Rathbone Unit Trust Management

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Rathbones
Look forward

Rathbone UK Opportunities Fund

Quarterly update September 2020

After the summer surge, markets are experiencing an autumn lull. And no wonder: Europe and the UK are dealing with a second wave of coronavirus cases, Brexit negotiations have hit the headlines again and the US election is just weeks away.

Markets have not been given their usual medicine of increased liquidity from central banks and September is usually the trickiest month for equities, so they unsurprisingly turned soft towards the end of the quarter. UK stocks fell almost 3% over the quarter, with the largest stocks dropping particularly heavily. The alternative part of the market, where your fund is overweight, actually rose close to 10% over the quarter.

	YTD	3 months	6 months	1 year	3 years	5 years
Rathbone UK Opportunities Fund	-8.5%	6.0%	21.9%	3.7%	-0.9%	23.5%
IA UK All Companies sector	-18.5%	-1.0%	13.1%	-12.8%	-8.0%	16.9%
FTSE All-Share index	-19.9%	-2.9%	7.0%	-16.6%	-9.3%	18.6%

	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 UK Opportunities Fund	3.7%	-10.9%	7.3%	12.5%	10.7%
IA UK All Companies sector	-12.8%	0.0%	5.5%	13.7%	11.7%
FTSE All-Share index	-16.6%	2.7%	5.9%	11.9%	16.8%

These figures refer to the past, which isn't a reliable indicator of future returns.

Source: FE Analytics; data to 30 September, I-class , mid price to mid price.

It has been a strange quarter for UK stocks because of gyrations in sterling exchange rates, brought on by the potential breakdown in UK-EU relations that may arise from the Prime Minister's Internal Market Bill. Mid-cap companies have been especially hard hit because they are – probably more wrongly than rightly – judged *en masse* to be hyper-sensitive to the vagaries of the currency. Meanwhile, weak sterling hasn't been the fillip it usually is for British multinationals, perhaps because many of them are oil and gas majors or financial giants, both of which haven't been so hot globally. In fact, not owning banks and oil companies was one of the drivers of your fund's performance over the quarter.

On the stock level, our two of our top performers were actually mid-caps that managed to buck the trend. Media company **Future** and software developer **Kainos**. Another was video game publisher **Team17**, a smaller company listed on the AIM market.

Kainos is a FTSE 250 software business. If you have renewed your driving license online, or downloaded a COVID-19 sicknote for work, you will have used Kainos software. It's doing a lot of work for the government's digitisation programme, and it has an excellent track record of making it work. Kainos also helps companies install, configure and test Workday, the $52-billion market-cap US-listed HR software business. Kainos's outstanding results sent its share price skyrocketing in the quarter.

Team17 creates irreverent, lovable computer games like the Worms series and Overcooked. It has a habit of beating profit guidance, raising its targets and beating again. The studio has no doubt been helped in recent months by bored punters whiling away lockdowns inside, but that sounds like a standard reaction to a typical British winter too! We're confident that Team17 can continue its strong performance, yet we've been trimming our position as the share price rose to keep our risks in check.

Meanwhile, a few of our stocks haven't been as rosy. Food shops **Greggs** and **SSP** and specialist insurer **Beazley** had a poor quarter.

Greggs and SSP have been victims of the pandemic; food purveyors have had little ability to hide. With fewer people going to the office and taking trains, these businesses are going to be in pain. Yet they are strong, well-capitalised businesses that should be able to endure the lockdowns and thrive once COVID-19 is in the rear-view mirror. Our holdings are relatively small too, with Greggs accounting for 1% of the portfolio and SSP making up 1.1%.

We had been feeling good about our holding in cyber security insurance specialist Beazley over the summer. It was immune from the business interruption court case against Hiscox and others, and so was handsomely outperforming. But recent results have shown increased costs from event cancellation payouts that Beazley will have to make for the rest of the year – large scale in-person events are unlikely to return soon. The stock was hit hard. This is frustrating as we can see lots of evidence that insurance rates are going up quite strongly in Beazley's favoured markets. In fact the company raised fresh equity during the summer to make the most of it, so we feel a little sore, but expect next year to be bumper.

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**. The company has since seen instructions rebound, leading us to buy more of it as we believe the company has a promising future in an age of more flexible working. Keystone is a platform operator that centralises the operating and administrative functions (and costs) of a legal practice in return for a share of fees. It then contracts with small practices, allowing them to focus their attention on building their book of clients and practising the law. Critically the lawyers don't get paid until Keystone gets paid, so cash is comfortable and offers protection in a downturn. It's proven a popular model and the number of fee-earning professionals contracting with Keystone has grown well over the last five years.

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.

Over the past few weeks, we had updates from a lot of our companies. Happily, most have shown incredible resilience or even improvement in their businesses since lockdown. Stand-outs include **Future**, the online magazine company, and **Diploma**, the people who distribute seals and controls to industrial customers. Future has been proving its detractors wrong by showing just how much cash it can generate from moving old-fashioned print magazines into the digital world. Country Life, Decanter, TV Times, woman&home are a selection of the latest titles which will be getting the 'Future' treatment. Industrial rising star Diploma has found a brilliant looking business to buy to further its US operations. We happily subscribed for more shares, our position now stands at more than 2.5% of our portfolio, as we see an invigorated management team with a super business they could boost. Business turnaround expert **Melrose** had a nice bounce after reminding the market that the sale of a previous acquisition will help bring its debt down, and that there are signs of life in the auto market.

The patchy nature of recent global economic activity means we are likely to see more fiscal and monetary support. The UK has recently delivered more positive surprises than most other developed countries though, including PMI figures and consumer confidence. We think that global investors have overlooked Britain's relative strength; the UK stock market currently trades at a two-decade low compared to the US. A resolution to the Brexit negotiations, signs that the second wave is coming under control or some M&A could easily be the spark that lights up UK equities. We feel increasingly positive the UK can gain back some ground into year end.

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.

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