JOHCM Global Income Builder Fund

GLOBAL VALUE AND INCOME DISPATCH

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Q1 review: In the midst of chaos, there is also opportunity

The World Health Organization previously warned of the risk of a "Disease X", which it defined as an "unknown pathogen that could emerge with little warning to cause a serious international epidemic." Alas, Disease X is here, and governments and policy makers have been caught woefully unprepared.

Machine-driven financial markets have also not handled the shock well. Liquidity has evaporated, and even higher quality assets such as investment grade debt and commercial paper have felt dislocation. The words of Sun Tzu remind us, "In the midst of chaos, there is also opportunity."

Q1 2020 returns & indicators

MSCI World Value Index	(26.80%)
Bloomberg Barclays US Agg	3.15%
ICE BofAML BB-B Global High Yield Constrained	(13.69%)
EUR vs. USD	(1.62%)
JPY vs. USD	1.02%
Gold	3.95%
US 10-Year Yield (31 Dec 19)	1.92%
US 10-Year Yield (31 Mar 20)	0.67%

Source: Bloomberg as at 31 March 2020.
Returns quoted in US dollar terms.

Portfolio Executive Summary

The Coronavirus pandemic has been a game-changing event for the global economy and has drawn parallels in the media to the Great Depression. However, much about the virus is **not** yet known (including the extent of its spread, its true mortality rate and potential treatment options). As a result, **extreme predictions, both pessimistic and Pollyannaish, should be viewed cautiously**.

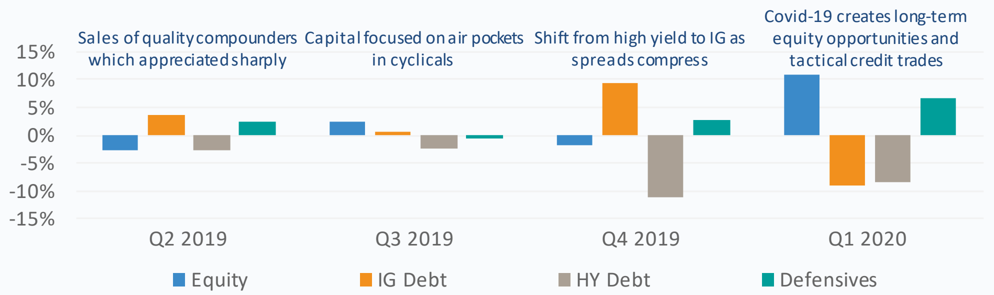
With time, the virus will likely be cured or contained. If not, we will adapt to live with it. More likely, SARS-CoV-2 (like other coronaviruses) will adapt to live with us. Unfortunately, the human cost has been, and will continue to be, very tragic.

Our strategy seeks to take advantage of market stress and so, after having been net sellers for much of the prior 12 months, we **deployed over 1,000 basis points into equities** during the coronavirus-related volatility.

Key recipients of capital can be grouped into the following three themes:

1. **Credit dislocation:** opportunities related to the freeze-up in high quality investment grade bonds and US utility shares;
2. **Quality compounder** businesses which we believe we can hold for 5+ years that had previously been too expensive; and
3. **Deep value** toehold investments in sectors disproportionately but temporarily affected by the virus, such as the travel and hospitality industries.

Capital deployment – trailing 4 quarters



Source: JOHCM, Bloomberg as at 31 March 2020.
Represents estimated capital shifts net of asset class performance.

Portfolio positioning

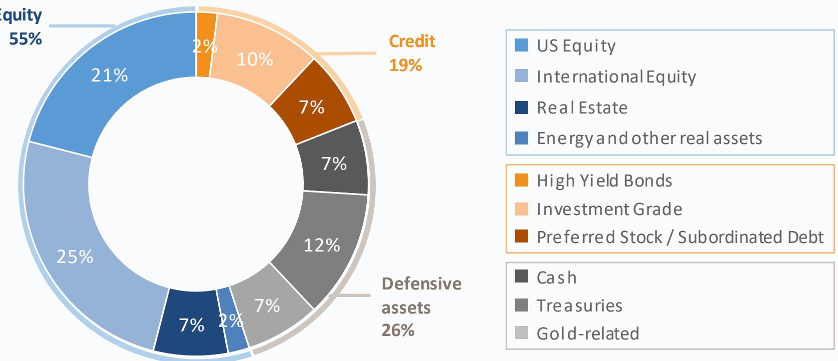
Despite the steep stock market falls, our equity exposure increased significantly and ended the quarter at roughly 55%, as the capital we deployed into equities more than offset market declines. **This represents the highest equity exposure we have had since we launched the Fund in 2017.**

Equity purchases were funded by sales of corporate debt investments. The decline of credit, however, masks significant intra-quarter activity. We raised cash from corporate debt in January and continued to do so in the early phases of the crisis. We expected there to be better opportunities to deploy the cash later on and wanted to build liquidity in advance of this. Some of this capital was deployed back into corporate debt as those markets broke down in mid-March and credit market weakness began to infect even the highest quality issues (see "TANSTAAFL?" below). In recent days we have harvested capital again from investment grade corporate debt as spreads quickly returned much closer to normalized levels.

We have also repositioned some of our defensive assets in favor of gold-related investments in anticipation of significant money printing in the years to come. Recent credit profit-taking has left us with significant additional liquidity to deploy.

GIB strategy by asset class and region (as at 31 March 2020)

Managers' estimates: subject to change without notice



Source: JOHCM, Bloomberg as at 31 March 2020.

#1a: Credit dislocation…TANSTAAFL?

Below we will review the three themes presented above in order. For those who are unfamiliar with the acronym above, it denotes the phrase **"there ain't no such thing as a free lunch."** We agree. However, with markets breaking down and liquidity vanishing, forced selling of some of the highest quality corporate debt during the week of March 16th provided the closest we have seen to free lunches since the forced liquidations of credit funds during the GFC.

We found debt of highly solvent businesses offered at spreads hundreds of basis points wider than normal. This opportunity was largely driven by liquidity shortfalls as investors exited ETF positions (such as the LQD) and prime money market funds in droves. We have written separately, in more detail, on investment grade (https://www.johcm.com/us/news-views/details/1890/global-value-and-income-dispatch).

ICE BofA Single-A US Corporate Index Option-Adjusted Spread

Source: Federal Reserve Bank of St. Louis. JOHCM.

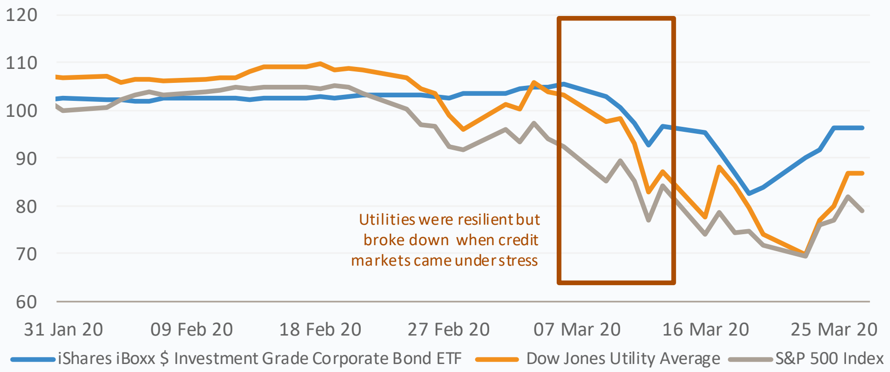
#1b: Credit dislocation echoes across asset classes

As a cross-asset team, we were also able to find ways to take advantage of the credit market dislocation through certain equity investments. For instance, the valuation of regulated utility companies is highly sensitive to investment grade (IG) credit spreads. As a result, when IG markets came under stress, as described above, utilities also fell sharply.

Once the Federal Reserve took steps to help stabilize the key funding markets (e.g repo, Treasury and commercial paper) along with programs targeted to explicitly purchase high quality corporate debt, credit markets reacted and it became more difficult to find attractive higher quality (IG) bonds to buy.

Equity markets, however, have been slower to process the impact of the Fed's actions on credit markets. This provided an opportunity to deploy capital into US regulated utilities, with the added benefit of knowing that the Fed had already undertaken actions to stabilize IG. The opportunity continued to persist even as credit markets were healing.

Credit market stress created opportunities to buy certain equities



Source: Bloomberg as at 31 March 2020.

We have already begun harvesting some of these investments as they have yielded double-digit returns, in some cases, in less than a week.

#2: Quality compounders: QARP-a-diem?

A broad-based market sell-off that is compounded by illiquidity can provide attractive entry points to some of the market's more exceptional businesses.

As a result, a significant component of the capital we have deployed has been directed to what we call **Quality-at-a-Reasonable-Price** (or **QARP**) investments. Such businesses have high barriers to entry, strong returns on invested capital and long secular growth runways. In the recent quarter, a number of these businesses reached prices where even valuation-sensitive investors, such as ourselves, have begun to find them attractive. QARP investments were focused on the technology industry (including both **hardware** and **software**) as well as platform businesses in **payments**, **online media** and **services** industries.

In some cases, this has also represented a re-entry into certain software and consumer products champion positions that we had only recently reduced.

We have managed through a number steep downturns in our respective careers, and QARP "entry points" are one of the signature hallmarks of broad-based market declines. The current crises marks the first time since December 2018 that we have seen value in some of these leading businesses of the day. These are businesses we would be eager to hold for the next 5+ years.

#3: Deep value

Clients have often heard us say that we view it as our job to deploy capital in times of market stress We know we will be early in so doing. However, as we have frequently written (See 'Blink and you might miss it'), market liquidity evaporates when volatility spikes. This can be true both on the way down and the way up (note S&P 500's 3-day near 20% rally on March 23). We feel it is important to commit capital when value exists and not only when one feels the market has bottomed. In volatile markets, waiting for comfort can often be too late.

Below are a few simple thoughts that we put into play when deploying capital into the industries that may seem at the heart of a market shock, but where (i) we feel that declines are likely to be temporary, (ii) there is good reason to believe that industry activity will normalize, and (iii) where price reactions have been extreme.

Deep value buyer's checklist:

1. Focus on companies with strong balance sheets as they can take advantage of stress and often emerge stronger;
2. Look for businesses that have high market share that are indispensable to their value chain; and
3. Pace yourself – there will likely be bargains the next day too.

Repositioning defensives – MMT is here (MPT is gone)!

With the unprecedented measures being undertaken to support markets by fiscal and monetary authorities, we have modestly increased the gold component of our defensives basket. Unlike the quantitative easing measures that sprung to life during the Great Financial Crisis, the trillions in stimulus currently planned by Congress appear to represent a more direct infusion of previously non-existent "helicopter" money into the real economy.

These measures will be supported by unlimited quantitative easing. To us, this effectively boils to "Modern Monetary Theory" (or MMT). We are financing an unprecedented spending program through outright purchases of sovereign debt.

The Fed is also employing 10x leverage to loss guarantees provided by the US Treasury. These measures are being replicated by other central banks globally.

There is ample justification for pulling out the policy bazooka given the current crisis. Still, with all this paper money flying around (see comments in margin), it makes sense to us to own a bit more of a currency that cannot printed.

Modern Portfolio Theory (or MPT) may once again have led investors astray. Under stress, correlations have once again gone to one and minus. Traditional risk models tend to break down when vol spikes (note stress in Risk Parity funds).

We believe that the ability to deploy cash into risk assets in time periods of stress will be viewed more favorably in the years to come, and that **asset allocators may have to rethink the style-box driven, fully invested approach** and the "false diversification" that it can produce.

A word on high yield debt

Generally speaking, we are not finding compelling value in high yield credit at the moment. Indeed we remain cautious with respect to the opportunity set in lower-rated corporate credit markets despite elevated spreads, as many issuers will face great difficulty navigating the current economic landscape. **This may seem surprising given that we have deployed capital into equities.**

The explanation lies in some of the sector exposures found in high yield indices. Roughly a third of the issuers are in areas directly affected, and we see strong bifurcation between more resilient issuers and those more challenged, as benchmark high yield managers are hiding in the former.

There is also just an element of adverse selection in high yield, as the ability of some issuers to withstand the intense short-term economic pain is unclear, while the compensation for investing in safer issuers is not yet that attractive.

Framing the uncertainty?

While we are not epidemiologists we did want to share our own base case for how the current crisis ***could*** play out. With every day that passes, more is known about Covid-19. Barring a significant adverse mutation (which is perhaps the biggest known risk), we may be past the period of peak uncertainty. Death tolls – tragically – will continue to mount in the weeks ahead, but it seems a playbook is emerging for how governments will handle the crisis that allows some economic assessments to be made. Below is **our sense** of a **reasonable base case**:

1. Lockdown measures reduce "true" case growth almost immediately (though this may not be seen immediately due to lag-effects and increasing testing rates);

2. Awareness/social distancing reduces the spread (or "R0") on an ongoing basis;
3. As lockdowns begin to ease, we may see flare-ups and second waves should individuals relax their social distancing practices;
4. Drug therapies show some effectiveness and treatments improve, which alleviates demand for ICU beds;
5. Hospital capacity ramps (temporary hospitals, fever hospitals, etc.) further alleviating the risk of overwhelming the medical system;
6. Hospitality, entertainment and personal services continue to suffer until there is a vaccine, leading to high unemployment and broader economic weakness;
7. With no "villain" (such as Wall Street greed or rating agencies) this time, fiscal and monetary authorities are **unshackled** and provide unprecedented support to cushion the blow, which, while appropriate, risks future inflationary effects;
8. Local authorities continue to impose lockdowns as needed to protect healthcare systems from overflow, but ongoing measures become more targeted and focus on elderly and infirm;
9. Testing ramps up significantly and allows for more effective quarantining;
10. Vaccine arrives ahead of schedule in 12 months but takes months to scale.

Our game plan

Given the opportunities from the market decline, we are now closer to a more fully-invested position. Fully invested would be roughly 65% equity exposure for our strategy. We are not all the way there, however, and so **we retain significant additional buying power**. We expect further volatility as governments struggle to restrain the virus and as market participants continue to dimension the long-term consequences. We are prepared to commit additional capital to risk assets should further market dislocations provide new opportunity.

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5 year discrete performance (%)

Discrete 12 month performance (%):

	31.03.20	31.03.19	31.03.18	31.03.17	31.03.16
A GBP Class	-1.28	-	-	-	-

Past performance is no guarantee of future performance.

Source: JOHCM/MSCI Barra/Bloomberg Index Services Limited, NAV of Share Class A in GBP, net income reinvested, net of fees as at 31 March 2020. The A GBP Class was launched on 30 April 2018. Performance of other share classes may vary and is available on request.