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Capital Management Group

GLOBAL VALUE AND INCOME DISPATCH

JOHCM Global Income Builder Fund

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Q3 review: The rise of tangible capital?

1. Current equity exposure sits at the upper end of neutral
2. We continue to lean on equity and preferred income to manage through this low rate environment
3. …however, income portfolios must avoid excessive sector or style biases

The third quarter continued the trend of growth outperforming value in equity markets.

There are signs that this trend may changing. In the years ahead the world will need copious **tangible capital** to de-carbonize and improve infrastructure.

Well-positioned income investors could potentially profit both from the need for tangible and intangible capital, if they don't focus blindly on yield.

Q3 2020 returns & indicators

MSCI World Value Index	7.93%
Bloomberg Barclays US Agg	0.62%
ICE BofAML BB-B Global High Yield Constrained	4.68%
EUR vs. USD	4.34%
JPY vs. USD	(2.35%)
Gold	5.89%
US 10-Year Yield (30 Jun 20)	0.66%
US 10-Year Yield (30 Sep 20)	0.68%

Source: Bloomberg as at 30 September 2020. Index returns quoted in US dollar terms.

Portfolio Executive Summary

Two key dynamics influenced capital shifts in our portfolios over the past quarter:

1. a shift into high yield "**cushion paper**," within credit and
2. the continued focus on **de-carbonization**-linked investments within equities.

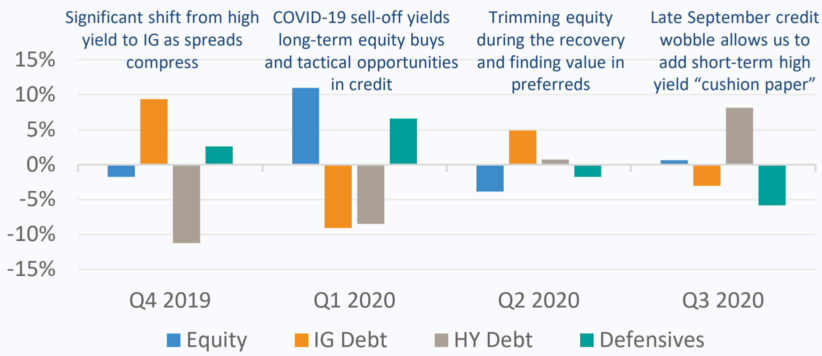
Cushion paper is a term for shorter duration high yield bonds that are likely to be called in the next couple of years. With credit spreads widening towards the end of the quarter, these became attractive.

De-carbonization is a key structural theme. Governments are increasingly aligned, and we see transformational opportunities for the providers of the physical capital that will be needed to move supply chains off fossil fuels.

We are also wary of the emerging **New Fiscal-Monetary Paradigm**. With no bad actor to punish, authorities are engaging in unprecedented stimulus. The pandemic will pass. Perhaps faster than expected, per the vaccine makers.

When the pandemic passes, we may finally see the rebirth of inflation. Income portfolios, in particular, must prepare for this risk.

Capital deployment – trailing 4 quarters



Source: JOHCM, Bloomberg as at 30 September 2020.
Represents estimated capital shifts net of asset class performance.

We found value and income in preferreds, as investors focus more on ploughing capital into the traditional debt

Portfolio positioning – defensive equities rather than bonds

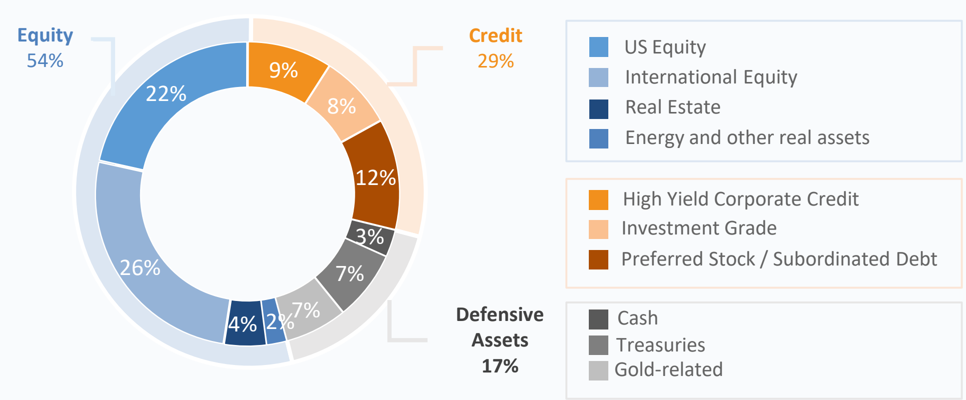
Equity exposure has stayed in the mid-50 percentages, ending the quarter at 54%. We tend to view equity exposures between 50% and 55% as being neutral for our strategy, so **current equity exposure sits at the upper end of neutral.**

Despite the recent additions of cushion paper, our high yield exposure remains almost 10% lower than late 2019 levels and almost 20% below where we began 2019.

With bond yields depressed by central banks, we have **pivoted more to defensive equities**, such as consumer staples and utilities, to generate income.

While the overall yields we earn here are lower than what we were able to collect from credit back in 2018, consumer staples have pricing power that offset inflation should it re-emerge. **Utilities could see multi-decade growth** from de-carbonization initiatives that could accelerate under a Biden presidency.

Current allocation (as at 30 September 2020)



Source: JOHCM as at 30 September 2020.

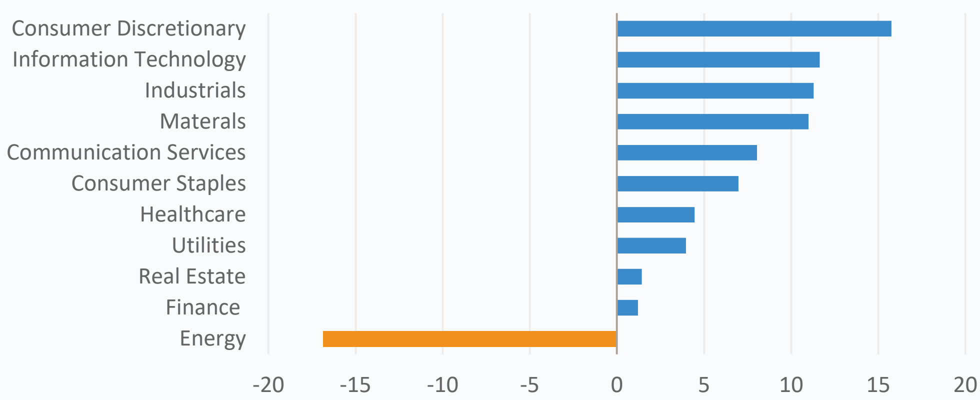
Within credit, preferred shares continue to have a much higher allocation than in prior years. We found value and income in preferreds, as investors focus more on ploughing capital into the traditional debt that central banks have been purchasing.

In could be some time before base rates (i.e. Treasury yields) go back up, and so we expect to continue to employ bond surrogates (such as defensive equities and preferred shares) to manage through this low rate environment for income and appreciation until better fixed income opportunities emerge.

Q3 saw a continuation of tech and internet leadership

Along information technology, the consumer discretionary sector, which is powered by its inclusion of Amazon, continued its momentum.

MSCI World Indices (Q3 2020 % change)



Sources Bloomberg, JOHCM.

We strive to create a resilient portfolio from which a flexible manager such as ourselves can take advantage of air-pockets

However, Q2 also saw signs of speculative excesses

We have taken notice of the fervour with which certain work-from-home and speculative automotive shares added billions of market caps in days.

Whether it was Robin Hood-style retail investors, overly exuberent algorithms or option whales creating the dynamic, it is generally a cautionary flag when speculative excess can be seen in markets.

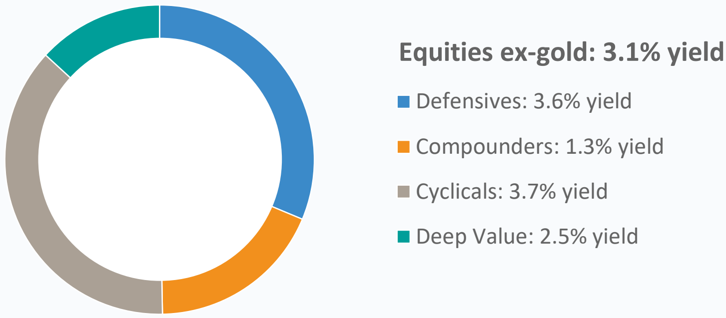
None of this is to suggest that a crash is coming or that the businesses that are subject of the speculations might not have good long-term business prospects.

All we would say is...be careful! As income and cash flow-minded investors, it is paramount that the source of corporate cash flows is durable and that the valuation thereof is not excessive.

Equity exposure by style

In terms of style, we are relatively balanced between more economically-sensitive clusters, such as cyclicals and deep value investments, shown on the left of the chart below, and more stable components, such as defensives and growth-oriented compounders, on the right.

Equity holdings and LTM yield grouped by style



Sources Bloomberg, JOHCM as 30 September 2020.

We strive to create a resilient portfolio from which a flexible manager such as ourselves can take advantage of air-pockets and opportunities to deploy capital. Each risk cluster contributes different elements to this overall goal.

Risk buckets serve unique roles in a modern income portfolio

Defensives
- Stable businesses that generate consistent income
- Growth prospects can be limited
- 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

Deep Value / Contrarian
- Generally idiosyncratic or counter-cyclical investments
- Yields can range from low to very high depending on the cycle
- Restaurants, hotels/travel, office real estate

It is critical to be aware of any sector or style biases which can present in your income portfolio

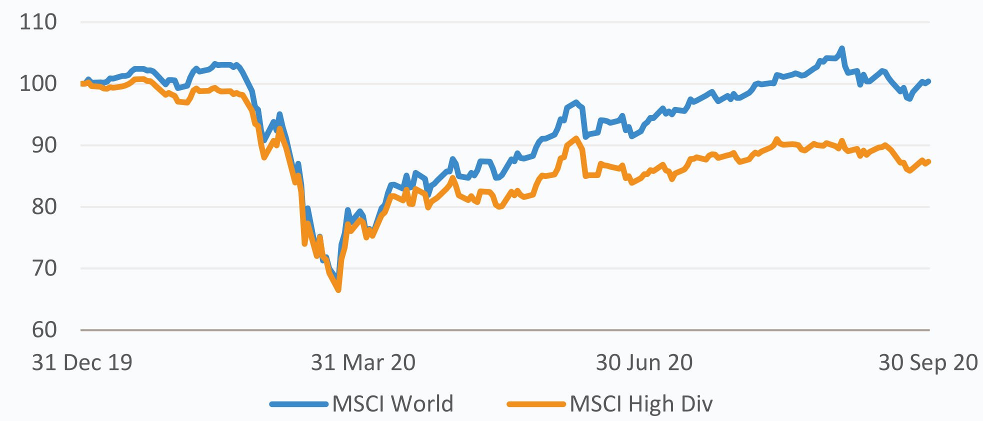
Earning income with "style"

The style bias of different income solutions is an important topic that we will return to in future papers, as it is underappreciated by income investors.

We have previously discussed how financials and energy are over-represented among high dividend shares. This is a risk when blindly buying high-yielding stocks and would have been quite painful this year.

Another common approach is to overlay a quality screen to income shares, as is done by the MSCI World High Dividend index. This tends to favour consumer staples businesses and healthcare stocks.

As illustrated below, this style bias would also have had a cost in 2020, as it missed out on more dynamic technology businesses.



Sources Bloomberg, JOHCM as 30 September 2020.

It is critical to be aware of any sector or style biases which can present in your income portfolio, as they are common in passive or static approaches and can have powerful impacts on performance.

Closing thoughts

- Traditional fixed income doesn't offer very much income today
  - ➢ Alternatives such as equity, preferred and hybrid income may be needed to earn carry and protect against capital loss should rates rise
- The New Fiscal-Monetary paradigm raises the risk of inflation and extreme outcomes
  - ➢ Income investors with long duration portfolios are particularly at risk
- Flexible approaches can evolve with the opportunity set, while static approaches may face structural biases that can hurt performance

JOHCM Global Income Builder Fund

5 year discrete performance (%)

Discrete 12 month performance (%):

	31.10.20	31.10.19	31.10.18	31.10.17	31.10.16
A USD Class	-3.40	-	-	-	-

Past performance is no guarantee of future performance.

Source: JOHCM/MSCI Barra/Bloomberg Index Services Limited, NAV of Share Class A in USD net income reinvested, net of fees as at 30 September 2020. The A USD Class was launched on 4 April 2019. Performance of other share classes may vary and is available on request.