Professional Investors Only

JOHCM UK Equity Income Fund

Monthly Bulletin: September 2024

Fund Overview

- The Fund aims to generate long-term capital and income growth through active management of a portfolio of UK listed equities.
- Established income investors James Lowen and Clive Beagles abide by a strict dividend yield discipline, which leads to an emphasis on higher-yielding stocks and promotes a naturally contrarian style.
- The Fund will typically have significant exposure to small and mid-cap stocks, often giving the portfolio a different holdings profile to many other income funds.
- Benchmark: FTSE All-Share Total Return Index.

Active sector positions as at 31 August 2024:

Top five

Sector	% of Portfolio	% of FTSE All-Share	Active %
Construction and Materials	10.78	0.48	10.30
Life Insurance	9.36	2.09	7.27
Banks	15.83	9.93	5.90
Industrial Metals and Mining	8.89	5.56	3.33
Retailers	4.52	1.74	2.78

Bottom five

Sector	% of Portfolio	% of FTSE All-Share	Active %
Pharmaceuticals & Biotechnology	0.00	12.08	-12.08
Personal Care, Drug and Grocery Stores	1.79	7.93	-6.14
Closed End Investments	0.00	6.07	-6.07
Aerospace and Defence	0.00	3.97	-3.97
Tobacco	0.00	3.06	-3.06

Active stock bets as at 31 August 2024:

Top ten

Stock	% of Portfolio	% of FTSE All-Share	Active %
Phoenix	3.17	0.17	3.00
Aviva	3.54	0.56	2.98
Standard Chartered	3.61	0.67	2.94
Barclays	4.26	1.38	2.88
ITV	3.00	0.13	2.87
NatWest	3.66	0.88	2.78
BP	5.26	2.99	2.27
TP ICAP	2.22	0.08	2.14
Legal & General	2.65	0.55	2.10
Paragon	2.08	0.07	2.01

Bottom five

Stock	% of Portfolio	% of FTSE All-Share	Active %
GSK	0.00	2.69	-2.69
Relx	0.00	2.73	-2.73
Unilever	0.00	4.94	-4.94
Shell	1.29	7.07	-5.78
AstraZeneca	0.00	8.11	-8.11

Performance to 31 August 2024 (%):

	1 month	Year-to-date	Since inception	Fund size (£m)	Strategy size (£m)
Fund – A Acc GBP	**-0.71**	**17.91**	**431.90**	**1,659**	**1,976**
Lipper UK Equity Income mean*	0.02	11.42	260.22		
FTSE All-Share TR Index (12pm adjusted)	0.61	11.62	295.95		

Discrete 12-month performance (%) to:

	31.08.24	31.08.23	31.08.22	31.08.21	31.08.20
JOHCM UK Equity Income Fund – A Acc GBP	14.83	1.97	6.50	41.22	-25.85
FTSE All-Share TR Index (12pm adjusted)	9.03	5.57	8.67	22.59	-14.76

Past performance is no guarantee of future returns. The value of an investment can go down as well as up and investors may not get back the amount invested. For further information on risks please refer to the Fund's KIID and/or the Prospectus. Source: JOHCM / Lipper Hindsight. NAV per share calculated net of fees, net income reinvested, ‘A’ accumulation share class in GBP. Performance of other share classes may vary and is available on request. Inception date: 30 November 2004. Index return is net income reinvested, adjusted for 12pm. * Initial estimate for the Investment Association's UK Equity Income sector.

Economic developments

Global stock markets were unsettled in the first part of August by a number of events. Commentary by the central bank of Japan on likely interest rate trajectory led to a sharp move in the USD / yen exchange rate (an unprecedented c. 10% in a two-week period). This could be the effective 'bell ring' to end the yen carry trade, at least in this form. It rapidly led to multiple knock-on events across global stock markets, including a sharp move lower in most major indices, and, in particular, US technology stocks. Nvidia fell by c. 25% but subsequently moved back towards where it started covering its all-time high prior to announcing its results at the end of the month. Those results saw the stock down 6%, representing a capital sum close to the market cap of the UK's second largest company – Shell. Until August, Nvidia contributed over a quarter of the overall gain of the US market year to date.

Volatility in the stock market coincided with a number of disappointing US economic data points, including the August Non-Farm Payroll report, which was weak. This created a growth scare which also pressured markets given the Fed had decided at the end of July not to cut or signal a future cut in rates, so policy error risk was also thrown into the mix.

The combination of all of these events led over the course of the month to a major re-evaluation of the future trend in US interest rates, as the market priced in a number of additional interest rate reductions to reflect the weaker outlook. The US 10-year Treasury yield fell c. 50bps from late July to the end of August. Fed chair Jay Powell effectively endorsed this market repricing in his Jackson Hole speech at the end of August where he indicated that the Fed were ready to start cutting rates in their September meeting. The loosening of financial conditions via rate changes led to a strong rebound in markets which recovered most of the ground lost in the initial week of the month.

The Bank of England cut UK interest rates at the start of August by 25bps to 5%. In our view this was a welcome and the correct decision given inflation has receded. Policy is still very restrictive. The Bank now has a narrow window to make further adjustments given that growth is better than expected – which was evidenced during the month by data such as recent GDP trends (which are now the strongest in the G7) – the continued improvement in consumer confidence and strong PMI figures. Although headline inflation will rise over the rest of the year (potentially to c. 2.7/2.8%), this is mainly due to the increase in the energy price cap. It is important to note that within the inflation mix, services inflation and core inflation (which is a focus of the Monetary Policy Committee) will fall even as the headline rate ticks up. UK bond yields have seen similar falls to those in the US over recent months. Given the points made above, which mean there are likely to be some, but a limited number of further interest rate cuts, the 2-year swap rate at around 4% looks too low, so could edge higher from here.

What this fall in forward rates means though is that mortgage rates are falling and will fall further as the swap rate moves through to the mortgage market. This should help stimulate the housing market through the rest of this year.

The one negative headline vis a vis the UK continues to be the Labour Party narrative that there is a large black hole in the national finances. We continue to think this is political posturing to paint the legacy they inherited in the worst possible light. There are negatives, but there is a materially offsetting positive that they are not

articulating. The better-than-expected GDP is leading to tax receipts being higher than expected which largely offsets the negatives. Whilst this may be right fundamentally, it does not help consumer psychology to see headlines like this, with the risk that a real negative (depressing animal spirits) could emanate, at least temporarily, from the current narrative.

In aggregate we remain very confident on the outlook for the UK economy.

The German economy, by contrast, is genuinely struggling, which was reflected in commentary during the reporting season by poor results from industrial groups in particular. In our view, the ECB is likely to respond with further easing before year-end.

Performance

The upward trend of the UK stock market was jolted in early August by the triangulation of the end of the Japanese yen carry trade, a global growth scare driven by poor US data, and concern that the Fed was behind the curve. The market, at its worst point, was down 5%. As the month progressed, markets rallied, US data modestly recovered and the Fed (via Powell's Jackson Hole speech) made clear they would cut interest rates in September. The FTSE All Share index ended up 0.61%. The Fund was down -0.71%. Year-to-date, the Fund is up 17.91% compared to the market, which is up 11.62%.

Looking at the peer group, the Fund is the best performing Fund within the IA UK Equity Income sector year-to-date. On a longer-term basis, the Fund is ranked 1st quartile over three years, five years and 10 years and is the best Fund in the sector since inception in 2004.[1]

The risk-off trend in early August tested the Fund's absolute and relative performance. By the end of the month, this had been partly neutralised. This was a function of the general recovery in risk appetite but also continued strong results at a company level. Notable names include **Costain**, up 17% relative, following results that included a surprise £10m buyback and a confident outlook with all end-use markets underpinned by strong investment levels (e.g. water, defence, energy), **International Personal Finance**, up 18% relative, following results that were ahead of expectations and the announcement of a buyback, **TP ICAP**, up 7% relative who also announced a buyback as well as continued progress on the IPO of its data business and **Keller**, up 6% relative, which indicated results would be materially ahead of previous expectations.

Another positive contributor was **Pheonix**, which was up 5% relative and continued to recover and reached a 12-month high. This stock still yields 10%. **DS Smith** continued to make new highs as the takeover by International Paper moved forward. The CEO of the latter laid out a plan to double the EBITDA of the base business (pre-DS Smith contribution) over the medium term, which was well received. The other positive trend was the continuation of the positive performance of certain domestically focused stocks, e.g. **Wickes** (up 12% relative) and **DFS** (up 8% relative) performed well. **Mobico**, a problem stock for much of the last 12 months, had an in-line set of results and was up 28% relative, as the low valuation partially unwound.

[1] Source: Lipper

On the negative side, both the oil and mining sectors were under pressure. This was partly a general point – linked to the risk-off mentality of the market noted above at the start of the month (e.g. **BP**, was down 6% relative, with **Glencore** down similarly) but there were also a number of specifics, e.g. **Diversified Energy** (down 25% relative) due to a poor response to their latest acquisition. **Energean** (down 15% relative) fell as the Israel / Gaza situation worsened.

Our recruitment stocks (**SThree** / **Page**) continued to underperform. These stocks are trading 'trough on trough' – trough valuation on trough earnings. **Centrica**, which had a difficult month in July post results, remained under pressure. Centrica needs to give greater clarity on its investment plans given its c. £2bn of surplus capital. **Polar Capital** fell early in the month as US technology (a major component of its AUM) fell and did not recover as the Nasdaq recovered towards the end of the month.

Portfolio activity

The strength of the market year-to-date and the volatility during August meant there were a larger-than-normal number of changes to the Fund.

We sold two stocks – **Bellway** and **Diversified Energy**. Bellway has recovered markedly from the lows at the time of the Truss / Kwarteng budget when the share price troughed at c. 1,600p, rising to current levels of 2,800 – 3,100p. With the stock trading at above book value and our assessment that returns will be lower this cycle than last cycle (closer to 10-12% vs 16-18%, due to higher tax, lower asset turn and no help to buy stimulus) coupled with opportunity elsewhere in the housing ecosystem, collectively contributed to the decision to sell the stock. We also continued to reduce **Vistry**, which made all-time highs during the month. We now have our lowest exposure to housebuilders in a decade – c. 75bps. We continued to add to **Forterra** (the second largest brick maker in the UK), where earnings can more than double to c. 30p per share if the housing market recovers. The shares at 175p would also likely double in that scenario. Our combined exposure to brick makers, with the other holding being **Ibstock**, is now c. 275bps.

Diversified Energy has been a very difficult holding, with several issues, including governance factors (which were driven by the fact this is a US company listed on the UK stock market). We also have a different view to the board on capital allocation issues, which was partially addressed by a reset of how free cashflow was allocated earlier this year and questions regarding how the business model resonated with carbon reporting in the UK (in effect we think the stock has the wrong owners against this backdrop). The management and the board were very helpful and engaged throughout the time we owned the stock. The lower yield after the capital allocation reset meant the stock yielded close to that of other stocks in the sector (e.g. BP and Energean), where we reallocated some of the proceeds. When performance is strong, and indeed at all times, it is important to make positive decisions on stocks where the outturn has not been in line with the initial investment case. This has been a particular focus for us this year, helping create the circumstances for a takeover of Hipgnosis, selling our small holding in Dolphin Capital and now the sale of Diversified Energy. This reduces the risk profile in the Fund.

We also continued to trim **DS Smith** as the stock made new highs as we move towards the consummation of its all paper takeover by International Paper. Our assessment of the earnings power of the new group means we will continue to hold the stock, but likely at a lower weight, reflecting the US axis and lack of index

inclusion in the UK. The **Tyman** takeover also consummated during the month. This was a part cash and part stock offer. The **Quanex** shares associated with this are also US-listed and now represent c. 30bps of the Fund. We will assess this stock on the same basis as our other holdings over time.

We started a position in two new stocks – **IAG** and **Picton**. Picton is a diversified property stock that the Fund has owned before. It has one of the best value creation track records in the sector over an elongated period of time under the same leadership team. It has hitherto always been rated at a premium to the sector and in line with its book value. Last year, it attempted (admirably) to lead (needed) consolidation in the sector. This ultimately failed and led to the stock moving to a large discount to book (c. 30%). This valuation gap created the opportunity for the Fund to re-enter the stock which yields c.5%.

IAG, which owns British Airways and Iberia, amongst other airlines, is recovering strongly post Covid. It has a strong balance sheet (which has led to a recent re-start of the dividend), has dominant positions in certain core markets (e.g. London to US, Spain to Latin America), has a credible recovery plan for BA, which is the main franchise that is underperforming and has a valuable data / reward business (Avios). The stock is very cheap – trading on a PE ratio of 4x.

We also continued to add to other recent additions, such as **FDM** and **Centrica** and finally, **First Group**, which has been weak.

We trimmed **International Personal Finance** and **Costain** – both very strong - back to their target weights and also top-sliced **Drax** following its strong run.

Outlook

The UK's economic outlook continues to improve and to confound the consensus view that it is some form of (sluggish) laggard. As noted above it is currently the fastest growing economy in the G7. This can be seen in the GBPUSD exchange rate which is now 1.32 (and also GBPEUR which is pushing towards 1.20).

With consumer confidence close to a 3-year high, savings ratios elevated, real wage growth of around 3% and a vast unspent stock of excess savings accumulated since COVID, the trajectory of improvement in consumer spending could surprise positively. The interest rate cut and a government seen to be doing (largely) sensible things will be the keys that unlock this. In this respect a move from setting a media narrative around criticising the legacy inherited to a focus on the opportunities ahead by the new Government would be a useful and suggested approach. The strength of the economy means future rate cuts will be modest, with maybe only one or two further rate cuts over the next 12 months.

As we said last month with political uncertainties high across Continental Europe and the US election outcome likely to be closer following Biden's exit, the UK post-election landscape looks comparatively stable, and this, combined with the improving domestic economy, should continue the nascent process of the UK stock market coming back in from the wilderness, particularly for international investors.

August saw some market volatility and an element of risk-off mentality, which saw some profit taking in a number of the Fund’s holdings. What was evident through August though (and the second half of July) was the strength of the results season.

At an aggregate level (c. 85% by our estimate), the Fund produced strong results through the second quarter, with forecast upgrades, more share buybacks and an 'air' of confidence in board rooms. The 85% is close to an all-time high for a results season in the Funds' 20-year history. The other 15% is mainly in sectors exposed to UK housing e.g. brickmakers, where the market is now clearly looking through short-term weakness given the interest rate cut and government policy.

We believe that strong economic momentum, rate cuts, companies performing well and low valuations make for a favourable backdrop as we move into the last third of 2024. We are also, as a result of this combination, likely to see more M&A, after the traditional summer lull. The Fund has seen five bids year-to-date, of which three have consummated. We would expect to see more before the year is finished.

We remain highly constructive about the prospects for the Fund.

Professional investors only.

Issued and approved in the UK by J O Hambro Capital Management Limited (“JOHCML”) which is authorised and regulated by the Financial Conduct Authority. Registered office: Level 3, 1 St James’s Market, London SW1Y 4AH. Perpetual Group is a trading name of JOHCML.

This is a marketing communication. Please refer to the fund prospectus and to the KIID / KID before making any final investment decisions.

These documents are available in English at www.johcm. com, and available from JOHCML at the address set out above.

Information on the rights of investors can be found here.

The distribution of this document in jurisdictions other than those referred to above may be restricted by law (“Restricted Jurisdictions”). Therefore, this document is not intended for distribution in any Restricted Jurisdiction and should not be passed on or copied to any person in such a jurisdiction.

The registrations of the funds described in this document may be terminated by JOHCM at its discretion from time to time.

Notice to investors in Switzerland: The representative of the Company in Switzerland is 1741 Fund Solutions Ltd., Burggraben 16, 9000 St. Gallen, Switzerland (the “Representative”). The paying agent of the Company in Switzerland is Tellco Ltd, Bahnhofstrasse 4, 6430 Schwyz, Switzerland. The Prospectus, the KIDs, the Instrument of Incorporation / the Constitution, and the annual and semi-annual reports may be obtained free of charge from the Representative. The Company is defined as J O Hambro Capital Management UK Umbrella Fund (domiciled in the UK), Perpetual Investment Services Europe ICAV (domiciled in Ireland) or Regnan Umbrella Fund ICAV (domiciled in Ireland), as relevant."

This fund has not been authorised by the Hong Kong Securities and Futures Commission and no person may issue, or have in its possession for the purposes of issue, whether in Hong Kong or elsewhere, any advertisement, invitation, or document relating to this fund, which is directed at, or the contents of which are likely to be accessed or read by, the public in Hong Kong. This fund is only for offer and sale to persons in Hong Kong who are “professional investors” as defined in the Securities and Futures Ordinance (cap. 571) of Hong Kong and any rules made under that Ordinance. This document and the information contained herein may not be used other than by the person to whom it is addressed and may not be reproduced in any form or transferred to any person in Hong Kong. The contents of this document have not been reviewed by any regulatory authority in Hong Kong. You are advised to exercise caution in relation to the offer. If you are in any doubt about the contents of this document, you should seek independent professional advice.

This document is only allowed to be distributed to certain relevant persons and not to the retail public in Singapore. The Fund, which is not authorised or recognised by the Monetary Authority of Singapore (the “Authority”), is registered under the Restricted Foreign Scheme with the Authority and the shares in the Fund (“Shares”) are not allowed to be offered to the retail public. Moreover, this document is not a prospectus as defined in the Securities and Futures Act, Chapter 289 of Singapore (the “SFA”). Accordingly, statutory liability under the SFA in relation to the content of prospectuses would not apply. Investors should consider carefully whether the investment is suitable for them. This document and any document or material in connection with the offer or sale, or invitation for subscription or purchase, of Shares may not be circulated or distributed, nor may Shares be offered or sold, or be made the subject of an invitation for subscription or purchase, whether directly or indirectly, to the retail public or any member of the retail public in Singapore other than (i) to an institutional investor, and in accordance with the conditions specified, in Section 304 of the SFA; (ii) to an investor falling within the definition of “relevant persons”, and in accordance with the conditions specified, in Section 305 of the SFA; or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA. Where Shares are acquired under Section 305 of the SFA by a relevant person, investors should note that the first sales and transfers of the Shares are subject to the applicable provisions of the SFA, which include section 305A of the SFA.

The investment promoted concerns the acquisition of shares in a fund and not the underlying assets. Past performance is no guarantee of future performance. The value of an investment and the income from it can fall as well as rise as a result of market and currency fluctuations and you may not get back the amount originally invested.

Investments may include shares in small-cap companies and these tend to be traded less frequently and in lower volumes than larger companies making them potentially less liquid and more volatile.
The information contained herein including any expression of opinion is for information purposes only and is given on the understanding that it is not a recommendation.

The information in this document does not constitute, or form part of, any offer to sell or issue, or any solicitation of an offer to purchase or subscribe for any funds or strategies described in this document; nor shall this document, or any part of it, or the fact of its distribution form the basis of, or be relied on, in connection with any contract.

Telephone calls to and from JOHCML may be recorded. Information on how personal data is handled can be found in the JOHCM Privacy Statement on its website: www.johcm.com

J O Hambro® and JOHCM® are registered trademarks of JOHCML.

Sources: JOHCM/MSCI Barra /Bloomberg (unless otherwise stated)