RATHBONE GREENBANK GLOBAL SUSTAINABILITY FUND

MONTHLY UPDATE JANUARY 2024

American inflation disappointed again when January's number was reported. After a resurgent fourth quarter that continued into January with only a slight pause, stock markets wobbled slightly again in mid-February.

For now, the optimists still outnumber the pessimists, yet the nervousness can be felt under the surface. For more than 18 months now, investors have been hoping for imminent rate cuts. And for 18 months and counting they have remained just over the horizon. US stock prices assume reasonably sharp cuts in interest rates over the coming year. While we broadly agree with that assessment, there seems to be more chance of disappointment and intervening turbulence than markets are expecting. The US S&P 500 stock market index surpassed 5,000 for the first time in early January.

Today, markets expect five 25-basis-point cuts in 2024, which would take the US benchmark overnight interest rate to 4.25%. Yet economic growth, job creation and wage growth continue to overshoot expectations. And while inflation does seem to be on a downward trajectory, it popped higher to 3.4% in December, to the surprise of most. In January, it fell to 3.1%, much more slowly than forecast.

US drives all before it

This all seems to point to a stronger than expected US economy, and therefore more global growth too. Europe has been so-so, and the UK fell into a mild technical recession in the fourth quarter of last year, yet both have done better than most forecast for longer. China is a concern, as it battles the consequences of a massive housing bubble and the failure of many dodgy retail investment schemes. Yet a vibrant US can pick up a lot of slack in economic demand.

This can't last forever – nothing can. But the big question is how long can the US power on for? A couple more quarters? Six months? Eighteen? Years? If you knew that for sure, you wouldn't be reading this. You would be sipping mojitos on your island.

The way we see it, 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 the coming year. 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 that 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 meant adjusting our portfolio over the tail end of 2023 to be more defensive, which is part of the reason why we added to our healthcare stocks – people who need an important operation typically don't put it off unless there's absolutely no other option. This tends to make their sales more resilient during a downturn. We had also added to consumer goods companies that usually remain in the supermarket trolley regardless of the economic situation.

We continued this work in January, bolstering our holding in **Lonza**. This under-the-radar business is a Swiss pharmaceutical manufacturer that creates drugs and specialist medicines and nutritional supplements for other pharma companies that have the intellectual property but not the production capacity or the laboratory muscle. Lonza is a critical partner to many of the world's leading pharmaceutical brands in both drug discovery and outsourced production. The pharmaceuticals business has lots of rules and regulations – as you would expect – so Lonza has few global competitors. Its expertise in biologic drug development (using live substances like enzymes, viruses and proteins, rather than traditional chemicals) could help drive consistently strong organic growth. We think this should protect its sales in any coming economic downturn, while an ageing world and the consequent increase in healthcare spending should help Lonza in the years and decades to come. The company plans to appoint a new chairman – Jean-Marc Huët, the current chair of beer company Heineken, who we think should do a great job. We expect more management changes to come.

Meanwhile, US pharmaceutical companies have had a very strong start to the year, especially our holding **Merck**, which has helped our high healthcare position. Similarly, tech names have continued to perform well. High-end computer chip designer **Nvidia** was a stand-out, but so was chip printer manufacturer **ASML**. Its most recent profit figures felt to us like a 2023 Nvidia moment – when investors sat up and realised the business's potential. We are well invested across the semi-conductor/computer chip equipment supply chain, including contract chip maker **TSMC** and ASML's rival chip printer manufacturer **ASMI** at a time when orders should start to ramp up.

A risky world

Here in the UK — and in Europe to be fair — the economic picture looks darker than in America. That means the path of interest rates could deviate somewhat. Essentially, if the US economy stays strong and Europe (including the UK) slides into recession, we would expect rates to fall faster on this side of the Atlantic.

In mid-January I visited Frankfurt for brokers UniCredit and Kepler's German Corporate Conference where I got to meet and listen to a whole range of businesses. I always find these events useful, as they offer a good snapshot of all sorts of businesses — and this one is helpful because it's right at the beginning of the year. It's the time when company leaders are setting out their goals for the year ahead, before reality and the detail get in the way. You can see patterns and common themes more clearly when it's literally in front of you for a concentrated dose of a continent's commerce.

After seeing more than 10 company executives, one-on-one, across several different sectors, I got the sense that snagged supply chains and high levels of stock in warehouses were starting to improve after a long post-pandemic few years. This is perhaps more important to the large European countries, because so many of them are heavily involved in the physical, as opposed to the software giants of the US. It cast a more reassuring light on management — they seemed to feel more in control than in recent years, which is a heartening sign. That said, as I mentioned earlier, the outlook for Europe is not great. Yet there are some fantastic businesses here and they are trading on big discounts to their history and to other nations — particularly those in the US.

Another bubbling risk is the Middle Eastern conflict between Israel and Hamas. After four months of fighting, a cessation looks extremely unlikely. Instead, the conflict has spread across the region, with border clashes and rocket attacks crisscrossing the region, as far afield as Pakistan. The most-watched flashpoint is attacks on container ships in the Red Sea. An Iranian-backed rebel Yemeni army called the Houthis has been firing missiles at ships and boarding others in solidarity with Palestine. American and British forces have moved to prevent these attacks, yet major shipping companies have already stopped using the dangerous route typically taken by 15% of worldwide seaborne trade. The alternative means going the long way around the southern coast of Africa, adding time and costs.

This is a fluid situation, which could develop yet further. But as it stands we think the current situation won't encourage the US Federal Reserve to change course on monetary policy.

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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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