Rathbone Strategic Growth Portfolio

Quarterly investment update, October to end December 2021

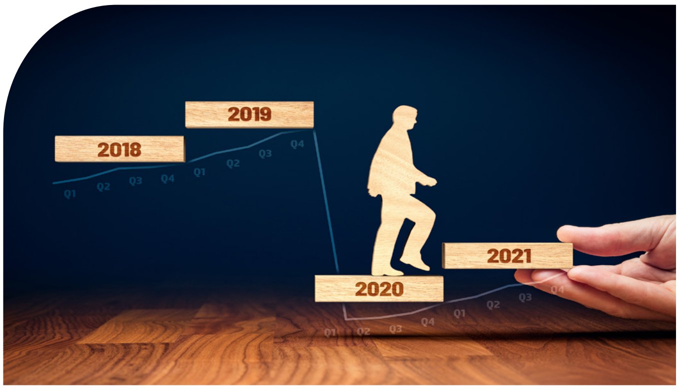
Rathbones
Look forward

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

The Grinch. When Omicron first appeared before Christmas, investors panicked at its increased infectiousness and its ability

to circumvent some vaccines. The fear being that it might force countries to rethink pandemic mitigation strategies founded on inoculation. The potential for yet more lockdowns, for shuttered shops, for closed borders was suddenly back on the table. Now, we've been expecting to see more variants pop up over time – it's something that is typical of viruses. Early reports of its lessened severity, despite increased infectiousness gave us confidence that it may be the beginning of the end of the pandemic – where COVID-19 evolves to endemic status. So, we took the plunge and bought into the bouts of stock market weakness during the fourth quarter and also in early January. COVID risks still abound mind, not least that there is large variation in how governments are reacting to the new strain – even within the UK. Some policymakers may find it hard to adjust their strategies as facts and circumstances change, which would impact investments.

Inflation nation. If we are right about the COVID cloud starting to recede then the global economy should continue to pick up into the higher gears. All things being equal, that will flow through to higher inflation hanging around for longer, which will push central banks to raise rates and cut back on quantitative easing (buying tonnes of government bonds to keep borrowing costs low). We've thought that inflation would probably run hot for a couple of years or so since about May 2021. Longer-term, it will be dragged down by those 800-pound gorillas that have been part of the fabric of the global economy for many years: rampant automation and digitisation, a highly indebted world and ageing populations. But in the coming years higher prices and (slightly) higher interest rates are probably on the menu. Global supply chain and shipping tangles look more complicated than most people first thought, and further COVID-related disruption could continue to support higher inflation. Because of this, we have been steadily building our positions in 'quality cyclicals', strong businesses that should benefit from rising interest rates and higher GDP growth. Mostly, these are blue-chip



industrials and manufacturers and select banks and other financial companies. This hasn't been a wholesale shift from the 'growth' stocks that we have favoured for a good many years, rather we felt it was time to introduce more balance across our equity portfolios.

Tech wreck. As rumblings of tighter monetary policy grew louder in December and January high-growth technology stocks took a beating. On our Christmas episode of ***The Sharpe End*** podcast we spoke about how the technology space can be broadly separated into three categories: 1. Mature companies with quality business models and attractive long-term growth prospects; 2. good companies with quality business models, perhaps a bit smaller, so the pandemic boost to their activity lit a fire under their share prices, sending them to astronomical valuations; 3. immature companies with speculative business

models, limited profits and ballooning share prices that many have since labelled 'spec tech'. We own the first bucket, and we have been consistently taking profits in those shares we own that are straying into the second. The third bucket – 'spec tech' – we won't own, and it's here where the worst recent tumbles cluster. These moves can – and do – bleed into more sensible tech stocks though. And with all the algorithmic trading funds and robots buying and selling based on short-term factor analysis – the characteristics of stocks based on quantitative metrics, for instance, 'growth' companies as a bloc – these sorts of sell-offs tend to be more volatile than in the past. This can be stressful, but it does offer us the chance to buy and sell at a wider range of prices, which helps us make money. When rate hikes do come through, this year and into next, it will be a headwind for the valuation of many of these strong mature tech companies. If rates go higher than markets expect, that will flow through to our growth companies because it will hit their price-earnings multiples due to the higher discount rate. That's just mathematics. Yet we still want to hold these businesses for many years, because we are confident that they can continue to push through earnings growth. For these reasons, though, we have rebalanced our equity portfolio to reduce our exposure to this growth factor and ensure we have other stocks that will do better if rates rise faster than expected.

Portfolio activity

Key purchases/additions	Key sales/trims
Shimano (new purchase)	Ashmore Emerging Markets Short Duration Fund (sale)
Paccar (new purchase)	DCC (sale)
Caterpillar (new purchase)	Trex (trim)
UBS Nasdaq Put Options (new purchase)	Dexcom (trim)
Siemens (addition)	Costco (trim)

Source: Rathbones

We added several more cyclical businesses with more attractive valuations to our portfolio this quarter (and indeed have been doing so all year).

We built a position in Japanese manufacturer **Shimano**, which makes gears, brakes, cranks and other components, along with returns on equity in the mid-teens. It has a reputation for quality among cyclists and is heavily embedded in the production of most bike manufacturers (it supplies between two-thirds and three-quarters of bike gears and brakes globally). That has translated to compound earnings growth of almost 20% over the past three years. With more of us hanging round the neighbourhood in the flexi-working age and lots of government money getting funnelled into cycleways, this should lend a strong global tailwind to cycle manufacturers and their suppliers.

Another more cyclical addition was American lorry maker **Paccar**, which makes all the vehicles you would expect: smaller models for city delivery, medium-sized ones for interregional haulage and the ginormous sort that will only really fit in America. It owns several different brands, including DAF (Leyland), Kenworth and Peterbilt. Half of its sales are in the US, another quarter are in Europe and a bit more than 10% in Asia. What attracted us to Paccar is that its trucks are known for their reliability and value, and Paccar is known for its no-frills focus on retaining and increasing that edge.

We also bought **Caterpillar**, the big yellow truck and dozer company. This business's fortunes are closely tied with global economic growth because its customers are raw materials producers, farmers and construction firms. These industries tend to run hot and cold depending on the economic cycle, yet Caterpillar is in no way a boom or bust company. It is renowned as a quality brand and it is run by cautious managers who are careful not to oversupply the market or degrade the quality of its machines. It focuses on selling to quality operators who are more likely to still be around in 10 years to swap in new machines, rather than ramping up production to sell as much as possible. This is important to ensure that the company doesn't overstretch itself and walk into an economic funk with more machines and production lines than it can sustain.

We also added **UBS Nasdaq Put Options** to our portfolio, which give us the option to 'sell' a slug of exposure to the index at a level roughly 10% below the price level where we bought. They were a similar price to put options on the S&P 500 index, but the Nasdaq has more of the highly valued technology companies that are most at risk of their price-earnings multiples falling if prevailing interest rates rise. This is the risk that we most wanted to hedge.

We completely sold the **Ashmore Emerging Markets Short Duration Fund** over the quarter. The US Federal Reserve is poised to raise interest rates and that usually bodes ill for emerging markets as money flows out of riskier assets and a stronger dollar weighs on developing economies.

We also took profits from many high-flying holdings, including faux wood composite decking producer **Trex**, diabetes monitoring business **Dexcom** and US discount wholesaler **Costco**. We also made a small yet timely trim of **Shopify** in mid-November just before its share price took a heavy hit in December and early January.

Meanwhile, in October we sold the last of our shares in distribution company **DCC** because we felt its price didn't account for the risk that its profit margins may be squeezed by higher costs.

Spotlight

In this quarter, the spotlight is on our **Estée Lauder** and **Dexcom**.

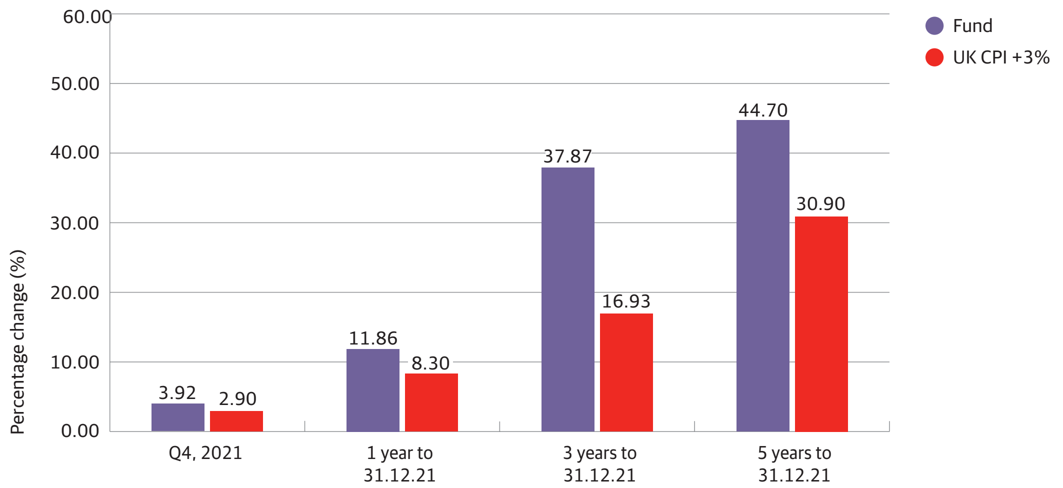
Estée Lauder

- A US listed global leader in skincare and beauty products
- Estée focuses exclusively on premium and prestige cosmetics and are truly omnichannel using online, speciality cosmetics stores, department stores, and travel retail – we all know the stores you have to walk through at the airport to get to the departure lounge
- The company has a very global presence which is weighted slightly more towards to the developed world but the China opportunity remains an exciting one as demand for their products continues to grow there
- A very wide ranging and high-quality stable of well-known brands including, Clinique, MAC, La Mer, and Bobbi Brown, along with their own name range
- Innovation is a key focus for Estée, whether that be innovation in products using the latest science and technology, or areas like packaging where they continually explore how to make their packaging ever more sustainable, using solutions like plant-derived plastics, whilst still retaining that high quality luxury product feel for consumers – in the prestige space it's a vital balance to strike

Dexcom

- Dexcom is a US-listed business which designs and manufactures continuous glucose monitoring (CGM) devices for diabetes patients
- Diabetes continues to be a growing problem and Dexcom's wearable device allows sufferers to track blood glucose levels in real time on their app and share data with their doctor rather than rely on the point-in-time finger stick tests of old
- Currently most of the market for these CGM devices are the type 1 diabetes patients, but increasingly the expectation is that use will widen meaningfully to the much larger pool of type 2 diabetes patients
- Dexcom's market-leading technology aims to deliver better patient outcomes but also offers the possibility of lowering long-term cost to healthcare providers by reducing the chances of serious complications from the mismanagement of the condition
- In 2021 they impressed with stellar results which beat expectations, and long-awaited news on the release of their new CGM device which is expected to solidify their foothold in having the leading technology in the space

Fund performance



Performance (based on 'S-class' shares).
Net of expenses and tax. Net income reinvested.

Data source: FE fundinfo

Discrete annual performance					
Year to:	**End Dec 2017**	**End Dec 2018**	**End Dec 2019**	**End Dec 2020**	**End Dec 2021**
Fund	+9.32%	-3.99%	+15.25%	+6.94%	+11.86%
UK CPI +3%	+6.25%	+5.36%	+4.44%	+3.39%	+8.30%

Price performance based upon bid to bid prior to 21 January 2019 and single price (mid) thereafter. 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.

Our benchmarks are calculated on the rate of change of the CPI index, over different time periods (e.g. if we were calculating year to date figures in January 2021, we would look at the percentage change from December 2020 to the end of January 2021). So we take CPI to the current value, and add on 3%, prorated over a year (roughly 0.25% per month). If the CPI Index benchmark were to fall, more than the amount pro-rata, the benchmark year-to-date will be negative, even though inflation as reported by the media (calculated specifically as a 12M rate of change), remains positive.

Top performers (%)		
Holding	**Performance**	**Contribution**
Tomra Systems	+35.97	+0.16
Trex	+31.93	+0.29
Accenture	+29.47	+0.23
Ferguson	+28.07	+0.24
Costco	+25.97	+0.22

Bottom performers (%)		
Holding	**Performance**	**Contribution**
Vestas	-23.03	-0.12
Travelsky Technology	-13.06	-0.06
AIA	-13.00	-0.09
China AMC China Opportunity Fund	-7.55	-0.05
London Stock Exchange	-6.53	-0.05

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

Our US equity exposure was the key contributor to fund performance in Q4 2021, but we had a range of sectors and names doing some heavy lifting in both the quarter and the year as a whole. On the growthier side, we saw meaningful contributions in the quarter from the likes of **Ansys**, **Cadence Design Systems**, **Microsoft**, **Thermo Fisher Scientific**, **ASML**, and **Edwards Lifesciences**. Whereas on the more cyclical side for the year as a whole, names including **BP**, **Shell**, **Schlumberger**, and **Total** all delivered positive contributions. **Costco** is a stock people could possibly consider as growth, cyclical, or defensive. Whichever classification investors wish to put them in the stock continued its ascent in Q4 2021 with another quarter of excellent contributions as the business goes from strength-to-strength and has continued to deliver.

Fund performance (continued)

Ulta Beauty was another key contributor and a company which, like Costco, has continued to deliver. At the last two earnings releases we have seen the company beat expectations and pre-COVID 2019 numbers by quite a distance and offer very encouraging guidance and commentary. We recently met with the company and continue to be impressed. Their focus on the customer, or 'guests' as Ulta management always refer to them as, shines through whenever you speak to the company. They have a real understanding of who their client is, what they want, and how to service them. The staggering success of their loyalty program speaks volumes. They have also partnered with Target to have mini Ulta stores within the larger Target stores, which will potentially offer Ulta an exciting footfall opportunity. They have also cleverly structured it so that loyalty points can be earned in Target but only spent in Ulta standalone stores, which should then help drive further footfall to their full stores where basket sizes may be expected to be larger as customers get the full Ulta experience.

Currency hedging was a positive contributor overall for the quarter, particularly against the euro and US dollar, but we lost a bit of performance towards the back end of the quarter due to sterling strength and us having reduced our euro hedge and removed our Swiss franc hedge. Also, as you would expect in an overall strong quarter for risk assets, our **put options** were all detractors from performance.

Finally, since we added the **US rates volatility notes** to our diversifiers we have seen them be positive contributors to returns as the emergence of the Omicron COVID variant and continued pressure on central banks with inflation data has led to an increase in the volatility of US rates.

Asset allocation ranges

Liquidity	Equity-type risk	Diversifiers
5% to 40%	40% to 80%	0% to 40%

Asset allocation change and strategy

There were no significant asset allocation changes during the quarter.

Asset allocation split	30.09.21	31.12.21	% Change		12 month change	
Liquidity assets	19.67%	22.45%	2.78%	▲	-1.36%	▼
Equity-type risk	68.77%	66.93%	-1.84%	▼	-0.39%	▼
Diversifiers	11.56%	10.62%	-0.94%	▼	1.75%	▲
	100.00%	100.00%				

Asset class split	30.09.21	31.12.21	% Change		12 month change	
Equities	65.26%	65.26%	0.00%	◀▶	4.62%	▲
Index-linked bonds	5.78%	5.24%	-0.54%	▼	2.35%	▲
Conventional government bonds	6.89%	6.74%	-0.15%	▼	-1.24%	▼
Corporate bonds	4.68%	3.28%	-1.40%	▼	-0.93%	▼
Emerging market debt	3.06%	1.26%	-1.80%	▼	-2.29%	▼
Private equity	0.41%	0.39%	-0.02%	▼	-0.05%	▼
Alternative investment strategies	5.45%	4.98%	-0.47%	▼	1.79%	▲
Property	0.00%	0.00%	0.00%	◀▶	0.00%	◀▶
Commodities	2.02%	1.95%	-0.07%	▼	-2.09%	▼
Cash	6.45%	10.90%	4.45%	▲	-2.16%	▼
	100.00%	100.00%				

For more information on our liquidity, equity-type risk and diversifiers (LED) risk framework, please consult our investor brochure.

Investment outlook

Energy prices are a big deal right now and will probably remain so for the rest of the year at least. We need to phase out carbon-heavy fuels as soon as possible, but the breakneck speed of the clean energy transition over the past few years has made energy markets more fragile the world over, and that has a knock-on effect on societies and economies. The pandemic-induced disruption to production and shipping, combined with many years of underinvestment in new oil and gas fields, has created a situation where energy is scarce and therefore expensive.

That all-important green source of base-load energy is yet to be developed, so it has fallen on natural gas to take the mantle from coal. While a much cleaner alternative, it's not clean enough for the world's climate change targets. And transport is still overwhelmingly powered by petrol and diesel. With little increase in the supply of this, that pressure has to release somewhere: the oil price, and so it creeps toward $100 a barrel. Meanwhile, Russia is becoming yet more bellicose in Eastern Europe. Any flashpoint will likely further curtail the global energy supply, either because of sanctions on Russia and/or the nation withholding gas exports to the European Union.

High energy prices are effectively a tax on consumption, a squeeze on the spare cash for both households and businesses. And it's an insidiously compounding one as well. Because energy is required for virtually everything, so the cost of everything, from shirts and vegetables to washing machines and IT packages, starts to rise along with the price of filling up your car (with electricity or fuel). This squeeze will attract political attention. For many years, the move away from fossil fuels has been a narrative of "we must do this now". We are now entering an era where the narrative may change to "how are we going to pay for it?" It's crucial that policymakers plot a sensible course that ensures there isn't a backlash against cleaner energy because the masses can't bear the higher cost.

Rathbone Unit Trust Management Limited
8 Finsbury Circus, London EC2M 7AZ
Tel 020 7399 0000

Information line
020 7399 0399
rutm@rathbones.com
rathbonefunds.com

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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