Rathbone Unit Trust Management

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Rathbones
Look forward

Rathbone Heritage Fund

Quarterly update December 2020

Your fund ended an extraordinary year in relatively rude health. COVID-19 and its global social and economic ramifications dominated 2020. Market reaction was swift and brutal at the onset of the pandemic at the start of the year, but the rebound from the March lows was dramatic. Not all areas of the market enjoyed the ride, however. Growth did well, especially in the technology arena, as did stable, secure defensive businesses. The flip side of this coin was the weakness – not surprising in light of COVID's economic impact – of shares in industrial cyclicals, and more evidently, in cheap stocks, or 'value' as the market names them.

However, in the final quarter of the year, there was a shift in mood. Investors started to look beyond the year end into 2021, and the promise of an economic revival, supported by ongoing monetary, and crucially fiscal, stimulus. For this period at least, the technology giants that dominated in the first nine months of the year seemed to reach a ceiling, and cyclical industries, such as the miners, the energy complex and financials, took over the baton of market leadership. Despite the horrors of 2020, asset prices ended the year pretty close to all-time highs.

Performance review

	3 months	6 months	1 year	3 years	5 years
Rathbone Heritage Fund	5.2%	6.5%	5.8%	11.2%	36.7%
CPI Inflation + 3%	1.0%	1.9%	3.4%	13.8%	25.9%
FTSE World Index (GBP)	8.6%	12.1%	12.7%	34.2%	97.1%

	31 Dec 19-31 Dec 20	31 Dec 18-31 Dec 19	31 Dec 17-31 Dec 18	31 Dec 16-31 Dec 17	31 Dec 15-31 Dec 16
Rathbone Heritage Fund	5.8%	16.3%	-9.7%	10.2%	11.6%
CPI Inflation + 3%	3.4%	4.4%	5.4%	6.3%	4.1%
FTSE World Index (GBP)	12.7%	22.8%	-3.1%	13.3%	29.6%

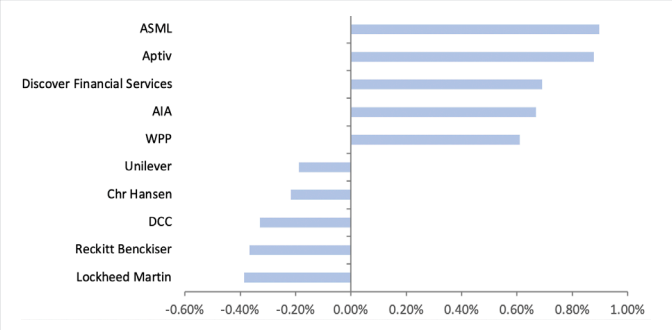
Source: FE Analytics; data to 31 December, I-class, mid price to mid price.

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

The value of your investments and the income from them may go down as well as up, and you could get back less than you invested.

The ongoing recovery in markets bolstered returns in the quarter. Your fund gained 5.2%, versus our benchmark CPI +3% which was up 1.0%. Over the full year, the fund rose 5.8%, versus the benchmark's gain of 3.4%. For reference, the recovery in equity markets is reflected by strength in the broad FTSE World Index, up by 8.6% and 12.7% over the quarter and the full year respectively, rounding off a resounding rally from the lows in March. We remain concerned that valuations are stretched. The percentage of our fund allocated to cash is determined by the global cyclically adjusted P/E (CAPE), a well-known measure of price versus earnings. At the year-end, with CAPE at 34 times earnings, cash and cash equivalents are elevated at 22.2% of the fund.

Principal stock contributions



Source: StatPro, Rathbones

The principal contributors to returns in the period are an eclectic mix, while the laggards fit neatly into the rotation narrative. The ongoing strength of the semi-conductor market has propelled **ASML** higher. We own the Dutch semi-conductor giant because we believe that it benefits from the wider trends across a diverse market; we don't have to pick the winning industry segment because we are buying exposure to the industry itself. **Aptiv** is a leading manufacturer of components for the car and commercial vehicle sector, which is seeing dramatic developments in hybrid and electric vehicles. As such vehicles become both more commonplace and more complex, Aptiv does well. Echoing our ASML strategy, Aptiv is also brand agnostic – it feeds the industry, rather than any particular marque.

US credit card business **Discover Financial Services** (DFS) recovered well in the final quarter. DFS is a solid financial enterprise, but it was inevitably rocked by the COVID pandemic and its impact on the US economy, and the finances of its customers. Nevertheless, the shares quadrupled from their March lows to hit an all-time high by the year-end. Hong Kong-listed life assurer **AIA** is a core holding which also recovered well through the year. We like the long-term trends driving insurance products in Asia, primarily demographics and increased prosperity. Finally, **WPP** recovered well at the end of a difficult year, as improving advertising revenues encouraged investors.

Of the laggards, we suggest that **Lockheed Martin**, **Reckitt Benckiser** (RB) and **Unilever** were weakened by the sector rotation out of defensive quality into areas of the market deemed to represent greater value. In the case of RB, and to a lesser degree Unilever, we are wary that the COVID uplift in sales of sanitising and cleaning products, and for RB, brands like Nurofen, will not be repeated this year. Any extrapolation of last year's growth is likely to be ahead of the mark in our view, and their results could disappoint.

DCC, the global distributor of petrochemical, technology and pharmaceutical products, also lagged. What was deemed a virtue back in the spring, during the height of the panic, is now an encumbrance: cash on the balance sheet generates no return, and as market confidence improved, some investors grew impatient with DCC's conservative approach to deploying its funds. We are happy for it to be patient. Of greater concern is the fact that, in our opinion, the company has been a little late in arguing for its Environmental, Social and Governance (ESG) credentials, which are important considering its exposure to the wider energy complex.

Finally, ingredients business **Christian Hansen** has struggled recently, on account of a deterioration in the Chinese dairy market and investor disappointment at results generated by a recent acquisition. This holding remains under review. However, our own analysis suggests that the price of the shares implies a view of the future that is too pessimistic.

Outlook

The coming year presents many clear and present challenges. The disciplined roll-out of vaccines worldwide will take many months., It will take many more for the world to return to a semblance of normality, and that normality will be different to what we once knew. The US needs to move on from the Trump years, but, as shown by the storming of the Capitol Building in early January, there are severe hurdles to overcome. And profound social and economic changes must be made. In the UK, there is a new future to negotiate outside the European Union, and great economic problems to solve. And globally, issues of climate change, and the challenges of inequality, as exemplified by the Black Lives Matter movement, and other humanitarian causes, are there to be resolved. The year 2021 is, indeed, likely to prove extraordinary.

However, we must look forward with optimism. If the challenges outlined above are overcome, and humankind does generally get things right, in the end things should get better. In the shorter term, the uncertainty of Brexit is behind us, and the roll-out of several vaccines has begun. British businesses have struggled, but many have survived, and evolved, and there should be a bounce-back as all the pent-up consumer demand comes on stream. Companies will change as our behaviours change; they will also be taking greater heed of ESG matters, we believe. And this is not just because of high-profile advocates and activists, such as Sir David Attenborough or Greta Thunberg, but because regulators are telling them to do so, and investors are asking them to do so. The US political upheaval tells us that people are angry and frustrated, so we need to be mindful that stakeholder rather than shareholder returns may become more important. Regulators are certainly pushing this agenda. As investors, we cannot stand still. We must look ahead, even if we cannot tell exactly what is around the corner.

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