APRIL 2021

J O Hambro Capital Management Group

CORE THOUGHTS

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Q1 2021 update

- We are increasing the resilience and growth prospects of the portfolio by focusing on companies with the pricing power to offset cost inflation.
- We are avoiding the increasing build-up of speculative capital by selecting proven businesses with genuine growth opportunities.
- We are maintaining our absolute valuation approach and sell discipline as market bubbles continue to build.

MSCI ESG RATINGS AA (CCC B BB BBB A AA AAA)

Rayner Spencer Mills RATED FUND

FE INVESTMENTS APPROVED

FE fundinfo Crown Fund Rating

MORNINGSTAR ★★★★★

JOHCM UK Opportunities Fund

Q1 2021 fund performance and positioning

JOHCM UK Opportunities Fund
Periodic performance (%) to 31.03.21

	3 m	6 m	1 y	3 y	5 y	SI p.a.[1]
JOHCM UK Opportunities Fund	5.23	11.66	26.10	18.04	27.99	7.79
FTSE All-Share TR Index	5.40	19.00	28.76	10.41	36.40	5.91
UK All Companies Sector	5.77	21.98	37.94	14.64	39.17	6.59
Quartile*	3	4	4	2	3	1

Past performance is no guarantee of future performance.

Source: JOHCM/Bloomberg/FTSE International. NAV of share class A in GBP, net income reinvested, net of fees, as at 31 March 2021. 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 March 2021. Note: The current managers took over the fund on 1 October 2017. [1]Annualised.

Q2 Fund positioning and company updates

This update will focus on four topics that have been dominating our thoughts and actions over the last quarter. First, we report on what companies are telling us about cost inflation. Second, we highlight a new wave of speculative capital and contrast our approach to investing in real growth opportunities. Third, we explain why we are determined to do our own work on environmental and social responsibility, rather than outsourcing it to ratings agencies. Lastly, we note that despite growing valuation bubbles in parts of the market, the portfolio is benefiting from both attractive valuation upside and good growth prospects.

What are companies telling us about inflation?

We are more interested in the inflation companies are seeing on the ground rather than the debate economists are having with their spreadsheets. Over the quarter, our companies reported an acceleration in cost inflation in items including freight, energy, chemicals, timber, corn, tea, palm oil and food ingredients. Wage inflation has been unsurprisingly benign, but almost all of our companies that reported expect it to increase.

Company responses to rising input costs divide into those expecting to raise their own prices and those planning to offset cost pressures with savings and efficiencies. We aim to own companies that fall into the first category. These include businesses like equipment rental company **Ashtead**, which is welcoming cost inflation by sending the message to its sales force that "there is a better rate to be gained". Paper and packaging firm **Mondi** made similarly positive comments, noting that inflation always comes with both better paper pricing and higher margins, which it is starting to see. Whilst there are many contributing factors to pricing power, the inability of supply to quickly increase to meet demand is the most reliable source. In Mondi's case, the significant capacity upgrade of its huge Ruzomberok plant in Slovakia started in 2017, with the latest machine only commencing production in January this year. In mining, the gap between planning and production can be much longer.

We started new positions in two mining companies during the quarter. **Antofagasta** is a Chilean-based copper miner. The company first listed in London in 1888 and the founding family, who retain a significant holding, share our view on sustainable investment for the long term. Copper is set to be a beneficiary of rising demand for electric vehicles and renewable energy. Supply is constrained, and there are few new ore discoveries in politically or geographically attractive locations.

In March, we also bought a new position in **Anglo American**. It is a more diversified miner, with exposure to precious metals and nickel assets, which should also benefit from accelerating structural tailwinds. Anglo has undergone a transformation under CEO Mark Cutifani, who we met during the quarter. It has invested well, upgrading both the quality of its assets and pioneering new technology to increase returns. Anglo's willingness to invest in growth was critical to our purchase.

Anglo's growth strategy is in contrast to that of **Rio Tinto**, which we sold from the portfolio during the quarter. We believe Rio's policy of paying out over 70% of profits as dividends risks starving its business of investment and growth. We have also become concerned that its poor handling of relations with local communities may be symptomatic of underlying governance problems, and will have a long-term impact on its ability to replenish its asset base in Australia.

We sold a number of stocks where we feel pricing power may be an issue in a rising cost environment. Both **Bunzl** and **Compass** have seen a strong recovery in share prices. However, their margin structures make them susceptible to increases in input costs. **Vodafone** has become used to a tough competitive environment. Nevertheless, we are concerned that a strategy now focused solely on cost reduction and dividend will damage the long-term prospects for the business. We exited our position.

In March we sold **GlaxoSmithKline**. Its pricing power is earned through the development of new drugs and is eroded as soon as patents expire. The overhaul of its research function three years ago has not produced enough new products to mitigate the patent expiries due over the coming years, and there is an increased risk that management will look to expensive M&A to plug the gap.

The return of snake oil salesmen

For the willing investor, 2021 has seen no shortage of opportunities to destroy capital. Special Purpose Acquisition Companies (SPACs) have raised more money in Q1 2021 than in the whole of 2020, and more in 2020 than in every previous year combined. SPACs are IPOs of companies with no revenues, which raise money in the hope of building a business through acquisition later on. The $100bn poured into SPACs so far this year looks to us like a self-destroying Ponzi scheme rather than a route to capital growth. Charlie Munger's comment that "The investment banking profession will sell sh*t as long as sh*t can be sold" reminds us that the market will never fail to find new ways to lose money.

In contrast, our quest to find growth involves buying established cash generative businesses that can deploy capital wisely into sensible long-term organic growth opportunities. **Bodycote** and **Mondi** are examples of two such companies that we purchased during the quarter.

Bodycote is the world's largest metal treatment specialist. The company offers innovative treatment techniques for lightweight metals that will be essential in reducing energy usage, particularly in electric vehicles and narrow body aircraft. Its strong balance sheet and high levels of cash generation allow significant investment in these growth trends, as well as expansion into new geographies.

We started a new position in Mondi, which is well-placed with its large and leading network of paper, cardboard and flexible packaging production facilities. Its volumes are continuing to see a material step-up thanks to e-commerce-driven cardboard box demand, its customers moving from plastic to paper bags, and the leading position it has in barrier coating technology, allowing paper solutions to reduce plastic use in consumer and other products. Management's investments in new and upgraded production have been well timed to meet accelerating demand.

Many of our companies reported promising growth investments during the quarter. **Whitbread** accelerated expansion in its German hotels business. A capital raise during 2020 has enabled it to invest at a time when its competitors are in financial distress and thus emerge in a stronger position. **Ashtead** has increased its spending on new rental equipment, further widening its lead against smaller competitors. The investment included the largest ever order of equipment from JCB, causing JCB to reverse its plans to cut jobs in the UK. **Smith & Nephew** reported its R&D spending rose by a third last year compared to the average of the last five years, which is in line with its strategy to reignite organic sales growth.

Beware the ESG badge of honour

Observant readers may have noticed our AA MSCI ESG rating on the front of this document. Grateful as we are to receive such accolades, we are convinced that badges and ratings are no substitute for thoughtful analysis and engagement. We are equally concerned that some companies themselves believe that they can fulfil their responsibilities by completing a questionnaire that places them above average in a poorly performing industry.

Our proprietary ESG scorecard continues to be critical to our analysis of and engagement with companies. Whilst we have access to research from third-party ESG providers, we find it of questionable quality and reliability. We continue to do our own detailed work on both governance and sustainability. Here we can now draw upon the resources and expertise of Regnan, JOHCM's affiliated responsible investment business, as well as collaborate with other investors through organisations such as ShareAction.

Our work on **Serco's** social agenda, particularly in relation to its operation of prison services, highlighted the excellent progress the company has made since new management arrived six years ago. Our checks with government inspection and monitoring bodies confirm this view, something that external ESG rating agencies have been slow to recognise. We believe that endeavouring to ensure that our companies operate sustainably remains the responsibility of investors. It is not something that can be outsourced to a third party for a fee.

Increasingly, our companies are not only improving the impact they have on the world around them, but are also benefiting from producing products and services that enable a positive change. Companies such as **SSE** and **Wood Group** are enabling the transition to renewable energy, whilst **Johnson Matthey** and **Bodycote** will play significant roles in the growth of electric vehicles.

We are continuing to press companies on issues such as plastic waste, having had some success last year in our engagement with **PZ Cussons**. A range of regulatory incentives and penalties for companies which contribute to plastic waste are coming into force across the globe, and we are encouraging more ambitious targets and greater transparency from our companies.

Valuation bubbles and discipline

Our optimism for the prospects of our portfolio does not extend to the overall market. As capital chases a recovery, there are growing valuation bubbles across the market which need to be avoided. The S&P 500 index has just finished its best 12 months in almost 100 years of back-calculated history, helped by the spectacular price rises of companies that make up the Goldman Sachs Non-Profitable Tech basket. Oil majors, desperately diversifying into renewables, drove UK offshore wind auction prices to levels that will ensure the winning bidders destroy value. At the start of the year, Tesla's market cap exceeded that of the world's top ten car makers combined.

Our determination to seek well managed businesses investing behind sustainable growth tailwinds does not diminish our focus on valuation control and sell discipline. During the quarter, we sold our position in **Intertek**, where the valuation more than reflected the enticing prospects we see for the company. The stocks we have added have come with both attractive valuations and positive long-term growth outlooks. At the time of writing, we can see better valuation upside in the portfolio than before the pandemic as well as better growth prospects.

FUND WEBINAR | Q1 2021

JOHCM UK Opportunities Fund

5 year discrete performance (%)

	31.03.21	31.03.20	31.03.19	31.03.18	31.03.17
A GBP Class	26.10	-14.67	9.71	-3.46	12.31
FTSE All-Share TR Index	28.76	-19.06	5.93	1.36	21.88
Relative return	-2.07	5.41	3.57	-4.76	-7.85

Past performance is no guarantee of future performance.

Source: JOHCM/FTSE International/Bloomberg, NAV of Share Class A in GBP, net income reinvested, net of fees as at 31 March 2021. 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.

Top 20 holdings

	Stock	Weight (%)
1	Ashtead	3.39
2	HomeServe	3.23
3	Smiths	3.21
4	Next	3.20
5	WPP	3.19
6	Serco	3.17
7	Anglo American	3.15

	Stock	Weight (%)
8	Whitbread	3.14
9	PZ Cussons	3.13
10	Johnson Matthey	3.13
11	SSE	3.10
12	Smith & Nephew	3.08
13	Antofagasta	3.05
14	Hays	3.02

	Stock	Weight (%)
15	UDG Healthcare	3.02
16	Tate & Lyle	2.99
17	Relx	2.99
18	Mondi	2.94
19	Morrisons	2.91
20	QinetiQ	2.88

Source: JOHCM/Bloomberg as at 31 March 2021. Cash position 6.55%.

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%	0.88%	£1,000
A Dis GBP	GB00B3K76Q93	B3K76Q9	JOHUOII LN	A0RGE1	Up to 5%	0.75%	0.88%	£1,000
Y Acc GBP	GB00B95HP811	B95HP81	JOHUOYA LN	A1XCAZ	Up to 5%	0.625%	0.75%	£50,000,000
Y Dis GBP	GB00B95J5C19	B95J5C1	JOHUOYI LN	A1XCAY	Up to 5%	0.625%	0.75%	£50,000,000

Source: JOHCM as at 31 March 2021. Performance fee: 15% on excess if Fund outperforms benchmark, calculated daily excluding the A GBP share classes. Any underperformance carried forward. *Other currency equivalents apply.