

# RATHBONE GREENBANK GLOBAL SUSTAINABILITY FUND

QUARTERLY UPDATE DECEMBER 2023

## **Counterintuitively, a gruelling 2023 was a good year for investment returns. Stock markets rose, while corporate bond prices rose rapidly as well.**

The driver of this strong year was a large fall in prevailing government bond yields towards the end of the year as investors first hoped for and then pre-emptively celebrated a 2024 of falling central bank interest rates, muted inflation and absent recession. It was an old-fashioned Santa rally: the returns came before the presents were handed out. The lower interest rates/yields are expected to be, the more future profits are worth to investors today, sending stock prices higher (especially those of high-growth companies that reinvest their earnings in hopes of larger profits years down the line). Similarly, if expectations of yet more rate rises resurface, all else equal, stock prices will fall back as those future profits are revalued.

The move in bond yields took most people by surprise – it was astonishingly fast. While, like many others, we thought that global interest rates – as set by the world's most important central bank, the US Federal Reserve (Fed) – had probably peaked in the late summer, there was some residual caution. Inflation, while bumpy, was clearly falling, even as global economic growth was holding up better than expected, yet the US economy was practically flying. That could fuel inflation or at least give the Fed pause before starting to cut rates.

Regardless, in December Fed Chair Jay Powell all but declared victory on inflation and lit the flares for guiding cuts in the first half of 2024 as long as inflation fell back to the 2% target. While rate cuts are no doubt on the horizon, we still think investors may be getting overexcited about how quickly they will arrive. Our view was reinforced by US inflation rising from 3.1% in November to 3.4% in December. We believe the path still tracks downward, but it shows how bumpy the road is likely to be on the final stretch to the target.

### **Yo-yo dieting**

During the third quarter and into October, investors worried that the next-generation diabetes and weight loss drugs using GLP-1 (glucagon-like peptide) technology would destroy every other healthcare business, leading to big falls in these firms' share prices. In the late fourth quarter, that faded. This drove very strong performance in a few of our companies, including diabetes monitoring equipment maker **Dexcom** and laboratory equipment supplier **Thermo Fisher Scientific**, which we had added to during the earlier sell-off.

We felt it was quite heroic to assume that next-generation weight loss and diabetes treatments will be silver bullets that eliminate obesity and all its attendant ills. While these GLP-1 drugs are certainly important and revolutionary new tools for combatting one of the greatest health challenges of our time, we think there will still be a need for glucose monitoring, surgery and other medical devices. Essentially, we think all these tools will be required to keep people healthy and to help those who fall ill. With many healthcare companies still trading at a discount to their recent history, we added to our holdings. Even UK mid-cap **Halma** was affected by the weight loss drug-driven sell-off, despite only one-third of its sales coming from its healthcare businesses and two thirds from environmental testing and fire and engineering fault detection. Because of this, we added to Halma as well.

Two firms, Denmark's Novo Nordisk and American pharma **Eli Lilly**, have developed the innovative GLP-1 drugs. We bought a position in Eli during the quarter, which makes the anti-obesity and diabetes management drugs Mounjaro and Zepbound. We have been consistently building our exposure to the healthcare sector throughout 2023, as we think valuations are extremely attractive on a long-term basis and see it as a sensible place to invest as the global economy appears likely to weaken. Like Novo Nordisk in Europe, Eli has benefited from a steep rise in its share price this year, yet we think its value still underestimates just how many potential customers it could have in the years to come.

With rates much higher than households and businesses have been used to for more than a decade, we expect higher borrowing costs and to bite in the coming year. Just as households are weighing whether to dispense with monthly subscriptions, to 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.

In advance of this, throughout the year we've adjusted our portfolio to be more defensive. This is part of the reason why we've been adding 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've also been adding to consumer goods companies that usually remain in the supermarket trolley regardless of the economic situation: toothpaste manufacturer **Colgate-Palmolive** and everything company **Unilever**.

**Performance review**

	3 months	6 months	1 year	3 years	5 years
<b>Rathbone Greenbank Global Sustainability Fund</b>	10.4%	5.0%	10.4%	-3.1%	60.7%
IA Global Sector	6.8%	5.8%	12.7%	17.9%	65.7%
FTSE World Index (GBP)	6.9%	7.6%	17.2%	32.8%	83.9%

	31 Dec 22-31 Dec 23	31 Dec 21-31 Dec 22	31 Sep 20-31 Dec 21	31 Dec 19-31 Dec 20	31 Dec 18-31 Dec 19
<b>Rathbone Greenbank Global Sustainability Fund</b>	10.4%	-24.1%	15.6%	32.5%	25.1%
IA Global Sector	12.7%	-11.1%	17.7%	15.3%	21.9%
FTSE World Index (GBP)	17.2%	-7.2%	22.1%	12.7%	22.8%

Source: FE Analytics; data to 31 December, S-class, mid price to mid price.

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

Also, in a world of higher inflation and scarce profit growth, American digital technology companies have led the way in recent years. We think these companies should also hold up better than most in a recession because they offer quality – and often indispensable – services to such a large spread of households and businesses with relatively low costs when you look at the scale of their customer base. With this in mind, we added to our holding of digital office and AI business **Microsoft**. Our digital technology investments now make up almost 25% of our fund.

Another more defensive company is German smartgrid utility **E.ON**. We bought the company for the first time in October as it has one of the largest energy infrastructure networks across Europe, primarily in Germany, but also in Sweden and the Czech Republic. E.On is investing significantly in renewable energy and we think its announced long-term investment plans are well thought through. An attractive regulatory framework set up to incentivise investment in the development of infrastructure to support the greater use of clean energy should also help provide a nice tailwind to earnings in the next several years.

**Looking for low debts and high cash generation**

With caution in mind, we kicked the tyres on all our companies, reviewing how they should fare in a downturn. After our review, we decided to sell our position in Finnish lift business **Kone**. While Kone has always been a highly cash-generative franchise, it has significant exposure (about 40% of its profits) to China. Historically, this was attractive, as China represents one of the true growth markets for lifts, given the huge number of large buildings it has thrown up. We have become concerned, however, about prospects for the Chinese construction market in 2024 and see more attractive opportunities elsewhere. We will keep Kone on our watchlist for the future.

We also sold our position in Japanese electric motor manufacturer **Nidec**. Disappointing sales growth twinned with poor explanations from senior management. Unfortunately, we struggle to see either of these factors changing in the medium term, so we sold. We see much better industrial opportunities elsewhere, so we used the cash to top up UK safety equipment manufacturer Halma and German warehouse equipment supplier **Jungheinrich**.

While the US economy hums along, the rest of the major economies aren't looking so hot. UK, Europe and Asia have faded. And while that fade hasn't been as bad as many expected, it's stark when compared with the US. These divergent paths – and the divergent central bank rhetoric – are causing some large swings in both stock and bond prices as investors weigh up the relative rates of return on offer in different regions.

Here in the UK, with inflation at 3.9%, the Bank of England (BoE) is adamant that it won't be cutting interest rates anytime soon – in fact it's still leaning toward more hikes than cuts. That's despite the economy brushing against recession and many households struggling as some refinance mortgages at treble the monthly payments and others pay stratospheric rents. Bond investors aren't buying it: UK government bond prices now imply a 25-basis-point cut to 5.0% by May and a roughly 1.4% drop in the BoE's bank rate over the whole of 2024. We are also sceptical, and think that the BoE will have to ease pressure on households and businesses if recession sets in during the first quarter and unemployment starts to rise.

Europe is in a similar position following the Fed's 'pivot' to more accommodative policy. Like the UK, its central bank is on a 'higher for longer' footing even as its economy struggles. And also like in the UK, investors are expecting the European Central Bank to fold and begin cutting rates in early 2024. China fell into deflation in the summer, i.e. general prices for goods and services are falling, rather than rising. China is struggling with a massive property bubble where developers, local governments and households have borrowed huge amounts to build and buy millions of speculative properties that no one needs. Some aren't even finished. Deflation makes those debts grow in real (inflation-adjusted) terms. The deflation is partly caused by the heavy overhang of debt, but it also makes the burden of those debts worse. In short, it starts a toxic feedback loop which hamstring economic growth.

More than ever, the US seems to be the sole engine of economic growth. This may well encourage investors to put yet more money into the sunny uplands over the Atlantic and shun now heavily discounted markets elsewhere.



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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.

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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