



JOHCM UK Equity Income Fund

Monthly Bulletin: February 2021

Active sector bets for the month ending 31 January 2021:

Top five

Sector	% of Portfolio	% of FTSE All-Share	Active %
Life Insurance	10.31	2.98	+7.33
Mining	14.64	8.08	+6.56
Media	8.36	3.28	+5.08
Food & Drug Retailers	6.30	2.16	+4.14
Banks	10.41	6.96	+3.45

Bottom five

Sector	% of Portfolio	% of FTSE All-Share	Active %
Pharmaceuticals & Biotechnology	0.00	8.34	-8.34
Equity Investment Instruments	0.00	6.92	-6.92
Personal Goods	0.00	5.43	-5.43
Tobacco	0.00	3.51	-3.51
Beverages	0.00	3.45	-3.45

Active stock bets for the month ending 31 January 2021:

Top ten

Stock	% of Portfolio	% of FTSE All-Share	Active %
BP	5.56	2.50	+3.05
Tesco	4.08	1.08	+3.00
Phoenix Group	3.16	0.17	+2.99
ITV	3.16	0.18	+2.98
Aviva	3.58	0.61	+2.97
Anglo American	4.33	1.37	+2.96
Barclays	4.00	1.08	+2.92
WPP	3.32	0.43	+2.89
Legal & General	3.57	0.68	+2.89
Vistry Group	2.97	0.09	+2.88

Bottom five

Stock	% of Portfolio	% of FTSE All-Share	Active %
Unilever	0.00	5.02	-5.02
AstraZeneca	0.00	4.59	-4.59
HSBC	0.00	3.68	-3.68
GlaxoSmithKline	0.00	3.12	-3.12
Diageo	0.00	3.08	-3.08

Performance to 31 January 2021 (%):

	1 month	Year to date	Since inception	Fund size (m)	Strategy size (m)
Fund – A Acc GBP	-0.67	-0.67	241.80	£1,849mn	£2,211mn
Lipper UK Equity Income mean*	-0.72	-0.72	157.99		
FTSE All-Share TR Index (12pm adjusted)	-0.44	-0.44	176.42		

Discrete 12-month performance (%) to:

	31.01.21	31.01.20	31.01.19	31.01.18	31.01.17
JOHCM UK Equity Income Fund – A Acc GBP	-12.40	8.18	-7.75	16.61	25.44
FTSE All-Share TR Index (12pm adjusted)	-7.28	10.81	-4.03	11.12	22.46

Past performance is no guarantee of future returns. 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

Economic data points continue to be heavily influenced by the degree of government-imposed restrictions on mobility. In the UK, the November lockdown had a relatively limited impact in most respects, with GDP falling by 2.6% month-on-month, a much smaller setback than was expected. For 2020, UK official GDP will have fallen by around 10%, which will be the largest drop amongst the developed nations. Whilst the UK's bias towards a services-based economy and its relatively modestly sized manufacturing sector has meant that Covid-19 has had a larger impact than elsewhere, we also strongly believe that the GDP fall has been significantly overstated by the unique way in which GDP is measured in the UK. Real government consumption will have fallen by around 8% in 2020 due to lower healthcare activity (essentially less hospital procedures) and school closures, an approach which looks at odds with the fact that government spending, on healthcare in particular, has risen considerably during the year. No other country adopts this approach, and, as such, if an adjustment were made for this impact, UK GDP would have fallen in 2020 by around 7%, a similar level to the likes of Spain, Italy and France. Conversely, it means that the UK's official GDP numbers will recover more strongly than other countries in 2021 as this effect reverses, combined with a recovery from the services sectors as vaccinations are rolled out and mobility restrictions are progressively relaxed.

In contrast to the official GDP fall, other more directly measurable economic outputs have proven to be more robust. Unemployment continues to surprise positively relative to expectations, helped by the UK furlough schemes. The PAYE data showed that net employment actually grew slightly in December and total hours worked are back to pre-virus levels. The value of UK retail sales only fell by 0.7% in 2020 and if one excludes fuel sales (which were down 26%), retail sales were up 2.3%, with the growth in online retailing (+33%) more than offsetting the fall from stores.

Signs that inflationary pressures are building continue to emerge, with UK CPI +0.3% month-on-month in December and rising input costs becoming more apparent as commodity prices, both metals and agricultural products, continue to move significantly higher. Inflation in 2021 will meaningfully increase, partly due to the base effects (e.g. when we annualise against the oil price falls of 2020 in March/April). The situation leaves the MPC in a tricky position in the short term, with the current lockdown having a significant impact on Q1 2021 GDP, but with the prospect of rising inflation and a major boost from pent-up demand from consumers likely to drive very strong economic activity later in the year. Keeping policy broadly unchanged and avoiding negative interest rates seems the most likely path they will adopt.

Chinese GDP grew by 6.5% in Q4 2020, leaving the annual increase at 2.3%, which is clearly better than other major economies but still reflects the country's slowest rate of growth since 1976. The industrial sector continues to lead the recovery there, with industrial output rising 7.3% for the year. In contrast, GDP in the US fell by 3.5% in 2020 and consumer spending was down by slightly more, reflecting the significant increase in unemployment. The Biden administration's expansionary policy agenda should provide support to the recovery this year, along with the vaccination programme.

Performance

Market dynamics were again volatile in January. Negative Covid-19 news (notwithstanding the recent falls in case numbers and hospitalisations), ongoing lockdowns and the risk of new variants of Covid-19 held the market back. Adding to the volatility, short squeezes in stocks like AMC and GameStop also created a short-term headwind for global equity markets as retail investors took on hedge funds.

The Fund performed slightly below the market, with a return of -0.67% compared to an index return of -0.44%. Looking at the peer group, the Fund ranked second quartile within the IA UK Equity Income sector for January. On a longer-term basis, the Fund is ranked fourth quartile over three years and first quartile over five years, ten years and since launch (Nov 2004).

The commodity sectors performed well over the month. The oil sector, including **BP**, our largest holding, was up 5-7% relative, whilst mining, which has been strong for much of the last six months, remained robust. **Glencore** was up 7% relative and small-cap **Kenmare** was up 30%. The mining sector remains very cheap, in our view, and, as highlighted in previous months, is at the centre of two positive trends: the global economic recovery led by China, which will spread as the vaccine is rolled out in 2021; and decarbonisation and the acceleration of the green agenda, which is metal intensive. The only weak stock in the commodity arena was **Petrofac** (down 13% relative) following a further regulatory setback.

Our small-caps continued to trend nicely on the whole. **Keller**, **Eurocell**, **Forterra**, **Sthree** and **U&I**, for example, were all up meaningfully. Three of the five had strong trading statements with associated upgrades.

Tesco and **Morrison** performed well towards the end of the month after a sluggish start. The former announced the return of capital from the sale of its Asian business, which will come in February. This allowed the market to properly see the low pro-forma valuation the stock is trading on.

Offsetting these positive trends, our financials saw a degree of pullback following a strong few months at the end of 2020 as renewed UK lockdowns began and bond yields were volatile. All our banks underperformed as did **Legal & General** and **Phoenix**. **TCAP** also fell as it navigated through the final stage of its rights issue. It should rebound materially once this technical hurdle is cleared.

Portfolio activity

We restructured our housebuilding exposure during the month in order to reduce the aggregate valuation profile, broaden the mix and, at a net level, slightly add to total exposure. We noted last month that we had reduced our position in **Countryside** following a strong share price recovery since March 2020, helped by the presence of an activist shareholder. We further reduced our position in January to around a 200bp active position. We used the proceeds to add a new position, **Bellway**. It has underperformed Countryside by 20% over the last year and subsequently, in our view, it is very cheap. On a forward basis it trades below book value, on a P/E ratio of 6-9x across the forecast period with a dividend yield rising to 6%+. It has a strong balance sheet, which should have a net cash position by 2022/23. Elsewhere in the sector our largest position is still **Vistry** which, by our calculations, has the most upside potential. With a supportive government policy framework, house prices that have gone up, not down, during the pandemic and a population that is more focused on its living space, this sector remains very interesting and very cheap, in our opinion.

The food retailers continued to perform sluggishly in the early part of the month, despite the many positives we have discussed previously (increased sales as a result of more people working from

home, better economics from the online segment due to increased demand, improved pricing power and an increase in market share versus the discounters). We added to both **Tesco** and **Morrison**. Both started to track higher towards the end of the month. With free cash flow yields of 10% they remain undervalued in our view. An interesting marker during the month was the corporate approach to Carrefour (which was subsequently withdrawn) at a 5% free cash flow yield.

A number of small-caps (**Kenmare, Savannah Energy, Headlam**) performed well and we marked our positions to target weights. All three had strong trading updates.

For much of the month the mining sector performed positively as commodity prices continued to increase. During that phase **Anglo American** and **Glencore** both reached our maximum active weight of c. 300bp and were reduced accordingly. Despite this recent positive performance (which rolled over in the last week of the month) they remain very cheap, in our opinion, with typical free cash flow yields of c. 15%.

We continued to modestly add to **Drax**, which we see as being uniquely positioned for evolving energy policy yet materially under-researched and misunderstood by the market. This was funded by a reduction in **SSE**, which is also well placed but is now the most expensive stock in the Fund. It is in the 'ESG Halo' club and the valuation has evolved to reflect this. As regular readers will know, our focus on ESG is to identify strong improvers and work with our holdings in that improvement process. It was encouraging in this context to end 2020 with 17 upgrades and only two downgrades amongst Fund holdings on the MSCI ESG rating system. This shows the process is working.

We reduced **National Express**, which has held up following its strong second half run despite (relative to the rest of the Fund) having more near-term headwinds. It remains well-placed for the medium to long term, but its recovery post Covid-19 will take longer than initially expected. We also reduced **Standard Life Aberdeen**, which had hit near-term relative highs.

We continued to add to recent addition and recent IPO **Conduit**. It announced the appointment of a very respectable finance director and also confirmed a positive trading backdrop. We see this stock as at least 50% undervalued on an 18 month to two-year perspective. We also added to banks, which were weak. This including the continued reduction of **Lloyds** in order to build up positions in **Natwest Group** and **Standard Chartered**. **Barclays** remains our largest exposure in this sector. We also added to **TCAP**.

Outlook

With greater certainty over Brexit, the vaccination rollout and the Biden administration's agenda, we continue to expect markets to generally look through the economic impact of the current lockdowns and to concentrate upon the likely recovery in activity from Easter onwards. The increasing signs of building inflationary pressures will also, in time, begin to impact bond yields, discount rates and consequently stock market leadership in favour of cyclicals and financials. However, this process is unlikely to be straight forward and may well exhibit a 'two steps forward, one step back' profile, as the precise timetable of the loosening of restrictions and the distribution and efficacy of different vaccination programmes is difficult to precisely predict.

However, what we do know is that the very loose monetary policy, the expansionist fiscal approaches, the resilient employment levels, the high savings ratios and the material pent-up demand will all be very supportive for our portfolio of stocks as we progress through 2021 and beyond. Furthermore, the fact that valuations remain very low in many parts of the recovery/value universe offers the potential for significant capital appreciation at some stage this year.

The Gamestop experience is a reminder of how very low interest rates can distort behaviour, share price performance and valuations in certain parts of the market and may well be a harbinger of further stock market leadership change. Whilst this may lead to some volatility in market indices during 2021, we remain extremely optimistic about the potential for significant relative outperformance as well as healthy capital appreciation from our portfolio over the next couple of years, particularly as dividend payments begin to rebuild. We are extremely focused upon clawing back last year's underperformance and feel that there is material upside in areas such as financials, commodities and smaller companies; the UK market overall looks extremely modestly rated too, compared to other international indices and sterling is a cheap currency. We would urge investors to consider whether they have enough exposure to the UK market, which has a healthy

bias towards the value factor and where most stocks trade on a very low valuation compared to their international peer group.

Further information

If you would like further information about the Fund, please call our Investor Relations team on +44 (0) 20 7747 8969, email us at info@johcm.co.uk or visit our website at www.johcm.com

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