RATHBONES

RATHBONE INCOME FUND

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"When you're a carpenter making a beautiful chest of drawers, you're not going to use a piece of plywood on the back, even though it faces the wall and nobody will ever see it. You'll know it's there, so you're going to use a beautiful piece of wood on the back. For you to sleep well at night, the aesthetic, the quality, has to be carried all the way through."
Steve Jobs

A few months into the COVID pandemic, a colleague commented on a novel positive. Working from home gave him time and space to think. It afforded opportunities to read deeply and to get his thoughts in order. He wasn't being rushed into hasty decisions and was spared the myriad distractions of traditional office life. Of course, this alone time with the mind was an immense hardship for many. But for some, it did create an opportunity to do what we so rarely get the chance to do — to go deep.

We're all thankful that those awful pandemic days are behind us, but have we lost something valuable in our return to normality (whatever that may be)? While it is interesting to ponder what this means for us, we can also draw parallels with the strategic imperatives of our companies.

Slow productivity
Cal Newport, computer science professor at Georgetown University in Washington DC, is a regular contributor to the New Yorker magazine, and the scribe of eight best-selling books. He's perhaps best known for his particular focus on the distractions of the digital world, with titles like *A World Without Email* and *Digital Minimalism* to his name. When you're sitting at your desk, with one or more computer screens in front of you, are you really concentrating on the job at hand? Or do your eyes flick up to your email feed or to the notification on your phone or smart watch? Can you resist the temptation to turn to the internet because some random thought has popped into your head? Are you constantly scanning your price feeds to check you're not missing the latest thing impacting markets?

All these diversions and distractions, which occur over and over again, break concentration on the job at hand. In his latest book, S*low Productivity*, Newport discusses the modern office environment. He rejects the idea that attending virtual meeting after virtual meeting or reading and responding to email after email constitute a sensible use of time. It's being busy for being busy's sake. It is all to easy to give the impression of endeavour, or what he describes as "pseudo-productivity", with multiple digital distractions conveniently in place. Newport's gentle remedy for the modern malaise is as follows: do fewer things; work at a natural pace; and obsess over quality.

This letter is not intended as a manifesto for modern day working practices. But we do think it's useful to consider how Newport's principles are reflected in what we learn when we speak to our companies. It would be wrong to contrive too strong a causal link between adherence to the principles and business success. Yet they do seem to echo some of the practices that our companies tell us they're espousing so we think it's worth digging a bit deeper.

Do fewer things
The Pareto Principle states that, in many cases, 80% of outcomes or consequences come down to the influence of just 20% of causes. And this is the reality for most businesses. We have focused a lot recently on **Unilever** so we don't want to go over too much old ground, but the emphasis placed by the new CEO Hein Schumacher to do fewer things, but better, by focusing on its power brands, echoes this principle. A limited number of 'Power Brands' are the most profitable and can be delivered most efficiently so Unilever aims to emphasise them most and to spend less time on more peripheral lines. The company's recent numbers, alongside its decision to relinquish the ice cream business, show progress towards these goals.

We're seeing a similar trend in the pharmaceutical industry. Emma Walmsley, CEO at **GSK**, has overseen the divestment of its consumer healthcare business **Haleon**, on the way to creating a pure-play pharmaceutical business. The driver for recent success has been concentration on four therapy areas: infectious diseases; HIV; respiratory/immunology; and oncology. The result has been a steady improvement in profitability which has translated into very strong share price performance since we reintroduced the shares back into the fund at the end of March last year. In a similar vein, **Novartis** has also reaped the rewards of a multi-year transformation of its portfolio and its re-engineering as a pure-play innovative medicines business. This has brought step-changes in its margins and free cash flow generation. In each case, these businesses' decisions to get smaller and to sharpen focus on what really matters are beginning to bear fruit.

Work at a natural pace
It can be dangerous to get too caught up in a long-term story. As investors, this can lead to complacency and a failure to be critical enough in assessing the risks inherent in any investment. This was one of the many lessons we learnt almost 20 years ago during the global financial crisis. But we do think that some of the greatest businesses have a long-term vision which they stick to come what may. **Games Workshop** is one such enterprise. We make no apology for so frequently quoting from its annual reports. Take its latest:

"Our ambitions remain clear: to make the best fantasy miniatures in the world, to engage and inspire our customers, and to sell our products globally at a profit. We intend to do this forever. Our decisions are focused on long-term success, not short-term gains."
Games Workshop, Annual Report, 2023.

It's taken decades to get the business to where it is now and to achieve its fertile mine of intellectual property, encapsulated in the models, books and games that so entrance its global clientele (and have attracted the attention of a content-hungry Amazon). Great businesses take a long time to truly blossom.

Obsess over quality
Obsessing over quality does sound like one of those answers that people give when they're asked at job interviews to name their biggest fault ("I'm just too much of a perfectionist" or "Sometimes I just work too hard"). We all realise that in business, compromises do have to be made. There's no point making the best widget ever if it's too expensive for your customers to afford or so good that it'll never need be replaced. However, there is a romance about this notion of obsession. Influenced by his adoptive father Paul's skills as a handyman, Steve Jobs famously obsessed over perfectionism and quality behind surface appearances, whether that was something as rudimentary as building a wooden fence with his dad, or as complex as the inner workings of an iPhone. Of course, everyone – even the great Steve Jobs – can make mistakes.

But, as investors, how much excellence should we demand from our businesses? And how do we even measure it?

Materials technology business **Vesuvius** is by no means the perfect company, but quality is paramount to its success. It provides high technology solutions to industrial customers including global steel manufacturers and foundries, whose workers operate in dangerous and challenging high temperature environments. Quality has, quite simply, life or death consequences. Vesuvius maintains its position at the forefront of its industry through its investment in research and development. The 2% of annual revenues it spends on technological leadership and product differentiation, often embedding its research teams within its customers' workforces, epitomises a focus on quality. That not only ensures operator safety, but also consistently improves the quality of the high technology steel products at the forefront of much industrial manufacturing.

Beyond basic busyness
We may aspire to endow investing with a heavy patina of academic rigour, but in the end we're all dealing with the nuts and bolts of real life. Academics like Cal Newport tend to focus on specific people and environments, like knowledge workers in hybrid offices, but the principles he advocates do have relevance for broader business and investment themes. Bigger is not necessarily better (the era of 1980s-style mega-conglomerates is way behind us, after all), but too often companies still argue the case for diversification away from their core expertise.

Operating at a natural pace may seem like a quaintly old-fashioned view of working life, but it can be a valuable counter-balance to overly short-term influences on decision making. Very few companies truly exhibit the innate confidence that prevents them getting distracted by the hurly-burly of quarterly reporting schedules. This is at odds with the undeniable truth that successful equity investment often depends on the patient compounding of returns over many years. Investment decisions demand time and space to reach maturity.

This philosophy dovetails perfectly with our search for quality – not necessarily perfection, but a sense of endeavour and detail that is often neglected in today's click-bait world of instant gratification. These ideas resonate deeply with us because they seem to be sensible anchors for the type of portfolio that we want to manage, and the outcomes we seek for our clients. In the end, there should be much common ground between our disciplines and those of the companies in which we invest.

Recent trading: We have reduced our holdings in **Shell**, **Lloyds Banking Group**, **Rio Tinto**, and US tobacco giant **Altria**. Funds were re-allocated to **IG Group**, **National Grid**, **Assura Group** and Unilever.

Companies seen this month: The first-quarter earnings season inspired many results webcasts, but no direct company contact.

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Find out more about the Rathbone Income Fund by watching this webinar and also these videos in which Fund Manager Carl Stick explores the implications of increased longevity.

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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