



RATHBONE GREENBANK GLOBAL SUSTAINABILITY FUND

MONTHLY UPDATE FEBRUARY 2024

The US economy has been extraordinarily strong for much longer than most people ever expected. This can't last forever – nothing can. But the big question is how long America will power on for. That will only be answered with time.

The way we see it, interest rates are now much higher than households and businesses have been used to for more than a decade, so we expect higher borrowing costs to bite in 2024. Just as households are weighing up whether to dispense with monthly subscriptions, pick up cheaper brands in the supermarket, shop around for a better energy deal or generally rein in spending, businesses are also making tough decisions. Company managers may need to shut down projects that are no longer viable now it costs more to borrow money and attract equity investors. If these changes come to pass, it could push some nations – or the world – into recession.

As we said, we could be off on our timing by months or even years. That's why we're not trying to make that call. Instead, we've been assessing our companies' ability to survive an economic downturn and thrive over the next five years and beyond. This has meant adjusting our portfolio over time to be more defensive.

Taking the medicine

That's resulted in us holding more of our portfolio in healthcare and pharmaceutical stocks – people tend not to economise with their health, which tends to make sales more resilient during a downturn. Last month, this meant increasing our holding of **Eli Lilly**, which manufactures next-generation GLP-1 (glucagon-like peptide) weight loss and diabetes treatments. Demand for Lilly's anti-obesity and diabetes management drugs Mounjaro and Zepbound remains extremely strong, which is driving expectations of profit higher. While there's a risk of increasing competition in the GLP-1 market, Lilly (and its rival Novo Nordisk) have a clear first-mover advantage.

We also added to **Lonza**, which makes drugs and specialist medicines and nutritional supplements for other pharma companies that have the intellectual property but not the production capacity or laboratory muscle. Lonza performed badly last year as it faced weaker demand after COVID-19. This was compounded by poor business execution and communication from its management team. Despite these missteps, we are still confident in the long-term value of the company. It has appointed an experienced new chair and we expect more management changes to come. We think this infusion of new thinking will help improve decision-making and improve the business's capital allocation. Meanwhile, demand for drugs and supplements appears to be stabilising.

We've also been adding to consumer goods companies that usually remain in the supermarket trolley regardless of the economic situation. The most recent of these was multinational consumer brands business **Unilever** after a helpful meeting with the new CEO and CFO. We are increasingly confident that there's a clear plan to improve growth in this business and an opportunity to optimise the products it sells. Unilever is attractively valued, in our view, but we think better focus and execution could see investors value the shares more highly in coming years.

We slightly reduced our holding in UK insurer **Legal and General**. While the company remains a core holding in our portfolio, we believe earnings momentum may be weaker in the first half of 2024, so we used the proceeds to increase several other holdings that we felt offered better value.

Another trim was pharmaceutical business **AstraZeneca**. Astra seems likely to experience subdued growth this year, so we redeployed our cash into Eli Lilly.

We also reduced our holding in Portuguese renewable power generator and developer **EDP Renováveis**. Operating conditions remain tough for the company, on the back of falling power prices and lower production because of El Niño's effects on wind.

Hope springs eternal

It was confirmed last month that the UK fell into recession in the second half of 2023. This wasn't too much of a surprise, and indeed stocks and bonds didn't flinch a bit.

The contraction in economic growth was very small (0.4% in six months) and the UK still grew 0.1% over the whole year. Some people – Bank of England Governor Andrew Bailey among them – argue that the recession may already be over. Everyone is still laser focused on the likely path of interest rates, both here, in Europe and across the Atlantic.

The big piece of the puzzle is inflation: will it continue to fall (we think it will), reassuring central banks that they can reduce borrowing costs without sparking another flare-up in prices? We have always suspected that the last mile of getting inflation back to 2% would be the hardest. And so it has been so far.

We would add another nuance to this point: all else being equal, it's harder to get inflation lower when your economy is flying than when it's in the doldrums. Especially now that the effects of global factors like energy price spikes, trade embargoes and supply chain snarl-ups have faded. When the economy is booming, money is flowing and people are spending with abandon, inflation is going to be cooking. When that starts to roll over: that's when upward pressure on inflation will decrease. That's not to say that inflation *cannot* fall alongside a strong economy – modern capitalism is good at delivering more with less – we're just noting that it's something else to overcome.

We think American rates will fall in time, but inflation and economic growth will need to moderate first, and when exactly that will happen is anyone's guess. Ours, for what it's worth, is sometime in the second half of this year.

On this side of the Atlantic, however, we think there's a greater chance of rates falling faster and further. Given dire economic growth, the rates situation seems more favourable than in the US, where there's greater evidence that inflation mightn't yet be vanquished. The UK and EU seem likely to cut sometime around the middle of the year.

Speaking of the UK, the government announced what seems likely to be its last Spring Budget. While tax receipts have risen by more than expected, there was still little room for manoeuvre for Chancellor Jeremy Hunt. Debt has risen considerably in recent years, as has the interest rate payable on it. This financing will squeeze the UK for the foreseeable future. As will further, unrealistic inflation-adjusted cuts to many public services and government departments.

Hunt spent much of his spare cash on reducing National Insurance Contributions by another two percentage points, taking the main employee rate to 8%. A year ago, it was 12%. He also tabled plans to reform the 'non-dom' tax status, which encourages wealthy foreign professionals and investors to move to the UK for work and commerce by allowing them to keep their foreign assets and income out of Britain's tax system.

There were myriad other measures, but in sum the Budget reinforced just how tough a job the winner of the next election will have. This corroborates why we typically find better investments overseas.



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For more info on our fund, including factsheets, performance and fund manager views, please click [here](#).

If you require further clarification on this commentary, then please contact your adviser or Rathbones at the contact details below.

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