RATHBONES

# RATHBONE GREENBANK DYNAMIC GROWTH PORTFOLIO

QUARTERLY INVESTMENT UPDATE

OCTOBER TO END DECEMBER 2023

Professional Adviser PA AWARDS 2022
WINNER
Best Multi-Asset Fund: Risk Managed

Professional Adviser PA AWARDS 2022
WINNER
Multi-Asset Group of the Year

## HOT TOPICS — 'TOP-DOWN' (MARKET AND MACROECONOMIC)

**Santa rally.** Counterintuitively, a gruelling 2023 was a good year for investment returns. Stock markets soared (UK excepted), while corporate bond prices rose rapidly as well. Even government bonds made positive returns in a year of central bank tightening. The driver of this strong year was a large fall in prevailing bond yields towards the end of the year as investors first hoped for and then pre-emptively celebrated a 2024 of falling central bank interest rates, muted inflation and absent recession. It was an old-fashioned Santa rally: the returns came before the presents were handed out.

As far back as August we thought that global interest rates – as set by the world's most important central bank, the US Federal Reserve (Fed) – had peaked. Inflation, while bumpy, was clearly falling, even as global economic growth was holding up better than expected. The US economy was practically flying, though, and we felt that the Fed was unlikely to start cutting interest rates in 2023 or the first half of 2024 because it would risk putting the bellows to inflation. In December, Fed Chair Jay Powell seemed more disposed to cuts in the first half of 2024, as long as inflation fell back to the 2% target (it was 3.1% in November). While rate cuts are no doubt on the horizon, we still think investors may be getting overexcited about how quickly they will arrive. Perhaps the big variable now, rather than inflation, is US economic growth. If it continues to power ahead, the Fed will find it difficult to justify reducing borrowing costs. If it begins to falter, then the door to lower rates opens. Unfortunately, GDP growth is an extremely lagging number – you won't know it's slowing till months after it's started!

In the face of this watershed, we're trying to keep our portfolio balanced. We take profits from stocks and bond that have had particularly strong runs and recycle that money into holdings that have dipped yet still have exciting prospects over the next five years or more.

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**Global crossroads.** The world is no longer as homogenous as it once was. While the US economy has boomed, the UK, Europe and Asia have faded. And while the economic fade hasn't been as bad as many expected, it's stark when compared with the US. These divergent paths – and the divergent central bank policies that are being applied – are causing some large swings in both stock and bond prices as investors weigh up the relative rates of return on offer in different regions.

Here in the UK, with inflation at 3.9%, the Bank of England (BoE) is adamant that it won't be cutting interest rates anytime soon – in fact it's still leaning toward more hikes than cuts. That's despite the economy slipping into recession territory and many households struggling as they refinance mortgages at treble the monthly payments and rents going stratospheric. Bond investors aren't buying it: UK government bond prices now imply a 25-basis-point cut to 5.0% by May and a roughly 1.4% drop in the BoE's bank rate over the whole of 2024. We are also sceptical, and think that the BoE will have to ease pressure on households and businesses if recession sets in during the first quarter and unemployment starts to rise.

Europe is in a similar position following the Fed's 'pivot' to more accommodative policy. Like the UK, its central bank is on a 'higher for longer' footing even as its economy struggles. And also like in the UK, investors are expecting the European Central Bank to fold and begin cutting rates in early 2024. China fell into deflation in the summer, i.e. general prices for goods and services are falling, rather than rising. China is struggling with a massive property bubble where developers, local governments and households have borrowed huge amounts to build and buy millions of speculative properties that no one needs. Some aren't even finished. Deflation makes those debts grow in real (inflation-adjusted) terms. The deflation is partly caused by

the heavy overhang of debt, but it also makes the burden of those debts worse. In short, it starts a toxic feedback loop which hamstrings economic growth.

China is still growing at an estimated 5%, however, and is actually convincingly overshooting what the IMF's World Economic Outlook had expected a year ago. No doubt aided by cheaper energy from, and increased commerce with, Russia in the aftermath of its invasion of Ukraine and subsequent sanctions by the West. However, many companies we see suggest the picture on the ground is far from as rosy as the headline numbers suggest. A heavily debt-laden Chinese trade partner is Japan. Its economic growth slumped unexpectedly in the third quarter as households and businesses abruptly stopped spending in the third quarter.

More than ever, the US seems to be the sole engine of economic growth. This may well encourage investors to put yet more money into the sunny uplands over the Atlantic and shun the problematic, yet often heavily discounted, markets elsewhere.

## HOT TOPICS — ‘TOP-DOWN’ (MARKET AND MACROECONOMIC) (continued)

**COP out.** December’s COP28 climate summit in Dubai delivered an “historic” deal that shows just how far we have to go if we’re to prevent serious climate change this century. More than 190 governments agreed to transition “away from fossil fuels in energy systems in a just, orderly and equitable manner, accelerating action in this critical decade, so as to achieve net zero by 2050 in keeping with the science”. Maybe we’re just old, but we seem to remember everyone agreeing that fossil fuels were the problem years ago! This is the first time in 30 years of UN climate conferences that this universally acknowledged truth has been stated in writing. That’s the “historic” part that the COP committee championed. In the hottest year on record, with wild and deadly weather causing mayhem around the world.

If you dig below the surface, the scale of the climate challenge becomes clear. The COP decision text noted that to limit global warming to 1.5 degrees Celsius (as agreed in the Paris COP of 2015) the world needs to cut greenhouse emissions by 43% by the end of the decade and 65% by 2035. Right now, emissions are still rising. This year the world’s carbon dioxide emissions are expected to hit 37.6 billion tonnes; when the world met for the first COP conference in Berlin in 1995 we were emitting 24.3 billion tonnes. That 55% increase has outpaced the world’s population growth by 15 percentage points.

Yet this is where we can all get a bit more optimistic. One helpful thing that COP28 focused on was the need to triple renewable power generation to 11,000 gigawatts and double the annual improvements in energy efficiency gains to 4% by 2030. We believe businesses can really move the dial here by providing the technology, the skills and the products to help us hit these goals. Clean energy experts and investors like **Hannon Armstrong**, **The Renewables Infrastructure Group**, **GCP Infrastructure** and **SSE**, all of which we own, are on the frontline of this fight. We also own US insulation supplier **Owens Corning**, which helps improve building heating efficiency, and UK transmission business **National Grid**, which is investing heavily in improving the country’s electricity capacity.

Weaning ourselves from carbon-heavy energy will be difficult, but it is possible. A co-ordinated plan that the whole world can subscribe to is perhaps the biggest challenge for creating a low-carbon global economy. Any plan must be realistic, in terms of science, the technologies available and the economic implications on real people. It must be fair between advanced nations that have already polluted heavily in the past and emerging nations which are currently using carbon-heavy energy to improve living standards. But it also needs to be fair to those countries that are being hit hardest by a changing climate and rising sea levels.

This is a tough ask and it’s why coming to an agreement has been so difficult. There was a large, yet unsuccessful, push at COP28 to include a “phase-out” of oil and gas usage over a set timeframe. This is particularly popular in regions suffering badly from extreme weather and rising water levels. But that terminology was blocked by other nations reliant on oil and gas revenues to pay the bills and live comfortably.

When it’s all boiled down, the difficulty with COP and climate policy is a familiar one: the tragedy of the commons. When it’s everyone’s problem, it’s no one’s problem. If the world is to mitigate climate change, all nations must change together. And as we change our habits, that creates plenty of investment opportunities.

## PORTFOLIO ACTIVITY

| Key purchases/additions | Key sales/trims |
|---|---|
| JP Morgan 4.5% Dispersion Note 2026 (new purchase) | Zebra Technologies (sale) |
| Zoetis (new purchase) | DSM Firmenich (trim) |
| Nvidia (addition) | |
| Alcon (addition) | |
| UK Gilt 0.875% 07/31/2033 (addition) | |

Source: Rathbones

## HOT TOPICS — BOTTOM UP

Because we think rates have peaked, both here and in the US, we've been in the habit of buying government and quasi-government bonds when yields pop higher (although, we don't buy US government bonds because they don't meet our sustainability criteria). These included the **UK Treasury 0.875% 2033** and **1.5% 2053**.

We expect the jerky sort of volatility – both up and down – that encapsulated 2023 to continue for the foreseeable future, which is why we bought the **JPMorgan 4.5% Dispersion Note 2026** structured product in the quarter. Structured products are contracts with investment banks that pay specific returns when triggered by certain scenarios. This one pays us a quarterly coupon amounting to 4.5% each year, as well as a return based on the 'dispersion', or volatility of a basket of stocks relative to the volatility of the S&P 500 stock market index. By volatility, we mean that the prices of underlying stocks within the index move up and down more than the price of the index itself. This structured product will repay our capital and then some if the difference in volatility between the basket and the index widens between when we bought it and the January 2026 maturity. If the volatility difference decreases over the period, we will lose money.

We sold US logistics and warehouse supplier **Zebra Technologies** because we wanted to reduce our investments in industrial areas of the economy. We think that a mild recession is very possible in the coming year or so and Zebra, which supplies RFID gadgets and inventory management software to consumer-facing businesses, could be vulnerable.

In October we bought **Zoetis**, a pet and livestock health business based in New Jersey, US. The company has been in the game since the 1950s and has diversified into many different areas, including drench and medicines for preventing parasites, vaccines against common diseases, skin ointments, diagnostics and others. Zoetis has strong and reliable profits that generate a lot of cash, which is something that we prize in investments. If a business makes a lot of profits – and sees them quickly in cashflows as opposed to accounts receivable debts with customers – it has options and the flexibility to take advantage of opportunities that arise. It also has the tools and resources to deal with threats before they become a fatal spiral.

We bought more **Put Options** on the US stock market in November and December as the S&P 500 ripped higher. These work like portfolio insurance in that you pay a premium up front and receive protection if markets drop. They become cheaper to buy when volatility is low and more expensive when it's high. The reason for this is that if volatility is high – if prices are yo-yoing all over the place – there's more chance that the option will be used, so it's more attractive. However, volatility isn't stagnant, so it's often best to buy insurance when the sun is shining, which is why we added to our put option exposure – stock market volatility fell significantly over the quarter.

We used stock market weakness in the first half of the quarter to add to some of our stocks that we felt had been unfairly punished for short-term dynamics. These included medical technology businesses **Dexcom**, **Boston Scientific**, **Smith & Nephew** and **Edwards Lifesciences**, which were hit hard by new weight loss drugs, and British medicine manufacturer **GSK**, toothpaste, vitamins and supplements business Haleon and Singaporean lender **DBS Bank**.

## SPOTLIGHT

In this quarter, the spotlight is on our **Advance Drainage Systems** and **Zoetis** holdings.

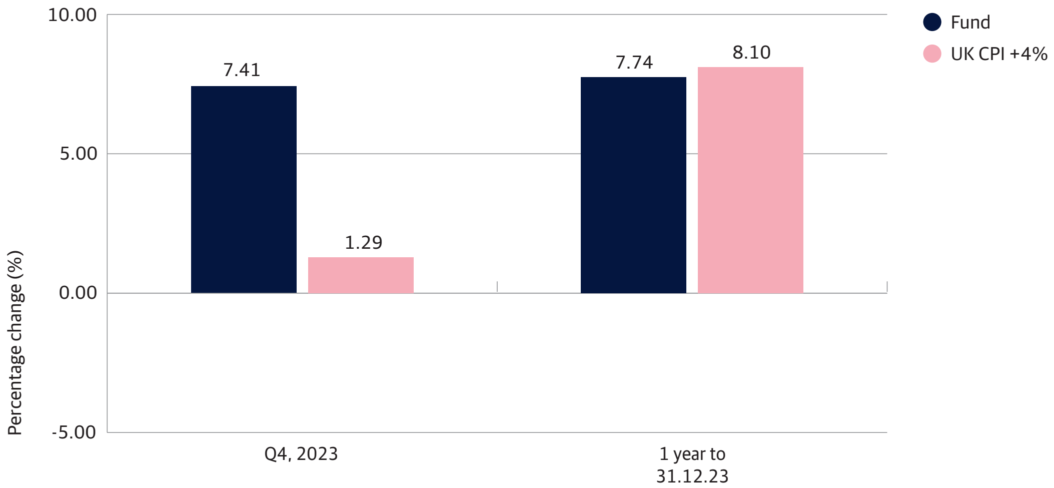
### Advance Drainage Systems

- Advanced Drainage Systems (ADS) is a US company focused on recycled-plastic drainage pipes and stormwater management infrastructure including chambers, basins, and filters
- As well as being recyclable, its plastic pipes are more cost-effective, more durable and lighter than traditional metal and concrete ones, which is driving its market share and profit
- The company's product portfolio of water management solutions is very well-positioned to benefit from increased government spending and regulatory focus on reducing water stress and improving water infrastructure to mitigate flooding challenges, for example the US's Inflation Reduction Act is committing $10 billion to water-related investments
- ADS's pipes and infrastructure keep waterways safe from pollution and prevent excessive stormwater runoff which is great for the environment, but also has social benefits as it makes land more arable and cities more liveable for communities
- Its innovative products include the Mega Green dual wall pipe, which has a minimum recycled content of 60% for sustainable infrastructure projects
- ADS is also the largest plastics recycling company in North America, saving hundreds of thousands of tonnes of old bottles and containers every year through its subsidiary ADS Recycling

### Zoetis

- Zoetis is a global animal health company that develops and commercialises vaccines, medicines, diagnostics and other technologies for companion animals and livestock including cattle, fish, swine and poultry
- Gen-Z and Millennials are fuelling the humanisation of pets and prioritising the health and wellness of their animals more than ever before which is a great tailwind for Zoetis and its companion animal segment
- It's also very common now for high income households to have more than one pet and studies show that when faced with a 20% decrease in budget, pet owners will not spend less on their pets. This provides Zoetis' revenue stream with an element of defensiveness and resilience in difficult market conditions which we like
- Turning to livestock, the global population is growing, leading to increased demand for animal protein sources. Zoetis' products support customers to raise healthy cattle, sheep, pigs, poultry and fish to enable sustainable food production and meet the demands of our growing population
- The Zoetis Centre for Transboundary and Emerging Diseases also develops vaccines for high-impact emerging infectious diseases globally by identifying infectious disease threats early and developing solutions to control them
- Overall, by providing animal health technologies, Zoetis is helping to improve the quality and length of life of a range of companion and livestock animals, supporting sustainable development and growth

# FUND PERFORMANCE




Performance (based on 'S-class' shares).
Net of expenses and tax. Net income reinvested.

Data source: FE fundinfo

| Discrete annual performance | | | | | |
|---|---|---|---|---|---|
| **Year to:** | **End Dec 2019** | **End Dec 2020** | **End Dec 2021** | **End Dec 2022** | **End Dec 2023** |
| Fund | – | – | – | -16.68% | +7.74% |
| UK CPI +4% | +5.45% | +4.40% | +9.35% | +15.08% | +8.10% |

Price performance based upon single price (mid). Past performance should not be seen as an indication of future performance. The value of investments and the income from them may go down as well as up and you may not get back your original investment.

| Top performers (%) | | |
|---|---|---|
| **Holding** | **Performance** | **Contribution** |
| Shopify | 36.78 | 0.37 |
| Hannon Armstrong | 29.31 | 0.23 |
| American Tower | 27.87 | 0.32 |
| Dexcom | 27.79 | 0.29 |
| Assa Abloy | 26.95 | 0.29 |

| Bottom performers (%) | | |
|---|---|---|
| **Holding** | **Performance** | **Contribution** |
| Nidec | -16.62 | -0.13 |
| Aptiv | -13.18 | -0.14 |
| Zebra Technologies | -12.85 | -0.12 |
| SIG Combibloc | -10.81 | -0.10 |
| DSV | -10.18 | -0.12 |

Note: Top and bottom performers are taken from the list of all holdings of 0.25% and above of the portfolio.
Performance and contribution data shown above is based on unhedged GBP capital returns.

Source: Rathbones

Government bond yields fell materially over the fourth quarter of the year, with falls accelerating in December after US Federal Reserve Chair Jay Powell told a press conference that monetary policy should be looser next year. Lower bond yields, which are driven by higher bond prices, gave our portfolio a substantial boost. Over the past year or so we had built up our holdings of government and quasi-government bonds (although not US Treasuries, as they don't meet our sustainability criteria) and increased the length of time till they mature, which makes their values more sensitive to movements in interest rate expectations. We believe that government bonds are still attractive on an absolute basis, and should also provide portfolio protection if an economic downturn arises.

The sharp fall in bond yields helped stock markets as well because profits expected far into the future have a greater value when interest rates are lower. The biggest gains came from growthier stocks like e-commerce platform Shopify and more traditionally rate-sensitive stocks like telecommunication infrastructure company **American Tower** and data centre property company Equinix. The change in mood music also helped drive a rally in businesses that had been hit hard in the third quarter. These included industrial businesses, such as global locksmith and access company **Assa Abloy**, US waste pipe supplier **Advanced Drainage Systems**, American rubbish and recycling business **Waste Management**, and technology business **ASML**, which designs high-end computer chip printers.

## FUND PERFORMANCE (continued)

Our significant position in medical technology stocks held us back in the third quarter because of concerns that next-generation weight loss drugs, such as Ozempic, would badly damage many healthcare businesses. We used that share price weakness to add to our holdings and this was rewarded by a large reversal in November and December. As an example, one of our key holdings in this space, diabetes monitoring company **Dexcom**, rose from around $75 a share at the height of the pain in mid-October to end the year around $125.

The key detractor from our quarterly performance was Ireland-listed **Aptiv**, which supplies the systems and connectors that become the central nervous system of increasingly computerised modern cars. Aptiv delivered solid results in the quarter, yet its share price fell as investors worried about future demand for its services. Some electric vehicle models have been delayed and production numbers have slowed recently; however, we think this is just a blip. All cars – whether petrol-powered, hybrid or fully electric – are increasingly digital and the technology Aptiv sells is crucial to electrification. We think the company is a great opportunity when looked at over a period of years, so we used the weakness to buy more shares

## ASSET ALLOCATION RANGES

| Liquidity | Equity-type risk | Diversifiers |
|---|---|---|
| 0% to 30% | 50% to 90% | 0% to 30% |

## ASSET ALLOCATION CHANGE AND STRATEGY

There were no significant changes over the quarter.

| Asset allocation split | 30.09.23 | 31.12.23 | % Change | 12 month change |
|---|---|---|---|---|
| Liquid assets | 20.80% | 23.86% | 3.06% | 6.19% |
| Equity-type risk | 73.38% | 70.27% | -3.11% | -7.36% |
| Diversifiers | 5.82% | 5.87% | 0.05% | 1.17% |
| | 100.00% | 100.00% | | |

| Asset class split | 30.09.23 | 31.12.23 | % Change | 12 month change |
|---|---|---|---|---|
| Equities | 69.59% | 67.34% | -2.25% | -5.83% |
| Index-linked bonds | 1.00% | 0.95% | -0.05% | -0.39% |
| Government bonds | 6.11% | 5.97% | -0.14% | 0.90% |
| Corporate bonds | 10.83% | 7.32% | -3.51% | -1.30% |
| Emerging market debt | 0.00% | 0.00% | 0.00% | 0.00% |
| Private equity | 0.00% | 0.00% | 0.00% | 0.00% |
| Alternative investment strategies | 5.82% | 5.87% | 0.05% | 1.17% |
| Property | 0.00% | 0.00% | 0.00% | 0.00% |
| Infrastructure | 0.00% | 0.00% | 0.00% | 0.00% |
| Commodities | 0.00% | 0.00% | 0.00% | 0.00% |
| Cash | 6.65% | 12.55% | 5.90% | 5.45% |
| | 100.00% | 100.00% | | |

| Sustainable category split | 30.09.23 | 31.12.23 | % Change | 12 month change |
|---|---|---|---|---|
| Decent work | 13.20% | 12.32% | -0.88% | -1.32% |
| Resource efficiency | 8.21% | 7.79% | -0.42% | -1.90% |
| Habitats and ecosystems | 0.00% | 0.00% | 0.00% | 0.00% |
| Inclusive economies | 4.86% | 4.32% | -0.54% | -1.74% |
| Energy and climate | 19.11% | 18.51% | -0.60% | -0.05% |
| Health and wellbeing | 18.15% | 18.76% | 0.61% | 1.50% |
| Resilient institutions | 2.99% | 2.61% | -0.38% | -2.57% |
| Innovation and infrastructure | 21.05% | 17.26% | -3.79% | -0.55% |

The ‘resilient institutions’ category includes government bonds.

## INVESTMENT OUTLOOK

The markets for bonds and locking in future interest rates imply that it's probable that the Fed will cut interest rates as soon as the first quarter. While anything is possible, we think it would require serious economic disintegration for the Fed to cut rates within the next four months or so. With current growth so high, that would be a breath-taking slump in economic activity. Instead, it seems more likely that the Fed will hold fast for a while yet. On a human level, we think central bankers' professional reputations and legacies are more at risk if they cut rates too early and let inflation flare up again. If they keep rates high and cause a minor recession, well, that's just the cost of prudent leadership…

Of course, that's not what the rest of the market hears when Fed voting members get to talking. We will have to wait and see. One of the main disconnects we see as 2024 kicks off is that many investors expect rates to follow a downward path that implies sharp economic deceleration, while simultaneously expecting chunky double-digit profit growth for companies that's rare in times of slowing (or falling) GDP.

To avoid being too badly burned by any disappointments, we've been trimming stocks whose valuations appear to have got a bit toppy and using that cash to add to stocks and other assets that have fallen from favour. We don't want to sell these businesses completely — lots of people want to buy them for a reason! — because over five years or more, we think they have the opportunity to grow well and become more valuable. Yet we try to minimise the short-term downdraughts that happen.

If there are any of the commentaries you require further clarification on, then please contact your adviser or Rathbones at the contact details below.

Past performance should not be seen as an indication of future performance. The value of investments and the income from them may go down as well as up and you may not get back what you originally invested.

**Rathbones Asset Management**

8 Finsbury Circus
London EC2M 7AZ
+44 (0)20 7399 0000
Information line:
+44 (0)20 7399 0399
ram@rathbones.com
rathbonesam.com



8756.01.24