..Professional Investors Only

JOHCM UK Equity Income Fund

Monthly Bulletin: August 2022

Fund Overview

- The Fund aims to generate long-term capital and income growth through active management of a portfolio of UK listed equities.
- Established income investors James Lowen and Clive Beagles abide by a strict dividend yield discipline, which leads to an emphasis on higher-yielding stocks and promotes a naturally contrarian style.
- The Fund will typically have significant exposure to small and mid-cap stocks, often giving the portfolio a different holdings profile to many other income funds.
- Benchmark: FTSE All-Share Total Return Index.

Active sector bets for the month ending 29 July 2022:

Top five

Sector	% of Portfolio	% of FTSE All-Share	Active %
Life Insurance	9.79	2.52	7.26
Industrial Metals and Mining	13.17	6.52	6.65
Construction and Materials	6.62	1.39	5.23
Household Goods & Home Construction	6.00	1.24	4.76
Media	7.24	3.19	4.06

Bottom five

Sector	% of Portfolio	% of FTSE All-Share	Active %
Pharmaceuticals & Biotechnology	0.00	11.27	-11.27
Personal Care, Drug and Grocery Stores	0.00	7.36	-7.36
Closed End Investments	0.00	6.42	-6.42
Beverages	0.00	4.04	-4.04
Tobacco	0.00	4.00	-4.00

Active stock bets for the month ending 29 July 2022:

Top ten

Stock	% of Portfolio	% of FTSE All-Share	Active %
NatWest	3.75	0.54	3.22
ITV	3.29	0.12	3.17
Glencore	5.62	2.51	3.11
Phoenix	3.25	0.20	3.06
Barclays	4.11	1.07	3.04
Vistry	3.12	0.09	3.03
Legal & General	3.66	0.65	3.01
DS Smith	3.15	0.16	3.00
BP	6.10	3.18	2.92
Paragon Banking	2.87	0.05	2.81

Bottom five

Stock	% of Portfolio	% of FTSE All-Share	Active %
Diageo	0.00	3.72	-3.87
Shell	2.61	6.81	-4.21
Unilever	0.00	4.30	-4.30
HSBC	0.00	4.41	-4.41
AstraZeneca	0.00	7.19	-7.19

Performance to 29 July 2022 (%):

	1 month	Year-to-date	Since inception	Fund size (£m)	Strategy size (£m)
Fund – A Acc GBP	**4.38**	**-3.40**	**314.70**	**1,899.9**	**2,226.4**
Lipper UK Equity Income mean*	3.72	-2.16	197.36		
FTSE All-Share TR Index (12pm adjusted)	3.92	-0.66	224.83		

Discrete 12-month performance (%) to:

	29.07.22	29.07.21	29.07.20	29.07.19	29.07.18
JOHCM UK Equity Income Fund – A Acc GBP	1.92	-0.06	50.00	-25.29	-9.52
FTSE All-Share TR Index (12pm adjusted)	5.23	-5.03	24.84	-16.81	1.33

Past performance is no guarantee of future returns. The value of an investment can go down as well as up and investors may not get back the amount invested. For further information on risks please refer to the Fund's KIID and/or the Prospectus. Source: JOHCM / Lipper Hindsight. NAV per share calculated net of fees, net income reinvested, 'A' accumulation share class in GBP. Performance of other share classes may vary and is available on request. Inception date: 30 November 2004. Index return is net income reinvested, adjusted for 12pm. * Initial estimate for the Investment Association's UK Equity Income sector.

Economic developments

"While another unusually large increase could be appropriate at our next meeting, that is a decision that will depend upon the data we get between now and then."

- Jerome Powell, 27 July 2022

Despite the Federal Reserve increasing interest rates by 75 bps at last month's (July) meeting, market participants began to speculate as to whether the change of tone and language, signalled a Fed "pivot" away from aggressive monetary tightening. Indeed, Powell described current policy as now having reached "neutral", which suggested they felt they were no longer behind the curve. This might look optimistic given June's CPI, up 9.1% on the year and 1.3% on the previous month. But the core measure, excluding food and energy, was up less significantly at 5.9% year on year and there are numerous indications around that in many respects inflationary expectations may have peaked. Oil and copper are both 25% lower than their 2022 peak levels and freight rates have fallen back even more substantially. Activity in housing is slowing quickly in response to higher mortgage rates, with new home sales down 8% and existing home sales down 5% in June. Whilst it still feels likely that the Fed will move rates higher again in September, the pace of increases feels likely to slow with 2-year bond yields now below 3% having peaked at 3.43% in mid-June. The fall in US GDP in Q2 of c. 1% still looks somewhat high relative to the experience being reported by companies, or to the tight labour market, but regardless it adds to the sense that the Fed are no longer chasing inflation.

In the UK the picture is not dissimilar although inflationary pressures are a little more elevated, hitting 9.4% in June. Excluding energy, this number was 6.2%, flat vs the prior month, but unfortunately the energy issue is unlikely to improve in the short term and may drive CPI towards 11% later this year. However, despite these pressures, the economy has shown some resilience, with May's 0.5% growth GDP signalling that the economy is unlikely to have contracted in Q2 despite the impact of the extra Jubilee bank holidays in June. The latest PMI services reading of 53.2 also suggests continued moderate growth for the largest sector in the UK but clearly parts of the retail sector are suffering, particularly those that benefitted from a boom during the COVID lockdowns. UK labour markets remain tight. Employment growth is beginning to slow but vacancy levels remain high. Encouragingly the participation rate has begun to rise (up 0.5% to 63.5%) as higher wages and cost-of-living pressures drive people back into the active labour force.

In continental Europe, the irony of a simultaneous change in strategy by the ECB via a 50 bps rate increase, combined with the launch of their latest bond-buying anti-fragmentation tool, and yet another political crisis in Italy, is stark. In the short term, GDP prints across the region for Q2 beat expectations, but availability of gas supplies has become the critical issue for business and consumer confidence and it feels like there will be plenty of volatility on that front over the coming months.

Performance

The UK market had a better month in July, rallying off a mid-month low point to finish higher, with the FTSE All Share total return index rising 3.92%. The fund modestly outperformed during the month, recording a return of 4.38%. Year to date the fund is down 3.40%, behind the index return of -0.66%. Looking at the peer group, the fund is ranked 3rd quartile within the UK Equity Income sector so far in 2022. On a longer-term basis, the fund is ranked 2nd quartile over five years and 1st quartile over three and ten years and since launch (Nov 2004)*.

* Source: Lipper Hindsight

The mid-month rally also saw a pivot in the market, with defensives underperforming and cyclicals and financials outperforming. This was likely supported by the robust results season in the cyclical / financial sectors, a factor also clear across large parts of the Fund. It was likely also supported both by the low valuations in these sectors and by the perception of softening in the Fed's language.

The standout of the results season thus far has been the banks sector, with very strong (above forecast) income driven by rising interest rates, provisions remaining low and costs under control. All banks announced incremental capital returns in the form of buybacks or special dividends. **NatWest Group** was the strongest across all measures, up 15% relative over the month. Most of our holdings either met or beat forecasts, with only one stock downgrading its guidance – **Curry's**. In retail, where our holdings are modest at a combined 4% of the Fund (**DFS**, **Curry's** and more tangentially **Lookers**), we are balancing near term forecast risk with long term value. The theme across the holdings is high market share (in 2 of the 3 names c. 30%+), strong balance sheets (in 2 of the 3 names net cash) and omnichannel leadership. Lookers actually upgraded profit guidance at the end of June and as we have discussed before is trading below its property value and has seen an industry competitor acquire c. 20% of its outstanding capital in January of this year around 35% above the current screen price. Any bid for the whole company would have to be materially higher than this transaction was struck at. All of these names, given how lowly valued they are, have material upside.

Small cap's were generally weak in July, though with a distinct lack of any (negative) fundamental drivers. We expect them to see a delayed recovery, if the comments on the market generally and market mix noted above are sustained.

Drax recovered (up 18% relative) following underperformance in previous months on concerns over windfall taxes. Liz Truss, the most likely victor in the Conservative leadership contest, has clearly ruled them out. **ITV** also recovered (up 10% relative) following stronger results and a clearer articulation of its new strategy. Both our housebuilders were also strong.

Portfolio activity

As we have highlighted for several months, it is hard to find sell ideas given the materiality of the upside that currently resides in the Fund, which itself is a function of the ultra-low valuations across the parts of the market in which we are invested. The recovery in markets from the middle of July, if continued, will start to change this dynamic.

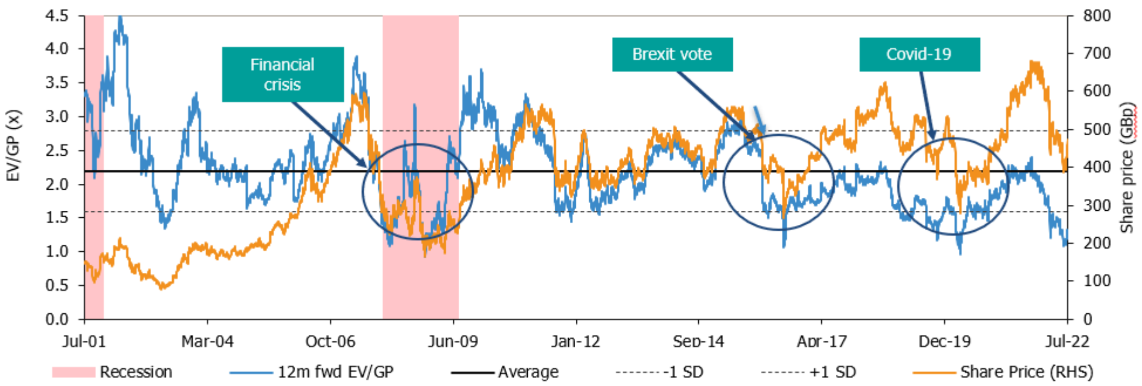
We finished selling our position in **Tesco**. The stock has done well, in relative terms in recent months due to the general rush to perceived safety, which we have seen across the market. Over the course of the Fund's ownership it contributed c. 60bp of relative performance. The stock was at the edge of the valuation envelope within the Fund on a PE of 12x – whilst this does not sound high in an absolute sense, on average the stocks in the Fund sit at around half this level. Whilst viewed as defensive, we think there are risks to Tesco's earnings profile as cost pressures are high, while there is limited flexibility to pass this on due both to competition from other retailers and the sector's significant public profile at a time of food-price inflation. We note that Morrison (now in private ownership) and Walmart in the US have had several profit warnings.

A number of stocks that performed well during the month hit our 300bp maximum position and we top-sliced accordingly (**ITV**, **Natwest**, **Vistry**, **Phoenix**). Readers will note some positions ended the month just above 300bp, reflecting imminent ex dividend dates, which will lower the weightings. This is particularly the case for Natwest, which saw its share price up 8% on the last day of the month following its results which included a special dividend of c. 17p which is around 7% of the current market capitalisation.

We continued to build up recent additions to the Fund, namely **Land Securities**, **Tyman**, **Lancashire** and **Ashmore**. These collectively are now 250bp of the Fund. We will continue to build all four of these holdings as prices allow. We also added one new name to the Fund, which we will discuss in more detail in future months after establishing a fuller position. This stock is a market leader whose value has halved over the last year. It is now on a PER of 6x, a 7%+ yield and has net cash equal to 30% of its market capitalisation.

As noted above small caps were generally weak and did not participate in the rally in the wider market in the second half of the month. We generally added to these names including **DFS**, **Kenmare**, **Savannah Energy** and, as noted above, Tyman.

A number of other stocks were weak and we added to them. **DS Smith**, which had good results at the end of June, is now on a PER of 8x and **Redde**, which likewise had strong results at the beginning of the month, on a PER of 7x, fell into this category. We have pointed out elsewhere and in previous reports that the market as a whole – in terms of the rating differential between cyclicals and defensives – which is at its widest ever – is discounting a material fall in earnings. This is also very clearly shown in the chart below, which shows the evolution of the share price of **Page Group** and its valuation – another stock added to during the month. The valuation represented by the blue line, enterprise value to gross profit, is at a low point. Equivalent low points were posted in the financial crisis, for a few weeks around the Brexit vote and during Covid, ie the share price is discounting a material slow down. What is also clear from the chart is the shares tend not to stay at this level for long and recover very strongly and quickly after the low point has been reached.



Source: HSBC

Outlook

As highlighted in the first section, how markets perform from here for the balance of 2022, will depend largely upon whether investors feel Central Banks are no longer behind the curve. The less aggressive language from the Federal Reserve suggests that there may now only be one or two more rate rises in 2022 and whilst it is premature to start speculating on whether there may be monetary easing in 2023, this inflection point is highly significant all the same.

Of course, in the meantime corporates are likely to report slowing activity but as we have shown above, in many sectors we believe this is already discounted. Valuations of many cyclical sectors had not recovered from the COVID-induced shock before investors moved on to worry about a slowdown driven by higher energy costs and the impact on the cost-of-living. As such we continue to find many attractive stocks on highly attractive multiples across a wide range of sectors.

Inevitably, if we have seen peak bond yields in the short term, many investors will wonder whether that means they should be looking to allocate more capital to “growth” sectors given the de-rating they have seen. We would still point out that, despite their de-rating, growth stocks and sectors still look abnormally richly priced relative to names found in the "value" part of the market. Interest rates are unlikely to return to zero again and, as such, relying upon the relationship established between growth and value since 2008 may be dangerous. Given the heavy de-rating seen by many of our stocks since the war in Ukraine started, it feels like these are the sorts of stocks that can recover more significantly if investors begin to worry less about a deep recession brought about by Central Bank tightening. We continue to believe many investors are too focused upon a potential real GDP recession rather than thinking about the healthy rates of nominal GDP growth still being experienced, which in many cases are more important for corporates' earnings.

The Fund continues to be populated by very modestly valued stocks, most of which have seen, as of yet, very little slowdown in their businesses. Whilst that is likely to occur for many during the second half of 2022 (and is being forecast), with the Fed having changed its tone and with recession priced into many sectors, we continue to see a highly attractive risk/reward set up.

Further information

If you would like further information about the Fund, please call our Investor Relations team on +44 (0) 20 7747 8969, email us at info@johcm.co.uk or visit our website at www.johcm.com

The annual management charge is deducted from the capital of the Fund. This will increase the income from the Fund but may constrain or erode potential for capital growth.

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Sources for all data: JOHCM/Bloomberg (unless otherwise stated).