J O Hambro
Capital Management Group

JOHCM UK DYNAMIC FUND

UNDER THE BONNET

Q1 2023 REVIEW

Alex Savvides
Senior Fund Manager

Stephanie Geary, CFA
Analyst

Siddharth Sukumar, CFA
Analyst

INVESTMENT BACKGROUND

Factor Shifts in a Rotating Market

Whilst recognising it is an ongoing process through the year, we nevertheless always start the year by conducting an in-depth review of the Fund's positioning and associated earnings and dividend outlooks. It's an important job, not only in preparation for the full year reporting season where we routinely get deeper insights into management's views of the year ahead, but perhaps more-so in shaping the messaging and conviction of this team as we construct the JOHCM UK Dynamic investment case for our client's own in-depth reviews.

And so, whilst 2023 was no different in this regard, this year the job was made acutely more difficult given the extraordinarily volatile conditions ever present through 2022 and the plethora of questions over the (presumed) difficult economic and financial backdrop for the year ahead. That 2022 actually finished on a high made the exercise even trickier. We tried to think about the basis and longevity of the rally, we had to balance comedy valuations, low expectations and a wide range of potential outcomes amidst an extraordinary shift in financial conditions that 2022 had brought us.

Our over-arching view coming out of these reviews was that although there were signs of resilience in economic activity, consumer expenditure and change afoot in the inflationary outlook, **the picture was not clear enough to be able to decisively predict what central bankers might do next.**

That said, as data came through and the debate over various economic landing scenarios gave way to increasing probabilities of a soft landing in the US, it was difficult not to feel that the Fund was better positioned on a sectoral basis at the beginning of this year than it had been during 2022. If 2022 was about idiosyncratic outperformance, we thought early 2023 might be more about the benefits of being allocated correctly.

European cyclicals closed 2022 strongly and continued their winning streak in January and February, supported not just by the fading recession fears but also by the full re-opening of China after 3 years of restrictions and by retreating gas prices. Global equity markets rose in tandem, led by Europe, and recorded their strongest January on record since 2013.

Earnings season generally supported the improved sentiment, with many companies reporting results that were more resilient than expected. In the UK in particular, consumer exposed stocks rallied with retailers generally reporting festive trading that was better-than-feared given the cost-of-living backdrop and extensive industrial action in December. Airlines continued their post-Covid recoveries, further boosted by the relaxation of Chinese travel restrictions and banks were strong as rates rose and impairments remained low.

On balance, Europe enjoyed more success over earnings season than the US, driven by its cheaper valuations, and this was reflected in both investor flows into the region and in performance, with the DAX, CAC and IBEX indices delivering returns of 10.4%, 12.4% and 14.2% by the end of February.

The FTSE All Share lagged the other European regions, but still recorded an all-time high of 4,377 on 16th February, registering a year-to-date return of 7.65% at that point. Given the trough-to-peak return of +18% from early October, we wondered if the entire year's return would be delivered in the first quarter.

From a UK perspective, ONS data in February confirmed that the UK had avoided falling into recession in 2022, despite flat growth in the final quarter impacted by industrial action. Debates of a much shallower UK recession, or no recession at all, emerged. Consumer confidence as measured by the GFK barometer improved, and Inflation readings remained high despite gas and power prices falling. Whilst the Fund is not overly biased to UK domestic revenues, overall positioning is overweight the UK and there was some benefit therefore from the improving UK picture.

The FTSE's market leadership up until February had been from retail, banks, construction and travel & leisure. The defensive sectors of

consumer staples and pharmaceuticals lagged, reversing 2022 trends. Value established itself as a clear style winner, followed by dividend yield and smaller companies. Growth and quality lagged, whilst the momentum factor continued to struggle without sustained trends in market leadership.

March brought us something altogether very different, with the collapse of SVB and Signature Bank in the US, giving a first indicator of the possible fall out from last year's central bank actions. Though initially considered to be a US problem, with European and UK banks under more stringent regulation to avoid such issues, the fear spilled over post news of Credit Suisse's potential collapse. With memories of the Lehman's collapse front of mind, global banks aggressively sold off on worries of contagion, taking insurance companies and financial services out with them. The value leadership that had previously emerged was put into reverse, with defensives, quality and growth the preferences amid heightened volatility. Market speculation mounted over whether Central banks would still continue to hike rates in the battle against inflation. Despite the UK rates moving to 4.25% due to a 25 bps hike, 10 year UK Government bond yields retreated to end the quarter lower at 3.5%.

March also brought the UK Chancellor's Spring Budget and was followed shortly by the government's 'Power Up Britain' plan. Key announcements included the anticipated rise in corporation tax to 25%, alongside new incentivisation for investment in the form of tax breaks, increases to the defence budget and an extension of the Energy Price Guarantee. Additional public funding in support of nuclear energy was also announced, and increases to the lifetime pension allowance. The OBR predictions accompanying the budget suggest the UK will avoid recession in 2023, which to some extent has driven a recovery in GBP vs the US dollar from overly depressed levels. As the macro picture in the US begins to look less assured, the safe haven status of the dollar looks questionable.

STRATEGY UPDATE

Results Skewed to the Upside

The Fund delivered an absolute return of 4.14% during the quarter, outperforming the FTSE All Share by 1.05%. It is worth noting that this quarter saw the roll-off of the March 2020 data point from the Fund's 3-year Lipper numbers, the impact of which has been to re-establish the Fund as a top decile performer versus peers[1] over the period.

Having been firmly ahead of the benchmark in the first two months of the year, there was some relative performance give back in March, in part driven by the Fund's insurance and banking positions that were caught up in the wider sell-off. Helpfully, we took the decision in February to reduce the Fund's beta slightly, given the strength of market moves in the early part of the year. This was mostly funded through reducing the Fund's energy and materials positions, which consequently sold off on receding prices during March. It is worth noting that Anglo American was moved out of the Fund's top-ten positions over this period for the first time in a number of years.

The Fund has been more balanced in its exposures as well with the team taking the view that given a hard to predict external picture, some of the Fund's capital would be better placed in more predictable and resilient revenue streams where there was evidence of material undervaluation. GSK and Pearson, both after bouts of weakness, were the primary beneficiaries, while holdings in both PZ Cussons and Johnson Matthey were also increased. Whilst not fully protected in the downturn, these actions helped to cap the Fund's downside.

Another positive has been that the negative allocation headwinds the Fund suffered in 2022 have subsided, with sector allocation registering positive contributions so far in 2023. Whilst the Fund has no representation in either the retail or travel & leisure sectors, cyclical leadership was a more supportive factor exposure, with the Fund's positioning within media adding positively, as well as underweights to consumer staples and mining.

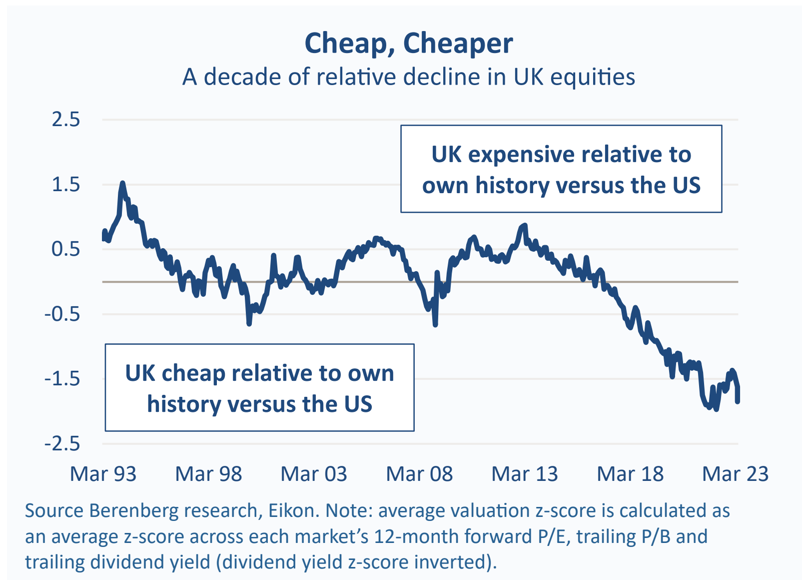
Allocation to FTSE 100 remains towards the high end of historical range at c72% of Fund capital. The gradual increase to FTSE 100 over time has, to a large degree, been driven by:

1. Promotions of some longer-standing positions from the top end of the FTSE 250, such as Beazley, RS Group and Convatec, to the FTSE 100 index, and;
2. A higher degree of business transformation opportunities in this space, where we have increased conviction in corporate boards' willingness to deliver, for example Aviva, WPP, Vodafone, GSK and Johnson Matthey.

It is worth reminding our clients that, despite this higher absolute allocation to the FTSE 100, the composition of the Fund's exposures is substantially differentiated from the benchmark, with only a 32% representation in the largest 25 companies, compared to their 62% weighting in the FTSE All Share index. As a result, the Fund's style tilt to size is nearly 3 standard deviations[2] underweight relative to benchmark, with lower representation in defensive and commodity-oriented sectors (all of which contributed to last year's allocation headwinds). Positioning across the Fund remains 'bar belled' to defensives/cyclical tilts, but is ultimately driven by our conviction in the idiosyncratic opportunities we see. We consider some of the upside return opportunity in the Fund's FTSE 100 names, currently not to be dissimilar to what's typically on offer further down the cap curve, if management can successfully execute on their business transformations whilst navigating the macro environment, all at a risk premium that is lower than that of small caps.

Much of this is due to the severely depressed valuation base across a wide range of FTSE 100 stocks as international investors continue to shun the opportunities on offer. Whether it is GSK on 9x earnings yet getting consistent upgrades, WPP similarly on 9x earnings with globally relevant and often dominant brands in the creative advertising and media buying spaces, Johnson Matthey again on 9x earnings with world leading PGM metals, catalyst and hydrogen technologies expertise or Centrica, a business and balance sheet completely

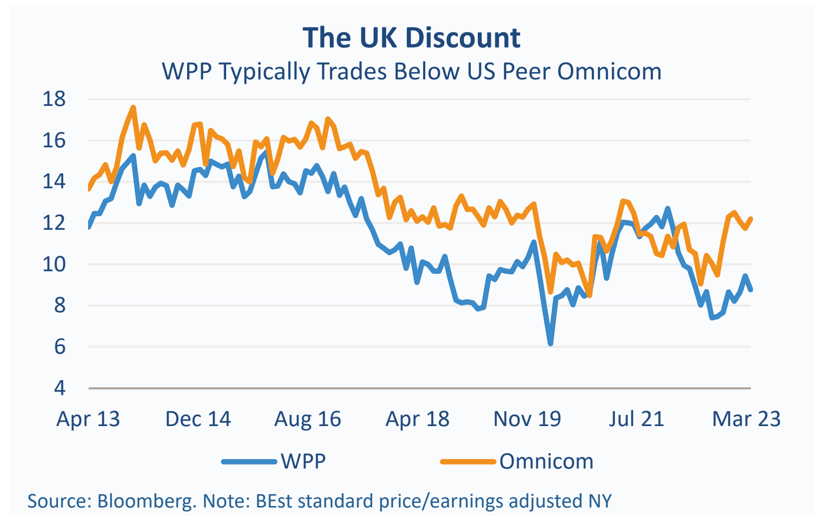
transformed and generating enough cash to essentially buy all its equity back within three years. Without making excessive assumptions on valuation there are opportunities to at least double the Fund's money over a 5-year period in each of these names. Small-cap-like returns from the FTSE 100.



Source Berenberg research, Eikon. Note: average valuation z-score is calculated as an average z-score across each market's 12-month forward P/E, trailing P/B and trailing dividend yield (dividend yield z-score inverted).

With the sheer number of cheap stocks on the UK market it is inevitable that management teams and market participants and commentators will look for someone to blame. Flows out of UK equities have remained at a high level this year and remain part of a wider UK brand and narrative problem encompassing political risk, currency fears, listing fees and requirements, reporting requirements, ESG regulation, and awful stewardship box ticking. We have publicly commented on some of these issues here. We would urge all our corporates to agitate for improvements along all these vectors rather than try and look for a way out. It is true that comparable US companies often trade at a higher multiple than their UK equivalents – Just look at WPP against Omnicom or Interpublic as an example. But the issues are complex and multi-faceted and are not captured in a headline and are not easily solved by moving a listing. We are obviously aware of the noise around the competitiveness of the UK market as a place to list and as a UK only Fund are acutely aware of the need for a strong and active listings market and a competitive executive jobs market.

With that in mind we have engaged with a number of our investments on this issue including WPP, Convatec and Pearson, three very international companies. Our message to them is simple, if you leave looking for a rating, be careful what you wish for and be aware you will not get our support. If you stay and do a good job, capital is mobile and the capital will find you. It is incumbent on boards to not waste time chasing a rating but to do a good job for the right reasons continually. If they do then the following and rating will come. Good investments become well followed and well rated wherever they are. The above three would all be lost in the US but can be stalwarts of a FTSE 100.



Source: Bloomberg. Note: BEst standard price/earnings adjusted NY

The noise around ARM (maybe) re-listing in the US is because it was so highly rated on the UK market. Shareholders voted to sell it because the premium was large and the rating very high. Do we forget these things? Ferguson left the UK market because it no longer looked remotely UK, in fact, it was majority US. In those situations there might be a case to answer and we would be open-minded, but if a corporate want to be in the US for a higher rating, we would unlikely support them.

Now onto company results. 80% of the Fund by weight[3] reported during the quarter with delivery across the Fund skewed to the upside. 37% of the Fund beat market consensus and 23% delivered an in-line performance. 17% of the Fund delivered results that were either mixed messages or considered to be modestly negative, with a remaining 3% missing. Frustratingly two of the Fund's smaller positions issued profit warnings.

Whilst yet to report in 2023, we must flag **3i Group (+104bps)**, which ended the quarter the Fund's top contributor as the shares recorded a new all-time high. A capital markets day event for key asset, Action, outlined the continuation of impressive revenue increases year on year, whilst executing its store expansion strategy and improving margins on cost discipline. In line with trends in the wider retail space, **Action's** performance in the first 11 weeks of 2023 has remained resilient, leading to further upgrades. The remainder of the portfolio continues with good operating momentum, and whilst there is some concern over the knock-on of higher rates to private equity refinancing, we highlight the lower leverage profile at 3i Group and management's cautious strategy to not over-lever companies. As such, any refinancing risk should be manageable. 3i Group remains the Fund's largest position.

Moneysupermarket (+88bps). The shares had performed well even before they reported strong operating performance, as analysts upgraded on a supportive consumer backdrop to the platform's credit and financing channels. Optimism over the return of insurance and energy switching have further supported the share price, although surprisingly the company did not guide to the latter returning in 2023. Should energy prices continue to recede, this will provide a further tailwind. The company also took the opportunity to outline detail on the threat of Amazon entering the insurance space, both from a product and regulatory perspective, which at this stage does not appear to compare in size to Moneysupermarket's larger and established product range. The macro environment is no doubt supportive here,

but let us not forget the headwinds faced since the pandemic, which have masked the progress in the underlying business transformation under Peter Duffy since 2020.

Rolls Royce (+50bps) shares rose 60% in the first quarter. The company reported and guided to free cashflow well above consensus forecasts, marking a positive start for new CEO Tufan Erginbilgic's tenure, as well as announcing a comprehensive business transformation strategy aimed at improving the culture, profitability and net debt position of the business. The full reopening of Chinese travel provided further support, in anticipation of the full return of wide-body flying hours. The move has been strong, but some of that is attributable to short covering from very depressed levels. We think there's much more to come from Rolls Royce on successful execution of the new strategy, whilst its small modular reactors (SMRs) division stands as a potential beneficiary of government contracts under new nuclear investment mandates.

Pearson (-33bps) and Aviva (-29bps) were among a cohort to deliver either in-line or better than expected results, however their respective contributions to Fund performance was negative in the quarter. In the case of **Aviva**, concerns over the insurance sector's wider asset risk exposure weighed on what had otherwise been a good showing at results, with the announcement of a share buyback and ambition to grow the cash dividend by more than expected.

In terms of **Pearson**, the publisher delivered an in-line set of results, however the market was overall disappointed due to the absence of a new share buyback programme. Our conviction here stays high, as the company continues to make good progress by disposing of non-core assets, right-sizing the cost base and transforming from a textbook publisher to a digitally led lifelong learning partner.

Onto the disappointments, and **PZ Cussons (-21bps)** delivered a mixed set of interim results. Revenue grew on a like-for-like basis driven by Asia and Africa, but operating profit margins declined on the adverse mix, with Europe and the Americas weaker than expected. Election uncertainty in key market Nigeria compounded the negative sentiment. We believe there is a valuation opportunity here relative to peers and good underlying progress in the strategy execution, and whilst the macro impacts of Covid and inflation have played a part in the mixed delivery of results, there is certainly room for improvement in managing the issues, particularly with regards to pricing to drive better top line delivery. With improvement guided in H2, we hope the recent weakness marks the low point in the share price and have added to the position.

Miners were in general weak over the quarter, but it was idiosyncratic issues at **Anglo American (-45bps)** that saw the allocation benefit of an overall mining underweight offset by negative stock selection. The company delivered earnings that were in line, however a $1.7bn impairment relating to CAPEX spend at the Woodsmith potash mine weighed on the shares.

The Fund's positions in **Barclays (-28bps)** and **HSBC (-2bps)** were both negatively impacted by the wider banking sell-off in March. Whilst the Fund was in aggregate equal-weighted in banks versus benchmark, and equal-weighted to HSBC, Barclays underperformed the wider sector. Firstly, reported revenues announced in February disappointed, cost savings of 3% not being enough to offset the impact of a lower net interest margin (NIM) in the UK bank and lower trading revenues from the FICC division. 2023 guidance for NIM and the share buyback were also below consensus. Then in March, as the banking sell-off unfolded, market participants showed greater levels of concern for those banks with investment banking divisions and a higher market beta, taking the shares down more aggressively than other UK banks. Barclays currently trades on a price to book ratio of 0.4x; we believe there is significant value and the potential for a lot of upside from here, but we stay attuned to the macro environment.

Direct Line (-48bps) issued an unscheduled trading update and profit warning in January. Weather related claims and a poor underwriting performance in the motor division left the company's solvency capital position at the bottom of preferred range, leading management to cut the final dividend. At the full year results, the solvency position remained depressed despite action having been taken on the dividend. CEO Penny James has departed, and the main focus of the board from here is to restore profitability within the motor division and rebuild balance sheet resilience through internal levers, which have been laid out. At this point we feel that risk is now skewed to the upside and have tentatively added back to the position.

NCC (-59bps) issued a profit warning at the end of March, less than 2 months after downgrading full year guidance with interim results in February. Having already warned of lengthening sales cycles in its US cyber security business in February, management moved to downgrade the 2023 operating profit expectations by c 35%, citing demand contraction in the Assurance (cyber) division on declining US technology sector budgets. Performance from the Resilience (escrow) division remains on track as does the strategic review of that asset. Shares traded below some market participants estimates of the fair value of that division c £300m although we recognise that there are risks to that valuation. This has been a poor period from the company and they are under severe pressure. Since selling some shares to reduce the position in Q4 2022 we have not yet added.

OUTLOOK

UK Valuations Remain Compelling

Despite a small number of idiosyncratic issues experienced this quarter, whilst recognising that there have been material issues in two cases (NCC and Direct Line) they have typically come from smaller positions and they should not distract from the fact that the Fund's holdings have generally been very resilient, with earnings and strategic outcomes skewed to the positive. GSK, Centrica, Moneysupermarket, Pearson, Convatec, Ricardo, Man Group, RS Group, Aviva, Beazley, Elementis and Landsec all stand out in this regard in the first quarter.

Yet the strong performance has not always been rewarded and this has left large parts of the portfolio where we have strong or growing

conviction and have allocated material capital languishing a little in share price terms year-to-date. Of the above names only Centrica and Moneysupermarket have performed above the market this year. The remainder account for around 30% of the Fund's capital and are either in-line or below the market year-to-date. Some, like Pearson and Beazley are down materially. To be clear, none of these names have announced anything of note that could be construed as materially disappointing.

In fact, most have outperformed expectations. There are therefore some meaningful catch-up opportunities where good results have not been rewarded, as either the wider macro narrative has dominated, or the market has overstated a minor short-term idiosyncratic negative.

We remain confident that good management teams with clear but flexible plans will continue to navigate the challenges of the current environment, although questions will obviously remain if earnings can hold up. In most cases the earnings risks are more than adequately discounted through the low valuations. As you would expect, we will continue to back those companies where we have most confidence in execution nor are we afraid to continue shrinking positions where appropriate. We would rather be focused than 'di-worse-ified' and recognise there is still more work to do on this front.

Whilst we do not attempt to predict or rule out any further volatility or fall-out in the financial sector, there remains material value in some of the fund's banks and insurance positions over the long term, even as share prices have recovered into April.

The constant rotations in market leadership we have experienced over the last year feel symptomatic of regime shift, and in this environment it is difficult to predict what comes next. We remain of the belief that the UK is very attractive on valuation grounds, despite continued investor outflows from the region. The strategists we follow appear to agree, with the UK a preferred home for equity allocations, as the current valuation discount implies distressed levels. Political risk must again be considered however as there is also an election on the horizon.

The recent strengthening in sterling versus the US dollar also gives hint of a US recession on the horizon, and if the currency move is to be sustained in favour of sterling, we would see this benefitting UK domestic earnings near term.

Overall, cognisant of the external risks which will continue to push the Fund around, we remain confident in this Fund's balanced positioning and the idiosyncratic opportunities for further outperformance, but in a measured manner as management teams continue to deliver against their transformation plans.

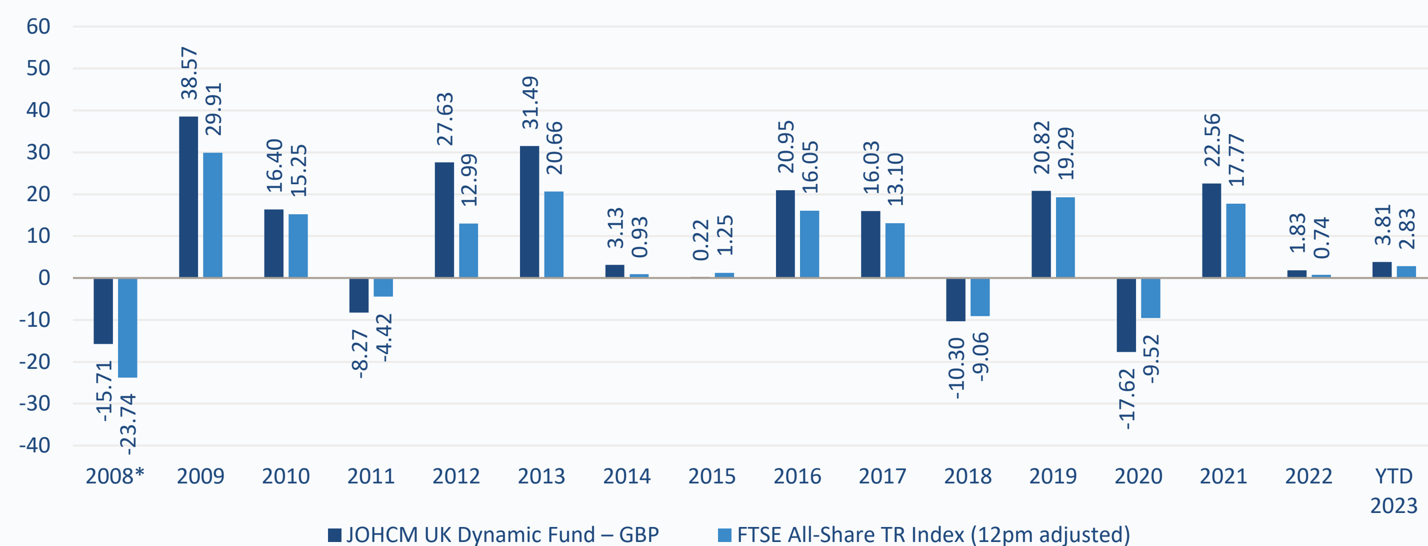
[1]Peer Group is IA UK All Companies

[2]Source Style Research as at 31st March 2023. -2.83 standard deviation style tilt to Market Cap vs FTSE All Share

[3]Based on average position sizes over Q1 2023.

FUND PERFORMANCE

JOHCM UK Dynamic Fund calender performance (%):



Periodic performance (%):

	1 month	3 months	1 year	5 years	10 years	SI annualised
Fund	**-4.98**	**3.81**	**4.53**	**21.92**	**95.95**	**8.86**
Benchmark	-3.00	2.83	2.40	27.79	75.24	6.06
Relative return[1]	-2.04	0.95	2.08	-4.59	11.82	2.63

Discrete 12 month performance (%):

	31.03.23	31.03.22	31.03.21	31.03.20	31.03.19
Fund	**4.53**	**11.42**	**40.66**	**-27.03**	**1.99**
Benchmark	2.40	13.03	28.76	-19.06	5.93
Relative return[1]	2.08	-1.42	9.24	-9.85	-3.72

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 March 2023. 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. *Part period return from since inception 16 June 2008 to 30 September 2008.

ONE MONTH STOCK RELATIVE CONTRIBUTORS

Top five

Rank	Stock	Relative Return Contribution %
1	Moneysupermarket.com	0.45
2	3i	0.33
3	Shell	0.28
4	Convatec	0.20
5	Melrose	0.17

Bottom five

Rank	Stock	Relative Return Contribution %
1	Barclays	-0.50
2	AstraZeneca*	-0.40
3	NCC	-0.33
4	Vodafone	-0.25
5	Land Securities	-0.24

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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 28 February 2023 to 31 March 2023. 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.

Q1 2023 STOCK CONTRIBUTORS

Top five

Rank	Stock	Relative Return Contribution %
1	3i	1.04
2	Moneysupermarket.com	0.88
3	Glencore*	0.60
4	Rolls Royce	0.50
5	WPP	0.50

Bottom five

Rank	Stock	Relative Return Contribution %
1	NCC	-0.59
2	Direct Line	-0.48
3	Anglo American	-0.45
4	Pearson	-0.33
5	Aviva	-0.29

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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 31 December 2022 to 31 March 2023. 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.

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