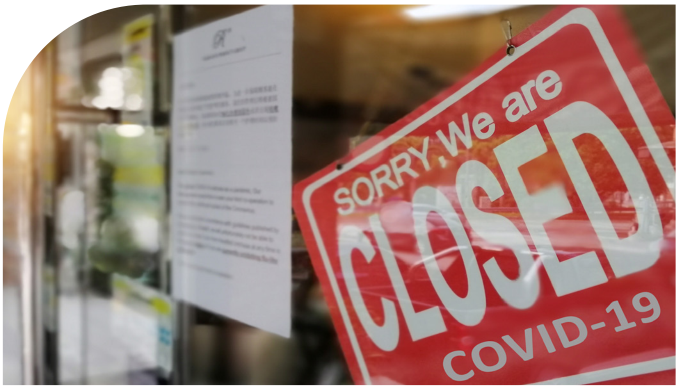
Rathbone Greenbank Total Return Portfolio

Quarterly investment update, October to end December 2021

Rathbones
Look forward

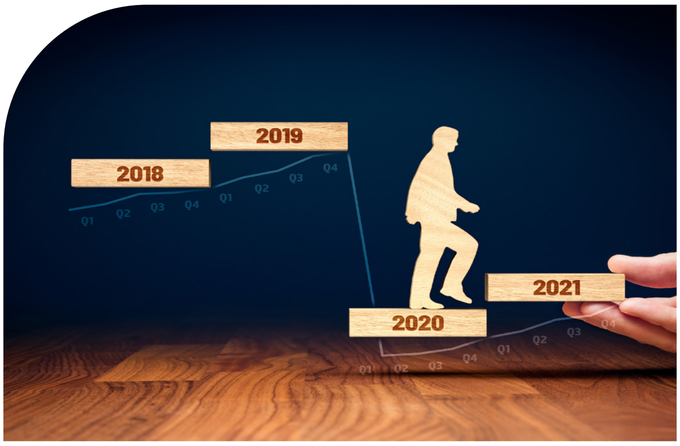
Hot topics – 'Top-down' (market and macroeconomic)

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 built 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, as a team, have favoured for a good many years, but we felt it was time to have more balance across our equity portfolios in the current market environment.

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 allowed those shares we own that are straying into the second to drift down in size. 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
UBS Nasdaq Put Options (new purchase)	Advanced Drainage Systems (trim)
JP Morgan Emerging Markets FX Momentum (addition)	Trex (trim)
Société Generale VRR Index Structured Product (addition)	A.O. Smith (trim)

Source: Rathbones

We continued to add to the **JP Morgan Emerging Markets FX Momentum** structured product during the quarter. This contract with an investment bank gives us exposure to a 'momentum' index of emerging market currencies. It uses price trend data to anticipate whether the basket of currencies will rise or fall against the dollar. This should enable us to generate positive returns in benign markets, and historically it has provided some protection in times of crisis as emerging market currencies typically sell off against the dollar, and the index model has picked up on this trend and moved to a long dollar position.

We also bought more of the **Société Generale VRR Index Structured Product**, which makes money if the volatility of US Treasury yields increases. So, if yields rise rapidly because of an inflation scare or if they slump because of GDP growth concerns we make a return. Any increase in the size or frequency of moves in US treasury yields is good for this investment. However, if yields just amble along with little movement, we will lose money. And we would actually prefer the latter: if yields shoot up or down stocks are likely to be falling because of the fears driving the move. Whereas benign yields should be great for our stocks. Long story short, we view this product as an insurance policy for wobbly markets.

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 took profits from a few companies that have done well in 2021 on the back of strong homebuilding in the US. They consisted recycled plastic drainage pipe supplier **Advanced Drainage Systems**, faux wood composite decking manufacturer **Trex** and US boilermaker **A.O. Smith**.

Spotlight

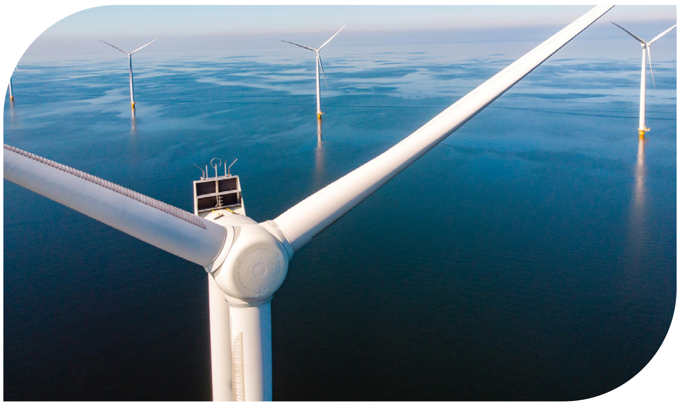
In this quarter, the spotlight is on our **SSE** and **Ecolab** holdings.

SSE

- SSE is a leading UK energy company that develops, owns and operates electricity infrastructure including onshore and offshore wind, hydro power and electricity transmission and distribution networks
- SSE's core focus is to help enable the transition to a more sustainable future through investing in low carbon infrastructure and they have the largest renewable electricity portfolio in the UK and Ireland
- As the UK has committed to reach net-zero by 2050, electricity will be a key area to decarbonise to deliver that vision, and SSE are ideally positioned to benefit from this change with their strategic effort to build out renewable energy solutions, as well as some carbon capture and hydrogen projects
- Following COP-26 in Glasgow last November, they have accelerated their net zero investment plans over the next five years, making them the biggest constructor of offshore wind in the world
- They were the first company to produce a Just Transition Strategy, which outlines their principles and actions in order to support workers to transition from high to low-carbon careers and they have been Living Wage accredited in the UK since 2013

Ecolab

- Ecolab is a US company specialising in water, hygiene and infection prevention solutions to help make the world cleaner, safer and healthier
- Ecolab's strategy is focused across the four areas of water, food, health and climate all of which are supported by long-term macroeconomic and consumer trends, with the health segment particularly catalysed by the COVID-19 pandemic
- They have a wide portfolio of innovative products serving a huge variety of industries including water treatment for industrials and cleaning and sanitising products for healthcare and pharmaceuticals
- By providing a high-quality service, scientific expertise and data-driven insights they have created a huge competitive advantage leading to strong pricing power and recurring revenues from loyal customers
- Through their products and services Ecolab help to save trillions of gallons of water annually and they have launched 2030 Sustainability Impact Goals to further accelerate their action



Fund performance

Top performers (%)		
Holding	**Performance**	**Contribution**
A.O. Smith	+40.13	+0.22
Tomra Systems	+35.78	+0.15
Trex	+32.96	+0.09
Accenture	+29.34	+0.16
Advanced Drainage Systems	+25.37	+0.13

Bottom performers (%)		
Holding	**Performance**	**Contribution**
Vestas	-23.60	-0.09
AIA	-13.20	-0.09
Shimano	-9.77	-0.05
GN Store Nord	-9.48	-0.04
PGH Capital	-6.59	-0.06

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 equity exposure, in particular US equities, was a key contributor to fund performance in Q4 2021. The names which have been a significant part of this strong performance, have come from a range of different sectors, some which have growthier characteristics and others which are more cyclical, demonstrating the benefit of having this balance within the funds. On the cyclical side, we saw meaningful contributions in the quarter from industrials including the likes of **A.O. Smith**, **Johnson Controls**, **Trex** and **Advanced Drainage Systems**. A.O. Smith have seen favourable growth as housing construction and housing sales continue to trend upwards in the US which benefits their portfolio of products including residential and commercial water heaters, boilers and water treatment products, for which they have strong brand recognition and a leading market position. They've also seen a significant increase in sales in China where products such as tankless water heaters have been received well.

On the growthier side, a number of names have been performing well across sectors such as healthcare and technology including **Accenture**, **Abbott Laboratories**, **Ansys** and **Cadence Design Systems**. Abbott Laboratories has made significant gains, particularly over December, due to a recent demand surge for their at-home COVID-19 tests following the emergence and spread of the new Omicron variant. Abbott sells a diversified portfolio of tests, including their at-home BinaxNOW test which turns around results within 15 minutes and have been very popular in the US. Alongside their diagnostics division, Abbott's established pharmaceutical division is also growing strongly particularly in emerging markets.

Alongside equities, our **ESG dispersion note** within the diversifiers bucket, has been a leading contributor to performance, providing some decent positive uncorrelated returns through a period of general uncertainty caused by the Omicron variant and inflation. **Currency hedging** has also contributed positively, 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.

Some companies were weaker, including names such as **Vestas** and **GN Store Nord**, following disappointing earnings reported earlier in the quarter. They explained supply chain issues and lower wind speeds (Vestas) and delayed product development (GN Store Nord) were the cause of these results. Unsurprisingly, our **put options** also detracted, in an overall strong quarter for risk assets.

Asset allocation ranges

Liquidity	Equity-type risk	Diversifiers
10% to 50%	20% to 60%	0% to 50%

Asset allocation

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	47.49%	52.32%	4.83%	–
Equity-type risk	44.30%	40.45%	-3.85%	–
Diversifiers	8.21%	7.23%	-0.98%	–
	100.00%	100.00%		

Asset class split	30.09.21	31.12.21	% Change	12 month change
Equities	32.56%	30.34%	-2.22%	–
Index-linked bonds	3.34%	2.35%	-0.99%	–
Conventional government bonds	16.12%	18.23%	2.11%	–
Corporate bonds	23.65%	23.46%	-0.19%	–
Emerging market debt	0.00%	0.00%	0.00%	–
Private equity	0.00%	0.00%	0.00%	–
Alternative investment strategies	8.21%	7.23%	-0.98%	–
Property	0.00%	0.00%	0.00%	–
Commodities	0.00%	0.00%	0.00%	–
Cash	16.12%	18.39%	2.27%	–
	100.00%	100.00%		

Sustainable category split	30.09.21	31.12.21	% Change
Decent work	9.55%	9.20%	-0.35%
Resource efficiency	4.58%	4.21%	-0.37%
Habitats and ecosystems	0.00%	0.00%	0.00%
Inclusive economies	4.72%	5.30%	0.58%
Energy and climate	10.85%	9.47%	-1.38%
Health and wellbeing	8.66%	7.55%	-1.11%
Resilient institutions	19.46%	20.58%	1.12%
Innovation and infrastructure	17.85%	18.07%	0.22%
Diversifiers	8.21%	7.23%	-0.98%
Cash	16.12%	18.39%	2.27%
	100.00%	100.00%	

The ‘resilient institutions’ category includes government bonds.

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?"

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.

7631.01.22