JOHCM Funds

April 2021

Global Value and Income Dispatch

Fishing in the right ponds: responding to shifts in market regime

Highlights

We pride ourselves on the team's ability to deploy capital quickly and in a focused manner. This was on display again in the past quarter

Our equity exposure is up, our fixed income duration is down and our stylistic tilt is increasingly pro-cyclical.

The fixed income we do own tends to be shorter duration or event-driven credit with catalysts to drive upside potential

Portfolio Executive Summary

We have potentially entered a new fiscal-monetary regime. The January US Georgia Senate election may have been the final puzzle piece. Since then, three massive spending bills have been announced (one has already passed), and central banks are trying to boost inflation. Our key thoughts are as follows:

1) **Real yields are still quite low and so rates may rise further**
   - The coming quarters may see some of the strongest economic growth in decades, which could be inconsistent with currently *negative* real yields
   - It remains to be seen how much central banks will intervene against rising rates in a strong economy
2) **Stimulus is focused on infrastructure, de-carbonization, and de-globalization, which could trigger a sustained capex boom**
   - Long term structural trends, such as digitalization, can persist as well
3) **We continue to see risks skewed to the upside for rates & inflation**
   - We are positioning to manage though this regime
   - We have reduced fixed income duration and sought business models that can benefit from the current regime

Portfolio positioning – the competition for capital

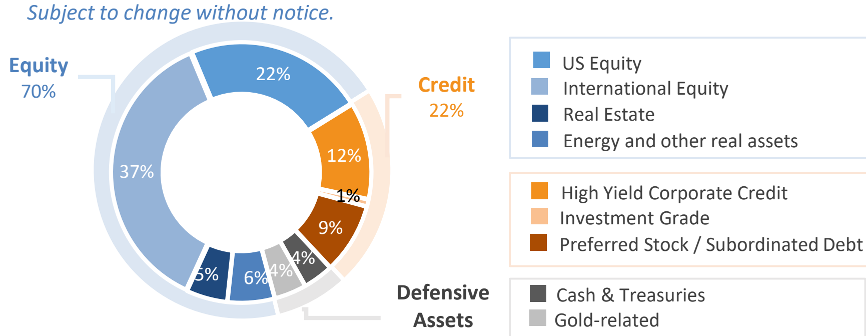
In this day and age of factor flows and macro effects, it is critical for investors to be mindful of regime, as macro elements can provide powerful head or tail-winds for the prospects of businesses and the valuations of the securities they issue.

In a rising rate regime long duration assets tend to fare poorly. This creates strong headwinds for traditional bonds, and **fixed income is indeed having difficulty competing for capital in our portfolio**. This can be seen in the chart below showing our relatively high equity weight.

The fixed income we do own tends to be shorter duration or event-driven credit with catalysts to drive upside potential. Within equities, we look for business models that can benefit from the current regime rather than be harmed by it (the good news is that they do exist!).

Current Allocation (as of 03/31/2021)

Subject to change without notice.



Source: JOHCM, as of March 31, 2021.

Portfolio positioning (cont.) – Allocation shifts

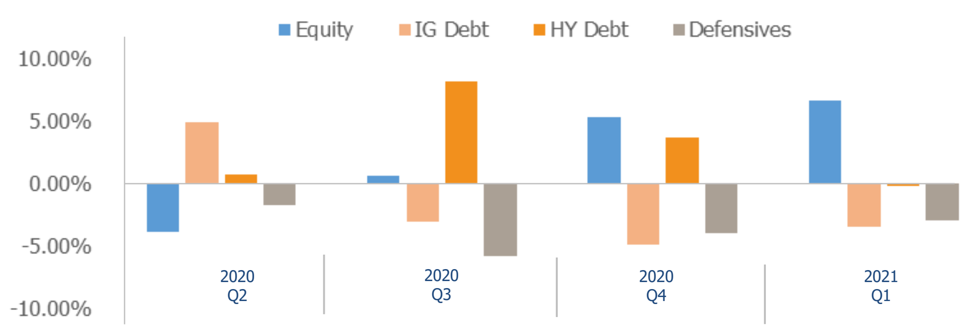
The capital deployments above have shifted the stylistic exposure of the strategy to be more pro-cyclical

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.

We pride ourselves on the team's ability to deploy capital quickly and in a focused manner. This was on display again in the past quarter as our cyclicals exposure increased by roughly 1000 basis points. The late January "Variant Scare" created an air-pocket that allowed us to deploy additional capital into industrial, financial and materials shares, as well as re-opening beneficiary stocks.

Rising rates and steepening yield curves are game changers for many financial ("spread") businesses, as they can profit from the difference between short and longer term interest rates. These providers of capital are one of the few segments of the market that appropriately rejoice when capital becomes more expensive.

The link with materials and industrials is that the same strengthening economy that is pushing up interest rates, often also pushes up the prices of key supply chain inputs. This is especially true for materials that have inelastic short term supply responses, like copper for instance, where it can takes years, and even a decade sometimes, to bring on a new mine.

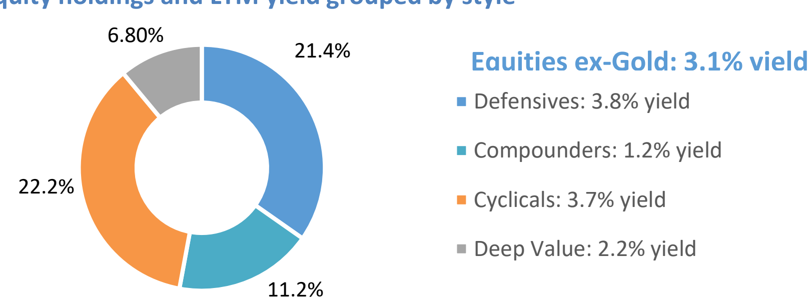


Source: JOHCM, as of March 31, 2021.

Stylistic positioning

The capital deployments above have shifted the stylistic exposure of the strategy to be more pro-cyclical. As modern value investors, we pay close attention to stylistic, factor and industry exposure, as we want to make sure we feel we are getting paid for the risks we take.

Equity holdings and LTM yield grouped by style



Sources Bloomberg, JOHCM as December 31, 2020.

Regime, Styles and Securities

Regimes can have very powerful effects on security valuation and performance. As a result, it is critical to have a sense for how to manage and preserve purchasing power through different regimes.

The near term may be bumpy, as Covid-19 cases continue to rise in many parts of the world.

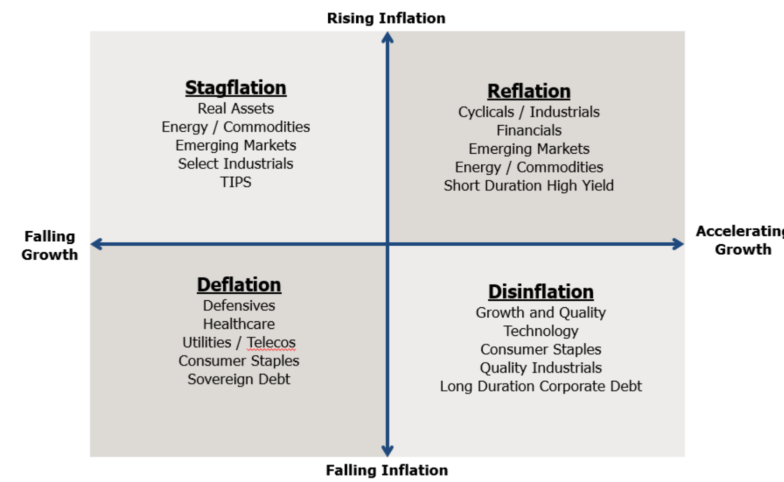
When interest rates are rising, it will be difficult to find fixed income or bond proxies that can overcome this headwind. The value of fixed cash flows is reduced by the time value of money effect. Fixed income also doesn't care about the reason for the rate increase. Irrespective of whether rates are rising due to inflation or due to economic growth, it is all bad for longer term bonds.

In contrast, the reason for a rate increase can make a very big difference to equity investors. In an inflationary environment, commodity producers and other cyclical businesses can make up for higher inflation through higher revenues.

In a low inflation environment, raising prices becomes more difficult, and portfolios can benefit by leaning more on structural growth versus cyclicals.

The chart below provides a framework for how to think about different regimes and the security types that align best with the macro-economic landscape.

Managing through different macro regimes



Where do we go from here?

As the baseball philosopher Yogi Berra highlights, making predictions is difficult, … especially when they are about the future. Thinking through the range of options, we continue to see the risks skewed pro-cyclically, with vaccine availability continue to ramp up throughout Europe.

The near term may be bumpy, as Covid-19 cases continue to rise in many parts of the world. The risk of a deflationary pulse from policy is always present (for instance, from excessive policy tightening in China). With the pandemic as a backdrop, however, near term shocks will likely be met with added (likely unconventional) policy.

There is upside risk to inflation as well. It may be harder than anticipated to pull employees back into the labor force. We hear frequent anecdotes about businesses being unable to fill positions. Much depends on when and how temporary unemployment assistance will be allowed to taper. Policy makers who are eager to raise wage rates may wish to continue these policies.

At some point in the quarters or years ahead, the pace of the Covid-19 recovery will moderate and the rising tide will cease lifting all boats.

In order to be sure we are fishing in the right ponds, we pay close attention to key structural trends that can drive growth. We then train our bottom-up sites on finding those companies with iron-clad grips on their value chains. Below are some of the key trends we see today.

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Macro Themes

- **Digitization –** Rain or shine, the world continues to move to the cloud and do more with IT
- **De-carbonization –** An idea whose time has come with much of the world migrating off fossil fuels
- **De-globalization –** Supply chains are reshoring across semiconductors, pharmaceuticals, and energy transition technologies
- **Reflation –** A new fiscal-monetary regime may be upon us due to increasingly accommodative central banks and expansive fiscal packages. The lows in interest rates may be behind us

Micro Themes

- **"Chips are the new oil"** – semiconductor content is increasing everywhere: Electric Vehicles (EV), Assisted Driving, Manufacturing Automation, Renewable Energy, Cloud / Datacenter, 5G Wireless
- **King Copper** – supply is hard to add and decarbonisation will drive significant amounts of new demand across autos (EVs are 4x ICEs), solar, wind and home / general electrification
- **Infrastructure / Revenge of the Old Economy** – we have underspent for decades, but new regime fiscal policy is ready to do so. Supply chains are tight for more than just copper…
- **Re-opening** – Vaccine rollouts will allow many currently depressed services to return to more normal operations (including restaurants / food & beverage, travel & leisure, real estate)
- **Cars are the new phones** – EVs and ADAS (Advanced Driver Assist Systems) could prompt fleet upgrades across passenger, commercial and heavy truck with opportunities for OEMS and suppliers
- **Better Defensives** – Some traditional defensives may suffer in a rising rate / rising inflation environment. Portfolios still need ballast; we are on the lookout for defensives with pricing power

Closing thoughts

#1 Risks for rates, growth and inflation still skew positive in our view

- Looking out 12-18 months the world could be in a significantly better place regarding Covid-19. Emerging markets, which have been slow to access vaccines, will have made significant progress and there is hope that the great pandemic may fade into the background

#2 Some adjustment has taken place and took place quickly

- The move in 10-year US bond yields from 0.91% at year end to 1.74% on March 31, 2021 is was very swift and is typical of the rapid way in which today's quant/algorithm–driven markets can adjust
- It is reasonable to expect a period of consolidation even as the trend remains higher

#3 We value our flexibility to adapt to different regimes

- While we remain pro-cyclically skewed, we are planning ahead for the time when the economy stabilizes, which may warrant a shift in focus toward emerging structural trends.

Source for all data JOHCM/Bloomberg (unless otherwise stated).