Rathbone Unit Trust Management
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Rathbones
Look forward

Rathbone Heritage Fund

Update, Q4 2018 update

Over the fourth quarter our fund lost 11.1%, marginally behind the FTSE World Index (GBP) at -10.9%, while CPI+5% delivered 1.7%. Portfolio volatility was 9.2% and the FTSE World 10.2%. The maximum drawdown of our fund over the quarter was -12.0%, compared with -14.9% for the FTSE World.

Fraudulent accounting issues at **Patisserie Holdings** were revealed at the beginning of the quarter, which we discussed in our last letter. This was our biggest detractor from performance for Q4. At the time of writing, the company had been put into administration.

Markets changed tack sharply in the final quarter. The confidence which had pervaded the US throughout the year finally broke. A variety of factors intersected, including global growth concerns, as well as the expectation of more US rate rises than the economy could endure. Hence our other major laggards for Q4 were American stocks, with weakness in more volatile names like autoparts business **Aptiv** and music streaming service **Spotify**, which were impacted as investors became more cautious on future growth potential.

We did see small positive contributions from a number of stocks in the quarter, led by information and analytics firm **Relx,** whose long-term earnings consistency comforted investors. Another bright spot was Swiss pharmaceutical company **Novartis**. We also saw positive contributions from airline ticketing platform **Travelsky** and internet conglomerate **Tencent**, two Chinese businesses which had been weak earlier in the year. Their performance improved from mid-October as Chinese government roadblocks were removed and the ebbs and flows of trade negotiations seemed slightly more positive (for the moment).

We were pleased that our quarterly drawdown was shallower than the market, despite the impact of Patisserie Holdings.

Over the past quarter, we have added four new holdings: **Mondelez**, **Microsoft**, **Henry Schein** and **GlaxoSmithKline**. And exited two: **Wabtec** and **Delphi Technologies**. This boosted the number of our holdings to 34, the largest number we have had in a long while. We are comfortable with this increased diversification, as it will help to reduce idiosyncratic/stock-specific risk. We may even include a couple more companies in due course.

Three of the four new holdings, Mondelez, Microsoft and Henry Schein, are US businesses. Food company and Cadbury Chocolate producer Mondelez is a company that we have monitored for a while, and we felt it offered an improved risk/return opportunity. Microsoft is a strong business with the capacity to drive double-digit growth in both earnings and cash flow, driven by its leading position in the multiyear trend of digital transformation. As users shift from licensed software to subscription-based services and the migration to the cloud continues. Henry Schein is an interesting business in the wider healthcare sector, as the leading dental supplies distributor in the US. It also sells to the animal health and medical sectors, in all cases providing the vital link between the equipment manufacturer and end customer. We have also added large pharmaceutical company GlaxoSmithKline, increasing our exposure to the healthcare sector.

Earlier in the year, American rolling stock engineer **Wabtec** announced a merger with the transportation division of GE. Following the tie-up, Wabtec's business will be fundamentally changed from a business that manufactures parts to one that will manufacture original equipment. This makes Wabtec more cyclical. This change, along with the risks associated with the integration of two large businesses, led us to exit the position.

We also sold our holding in Delphi Technologies in early October, as outlined in our last quarterly update.

As we go into 2019 there remains much uncertainty. Global trade issues remain unresolved, as does Brexit. The US government is in the midst of the longest shutdown in its history and saving face/beating the other guy seems more important than doing what's in the best interests of the people. Meanwhile, concerns for the economy and the US Federal Reserve's monetary policy are growing. On the other side, US consumers still appear robust and they could be further boosted as they do their taxes and receive the benefits of Donald Trump's tax cuts for the first time. But is this the best it can get? Whether the US sinks as far as recession, and when that might happen, remains to be seen, but things are not as rosy as they were.

Under these circumstances cash remains key for us. In uncertain times, companies that generate cash – and continue to do so – give us great comfort.

The Rathbone Heritage Fund team

The Rathbone Heritage fund team's views are their own and not to be taken as investment advice.

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