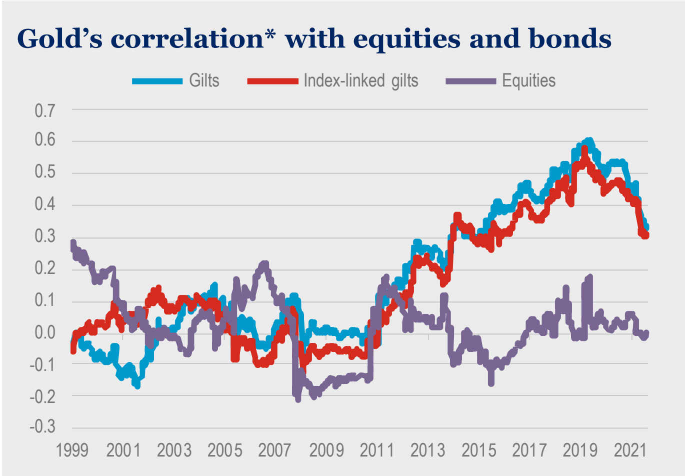

Figure 13

This chart shows the three-year rolling correlations of gold with other assets. *The higher the correlation the more the assets move in tandem, while a negative correlation means they tend to move in opposite directions.

Source: Refinitiv, Rathbones

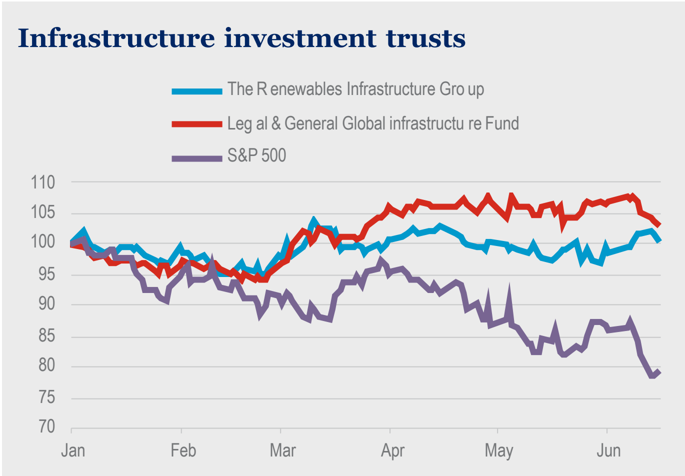

Figure 14

Infrastructure funds have outperformed equities this year, given their inflation resilience.

Source: Factset

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