Rathbone Unit Trust Management

Contact us 020 7399 0399 rutm@rathbones.com

Rathbones
Look forward

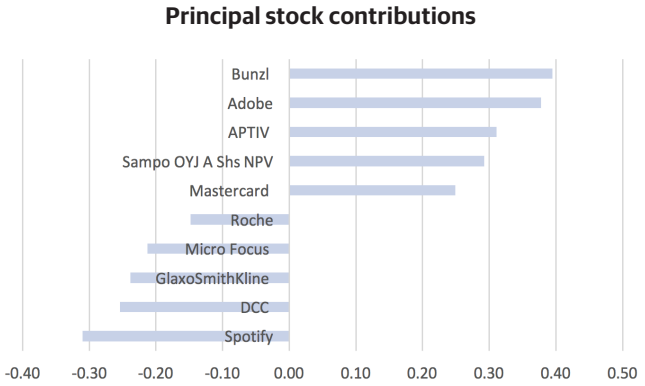
Rathbone Heritage Fund

Quarterly update September 2020

Over the quarter your fund outpaced its benchmark of UK CPI inflation, yet lagged the FTSE World index. As argued in our previous quarterly review, high valuations across areas of global equity markets have persisted – specifically technology – which has meant that our cash level has stayed well above 20%, dampening performance in strong markets.

Global markets have been propelled by a heady mix of central bank stimulus and demand for technology and "stay at home" stocks, a performance in stark contrast to the extraordinary global environment to which we have become accustomed this year. As we look toward a final quarter that certainly heralds even more uncertainty, and therefore volatility, we wonder if this 11-year bull run (ignoring the short-lived COVID slump of March) is beginning to falter. By contrast, many still argue that a further leg higher is in the pipe because the US Congress should finally agree on the next phase of its stimulus. Our analysis of the eclectic mix of businesses that have led markets over the last three months does hint at a market where the drivers are becoming less clear. This may or may not reflect more cautious investor behaviour, but we continue to be very wary of market levels.

Performance review



The most prominent contributor to our performance through the summer was **Bunzl**, the global distributor of non-food consumable products. Their broad spread of clients has had wildly contrasting experiences this year: exposure to the leisure market has been disastrous – think disposables used in cafes and coffee houses; on the other hand, medical supplies have been very strong. Like-for-like sales have been volatile both up and down, but in Bunzl's latest results the netting out of big numbers resulted in a strong positive beat on sales and profit. Much like the market, Bunzl has made progress, but there have been a lot of moving parts.

	9 months	3 months	6 months	1 year	3 years	5 years
Rathbone Heritage Fund	0.6%	1.2%	16.9%	2.1%	8.8%	39.8%
CPI Inflation + 3%	2.3%	0.8%	1.5%	3.2%	14.3%	25.5%
FTSE World index (GBP)	3.8%	3.2%	23.8%	5.2%	29.7%	96.4%

	30 Sep 19-30 Sep 20	30 Sep 18-30 Sep 19	30 Sep 17-30 Sep 18	30 Sep 16-30 Sep 17	30 Sep 15-30 Sep 16
Rathbone Heritage Fund	2.1%	1.9%	4.6%	9.5%	17.3%
CPI Inflation + 3%	3.2%	4.8%	5.7%	6.0%	3.6%
FTSE World index (GBP)	5.2%	7.9%	14.2%	15.4%	31.2%

Technology continues to be a primary driver of our returns, but momentum does seem to be slowing, at least as far as stock prices are concerned. From a business point of view, **Adobe** has beaten estimates consistently. The trick was repeated in its third quarter numbers, energised by a very strong performance in its digital media division. We regard **Mastercard** as a technology platform as well, and so it comes with similar caveats regarding valuation. Cashless payment trends have only increased this year, despite broader consumer headwinds, and the shares have responded. On the other hand, music streaming business **Spotify** gave back gains in the third quarter. The story remains intact, but the valuation had run away from itself; indeed, since period-end the price has recovered. We have trimmed the position to lock in healthy profits.

The other noticeable winner was automotive parts supplier **Aptiv**. Although the broader automotive market has faced trials and tribulations this year, both in terms of demand and stresses in the global supply chain, Aptiv offers us a way of playing important trends within the industry, such as electrification and safety systems, without being exposed to any individual car manufacturer. We don't need to bet on the pace of change, or on the winning platform; Aptiv provides exposure across the industry. These long-term trends remain strong, despite the unpromising backdrop of 2020.

What the market giveth, the market taketh away. While Bunzl has been strong, another global distributor, **DCC**, has been weak. We like this company fundamentally, and it remains a core holding in our fund. However, half of the business is involved in the distribution of petrochemical products. And in a world of slowing growth and greener aspirations, investors latterly have edged away. Meanwhile, the abundance of cash on DCC's balance sheet – which was a clear plus when markets were very shaky in the spring – is now viewed as a negative. Investors want the cash to be put to work. So why is our view different? Firstly, the company needs to remind the world that it's part of a wider energy complex, and that it can participate in the new trends. For example, by exploiting its expertise in unmanned fuel stations, which could one day include a network of electric pod points. Secondly, DCC is a disciplined acquirer of businesses, and we don't expect it to be hurried along by the stock market. It will buy when the time and the price are right.

Pharmaceuticals, in general, were weak in the third quarter, yet we have maintained our positions in **GlaxoSmithKline** and **Roche**, as well as **Novartis**. **Micro Focus International**, too, has been volatile. We came to the conclusion that it should not be in our fund and have sold it.

Outlook

This extraordinary year continues. Bond markets have done a round trip to nowhere, and investors have had to buy more risk to generate a return. A narrower cohort of stocks were benefiting earlier in the year, but there are suggestions that this is beginning to unwind. The sensible thing to do is to take a step back and consider the risks that are relevant right now.

The days leading up to the US presidential election are going to be fractious, and it's unlikely to end there – even if the vote is decisive, tremors will no doubt impact the market for several weeks afterwards. There is the uncertainty over the timing and scale of any stimulus bill in the States too.

The UK has its own problems, largely of its own making. The twin threats of COVID and Brexit herald a traumatic next few months. But to what extent is the worst priced in? And how will UK markets and sterling respond if there is any modicum of good news?

European nations trundle on, and there has been random support for shares across the Channel, but, again, COVID threatens the wider European project. And, finally, there's China. Often depicted as the villain of the piece this year, it is now a source of economic momentum that is sorely lacking elsewhere in developed markets. Indeed, internet giant **Tencent** and insurer **AIA** remain two of our largest core positions.

We are still looking at global equity markets through a different lens than many other investors. Markets are expensive, so we are sitting on a lot of cash, as dictated by our valuation-linked cash management mechanism; the higher they go, the more painful this may feel. However, if they do correct, we will redeploy this cash swiftly; we just require the correction to be meaningful enough to make a big difference to us, and that would mean pain for the wider investment community. We are sticking to our guns because that is the purpose of our strategy and our portfolio structure. It's what sets us apart. This is not a prediction, just a discipline.

The Rathbone Heritage Fund team

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

7046.10.20