J O Hambro
Capital Management Group

LATEST REFLECTIONS

Ben Leyland
Senior Fund Manager

Robert Lancastle
Senior Fund Manager

- The cyclicality of the portfolio has waxed and waned over the period, led by valuation and without sacrificing our quality requirements. At the same time, we have found ourselves able steadily to raise the structural growth potential of the portfolio by adding a variety of new names.
- It does seem clear that from a macroeconomic perspective we are moving into the mid cycle phase, in which the focus turns to the timing and pace of interest rate rises and during which market leadership broadens out and becomes less predictable and more idiosyncratic.
- From our perspective, this offers hope that the underlying quality and growth of the companies in our portfolio will be recognised. The last such phase, roughly from 2012-16, was a period of very strong relative performance for the strategy.
- We are actually more enthusiastic about the underlying growth prospects for our portfolio than we have been for some years.

JOHCM Global Opportunities Fund

Our underperformance of an extremely strong equity market over the last 12 months is largely a result of our positioning in the less macro-sensitive "forgotten middle", rather than at either extreme. It is notable that the technology and financials sectors are up almost exactly the same amount over the last year and both significantly ahead of the index, even though they outperformed in completely different phases, either side of the vaccine announcements in early November, as a herding into technology-biased Covid winners shifted sharply into a reflation trade favouring highly geared Covid losers.

Our own exposure to what we had called Covid-disrupted structural winners – a total of 26% of the Fund, in names such as Compass and Safran – performed very well in absolute terms during the post-vaccine phase, but not enough to keep up with either their more distressed and leveraged peers, or a market led by the financials and energy sectors – two areas where we do not typically have much exposure.

Although June was another month of extreme rotation, this time back towards technology, in general in recent months we have been encouraged to see a number of our names start to recover some lost ground, including both longstanding holdings like Oracle and Philip Morris, as well as newer additions, including Motorola Solutions, Henry Schein and American Tower.

We would also note the short-term tailwinds but long-term opportunities created by the increased influence of ESG factors and third-party rating agencies on capital flows and sector performance. It is notable, for example, that over the 18 months to 30 June 2021, the only sectors to be down in US dollar terms are utilities and energy, despite a decline in interest rates and a rise in the oil price. It cannot be coincidental that these two sectors are responsible for a significant amount of carbon emissions and thus likely 'fail' various tests for inclusion in semi-passive ESG mandates. We think such tests are too focused on spot metrics and ignore the potential for value-creation through change and reinvestment. Regulated utilities in particular have huge reinvestment opportunities as they phase out coal and gas generation capacity in favour of renewables. For now, this is being ignored and the sector has struggled to perform, but we believe this creates a very interesting entry point for patient, long-term investors.

We have been active over the last year both in terms of name turnover and position weight management. One significant evolution has been in our exposure to Covid-disrupted names. We increased this in September and October as share prices reacted negatively to the onset of second lockdowns, whilst at the same time Q3 results gave us confidence that companies like Safran, Compass, Continental and Wartsila had started to control the cash burn we had seen in Q2. We also added a number of new names in the same category, such as Smith & Nephew and Motorola Solutions. Given uncertainty over timing and extent of eventual recovery, we maintained an emphasis on temporarily-disrupted high-quality companies with strong balance sheets, rather than more structurally-challenged and/or leveraged names for whom the timing of recovery was much more critical.

The vaccine news in November prompted a significant change in momentum for these stocks and by Q1 a number of them were pricing in a full recovery of activity sets. As a result, we have reduced exposure materially, including the complete sale of a number of positions such as Safran, Nokian Tyres, Pola Orbis and Bureau Veritas. The cyclical names we have retained, for example Continental and Wartsila, are those which had been going through a cyclical lull, compounded by a reinvestment phase, well before Covid struck. As a result, they still offer plenty of upside as we see the fruits of that reinvestment gradually emerge.

So, the cyclicality of the portfolio has waxed and waned over the period, led by valuation and without sacrificing our quality requirements. At the same time, we have found ourselves able steadily to raise the structural growth potential of the portfolio by adding a variety of new names which for one reason and another have been ignored by a very macro-focused market. Many, although not all, are somewhere in the middle of a reinvestment phase, which has supressed short-term earnings momentum for a period but is laying the foundations for longer-term value creation and a reacceleration of growth. Some are exposed to structural growth areas such as digitisation or decarbonisation; others are likely to gain significant market share due to sustainable competitive advantages over weaker peers. We would also emphasise there is no particular sector or regional bias to this group – it includes plenty of US-listed companies as well as European ones, and includes financials (Progressive, Deutsche Boerse, Intercontinental Exchange, Svenska Handelsbanken), and retailers (O'Reilly, Dollar General) as well as utilities (CMS, Iberdrola), healthcare (Henry Schein) and consumer staples (Reckitt Benkiser).

General outlook

We used to talk about the equity market as a see-saw, in which sector rotations were likely to be more extreme and violent than the overall index, and as a result positioning oneself at either end could result in significant capital loss. That has proved to be an unhelpful analogy especially since November, a period in which deep cyclicals have rallied hard but the technology sector has not suffered at all. Having rallied 75% between the lows in March to the end of September 2020, it rose a further 36% between the end of October 2020 and the end of June 2021 – outperforming the broader market in both phases.

More broadly, we are struck by how the direction of the overall market seems astonishingly uncorrelated to the macro backdrop. Equity markets rose in the middle of last year "because" extremely low bond yields justified paying extremely high earnings multiples for long duration growth assets, and they have apparently risen since November "because" of a reflation trade which almost completely reversed the decline in (at least long-term US) yields. We do acknowledge that the common factor is the influence of central banks on short rates, yield curve steepness and, via inflation expectations, real yields. We understand the relative appeal of equities over other asset classes in this environment. But we are left profoundly uncomfortable with the implication that there are no circumstances in which the equity market will (be allowed to?) decline materially. It should not be a surprise that we view this conclusion as very complacent, and we continue to believe in the importance of patience and discipline when stewarding our clients' capital through a cycle.

Although it seems likely that the next 12 months will see a gradual post-Covid normalisation in the real world, there are a huge number of unknowns from here. That is true of the real world itself and the policy responses we see from governments and central banks, let alone how those interact with financial markets (including currencies and commodities as well as interest rates and risk premia) and how the internal dynamics of financial markets unfold independently, for example as ESG factors continue to gain influence.

All that said, and despite the many peculiarities of this particular cycle, it does seem clear that from a macroeconomic perspective we are moving into the mid cycle phase, in which the focus turns to the timing and pace of interest rate rises and during which market leadership broadens out and becomes less predictable and more idiosyncratic. From our perspective, this offers hope that the underlying quality and growth of the companies in our portfolio will be recognised. The last such phase, roughly from 2012-16, was a period of very strong relative performance for the strategy.

Outlook for our portfolio companies

We are actually more enthusiastic about the underlying growth prospects for our portfolio than we have been for some years. Covid-related disruption has reinforced our confidence in the competitive advantages and potential for growing market share and/or share of wallet for companies like Progressive, Henry Schein, Dollar General, O'Reilly and Compass. We see huge growth potential in regulated utilities driven by decarbonisation of power generation, and yet their share prices are widely overlooked because they screen poorly on spot emissions metrics. And we are already starting to see encouraging results from multi-year reinvestment phases at the likes of Philip Morris and Sanofi, Reckitt Benckiser and Thales, with Wartsila and Continental also well through their own reinvestment phases, albeit more macro dependent to demonstrate this in results.

We know from last year that strong fundamental execution is no guarantee of share price performance over a 12-month or shorter time period. But we are very confident that the intrinsic value of the portfolio should continue to grow, and that ultimately this will be recognised by the market.

JOHCM Global Opportunities Fund
5 year discrete performance (%)

Discrete 12 month performance (%):

	30.06.21	30.06.20	30.06.19	30.06.18	30.06.17
A USD Class	12.81	-0.21	11.65	5.15	16.36

Past performance is no guarantee of future performance.

Source: JOHCM/MSCI Barra. NAV of share class A in GBP, net income reinvested, net of fees, as at 30 June 2021. All fund performance has been shown against the MSCI ACWI NR Index (12pm adjusted). Performance of other share classes may vary and is available on request.