# CORE THOUGHTS

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## Q2 2021 update

- Over the last three months the fund returned 3.83% compared to the FTSE All-Share Total Return index's return of 5.09%.
- The strongest performers included Morrisons and UDG, both of which received private equity bids. Ashtead, Smith and Nephew and AstraZeneca were up over 15% during the period.
- We will vote against deals which undervalue our portfolio companies, as we did recently with UDG, and will advise companies to use their best defences.
- We have continued to find new opportunities in companies that are investing in future growth. AstraZeneca, Inchcape and Glencore were all added to the portfolio during the quarter.
- Our valuation control led to the complete sale of Sage and Diageo. We sold Antofagasta on news of a deterioration in the political and tax situation Chile.

FE fundinfo Crown Fund Rating
FE INVESTMENTS APPROVED
MSCI ESG RATINGS AA
Rayner Spencer Mills RATED FUND

Ratings as at 31 May 2021.

## JOHCM UK Opportunities Fund

### Q2 2021 fund performance and positioning

**JOHCM UK Opportunities Fund**
Periodic performance (%) to 30.06.21

| | 3 m | 6 m | 1 y | 3 y | 5 y | SI p.a.[1] |
|---|---|---|---|---|---|---|
| JOHCM UK Opportunities Fund | **3.83** | **9.26** | **15.45** | **13.84** | **28.72** | **7.92** |
| FTSE All-Share TR Index | 5.09 | 10.77 | 21.04 | 5.98 | 39.77 | 6.15 |
| UK All Companies Sector | 9.78 | 16.85 | 28.50 | 10.99 | 44.31 | 6.90 |
| Quartile* | 4 | 4 | 4 | 2 | 4 | 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 30 June 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 30 June 2021. Note: The current managers took over the fund on 1 October 2017. [1]Annualised.

### Long-term capital growth

We aim to grow your capital over the long term. For all the complexities of process, valuation techniques and portfolio construction, the end game is the same. Our focus is to take every pound entrusted to us and turn it into something greater. To do this we invest your money (or your clients') in companies where we believe future cash flows are going to be bigger than the cash flows they make today. Of course, what we pay for those cash flows today matters a lot (more on that later), but we start this quarterly review by discussing how the new investments we made in the quarter will, we believe, grow their cash flows in four very different markets.

### AstraZeneca

AstraZeneca is one of the world's leading pharmaceutical companies. To grow, pharma companies must discover new treatments and cures that are better than those currently available. To do this they will need a research and development process that is positioned at the leading edge of science yet retains a commercial focus. AstraZeneca overhauled its R&D function in 2012, so we have a reasonable pool of data to assess its R&D capability. The model has been to locate three global R&D centres in areas of scientific excellence: One near the University of Cambridge Biomedical Campus, one in the US life sciences centre in Maryland and one in Europe's "Medicon Valley" in Gothenburg. During that time, the company's R&D productivity has moved from being well below industry levels to a level almost three times the industry average. In the next few years, growth will be driven by new drugs that have already been approved and cash flow will accelerate as drugs move out of the development phase and into production. Having remained on the sidelines for many years, mainly due to valuation concerns, we used share price weakness in April to build a full position.

## Inchcape

Inchcape makes 90% of its profit as a distributor for large car companies. It acts on behalf of companies such a Toyota, Jaguar Land Rover and Daimler in various countries, taking responsibility for sales planning, importing vehicles and parts, marketing and managing local independent car retailers. Its investment in systems and technology makes it the market leader and partner of choice for car manufacturers in countries that are deemed too small for them to set up their own operation. Inchcape's success in winning new contracts has been accelerating, with contracts wins from Jaguar Land Rover in Indonesia and Daimler in Guatemala announced this year. In addition to new contract wins, it aims to grow by using digital technology to extend its share of the used car market. The business is benefiting from increased demand for car ownership in its main geographies, which has accelerated as a result of the Covid-19 pandemic. And, in the medium term, we will also see a big replacement cycle as new car technologies become more widespread.

The business is well-managed, investing for growth and runs a nearly net cash balance sheet, both because it has large working capital requirements and to act as a buffer in cyclical downturns.

## Moneysupermarket

Moneysupermarket is by far the UK leader in comparison websites, operating websites such as MoneySavingExpert and TravelSupermarket in addition to the eponymous Moneysupermarket.com. It has good growth potential in energy, credit cards, mortgages and personal loans. New auto-switching products such as the Cheap Energy Club are also driving faster growth as well as improved customer retention. Its technology is increasingly being sold as a white label product to third parties.

The business model is attractive, offering good levels of recurring revenues in a consolidated market, high margins, net cash on the balance sheet and a long runway for growth. We used share price weakness in March, which offered an attractive valuation entry point, to start a position.

## Glencore

Glencore is a mining company that finds itself with assets that are critical enablers of the global energy transition. It has significant exposures to both copper and cobalt, where industry supply is increasingly constrained by geography, geology and politics.

One of Glencore's main weaknesses has been its record on sustainability. The company has witnessed a transformation in its culture recent years, with new heads in each division and, from June this year, a new CEO. It has committed to reducing legacy coal production and to ambitious carbon net neutral targets. Our work on its approach to sustainability revealed a company that has made significant strides and is determined to position itself at the forefront of its industry. Past infringements mean that it is has had to provide for a material fine from regulators, which will be announced shortly. This should serve to remind management of the importance of strong governance policies and proper implementation.

The business has also been run with very high levels of financial leverage in the past, which has prevented us from owning the shares. Its debt levels have greatly reduced, and we forecast net debt:EBITDA to be just above 1x in 2022, with management committing to maintaining these lower levels of leverage in the future.

Based on a range of commodity price scenarios and the improvements being made to the business, we believe the shares offer good valuation upside.

## Valuation control at work – Sage and Diageo

After a decade when steady growth stocks mostly only went up, it is important to remind ourselves that the prices of great growing businesses can also go down. The profit you make on any investment is heavily dependent on the price you paid to start with. Buyers of Microsoft in late 1999 know this well. It took over 15 years for them to break even, despite ongoing growth in profits throughout that time.

We sold Sage and Diageo during the second quarter. Both remain high quality businesses with long track records of growth. Our valuation control suggested that the likelihood of us making money from the current valuation had diminished, even if the businesses continued to grow as we expect they will. We think of these businesses as long-term holdings with a current portfolio weight of zero. We will revisit them when the odds of making money are back in our favour.

Antofagasta was sold due to a change in the political situation in Chile and the risk of highly punitive mining taxes. After consulting with a Santiago-based mining tax contact, we concluded that calculating the probability of the change and the level of any new tax burden fell into the "too hard" bucket. Whenever there is significant risk of a material capital loss, our sell discipline kicks in and we exit. In this case, we have booked a good profit since we purchased the shares at the start of the year.

## Balance sheets – strong, not efficient

We like balance sheets to be strong, not efficient. The pandemic is a timely reminder that the unexpected does happen and that having cash reserves on hand enables not just survival but the ability to emerge in a stronger position than debt-laden competitors.

Balance sheet repair has been a decisive factor in the purchase of a number of current portfolio holdings. WPP's debt halved between 2017 and 2020, allowing us to start a position in a business that has the financial flexibility to invest for future growth. Wood Group's debt needed to fall 40% before we considered investing, whilst Glencore's changed approach to debt has enabled us to purchase a stock that would not have passed our quality control five years ago.

We have been willing to tolerate higher leverage in utility companies where debt is asset-backed and supported by revenue streams with high visibility. However, our patience with increasing levels of debt within our utility sector holdings is being tested. These businesses are beholden to the needs of income investors who value dividends above corporate resilience. We have arranged a meeting with the incoming chair of SSE to raise our concerns, which we hope will be received with more sympathy than they have been by his predecessor.

## Barbarians at the gate

June saw two bids for stocks in our portfolio. UDG received an increased offer following on from the initial bid that we rejected in May, whilst Morrisons has received offers from two private suitors with a potential third bidder considering their position.

We don't own companies with the intention of selling them to private equity at a higher price. Our experience is that private equity are not good owners of companies. Any business model that depends on loading a company with debt so that massive dividends can be extracted is bad news for the company and its employees, suppliers and customers. Our job as listed equity fund managers is to own companies which are well-positioned, investing in the future and doing the right thing for all stakeholders. We believe the openness with which listed companies have to disclose strategy and its impact on stakeholders is a critical part of ensuring accountability. We also need to implement an investment process which includes a valuation control. We will vote against deals which undervalue our portfolio companies, as we did recently with UDG, and will advise companies to use their best defences. Our belief is that regulators and governments need to do a better job of protecting listed companies from barbarians at the gates.

The knock-on effect of this year's record level of bids is that boards of companies with strong balance sheets will become tempted to increase their own level of debt as a pre-emptive defence. Debt levels at our portfolio companies remain well below the market average and have been reducing since the start of the pandemic. We will continue to encourage executives to target strong balance sheets and will be intolerant of those that do otherwise.

## Sustainability

Companies that do not address their impact on society and the environment will fail in the long run. We continue to push companies to address their most significant issues with meaningful targets and transparent disclosures.

During the quarter, we continued our work to push our plastic producing companies to do more to improve their impact on the environment. We held meetings with Unilever and PZ Cussons and had email correspondence with Reckitt Benckiser.

The change in consumer preferences and increasing legislation is a growing headwind for companies who are not addressing their level and type of plastic production. New regulations from Chile to India to the EU are tightening restrictions on single-use plastic containers. In a recent survey, 47% of UK consumers said they would be willing to pay more for sustainable packaging. For companies, this is also an opportunity to deliver a premium-priced product.

Plastic needs to be both made from recycled material and be easily recycled. Companies need to invest in reuse and refill schemes and partner with local authorities in regions where recycling initiatives are limited. During the quarter, we pushed companies on targets, disclosure and, most importantly, on progress in this area.

We have also begun engagements with the mining companies in the portfolio. The mining sector has the potential to have both the most dramatic negative sustainability impact as well as the opportunity to act as a force for positive change. The best mines are investing not only in environmental and safety improvements, but in healthcare, education and infrastructure in some of the most deprived areas of the world. In addition to the positive impact this can have on communities, it also makes good business sense. We have found that companies that work with and for local stakeholders have better relationships with governments and regulators, suffer few strikes and have higher productivity. We are encouraging our mining companies to do more in this area and improve their disclosure.

## JOHCM UK Opportunities Fund

5 year discrete performance (%)

| | 30.06.21 | 30.06.20 | 30.06.19 | 30.06.18 | 30.06.17 |
|---|---|---|---|---|---|
| A GBP Class | 15.45 | -5.61 | 4.48 | 2.67 | 10.12 |
| FTSE All-Share TR Index | 21.04 | -12.56 | 0.14 | 8.66 | 21.37 |
| Relative return | -4.62 | 7.95 | 4.33 | -5.51 | -9.27 |

**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 30 June 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 | AstraZeneca | 3.57 |
| 2 | Smith & Nephew | 3.44 |
| 3 | Ashtead | 3.36 |
| 4 | Smiths | 3.33 |
| 5 | IMI | 3.28 |
| 6 | WPP | 3.26 |
| 7 | Morrisons | 3.20 |

| | Stock | Weight (%) |
|---|---|---|
| 8 | Johnson Matthey | 3.20 |
| 9 | SSE | 3.18 |
| 10 | Next | 3.17 |
| 11 | QinetiQ | 3.16 |
| 12 | Relx | 3.16 |
| 13 | Serco | 3.13 |
| 14 | Homeserve | 3.09 |

| | Stock | Weight (%) |
|---|---|---|
| 15 | National Grid | 3.08 |
| 16 | Mondi | 3.03 |
| 17 | Hays | 3.01 |
| 18 | Tate & Lyle | 2.98 |
| 19 | Whitbread | 2.97 |
| 20 | Unilever | 2.96 |

Source: JOHCM/Bloomberg as at 30 June 2021. Cash position: 6.75%.

## Share class details

| | ISIN | SEDOL | Bloomberg | WKN | Initial charge | Annual charge | Ongoing charge | Performance fee | Minimum investment* |
|---|---|---|---|---|---|---|---|---|---|
| A Acc GBP | GB00B0LLB641 | B0LLB64 | JOHUOIA LN | A0H1DL | Up to 5% | 0.75% | 0.90% | No | £1,000 |
| A Dis GBP | GB00B3K76Q93 | B3K76Q9 | JOHUOII LN | A0RGE1 | Up to 5% | 0.75% | 0.90% | No | £1,000 |
| B Acc GBP | GB00B0LLB757 | B0LLB75 | JOHUORA LN | A0JLVD | Up to 5% | 1.25% | 1.40% | Yes | £1,000 |
| B Dis GBP | GB00B3K76P86 | B3K76P8 | JOHUORI LN | A0RGE2 | Up to 5% | 1.25% | 1.40% | Yes | £1,000 |
| Y Acc GBP | GB00B95HP811 | B95HP81 | JOHUOYA LN | A1XCAZ | Up to 5% | 0.625% | 0.76% | Yes | £50,000,000 |
| Y Dis GBP | GB00B95J5C19 | B95J5C1 | JOHUOYI LN | A1XCAY | Up to 5% | 0.625% | 0.76% | Yes | £50,000,000 |

Source: JOHCM as at 28 May 2021. Performance fee charged on classes B and Y at 15% on excess if Fund outperforms benchmark, calculated daily. Any underperformance carried forward. There is no performance fee on the A GBP share classes. Any underperformance carried forward.*Other currency equivalents apply.