JOHCM Funds

January 2021

Global Value and Income Dispatch

Managing through rising rates with "2020 Hindsight"

Highlights

Flexible strategies like ours can help shepherd assets through the process of rate normalization

Relative to traditional fixed income we feel that equities offer better income, total return and resilience to rising rates

When we did deploy capital into fixed income it was often into more event-driven credit investments

Portfolio Executive Summary

As we enter 2021, we would highlight three key considerations for global value and income investors:

1) Think outside the bond!

- With fixed income offering minimal yield and high interest rate risk, we believe **dividend equities with pricing power can replace traditional bonds**.

2) Can value be the new growth?

- Our "Green Value" theme could dominate the 2020s as **decarbonization efforts globally will require trillions of dollars of *physical* capital**.
- Value investments also benefit from steepening yield curves and inflation and can help protect traditional fixed income against rising rates.

3) The "investment climate" is changing as ESG trends accelerate

- Income funds are some of the worst ESG offenders prominently featuring tobacco stocks and oil firms that don't have a "Paris-aligned" carbon plan.
- JOHCM Global Income Builder has divested tobacco, and we are proud to offer investors a **Smoke-free Income** alternative that is mindful of ESG.

Portfolio positioning – seeking careful balance

Equity exposure increased somewhat during the Q4 2020 to just over 60 percent of our portfolio, as the market appreciated and income stocks took share from bonds.

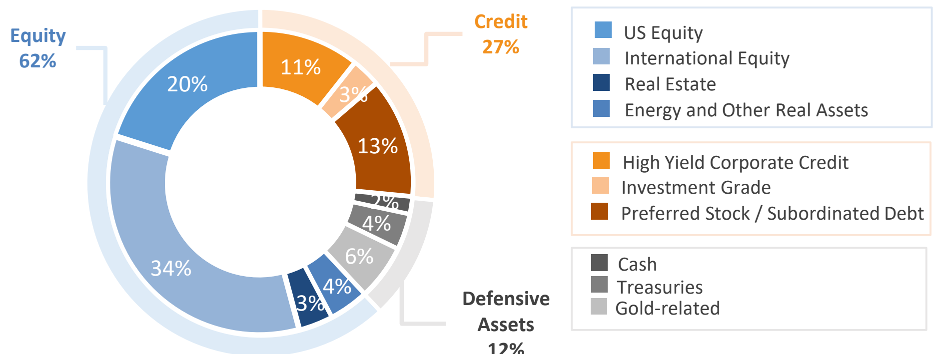
We may have seen the lows in US bond yields, and so it is critical to balance:

1. Longer duration, **rate sensitive assets** (across fixed income **and** equities) that could be impacted by rising rates with
2. **Cyclical, recovery-oriented investments** that could potentially profit from inflation, higher yields and/or steeper yield curves (see more on page 3).

Within credit, we continue to have a sizeable allocation to what a client once referred to as "Tweeners" (or non-traditional bonds such as preferreds, converts, hybrids and subordinateds). This is where we see value, with credit pretty well bid.

Current Allocation (as of 12/31/2020)

Subject to change without notice.



Source: JOHCM, as of December 31, 2020.

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Styles and factor exposures, like all risk measures, should be thought about along a continuum

Portfolio positioning (cont.) – Allocation shifts

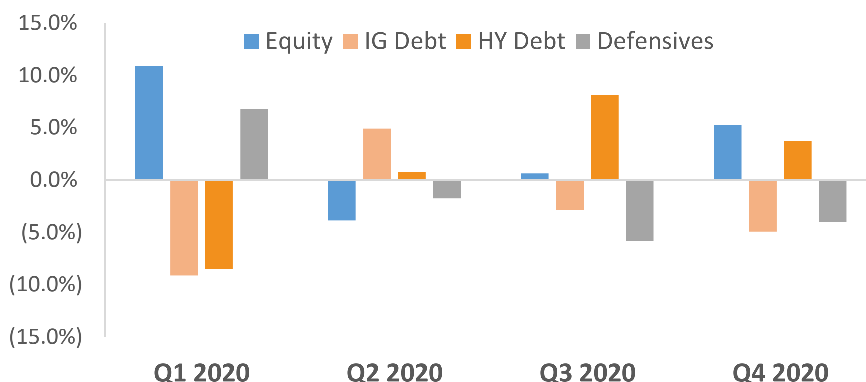
The most recent quarter's net deployment into equities can be seen on the right of the chart below, which shows allocation changes without the effect of price moves.

With many **recovery-oriented shares appreciating, we took some profits** in such areas as travel companies, foodservice and office real estate. We also exited an investment in a communication services company which is being acquired.

As recovery stocks rallied, defensives sold off, and so we more than offset our sales by **purchases of defensives that we feel have a *cyclical* component.** These were sold off along with other defensives and include pharmaceuticals, consumer staples and select utilities with a green energy transition aspect.

Both p**harmaceuticals and staples offer attractive income and growth**, while boasting strong pricing power to help offset inflation. Utility investments that can benefit from the transition to greener energy can recapture – as growth – some of the headwinds they may face from stimulus pushing up rates.

In fact, **a leading global green utility has just become a top ten holding**.



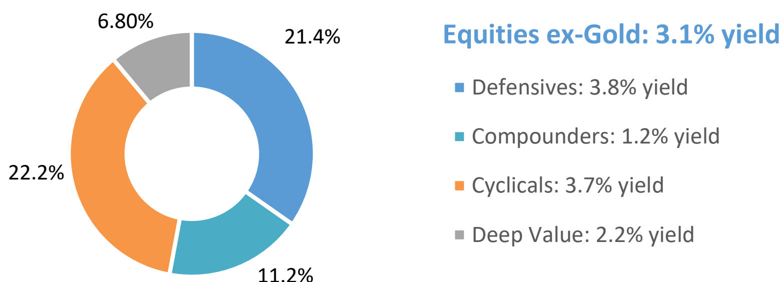
Source: JOHCM, as of December 31, 2020.

When we did deploy capital into fixed income it was often into more event-driven credit investments that we believe could have equity like returns. One example is a "busted" telecommunications company convertible bond (a "busted" convert has a strike price well above the share price, such that the buyer of the convertible pays very little for the embedded equity option). The bond is well covered by balance sheet cash, and the option could have more value than market participants think. We continue to hunt for cheap optionality in converts.

Stylistic positioning – it's all relative!

Styles and factor exposures, like all risk measures, should be thought about along a continuum, rather than distinct groups. While, the capital flows described above have led the nominally defensive component of our equities to increase, as described, these are carefully selected for their potential resilience to rising rates.

Equity holdings and yield (last 12 months) grouped by style



Sources Bloomberg, JOHCM as December 31, 2020.

Stylistic Review – it is all relative! (Cont.)

The wake of the January 5th US Senate runoff provided a good example of how managing rising rates can work in practice.

Indeed, in many ways these more "cyclical defensives" should be contrasted with traditional fixed income, rather than other stocks. In our view, they offer better duration featuring superior income, total return and resilience to rising rates.

This risk of rising rates is balanced further by our cyclical and deep value investments, which include financial services, materials and industrial businesses that should benefit from higher yields and inflation.

This balance can be seen in the previous chart, with longer duration businesses (defensives & compounders) in blue/green on the right and cyclicals on the left.

The wake of the January 5th US senate runoff provided a good example of how this can work in practice. **Materials, financials and other cyclicals generated strong returns even as interest rates rose,** as a Democrat majority in the US Senate can enable more, potentially-inflationary stimulus.

Utility shares also appreciated (especially those strong in renewables), demonstrating how their enhanced growth prospects were able to shield against the impact of rising rates.

Investment grade bonds, in contrast, saw declines.

The roles of different stylistic risk buckets in a modern income portfolio

Defensives	• Stable businesses that generate consistent income • Growth prospects often more moderate but durable • Consumer staples, healthcare, utilities, telecom services
Cyclicals	• Earnings streams that are economically sensitive • Potential inflation hedge for defensives and bonds • Industrials, materials, business services, financials
Compounders	• Strongly positioned in secular growth industries • Often lower income due to higher multiples • Software, semiconductors, automation equipment
Special Situations & Deep Value	• Generally idiosyncratic or counter-cyclical investments • Yields can range from low to very high depending the cycle • Current includes: restaurants, hotels/travel, office real estate

A value resurgence?

Since the announcement of the successful trials for the Pfizer / BioNTech and Moderna vaccines in early November, we have seen a strong resurgence in cyclical and recovery-oriented shares, as the impressive efficacy of the vaccines held out a path to a more complete normalization of everyday life.

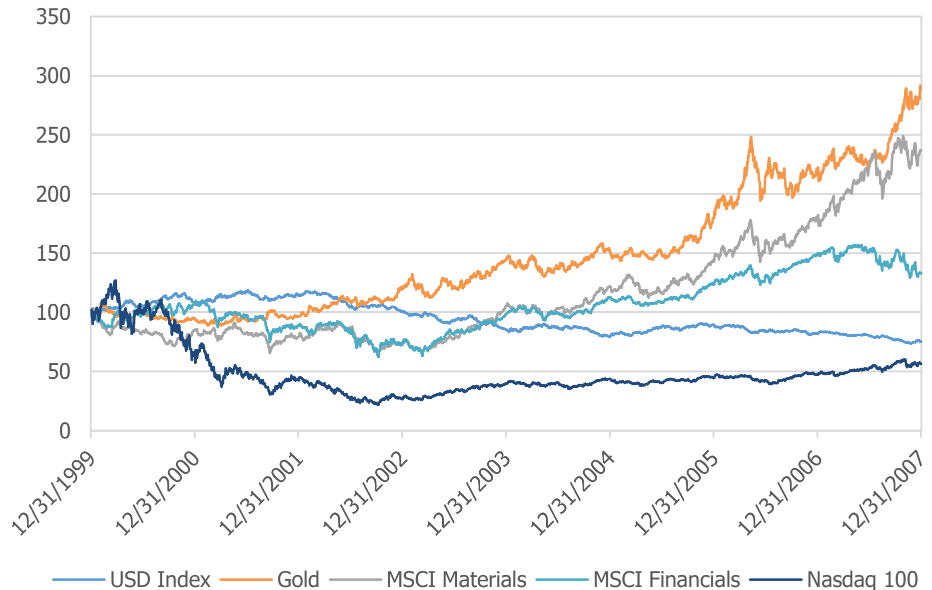
The European Green deal and hopes for more stimulus from a now Democratic US Congress and President have added to this.

It remains to be seen just how much stimulus will ultimately come out of the US Congress and how quickly the European Green Deal funds will actually be spent.

Still the backdrop could augur an echo of the decade of the 2000s, with rising rates, commodity inflation and stronger performance from financials and EM.

Today's certainty can be tomorrow's fallacy, so it is important to build in resilience

Will markets party like it's 1999?



Closing thoughts

- **#1 Preparation over prediction**
  - We are prepared for the possibility of a new reflationary decade, but today's certainty can be tomorrow's fallacy, so it is important to build in resilience
- **#2 Key themes play well to value and income investing**
  - De-carbonization, de-globalization and de-densification will require significant amounts of **physical capital** from businesses that can deliver income and growth
- **#3 Flexible strategies like ours can help shepherd assets through rate normalization**
  - We believe equities can generate income while being more resilient than traditional bonds to interest rates rises
- **Lastly, and most importantly, we wish you all the best for the new year and in particular much health (and also happiness!)**

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Past performance is no guarantee of future results.

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The views expressed are those of the portfolio manager as of January 2021, 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.