J O Hambro
Capital Management Group

JOHCM UK DYNAMIC FUND

UNDER THE BONNET

Q4 2022 REVIEW

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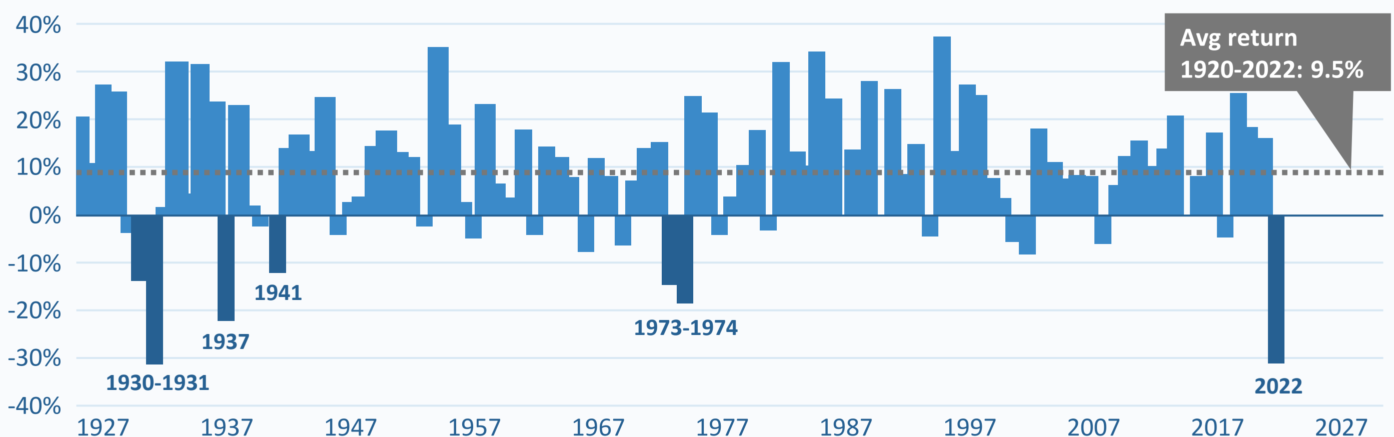
INVESTMENT BACKGROUND

Investing in 2022 was difficult. Very difficult. It was a year when the very basis on which capital had been allocated for a generation of investors was fundamentally challenged. A year where the effects of years of monetary largesse combined with the supply shocks of a global pandemic and war on the borders of Europe to ruthlessly implant the word 'inflation' back into the investment vernacular.

A year where central bankers and economic policy setters were woken from their collective QE slumber and inserted straight into a tightening race to normalise rates and to get ahead of the inflation curve. A year for bond yields and interest rates that therefore ended very differently to how they started, perhaps most starkly represented in Germany where the 10yr government bond yield started the year at -0.18% and ended a mere 275bps higher at 2.57%. In the US the target Federal Funds rate started at 0.25% and by mid-year was at 1.75% with a year-end target of c.3.50%. Inflation prints continued to surprise to the upside however and so the rate ended the year at 4.50%, a level not seen since 2007. The market now predicts a peak for this cycle of 5.0%. Having been behind the curve all year, what chance a policy error is now being made?

In performance terms it was a rare year where bonds and equities fell in unison – the average 60:40 fund endured the worst year since the 1970's (Source: BofA Global Investment Strategy) – where seemingly all geographies moved together and where, within each asset class, a positive absolute performance was difficult to achieve. Growth, technology and momentum suffered, taking with them the performance of so many ESG and thematic investment baskets. The Nasdaq 100 TR index fell 32.7%, the MSCI All Country World index fell 19% (in USD) and the S&P 500 TR fell 18.1%. In the UK the FTSE All Share Index TR stood out, rising by 0.3% over the year with the FTSE 100 TR index taking the lead rising by 4.7% against a 17.4% decline for the FTSE 250 TR index.



Source: BofA Global Investment Strategy, GFD Finaeon. 2022 estimate is annualised as of October.

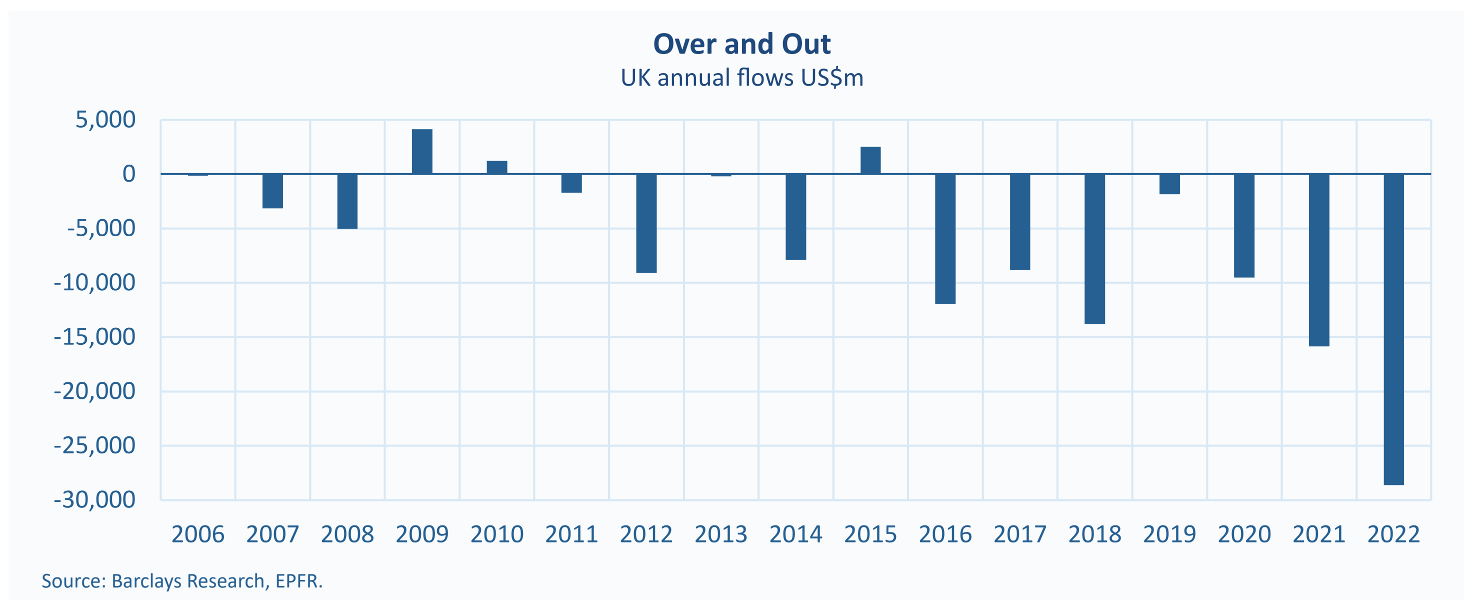
And yet in many ways, it was a necessary year. Investment principles that had so long been ignored suddenly mattered again. Actual, not predicted results mattered (the dreaded 'TAM' acronym can be consigned to history for another cycle). Cash generation mattered. Historic financial performance mattered. Business qualities and balance sheets mattered. Most importantly, valuation mattered.

Some things did not change. The UK remained at the bottom of investors' lists, despite falling to a PE of c 8x by the beginning of Q4 and being at a 33% discount to its 10-year median, a discount only beaten by Italy (40%). Indeed Italy was the country with which the

UK suddenly became compared during four weeks of political and economic madness ('Trussonomics') between September 23rd and October 25th.

Rishi Sunak's appointment as UK prime minister on the 25th October served to calm markets. The UK 10-year yield had spiked up to 4.5% in October and the GB Pound collapsed to near parity with the US Dollar. By year-end, sterling was back at 1.21 and the 10 year Government bond yield had retraced to 3.67%.

Whilst some calm had definitely been restored, as a consumer and financial services led, import reliant economy, the triple threats of the energy crisis, the self-induced political crisis and GBP weakness was too much for investors to bear. Despite the blatant value emerging in UK equities (and indeed all equities) the market remained in outflow mode in Q4 leaving 2022 set to be one of the worst years on record for UK flows (see chart below).



Consumer sentiment in the UK remains in the doldrums - the GFK consumer confidence index spent the last 8 months below -40 for the first time in the 50-year history of the index. Employment trends have remained relatively strong through the year and in Q4 signs emerged of more resilience in spending trends than sentiment surveys would suggest. Coupled with early signs of a peak in inflation data, in particular with energy prices in Europe falling markedly, and with mortgage rates ending the year on a downward trajectory, sentiment in the UK ended the year with a more positive tone. Whether that endures into 2023 remains the big question.

STRATEGY UPDATE

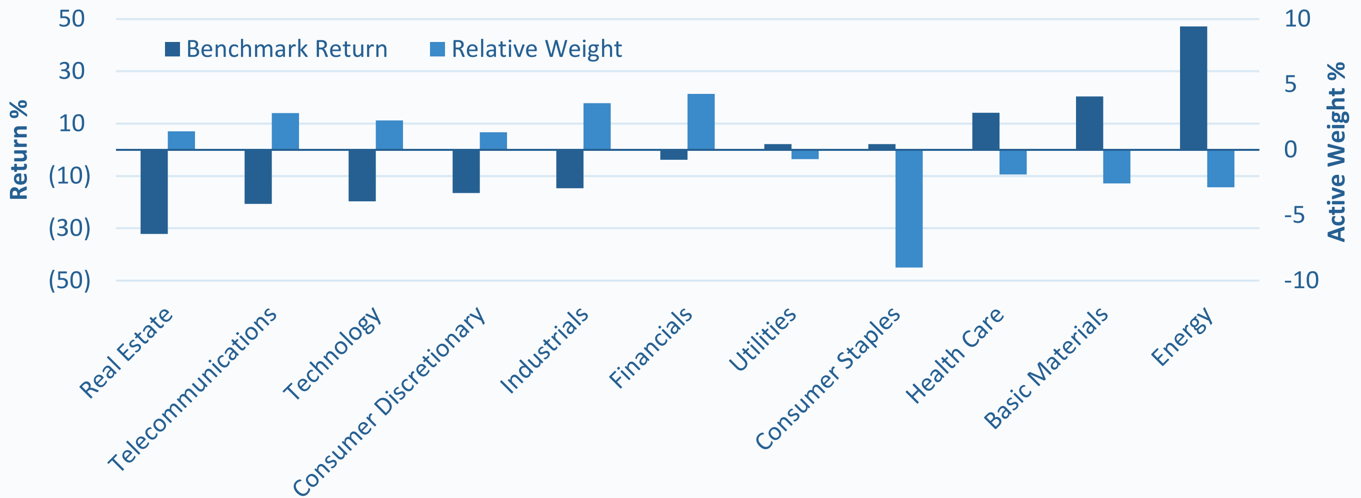
It is with no irony that we say we are proud to have finished the year with the Fund up 1.83%. This was one of the hardest years in which to manage money that some of us on the team can remember. And that includes the COVID years and GFC years where it was perhaps easier to understand the directional trends, and predict what might happen next, particularly with the support of central bank monetary policy and government fiscal policy.

We are proud therefore to have finished the year up in absolute terms, the result of a strong fund and market recovery in Q4 as external financial conditions eased somewhat. The benchmark FTSE All Share TR index (12pm adjusted) rose by 9.11% in Q4, whilst the fund rose by 13.21%, a 3.76% relative outperformance for the quarter. For the year the relative outperformance was 1.08%.

Our pride in the performance comes not from the absolute or relative returns but the investment context within which the numbers were delivered. Whilst value styles had a better year and outperformed growth, sector performance was extremely narrow (see the chart above) and the value sectors that performed best over the year were sectors and sub-sectors that the fund were either underweight or not weighted in.

Energy, tobacco, basic materials and aerospace and defence sub-sectors led the charge. The fund was underweight energy and basic materials all year and has no position in tobacco. **QinetiQ** is the Fund's sole direct defence exposure in defence and predictably the stock had a strong year. Within healthcare, which broadly did well this year, and whilst the fund has exposure through **Convatec**, which also had a good year, like many funds we are zero-weighted in AstraZeneca, which resulted in a c 180bps relative headwind. In financials, banks were the main sub-sector to outperform and again the fund is underweight.

On the other side of the equation the fund was overweight the sectors that underperformed in 2022, being financials, industrials, consumer discretionary, technology, telecommunications and real estate. The following chart clearly shows how sector positioning was a material headwind and for what it's worth we do not believe there has ever been a calendar 12 month period prior to this where the fund has had a negative contribution to asset allocation from every single sector.



Before getting into the detail of why the fund fared ok on an idiosyncratic stock selection basis it is worth recognising that asset allocation headwinds were material this year and took away from relative performance in each quarter. In totality, allocation effects were a negative 3.60% to relative performance (gross of fees). There was no 'value-rally' free carry for this fund in 2022.

Looking at the contributors to relative performance the first standout in 2022 was **Euromoney** which was taken private over the year for a premium of 34%. We had previously talked about the company as being held back by its conglomerate structure and with no real synergies between the operating divisions. Over the period from our first involvement management did a good job focusing the organisation and building clear divisions. In particular they did a good job expanding the PRA (Price Reporting Agency) division, latterly known as Fastmarkets, into a more diversified, more relevant and more financially attractive asset. We thought this division was worth materially more than implied market expectations, particularly in the post-pandemic period when the Euromoney share price suffered from its events exposure, but where Fastmarkets subscriptions-based revenues remained in growth mode. And indeed so it proved. The transaction actually involved two bids from two buyers, with one separately acquiring the fast-growing Fastmarkets division and the other the rest of the group. We were supportive of this transaction.

This time last year in the annual review we highlighted the strange relative performance over 2021, and particularly in the second half of the year, of three of the fund's higher conviction and more differentiated holdings, **Convatec**, **Pearson** and **QinetiQ**. We highlighted that they contributed -321bps of relative performance (a material headwind for the year) but 'that we feel sure that the underperformance will prove transitory'. This has indeed been the case and we are pleased to report that in 2022 these three names in combination contributed +381bps to relative performance.

Pearson performed well, aided initially by a bid from Apollo for 870p which was unanimously turned down by the board, but then further boosted by the company beating expectations and raising guidance for 2022 and 2023 via a robust trading performance and via further targeted operating efficiencies. Whilst performance was good and the new Pearson is taking shape, the benefits of the investments being made into the business, particularly behind the key growth platforms of English Language Learning, Workforce Skills and direct-to-consumer are still in the early stages of having a financial impact on the group. We remain confident of further strategic and financial progress at Pearson.

Convatec delivered good results through the year, particularly on the top-line where guidance at the beginning of the year for c 5% growth was upped later in the year towards 5.6% and which may still end up slightly higher than that. While cost inflation has kept margin growth in check thus far it sets the firm up well for 2023, a year where there is the added benefit of a number of new product launches and the contribution from the high growth Triad Life Sciences acquisition and where inflation headwinds will not be as steep. The company held a capital markets event towards the end of the year that fleshed out the further plans to deliver sustainable growth in the mid-single digit range and to expand margins and grow EPS by double digits consistently in the medium term.

QinetiQ had a strong year in the background of heightened geopolitical uncertainties emanating from events in Ukraine which has led to projected increases in defence spending from certain nations. Strategically the year has also progressed well for the company with their operating performance stabilising after the contract issue and decline in the US business in 2021 which led to a collapse in the share price. On the acquisition front the long-signalled acquisition in the US market to grow and diversify the operating platform in that market was successfully executed through the acquisition of Avantus Federal LLC for a headline $590m, which completed in November. This is the major strategic initiative of CEO Steve Wadey's tenure and, with the use of leverage (to c 1.3x net debt EBITDA) marks a departure from the more conservative net cash balance sheet of the prior few years. We engaged extensively with the company both before and after the

acquisition, nervous that they would take on too much debt for a risky acquisition. In the event, the acquisition and end-state leverage metrics were at the more acceptable end of the range they had provided but we have called for restraint from here with regard further M&A and further re-leveraging. With that in mind, recent messaging that major acquisitions are off the table for now are welcomed. We reduced our position in the stock over the year given the changing balance sheet risk profile but retain a c. 2.0% weighting.

On the negative side the major contributors to underperformance were from large stocks that the Fund does not own or is underweight. **AstraZeneca**, where the Fund is zero-weighted, continues to perform well on the back of the so far successful execution on its immunotherapy growth plan, having particular success in the cancer market. The shares rose 30% absolute in a tough market and ended the year as by far the largest stock in the UK all-share index at a weighting of c 7.2%. What happens to AstraZeneca shares matters for all benchmarked UK equity funds and we are aware that it remains a relative performance headwind for this Fund. It is worth mentioning that there is a key read-out for one of its major Phase III pipeline products 'Dato-DXd', which if successful will likely lead to further absolute and relative outperformance from the stock in Q1/Q2. By being zero weighted in it, it allows the Fund to have a large positions elsewhere, for example in Convatec and a growing position in GSK, two stocks which more represent the idiosyncratic value creation characteristics which we seek.

Shell and **Glencore**, where the Fund is underweight and zero weighted respectively performed strongly driven in the main by their underlying commodity exposures. Together they provided a c.250bps relative contribution headwind albeit offset in part by the positive contributions elsewhere within the Fund from positions in Centrica, BP and Anglo American (+236bps).

The sorry events around **Cazoo** are sadly also worth mentioning. Cazoo is an online car retailer that was spun out of DMGT which itself was being taken private, in December 2021. However the shares the Fund received as part of the privatisation were unregistered with the SEC and therefore unable to be sold until the registration process took place, which was not until the end of June 2022. In that time the shares collapsed from $10.00 to below$1.00. The sales price achieved, whilst well timed by the team, still crystallised a material loss of value (-78bps) that we could do little about.

Vodafone was also a negative contributor over the year. Hope during the first half of the year that the executive team would be able to deliver on their plan for asset sales gave way to impatience, operational deterioration and ultimately disappointment over the nature of the sell-down of key asset Vantage Towers. The combination of delayed asset sales, poor messaging around the interim results and the markets underwhelmed reaction to the Vantage transaction led the board to conclude that a new way forward was needed. To that end Nick Read was ousted as CEO during December. This represents hard evidence of the increasingly activist role not of any external investors claiming to be activist, but critically, of the relatively new board led by chairman Jean Francois Van Boxmeer. That the board have now taken control of the situation can only be seen as a good thing and while there might be financial implications from the change that may include a dividend cut, what is undoubted is that the strategy from here will be exactly what we have been looking for: a focus on cash flow, balance sheet de-risking, a customer service led model which prioritises existing customers and ultimately deeper exposure to fewer core markets. The path in 2023 will not be smooth but this change at the top has a number of positive long-term implications for Vodafone equity.

Elsewhere we were disappointed but not surprised over the year to receive the news that Lindsley Ruth the enigmatic and hugely successful CEO of **RS Group** (previously Electrocomponents) would be leaving the company for personal reasons. We were lucky enough to be one of the first investors to meet Lindsley in 2015 after his appointment in April that year and we immediately bought the shares for the fund. His turnaround plan, strategic ambition, ability to narrate that ambition and his galvanizing qualities we thought would be a powerful combination. Since 2015 the shares have essentially risen four-fold and re-entered the FTSE 100 for the first time since 2002 and RS Group sits proudly as the Fund's second best individual stock contributor since inception of the Fund. Lindsley leaves a strong operational legacy and a culture of success and continual improvement which we expect to continue to drive the company forward. The fund remains an owner of the shares, but with a reduced overall position (reduced in the prior 12 months) and we continue to support CFO David Egan whose role in the turnaround must not be forgotten.

OUTLOOK

It is unusually difficult to predict what might happen next in the UK and global markets. There are so many completely unanswerable questions at this stage:

1. Will inflation remain high and prove to be sticky?
2. Will inflation undershoot expectations as energy markets annualise extremely high prices?
3. Have central banks increased rates by too much or too little?
4. If too much, how big will the policy error effect be on the pace of decline of the economy?
5. If too little, what is the end state for the current tightening cycle?
6. When will labour markets show weakness and how high will the unemployment rate get?
7. What will be the size and shape of any recession?
8. Will value outperform growth again?
9. Will small caps and mid-caps do better than large caps?
10. Which regional markets will be most in or out of favour?

11. What will earnings do in each market?
12. How deep will a corporate earnings recession be?
13. What earnings outcomes are shares discounting individually and collectively?
14. Does china re-opening change the outlook materially?

The questions are endless, the outcomes too numerous to compute.

We do feel certain about two things though. First is that we are incapable of correctly predicting what exact global macro-economic conditions will prevail at the end of this year versus the beginning and so we will not attempt to. The second though, is that it is highly likely that the changes we have seen over the last 12 months are profound, structurally embedded and that their ramifications on both the high street and the exchanges are yet to be fully felt.

With this in mind we take exactly the same approach that we have always taken. The things that matter are that we attempt to create shareholder value through backing rational managers, in charge of good businesses, which trade at discounts to fair value and where that value can be unlocked through strategic interventions that highlight the enduring strengths of those underlying businesses. Business transformation. Nothing more and nothing less.

We are ready for the undoubted challenges ahead and face the future confident in this Fund's process and its ability to create value for its investors.

FUND PERFORMANCE

JOHCM UK Dynamic Fund performance (%):

	1 month	3 months	1 year	5 years	10 years	SI annualised
Fund	**-0.31**	**13.21**	**1.83**	**11.42**	**112.51**	**8.74**
Benchmark	-1.14	9.11	0.74	16.45	88.47	5.97
Relative return[1]	0.84	3.76	1.08	-4.32	12.75	2.61

Discrete 12 month performance (%):

	31.12.22	31.12.21	31.12.20	31.12.19	31.12.18
Fund	**1.83**	**22.56**	**-17.62**	**20.82**	**-10.30**
Benchmark	0.74	17.77	-9.52	19.29	-9.06
Relative return[1]	1.08	4.07	-8.95	1.28	-1.36

Past performance is not necessarily a guide to future performance. 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/Bloomberg/FTSE International. NAV of share class A in GBP, net income reinvested, net of fees, as at 31 December 2022. Inception date: 16 June 2008. Note: Performance data for the period 16 June 2008 to 22 October 2009 is for Ryder Court UK Dynamic Fund. From 23 October 2009 onwards, the Fund converted to JOHCM UK Dynamic Fund. All fund performance is shown against the FTSE All-Share TR Index (12pm adjusted). Performance of other share classes may vary and is available upon request. Data representative of UK Dynamic Fund, a sub fund of J O Hambro Capital Management UK Umbrella Fund domiciled in the UK.

ONE MONTH STOCK RELATIVE CONTRIBUTORS

Top five

Rank	Stock	Relative Return Contribution %
1	Shell	0.18
2	London Stock Exchange*	0.15
3	3i	0.12
4	Convatec	0.12
5	Centrica	0.12

Bottom five

Rank	Stock	Relative Return Contribution %
1	Vodafone	-0.20
2	Prudential*	-0.19
3	WPP	-0.14
4	Rio Tinto*	-0.14
5	AstraZeneca*	-0.13

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Source: JOHCM/FTSE International/Bloomberg. Figures are at end of day and calculated gross of fees on an arithmetic basis in GBP. All performance is shown against the FTSE All-Share TR Index. Data from 30 November 2022 to 31 December 2022. Data representative of UK Dynamic Fund, a sub fund of J O Hambro Capital Management UK Umbrella Fund domiciled in the UK. *Stock was not held during this period.

Q3 2022 STOCK CONTRIBUTORS

Top five

Rank	Stock	Relative Return Contribution %
1	Centrica	0.97
2	3i	0.66
3	ITV	0.54
4	Diageo*	0.52
5	Land Securities	0.40

Bottom five

Rank	Stock	Relative Return Contribution %
1	Vodafone	-0.78
2	RS Group	-0.39
3	Man Group	-0.30
4	AstraZeneca*	-0.28
5	Rio Tinto*	-0.25

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