Rathbone Unit Trust Management

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Rathbones
Look forward

Rathbone UK Opportunities Fund

Quarterly update December 2020

In December your fund returned 6.8% versus an average 4.5% increase in the IA UK All Companies sector. Over the final quarter of 2020, the fund rose by 16.7% while the IA UK All Companies added 15.3% and our benchmark, the FTSE All-Share Index, 12.6%. For the full year, we posted top-decile performance.

	3 months	6 months	1 year	3 years	5 years
Rathbone UK Opportunities Fund	16.7%	23.7%	6.8%	7.7%	36.5%
IA UK All Companies Sector	15.3%	14.2%	-6.0%	2.0%	28.9%
FTSE All-Share Index	12.6%	9.3%	-9.8%	-2.7%	28.5%

	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 UK Opportunities Fund	6.8%	25.1%	-19.4%	17.5%	7.8%
IA UK All Companies Sector	-6.0%	22.2%	-11.2%	14.0%	10.8%
FTSE All-Share Index	-9.8%	19.2%	-9.5%	13.1%	16.8%

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.

A bumpy ride, but a good one

This strong performance disguises a high level of volatility throughout the year. Mid-caps bore the brunt of the pain during the frenzied sell-off in March, only to go on to rally the hardest ever since.

Markets didn't wait for positive news of COVID-19 cases topping out, or for the arrival of the vaccine. It was the commitment from central banks around the world to inject serious liquidity that led to the snapback. Thanks to this downward pressure on interest rates, the year was also characterised by a clear trend of long-duration, 'quality-growth' names outperforming 'cyclicals' and 'value' names. This is good for your fund as we are overweight quality-growth sectors such as technology. Our investment process kept us out of the majority of the worst-hit areas like airlines, banks, energy and commodities, and we had some very strong individual stocks picks, with our best performer up 400% over the year.

Everything changed again in November when the first of the COVID vaccines was announced. Markets saw a rapid rotation away from the companies that managed to benefit from lockdowns, back towards the stragglers. The imminent Biden US presidency added to the move back into cyclicals as they enjoy a more reflationary environment. Our underweight position in commodities, banks and energy could be a headwind if this continues.

Finally, a tricky year was topped off by the last-minute signing of a trade deal between the UK and the EU. This boosted the performance of most UK assets, particularly domestic names.

Top contributors by stock Q4	
Ceres Power	+137%
Melrose Industries	+54%
SSP	+84%
GB Group	+34%
Kainos	+23%
Intermediate Capital Group	+46%

Worst contributors by stock Q4	
AVEVA	-17%
Future	-11%
Ocado	-17%
James Fisher & Sons	-16%
Grainger	-3%
AJ Bell	-4%

Source: Bloomberg; data is share price total return, 30 September 2020 to 31 December 2020.

The road ahead

As we noted in the summer, the recovery will be uneven and fragile. Whole sectors such as hospitality and travel remain in forced hibernation while areas such as video gaming, renewable energy and home renovations are flying high. These COVID winners have been the major positive drivers of our performance over the year, offset in part by our losers.

SSP, an operator of cafes and bars in airports, was our major drag this year. But it was also the biggest riser in the FTSE All-Share on the day the first vaccine was announced and so one of our best performers this quarter. We think this neatly demonstrates what investors are looking for to play this recovery: high-quality, well-run businesses that have – through no fault of their own – been squashed by lockdowns. In the very short term, we may see the super cyclicals rebound the most, but after a couple of easy quarters, those with structural challenges will still face those headwinds. We saw similar moves from **Melrose Industries**, an industrial turnaround specialist. Its auto and aerospace exposure was extremely painful earlier in the year, but aggressive cash management and a pickup in the auto market has helped the firm recover a lot of value. We have held onto both of these names, backing experienced management to make the best of the situation and come out stronger. Both companies are coiled springs, ready to rebound.

There was one company which was seemingly immune to the vagaries of the cycle, COVID *and* Brexit: **Ceres Power**. We have written about this renewable energy firm almost monthly this year; the shares have been on a heroic journey (+400%) thanks to the progress the business has made internally and also due to the increasing focus on renewable energy around the world. We have continued to trim the position in line with our internal preference not to hold more than 3% of any one AIM or small-cap stock, but see much more to come as investors recognise the need for renewable energy exposure and the company continues to progress.

Kainos and **GB Group** are two of our companies tapping into the rapid digitalisation that corporates and governments are undergoing. COVID has simply accelerated this trend. Both reported phenomenal numbers in the quarter, beating expectations and managing to grow despite, nay even thanks to, remote working.

It wasn't all positive for our tech holdings though; some punchy M&A took the shine off **Future** and **AVEVA**. Future made a bid for another UK-listed company, GoCompare, which will add yet more audience and services to the Future machine. AVEVA bought a US technology business which also looks very promising, but the large rights issue to finance it soaked up a lot of demand for the shares in the near term. Both companies have added to the long-term growth trajectory for their businesses.

December was all about Brexit and vaccines, so that cyclical rotation was in evidence again. Our reopening plays, such as **Melrose** and **AB Dynamics**, were strongest, and UK domestic names also performed well thanks to a 'no-deal' Brexit being avoided. We are hopeful this marks a new chapter for UK assets.

After a bit of a pandemic-induced pause, our companies were finally busy with M&A again. **Keywords Studios**, **Halma**, **Croda** and **Alliance Pharma** all rallied on news of acquisitions.

Another area that COVID has accelerated is our desire to make home improvements. Unable to spend on holidays, consumers have upgraded their home office, their patio, their kitchen and their bathrooms. We are also moving house at record levels. This is all very positive for RMI spending (repair, maintain, improve) so we have been adding to our exposure here; more on this next time.

The race to inoculate

Twenty-twenty ended with hope for a better future. We have multiple COVID vaccines, a Brexit deal and a more conventional US administration. Economies will get support from all three contributors spending at once: governments, corporates and consumers. This dynamic should be very positive for equity markets.

The roll-out of the vaccine will be critical in the near term; we will be watching the race between infections and injections closely. Over the longer term, we anticipate the strong getting stronger so will continue to seek out quality-growth businesses to give you exposure to any exciting multi-year themes ahead.

Alexandra Jackson
Fund Manager

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 and the income from them may go down as well as up and you may not get back your original investment.

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