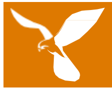


November 2018

JOHCM Funds

Global Value and Income Dispatch

Time to step outside ... but bring an umbrella!

- *A strong Q3 seems ancient history as trade friction, rising real rates and earnings misses upend the momentum-fueled rally*
- *A traditional cycle seems to be emerging – inflationary pressures are building and were rendered more acute by Trump stimulus, heightening the need for tighter monetary policy and cooling off – this is the right thing to do!*
- *It's the same world, only cheaper ... improved valuations lead us to "step outside" and add capital to equities during the market sell-off while being mindful of the impact of ebbing global liquidity and pacing ourselves ("carrying an umbrella")*

Q3 market summary

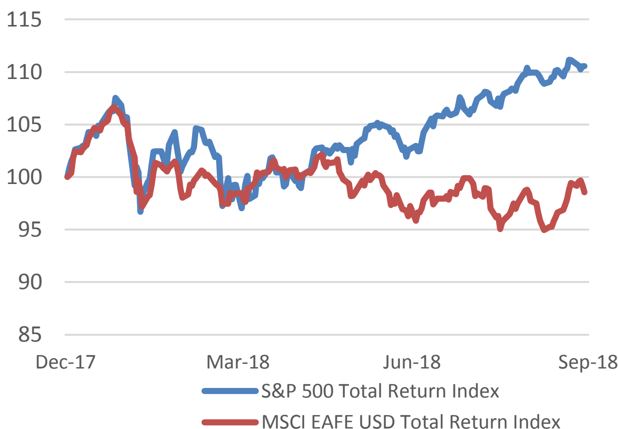
The MSCI World Index increased by 5.1% during Q3 2018 in dollar terms, while the Bloomberg Barclays US Agg Total Return Index was flat and the ICE BofAML BB-B Global High Yield Constrained Index rose 2%.

The US dollar continued to appreciate, with the euro, the yen and gold price returning -0.7%, -2.6% and -4.9%, in turn. Crude oil rose once again, with the price of Brent rising 5.5%. US 10-year Treasury yields increased from 2.86% to 3.0%.

America was indeed first ... last quarter

The quarter was a tale of two worlds, with the S&P 500 index outperforming the MSCI EAFE Index by over 600 basis points. Strength was broad-based, unlike earlier in the year when the US market was driven by technology shares. Tariff concerns hit Asian shares and political uncertainty (Brexit, Italy) weighed on Europe, while US markets benefited from flight to safety inflows that pushed up valuations.

The S&P 500 versus the MSCI EAFE

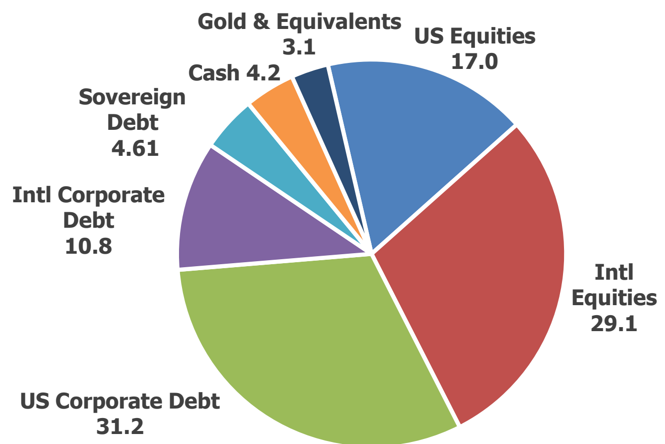


Source: Bloomberg.

Fund positioning in Q3

Fund positioning continued to be conservative during Q3. The strong momentum rally in US risk assets certainly did not improve the margin of safety available to investors. The slight increase in US equity exposure was largely the result of market performance.

GIB strategy by asset class and region (%)



Source: JOHCM.

Q3 seems to be ancient history

October saw the MSCI World index decline by 7.30%, sparked by US 10-year Treasury yields rising from 2.86% in early September to a peak of 3.23% in early October along with a spate of disappointing earnings reports.

Even though rising rates may have sparked the sell-off, rate-sensitive defensives, such as utilities, consumer staples and telecom shares, actually performed well during the decline. The technology trade finally seemed to fall victim to interest rate rises and tariff threats, as did various cyclical industries such as industrials, energy and consumer discretionary.

Drizzle or deluge?

It is a confusing environment. As markets fluctuate wildly from one tweet to the next, it can be hard to for investors not to get whipsawed. **Should investors buy because prices are lower or sell because the economy may be slowing?**

In times like this we recall the wisdom of legendary investor Jean-Marie Eveillard, with whom we had the great pleasure of working, who would warn that value investors get tripped up when they ignore the top down.

As a result, even as we are attracted by the lower valuations of many securities, we are mindful that for over a decade now central banks have pumped money into the

financial system. This rising tide of liquidity has indeed lifted many boats, and **we must not underestimate what can happen when liquidity tides ebb**.

The future is (always) uncertain…

We are big believers that the world is always an uncertain and unpredictable place, irrespective of whether market participants are focused on the risk or not.

Benjamin Graham, the father of value investing (and Warren Buffet's mentor), would often speak about the "uncertainties of the future." Given that the future is uncertain, investors should demand a margin of safety **whenever** they invest in risk assets in order to protect ones capital against "the vicissitudes of time"!

When we consider investments, we want to be mindful of the environment in which our estimates of business value are made. Many businesses tend to have stronger earnings streams when funding costs are held down by central banks and when their economies are boosted by deficit spending and rising debt levels. These are not the durable earnings streams in which we seek to invest.

US equity markets have been a difficult asset class for margin of safety investors, with valuations elevated due to money pouring in from other parts of the world. The current bout of debt and deficit fueled spending in the US had made us further inclined towards more sober estimates of long-term earnings.

…but lower prices are not

However, things have begun to change. While much of the uncertainties about trade wars, US Fed tightening and global economic slowdowns persist, **one important thing has changed: the world has become cheaper!**

For value investors, there is almost no more important factor. We seek to buy great business at good prices or good business at great prices, and we tend to have longer-term holding periods that often stretch across cycles. As a result, we look to periods of uncertainty and cyclical troughs to build positions that will drive returns for years and decades to come.

So what does all this mean?

Being a value investor often means taking the other side of human behavioral biases. At the same time, we must be aware of the effect of these biases on ourselves and acknowledging the limits of our knowledge.

At the core of this philosophy is the belief that markets are often inefficient and are dominated by short-term emotion or irrational thought patterns. Ironically, quant and momentum factor strategies may have amplified this. By seeking to front run human biases, these strategies may only serve to amplify them and lead to higher momentum peaks and bigger, more frequent troughs. This creates opportunity. When momentum breaks, there is limited liquidity to arrest the fall.

We observed this in particular over the summer, when minor earnings misses were greeted with spectacular share declines. Can a slight wobble in any specific quarter change the long term value of a business by more than 10%? To us this often seems unlikely and is certainly worth investigating.

All we can do is patiently and conservatively seek to assess those long-term values and add capital when margin of safety afforded by prices increases.

When prices decline, such that risk assets offer a greater margin of safety …we lean in!

Our advantage

One element of our investment process that is different is that we are an integrated team that looks across the capital structure. As a result, we don't have to be fully invested in any one asset class or area.

This allows us to have an absolute return approach that seeks above all to avoid permanent capital loss. When the equities of the business don't offer a margin of safety, we can often find a margin of safety, not to mention an attractive risk-adjusted return, by investing in the company's debt.

This capability allows us to practice the patience that we preach and represents a useful framework to help assess when it is worth the risk of adding capital to equities.

An investor should consider the Fund's investment objectives, risks, and charges and expenses carefully before investing or sending any money. This and other important information about the Fund can be found in the Fund's prospectus or summary prospectus, which can be obtained at www.johcm.com or by calling 866-260-9549 or 312-557-5913. Please read the prospectus or summary prospectus carefully before investing. The JOHCM Funds are advised by J O Hambro Capital Management Limited and distributed through FINRA member Foreside Financial Services, LLC. The JOHCM Funds are not FDIC-insured, may lose value, and have no bank guarantee.

RISK CONSIDERATIONS:

Investors should note that investments in foreign securities involve additional risks due to currency fluctuations, economic and political conditions, and differences in financial reporting standards. Smaller company stocks are more volatile and less liquid than larger, more established company securities. 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. Fixed income securities will increase or decrease in value based on changes in interest rates. If rates increase, the value of the Fund's fixed income securities generally declines. Other risks may include and not limited to hedging strategies, derivatives and commodities.

The views expressed are those of the portfolio manager as of November 2018, 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.