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Rathbone UK Opportunities Fund

Update, December 2018

In December, the Rathbone UK Opportunities fund returned -6.4% versus a -4.7% average for the IA UK All Companies sector. This wraps up an unedifying year where your fund fell 19.4%, compared with an 11.2% average drop for the sector, relegating us to the fourth quartile. Needless to say, this is not the outcome we wanted for our clients. We are working hard to improve performance for 2019. The FTSE All-Share fell 9.5%, its worst annual performance since the financial crisis, and from a global standpoint UK assets were unfortunately the worst-performing asset class.

Review of the year

November and December saw trends that began in the autumn intensify. In the UK, Brexit rhetoric ramped up considerably yet there was no actual progress. However, we can see now the obvious impact it had on shopping habits leading into Christmas. We will see it in the cash flows of our businesses too: having to stockpile food, medicine, ingredients and component parts ties up cash that could otherwise be working harder for shareholders. Globally, trade talks between China and the US barely budged, although we are more confident of a resolution now. China's economy is slowing and fears are rampant that the US will not be far behind, exacerbated by overzealous interest rate rises. After 10 years of markets rising, this jump in risk around the world has understandably hit investors hard.

Over the summer we became incrementally nervous about Brexit-induced sleepiness for UK businesses, leading us to sell our early cycle industrial positions and top up on more predictable, highly profitable investments. This enhanced the fund's return until the autumn. We didn't go far enough, however; during the final quarter of the year stocks capitulated and investors pulled record sums of money from UK funds (none from this fund, however). Given this set-up, it was unsurprising that the defensive end of the market outperformed into year end. The sell-off was particularly acute in names that strong runs in the first part of the year and looked 'expensive' – technology niches and growth stocks, both areas where your fund is very overweight. This dynamic was the biggest headwind to performance during the year, alongside two stock-specific issues which will be discussed later. Large companies fell the least (buoyed by international earners in the FTSE 100), but all size indices were down over the year. This was a further headwind for your fund, as our benchmark is over 80% FTSE 100 compared to our 30% weighting.

We raised cash throughout the fourth quarter, trimming large positions that had done extremely well, such as student housing developer **Unite Group**, medical devices maker **Advanced Medical Solutions**, alternative asset fund manager **Intermediate Capital Group** and our mining positions. We recycled some of this cash into new holdings that had been weak, including an old favourite, safety process company **Halma**. The other addition was under-the-radar early-stage investment company **Draper Esprit** (it has core positions in unlisted tech businesses, such as digital challenger bank Revolut, healthy snack company Graze, AI semiconductor firm Graphcore and reviews website Trustpilot). At year end, cash stood at 7.5% and we intend to deploy it as we get closer to the Brexit deadline.

Healthcare was easily the best-performing sector of 2018, unfortunately it's an area where we are underweight, owning neither AstraZeneca nor GlaxoSmithKline. We have been adding to our healthcare exposure via **Abcam** (it sells antibodies to science researchers). Oil & gas had a good year despite a year-end falter. Tobacco, banks, and telcos were the worst sectors – happily we continue to have zero weights here. Our top contributors were design software business **AVEVA**, which was subject to a reverse takeover, industrial rubber belt business **Fenner,** which was bought by Michelin, and litigation finance fund manager **Burford Capital**.

Our worst performers all suffered from large and unexpected profit warnings. Legacy software consolidator **Micro Focus** issued a spectacular profits warning in March 2018 where the worst case outlined has in fact not transpired (the stock is +50% since then). **ASOS** sharply cut profits in December, blaming nervous shoppers ahead of Christmas. We await further news on **Patisserie Holdings**, which remains suspended, but we are relieved to see the arrival of new management and directors.

Outlook

Brexit means more factors are out of our control than normal, which does not feel comfortable. We would welcome increased certainty around the outcome for the UK. For businesses to start investing again and consumers to feel confident, we need more clarity than the Westminster bubble has provided so far. But for the long-term investor, the opportunities revealed by swathes of global investors deserting the UK will be enriching. We must be patient.

Housekeeping

From 21 January, our fund units will move to a single-price, dropping the current dual-price system. Rather than have a buy price and a marginally lower sell price, a single price will be issued for our funds at noon each day. Both purchases and sales of units will be based on this single price.

In line with the industry, we intend to operate a 'swinging' single-pricing mechanism for our funds. This ensures the fair treatment of all unitholders by minimising the effects of the 'dilution' that occurs when stocks are bought and sold. From January 21, the single price will swing in response to large purchases or sales in order to mitigate these effects.

Once the single price of a unit has been determined, a 'dilution adjustment' will be applied to the price in accordance with the policy outlined in the prospectus for our funds. For example, when there are net inflows to a fund, a dilution adjustment increases the price (price swings up) and when there are net outflows from a fund, a dilution adjustment reduces the price (price swings down). However, regardless of whether the price is adjusted up or down, all investors buy and sell at the same price.

With best wishes for a prosperous new year.

Alexandra Jackson, CFA
Fund Manager

This is a financial promotion relating to a particular fund. 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 may go down as well as up and you may not get back your original investment.

Source performance data, Financial Express, bid to bid, net income re-invested.