Rathbones
Look forward

Rathbone Global Opportunities Fund

Update December 2018

In December, the Rathbone Global Opportunities Fund returned -6.9% versus a 6.7% average decrease in the IA Global sector. In 2018, the fund fell 0.5% versus a -5.7% IA Global sector average, top-quartile relative performance.

The fund delivered top-quartile performance in 2018, but that's nothing to celebrate after a very difficult fourth quarter. Over the year our bias to growth stocks, tech, med-tech and less economically sensitive businesses like food producers & ingredients, beverages, pest control and healthcare equipment paid off. Our geographic exposure was also on the money, with heavy exposure to the US and underweight or zero exposure to emerging markets and the UK. Commodity stocks and banks were the worst performing sectors worldwide; we hold almost none of these companies, save a single US bank called **First Republic** which was actually up for the year.

Top contributors

Abiomed +84%
Miniaturised heart pumps

Salesforce.com +42%
Cloud-based applications and software

Amazon +36%
Cloud computing and online retail giant

Match Group +53%
Online dating and Tinder

Adobe +37%
Creative software

Bottom contributors

Aurelius -39%
European private equity and turnaround specialist

VAT Group -25%
Semiconductor equipment

Eurofins -35%
Food and pharma testing

Osram Licht -33%
Automotive lighting

Tencent -18%
Chinese internet giant

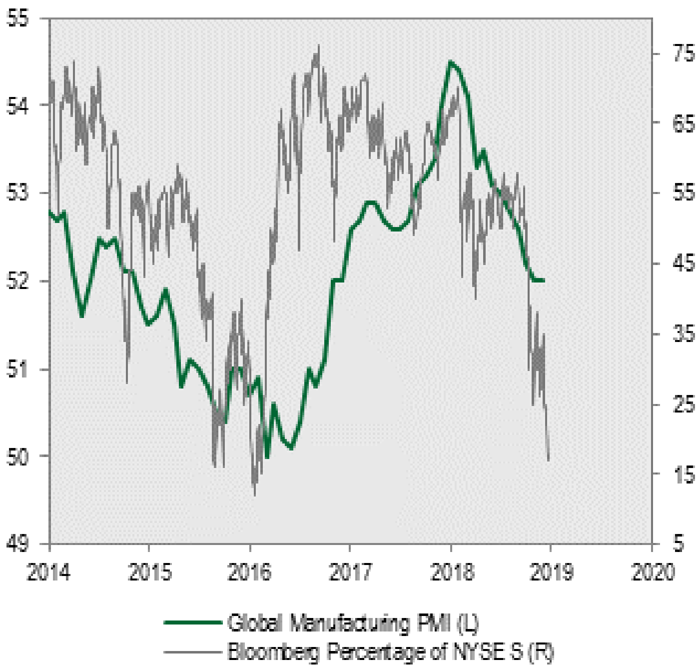
Our worst performers were in areas where the economic deceleration toward year-end appeared first. Future orders for the auto and semiconductor sector appeared to peak in the middle of 2018, despite pleadings that the cycle would continue for much longer. We sold **VAT** and **Osram** as management and the market tend to underestimate the leverage on the downside as cycles roll over. **Tencent**, a popular Western proxy for exposure to Chinese digital growth, was hit as the trade war raged on and regulatory pressure delayed new game launches. **Eurofins Scientific**'s aggressive approach to M&A has been dented as weak capital markets may thwart further financing. The bear market also hurt **Aurelius**. The turnaround specialist retreated sharply because of fears that it may have to delay some portfolio company exits.

We predicted stormy market conditions in 2018, but it turned into a hurricane in Q4. The collapse in investor sentiment drove the ninth-worst selloff in US market history – other episodes included five selloffs during the Great Depression, the 2008 great financial crisis, the 1987 crash, and the dark days after Pearl Harbour. Comparing the current environment to those horrors makes you question whether fear has outstripped reality.

An equity strategist at JPMorgan sums up the fear and mitigation: *"The current cycle is just shy of becoming the longest uninterrupted expansion since 1860. Its sheer longevity has become a source of anxiety. Long cycles can lead to excesses followed by a crash. Currently, this concern seems misplaced, in our opinion, since the present cycle has already experienced two intra-cycle resets, in mid-2011 and late-2015. These resets are healthy and should prolong the overall cycle as they put a brake on excesses by repricing risk, causing style/sector rotations to realign valuations and draining out excess leverage from the market. Similarly, 2018 could be viewed as a third reset — a year characterized by significant de-leveraging and unwinding of crowded trades."*

There is a tug of war going on between the market, the Federal Reserve (Fed) and most strategists who clearly believe that downside risks, like deteriorating leading indicators such as global PMIs, have been overblown and that the US economy can withstand further rate hikes before it breaches the neutral interest rate. But risks are clearly increasing because at the beginning of 2018 every country had a PMI greater than 50. Now eight countries are flashing recession warnings. The stock market is unlikely to stabilise until these key pieces of economic data stabilise.

US stock momentum mirrors manufacturing indicator



Source: Cornerstone Macro

The market clearly believes that downside risks are rising and investors are punishing companies with higher levels of economic sensitivity. More recently the selloff has been most acute in previous outperformers – tech and growth stocks – where investors believe historic outperformance is a proxy for risk. The speed of this change of view is surprising in that it exaggerates many timelines, indicators and waypoints that have historically been helpful guides for investors. But perhaps that's a symptom of a market where information flows so quickly that everyone knows about the tell-tale signs of impending recession (like the obsession with even a tiny inversion of the yield curve) and jumps the gun.

Asset Class Return 2018		
1	US Dollar (UUP)	8.0%
2	Health Care (XLV)	4.5%
3	Utilities (XLU)	3.7%
4	Consumer Disc. (XLY)	1.8%
5	S&P 500 Growth (IVW)	0.4%
6	Tech (XLK)	-0.4%
7	Mega Caps (XLG)	-3.3%
8	S&P 500 (SPY)	-4.4%
9	Treasuries (TLT)	-5.7%
10	REITS (VNQ)	-6.7%
11	High Yield (JNK)	-7.3%
12	Consumer Staples (XLP)	-7.5%
13	Commodities (DBC)	-10.0%
14	Small Caps (IWM)	-10.2%
15	S&P 500 Value (IVE)	-10.6%
16	Industrials (XLI)	-12.4%
17	Financials (XLF)	-14.3%
18	Materials (XLB)	-16.2%
19	Energy (XLE)	-17.6%
20	Oil Commodity (OIL)	-18.7%

Defense

Cyclicality

Source: Cornerstone Macro

But amid the consensus gloom of investors and businesses, there are upside scenarios in the near future. The Fed could signal a change in its rate-hiking posture, a truce in the US-China trade war could be brokered or economic data could tick upwards from its recent downtrend.

What changes did we make in 2018?

We sold all of our tobacco exposure because we fear accelerating volume declines in traditional cigarettes and uncertain growth and regulatory response for next-generation e-cigarettes. We sold our most economically sensitive industrial companies including **ABB** and **Caterpillar**. We sold semiconductor equipment companies such as **Aixtron** and **VAT Group** due to the potential for a deeper cyclical downturn following many years of blockbuster capacity expansion. We sold **Facebook** at the beginning of the year as we thought the company had entered a vicious cycle where boring, repetitive and ad-driven content on the newsfeed would drive less engagement and time spent and, therefore, less advertising revenue. And finally we sold our video games companies, **Activision Blizzard** and **Electronic Arts**, as they struggle with stale content and new competition. This has challenged investors' faith in the enduring and sustainable qualities of these franchises. Either way, there are lots of things to fix in 2019 so we have exited. We will revisit them if engagement and innovation improves.

We used cash raised from these sales to add to existing holdings during pullbacks, but also to buy some new consumer-facing companies, such as **Costco** and **Estee Lauder**. We have made new investments in software and streaming music companies, a company that makes French fries and a company that collects garbage. We have added to our weatherproof and recession-resistant businesses in the food & beverage industry, such as **Christian Hansen** (cultures and enzymes), **Campari** (Aperol Spritz) and **Heineken**. We also added to our healthcare equipment companies which allow pharmaceutical companies to outsource, speed time to market for new drugs and reduce the upfront expense of new drug manufacturing facilities.

Fund moving to 'single price' for buying and selling

From 21 January, our fund units will move to a single-price, dropping the current dual-price system. Rather than have a buy price and a marginally lower sell price, a single price will be issued for our funds at noon each day. Both purchases and sales of units will be based on this single price.

In common with the industry we intend to operate a 'swinging' single pricing mechanism for each fund. This mechanism is intended to ensure the fair treatment of all the investors in a fund by minimising the effects of 'dilution'. The price will swing for buyers or sellers in response to large purchases or sales in order to mitigate the effects of dilution for the existing investors.

Once the single price of a unit has been determined, a 'dilution adjustment' will be applied to the price in accordance with the policy outlined in the prospectus for our funds. For example, when there are net inflows to a fund, a dilution adjustment increases the price (price swings up) and when there are net outflows from a fund, the dilution adjustment reduces the price (price swings down). However, regardless of whether the price is adjusted up or down, all investors buy and sell at the same price.

James Thomson

Fund Manager

Sammy Dow

Assistant Fund Manager

This is a financial promotion relating to a particular fund. 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 may go down as well as up and you may not get back your original investment.

Source performance data, Financial Express, bid to bid, net income re-invested.