JOHCM UK OPPORTUNITIES FUND Q3 2023 Review

CORE THOUGHTS

Fund Literature	Fund Facts	Latest Fund Webinar

Investing through the revolving door

The **JOHCM UK Opportunities Fund** employs an investment philosophy focused on three key pillars:

1. **Structural Growth** – The team identifies companies benefitting from long-term tailwinds which will help to drive growth through economic cycles
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 JOHCM UK Opportunities Fund is a concentrated portfolio of 20-40 large and mid-cap companies. It is not constrained by benchmark weightings.

Political green shoots?

By the end of October, Rishi Sunak will have been Prime Minister for over a year. With an election likely next year, the odds are currently against him celebrating a second anniversary.

Much has been made of the increasingly short tenure of company CEOs, with a median tenure of 4.3 years, but most FTSE 350 CEOs have seen four UK prime ministers whilst in their current role. This instability has led to confusion on post-Brexit policy, energy transition and, lately, high-speed rail construction. Such uncertainty is not good for corporate planning or the patience of asset allocators.

However, some green shoots are emerging with what seems to be a more business-friendly opposition party and a government less likely to be toppled by its own backbenchers. As we enter the straits of the next election, it feels to us like the UK political agenda is moving forward. As these winds change, it could mark the beginning of a new era, with the nation back on the front foot. With this increased political credibility comes the potential for corresponding flows back into UK equities.

Whilst the tenure of CEOs might exceed the low bar of recent UK prime ministers, it is nothing to shout about. The optimum number of years a CEO should stay in office to maximise shareholder value has been the subject of numerous studies. The consensus suggests a range between 10 and 16 years. No one believes it to be around the current average of four.

Our longest serving CEO within the portfolio is Simon Wolfson, the CEO of Next, who is one of only nine FTSE 350 CEOs to have been in their post for more than 20 years. Next reported strong results during the quarter, partially boosted by a 45% reduction in late deliveries as they benefitted from the partial opening of a new warehouse facility. The planning application for the warehouse was first submitted in 2019. The final automation will not be

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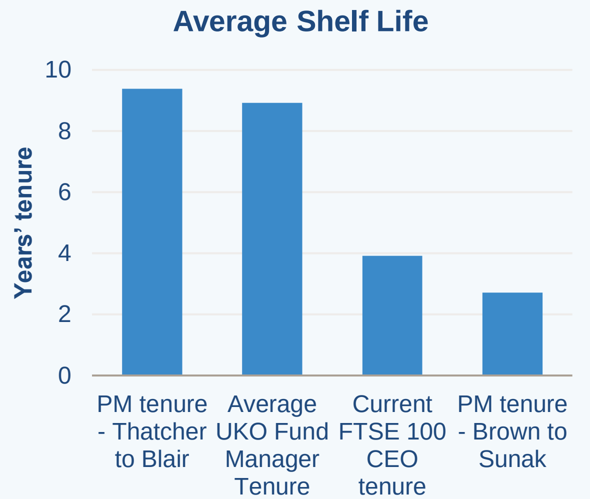
complete until 2024. We suspect that Next's position as the UK's leader in online clothes retail owes much to its ability to plan projects where the payback is well beyond the typical executive lifecycle.



Source: JOHCM as at 30 September 2023.

Looking back on some of the highlights of the quarter were the updates from Relx and Experian, which both reported accelerating rates of organic growth and investment in their businesses. Both companies have maintained a consistent strategy of building data sets and analytics that sit at the core of their operations. They have not participated in transformational acquisitions nor significant corporate restructuring. Instead, their CEOs, who have both been in place for over a decade, have followed strategies that have evolved gradually and resulted in the type of reliable growth that we favour for our fund.

New Brooms

Whilst our preference will always be for great management teams that stick around, the short shelf-life of executives means we frequently need to evaluate new appointments and the inevitable new strategy (and restructuring charges) that come with them.

The pressures on CEOs for short-term results combined with poorly designed incentive structures make it imperative we own businesses that can withstand a period of poor executive management. A sentiment neatly summarised as *"buy stock in a company so good that an idiot could run it – because sooner or later one will" – Warren Buffett.*

In August, we met with the new chairman of Unilever. This company needed a corporate refresh after a period of poor capital allocation, and the change in Chair has been accompanied by a change in CEO and a forthcoming change in finance director. We are optimistic that the new team will focus on investing for long-term growth rather than on value-destroying M&A and excessive capital returns. Whilst Unilever has delivered top-line growth over recent years, we believe this is a company punching well below its weight and that the new team have an opportunity to unlock significant value.

We also met with the new CEO of Hargreaves Lansdown, whose first job is to rectify the period of underinvestment that occurred under predecessors. Our thesis in this investment is based upon the company's 92% client retention rate, its market-leading position and the long-term structural growth in savings products. We are buoyed by the new CEO who is focusing on areas such as customer service which is a key differentiator for the business.

Performance

During the quarter, the fund declined by -1.76% compared to the All Share 2.63%. Market sentiment around rising bond yields was the biggest driver of weak share price performance in sectors like consumer services and utilities, whereas banks where we own nothing and commodity sectors where we only have a small exposure performed strongly.

For the large part, companies reported positive updates. Next upgraded its profit expectations for the year once again and articulated a clear strategy around its brand and online platform. Smiths Group reported organic revenue growth for the year to end-September of 11.6% year-on-year, citing strong

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demand in both traditional and green energy segments and healthy demand for their new airport scanning devices, meaning passengers no longer need to remove liquids from their hand luggage at security. The company has stepped up its R&D and capex spend, whilst using excess cash flow to de-gear to 0.7x net debt:EBITDA and to increase its regular dividend by 5%.

SSP has now seen passenger volumes in airports exceed pre-Covid levels and has a positive outlook for increased demand for travel in Europe, the US and Asia. The recent update demonstrated the company increasing its win rate ahead of the competition, investing more in its brands and de-gearing. The company has a much lower exposure to the UK than in the past, which meant that short-term forecasts were trimmed as a result of the strengthening of sterling, but such short-term moves have no longer-term impact on the value created by a business that we estimate could double its profits in the next two years.

Bunzl

In August, we started a position in Bunzl, the global market leader in the distribution of 'not-for-resale' goods. It has grown earnings around 9% pa for the last two decades whilst consistently growing its dividend (it currently yields 2.5%).

Frank van Zanten, Bunzl's CEO, has led the company for almost eight years. At 24, van Zanten was appointed CEO of his father-in-law's business, which he sold to Bunzl after three years. In the subsequent thirty years, he has implemented the same strategy across the Netherlands, Germany and later Continental Europe before becoming Group CEO in 2016.

We expect that Bunzl's well-established strategy, experienced management team, and its exposure to areas such as safety, healthcare and food retail will enable it to maintain the resilient long-term growth that is the defining characteristic of our portfolio. The stock is currently trading on a forward-looking free cash flow yield of 6%, which equates to roughly 15x earnings.

Short termism and incentives

Over the quarter, we continued to press company boards for incentives that encourage executives to manage their companies to achieve long-term value creation rather than an unsustainable one-year earnings boost.

Whilst the third quarter is quiet for AGMs, we were compelled to vote against remuneration policies or reports at three companies: Diageo, Experian, and National Grid. We see the allocation of capital as the key responsibility for executive management and, therefore, some measure of the return generated on capital should form part of remuneration. In Experian's new remuneration policy, return on capital makes up only 6% of the overall bonus opportunity. In Diageo's new policy, it is missing altogether. Return on equity is a significant part of National Grid's remuneration structure, but it is not balanced with any leverage target, leaving management free to take on more debt to boost the return.

We also engaged in the implementation of policies, something that seems to go unnoticed by analysts at the proxy voting organisations. Unilever, which includes return on invested capital within their incentives, rendered the metric ineffective by lowering the bar for target returns in the aftermath of large and expensive acquisitions. We expressed our exasperation at a meeting with the chair of Unilever's remuneration committee in September.

The impact of targeted engagement

We have been engaging with Next on the topic of plastic reduction for over two years and in March the company announced new targets related to the use of recycled plastics and the recyclability of its packaging. The company has since confirmed several practical steps, including the successful trial of removing an unnecessary layer of plastic from single items ordered online to stores. Next are now rolling the project out to all stores and estimate that it will reduce the amount of outer packaging used online by around 20%.

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We also pushed the company to disclose employee engagement scores, a metric that we track across the portfolio. The company have since disclosed the score publicly for the first time as part of their corporate social responsibility reporting.

Outlook

Whilst politics will remain noisy in the coming months, we will continue to focus on owning globally leading companies that have the best long-term tailwinds, that allocate capital sensibly and do their bit for society. We are fortunate to have a portfolio chock full of best-in-class businesses, which, thanks to the unpopularity of the UK market, are currently offering us 10% per annum growth in cash flows for the next 3 years with very attractive levels of upside, with a forward-looking free cash flow yield of nearly 7%.

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FUND PERFORMANCE

Periodic performance (%)	1 month	3 month	1 year	3 years	5 years	SI	SI annualised
Fund	**-0.15**	**-1.76**	**11.69**	**14.13**	**11.88**	**223.00**	**6.79**
Benchmark	2.17	2.63	14.49	40.55	20.53	185.07	6.05
Relative return[1]	-2.28	-4.28	-2.45	-18.80	-7.17	13.31	0.70

Discrete performance (%)	30 Sep 23	30 Sep 22	30 Sep 21	30 Sep 20	30 Sep 19
Fund	**11.69**	**-12.07**	**16.22**	**-7.24**	**5.68**
Benchmark	14.49	-4.33	28.31	-16.51	2.72
Relative return[1]	-2.45	-8.09	-9.42	11.10	2.89

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 30 September 2023. Inception date: 30 November 2005. 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. [1]Geometric relative.

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