

Rathbone Global Opportunities Fund

Monthly update May 2022

In May your fund returned -5% versus a -1.7% average drop in the IA Global sector. Year-to-date the fund is down 20.6%.

The great rotation from 'growth' to 'value' stocks intensified in May as investors continued to dump long duration assets in favour of short-term beneficiaries of rising energy and commodity prices (notably, oil & gas and mining). We suffered this month due to zero exposure to commodity stocks. And our holdings in consumer discretionary stocks such as Costco and Freshpet were hit hard as high-profile retailers like Walmart and Target (which we don't own) indicated that their inventory levels had rocketed due to supply chain fear over-ordering and demand dropping as consumers switch spending from goods to services. Our medical technology holding Dexcom also dropped sharply as the company was rumoured to be buying a competitor in the diabetes space to offer a full-suite solution for patient glucose monitoring. Dexcom subsequently refuted this rumour, but this is a market that sells the rumour if there's a potential hit to short-term profit estimates.

The hotter-than-expected US inflation print for May dashed hopes that inflationary pressures might ease in June. While some components of the US consumer price index (CPI) did fall, the services sector (such as flights and hotel prices) rose sharply for this summer's great getaway. Hilton's CEO remarked "we will have the biggest summer we've ever seen in our 103-year history". And Marriott's CEO commented that revenue per available room was up about 25% in 2022 compared with pre-pandemic 2019 prices.

While yet another delay in the peaking of inflation and interest rate expectations is disappointing, we have to remember that inflections in markets are a process rather than a single point in time. Many of these spikes in prices are unlikely to be repeated and are unique reopening events that are dropping like dominos. The best cure for high prices will be high prices: consumers are starting to push back.

We believe we'd see a major turn in markets if the man-made crises in Russia or China eased. The Russia crisis is inflicting supply losses (oil, grains and fertiliser) and squeezing inflation higher, while China's zero COVID policy is inflicting demand losses (as a result of lockdowns) and driving many businesses' profits lower. Many businesses are suffering from a quadruple whammy of new supply chain disruptions limiting ability to ship products, store closures due to COVID lockdowns, rising costs of goods sold, and staff shortages. This feels like the perfect storm. But stock markets have already discounted a lot of pain and there's still very genuine potential for a short-term rally, even if it hinges on 'known unknowns' such as Russia, China and stubbornly high inflation.

This is a macro driven market and while we build the portfolio on the basis of bottom-up stock selection, companies don't exist in a vacuum and their short-term trading is currently being dominated by inflation and interest rates. Inflation will benefit from easing comparisons from the autumn of last year when inflation started to spike (see US Consumer Price Index chart).

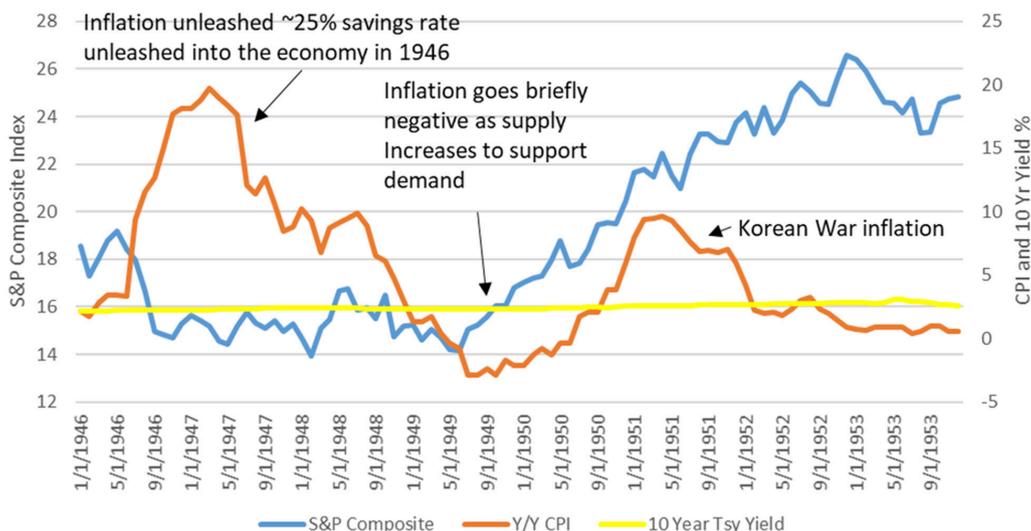
US Consumer Price Index historical data

US CPI YoY							
1/31/2020	2.5	1/31/2021	1.4	1/31/2022	7.5	1/31/2023	Comp 7.5
2/29/2020	2.3	2/28/2021	1.7	2/28/2022	7.9	2/28/2023	Comp 7.9
3/31/2020	1.5	3/31/2021	2.6	3/31/2022	8.5	3/31/2023	Comp 8.5
4/30/2020	0.3	4/30/2021	4.2	4/30/2022	Comp 4.2		
5/31/2020	0.1	5/31/2021	5.0	5/31/2022	Comp 5.0		
6/30/2020	0.6	6/30/2021	5.4	6/30/2022	Comp 5.4		
7/31/2020	1.0	7/31/2021	5.4	7/31/2022	Comp 5.4		
8/31/2020	1.3	8/31/2021	5.3	8/31/2022	Comp 5.3		
9/30/2020	1.4	9/30/2021	5.4	9/30/2022	Comp 5.4		
10/31/2020	1.2	10/31/2021	6.2	10/31/2022	Comp 6.2		
11/30/2020	1.2	11/30/2021	6.8	11/30/2022	Comp 6.8		
12/31/2020	1.4	12/31/2021	7.0	12/31/2022	Comp 7.0		

Source: Jefferies trading desk

The red-hot inflation picture could look like historic post-war periods, particularly the one that followed World War II when inflation soared as a 25% savings rate was unleashed into the economy in 1946. This time it is the unleashing of \$6 trillion in COVID stimulus in the US, combined with supply shortages and a long period of neglect of some vital industries such as oil & gas, that has driven the inflationary spike.

1946-1953 as inflation is a sine wave without help from rates



Source: Raymond James

Capitalist impulses, demand destruction, a supply-side response and easing year-on-year comparisons brought inflation back under control after World War II and the Korean War that followed a few years later. Time will tell whether history will rhyme in this case.

In the meantime, despite the urgency to stop the pain of underperformance we are resisting the urge to invest in the short-term harvesters of the current macro dislocation. Our focus is to avoid being a ‘deer caught in the headlights’ and to use price weakness to buy some growth stocks we’ve long wanted to own, but missed out on. Our mandate is to invest in ‘under the radar’ and ‘out of favour’ growth opportunities – stocks that have fallen out of favour recently have proved our key hunting ground. This doesn’t mean investing in stocks you’ve never heard of, but in fact stocks with underestimated potential to grow their revenue and earnings. This could be because their fundamentals are more resilient than recognised, they have greater potential to grow market share and penetration than generally realised, and the platform for significant potential sales growth through expansion into new markets.

We bought **LVMH** and **Apple** earlier in the year on this basis. And we’ve recently bought back into **Home Depot**, one of the world’s leading DIY retailers. This stock has been caught up in the consumer discretionary storm that’s hitting most retailers at the moment. But it could buck that negative trend for several reasons. First, 90% of US DIY customers own their own homes,

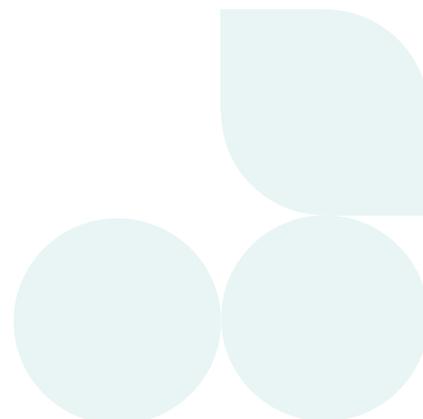
which means that they continue to benefit from the strong rise in house prices that we’ve seen in the US. In addition, its sales to professional customers are almost exclusively destined for jobs for homeowners. And 93% of Home Depot’s home-owning customers have a fixed rate mortgage (most US mortgages run for 30 years) so they’re somewhat shielded from rising rates. Its professional customers, meanwhile, simply pass on their inflated costs to the underlying home owner. Yes, all this won’t last indefinitely, but it does mean that Home Depot is shielded from some of the headwinds confronting more generic retailers. These positives, combined with one of the lowest valuations we’ve seen for this best-in-class retailer in 20 years, are driving us back into the stock after selling it last year following the immediate post-pandemic reopening rally.



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 what you originally invested.