Rathbone Unit Trust Management

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Rathbones
Look forward

Rathbone Greenbank Global Sustainability Fund

Quarterly update September 2023

The US 10-year government bond yield – the global benchmark for valuing investments of all stripes – soared over the summer. From 3.84% at 30 June it ended September at 4.58%. And after quarter-end it surged further to 4.80% before abating. These are big moves in an important market that has had knock-on effects on global stock markets, including our fund.

Government borrowing markets are the bedrock for all longer-term interest rates in the economy. When a household or company wants a loan, a bank will take the long-term bond yield and then add a percentage on top to account for the risk of default and to make a profit. So what has caused such a wild ride in markets that should be relatively stable and calm? Inflation, particularly in the US, has eased and economic growth forecasts haven't changed all that much in the past few months.

A spike in the oil price above $90 a barrel may have fuelled concerns that inflation may come back for one last scare. Yet we're more of the opinion that a higher oil price should actually cool wider inflation because it's a tax on people and businesses. When you spend more on getting from A to B, there's less left over for buying other stuff, so overall demand should cool, alleviating inflation.

Signs of economic weakness are increasing around the world and inflation is generally falling, so it seems to us that the reason for the sharp uptick in bond yields is heightened uncertainty about the future.

	3 months	6 months	1 year	3 years	5 years
Rathbone Greenbank Global Sustainability Fund	-4.9%	-2.1%	3.2%	-2.2%	30.4%
IA Global Sector	-1.0%	1.4%	7.8%	21.0%	37.4%
FTSE World Index (GBP)	0.7%	4.6%	12.2%	34.9%	53.3%

	30 Sep 22-30 Sep 23	30 Sep 21-30 Sep 22	30 Sep 20-30 Sep 21	30 Sep 19-30 Sep 20	30 Sep 18-30 Sep 19
Rathbone Greenbank Global Sustainability Fund	3.2%	-22.5%	22.3%	24.7%	6.9%
IA Global Sector	7.8%	-8.9%	23.2%	7.2%	6.0%
FTSE World Index (GBP)	12.2%	-3.0%	24.0%	5.2%	7.9%

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

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

Wonder drug

Everybody loves a panacea. Relying on a simple salve to banish intractable troubles can be alluring, so there's always a wonder drug getting people excited. Yet I always think it's better to avoid taking a drug unless you absolutely have to. Chemistry and our bodies are complicated things, so we never know how they will react, especially over the long term. With medication you're often merely swapping one ailment for another, so it's best to be sure that it's a good trade.

The latest blockbuster drugs are next-generation diabetes and weight-loss injections developed by Danish firm Novo Nordisk and American pharma Eli Lilly (neither of which we own). These regimens use a formulation called GLP-1 to control blood sugar levels by significantly altering the activity of virtually every major organ in the body. It slows the rate that food is digested by the stomach, but increases insulin production in the pancreas, the absorption of sugar by muscles and the flow of blood from the heart. All of this has the effect of suppressing appetite in the brain. They have had very impressive results in helping people lose weight, although early indications show that people quickly reverse course once they come off the drugs. They also have some spicy side effects, particularly nausea, which is no surprise when you read up on just how much of the body it affects.

As I mentioned before, drugs often have long-term effects that simply won't be known for years to come. It's unclear whether that's even possible: about 30% of patients abandon the drug in the first year — half of those because of the side effects, according to research reports I've read. Over two years, other studies show fully half the patients quit the drug.

Despite this, customers and investors are getting very, very excited. Novo and Elli's share prices have both rocketed more than 65% in the past year at the expense of companies with existing treatments. Diabetes monitoring companies, like our holding Dexcom, which fell 30% over the quarter, have borne the brunt. We think this is well overdone, as glucose monitoring is an important tool for managing diabetes over the long term. A survey showed that, among Type 2 diabetes patients, the usage of glucose monitors — like those sold by Dexcom — *increased* after starting GLP-1 treatments. This is why we added **Abbott Laboratories** to our portfolio this quarter. Abbott is a name that we have owned in the past, and we have always admired the strength of its franchises in nutrition and diabetes care. We think that the market is undervaluing the opportunity in diabetes, in particular, where Abbott has strong positioning through its Libre arm patches that deliver continuous blood sugar monitoring. Added to this, we believe Abbott's comprehensive product portfolio should be particularly attractive in a slowing economic environment.

Meanwhile, big-bank stock analysts have started to extrapolate the implications of GLP-1 diet drugs deeper into markets. Airline profits are set to soar because lighter people mean less fuel burn. Restaurateurs' takings will slump because people won't be eating out as much. Presumably sales of nausea pills will pop as well, given the side-effects, but we haven't seen any news on that.

It will be years before the effects of these new treatments on people, lifestyles and markets can be discerned, yet a little too much of this has been frontloaded blindly into today's prices, we believe.

Technology is the future

We bought **Nvidia** this quarter. The company has long been a leader in the development of graphics processing units (GPUs) that are integral to creating the efficient and powerful computing power required to run data centres and high-end graphics and physics engines for computer games. Of course, there's something else that requires extreme computing power: artificial intelligence (AI). It's fair to say that excitement around generative AI has hit fever pitch this year and Nvidia has been at the centre of this. Despite the hype, we believe the company's valuation is actually not egregious, given that its earnings expectations have increased significantly since the beginning of the year. We think these estimates may underplay the opportunity for Nvidia to increase profits, too. The company has long invested in next-generation chip technology, with the expectation that artificial intelligence would gain traction. This focus has paid off for the business and established significant barriers against competition entering the space anytime soon. The management team have created an ecosystem that is hard to displace, at a time that uses for artificial intelligence are compounding quickly.

Another addition to our portfolio was US animal healthcare business **Idexx Laboratories**, which specialises in diagnostic tools for pets. The company's equipment allows vets to diagnose and treat a range of illnesses, many of which were previously hard to detect. There are multiple tailwinds in Idexx's favour: growing pet ownership, a relatively immature market for diagnostics, and the opportunity to cross-sell incremental software services to vets over time. Idexx has consistently grown its sales at a multiple of US GDP and generated strong profit margins, which we think reflects the quality of their products.

We sold our position in **Tomra**, the Norwegian recycling technology business. Tomra is the clear global leader in automated plastics sorting and recycling solutions and had enjoyed stellar growth until 2022. While the long-term opportunity for Tomra remains interesting, we became concerned about slowing adoption of deposit-return schemes in several markets (including the UK). The share price was still implying a more optimistic picture of profits and we saw better opportunities elsewhere in the industrial space. The move to a more circular economy that creates less waste is still a long-term trend and Tomra remains on our watchlist for future potential investment.

We also sold our holding in **DSM-Firmenich**, the Dutch-listed ingredients and flavours company. The merger between DSM and Firmenich was extremely exciting as it offered the potential for a globally comprehensive product portfolio with clear areas of improving efficiency and reducing costs. Execution, however, was not optimal and we became concerned about the level of senior management turnover at a critical time. Added to this, the demand for the company's products also weakened and we were unconvinced that pricing power in the business was strong enough to offset falling volumes.

We reduced our position in US water technology business **Xylem**, which had grown too large. We had previously owned Evoqua Water Technologies, which was acquired by Xylem. We think the combination of Xylem and Evoqua should be exciting given the scale of spending needed on global water infrastructure in the next 10 years. There is also significant potential to increase efficiencies and cut costs in this business too.

Invest for credibility

Tackling climate change will be the enduring task of our generation — and likely the next couple as well. Cleaning up how we power our societies and minimising the effects of rising global temperatures is as important as it is difficult and expensive.

Unfortunately, climate policy is complex, and it's difficult to know what's achievable. It's understandable when you have such a huge issue relying on decades-long milestones, cross-border agreements, assumptions about technologies that haven't been developed yet and large behavioural adjustments by billions of people. Sometimes you can get ahead of yourself and sometimes your assumptions are found to be unrealistic. Perhaps that's where the UK government believes it found itself, and why it's starting to unwind or delay many policies it had planned in order to achieve net-zero by 2050. These include scrapping energy efficiency requirements for residential landlords, delaying the ban on the sale of combustion-engine cars by five years to 2035 and extending the phase-out of gas boilers by nine years, again to 2035.

The government is adamant that its row-back won't affect the UK's legally binding commitment to reduce the nation's net emissions to zero in 27 years. Scientists and the government's independent advisory body, the Climate Change Committee, disagree. Bluntly, this comes down to politics, and who's going to pay for the transition to clean energy. Being happy to pay extra for everyday expenses is a luxury most people cannot afford. And helping them afford it tends to mean taxing the wealthy more to help subsidise those less well off. People struggling to pay the bills don't deal well with diktat and upheaval, and governments don't like approaching elections with promises to increase taxes.

With a cost-of-living crisis bubbling away, inflation stubbornly high and an election in the offing, an unpopular government thinks Britons simply cannot cope with what they are being asked to bear. Whether they could or not is sort of irrelevant, unfortunately, as it's another one of those assumptions — we won't know till it's tried. Rather than focusing on setting customer-focused goals like banning cars or types of heating, we would prefer the government was bold and ramped up support for supply of the technologies it wants people to adopt. To help make them better and cheaper so customers *want* to change, rather than allowing them to gripe that they are being forced to give up what they have.

The UK government's investment in the energy transition and the infrastructure it requires has been miserly over recent years, while the US, Europe and China have ramped up spending markedly. Here's a question: if roughly a third of British cars used electricity in seven years' time, would we have the grid capacity to power them, let alone with renewable electricity? UK renewable projects face tough planning hurdles as well as the longest wait in Europe to connect to a national grid. The same electricity capacity concern goes for replacing gas boilers with electric boilers and heat pumps. The UK desperately needs a plan to achieve its net-zero targets. It needs to be bold and imminent, but also credible.

David Harrison
Fund Manager

Rathbone Greenbank Global Sustainability Fund

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

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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