Rathbone Dynamic Growth Fund

Quarterly investment update, July to end September 2020

Rathbones

Look forward

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

Remember, remember the 3rd of November. Well, the US election certainly got interesting. As if it wasn't already. There's a lot flying around over there. The culture wars are in full swing as the Republicans pushed through the Supreme Court Justice nomination that personifies them. The strength of the American economic recovery is still uncertain, and protesters are never

far from the streets. The cocktail of political activism and antagonism, economic uncertainty and the stubborn pandemic are lining this election up to be one of the hardest fought in decades. It's also disquietingly familiar. A television-savvy Republican running with few policies except for dealing with the kids on the streets faces a compromise Democrat offered up by party bigwigs during a leftward surge by its grassroots supporters. This could be Nixon versus Humphrey in 1968. If only we had Norman Mailer, Walter Cronkite and Hunter Thompson still filing... where has the fun gone indeed. The electoral college forecasts give Democrat Joe Biden an edge, but news from the swing states blunts it. Regardless who wins, we believe the US will be alright. If Donald Trump is re-elected, the government will bumble along as it has while US businesses will keep more of their profits because of retained lower tax rates. If Mr Biden wins he plans to spend big on green infrastructure, and if he takes the Senate he will be able to do so unchecked, offering plenty of fiscal stimulus. Of course, he would also be able to increase taxes, which could spook the market a bit. Unless something completely leftfield crops up, we would use such falls to add to our US stocks.

Silence is golden. We've been so used to the hubbub of Brexit bickering in the background for years that you can forget it's there. It's monotonous and repetitive. Yet you should try to keep note of it. Because when it all goes quiet, when it has been a fortnight or more since anyone's mentioned some prospective outrage, when that constant tension headache has lifted, that's when you should be ready. When you haven't seen Michel Barnier on your television set for ages, that means the European Union envoy is probably skulking round the West End letting off steam with a deal in the bag. Getting a trade agreement is in the interests of everyone, despite the fighting talk emanating from both sides of the Channel. We still think it will go down to the wire, however. And after that, it will take a bit of time before the effects of the agreement start to be seen in the two economies. Businesses will adjust. Some will thrive, some will fail. Market conditions will change, and opportunities and risks with them. The intricacies of the deal itself will drive these changes, yet cross-border commerce is so intricate and trade deals that

govern them so complicated, that not even the architects of these agreements really know the full effects of their agreements ahead of time.

No good options. After the initial lockdown, you could feel the unease within the UK government. The cost of supporting the economy ballooned well above the fevered nightmares of any debt-shy conservative minister. Yet the alternative, the untaken road, well, that would likely have been even worse. And the political backdraft would have been catastrophic. Now, with

the end of the year in sight, case numbers are rocketing once again. And the government is being lambasted in the counties for not laying on the largesse. They haven't exactly played their bad hand like pros, but you can feel some sympathy. They are trying to balance the health and wealth of 65 million in a two-speed economy during a period of heightened animosity. Try advertising that job on Gumtree. The one bright spark through all of this was that the huge jump positive tests was unaccompanied by a proportionate leap in deaths and hospitalisation. Yet they are now creeping steadily higher, too, albeit still much lower than during March and April. Europe is in a similar position, while the US is ticking along a little better economically even though the virus is spreading just as rapidly there. The appetite for more widespread lockdowns just isn't there in the US. Or at least, it hasn't appeared yet as it has on the other side of the Atlantic. It's also easier for the states to enforce their rules: if you shut the bars in Blackburn people will catch the train to Manchester for a session; no one's driving to Phoenix from Los Angeles to grab a pint. It will be bumpy, but we think the Americans will be better able to fight the virus without crippling their economy.

Portfolio activity

Key purchases/additions
Kion (new purchase)
Next (new purchase)
Japanese Government 0.1% 2023 Bonds (addition)

Key sales/trims
Hargreaves Lansdown (sale)
Adobe (trim)
Amazon (trim)

Source: Rathbones

We used new investment flows to top up our existing holdings, across shares and funds.

We bought more **Japanese Government 0.1% 2023 Bonds** over the quarter, adding to our yen exposure because we believe this is a safe-haven currency that should offer some protection in periods of market stress. We also increased our dollar hedge from 60% of our US assets to 70%. This means that we have locked in a set exchange rate for almost three-quarters of our dollar-denominated assets, so subsequent moves in the sterling/dollar rate won't affect their value.

After a strong summer for equities, we took some profits from software developer **Adobe** and ecommerce giant **Amazon**.

We bought German warehouse and logistics design company **Kion**. The business is an automation expert, supplying robotic arms, mobile robots and state-of-the art conveyors to businesses in a range of industries. As the growth in ecommerce accelerates in the wake of the pandemic, many warehouses are accelerating automation plans to increase their efficiency and get more orders out the door. A particularly strong area of expansion is online grocery. Kion helps supermarkets develop click and collect services for this difficult segment that have grocery orders ready for pick up in as little as 15 minutes.

We sold **Hargreaves Lansdown** because we had lost faith in its future strategy. While low-cost American stockbroking rival Robin Hood gave up on its sortie into the UK, we feel like there will always be more Robin Hoods. In our opinion, Hargreaves is focusing on high-cost solutions when the market seems to be looking for low cost.

We bought UK retailer **Next** because we believe it should get through the pandemic and general decline in high street shopping more or less in one piece. The industry has been mauled recently, yet Next has a good online shopping channel. Not something that all its rivals can boast. We think that Next could be the last man standing in the premium economy area of UK retail, which should be an attractive place to be over the coming years.

Spotlight

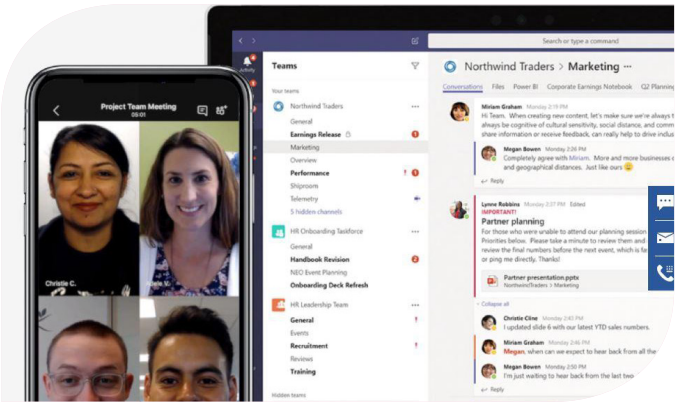
In this quarter, the spotlight is on our **Linde** and **Microsoft**.

Linde

- Largest industrial gases company in world created by the merger of Linde and Praxair in 2018 with around a 30% market share
- Diverse global exposure and a very diverse customer base coming from Manufacturing, Chemicals, and Healthcare sectors to name a few
- Innovative solutions for their customers that are vital to their operations, such as a CO_2 based solution for paper mills helps improve pulp washing efficiency, helping increase capacity without shelling out on new equipment, or ultra-high purity oxygen to keep a room 'clean' for electronics manufacturing
- A resilient business model with either resilient end markets, or large fixed fee components, such as a rental on gas cylinders, which has historically been very resilient due to the low overall cost to the end user, and need to retain the cylinders in order to be able to restart manufacturing quickly

Microsoft

- The well-known global computing giant that revolutionised personal and business computing packages with software like Windows and Office
- Over the year Microsoft has pivoted into new areas of growth, such as cloud computing with its Azure business, and analytics and data for business with Dynamics
- Microsoft also has a strong foothold in the ever-growing video game market with its Xbox console and newer game subscription services that allows users to consume video games like they are now used to consuming their favourite TV shows and movies
- The Teams software, which enables video conferencing and connects with your other Microsoft packages like Office, has been one of the most recent additions to their huge range of products and services
- With working from home likely to stay in some capacity even after COVID-19 is in the rear view mirror, Microsoft is incredibly well placed for this trend with Azure providing the necessary cloud capacity businesses will need, and Microsoft Office, Dynamics, and Teams, providing the all-important complete and connected IT infrastructure for businesses to effectively operate this way



Fund performance

Top performers (%)		
Holding	**Performance**	**Contribution**
Nike	+22.83	+0.14
Eurofins Scientific	+20.98	+0.14
HG Capital Trust	+19.06	+0.24
Ferguson	+18.50	+0.13
Travelsky Technology	+18.10	+0.08

Bottom performers (%)		
Holding	**Performance**	**Contribution**
BP	-25.31	-0.22
Royal Dutch Shell	-24.92	-0.22
Vodafone	-20.81	-0.21
Invesco Markets US Energy Infrastructure ETF	-16.23	-0.07
Legal and General	-12.28	-0.12

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.
Performance (table above only): Gross of charges.

Source: Rathbones

US equities were once again a key contributor to returns as the S&P 500 Index hit new highs during the quarter. There was however, a bit of change of leadership in the drivers of portfolio returns in Q3 with some of the names that have done so well for us year to date seeing their surge slow a little and other names, such as **Ferguson**, **Nike** and **Aptiv**, picking up the pace on their recoveries. We saw some further strength in our healthcare related exposure with names like **Abbott Laboratories**, **Eurofins Scientific** and **Thermo Fisher** having a good quarter as the governments continue to ramp up the need for COVID testing capabilities.

Our currency hedging played a key role during the GBP rally we saw in the quarter. The GBP strength at one point saw the UK currency recover back to around 1.34 against the US dollar after starting the quarter at 1.24, but sterling came off the boil in September as poorer sentiment around COVID responses and concern around Brexit took hold again. The hedging, and in particular, the US dollar hedge, in the portfolio was a key contributor to returns as it stopped the portfolio feeling the full pain of GBP strength in the overseas denominated exposure. The portfolio continues to have around 70% of the US dollar hedged back to GBP, along with the majority of the EUR exposure. We feel this hedging continues to be prudent in the face of GBP remaining weak and the risk of a period of GBP strength if we do see a trade deal with Europe as the countdown clock ticks down to zero.

Gold was higher and a positive contributor over the quarter, but it was a tale of two halves over the period for the shiny yellow metal. We saw a big surge in the price of gold early in the quarter, but as real rates (rates after the effect of inflation) seemed to bottom somewhat and then tick up we saw gold under pressure. Real rates are one of the key data points to watch for gold as the correlation tends to be a very strongly negative one.

As you would expect with the continued positive returns from equity markets over the quarter, the put options that served us so well in Q1 were detractors from performance. We added a new put option with a December expiry to join the existing one that expires in December. We believe that given the potential volatility we could see in Q4 given both the US Presidential election and uncertainty over how a second COVID wave may play out, having more protection covering us over this period seems prudent.

Asset allocation change and strategy

Beyond the adjustment to our dollar exposure, there were no significant asset allocation changes during the quarter.

Asset allocation split	30.06.20	30.09.20	% Change
Liquidity assets/lower volatility	10.70%	8.28%	-2.42%
Equity-type risk (economically sensitive assets)	84.39%	86.90%	+2.51%
Diversifiers	4.91%	4.82%	-0.09%
	100.00%	100.00%	

Asset class split	30.06.20	30.09.20	% Change
Equities	78.53%	75.89%	-2.64%
Index-linked bonds	2.36%	1.38%	-0.98%
Conventional government bonds	3.62%	4.30%	+0.68%
Corporate bonds	1.96%	5.05%	+3.09%
Emerging market debt	2.86%	4.48%	+1.62%
Private equity	1.04%	1.48%	+0.44%
Alternative investment strategies	0.52%	0.14%	-0.38%
Property	0.00%	0.00%	0.00%
Commodities	3.72%	3.22%	-0.50%
Cash	5.39%	4.06%	-1.33%
	100.00%	100.00%	

Asset allocation ranges

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

Investment outlook

There really is no visibility for the rest of the year, even beyond it. The US goes to the polls in a matter of days and in a matter of months the UK will – one way or another – finalise its relationship with its largest trading partner. As a backdrop to these punchy events, we have the worst pandemic in a century tearing across the world.

It is extraordinarily difficult to tell how all this will pan out. Despite that, we think it's untenable for investors to wait on the sidelines. Periods of flux like this offer the opportunities that can make fortunes. They come with the risk of losing big as well. But to completely sit out investing over this period would be a fundamental mistake, we believe. Better to balance your risks, spread your investments and ensure that you share in the fluctuations of capital markets.

That's our strategy: trying to ensure that we have a blend of assets that shouldn't be significantly hit by a Brexit disaster – or success for that matter – when sterling shoots one way or the other; making sure that our holdings aren't a coin-toss gamble on who wins the presidency, or on whether a COVID-19 vaccine arrives in six months, 12 or not at all. Meanwhile, during this time of pandemic-induced "quiet time", we've been assessing all of our holdings and those that are on our 'bench'. We've been trying to nail down, as best we can, how the post-pandemic market landscape will look and whether this creates opportunities or adds more risk.

In deciding whether these companies can thrive in, or at least deal with, these changes, we've focused on the flexibility of their businesses and the competency of their managers. This is why we're so hot on companies having relatively low levels of debt and why we prefer them to produce a lot of earnings in cold cash rather than promises to pay later. Simplistically, these two features are bywords for flexibility. There's a saying that money can't buy you happiness, but it can buy you freedom. This truth applies to companies too. Having lots of cash flowing through your business means you can pull the trigger on lucrative new projects or buy up struggling rivals without having to go to investors.

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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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