Q4 2022

J O Hambro
Capital Management Group

LONG HAUL INVESTING

Finding structural growth in established businesses

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Fund overview

- The strategy aims to preserve and grow client capital through active management of a concentrated portfolio of listed UK equities and up to 10% exposure to non-listed UK equities.
- The team invests in high quality companies that generate predictable cash flows and have robust balance sheets when they are attractively valued.
- The Fund is run with an absolute mind-set both in terms of valuation and in making investments irrespective of benchmark weightings.
- Environmental and social characteristics are promoted throughout the investment decision making process.
- Benchmark: FTSE All-Share Total Return Index.
- The use of the Index does not limit the investment decisions of the fund manager, therefore the composition of the portfolio may differ significantly from those of the Index.
- Please refer to the Prospectus/KIID for further information.

JOHCM UK OPPORTUNITIES FUND

Q4 2022 fund performance and positioning

JOHCM UK Opportunities Fund
Periodic performance (%) to 31 December 2022

	3 m	6 m	1 y	3 y	5 y	10 y	SI p.a.[1]
JOHCM UK Opportunities Fund	9.68	8.00	-4.02	1.47	12.60	80.64	6.99
FTSE All-Share TR Index	9.11	5.38	0.74	7.35	16.45	88.47	6.02
UK All Companies Sector	9.56	4.15	-9.24	-0.31	8.48	84.16	5.93
Quartile*	2	1	2	2	2	2	1

Past performance is no guarantee of 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. Benchmark: FTSE All-Share TR Index (12pm adjusted). Performance of other share classes may vary and is available upon request. Inception date: 30 November 2005. *Lipper Hindsight, IA UK All Companies Sector Rankings to 31 December 2022. Note: The current managers took over the fund on 1 October 2017. [1]Annualised.

Introduction

The UK Opportunities Fund utilises an investment philosophy focused on three key pillars:

1. **Thematic Growth** – The team identify long-term thematic tailwinds whilst avoiding cycle up/cycle down structural headwinds
2. **Capital Preservation** – The team see capital preservation as an essential component of long-term value creation, and place significant emphasis on balance sheet strength, competitive position and valuation control.
3. **Engagement** – The fund managers engage directly with companies to encourage them to improve their impact on the environment and society

The UK Opportunities Fund is a concentrated portfolio of between 20-40 large and mid-cap companies. It is not constrained by benchmark weightings

Markets

Anyone who has not been hiding under a rock will have heard the bleak and plausible predations for the global economy. Inflation, rising interest rates, supply chain constraints and a European war are not typical ingredients for economic growth. Balanced against what one colleague has referred to as "the most widely predicted recession in living memory", are some strong thematic growth drivers (around which our fund remains positioned) and some very attractive UK valuations.

As we enter 2023, the UK stands out as one of the world's most attractively valued and most unpopular stock markets. This has gone unnoticed by asset allocators who, by moving to global allocations, continue to increase exposure to the world's most popular and most overvalued market.

It is worth considering some of the positives in the UK economy which are rarely mentioned. In an era of political shocks, the UK has emerged to the other side of a chaotic 2022, with the extremes of both major parties in retreat and with the long-standing Brexit debate surely behind us. Private sector debt service ratios are relatively benign in the UK, certainly compared to France or China. The strong performance of the FTSE in the three months after the mini-budget is a reminder that markets look forwards not backwards.

Performance

Across 2022, three of our five best performing stocks have been from our traditional hunting grounds of businesses with defensive and stable (but growing) cashflows. Those three are Serco (where most of the revenues are in inflation linked contracts), Homeserve (a growing subscription-based business which succumbed to a takeover mid-year) and AstraZeneca. The other two were commodities companies Anglo American and Glencore, the latter of which was sold during the quarter (see below).

This quarter, Conduit Reinsurance was the best performing stock, rallying over 20% as reinsurance rates continue to harden. Conduit is our only "balance sheet" financial, with a clean book of business and no legacy contracts. The specialty/reinsurance market has been a victim of QE and record low global interest rates, with new capital flooding the sector and destroying returns. Our initial investment came as a series of losses and the changing rate environment started to drive the "new" capital out of the sector with rates and return on equity again looking attractive. Reinsurance offers a low correlation to the economic cycle and will benefit on the income line should interest rates stay higher for longer.

This quarter two of our more cyclical names, Next and SSP, rose over 20%. In owning cyclical revenue streams it is essential to our process that the business is also exposed to long-term structural growth trends, and that it has the balance sheet and cashflow to invest throughout the cycle.

Next reported half year results during the quarter. The disruption of COVID means comparisons with 2019 are the most relevant. In the structurally growing online segment, Next has seen sales grow by 46% since the pre-COVID comparator. Almost all of that has come through its Label business where is sells third party brands through its website. Pressure on consumers will make for a tougher outlook across the sector, but Next has a significant advantage over its online only competitors. Next is on track to generate an 18% profit margin when it reports full year results early this year. That contrasts with Asos, which is expected to deliver margins of less than 1% and Boohoo which is on track for a loss. The translation of the massive margin advantage into cashflow allows CEO Simon Wolfson to adamantly refuse to cut the company's investment in technology, product and logistics which will further widen their competitive advantage.

SSP is a global leader in food outlets at airports and railway stations. This is an attractive business with long-term contracts and a captive customer base for whom speed of service is often more relevant than price. SSP are winning share as the industry consolidates around operators with global expertise and scale, whilst the underlying market benefits from ongoing trends for longer airport dwell times, declining in-flight food offerings and growing international travel, especially from Asia. SSP continues to win share, having won an estimated £550m of annualised revenue in contract wins since 2019. Like Next, SSP's ability to invest throughout the COVID downturn is key to its ongoing market share gains.

Long-term thematics vs the cycle

A key part of the process is our focus on long-term thematic or structural growth. Whilst cyclical headwinds will periodically interrupt the longer term themes, we look for companies that continue to invest for long-term growth whilst their competitors focus on retrenchment and redundancies. Two companies that reported during the quarter exemplify that focus on long-term investment and growth.

Experian is a great example of a company with the cashflows to invest behind a compelling thematic. Last year it invested around $1.5bn on data and technology, an amount equal to almost 25% of revenues. This is resulting in profitable growth from multiple data related business streams.

Experian's exposure to credit markets poses a cyclical headwind in a rising rate environment. This is particularly the case for credit checks for US mortgage applications, which were down 40% year on year when the company reported in November. Fortunately, the significant investment made by the company to diversify its revenues over the last decade means US mortgages comprise only 3% of Experian's total sales.

Its Brazilian business, which is almost five times the size of its US mortgage business is booming due to a structural change in the local market. Since the regulatory opening of Brazilian credit data markets in 2019, Experian has introduced over 190 new local products, growing revenues by a third in just three years. In the US the company has seen significant growth in its healthcare payments systems, automotive data services, and verification and employment businesses, all focus areas for its data and technology investment.

Experian is one several portfolio companies that are delivering growing cash profits from sustained investment in data and analytics.

Tate and Lyle reported results that highlight its transformation into a business focused on the global trend towards healthy eating, namely calorie reducing sweeteners, clean label texturants, and health & wellness ingredients including fibre enrichment. Like Experian, Tate is investing behind an enduring growth trend. Tate have committed to increasing R&D with new products already account for 15% of revenues. Investment into R&D is key to differentiating products and thus being able to pass on cost inflation – something Tate has been able to do with margins increasing at the half year despite higher input costs. This led to a 29% increase in profit reported in November.

Infrastructure and Energy Transition thematics continue to gain pace

January 1 2023 marks the date when US citizens and businesses became eligible for the climate related incentives under the Inflation Reduction Act (IRA). The legislation is the by far the most ambitious step ever taken by the US Government to tackle climate change. It's far-reaching provisions have two positive implications for our infrastructure growth and energy transition thematics.

Firstly, the bill provides significant new incentives for the building of clean energy infrastructure including new renewable energy production, the development of energy storage, carbon capture and battery manufacturing. Most of these incentives are uncapped leading to estimates of a $1.7trn impact over ten years.

Secondly, much to the ire of the EU, the US is heavily incentivising US manufactured products. For example, to qualify for the $7.5k EV subsidy, the battery component and 40% of other manufactured parts must be made in the US. In response to this, chemical and automotive companies continue to break ground on vast new manufacturing facilities. In November, LG Chem became the latest to announce a new US based battery facility, following similar plans from BASF, Posco and Umicore. LG's will spend $3bn building the plant in Clarksville, Tennessee.

The IRA builds on $450bn Infrastructure Investment and Jobs Act (IIJA – discussed last quarter). We expect the positive backdrop for US non-residential construction to flow through to the profits of both Ashtead and CRH, both of which are well positioned for the increase in US spending plans. National Grid, Smith's Group, IMI and Anglo American will benefit from the increased focus on US energy transition.

Purchase of Diageo

We started a position in Diageo during the quarter. We sold the stock in March 2021, when the earnings valuation was 30% higher than it is today. In addition to the improved valuation, our purchase of Diageo hinges on three key factors. Firstly, the company continues to benefit from population growth, changing demographics and growing incomes in emerging markets, driving the growth of high value premium spirits and delivering a revenue CAGR of over 8% since 2010. Secondly, the strong growth of its high margin US business is likely to continue through its position as the country's largest spirits distributor with the largest salesforce. Lastly, in an environment of cost inflation we can see considerable merit in owning a company that has delivered positive pricing every year for the last 20 years.

Sale of Glencore

We continued our engagement with executives at Glencore on the topics of community relations and carbon reduction. In the area of community relations, we have looked for more disclosure on the impacts of mines on local communities and on actions taken by Glencore to improve those impacts. On climate change we have pushed the company for better disclosure, including a request to follow best practice and to submit data to the Carbon Disclosure Project. Whilst similar engagements with Anglo American and Barrick Gold have made progress, the overall response from Glencore gives little confidence that we will be successful in this instance. We consider standardised and audited disclosure to be essential if investors are to hold companies to account on sustainability issues and remain reluctant to allow management to mark their own homework. We have sold our position in Glencore, with the shares having generated a total return of 80% since first purchase.

Other Engagements during the quarter

In November we met with the Head of Sustainability at Ashtead to again push for improved targets for GHG reduction and encourage progress towards SBTi verification. Whilst some progress has been made since our initial interaction in 2021, including the signing of a contract with the Carbon Trust to map scope 3 emissions and to develop a credible plan for SBTi verification, the company confirmed that their the next targets are likely to emerge in 2024.

The company are investing in electric fleet and delivery vehicles not only to reduce their carbon emissions, but to harness a material revenue opportunity as their customers seek to hire more low emission equipment. The emphasis on improvement in this area was echoed in a meeting we had with the Chairman earlier in the year and in by the Chief Executive who we met at our offices in December.

We met with non-Executive's at three companies to encourage changes to remuneration structures. Whilst there is no once size fits all approach, our general preference is for an emphasis on organic growth, free-cash flow generation and return on capital employed. During the quarter we made suggestions of this nature in meetings with the Non-Executive Heads of remuneration at Smith and Nephew and Hargreaves Lansdown, and with the Chair of Next.

We endeavour to speak directly with non-Executives well in advance of the typical three year remuneration policy cycle. Boards will receive conflicting requests from multiple shareholders, however, we expect to get at least some of what we want and will vote against remuneration policies which fail to align with long-term value creation.

Outlook

Our conservative estimates show a portfolio free cashflow yield of 6.8%, which remains attractive in the context of our expected annual growth in cashflows of over 12% in each of the next three years. Average portfolio leverage of 1.2x net debt to EBITDA, a margin of 18.5%, and a return on capital employed of over 19% demonstrate a resilient and high quality portfolio of businesses.

The fund is positioned behind enduring growth tailwinds though a concentrated portfolio of well managed and well capitalised companies. Our investment approach continues to favour businesses that are both strong enough to withstand a tougher economic environment, and positioned to benefit from long-term thematic change.

JOHCM UK Opportunities Fund

5 year discrete performance (%)

	31.12.22	31.12.21	31.12.20	31.12.19	31.12.18
A GBP Class	-4.02	10.06	-3.93	13.06	-1.85
FTSE All-Share TR Index	0.74	17.77	-9.52	19.29	-9.06
Relative return[1]	-4.73	-6.55	6.17	-5.22	7.94

Past performance is no guarantee of 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/FTSE International/Bloomberg, NAV of Share Class A in GBP, net income reinvested, net of fees as at 31 December 2022. The A Acc GBP class was launched on 30 November 2005. Benchmark: FTSE All-Share TR (12pm adjusted). Performance of other share classes may vary and is available on request. [1]Calculated on a geometric basis.

Top 20 holdings

	Stock	Weight (%)
1	Unilever	4.60
2	BP	4.47
3	Experian	4.40
4	AstraZeneca	4.39
5	Relx	4.32
6	Ashtead	4.21
7	SSE	4.00
8	National Grid	3.89
9	Smith & Nephew	3.78
10	Conduit	3.70

	Stock	Weight (%)
11	Serco	3.61
12	Anglo American	3.51
13	Barrick Gold	3.38
14	Tate & Lyle	3.38
15	CRH	3.33
16	Next	3.18
17	WPP	3.15
18	Hays	3.05
19	Inchcape	3.00
20	Whitbread	3.00

Source: JOHCM/Bloomberg as at 31 December 2022. Cash position: 3.51%.

Share class details

	ISIN	SEDOL	Bloomberg	WKN	Initial charge	Annual charge	Ongoing charge	Minimum investment*
A Acc GBP	GB00B0LLB641	B0LLB64	JOHUOIA LN	A0H1DL	Up to 5%	0.75%	0.90%	£1,000
A Dis GBP	GB00B3K76Q93	B3K76Q9	JOHUOII LN	A0RGE1	Up to 5%	0.75%	0.90%	£1,000
B Acc GBP	GB00B0LLB757	B0LLB75	JOHUORA LN	A0JLVD	Up to 5%	1.25%	1.40%	£1,000
B Dis GBP	GB00B3K76P86	B3K76P8	JOHUORI LN	A0RGE2	Up to 5%	1.25%	1.40%	£1,000
Y Acc GBP	GB00B95HP811	B95HP81	JOHUOYA LN	A1XCAZ	Nil	0.625%	0.77%	£50,000,000
Y Dis GBP	GB00B95J5C19	B95J5C1	JOHUOYI LN	A1XCAY	Nil	0.625%	0.77%	£50,000,000

Performance fee: 15% on excess if Fund outperforms benchmark, calculated daily. A Acc and A Dis share classes are not subject to a performance fee. Any underperformance carried forward. Ongoing Charge is as at 31 December 2022. *Other currency equivalents apply.

Professional investors only.

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This is a marketing communication. Please refer to the fund prospectus and to the KIID before making any final investment decisions.

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The investment promoted concerns the acquisition of shares in a fund and not the underlying assets.

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

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