Rathbone Dynamic Growth Portfolio

Quarterly investment update, January to end March 2021

Rathbones

Look forward

Hot topics – 'Top-down' (market and macroeconomic)

Yield party. Bond markets were where the party was in the first quarter. Literally, the only legal party that we know of. The 10-year US Treasury yield continued to barrel higher in 2021, ending March at 1.74% having started the year at 0.92%. The gilt market was even more rip-roaring: UK 10-year yields leapt to 0.85%, up from 0.20% at the start of the quarter. Government bond

yields had been hammered lower over 2020, so they were due a reversal. Yet the sheer speed and aggressiveness was something to behold. Yields are rising because of steadily growing concerns about inflation and the expected recovery in GDP growth, both of which tend to push government yields higher as investors find more enticing (riskier) investments elsewhere. While we're expecting inflation to spike mid-year, we believe this is simply a short-term inevitability caused by a pandemic-induced price slump and a sudden recovery. In short, the impending bout of inflation will be akin to an elephant passing through a snake: an interesting curiosity for people to talk about, but it will sort itself out before you know it. Bond market moves have significant knock-on effects for stocks as well. Higher yields tend to hurt 'growth' companies – those which pay less in dividends and instead reinvest in their business to boost long-term value. The higher GDP growth and inflation that underpins higher yields are great for cyclical companies, however, so there has been a sizeable rotation into these types of businesses that should benefit from reopening and recovery.

Shadow finance. Almost half of global finance is now extended by non-bank institutions like money market funds, securitisation, hedge funds and specialist vehicles. That's up from 42% in 2008, just after the credit crunch went pop, and still higher from the 46% in the early 2000s when subprime mortgages were getting packaged up and sold to unsuspecting investors. The growth in non-bank finance is everywhere. It's the proliferation of private car leasing companies (one of which went bust in March) and the big brand dealerships offering in-house financing. It's the new phones that are bought on monthly payment plans (loans). It's investment funds, like New York-based Archegos Capital, leveraging up through derivative contracts to double down on stocks. It's non-bank financiers, like Greensill Capital, branching out from short-term loans to help smooth cash flow through supply chains to making highly speculative, and potentially fraudulent, long-term gambles based on hypothetical deals. (And, of course, bundling them up and selling these loans to other investors). It could be a coincidence that these blow-ups happened as yields – borrowing costs – were rising. However, the common denominator is large amounts of debt. Shaky, shaky debt. This

is why we bang on about ensuring that our investments keep debt levels manageable and steer clear of racking up debts that are more likely to go unpaid (subprime). These loans make good money when borrowing costs are falling (as they have been for years and years). But they tend to fail spectacularly when that trend reverses. Leverage is a useful tool – without it, the world would be so much poorer – but it must be used cautiously. If you're not careful it can quickly overwhelm you.

Big spender. Renewable energy has come a long way. Back in the early days, it was Farmer Giles renting a corner of his paddock to some enterprising City partnership so they could put up a wind turbine and plug it into the network. Then more sophisticated outfits – funds and the like – with bigger bags of money came calling. They started buying up large stretches of land and building veritable forests of generators. Then specialised listed companies emerged, with research and development budgets,

masses of capital and plans to up-scale significantly. Yet, in the main, the oil majors have stayed mostly on the side-lines. Sure, they've each spent hundreds of millions in the past few years buying up renewable assets, but that's only about 1% of their businesses. So, BP's stonking bid, as part of a consortium, for windfarm sites in the Irish Sea, sounds a bit like a starting shot. BP and its German partner will pay £900 million to option two sites, at a cost of £154,000/megawatt per year. That was about 15 times similar past deals and 80% higher than the next highest offers. And there are development and maintenance costs on top of that, before the royalties move to a percentage of revenue. Now, it's the first offer of seabed by the UK government in a decade and the first by competitive tender, so a bit of an uptick in price should be expected. But the eye-popping price has left the renewable specialists spluttering and laughing. They may well be right – BP could have secured those assets at a much-reduced cost. But the fact that so many hundred millions of pounds is almost de minimis to BP is the point of the story. These oil majors have budgets on a scale that most renewable specialists simply couldn't imagine. If this really is the start of a sustained move by the big boys of yesterday's energy into the green voltage of tomorrow, it will have huge impacts on the renewables marketplace.

Portfolio activity

Key purchases/additions
UBS CSI 500 Index structured product (new purchase)
Nidec (new purchase)
Shopify (new purchase)
Taiwan Semiconductor Manufacturing Company (new purchase)
SIG Combibloc (new purchase)

Key sales/trims
iShares Physical Gold ETF (sale)
Johnson Controls (sale)
ASML (trim)

Source: Rathbones

With yields rising, the opportunity cost of holding gold (which pays no income) increased. We sold the entirety of our **iShares Physical Gold ETF**.

We bought the **UBS CSI 500 Index** structured product during the quarter. This investment is an agreement with an investment bank that will give us the return of the CSI 500, a small and mid-cap Chinese A Share index. It also pays us an almost 10% income for allowing our shares to be lent out to other investors. The demand for borrowing these shares is large, as it helps stock dealers hedge their positions, yet few shareholders are willing to do so in this market because the volatility can be pretty high and local traders tend to buy and sell often. We believe this income stream more than compensates us for the risks involved.

We bought Japanese electric motors manufacturer **Nidec**. These motors are quite sophisticated and are used in all sorts of gadgets. From ultra-thin, shock-resistant cooling fans for computer hard-disk drives, to motors for wind turbines and automobiles. The business should benefit from a number of rising trends, including electric vehicles, renewable energy and cloud technology (its motors go into the servers).

We added Canadian ecommerce platform **Shopify** to our portfolio. This business is popular among small and mid-sized businesses, offering them a full white-labelled digital sales system, from website design and hosting to payment, shipping and after-sales care. Shopify's services are so good that even larger brands use them too. There has been a clear acceleration in ecommerce over the past year, yet online sales in many countries still make up a small proportion of overall retail sales. We think there's plenty more growth to come in this trend that pre-dates the pandemic.

We bought **Taiwan Semiconductor Manufacturing Company** during the quarter. This is one of a handful of businesses that dominate production of the computer chips that seem to go into everything these days. The technology in this industry – and its progress from year to year – is blistering. The exponential growth in computing power we have all enjoyed is driven by the ability to accurately print components at ever-smaller scale on silicon wafers. This means huge outlay on research and development and new equipment, which discourages new rivals and keeps prices steadier. At the moment, there is a huge global shortage of computer chips which has stopped gadget makers and vehicle production lines in their tracks. This is a short-term phenomenon, however, and the long-term case is underpinned by the Internet of Things – chips are going in everything nowadays, including your kettle.

We added Swiss carton-maker **SIG Combibloc** to our portfolio. SIG's cartons are aseptic, which means they don't have to be refrigerated to avoid spoiling their contents. This also means they are a higher-end product than you would first expect. The company sells its packaging lines to food makers and then supplies them with materials, a particularly sticky business model that means its average customer has been a partner for more than 20 years. The company is growing steadily, led mostly by the emerging markets of South America and Asia.

We sold **Johnson Controls** early in the quarter. This commercial fire safety, security and HVAC (heating and ventilation) supplier has been a good investment for us, but we felt that competition in its main markets could hot up in the post-pandemic world.

Spotlight

In this quarter, the spotlight is on our **Abbott Laboratories** and **Ansys**.

Abbott Laboratories

- A global health care company focused on medical devices, diagnostics, nutrition and generic pharmaceuticals
- Medical devices make up the largest portion of sales and is well diversified across a range of conditions, with cardiovascular and diabetes being two particular areas of focus
- Abbott's Freestyle Libre 2 is a wearable device that is designed to monitor blood glucose levels for diabetes patients and remove the need for finger stick testing – the ability to track blood glucose in real time can help patients and their medical professionals better monitor and manage their condition
- The company was also heavily involved in COVID-19 testing over the last year or so with their competitively priced and rapid antigen test which produced results in 15 minutes and gave you access to a free app to display your negative test result if asked to do so
- Overall global demographics and the increasing need to manage medical conditions for lengthier periods as people live longer leaves Abbott and their innovative product suite well supported in the long-term.

Ansys

- A market leader in engineering simulation software for product design, testing and operation
- Simulation is becoming increasingly important to aid companies with R&D during product design and provides the ability to simulate millions of real-world scenarios to establish how products would behave
- Examples of the uses of simulation include validating autonomous cars, designing golf clubs, designing water pumps, and simulated crash testing of vehicles which saves some of the cost of expensive physical testing
- The areas Ansys specialise in are not only vital but very complex, which helps to protect Ansys from new competitors entering the market – if you need to safety test your product with simulation you need to know you're going to a firm with the depth of expertise Ansys has
- Ansys also look to further entrench their services into the product design world by offering Ansys Academic software for teachers to incorporate into their curriculums, which results in graduates leaving education with knowledge and experience of Ansys' software on day one of their employment.

Fund performance

Top performers (%)		
Holding	**Performance**	**Contribution**
ASML	+24.42	+0.21
Schlumberger	+24.12	+0.11
DCC	+21.50	+0.14
US Bancorp	+18.94	+0.16
BP	+17.25	+0.12

Bottom performers (%)		
Holding	**Performance**	**Contribution**
London Stock Exchange	-23.26	-0.21
Ubisoft Entertainment	-20.86	-0.05
Fevertree	-13.92	-0.08
Nidec	-12.57	-0.09
CTS Eventim	-12.34	-0.07

Note: Top and bottom performers are taken from the list of all holdings of 0.25% and above of the portfolio. Performance and contribution data shown above is based on unhedged GBP capital returns.

Source: Rathbones

Currency hedging continued to be a positive contributor during the quarter as we saw sterling to continue to strengthen against a broad range of currencies, with the US Dollar gaining some ground back towards the end of the period. Our hedging of euro, Swiss franc, and 70% of our US dollar exposure all contributed positively over the first quarter of the year. As the US dollar/sterling rate hit around 1.40 we took off some of the USD hedge and continue to watch this for a point at which we may further reduce if we see more sterling strength. We were hedging all of our Swiss franc back to GBP at the beginning of the quarter but as we began to approach 1.30, we took half of the hedge off.

Balance in the portfolio continue to play a pivotal role as markets rotated back and forward between "go out" names and "stay home" names on an almost daily basis. Many of our more cyclical leaning names – the oil majors, US financials such as **CME Group**, **US Bancorp** and **First Republic Bank**, and more industrial names like **Kion** and **Assa Abloy**, rallied as bond yields rose and inflation expectations moved higher. On the other side of the portfolio we had a mix of some quality growth leaning names doing well such as **ASML** and **Alphabet**, whilst others such as **Adobe** and **Amazon** weakened as the market moved to recalculate what they were willing to pay for these kinds of assets in the face of higher yields. Adding some quality cyclicality to the funds last year has been important in enabling more balance from the return in equities, although we will still not be chasing recovery stocks into fundamentally challenged sectors such as restaurants, hospitality, and airlines – we're happy not attempting to thread the needle of timing entries and exits from lower quality businesses with structurally challenged end markets.

London Stock Exchange had a difficult quarter after they reported the level of the costs associated with the integration of their acquisition of Refinitiv. The level of the cost was a surprise to the market, but you can sometimes see the integration costs of large acquisitions like this one be sizable and the process take some time given the size and scale of what is being brought together. We still have confidence in LSE's business model and their ability to generate shareholder returns from the Refintiv acquisition, but we need to remain watchful of how costs progress on the integration to ensure they remain sensible and there is not continuous creep.

Gold had a tough quarter as real rates picked up. The correlation between the two tends to be strongly negative and therefore gold continued a period of weakness after hitting the highs of around $2,000 last year. Although we still view gold as a helpful tool in portfolios, we entirely cut our exposure as for us the risk/reward seems to be skewed to the downside for now.

Asset allocation change and strategy

There were no significant asset allocation changes during the quarter.

Asset allocation split	31.12.20	31.03.21	% Change	
Liquidity assets/lower volatility	11.51%	12.35%	+0.84%	▲
Equity-type risk (economically sensitive assets)	83.12%	81.88%	-1.24%	▼
Diversifiers	5.37%	5.77%	+0.40%	▲
	100.00%	100.00%		

Asset class split	31.12.20	31.03.21	% Change	
Equities	70.37%	72.82%	+2.45%	▲
Index-linked bonds	0.96%	0.71%	-0.25%	▼
Conventional government bonds	3.49%	2.92%	-0.57%	▼
Corporate bonds	6.73%	5.02%	-1.71%	▼
Emerging market debt	4.75%	4.17%	-0.58%	▼
Private equity	1.27%	1.29%	+0.02%	▲
Alternative investment strategies	1.52%	1.86%	+0.34%	▲
Property	0.00%	0.00%	0.00%	◀▶
Commodities	2.84%	1.77%	-1.07%	▼
Cash	8.07%	9.44%	+1.37%	▲
	100.00%	100.00%		

Asset allocation ranges

Liquidity	Equity-type risk	Diversifiers
0% to 30%	50% to 90%	0% to 30%

Investment outlook

The US has bounded ahead into 2021. It relaxed lockdowns well ahead of most other advanced nations and has been quick to vaccinate. Business and household surveys have been shooting the lights out for months – as you would expect after a year of despair, disappointment and house arrest. Light never looks brighter than when you emerge from the tunnel. As for Europe and the UK, things aren't as rosy.

Europe has made a botch-job of its vaccination rollout, leading to yet another round of infections and lockdowns. This is disappointing, and not only for all of us Brits who were dreaming of a sneaky bit of Mediterranean sun. Brexit doesn't change the fact that our largest trading partner is the European Union; their economic troubles will spill over into our businesses too. Thankfully, the UK has been pretty good at adapting to lockdown commerce, so the latest GDP figures haven't been as bad as many thought they would be. Savings have ballooned, raising hopes of a spending extravaganza when reopening begins. Unemployment even fell back slightly to 5% (but that's probably because the number of people not looking for work is rising).

More than ever, the global economy is being driven by America and China, the two large nations that have managed to wrestle themselves out from under the burden of the pandemic. Hopefully, the UK can be added to that list soon. And we're still praying that Europe will get its act together as well. As investors, the measure to watch in coming months will be the 10-year US Treasury yield. This benchmark borrowing cost for the world will be a barometer for how investors feel about the future and the potential for inflation. Movements in that yield will also have a large impact on investment performance.

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Rathbones
Look forward

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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