Rathbone Unit Trust Management

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Rathbones
Look forward

Rathbone UK Opportunities Fund

Quarterly update December 2021

In the fourth quarter, your fund returned 3.3% versus an average 2.1% increase in the IA All Companies sector.

	3 months	6 months	1 year	3 years	5 years
Rathbone UK Opportunities Fund	3.3%	9.7%	21.4%	62.3%	53.7%
IA All Companies Sector	2.1%	4.9%	17.3%	34.7%	36.4%
FTSE All-Share Index	4.2%	6.5%	18.3%	27.2%	30.2%

	31 Dec 20-31 Dec 21	31 Dec 19-31 Dec 20	31 Dec 18-31 Dec 19	31 Dec 17-31 Dec 18	31 Dec 16-31 Dec 17
Rathbone UK Opportunities Fund	21.4%	6.8%	25.1%	-19.4%	17.5%
IA All Companies Sector	17.3%	-6.0%	22.2%	-11.2%	14.0%
FTSE All-Share Index	18.3%	-9.8%	19.2%	-9.5%	13.1%

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 performance.

The Omicron effect

The quarter began with investors materially more concerned about supply chain shortages, spiking energy prices and tight labour markets, all of which were exerting upward pressure on inflation. We felt the most useful signals came from our companies, which, by and large, reported stronger and more resilient earnings than we'd expected.

The new Omicron strain of COVID-19 then struck and investors rapidly reached for the lockdown playbook once again. Worries about the variant's potential impact dominated markets and investor sentiment for much of the rest of the year.

Thankfully, it does seem that early data from South Africa was correct and the more infectious Omicron strain is causing milder disease. Moreover, widespread infection without severe harm should increase immunity without over-burdening healthcare systems. Therefore, Omicron may prove a tangibly positive step in the pandemic, enabling us to think more about 'normalisation' and how that might look.

Omicron initially dented stock markets 'Santa rally'. But the big man showed up in the end, leaving most UK markets comfortably up over the quarter.

For the year, we are pleased to report strong outperformance against both our benchmark and peers. The baton of market leadership has shifted more or less constantly across different styles and sectors, but our process has kept us invested in the 'right' parts of the market for the last few years (tech and industrials). It has also kept us out of the worst performing parts (energy and banks). Our multi-cap mandate with a bias towards mid-caps has also contributed positively. But active stock selection (and avoidance of the poorest performers) should always be the biggest driver of your fund's 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.

We had a few slip-ups: cyber security software business **GB Group** raised cash from shareholders to do a chunky deal in the US which went down badly, largely thanks to the price of the deal. Online supermarket **Ocado** won its initial lawsuits against freshly listed competitor AutoStore, but it hasn't announced material new contracts in a while.

Most of our tech names have ploughed ahead — video game developer **Team17** bounced nicely towards the end of the year, as did tech recruitment firm **FDM**, which is seeing phenomenal demand for its trained consultants. Insurance provider **Beazley** made a rare appearance on our leader board too as it confirmed the industry is entering a more profitable period as higher premiums finally offset years of above-trend losses.

The shift into a rising-rate world

This year started in a similar fashion to 2021. Central banks have admitted that interest rates need to be higher, although this time they are more inclined to act. The Bank of England was the world's first major bank to lift, with a small hike in December. The very strong pick-up in global demand for goods (not services) over the last 18 months, combined with 'stop-start' supply chains, has (unsurprisingly) led to a bold increase in inflation. Spiking energy prices are the latest result. Wage inflation looks likely to be the next.

That said, although some near-term inflation numbers will look scary, our research suggests that inflation is in the process of peaking. Supply chains are coming unstuck, fewer shortages are being reported and demand has passed its seasonal peak. All this suggests that investors' current expectations for central bank rate rises are sufficient (and could, in fact, be overdone).

Markets started the new year in full 'flap and panic' mode as investors have rushed to reposition themselves for a rising-rate environment in which more 'cyclical' stocks tend to outperform initially. This rotation has been particularly aggressive after yet another year in which 'quality growth' names were the overall winners. As growth investors, we can't hide from this dynamic and acknowledge it may cause us some pain. But for our core of UK mid-caps, the rotation is less important than it might be for, say, US large caps.

We are keeping calm and carrying on in the knowledge that stock fundamentals will still matter, probably more so if price-earnings multiples are under pressure from rising rates. As a result, we've dialled up the spotlight on stocks that we believe can beat and upgrade their numbers. Companies with little or no near-term earnings momentum are likely to suffer most in the new market paradigm, alongside those that miss their forecasts. This year, avoiding the traps might be just as crucial as finding the springboards!

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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