FE TRUSTNET BE BETTER INFORMED

'A near perfect storm': Rothschild says last year was most 'treacherous' since 2008

6 March 2019
By Rob Langston

RIT Capital Partners chairman Jacob Rothschild explains why last year was the most difficult since 2008 and how the trust positioned to withstand much of the market challenges.

Markets in 2018 proved to be one of the toughest environments for protecting capital since the height of the financial crisis, according RIT Capital Partners chairman Jacob Rothschild, as the trust continues to back a cautious approach.

The chairman of the £3.2bn investment trust said 2018 was "the most difficult and treacherous year for investors since 2008", as it made a loss of 1.01 per cent against a 4.81 per cent fall for the average IT Flexible Investment peer.

Rothschild said he had warned against adding risk last year despite a background of broad-based economic growth and low unemployment.

The unwinding of years of ultra-loose monetary policy caused jitters as markets become more concerned that the US Federal Reserve would tighten rates too quickly and cause a recession.

"The dangers of holding assets inflated by low interest rates and quantitative easing are now visible to all," he explained.

Performance of trust vs sector in 2018

Source: FE Analytics

Ron Tabbouche, chief investment officer of J. Rothschild Capital Management, the trust's manager, said that 2018 would be remembered as an inflexion point for two entrenched macroeconomic trends.

The first inflexion point, he said, was the interruption of a decade of excess liquidity – as mentioned above – which has been chasing and inflating financial assets.

"As authorities reduce this liquidity, it is of little surprise that those financial assets deflated, almost regardless of fundamental macro data," he explained. "Across asset classes there was little place to hide."

The second inflexion point highlighted by Tabbouche was the ending of another multi-year trend and an international outcry towards Chinese global ambitions.

"The US, through the 'trade war', is clearly taking the lead preventing China gaining any further unfair competitive advantage," he said.

"While of course much wider in its scope, this will have important implications – both positive and negative – on Chinese domestic policy, as well as on many global sectors that are at the forefront of innovation, and ultimately the drivers of economic growth for the next decade."

As such, the chief investment officer said the trust had reduced its quoted equity portfolio – made up of long-only funds, hedge funds, stocks, listed co-investments and equity exposure management positions – towards the lower levels of historical ranges.

Furthermore, the trust held with higher levels of cash than usual, while additions to government bond and gold exposure benefited from the 'flight to safety' at the end of last year.

As mentioned, last year RIT Capital Partners redeemed more than 10 per cent of its long-only and equity hedge funds to reflect its more cautious approach and in acknowledgment of a more difficult environment for these strategies.

However, Tabbouche said it did make some additions to the quoted portfolio with weakness in emerging markets providing the opportunity to add exposure.

Source: FE Analytics

“Tightening global liquidity, the trade war, declining commodity prices and investor outflows all played a role in a near perfect storm for these assets in 2018,” he said.

“There are good reasons to be hopeful however: some Latin American economies have seen the emergence of pro-market leaders, commodity prices appear fundamentally undervalued and, perhaps most importantly, Chinese policy makers have a renewed sense of urgency to stabilise their economy.

“This backdrop is unfolding just as the Fed is seeming to be less restrictive, and with valuations more attractive.”

Elsewhere, its allocation to US assets remained little changed over the year despite concerns over whether too much growth has already been priced in to markets after years of accommodative monetary policy and president Donald Trump’s tax cuts.

There were also concerns over a slowdown in the European economy, with Tabbouche arguing that a structural shift is needed for it to become a viable long-term investment alternative to the US.

Despite significant gains for markets recorded already this year, RIT Capital Partners chairman Rothschild said the trust would remain cautious in 2019 as downside risks have accumulated.

“Global growth is declining, with the IMF having further reduced its forecasts,” he said. “The weakest Chinese GDP growth in nearly three decades is clearly having an impact on other regions, while German manufacturing output has contracted for the first time in four years.

“The most recent retail figures in the US lead one to believe that the economy will find it difficult to repeat last year’s fiscal-fuelled results.”

As well as a weaker economic backdrop, geopolitical risks have also failed to lift, he added.

“We are surely witnessing the worst political situation in the UK since the Suez crisis, while social unrest and populism in a number of European countries cloud the future,” Rothschild said.

“The question is whether current stock market valuations discount these concerns and take into account the likelihood that corporate profits are on the way down, undermined by reduced demand, increased wages, and higher input costs – due to tariffs.”

He concluded that the trust’s manager anticipate a continuation of heightened market volatility for the near term, which means capital preservation will remain as high a priority as any.

“While we remain cautious and selective, we continue to see specific opportunities across equity and debt markets, and seek to ensure that new investments provide a ‘margin of safety’ in terms of valuation,” he said.

Over the past 10 years, RIT Capital Partners has made a total return of 187.16 per cent against a 99.43 per cent gain for the peer group, as the below chart shows.

Performance of trust vs sector over 10yrs

Source: FE Analytics

Analysts at Numis Investment Companies lauded its long-term track record of delivering growth, while preserving shareholder capital.

"Since inception in 1988, it has delivered an attractive return profile, participating in 75 per cent of market upside, but only 39 per cent of market declines," they said. "We believe that the fund's emphasis on capital protection fits well with the risk tolerance of many private investors."

RIT Capital Partners is 19 per cent geared, has a yield of 1.6 per cent and ongoing charges or 1.02 per cent, according to data from the Association of Investment Companies (AIC). It is currently trading at a premium to net asset value (NAV) of 8.4 per cent, slightly higher than its three-year average premium of 6.11 per cent.