JOHCM Funds

Christopher Lees
Senior Fund Manager

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International Select Fund Monthly Report

February review; Ukraine invasion

In February, the fund fell 4.46% versus a fall of 1.77% for the broad EAFE benchmark index as markets worried about Russia's invasion of Ukraine. Previously we adapted to the COVID crisis, now we need to adapt to the tragic events of the Ukraine crisis which is a humanitarian disaster, a geopolitical inflection point, and a stock market regime shift. While we have no direct exposure to Russia/Ukraine in the portfolio, some of our companies do have small revenue exposures there. This indirect exposure is not significant, and we are continuing to monitor developments in Ukraine/ Russia closely, particularly the emerging new supply chain disruptions that could be a potential new risk. It's not just going to be an oil and natural gas problem, as for example, Russia and Ukraine account for 30% of global wheat production. So far, we have done what we did at the onset of the COVID crisis when we said "don't try and ski in an avalanche," which means weeding out a few losers and let cash temporarily drift up to around 10%.

The Ukraine crisis is probably the "value" to "defensive" market inflection point. After a difficult start to the year, it appears the value to defensive regime shift has taken hold. Post the invasion, our evidence based, probability adjusted investment process is slightly more defensive, having gone from 70% bullish (30% bearish) to 60% bullish (40% bearish). We assess a 40% probability of markets rallying on any signs of de-escalation with some of the old "growth" leaders (i.e stable growth & high quality stocks), but only a 20% probability of markets rallying with some of the new "value" leaders (i.e cyclicals & financial stocks). We assess a 40% probability that equity markets keep falling as the new humanitarian and geopolitical risks are added to the existing Fiscal and Monetary policy mistake risks in this "post invasion" Stagflationary regime of slowing growth and rising oil prices.

Outlook and Positioning; mid-cycle correction or bear market?

A crucial question to consider is whether this a "mid-cycle correction" or the beginning of a "major bear market?" The honest answer is that nobody knows, but the probability of the latter has clearly risen post the Ukraine invasion - with yield curves flattening, credit spreads widening, oil prices rising and equity markets falling. It is worth remembering that 11 of the last 12 US recessions followed a rise in oil prices. Our top-down monthly sector/regional scorecard has changed slightly since the invasion, with Europe and the Consumer Discretionary sector deteriorating as the natural resource/ commodity areas of Latin America and the Energy sector improve. At this point in the cycle, regardless of whether it ultimately turns out to be a mid-cycle correction or the beginning of a major bear market, we think the best advice

is to sell "growth traps" (i.e. speculative, unprofitable, concept stocks), sell "value traps" (i.e. cyclicals with leveraged balance sheets) and look to buy the dip in steady growth "compounders." As Warren Buffet wrote in his 1989 letter to shareholders, "it is far better to buy a wonderful company at a fair price than a fair company at a wonderful price."

This commodity cycle will be different from the last one. The 2002-2008 commodity cycle was driven by the positive demand shock from China joining the WTO (i.e. equity market bullish), but the new 2022-202? commodity cycle is driven by the negative supply shock from Russia invading Ukraine (i.e. equity market bearish). If policy makers recognize and react to this new radically different regime and realize that putting up interest rates does not cure a supply side problem, then this will probably turn out to be a "mid-cycle correction - buy the dip." If not, and policy makers keep raising rates while yield curves flatten then invert, credit spreads widen, and we go into a recession, then we will get more bearish and change the portfolio accordingly. In this scenario, many low quality stocks with stretched balance sheets will have a very long way to fall; and we would move the portfolio up the quality curve and focus on those companies with rock solid balance sheets that can weather the difficult combination of rising interest rates, rising input costs, and slowing economic growth.

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

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RISK CONSIDERATIONS:

The Fund invests in International and Emerging Markets. International investments involve special risks, including currency fluctuation, lower liquidity, different accounting methods and economic and political systems, and higher transaction costs. These risks typically are greater in Emerging Markets. Such risks include new and rapidly changing political and economic structures, which may cause instability; underdeveloped securities markets; and higher likelihood of high levels of inflation, deflation or currency devaluations.

Emerging Markets involve heightened risks related to the same factors, in addition to those associated with their relatively small size and lesser liquidity.

The small and mid cap companies the Fund may invest in may be more vulnerable to adverse business or economic events than larger companies and may be more volatile; the price movements of the Fund's shares may reflect that volatility.

The views expressed are those of the portfolio manager as of February 2022, are subject to change, and may differ from the views of other portfolio managers or the firm as a whole. These opinions are not intended to be a forecast of future events, a guarantee of future results, or investment advice.