

Rathbone UK Opportunities Fund

Monthly update February 2023

Last month we said we were looking forward to spending **less time on central bank 'dot plots' and more time on fundamentals**. Best laid plans and all that! The rally we've all been enjoying since October faltered in February as investors were forced to take another pass at American interest rate expectations. Higher, and for longer, according to the latest economic data (especially US job creation) and the comments from the US Federal Reserve.

Bond yields spiked, and by now you will know what happens next... But, interestingly, while American stocks wobbled in February, there was no major derailment as there was every time interest rate projections were adjusted last year. Investors seem to have become more comfortable with discounting higher rates, and the knowledge that we are only tens of basis points off the ultimate peak anyway helps of course. If economic data continues to come in better than feared – as has been the case in the US, yet notably also in the UK – the market can worry a bit less about recession, but a bit more about inflation.

If this scenario of generally better economic growth and higher inflation persists, it should benefit British share prices. US stocks dropped in February, yet headline British indices still posted small positive returns. We believe the large and long-standing discount for UK companies relative to those in the rest of the world creates a defensive margin of safety for investors. Also, many large UK companies tend to do well when inflation, interest rates and global growth are rising: oil and gas, big banks, miners, etc. We don't own these businesses because they are commoditised and solely reliant on the fortunes of business cycles. However, when they do well, they pull the UK index higher too. If this outperformance continues, it should help rehabilitate the UK's tarnished brand as a place to invest. Then, more people may start to discover the quality mid and smaller-sized companies that are on offer here.

UK retailer goes global

So, back to our resolution to talk more about these quality companies!

Reporting season is well underway; it's a hectic period for investors, but it's also crucial to sit down with as many management teams as we can to understand how they are faring. We observe a couple of trends. Several companies issuing decent updates have struggled to move their share price higher because they've already rallied hard in the last few months.

Howden Joinery, which we own, is a case in point. Conversely, some names which delivered just slightly shy of Armageddon were able to rally if expectations and positioning were low enough (no names named, we would be unlikely to own businesses with poor fundamentals anyway).

One standout did manage to convert very strong results to a higher share price: trainer retailer **JD Sports** has doubled its value since October but also managed to pop 10% higher on a super update. It's a top-five position for us.

Here's LeBron James, who broke the NBA all-time scoring record last month. In 2019 he was also the first player ever to record a 'triple-double' against every NBA team (that's a double-digit number in three of the following stats in a single game: points, rebounds, assists, steals and blocked shots).



Why is he in this note? JD announced an ambition to rack up a triple-double of its own over the next five years. That's double-digit revenue growth, double-digit market share, and double-digit operating margins. To achieve this, it's planning to open 250 to 300 stores each year. Even if they only achieve one or two of these aims, the shares look attractive. Remember, JD isn't just a UK high street play anymore – exposure to the UK is just two-fifths of the company's sales, and falling.

Nobel pursuits

We again got out to see our companies in their natural habitats, rather than just the sterile boardroom. A trip to see **Oxford Instruments** (a top-10 position in your fund) was a highlight. A superb example of what UK PLC has to offer if you look under the bonnet, this is a FTSE 250 scientific instruments business. Its kit is used by scientists the world over in research and practical application: spectrometers to analyse illegal substances, advanced cameras for deep space imaging, etching and deposition tools for the new generation of semiconductor manufacturing. We love that the 2022 Nobel Prize Winners for both physics and chemistry used Oxford Instruments' equipment for their research.

Alain Aspect, John Clauser and Anton Zeilinger pushed the envelope of quantum physics in their three separate experiments into the nature and behaviour of 'entangled particles'. These strange particles are connected in some as-yet-unexplained way, so that what happens to one affects the other, despite them being far apart. Entanglement is one of the keys to the secrets of quantum physics and quantum computing, which is being developed from this mind-bending branch of science. Oxford Instruments designs and manufactures the phenomenally sensitive light detectors used in this field – so finely tuned they can accurately measure single photons.



The major challenge to recording distant and faint astronomical objects, with a high magnitude, is the ability to conduct very long exposures. The historical dilemma which astronomers have faced is choosing between moderately cooled cameras that are convenient to operate or deep-cooled cameras which have some challenges associated with heat pumps or handling of cryogenic liquids. Vacuum sealed, deep-cooled sensors facilitate very long exposures with minimal challenges, and for the vast majority of applications, there is no need for coolant or any other external infrastructure.

Source: Oxford Instruments 2022

Carolyn Bertozzi won the 2022 chemistry prize for effectively writing the book on chemical reactions that are compatible with live organisms. Her contribution to 'click chemistry' – a type of reaction that allows you to easily join two molecular structures together – has pushed open the door to more targeted treatment of disease and tumours. By finding ways to use click chemistry within living organisms, it presents the potential for creating diagnoses and cures that target culprit cells with laser-guide-like precision. Oxford Instruments' highly sensitive cameras were used in Bertozzi's work as well.

Contrary to popular opinion, high-quality products *are* made right here in Britain.

Flows into our fund during February suggest appetite towards the UK might be increasing. These inflows have left us with a bit more cash than usual, which we will deploy into more exciting companies when markets weaken. We have already added some of this cash to existing holdings on 'red' days, and some is earmarked for new holdings that we hope to share with you soon!



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Fund Manager

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