Contact us 020 7399 0399 rutm@rathbones.com

Rathbone Global Opportunities Fund

Monthly update January 2022

In January, your fund returned -12.9% versus a -7.2% average for the IA Global sector. In 2021 the fund was up 20.2%.

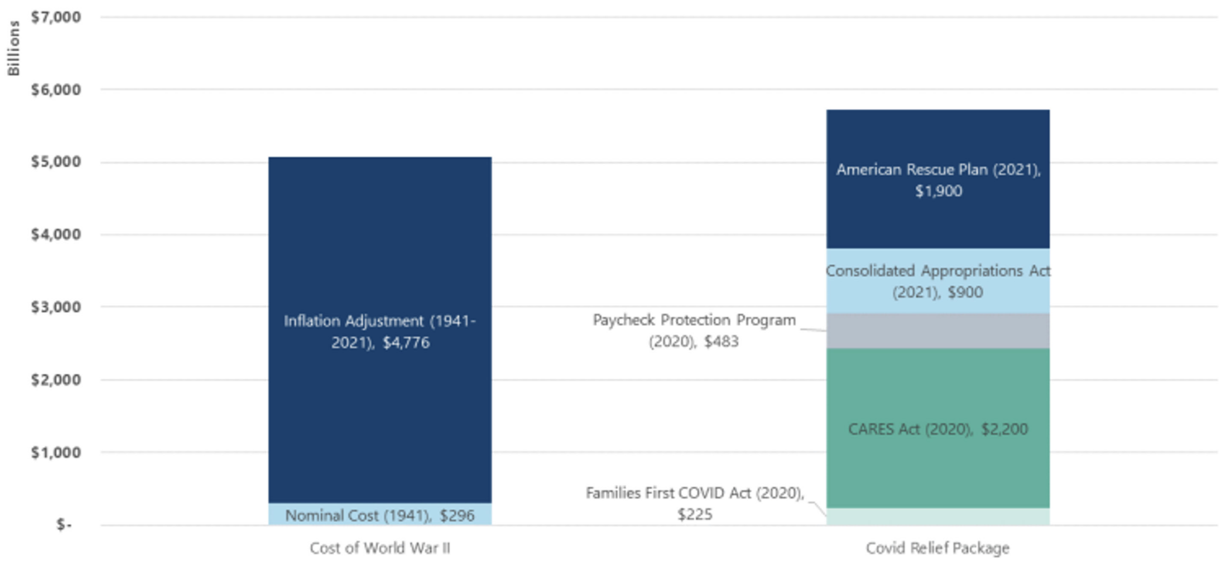
I'm sorry, this month's performance has been poor. Resilient-yet-higher-valuation long-duration 'growth' assets have been dispatched as US Federal Reserve (Fed) expectations quickly moved from one rate rise in 2022 to five. This acceleration in monetary tightening cut the present value of future cash flows, hurting these growthier businesses more.

Perhaps not coincidentally, our worst performers this month were our best performers in 2021 and 2020: **Nvidia** (datacentres and gaming chips), **Sartorius** (medical equipment for drug and vaccine manufacture), **Align Technology** (Invisalign braces for a Zoom smile), **Shopify** (website development platform for small businesses) and **Idexx Laboratories** (veterinary diagnostics and equipment). The common thread between these companies is they've all benefited from significant earnings upgrades over many years, are market leaders with growing market share in fast-growing categories, trade on higher valuations justified by the apparent long-term durability of that growth, and have all been supercharged and had appreciated between 250% and 500% since the start of the pandemic.

Ferocious, though not irrational

The rotation from winners into laggards is a frequent mean reversion tactic at inflection points, yet January's rotation was particularly ferocious. But we don't think it's irrational. The one-sided dominance of growth strategies is starting to wane. Growth has outperformed, almost without challenge, for the past 15 years. Many parts of the market have been starved, so a period of catch-up has been likely for some time. I think it means that we're getting back to an investing world that isn't so binary anymore. We started to see this shift last year. The scarcity of growth over the last decade or so drove the pivot to long-duration, resilient, high-quality growth investing strategies. But COVID-19 has changed the calculus… growth is no longer scarce as the global economy digests more COVID relief spending than the entire World War II budget (adjusted for inflation). Oil & gas, mining and recovery banks that have been starved of capital, pricing power and investor interest have been reflated by stimulus demand colliding with non-existent spare capacity.

COVID-19 relief spending vs World War II budget



Source: Congessional Research Service, Jefferies

The S&P 500 had its worst January since 2009. Usually during market dislocations, our 'weatherproof' bucket of more defensive, less economically sensitive investments provides a buffer. This time it didn't help because the world isn't short of economic growth: it now has too much demand chasing too few goods. Our top performers, including tractor manufacturer **Deere & Company**, payment duopoly **Visa** and **Mastercard**, and American stock broker **Charles Schwab**, barely squeaked out positive returns (yet positive all the same). They are not defensive though – in fact they are actually pro-cyclical or 2021 underperformers, or rate beneficiaries.

What really raises an eyebrow are the characteristics of the market's largest outperformers (which we don't own), according to analysis by Baird:

– Low P/E outperformed high P/E by 15 percentage points

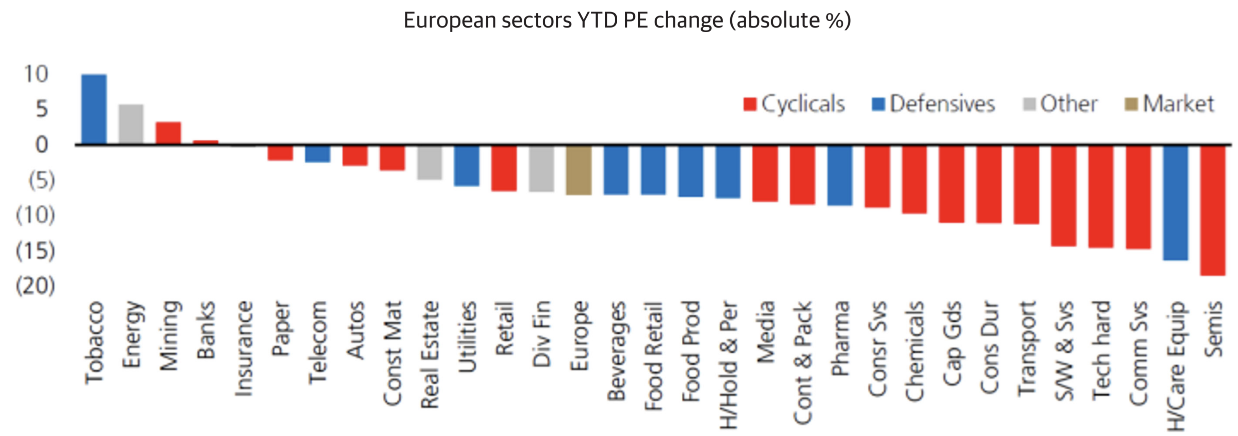
– Low 'return on capital' outperformed high ROC by 7 percentage points

– High credit default swap price (i.e., higher chance of going bankrupt!) outperformed low CDS by 6 percentage points

– Low sales growth outperformed high sales growth by 7 percentage points.

Not many investment books or sparkling careers have been built around these factors. But while we all long for a world without Marlboro Reds, fossil fuels and grubby bankers, we're not quite ready for the complete transition to virtue. The reversal of these deeply embedded trends reflects the concentrated and sustained outperformance of growth stocks and extreme underweight of old economy commodity and sunset industries. The rotation in valuations is clear to see…

A rerating revolution



Source: MSCI, Thomson Datastream, UBS European Equity Strategy

Beware 'value-washing'

The open-ended nature of rising rate expectations has been the trigger for this mammoth shift and volatility will remain high until the market can properly frame the increases in inflation and rates. In his press conference following January's rate-setting meeting, Fed Chair Jay Powell ripped up the "gradual" rhetoric – the guard rails are off and the Fed won't be sensitive to stock market weakness. This all means abandoning the age-old Fed 'put' unless markets drop significantly more than they have. This year the default decision at Fed meetings will be tightening unless the data convinces otherwise, rather than the other way round, which has been the *modus operandi* to date.

Now, as we noted earlier, some of our best economists think the Fed will raise rates five times in 2022 (up from four a week ago, and just one a month ago). They believe that, even with these hikes, policy is still not restrictive and won't damage economic growth. But that won't stop market turmoil until we see the argument borne out in the numbers and a clear trend change in inflation.

While the rotation in valuations is understandable – and probably overdue – the change in company fundamentals may not follow. The digital transformation is not going away. JPMorgan alone is spending $12 billion a year on tech. Software stocks are high beta, yet software *businesses* are <u>not</u>. Businesses can't just turn off enterprise software because the economy dips, it's mission critical and irreplaceable. Recent results from some of our key holdings are starting to rebuild confidence in this reality.

The roller coaster will continue this year, but I don't think you have to get off the ride. This is an environment that calls out for balance — a blend of re-opening and pandemic winners, pro-cyclical and defensive, reflation and resilience, and, yes, growth and value. Even though I'm not the home of pure value investing, it's not the time for one-way bets. But it's also not the time to 'value wash' and become something I'm not. I don't want to wade into companies that may have only fleeting, temporary periods of supernormal profits before sliding back into terminal decline.

Also, while we're leaving a period of exceptionally low rates and GDP growth may have peaked for now, it doesn't mean that a recession is imminent or 'stagflation' is lurking around the corner. Consumers have $2 trillion more in their bank accounts, their investments are up, their house prices are up, wages are going up and jobs are plentiful. Combine that with valuations that are back to pre-pandemic P/E multiples despite undeniably more fertile conditions and a bear market without a recession in sight.

Should we retreat from turmoil and revisit when the picture becomes clearer? Well, you could, but history shows us that market timing is a dark art and some of the best returns come when you least expect it.

James Thomson
Lead Fund Manager

Sammy Dow
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.

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

7622.12.21