RATHBONES

RATHBONE GREENBANK GLOBAL SUSTAINABILITY FUND

QUARTERLY UPDATE MARCH 2024

At the back end of last year, investors were confidently forecasting six or seven interest rate cuts from the US Federal Reserve (Fed) in 2024. They've since reined those bets in big time and currently think the Fed will deliver about two 0.25% cuts – if that – perhaps starting in the autumn.

That about-turn has driven big moves in government bond markets. Government bonds are the asset class most sensitive to rate expectations, so it's hardly surprising that their yields have risen, driving their prices down. And yet stock markets have hardly blinked so far this year as rate cut bets have been aggressively pared back. It seems that investors have got a lot more comfortable about higher-for-longer rates. Who needs cuts when America's economy keeps defying recession forecasts and is booming instead?

As we've mentioned before, 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. Providing company profits prove sustainable, stocks can probably keep rallying for a while longer. Stronger profitability would tend to imply a better economy and, therefore, less pressing need for those ever-elusive rate cuts. Stock market bulls also argue that gains are getting broader, and less alarmingly concentrated. In contrast to the first 10 months of 2023, when an unusually small number of stocks were responsible for the gains of the entire US index and most underperformed, more global companies are participating in this year's rising markets.

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 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 has meant adjusting our portfolio over time to be more defensive.

From pastime to paradigm

You wouldn't be too far wrong if you said that computer chip designer **Nvidia** *was* the market this quarter. It seemed like everyone was waiting for its results and the S&P 500 Index was a flock of sheep following its bellwether. In the first quarter, Nvidia's share price soared 82%, while the S&P 500 was up 11%. Nvidia accounted for almost a quarter of the index's total gain in Q1.

This huge increase in the price of Nvidia's shares wasn't driven by hype. It was underpinned by a more than 400% rise in its quarterly earnings per share compared with a year earlier. This surge in profits means that despite Nvidia's soaring share price, its price-to-earnings multiple (at 35x next year's forecast profits) is roughly half what it was in the second half of last year. Without Nvidia's profit growth, the S&P's information technology sector's Q1 profits would have gained just 8% on the previous year. With Nvidia, the sector — which is stacked with some of the world's largest and most successful companies — made 20% more.

However, Nvidia was just the posterchild for a wider dawning of AI. Most companies in the AI supply chain gained as well. Businesses that print the chips, like **Taiwan Semiconductor Manufacturing Company**, those that sell the intricate machines that allow companies to make chips, like **ASML** and **ASM International**, and companies that sell AI tools, like **Microsoft**, have performed very well this quarter as well (we own all of these). To roll out AI as expected, there needs to be huge investment in the infrastructure: in the data centres and servers that deliver the computing power AI requires. Because of exponential improvements in computing power from year to year, the life cycles of these AI-enabling data centres are decreasing. Meanwhile, rampant demand is driving the need for more. More chips are needed each year to go into the centres today, and better ones need to be ready for replacing them in years to come.

This has all the hallmarks of a step-change in technology akin to the Industrial Revolution and the creation of the internet. And that means great opportunities and great risks. Moments of change like this often make fortunes and squander others. It's very easy for people and businesses to get overexcited and overbuild, creating a glut that upends prices and profits. Sometimes businesses simply find themselves with the wrong business model. Everything is new, so no one knows just how many chips we will need, what the most lucrative part of the business will be, or what pitfalls lurk in an AI-enabled future.

We have spread our investments across the AI supply chain, owning the chip designers, the chip makers, the companies that make the printers for the makers, and the businesses selling AI tools to households and businesses. The steady and punchy increases in sales across all parts of the AI supply chain show that this is no longer just over the horizon, this is happening right now.

Performance review

	3 months	6 months	1 year	3 years	5 years
Rathbone Greenbank Global Sustainability Fund	9.7%	21.1%	18.5%	8.5%	60.7%
IA Global Sector	7.8%	15.2%	16.7%	23.2%	62.7%
FTSE World Index (GBP)	9.6%	17.1%	22.5%	39.8%	83.9%

	31 Mar 22-31 Mar 23	31 Mar 21-31 Mar 22	31 Mar 20-31 Mar 21	31 Mar 19-31 Mar 20	31 Mar 18-31 Mar 19
Rathbone Greenbank Global Sustainability Fund	18.5%	-10.7%	2.5%	44.6%	2.4%
IA Global Sector	16.7%	-2.7%	8.4%	40.6%	-6.0%
FTSE World Index (GBP)	22.5%	-0.7%	14.9%	39.9%	-6.0%

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

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

Fine-tuning our portfolio
As part of our steady shift towards a more defensive positioning to protect against any slowdown later this year or early next, we've moved more of our portfolio into healthcare and pharmaceutical stocks. People tend not to economise with their health, which tends to make sales more resilient during a downturn. 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.

Finally, 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 the disruption to normal wind patterns caused by El Niño.

DAVID HARRISON
Fund Manager

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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