JOHCM Global Income Builder Fund

GLOBAL VALUE AND INCOME DISPATCH

JULY 2020

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Q2 review: The global income challenge

As we write, the Covid-19 health crisis has not yet turned into a full financial crisis. Credit goes to policy responses, which have been considerable and have spurred a strong rally from the March lows.

The risk of severe adverse economic outcomes continues to exist and the costs of future policy missteps could be high.

Market participants have flocked to safety in a narrow handful of industries leaving significant upside elsewhere. We are thus optimistic about medium-term returns.

Over the near term, we continue to see volatility.

Q2 2020 returns & indicators

MSCI World Value Index	19.36%
Bloomberg Barclays US Agg	2.90%
ICE BofAML BB-B Global High Yield Constrained	11.17%
EUR vs. USD	1.84%
JPY vs. USD	(0.37%)
Gold	12.92%
US 10-Year Yield (31 Mar 19)	0.67%
US 10-Year Yield (30 Jun 20)	0.66%

Source: Bloomberg as at 30 June 2020.
Returns quoted in US dollar terms.

Portfolio executive summary

We continue to view the coronavirus pandemic as a tragic but transient phenomenon. "Recency bias" can make this difficult to comprehend, as humans are wired to see the world around us as it is today. It can be a struggle to visualise what circumstances may be in a year or two. **Risk-reward must be our guide.**

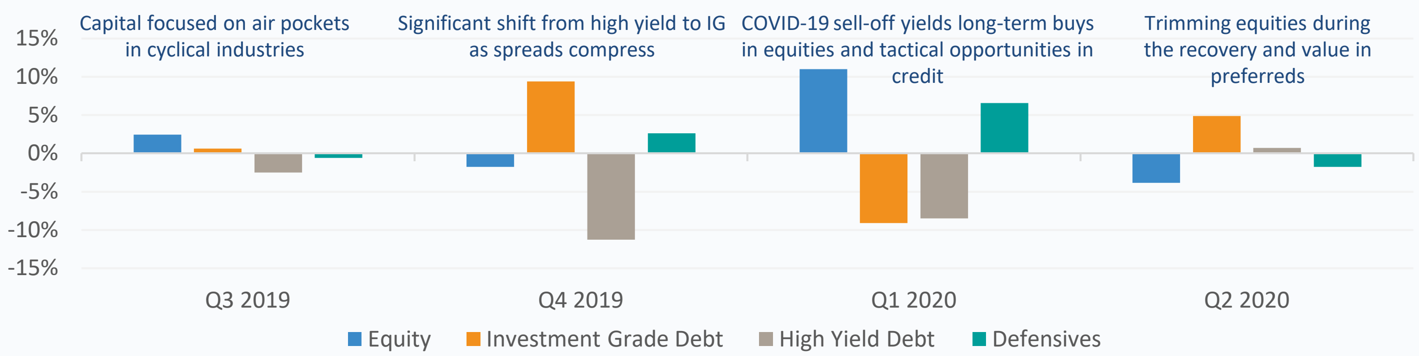
In Q1, we deployed over 1000bps into equities largely into three key areas: (1) opportunities linked to credit-market dislocation; (2) quality compounders; and (3) deep value investments.

With the market recovering sharply in Q2 **we have trimmed from each area**, and so **roughly 400bps of capital came out of equities this quarter**.

Instead, **capital has been deployed into preferred shares**, which is an asset class where we continue to find value. Preferreds can slip between the cracks of traditional "style-box" investment strategies and are currently not being bid up by central bank buying.

With US interest rates joining European and Japanese yields near zero, preferred shares along with dividend-paying equities are an important source of non-traditional income. **Investors will increasingly need to think beyond traditional fixed income for yield.**

Capital deployment – trailing 4 quarters



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

Portfolio positioning

Due to the trims discussed above, equity exposure is down to 53%, which is getting close to a more neutral stance.

The key driver of the trims has been the investor stampede into the shares of businesses perceived as resistant to the economic impacts of coronavirus. This pushed up valuation levels for quality compounders and some defensives. A brief-but-sharp rally in cyclical and recovery shares in mid-June prompted us to also trim some of our deep value investments, which fall into these categories. This rally was short-lived, and so we have rebuilt some of those positions.

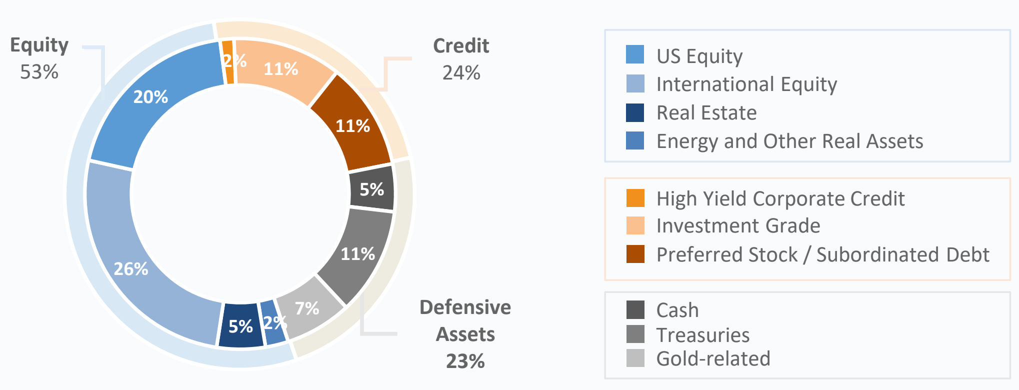
Within credit, we deployed capital into preferred and subordinated/hybrid debt. This asset class grew by 400bps during Q2 to end at 11% of AUM.

Gold-related investments continue to be a substantial portion of our defensive assets, in anticipation of significant ongoing central bank money printing. We retain significant buyer power with roughly 15% in cash and sovereign debt to deploy in the event that further volatility produces opportunity.

Q2 review in brief – growth is in the green...

If a picture is worth a thousand words, there is perhaps no more telling chart than the one below showing the stark divergence between value and growth.

Growth shares finished Q2 up for the year, while value languished with near 20% declines. Growth performance was powered by technology, with some of the **biggest beneficiaries being stay-at-home plays** such as internet shopping and online collaboration businesses. There is some irony that these often early stage technology companies have been perceived as the safest place for capital.



Source: JOHCM as at 30 June 2020.

Momentum and trend following strategies have likely piled into rising shares and amplified some of these market moves.

Sources Bloomberg as at 30 June 2020.

We participated in growth performance through ownership of various dividend-paying software and semiconductor companies, which we added to during the Q1 sell-off. These were a big component of our "quality compounder" purchases.

It may be surprising to some to find an income manager discussing technology shares. However, strong barriers to entry, high returns on capital and favourable growth trends make us structural fans of many IT businesses, in contrast with some of our income and value investing peers.

Our allocation to IT continues to be significant. However, with many of these businesses now trading at all-time highs, we see a less compelling risk-reward profile and have been **trimming our IT holdings back on appreciation**.

...but could it be time for some "green" value?

Traditional, capital-intensive **"real economy" shares have lagged**, but there are signs that this may be changing. This is particularly true for companies that participate in the de-carbonisation supply chain. The European Green Deal, as well as a more left-leaning future US government, could spur a wave of investment that should benefit providers of the physical capital needed to reduce carbon.

We have a number of investments in such physical capital providers including: (a) industrial gas companies that are winning business to produce hydrogen; (b) automotive suppliers (from semi-conductor providers to factory automation and robotic paint system makers) that should benefit from the launch of more electric vehicle (EV) models; (c) utility companies who will earn returns on additional investment to “green-up” the power grid; and (d) even some traditional construction and building materials companies who will be called upon to put it all together. **If you want to go green, you may need a lot of grey to get there.**

We also continue to see attractive returns in foodservice and hospitality (and even aerospace) industries as these normalise in the years to come.

In summary, we are increasingly seeing value in some of the shares that have lagged, rather than the shares that are leading.

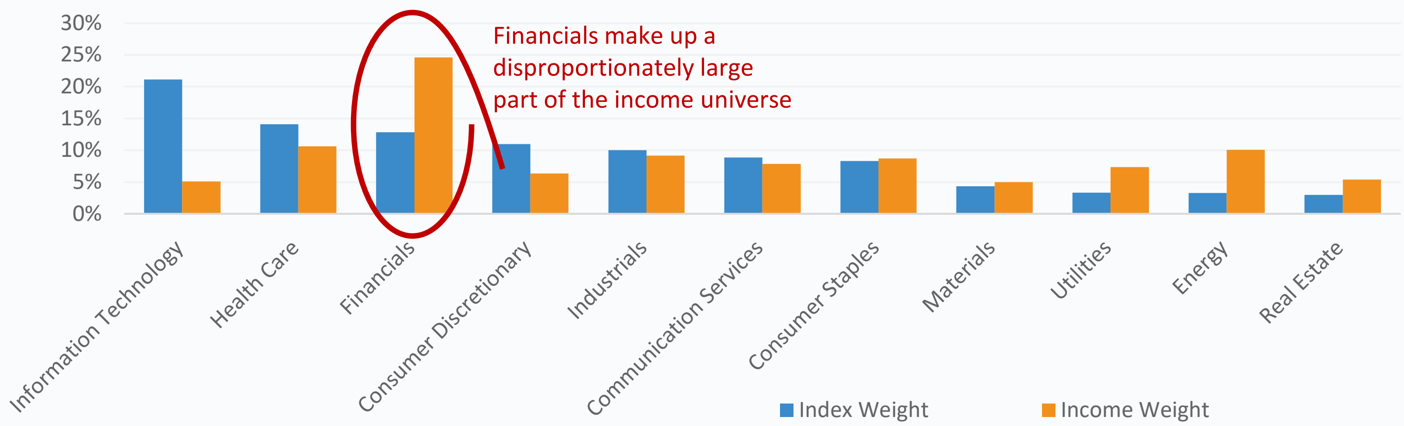
Beware of too much “financial” income!

The key, in our minds, to managing through uncertain environment is to maintain a portfolio that is balanced across different themes and styles.

However, this can be difficult to achieve for investors with an income mandate.

The chart below shows the sector composition of high income equities versus that of the MSCI World index overall. Financials are prominent among income assets, and so **many traditional income fund managers lean heavily on financials.**

Sectors weights for high-income equities versus MSCI World index

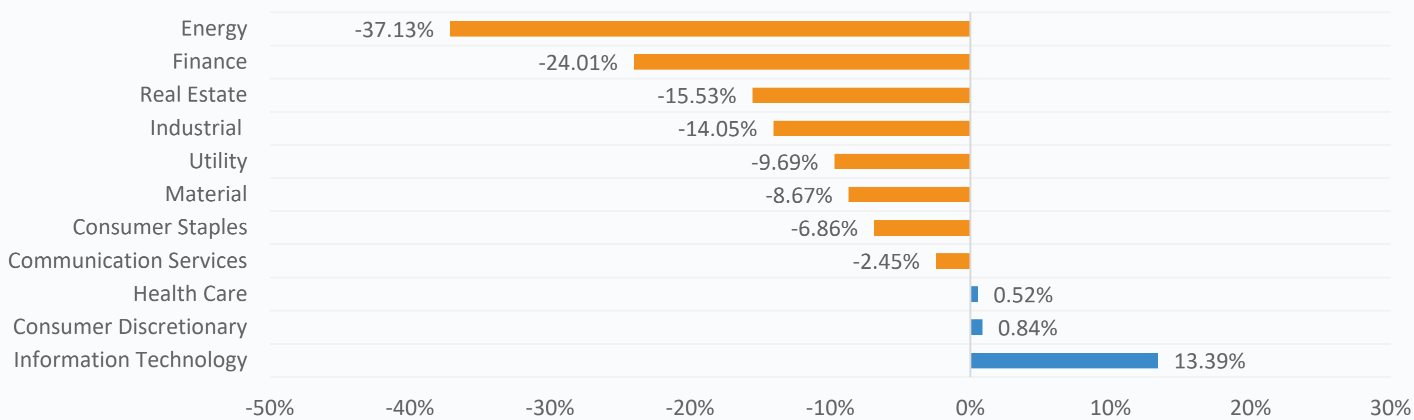


Source: Bloomberg, JOHCM as at 30 June 2020. High income defined as MSCI World index constituents with more than 3% trailing yield.

The importance of balance – especially for income

Unfortunately for many traditional equity income investors, financials have had a particularly difficult year, while a technology underweight has also been costly.

MSCI World sector returns (from 31 December 2019 to 30 June 2020)



Source: Bloomberg, JOHCM.

The problem is that many financials generate income by borrowing to buy assets such as loans and mortgages. This can make share prices volatile and risk permanent impairment. **Leaning too heavily on financial shares for income can be a bumpy ride.**

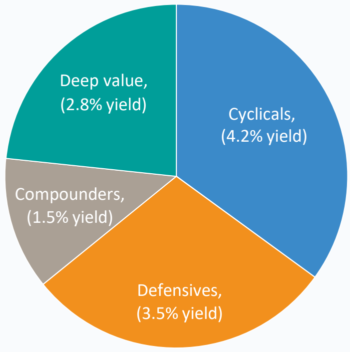
More on positioning

When we think about balance we want to pay heed not just to sector, but to look more broadly at different clusters of risk and factor exposure.

To show where we are earning income, below you can see equity exposure based on our own style classification as well as estimated yields for each of these styles.

- **Cyclicals and defensives** are the largest and highest-yielding equity components of the Fund. Defensives, such as consumer staples, healthcare and utilities, serve to counterbalance the more economically-sensitive cyclicals.
- **Compounders** make up the third-largest cluster and are among our lowest-yielding investments. Here you will find the majority of our technology and software-oriented investments, which are intended to drive long-term growth.
- **"Deep value"** investments are the smallest category and include high quality businesses in such industries as foodservice that have been affecfted by the pandemic, but where we see significant recovery and appreciation potential.

Equity holdings and last-12-months yield grouped by style

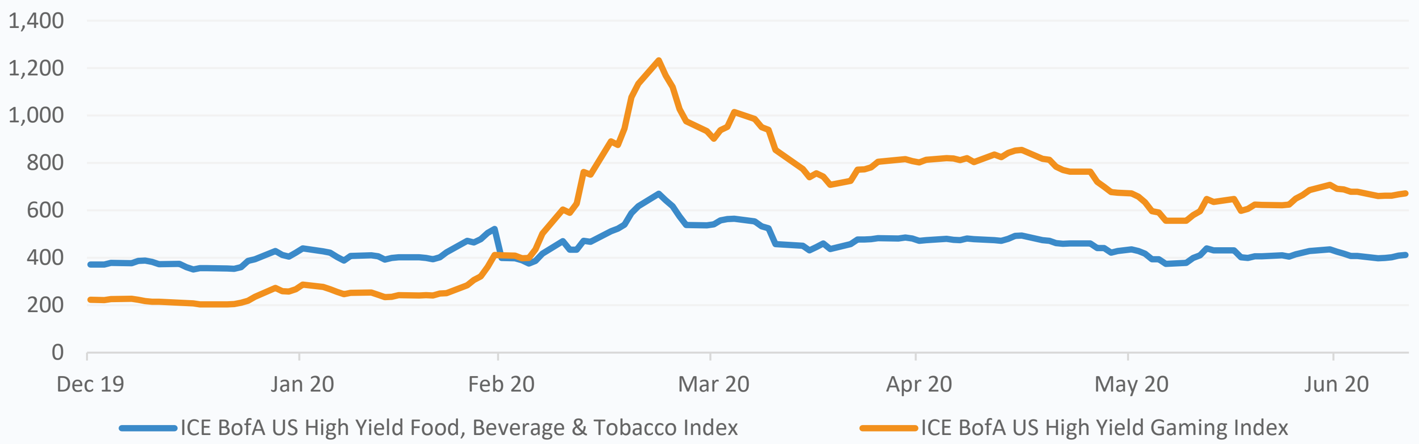


Sources Bloomberg, JOHCM as 30 June 2020.

Bifurcation in credit markets

We have spoken often about bifurcation in credit markets. The chart below shows credit spreads for the food and beverage sector in contrast with the gaming sector. Food and beverage spreads have returned to their pre-Covid-19 levels, while gaming spreads have understandably widened considerably.

Credit spreads – food-beverage-tobacco vs. gaming



Sources Bloomberg.

Spreads for the high yield asset class have widened overall, but this has been driven by sectors (like gaming and energy) where there is significant downside risk due to the coronavirus. Absolute yields for many bonds are significantly lower due to the pronounced Covid-19-related decline in both short- and long-term interest rates. We see better risk-reward from equities for taking recovery risk.

Closing thoughts

- Coronavirus has swept across the world: pre-existing **assumptions must be challenged and affirmed** regarding both business and life in general.
- The depths of despair in March and some recent heights of optimism are part of the pendulum of market emotion translated to today's market structure.
- It is critical to **buy the despair and fade the extreme optimism**.
  - We note that our process has led us to be incremental sellers.
- Today's **market structure is amplifying trends**, so continue to expect and prepare for volatility in bursts. It is the rule of the day until proven otherwise.
  - A flexible strategy can continue to **take advantage of the volatility**.

JOHCM Global Income Builder Fund
5 year discrete performance (%)

Discrete 12 month performance (%):

	30.06.20	30.06.19	30.06.18	30.06.17	30.06.16
A USD Class	-1.88	-	-	-	-

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 June 2020. The A USD Class was launched on 4 April 2019. Performance of other share classes may vary and is available on request.