Rathbone Unit Trust Management

Rathbone Luxembourg Funds SICAV
Contact us +44 (0)20 7399 0800 international@rathbones.com

Rathbones
Look forward

Rathbone SICAV Global Opportunities Fund

Quarterly update December 2021

In the fourth quarter, your fund returned 6.1% versus a 4.7% average increase in the IA Global sector. Since its launch on 11 March 2021, the fund appreciated 20.6%.

One year ago we thought we were entering the end of the socialising recession and a period that might resemble the sequel to the roaring twenties. The year didn't feel at all like that. Fast forward a year and visions of sugar plum fairies and reflationary nirvana have faded. My fund is up over 20% in the past year, but it's the sort of bull market that gives you grey hair. The waves of COVID-19, the supply chain disruptions, the booming employment picture, the $2.7 trillion of US and European excess savings, the inflation spike and spectre of rising rates are blending and bumping up against each other. The business cycle and the COVID cycle are intertwined and putting the outlook into a constant state of flux. Policymakers and investors face a challenging environment: heightened uncertainty and volatility that obscures signal from noise.

	3 months	6 months	Since launch 11 March 21
Rathbone SICAV Global Opportunities Fund	6.1%	10.0%	20.6%
IA Global Sector	4.7%	6.7%	15.5%

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

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

Erratic markets and investors here to stay

Once again, we have experienced a year where a high degree of stock market performance has been concentrated in only a few names. As of early December, the five stocks contributing the most to the overall market return – **Microsoft**, **Alphabet**, Apple, **Nvidia** and Tesla – had driven almost half of the market's performance in 2021. Yet the timing of that contribution has not been linear. Instead, it has been delivered by periods of violent outperformance and underperformance from one month to the next. Luckily we owned three out of five of those companies, yet it hasn't been a smooth ride across the portfolio all the same.

We have sold four of our five worst 2021 performers, and the remaining is under review. With so many good companies on our watchlist we don't tend to agonise over selling underperforming companies where the outlook is cloudy. Some of these companies benefited disproportionately during pandemic lockdowns, but weren't able to maintain their growth rates or lofty investor expectations as we emerged. Some businesses, such as online tutoring business **Chegg**, experienced surprising (but rational) changes in their customer bases as a result of strong employment and wage opportunities in the US. Chegg found that millions of students simply didn't go back to school in September as $20/hour wages from Amazon and Starbucks tempted them away. Others, like **Ocado**, face fresh and well-financed challengers, a consumer who isn't as wedded to online grocery as we imagined and a click 'n' collect rival in the US that's working well for consumers and grocers. **RingCentral**, the cloud-based telephony business is also facing stiff competitive threats from Zoom and other integrated communication services from the most trusted corporate technology partner: Microsoft.

A modest pullback from peak growth in economic and earnings growth and a sharper inflection in monetary policy are driving heavy rotations in markets as investors try to weigh up the future by drawing on past experiences to address developments they've never seen before. Market moves are being amplified by trend-following machines which switch allegiance without thought, let alone pause. This is an environment that calls out for balance: a blend of re-opening and pandemic winners, pro-cyclical and defensive stocks, growth and value, reflation and resilience. It's not the time for one-way bets.

We think that the economy and stock market could well stay skittish, while also still trending higher. This is because the global employment picture is so healthy, inventories are low, consumer savings are high and capex – while booming – still hasn't caught up with demand.

That said, investor sentiment has certainly got more fragile and the size of the moves is challenging some trends that had become deeply embedded (for example buying tech and avoiding or selling energy). Some investors believe the recent sell-off in technology and growth shares has a historical relation to the dotcom crash. We are certainly not among those investors.

We believe that any rotation-driven sell-off should not be confused with previous euphorias around highly valued *profitless* tech bubbles. As the table below illustrates, most American tech businesses (excluding unprofitable 'spec tech' where we don't invest) is much more profitable, mission critical, more lowly valued and a smaller part of the market than during the 2000 mania. While technology stocks may be popular with almost everybody, the mission-critical tech companies we own are built on durable pillars.

Tech is very different to the bad old days

	2000	Today	Comments
Tech + Comm Svcs % Market Cap	45.9%	38.8%	Smaller % mix today vs 2000
Tech + Comm Svcs % Revenue	16.7%	26.1%	...but BIGGER % of revenues (they're "real "companies)
Tech + Comm Svcs % Net Income	23.1%	33.5%	and MUCH bigger % of profits (they're very profitable)
Tech Median P/E	84.6x	31.2x	Tech names 64% cheaper than 2000
Comm Svcs Median P/E	29.0x	19.8x	Comm Svcs 32% cheaper
AAII Bullish Sentiment	48%	40%	Bullish sentiment lower
AAII Bearish Sentiment	23%	29%	...but BEARISH sentiment higher
S&P500 P/E (fwd)	25.6x	21.0x	The market is ~20% cheap than 2000
10 biggest stocks % of market caps	27.5%	30.8%	The 10 biggest stocks are bigger than before...
10 biggest stocks % of net income	16.4%	30.4%	...but their profits are MUCH bigger than before
Fed Funds Rate	5.75%	0.25%	The Fed funds rate is super low
Fed policy	Tighening	Easing	And they're easing (QE) not hiking rates like 2000!
10 year yield	6.40%	1.55%	A low 10 year yield justifies high P/E
Yield Curve	Inverted	Positive	A positive, not inverted yield curve
US M&A as % of GDP	9%	7%	M&A below prior peaks
Employment	Peaking	Bouncing	And employment is recovering, not peaking

Source: Baird

As we enter a different phase of the COVID and interest rate cycles, investors keep churning between reflation, stagflation and resilient growth stocks with alarming inconsistency. Factor and style shifts blaze up quickly and then burn themselves out.

Many companies have suffered recently as rising operating costs, product shortages and delays have crimped demand. We think the world of 2022 will be one of unreliable earnings growth – just as it has been for the previous few years. However, we believe the worst of the supply chain disruptions are behind us and the bar for earnings expectations has been lowered once again, paving the way for happy surprises. Recent surveys indicate many businesses plan to increase prices by significantly more than they plan to further raise wages, which should benefit those companies with pricing power. If these price rises stick and sales volumes remain robust, this could deliver some explosive earnings upside even though the journey toward them will be bumpy.

James Thomson
Lead Fund Manager

Sammy Dow
Fund Manager

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Rathbone Unit Trust Management Limited
8 Finsbury Circus, London EC2M 7AZ

International information line
+44 (0)20 7399 0800
international@rathbones.com
rathbonefunds.com

Investment manager:
Rathbone Unit Trust Management Limited
Authorised and regulated by the Financial Conduct Authority

A member of the Investment Association

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Management company:
FundRock Management Company S.A.
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