Rathbone Unit Trust Management

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Rathbones
Look forward

Rathbone UK Opportunities Fund

Monthly update February 2022

The world had a low bar for expecting 2022 to be better and easier than 2021. And so our already exhausted populace watches, horrified, the invasion of Ukraine by Russian President Vladimir Putin's forces. The COVID-19 crisis, for most in the UK at least, already feels a long time ago even though restrictions only ended in February.

As we write, the war is intensifying and it is hard to see a landing zone for peace in the near term. The dependence of Europe, specifically Germany, on Russian energy makes the West's response complex. Markets have been very quick to reflect this in asset prices — equities in some areas are close to bear market territory, while oil daily flirts with multi-year highs. Investor sentiment is worse than during the first frightening weeks of the COVID lockdowns or the Great Financial Crisis in 2008.

Second-round impacts of the conflict

Your fund has no direct exposure to Russia or Ukraine as we only buy UK-listed companies. We estimate that less than 1% of the fund's revenue is derived from the two countries, for example global drinks companies **Diageo** and **Fevertree** sell their products into Russia, building materials company **CRH** has a site in Ukraine and video game developer **Keywords Studios** uses highly skilled Russian coders. The main impact on the fund is from the move away from risk assets and the unwelcome impact of surging energy prices at a time when inflation is already uncomfortably high. Additionally, one of the first areas that typically gets hit when asset allocators are attempting rapid risk reduction is small and mid-caps, and this dynamic is exacerbated by recent strong returns from the smaller indices. On top of an already poor January, this has meant our fund underperformed further in February.

As a reminder on fund positioning, we are overweight 'quality growth' and 'defensive growth' stocks. This means low leverage, high return on capital, limited sensitivity to the economy, clean accounts. These are the parts of the market that tend to outperform when times are tough. The current market backdrop is complicated by soaring energy prices, an area where we are very underweight. We don't have much exposure to discretionary consumer spending, which we think looks vulnerable as the cost of living spirals. And we don't own any banks either — we felt interest rate expectations had run too far and credit quality should be more of a focus. The liquidity profile of the fund is extremely strong: our most recent analysis suggested that 97% of the fund could be traded to cash within two days. We balance out our exposure to small and mid-caps (70%) with a selection of large, liquid growth compounders.

It can feel grubby to obsess over share prices during a humanitarian crisis, but protecting clients' savings is our hard-won responsibility. While many larger UK funds have faced sizeable redemptions, we are grateful for your continued support and will aim to put our 5% (and growing) cash pile to work in the coming weeks across our highest-quality names. This is our modus operandi — in times of market dislocation, we always try to increase the quality of the portfolio; selling the 'weakest links' and buying/adding to the very best, particularly names that we previously couldn't afford in valuation terms. This served us well in November 2018, March 2020 and February 2021.

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