Rathbone Unit Trust Management

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Rathbones
Look forward

Rathbone Greenbank Global Sustainability Fund

Quarterly update June 2022

Russia's war in Ukraine grinds on, and with every passing month the continued flow of gas to Europe gets ever more precarious. Natural gas, while much cleaner than coal and petrol, is not a sustainable energy source by any stretch of the imagination. However, it is the crutch that most developed nations use as they wean themselves from fossil fuels. Gas is the keystone of most European power grids, accounting for a quarter of all energy use, and it is heavily reliant on Russian pipelines.

Russia has already completely shut off the taps to five smaller nations, while six more (including Eurozone engine rooms France, Germany and Italy) have had their consignments severely curtailed. Yet more cuts could be on the cards. Ironically, an exceptionally hot summer has led to unseasonably high energy demand because of people cranking up the air-con. European countries – including the UK – have done well finding alternative energy import partners, yet completely reconfiguring our energy complex will take years, not months. It will of course need lots of investment, too, which is one of the long-term opportunities of our fund.

So, in the short term, restricted energy supplies are converging with increased demand, especially in Europe. Continental gas prices have soared roughly 60% since the end of March. The benchmark European gas price is now almost nine times the average price of the past decade. At bottom, energy is crucial for economic activity. You need people, sure, but without energy you have no technological uplift. Bluntly, it's the difference between you putting together your flatpack furniture with a screwdriver or doing it with a power drill. The extra cost of power will put pressure on households and businesses of all stripes. This spending squeeze is why many people are beginning to worry about a possible recession this year – especially in the UK and Europe.

	3 months	6 months	1 year	3 years	Since launch (16 July 18)
Rathbone Greenbank Global Sustainability Fund	-14.9%	-26.1%	-19.0%	17.3%	25.5%
IA Global Sector	-10.1%	-14.5%	-8.8%	21.0%	28.5%
FTSE World Index	-9.1%	-10.9%	-2.8%	29.0%	40.0%

	30 Jun 21-30 Jun 22	30 Jun 20-30 Jun 21	30 Jun 19-30 Jun 20
Rathbone Greenbank Global Sustainability Fund	-19.0%	28.3%	12.8%
IA Global Sector	-8.8%	25.9%	5.4%
FTSE World Index	-2.8%	25.5%	5.8%

Source: FE Analytics; data to 30 June, S-class, mid price to mid price.

These figures refer to past performance, which isn't a reliable indicator of future returns.

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.

A big shake-up

Energy markets are a big driver of the inflation that continues to crackle all around the world. In June, higher petrol prices pushed US inflation to 9.1%, the highest level of the year so far. It's not the only factor, either. Wage growth has roared back after more than a decade of pedestrian increases in pay. Also, the great untangling of supply chains following lockdowns has taken longer than expected. While delays, stoppages and delivery times for consignments have fallen away from their peaks, they are still fairly far away from the resumption of normal service.

All three of these markets — labour, shipping and energy — have had, or continue to experience, significant shocks to both supply and demand. Lots of skills appear to have been lost in a 'great resignation' after people reappraised their lives during the pandemic; meanwhile, many jobs have become more flexible due to remote working. Shipping and logistics companies have had to deal with sudden months-long shutdowns, extreme demand, spiking fuel prices and continued uncertainty from the zero-COVID policy in China, the world's manufacturing hub. And energy markets have been dealing with similar swings in demand while moving at a clip toward a cleaner energy mix.

As difficult as the flare-up in inflation has been for families, businesses and investments, the ability of people and companies to adapt to all these changes and hurdles has been very impressive. Granted, if the cost squeeze continues and beds in, 2022 will be a very tough year for everyone. Yet this human knack for finding solutions, for making the best of situations, always gives us confidence in the future — especially over several years. It's why we do what we do! It's endlessly fascinating to see how companies evolve and develop new products and services to fill a need or solve a problem.

Adjusting for greater risks

We bought more of our holding in **Ranpak**, a sustainable packaging business, after its share price dropped back. Ranpak supplies sustainably sourced paper and cardboard boxes and wrapping for industrial supply chains as well as e-commerce orders. It also supplies the machinery that's used to create the boxes and packaging from paper and card. Essentially, Ranpak sells quality packaging machines to its customers at a keen price and then makes money on their refills of paper and cardboard (the 'razorblades'). Paper currently accounts for less than 20% of the global packaging market, but is much more sustainable than other materials like plastics. We think the opportunity for paper to take market share in the packaging industry is huge.

We added to our investment in US payment network **Mastercard**. Along with **Visa** (which we also own), Mastercard dominates the payments industry, despite a plethora of upstarts popping up over the past decade or so. We think it should retain its strong position and continue to increase its sales as ever more cash payments move to card and digital options. This should offer more protection in a tougher economic environment as, while payment network revenues are sensitive to lessened spending, growth in the digital realm should mean Mastercard and Visa scoop up more of the total pie.

Another top-up was US software giant **Microsoft**. While mostly known for its eponymous and ubiquitous Office suite, Microsoft has so many more strings to its bow. It has steadily built a comprehensive portfolio of programs and services for businesses and homes, deeply embedding itself in its customers' lives. Many businesses — especially the larger ones — are spending much more on upgrading technology and this seems set to continue for many years yet. Businesses like Microsoft are a one-stop shop that offers everything from outsourced computing power and storage through its Azure cloud business to remote working tools like Teams and client management software. It's not all business, of course, with the Xbox gaming franchise giving Microsoft some exposure to the fast-growing computer game industry.

We cut back our holding in **Generac**, an American back-up generator manufacturer during the quarter. Generac is heavily reliant on the US housing market, where it is the number one provider of back-up power generators. While we believe the outlook for housing-related spending should stay strong in the medium term, there are signs of near-term weakness given the US Federal Reserve's pivot to tighter monetary policy. Generac is still a core holding in the fund, as we think the greater need for back-up energy because of wilder weather and strained energy grids is set to continue.

We also trimmed **Nidec**. This Japanese manufacturer of small electric motors was hit hard by the global supply disruption of the last six months, particularly after the Russian invasion of Ukraine in February. The company has addressed these issues and we anticipate it will be able to restore production back to normal levels before the end of 2022. Given the heightened short-term risk, however, we felt it prudent to reduce our position.

Another reduction was in **Littelfuse**, which makes high-quality fuses and sensors, with a heavy focus on electric vehicles. It sells into many sectors, including power grids and industry, and is well positioned to benefit from the electrification of the global transport fleet and increased role of renewables in the global energy mix. Its financial performance has remained robust in the past 12 months and we believe the company has significant growth ahead of it, yet given increased macroeconomic uncertainty we decided to reduce our position size.

Having fun while you can

Many nations' consumer confidence surveys are at or near record lows, yet people are still spending at levels that belie what they are telling pollsters about their moods. Meanwhile, in developed markets, household savings are much, much higher than you would have expected following the sharp shock of the lockdowns and the deepest recession (albeit also with the swiftest recovery) in history. Savings in excess of the historic norm total an incredible 13.5% of GDP in the US and a still substantial 5.5% across developed markets as a whole. In the US, there is evidence to suggest that these savings are more equitably distributed than you would expect. Bank of America data show that households with total income of less than $50,000 a year have nearly twice as much money in their accounts today than they did this time three years ago, for example. Psychology and cash in people's pockets should never be underestimated. People have had a really tough few years and a lot of us seem determined to have a bit of fun, inflation be damned.

Put simply, there's a whole world of moving parts out there. We've come through an unprecedented period of pandemic in a modern, globalised economy. We're in the midst of another big IT revolution. And we're between the waves of the largest loosening and the largest tightening of monetary policy in history. The future is never ours to know at the best of times, which is why we always think it's best to focus on the companies we buy.

It has been another tough quarter for our fund and we expect little let-up until inflation is inarguably under control. At that point, central banks should have less inclination to hike interest rates, which hurts the share prices of companies reinvesting in their futures. However, when looked at with a holding period of three to five years, we think our companies offer great value indeed. Our companies have products and services that people want and are willing to pay for. They have limited borrowing and high cash flow, which gives them options and flexibility.

David Harrison
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.

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