Rathbone Unit Trust Management

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Rathbones
Look forward

Rathbone Greenbank Global Sustainability Fund

Quarterly update June 2021

Markets have been acting like they have a split personality over 2021. Running hot, then cold, then hot again, investors seem unable to decide on how the pandemic will affect growth and inflation over the next year or two.

Looking around the markets, we see two camps that have set up tents.

The first group is adamant that the dislocation of the past 18 months will fuel greater, persistent inflation that would boost GDP growth in the shorter term but also spook central banks into raising interest rates and curtailing their quantitative easing bond purchases much earlier than expected. They believe that will cause a rise in most bond yields that will drive down the price of stocks with higher price-earnings multiples – the 'growth' stocks that make up most of our holdings – but boost 'value' companies that do better when GDP growth rises (at least in the short term).

The second camp is diametrically opposed. They believe that inflation is just a passing phase, created by disruption in supply chains and people's lives. They think that inflation will moderate before central banks are forced to raise rates to rein it in and global GDP will continue its long-term trend of low and steady expansion. That would be a boon for the price of stocks that can offer reliable earnings growth that isn't tied to the fortunes of global GDP.

These two camps have been jousting in the markets for months now, creating strange see-saw bouts of performance. For our fund, this led to two distinctly different quarters over first half of 2021. In Q1, we lost 2.1%, compared with a 4.1% gain in the FTSE World Index, as 'value' stocks roared higher. Then, in Q2 we gained 7.6%, outstripping our peers and the market.

	3 months	6 months	1 year	30 Jun 19-30 Jun 20	Since launch (19 July 18)
Rathbone Greenbank Global Sustainability Fund	7.6%	5.3%	28.0%	12.6%	54.8%
IA Global sector	6.9%	10.3%	25.9%	5.4%	38.3%
FTSE World Index	7.5%	11.9%	25.5%	5.8%	41.5%

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

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

Embrace complexity

The clash of these two camps is complicated further by steadily rising COVID-19 infections across the world. The delta mutation, which is yet more contagious than the early strains of the virus, makes some nervous that nations will have to reverse their reopening if hospitals become overwhelmed once again. For now, the number of people getting seriously ill hasn't increased in line with previous waves, suggesting that vaccine rollouts are doing their job.

Taking all of this in whole, we find it hard to simplify. We find it hard to make sense of all the moving parts in stock and bond markets. Increasingly, they are inconsistent. It seems, to us, like many investors have become extremely dogmatic in their positions. There is a lack of acknowledgement that reality will most likely fall somewhere in the middle. That goes for the progress of the pandemic, the paths of inflation and GDP growth, and the stock and bond prices that will be influenced by the mix of it all.

Faced with this, it just reinforces our need to focus on the cornerstones of our investment process: we want to buy good quality companies that will be around in 10, 20, 30 years' time; and we want the world as we know it to be around in 10, 20, 30 years' time. Over the last six months, we weren't investing based on what we believed would happen in the next six months.

Because such a huge amount of human activity is delivered by capitalism, businesses have an enormous part to play in ensuring we make the changes necessary to hit the goals set by the United Nations in its Sustainable Development Goals. Resource efficiency in industry can save countless tonnes of metal, fertiliser, water, plastics and greenhouse gases. Responsible supply chain management prevents people from being exploited or trafficked. Investment in exciting new technologies provides solutions to the problems of illiteracy, poverty and climate that face our world.

We are looking for the best possible businesses that are helping make the world better over a series of decades. When we find them, it then comes down to price: is it right for the opportunity offered? It's been a messy and bouncy year so far, which has flowed through to our performance. We expected that might be the case after the truly exceptional year that we had in 2020. Many of our holdings had rocketed higher and, while we have been careful to trim these holdings to ensure they don't grow too large and unbalance the portfolio, a correction in their prices seemed likely.

Getting industrious

Because of this, over the past six months we decreased the size of some of our more highly valued holdings and used that cash to buy companies at more attractive prices. These are still quality businesses that are doing just as much good for the planet and the people on it, they are simply in different industries. Typically, these parts of the economy had a tougher pandemic. This has meant our exposure to the industrials sector has increased to almost 28% of the fund, up from 24% in December.

One of these new industrial holdings is **Evoqua Water Technologies**. Based in Pittsburgh, Evoqua treats water and wastewater for local authorities and companies predominantly in North America. Everywhere where water needs to be filtered, made safe or purified, Evoqua can help. This is especially important in heavily regulated areas like aviation, food processing and pharmaceuticals. About 60% of Evoqua's revenue comes from this sort of ongoing operational, servicing and maintenance work. This is tremendously sticky business as it entails integrating water treatment into the production lines and processes of its customers. Changing suppliers can often mean having to shut down and refit. The rest of Evoqua's cash comes from one-off sales of filtration products, testing apparatus and even a patented renewable energy system that uses anaerobic digestion to turn dirty waste into clean power. There are so many opportunities in making water use more efficient, and this industry will only become more critical as our growing population puts pressure on finite water reserves. This is a very fragmented global market, so there's plenty of space for Evoqua to expand its business, both in its home markets and abroad.

Another industrial addition is **Advanced Drainage Systems** (ADS), an American plastic pipe manufacturer. These are mostly large stormwater, sewerage and mains water pipes. Development of new homes in the US has been steadily increasing since 2011 – the pandemic was only a slight hiccup and the trend has continued. These new homes need underground infrastructure and that's where ADS comes in. Added to this growth, many old concrete and cracked metal pipes need replacing and plastic is the solution. Plastic gets a bad rap because of the time it takes to degrade and how it litters our world. And with good reason. However, this long life is exactly why it is the perfect material for pipes – it doesn't rust, rot or corrode and should last for more than a century. ADS is the second-largest recycler of plastic in North America, using old cleaning product and drink bottles, caps and even carpet from kerbside collections to make its pipes. ADS calculates that 330,000 tonnes of carbon emissions are saved by its recycling.

To move into these companies, we continued to trim some of the companies that had done very well during the pandemic and which we felt made sense to take profits on. These included Dutch electricity grid designer and battery storage expert **Alfen**, German warehouse automation and forklift business **Jungheinrich** and **GN Store Nord**, a Danish manufacturer of headphones, headsets and hearing aids.

Also, we sold our holding in Danish renewable energy giant **Orsted** because we became concerned about the long-term durability of its business model. Orsted was one of the first large-scale utility companies to successfully move away from carbon-intensive generation. It has built up an excellent set of renewable power assets, but we feel this first-mover advantage is diminishing quickly. New entrants from the oil and gas sector have started bidding aggressively on new renewable projects, and we are seeing signs of irrational pricing in some cases. While Orsted is likely to win its fair share of contracts going forward, the economic return from these could be lower than anticipated which would impact the intrinsic value of the business.

Making the best

If there's one good thing to come out of the truly awful pandemic, it must be how well people have adapted to the new reality. Businesses and households have shown immense flexibility, stoicism and lateral thinking to get through this huge dislocation. The pandemic shocked us all, in both human and economic terms, offering us the chance to pause, take a breath, and rethink how we work and live.

Flexible working has been technically possible for years, yet its benefits for focused work and reducing unnecessary travel weren't recognised. Now that they have been proven, it should mean huge benefits for productivity, living standards and the environment. Shuttered businesses had to shovel money into technology to ensure they could operate remotely and to ensure they could sell online. Arguably many companies were very slow in embracing the digital age, but the pandemic suddenly made it an imperative. Meanwhile, people had to change how they lived, shopped and worked with friends, colleagues and family.

These dynamics, both positives and negatives, have whipped up the whirlwind of change that makes forecasting so difficult. We have started to become a little uneasy about just how adamant many investors have become about what the future holds. A little like the pandemic itself, it will be messy, complicated and hard to predict. That's why we will keep focusing on looking for the best possible companies that offer solutions to the pressing needs of tomorrow. Regardless of how GDP and inflation and interest rates play out over the coming years, efficient use of resources, more effective technologies and cleaner energy will be required.

David Harrison
Fund Manager

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