Rathbone Greenbank Total Return Portfolio

Quarterly investment update, January to end March 2022

Rathbones
Look forward

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

Rising rates. The first quarter of 2022 really was grim: fears of recession, war, rapid inflation, an energy crisis, a cost-of-living crisis and a stock market correction. This assortment of risks sent bond yields aboard a rocket ship. The 10-year UK government bond yield soared from 0.97% to 1.61% over the quarter, and then pushed above 1.80% in early April. The rise of the US 10-year was even more dramatic: from 1.51% at the dawn of 2022, it finished three months later at 2.35%. At time of writing, it had surpassed 2.80%. Investors expect central banks to deliver a whole bunch of interest rate increases and reverse their quantitative easing schemes, perhaps more tightening than is indeed possible. We took advantage of higher yields to slowly increase our bond holdings at better interest rates, as we have avoided them as much as possible in recent years because they offered virtually no return. Meanwhile, the values put on company profits (price-earnings multiples) have retreated – to an average of 19x in the case of American stocks – roughly where they were before the pandemic upended markets back in 2020. Put plainly, investors want much higher returns for lending money or putting up equity because of the foggy future. Even as company profits are actually growing at a fair clip. Investors are finding it extremely difficult to weigh up shorter-term risks with longer-term opportunities. This is leading to some pretty bizarre moves in share prices. Some stocks reporting earnings have dropped 10% in the morning only to finish the day 10% higher than where they started. That's barmy. But, mad as it is, it creates plenty of opportunities for us to trim winners and pick up bargains as we rebalance carefully and often to keep our portfolios prepared for rough waters ahead.

Upended energy. The war in Ukraine puts the spectre of a worldwide energy crisis front and centre. The news flowing from the embattled nation is awful to see, yet two months on Ukraine's defiant stand continues to frustrate Russia, which commands vastly more troops, supplies and equipment. Russia's attempts to pound Ukraine into submission have failed and instead sparked renewed discussion of wider sanctions among European Union (EU) members, specifically on Russia's copious oil and gas exports (which the US has already implemented). The price of energy has skyrocketed because of the uncertainty created by one of the largest producers invading its neighbour. If the flow of Russian oil and gas to Europe is halted, the effect on both Russia and the EU would be catastrophic. Many European nations would struggle to keep the lights on as energy costs rocket, while Russia would be stripped of a crucial flow of foreign cash. The whole mess has taught Europe an important lesson about energy strategy and security. But it will take more than a few years to put right. In the meantime, soaring prices for gas, petrol and electricity are squeezing households and businesses from Seattle to Singapore and virtually everywhere in between. This led the World Bank to cut its forecast for 2022 global growth to 3.2% from 4.1%. Households and businesses have broadly come out of the pandemic flush with cash and a hankering to spend. But a sustained increase in costs with no end in sight will rein that optimism in. Recent surveys suggest that may already be happening, but it's really too early to tell how long the squeeze will last. By summertime we should have a better idea of the path of inflation and how people are feeling about life.

Virus fatigue. The latest wave of COVID-19 in the UK has broken and numbers of daily infections are falling once again (although daily reported deaths are still climbing). But given that there was less than three months between this viral resurgence and the last one, you have to wonder whether to pencil in another variant and another wave for the summer holiday. COVID-19 has lingered much, much longer than any of us expected. The US seems to be a month or two behind Europe, going off daily case numbers, yet it's right in lockstep on its fatigue for the situation. After years of caution, testing and procedures, people are beyond tired of the virus and its effect on their lives. You will have seen the change as the months have slid into years: many of those initially most worried about their health have faded into a mixture of resigned acceptance and grim determination to do whatever it is they want to do. This of course makes it easier for the virus to spread, especially as every other month it makes itself more infectious. It seems unlikely that governments will implement any more lockdowns – with some exceptions, the most important being China – to combat any future spikes in the virus unless COVID-19 becomes markedly deadlier. However, the sheer number of people getting ill and falling out of the workforce for days at a time must surely drag on economic activity, particularly when many companies are struggling to find staff. Of course, the flipside of this devil-may-care attitude is a positive: people want to enjoy themselves, and if you've been out anywhere lately you have probably noticed that places are noticeably busier than the recent past. That's good for businesses and the people they employ. Let's hope COVID-19 doesn't have any more tricks up its sleeve.

Portfolio activity

Key purchases/additions	Key sales/trims
Generac (new purchase)	Clorox (sale)
London Stock Exchange (new purchase)	Jack Henry & Associates (trim)
Owens Corning (new purchase)	
DBS Bank (new purchase)	
Société Générale VRR Index Structured Product (addition)	

Source: Rathbones

We slightly increased the sensitivity of our bond portfolio's value to changes in interest rates by purchasing several government and supranational bonds that have longer to go till maturity. These included the dollar-denominated **European Investment Bank 0.75% 2030**, **UK Treasury 3/8% 2030** and the **New South Wales Treasury 2.5% 2032**, which is ring-fenced for sustainable uses.

In January we added to the **Société Générale VRR Index Structured Product**, which makes money if the volatility of US Treasury yields rises. Any increase in the size or frequency of moves in US treasury yields (both up and down) is good for this investment. However, if yields just amble along with little movement, we will lose money.

We used the first-quarter market correction to add to our stocks across the board. We also used the turmoil to buy some new companies. The first was **DBS Bank**. Set up in 1968 as an arm's length development bank by the government of Singapore, it has grown into a solid and responsible commercial bank and lender. It operates across Southeast Asia, albeit with a heavy focus on Singapore and Hong Kong. It also has a presence in the UK, US, Australia and United Arab Emirates. It is growing modestly yet dependably, with a solid return on equity that should have a tailwind if global interest rates continue to rise.

Another addition was US-based insulation and roofing supplier **Owens Corning**. It's the world's largest manufacturer of fibreglass insulation, which goes in hundreds of thousands of homes, offices and other buildings. Better construction techniques are crucial for improving heat retention and reducing energy consumption. Owens Corning's Pink Next Gen Fiberglas insulation is made with almost 75% recycled glass, the highest proportion in the industry. In just one year it saves 12 times the energy it takes to produce it.

We bought shares in the **London Stock Exchange** (LSE) for the first time. We are very familiar with the business, having held it in our core multi-asset portfolios for several years. We think the key to LSE is its data: it licences the rights to use thousands of indices, like FTSE, that funds and ETFs use to benchmark themselves. This critical information isn't easily dispensed with, which gives it very healthy profit margins. With the purchase of data provider Refinitiv in early 2021, LSE has started expanding into foreign currency and developing equity markets. Sales are increasing at a high-single-digit clip.

We also purchased back-up generator manufacturer **Generac**, which provides critical back-up power to residential and commercial buildings. It has a diverse product range and a strong reputation for the reliability and durability that is so crucial in its line of work. We think that its move into more renewables-based back-up power solutions opens up another growth opportunity for the business and should drive the development of clean tech.

We took profits in **Jack Henry & Associates**, a back-end computer programmer for banks, as it has done very well so far this year. Also, we sold bleach and home goods producer **Clorox**. The business's profit margin has fallen back in recent results, lending weight to concerns that it will have to absorb rising input costs rather than passing them on to customers or offsetting them with lower expenses.

Spotlight

In this quarter, the spotlight is on our **Advanced Drainage Systems** and **National Grid** holdings.

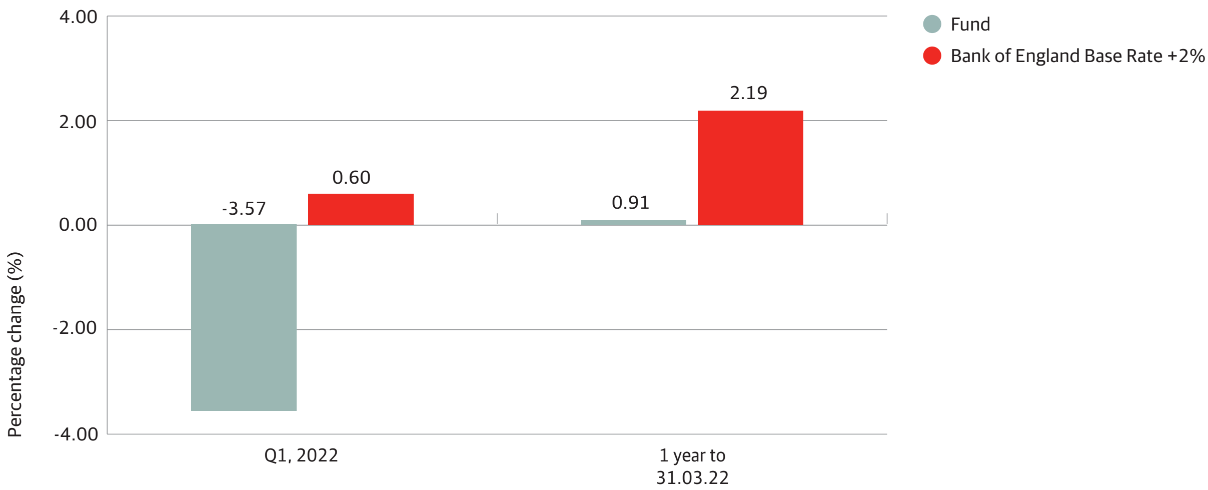
Advanced Drainage Systems

- Advanced Drainage Systems is a leading US company specialising in innovative drainage pipes, as well as stormwater management solutions including chambers, basins, and filters
- Their pipes are cost-effective, lighter, recycled and more durable than traditional pipes (mainly concrete) which helps to drive their market share, profits and pricing power
- They are well-positioned to benefit from the increased regulatory focus on reducing water stress and the recent infrastructure bill announced in the US which includes large amounts of spending on replacing water infrastructure
- Their solutions are designed to manage stormwater throughout its lifecycle – from capture and conveyance all the way through to storage and treatment – to ensure we are returning the precious resource of water back to its natural environment and avoiding excessive stormwater runoff
- ADS Recycling, their subsidiary, is the second largest plastic recycling company in North America and recycles more than 550 million pounds of plastic every year through converting plastic from the curbside into drainage pipes

National Grid

- A UK utility focused on transmission and distribution of electricity and gas
- National Grid are a key enabler of the energy transition and continue to support this through the modernisation of its network and a target of being net zero by 2050
- They have a balanced and well-diversified portfolio of energy assets across the US and UK with stable returns from a regulated asset base
- The company has made significant investments in large-scale renewable energy projects, including wind, solar and battery storage for use across the grid
- Focused on other diversity in renewable energy with an ambitious programme looking to build a hydrogen test facility in England to help decarbonise the energy system

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 Mar 2018	End Mar 2019	End Mar 2020	End Mar 2021	End Mar 2022
Fund	–	–	–	–	+0.91%
Bank of England Base Rate + 2%	+2.35%	+2.68%	+2.75%	+2.10%	+2.19%

Price performance based upon single price (mid). 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.

Top performers (%)

Holding	Performance	Contribution
Jack Henry & Associates	+21.47	+0.11
London Stock Exchange	+12.85	+0.06
Vodafone	+10.72	+0.08
National Grid	+10.60	+0.07
Aviva	+10.16	+0.06

Bottom performers (%)

Holding	Performance	Contribution
Shopify	-47.82	-0.27
Jungheinrich	-40.87	-0.28
Tomra	-25.80	-0.11
Aptiv	-25.14	-0.16
Smith (AO)	-23.11	-0.13

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

As you may expect, due to the significant growth to value rotation we saw for most of this quarter, traditional 'value' sectors such as financial services and telecommunications were the main contributors to performance. Our holdings in **Jack Henry & Associates**, **Visa**, **Mastercard**, **Vodafone**, **Verizon**, **Sampo**, **AIA** and **Aviva** in the equity space rallied to differing degrees but all contributed positively. Jack Henry & Associates in particular was strong, as they reported solid growth and margin improvement numbers in their quarterly earnings, particularly in their payments segment. **National Grid** and **SSE**, as well as **Vestas** to a lesser extent, also added to performance following the war in Ukraine which prompted a discussion on how best countries can reduce their reliance on countries such as Russia for oil and gas. One of the ways to do this is to more quickly shift into renewable energy which is what led to many renewable energy stocks, including these, to make gains.

In October last year, we added a **Nasdaq put option** to the funds to help protect us from a crash in equity markets, but specifically an equity market fall more focused on the growthier names which tend to be more prevalent in the Nasdaq index. This put option helped to protect the portfolios during some of the worst of the market falls, both the January rotation which hit the Nasdaq hardest, and then latterly when a period of broad risk off sentiment took hold after the Russian invasion of Ukraine. Importantly though, those puts gave us the confidence to add into some of the highest quality names in the portfolio towards market lows. The addition of the **US rates volatility notes** in 2021 also helped in the first quarter of the year as rates volatility was indeed higher. We took advantage of a drop in the price in January to add a little more into these notes to provide us more protection from increasing volatility in the US rates space. These volatility notes both provided a helpful positive performance contribution for the quarter and between them were a key part of mitigating some of the equity drawdowns.

Fund performance (continued)

Given the falls in equity markets it is of course no surprise that equities were the largest performance detractor. Our US equity exposure was the largest detractor with some specific companies being larger contributors to that such as **Shopify**, who were weaker at the start of the year given the market rotation, but after announcing much higher capex to build out more of their own fulfilment than had been expected the shares fell significantly. Europe has detracted less from performance given the smaller overall weight in the portfolio, but again there were some specific companies who were hit harder, such as **Jungheinrich**, a European industrial manufacturing forklifts, who issued a profit warning at the end of March due to challenges from raw material cost and supply chain issues dragging on growth. In fixed income, **conventional bonds** were a drag on performance as yields rose; but given our short duration positioning since launch this rise in yields did not prove to be a meaningful detractor to performance.

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	31.12.21	31.03.22	% Change		12 month change	
Liquid assets	52.32%	51.40%	-0.92%	▼	–	◀▶
Equity-type risk	40.45%	42.35%	1.90%	▲	–	◀▶
Diversifiers	7.23%	6.25%	-0.98%	▼	–	◀▶
	100.00%	100.00%				

Asset class split	31.12.21	31.03.22	% Change		12 month change	
Equities	30.34%	32.84%	2.50%	▲	–	◀▶
Index-linked bonds	2.35%	2.25%	-0.10%	▼	–	◀▶
Conventional government bonds	18.23%	19.94%	1.71%	▲	–	◀▶
Corporate bonds	23.46%	25.93%	2.47%	▲	–	◀▶
Emerging market debt	0.00%	0.00%	0.00%	◀▶	–	◀▶
Private equity	0.00%	0.00%	0.00%	◀▶	–	◀▶
Alternative investment strategies	7.23%	6.25%	-0.98%	▼	–	◀▶
Property	0.00%	0.00%	0.00%	◀▶	–	◀▶
Commodities	0.00%	0.00%	0.00%	◀▶	–	◀▶
Cash	18.39%	12.79%	-5.60%	▼	–	◀▶
	100.00%	100.00%				

Asset allocation (continued)

Sustainable category split	31.12.21	31.03.22	% Change
Decent work	9.20%	9.45%	0.25%
Resource efficiency	4.21%	3.80%	-0.41%
Habitats and ecosystems	0.00%	0.00%	0.00%
Inclusive economies	5.30%	5.31%	0.01%
Energy and climate	9.47%	11.85%	2.38%
Health and wellbeing	7.55%	7.93%	0.38%
Resilient institutions	20.58%	21.14%	0.56%
Innovation and infrastructure	18.07%	21.48%	3.41%
Diversifiers	7.23%	6.25%	-0.98%
Cash	18.39%	12.79%	-5.60%
	100.00%	100.00%	

The 'resilient institutions' category includes government bonds.

Investment outlook

The pall of uncertainty hanging over the future leads us to focus on ensuring our portfolios are ready for whatever jumps out of the gloom. This year is looking like it will be a tough one for households, businesses and some governments. Because of this, we are focusing our investments on 'quality' companies – those that have little debt, make a lot of cash and have products and services that are hard for their clients to pass up.

Strong cash flow really is so important for companies, especially when economies start to slow. Put bluntly, cash equals flexibility. It gives managers options: the ability to invest in promising ventures or take out struggling rivals for a song, to pay down debt or take on more at reasonable rates. These businesses have the best chance of coming through difficult situations unscathed – and sometimes even stronger.

While we're prepared for short-term pain, we still note that there's a chance of things turning out better than people expect right now. Prices in bond and stock markets suggest people are anticipating a royal flush of bad stuff. Yet the Citi Economic Surprise Index, which measures actual economic news against expectations, has risen sharply this year showing that so far the reality hasn't lived up to the nightmares. When the news is jammed full of war and inflation and pandemics it can lead you to think the world is going to the Inferno in a shopping trolley. But these things have plagued us before and, sadly, will again. People can be terrible, yet only a fool would bet against human ingenuity in the long run. To paraphrase the immortal Jeff Goldblum, humanity finds a way.

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

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A member of the Rathbones Group.
Registered No. 02376568

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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