Rathbone Unit Trust Management

Contact us 020 7399 0399 rutm@rathbones.com

Rathbones
Look forward

Rathbone Global Sustainability Fund

Quarterly update June 2020

By mid-July, global equities had climbed almost 40% since their March low, leaving them around 10% below the all-time highs reached in February.

We beat our FTSE World Index (GBP) benchmark over the quarter; our fund rose 21.3% compared with the FTSE World's 19.9%. Year to date, we are up 8.8% compared with the benchmark's 0.6%.

With stock prices this high and forecast earnings lower than they were just before the pandemic, many investors are happy to pay more today for less future value. This is the case when you look at headline indices, at least. When you dig deeper into specific companies the reality gets much murkier. Especially when you analyse companies in the global context of a truly extraordinary amount of government spending and central bank largesse.

There are always a lot of moving parts going into equity valuations. The prospects for GDP growth, the outlook for inflation, longer-term trends that change business environments, to name a few. And all these sorts of things will have varying effects by nations and markets, so every company's experience is different depending on its specific mix of regions and business lines. And that's before you start accounting for all the information and circumstances that are unique to every company: the processes and products it owns, its networks and staff, debt levels, cash flow and business opportunities.

Right now, it feels like every single thing that could affect a business valuation has been amplified by the pandemic, government and central bank responses to it, and the responses of people to the whole situation. Some people are worried about the arrival of crippling deflation because of the current worldwide slump in demand for goods and services. At the same time, others are terrified of runaway inflation driven by a tsunami of cash flowing from the public sector combined with widespread business bankruptcies that curtail the supply of goods and services. Companies that have shown themselves capable of operating remotely and offering smooth digitised services have been rewarded by investors, while those that appear behind the now accelerating digitisation and flexible-work trends have been sold aggressively.

These phenomena are being treated as extremely binary, win-big or lose-all, right-space or outmoded. Reality is rarely so clean cut. We can't have both deflation and inflation, for example. And a business's fortunes are influenced as much by the competence of its management and quality of its products as they are by how well fashioned the environment appears for its operations.

Just because a company is in 'the right space' and looks whizzy doesn't mean it's a good company or a good investment. Disgraced UK retailer Boohoo is a case in point. The Manchester-based garment maker has long trumpeted its commitment to sustainability, yet it has been rocked by reports that its British supply chain is rife with human rights abuses. Even in an advanced economy, the clothing industry can't seem to shake its reliance on sweatshops. This is something we can never abide. We have always been dubious of clothing retailers for this reason, and we still don't hold any shares in one, despite searching long and hard for a sustainable alternative. Instead, we invest elsewhere, in companies that are doing good by people, the planet and investors.

We took advantage of the quarter's volatility to buy stocks across the portfolio, and to build meaningful positions in three stocks.

We added to **Thermo Fisher Scientific** — one of the world's leading laboratory equipment businesses. Thermo Fisher's equipment can be found in most commercial, government and academic laboratories. We think the pandemic will create a structural tailwind of higher laboratory testing over the coming years. Its management have an excellent track record of allocating capital, both organically and through buying up rivals.

An addition to our portfolio was **TeamViewer**, a German software company that specialises in remote-working applications. TeamViewer has a particularly strong following among small and mid-sized businesses, and it is compatible with a variety of operating systems. I believe this technology has significant potential across many industries, and the recent shift to remote working should accelerate growth.

The third stock was Canadian ecommerce platform **Shopify**. This business is also popular among small and mid-sized businesses, offering them a full white-labelled digital sales system, from website design and hosting to payment, shipping and after-sales care. Shopify's services are so good that even larger brands use them too. There has been a clear acceleration in ecommerce this year, yet online sales in many countries still make up a small proportion of overall retail sales. We think there's plenty more growth to come in this trend that pre-dates the pandemic. Shopify should do well as it offers a slick and professional digital presence – pivotal for increasing sales in the 21st century, yet something which can be hard for smaller businesses to create on their own. Today, many shoppers prefer to shop quirky or local: boutiques are in the ascendance, and Shopify is helping give them a leg up. Shopify also offers tips, tools and guidance to help their customers drive sales – something that helps Shopify too. It's helping in other ways as well, offering free entrepreneurship and marketing courses for adults, free coding lessons for kids, and committing millions of dollars annually to its own sustainability fund to fight climate change.

We bought more shares in **EDP Renováveis**, the Portuguese renewable operator. We are confident in wind power's increasing share of the global energy mix, and EDP has a strong track record of building and operating large-scale renewable power projects. Another top-up was US Bancorp. We felt the company's valuation became extremely attractive during the market volatility so we took the opportunity to increase our exposure. We think US Bancorp's core franchise in the American Midwest remains solid.

We also sold several names that we had lost confidence in, largely due to the impact of COVID-19.

Drug marketing volumes could be lower for the rest of 2020 and into 2021, yet that hasn't been sufficiently discounted in the share price of UDG Healthcare. We sold our shares for this reason. We also exited our position in US dental distribution company **Henry Schein**. The pandemic forced much of the American dental market to shut for a prolonged period. We think the recovery in dental business will be slow, given patients' potential health concerns and the reduced capacity of clinics due to the extensive precautions they must take.

The decision to sell our position in medical devices business **Becton Dickinson** reflected two things: more attractive ideas in the healthcare space (such as Thermo Fisher) and our concern about the company's debts. The pandemic highlighted the vulnerability of businesses with significant interest bills in a world where they may have to shut down completely for weeks or months at a time. There is a very real chance that new waves or spikes in infections will disrupt businesses in 2020 and in the years to come. Because of this risk, we re-examined company leverage across our portfolio. We decided that, in this context, Becton Dickinson was too financially indebted for our liking.

We sold our position in **Xylem**, an American industrial water company. Xylem is involved in supplying and treating water for all sorts of uses, including communities, industry and isolated homes. We think this is an attractive market to be in; however, we were concerned about the quality of execution in the business. We have our eye on more attractive industrial water stocks.

Finally, we also reduced our position in Italian medical technology business **DiaSorin**. The company has been extremely proactive in developing tests for COVID-19, reflecting the quality of the management team and its core franchise. DiaSorin's valuation, however, became extended, so we reduced its weighting in our portfolio

Picking investments is multi-faceted and difficult – even more so during a pandemic that makes the world appear completely different to how it did back in 2019. In some respects, this is true: the experience of the pandemic will change people's habits and the way companies operate. Public sector responses will alter the financial landscape by influencing future growth rates and inflation. All these measures will change the world in which we invest. Hopefully changes in how all three parts of the economy behave will also push our societies towards cleaner energy and commerce too! Most of us like the safe, the familiar and the tested. Times like now push us out of our comfort zone, forcing us to do new things in new ways. That can lead us to better ways of doing things. Yet, in other respects, the world will carry on as it always has. People – and the institutions and customs they create – have an inertia that shouldn't be flippantly ignored. There will be many other parts of life that people will return to for the sheer familiarity of it. And other parts because it really was the best and easiest method.

When living through turbulent times, you can get swept up into thinking that the whole world will shift on its axis. Instead, you should try remain as objective as you can and try to survey every situation over the proper, long-term lens. You need to find out where true change is likely to bed in and determine what is likely to return to the old order; where companies' prospects have dramatically changed or where investors have let the times get to their heads.

This has led us to take profits from companies whose share price we believe has run too high and adding to those businesses that have been sold too heavily.

During the recovery from the March lows, markets have been flipping sharply and more often between the 'growth' companies that are less reliant on GDP growth to make greater profits and the 'value' companies for which accelerating GDP growth is crucial. For now, growth businesses have remained top dog, which is good for our fund. But if value companies really do roar back, we would do relatively poorly.

Such a resurgence in value would be fleeting, in our view. Which is why we're sticking with the quality growth companies that we've been drawn to since our fund was launched two years ago. We can't know the future, but our reasoning is that so many economic phenomena are blowing against a surge in growth and inflation. The world's population is older, more indebted and the IT revolution continues to drive down costs. All of these trends reduce the demand for goods and services in economies, making GDP growth scarce and dampening inflation. That would keep interest rates stuck to the floor and drive investors, in our opinion, toward those companies that are growing in spite of the overall situation.

Our fund doesn't chase themes. The investments we make are determined by the strength of individual companies and their prospects. Yet you can see how the global economic situation has framed our selection. The companies we hold tend to be those that are in the vanguard of the IT revolution, those that can provide for older people – particularly healthcare companies – and businesses that help alleviate the demand on our overloaded planetary resources.

These are the areas where we see potential over the coming five years.

David Harrison
Fund Manager

Rathbone Unit Trust Management Limited
8 Finsbury Circus, London EC2M 7AZ
Tel 020 7399 0000
Fax 020 7399 0057

Information line
020 7399 0399
rutm@rathbones.com
rathbonefunds.com

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