Contact us 020 7399 0399 rutm@rathbones.com

Rathbones
Look forward

Rathbone UK Opportunities Fund

Monthly update August 2020

Another month of improving economic data and sterling strength provided the backdrop for your fund's continued strong performance.

Once again, this went against the grain of the wider UK stock market, which was compromised by its bias to large-caps. Since 2016, UK large-caps have benefited from global revenue streams that provided a buffer to domestic economic concerns, while profiting from a weakened pound. In recent months, this diversification was more of a shackle than a shield. Furthermore, in light of second waves and lockdowns in other nations, the UK has gone from being a COVID 'loser' to looking somewhat better placed. Small and mid-cap equities benefit more from this improved economic and currency performance, creating a hospitable market for your fund to operate in.

Despite this, it remains too soon for outright bullishness. COVID-19 is not gone, government stimulus is scheduled to roll off, unemployment is in all likelihood going to rise and business closures are expected to accelerate. Furthermore, trade negotiations with our European partners are stalling. There are increasing murmurs that Westminster thinks the pandemic's economic destruction has cheapened the price of a 'no-deal' Brexit. Still, your fund's holdings are faring quite well, while some are even finding prosperity and opportunity amongst the disorder.

XP Power (XPP) makes converters, amplifiers and other 'nuts and bolts' hardware for industries with complex power requirements, like transport, healthcare, industrials and the tech sector. This holding of ours benefited from the increase in healthcare equipment spending during the pandemic, which is adding to a significant recovery in semiconductor end markets. XPP's orders grew 45% in the first half of the year, helping it beat analysts' earnings expectations by over 15%. We expect healthcare demand will normalise a bit from here. However, longer term, healthcare spending should be higher because of the pandemic.

Another holding, industrial software designer **AVEVA**, is embarking on another ambitious buyout off the back of its successful integration of Schneider Electric Software. OSIsoft (OSI) is another industrial software player whose data-collection products nicely complement AVEVA's aim of helping its customers wring as much efficiency from their operations as possible through process and systems design. Having come through a period of high investment, OSI has everything it needs to focus on revenue growth in the coming years. AVEVA sees an opportunity to help boost OSI's growth by cross-selling it in the Asian market. At the same time, AVEVA targets improving the quality of OSI's revenues by adopting a steadier, subscription-based sales model as opposed to the classical 'licence & maintenance' framework. We believe the combination of product integration, Asian growth and subscription pivot should generate a lot of value for AVEVA shareholders. Our confidence is bolstered because this deal bears some resemblance to the Schneider integration, which went very well.

The legal profession was a surprise loser in the COVID-19 fallout. Lockdowns and social distancing disrupted ongoing cases while reducing the number of new instructions, leading to fewer billable hours. Your fund holds a small exposure to the sector via its position in **Keystone Law Group**. Keystone is a platform operator that centralises the operating and administrative functions (and costs) of a legal practice. It then contracts with small practices, allowing them to focus their attention on building their book of clients and practising the law. Keystone gets a share of the fees generated from work. It's proven a popular model and the number of fee-earning professionals contracting with Keystone has grown well over the last five years. The disruption of COVID has been detrimental to revenue growth in the near term, so the shares have been weak. We expect Keystone to come out of this period, in time, but until we see an uptick in new instructions we expect little from the stock. Longer term, we expect more lawyers may find Keystone's options for flexible working more attractive than before lockdown ...

In August we added a small position in food producer **Cranswick**, which is one of the UK's largest meat processors. Food production is not an easy market to operate in. You're competing with some well-established peers for typically price sensitive customers. The name of the game is to invest in assets that increase efficiency (allowing you to be more price competitive), unlock new product lines or produce higher 'value-added' products. This requires a strong and experienced management team and Cranswick has that, we believe. Off the back of an intense investment period, we think the market is being too conservative on the growth Cranswick can drive through its revamped facilities. The result, we believe, should be higher-than-expected profits in the long run.

In closing, we are seeing green shoots, but confidence should be tempered by the many uncertainties that yet remain. Apart from the localised concerns discussed above, we are watching the early days of a new cold war between the developed world and China, a toxic US presidential election, moderate levels of civil unrest all around the globe and a growing 'second wave' of the pandemic in Europe and Asia. That said, the market is alert to these risks. Investors appear to still be net bearish on near-term prospects, according to recent investor surveys. As such, it remains the contrarian view that equities have further to run.

Alexandra Jackson
Fund Manager

***We aim to deliver a greater total return than the FTSE All-Share index, after fees, over any five-year period. Total return means the return we receive from the value of our investments increasing (capital growth) plus the income we receive from our investments (dividend payments). We use the FTSE All-Share index as a target for our fund's return because we want to offer you a better return than the UK stock market. We also compare our fund against the IA UK All Companies sector to give you an indication of how we perform against other funds in our peer group. Apart from investing exclusively in the UK, the funds in this sector aren't always similar to ours.**

This is a financial promotion relating to a particular fund. Any views and opinions are those of the investment manager, and coverage of any assets held must be taken in context of the constitution of the fund and in no way reflect an investment recommendation. Past performance should not be seen as an indication of future performance. The value of investments may go down as well as up and you may not get back your original investment. Source performance data, Financial Express, mid to mid, net income re-invested.

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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