Professional Investors Only

JOHCM UK Equity Income Fund

Monthly Bulletin: January 2018

Active sector bets for the month ending 31 December 2017

Top five

Sector	% of Portfolio	% of FTSE All-Share	Active %
Financial Services	8.47	2.97	+5.50
Construction & Materials	6.50	1.44	+5.06
Banks	15.56	11.21	+4.35
Mining	10.14	6.49	+3.65
Oil & Gas Producers	16.07	12.62	+3.45

Bottom five

Sector	% of Portfolio	% of FTSE All-Share	Active %
Tobacco	0.00	5.84	-5.84
Pharmaceuticals & Biotechnology	2.87	7.08	-4.21
Equity Investment Instruments	0.95	4.46	-3.51
Beverages	0.00	3.03	-3.03
Personal Goods	0.00	2.32	-2.32

Active stock bets for the month ending 31 December 2017

Top ten

Stock	% of Portfolio	% of FTSE All-Share	Active %
Aviva	3.83	0.82	+3.01
Lloyds Banking Group	4.89	1.96	+2.93
BP	6.98	4.06	+2.92
ITV	3.10	0.25	+2.85
Standard Life Aberdeen	2.97	0.48	+2.49
Rio Tinto	4.35	1.89	+2.46
Barclays	3.80	1.39	+2.41
DS Smith	2.52	0.21	+2.31
National Express Group	2.30	0.06	+2.24
Morgan Sindall Group	1.94	0.02	+1.92

Bottom five

Stock	% of Portfolio	% of FTSE All-Share	Active %
British American Tobacco	0.00	4.62	-4.62
Diageo	0.00	2.71	-2.71
GlaxoSmithKline	0.00	2.57	-2.57
Prudential	0.00	1.98	-1.98
Unilever	0.00	1.92	-1.92

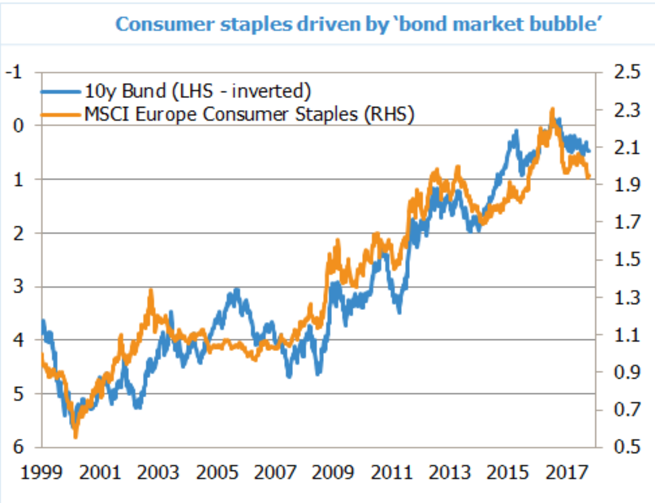
Performance to 31 December 2017

	1 month (%)	Year to date (%)	Since inception (%)	Fund size
JOHCM UK Equity Income Fund	**3.24**	**18.11**	**291.90**	**£3,584m**
Lipper UK Equity Income Mean*	2.38	10.79	174.11	
FTSE All-Share TR Index (adjusted)	3.18	13.10	182.87	

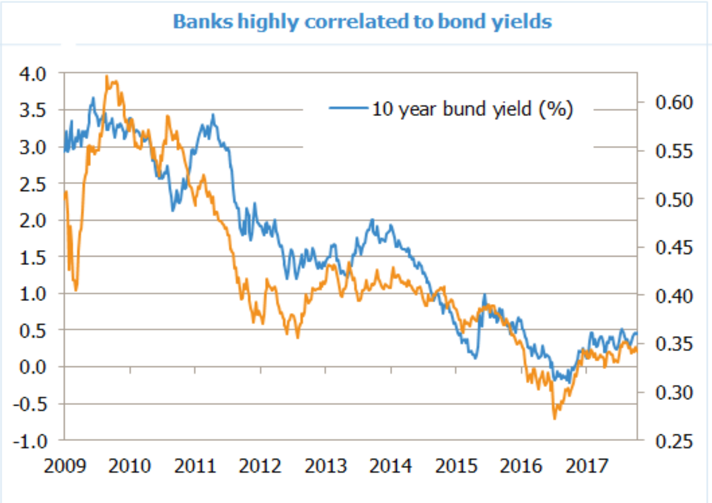
Past performance is no guarantee of future returns. Source: JOHCM / Lipper Hindsight. NAV per share calculated net of fees, net income reinvested, 'A' accumulation share class in GBP. Performance of other share classes may vary and is available on request. Inception date: 30 November 2004. Index return is net income reinvested, adjusted for 12pm. * Initial estimate for the Investment Association's UK Equity Income sector.

Economic developments

During the last quarter of 2017 there were a number of events that had a material impact on the outlook for the overall stock market, sectorial performance within the market and the likely performance of value vs. growth and cyclicals vs. defensives. The passage of the tax measures in the US, the first major Trump success on policy, will add momentum to an already strong US economy. We showed last month that consumer, manufacturing and business confidence are close to, if not at, record highs in the US. This backdrop will extend the current strength in economic activity; it will mean the Federal Reserve continues to increase interest rates/shrink its balance sheet; and it will help lead to higher wages, all of which will contribute to higher bond yields. We exited 2017 with US 10-year treasuries trading at 2.4% (close to the highest point of the year), and we expect this to push higher from here. We have shown again below two charts we published during 2017, which highlight how correlated defensives and banks are to bond yields. We expect defensives to continue to underperform financials and cyclicals in 2018, and the Fund remains positioned accordingly.



Source: Bank of America Merrill Lynch as at 6 October 2017



Source: Credit Suisse research as at 11 October 2017

In the UK, the Brexit breakthrough in December with agreement to move to the next phase of discussions is a major positive versus the implied outcome and the assumed (very negative) trajectory of the UK economy that is priced into domestic-related assets. Meanwhile, economic data is not as negative as portrayed. Wage growth inched higher to 2.3% (from 2.2%). As we highlighted last month, we expect this to move towards 3% during 2018, with a likely sharp shift higher in the first half against weak comparatives. Latest data on EU migration into the UK showed those arriving looking for work (as opposed to those with a definite job) were at the lowest level since 2004 (for EU 8) and 2011 (for EU 15). This will place increased pressure on an already tight labour market. As inflation falls from the current level (which will be the peak as the effect of the Brexit sterling devaluation drop out of the data) real wages will start to expand. Whilst the Citi UK Economic Surprises index (which is a barometer of how all economic data is progressing in relation to forecasts) has rebounded strongly since August. This corresponds to the narrative we hear from many of our UK holdings when we meet management teams. We expect sterling to continue its gentle appreciation. The biggest risk to the UK economy would be a Corbyn-led

Labour government. This is the main reason we have been measured in the pace of our increase in domesticity.

In Europe, data remains strong, particularly in France and Spain. This trend will hopefully be cemented and augmented by policy actions in 2018 that will create a better structural growth story. The recent introduction of **Kingfisher** to the portfolio and the increase in our **DS Smith** position are good examples of how we are trying to increase our exposure to these trends.

Finally, the oil price remains important to the Fund. This is due in part to our large positions in the two UK oil majors but also because of its implications for inflation. We discussed the OPEC decision to extend production cuts in last month's commentary. Along with better-than-expected demand growth and some questions over the pace of supply growth from US shale, the cuts have helped stabilise the oil price at around US$60/bbl. This is 30-40% higher than the low point in mid-2017, which means oil and oil derivatives will place upward pressure on global inflation as we move through 2018, contributing to the higher bond yield narrative, which, as shown above, is critical to how the equity market evolves.

This is the backdrop we have built the Fund around as we move into 2018. We are overweight oil/commodities; we are overweight financials; we continue to gradually increase UK domestics; and we are overweight small caps, where the valuation signal continues to be powerful. Against these active positions, we remain very underweight defensives, utilities, pharmaceuticals and other bond proxy type sectors/stocks.

Performance

The market was strong during December, with the FTSE All-Share Total Return Index (12pm adjusted) posting an increase of 3.18%. The Fund marginally outperformed the index in returning 3.24%. For 2017 as a whole the Fund finished up 18.11%, beating the benchmark return of 13.10%.

Looking at the peer group, the Fund was ranked first decile within the IA UK Equity Income sector in 2017. On a longer-term basis, the Fund is ranked first decile over three years, 10 years and since launch (November 2004) and first quartile (second decile) over five years.

The mining sector performed well in December following a sluggish few months where the focus was on China. The narrative broadened with a number of good capital market events, a renewed focus on the benefits that electric vehicles will bring the sector (particularly **Glencore** with its positions in copper, cobalt and nickel) and supportive valuations. Our new small cap name **Central Asia Metals** performed the strongest.

Our domestic names performed well, partly as a function of the agreement to move to the next stage of Brexit negotiations but also partly as a delayed reaction to the November budget. Our brick producers, particularly **Ibstock**, performed well while a number of our other construction-related names also moved higher, including **Severfield** and **Costain**. In other UK domestics, **Kingfisher** continued to perform well and **ITV** recovered somewhat.

A number of our best performers during 2017 continued to do well: **Brewin Dolphin**, following results in late November, **BBA Aviation** (which we have now sold – see below) and **Savills**.

Offsetting these trends we had a number of negatives, two of which were driven by negative news flow. **Low & Bonar** announced a second profit warning at the same time it announced its CEO had been poached by a much larger company (not a usual combination of events); the stock fell 20%. Elsewhere, **CMC** (down c.10%) was affected by the announcement of new EU regulation on CFD/spread betting. Whilst the new rules will hurt profitability – something that was already baked into market thinking after the FCA's announcement in December 2016 on the same subject – it is likely to lead to the closure of aggressively-run, offshore and lightly-capitalised competitors. In the long run, therefore, it should be a positive. **Laird** also fell, although there was no notable news flow.

Portfolio activity

We sold one stock from the Fund during December, **BBA Aviation**, and finished adding to a small cap name which we have not previously mentioned, **Polar Capital Holdings**.

We acquired BBA Aviation in late 2015 when it came under technical pressure from a large rights issue conducted to fund the acquisition of Landmark. This deal made it the largest owner/lessor, by some margin, of fixed base operations in the US (effectively airports for private jets). This transaction created one of the best assets in the Fund at a very good entry price. The share price has risen c.75% since the deal was consummated, with the stock contributing c.60bp to the Fund's relative performance. The position was sold purely on valuation grounds, with it trading on a P/E of 18x and yielding less than 3.5%.

Elsewhere in the Fund we also reduced our positions in **Savills**, **Brewin Dolphin** and **Keller**. All three of these stocks have performed well in recent months and have risen towards our target prices. We believe all still have moderate upside. We also slightly reduced our position in **Barclays** after it bounced following a period of share price weakness linked to a disappointing Q3 update in October. We remain very positive on Barclays from a valuation perspective, albeit some technical changes mean the tangible book value will decline in 2018, meaning the price-to-book discount will narrow to c.20%. It trades on a low multiple of normalised earnings (8x P/E) and, after the sale of the African operations, has adequate capital (with tier 1 capital now over 13%). A slightly lower weighting is appropriate for the following four reasons: firstly, the recent sluggish operational performance; secondly, the ongoing legacy issues (SFO inquiry into previous management and US mortgage-backed security litigation); thirdly, the likely delay to the full ramp up in the dividend reflecting the previous point; and fourth and finally, the narrowing of the price to tangible book value. Nevertheless, it remains a top 10 active position.

We added Polar Capital to the Fund progressively over the second half of 2017. Our average entry price is c.430p (vs. the current price of 535p). Polar is an asset management company with a good track record of performance and strong positions in some attractive niche areas (e.g. technology/healthcare). It has a solid balance sheet, with net cash of £70-80m. We acquired the stock for two reasons. When we first acquired it, it was clear to us that the underlying momentum of the business, in terms of both performance and new assets, was better than the headline figures suggested. The latter was distorted by continued outflows from its Japan fund, which used to be the dominant product in the group. In addition, Polar has also recently hired Gavin Rochussen as its new CEO, whom we rate highly from his time as CEO of JOHCM. He is likely to broaden distribution (which is very UK-centric) and fill product gaps (e.g. EM, Global).

Elsewhere, we added marginally to **Morgan Sindall**, which has been our best-performing stock in 2017. A positive trading update and capital markets event, coupled with our view that normalised EPS is >200p, suggests this can continue to perform well. We also added to employment agency **Sthree**, the mining sector (primarily **Anglo American** and **Glencore**) following weakness in the early part of the month, **DFS** and **Palace Capital**. The other notable change was packaging company **DS Smith**. We had reduced our position in the run up to its results, as its share price was buoyed by the stock's likely entrance into the FTSE 100 index (subsequently confirmed). After results which were very strong, particularly the acceleration in organic growth to 5.2%, raw material inflation recovery and the initial performance of the recent US acquisition, it fell back c.10%. We added about 30-40bp back to our position.

Fund dividend

Last month we upgraded the 2017 Fund dividend growth forecast to 13%. The final outcome was slightly above this at 13.4%. The discrete Q4 dividend was up c.7%.

As we indicated in November, the dividend base of the Fund looks strong as we move into 2018, with a solid growth trajectory across a number of areas. Large active positions like **Aviva**, **DS Smith** and **National Express** are expected to deliver good dividend growth in 2018; the strength in the mining sector will continue (we estimate this factor alone adds around 2-3% to the Fund dividend growth); and we expect the banks sector to continue to move towards a more normal dividend framework. When we look at our detailed, bottom up, stock-by-stock dividend forecasts, there is less identifiable stock-specific risk this year compared to last year. The main risk relates to currency, particularly moves in the GBP/USD exchange rate across the year. We do expect sterling to strengthen for the reasons we lay out above, which would place pressure on the overall UK dividend base. The sensitivity of the Fund's dividend growth rate to a five cent move in both the pound/dollar and pound/euro rate is c.2%.

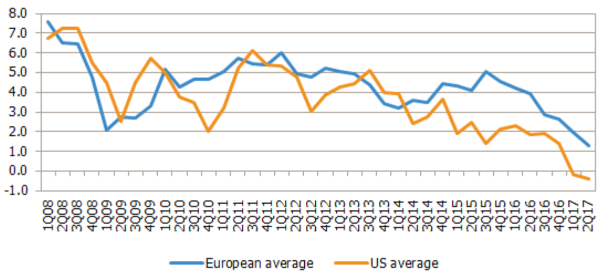
Given all of these factors, and building in a buffer for the FX risk, our initial guidance for the Fund dividend growth in 2018 remains at mid single-digit percentage growth. This would mean the Fund would yield 4.35% on a 2018 prospective basis. We will update this guidance at the end of Q1 2018 when we have seen the trends evident in the full-year results reporting cycle.

Outlook

The path to policy normalisation has categorically begun in the US, the UK and Europe. The true distortive impact of effectively zero interest rates in the developed world on various asset classes will only become apparent in future years. However, without doubt it has pushed valuations of many assets and individual instruments to elevated levels that will be hard to justify if the cost of capital rises. There are also a number of geopolitical risks that make for a more cautious tone from a future market return perspective – namely Korea, Trump/Russia, tensions in the Middle East, Brexit and so on. We would not be surprised if markets, after a strong run over a number of years, found life tougher at a headline level.

However, within the equity market, we strongly believe that the overvaluation is most apparent in consumer staples and other perceived defensive sectors such as utilities and pharmaceuticals. It is pleasing that we have started to see chinks in the armour in the operational performances of these businesses in the last year. The chart below shows the declining trend in like-for-like revenue performance in the European/US consumer staples sector. It shows clearly the pressures these businesses are starting to face. The table shows the high valuations that these types of perceived defensives trade on. The six stocks highlighted, none of which the Fund owns, constitute nearly 10% of the FTSE All-Share Index. The high valuations to which these stocks have been driven means they are a material element of the overall market. Passive strategies should beware.

Like-for-like growth is slowing…



Source: Redburn September 2017

Defensives are still expensive

	bp of FTSE All-Share	2018 PE
Compass	99bp	20x
Bunzl	28bp	17x
Unilever	205bp	20x
Diageo	271bp	21x
Reckitt Benckiser	174bp	19x
Reed Elsevier	75bp	20x

Source: JOHCM as at 12 December 2017

Conversely, we believe that many of the areas that we are exposed to will respond well to a change of stock market leadership if monetary policy were to normalise, particularly financials. Elsewhere, valuations in both the oil and mining sectors continue to look attractive to us, whilst there are also selective opportunities in the UK domestic arena, too.

The first breakthrough in the Brexit discussions in December provided a more balanced narrative for the domestic side of the UK equity market. As reflected in the gilt and FX markets and within the domestic side of the stock market, sentiment does, however, remain polarised. Even a small amount of additional progress in 2018 would cause a big adjustment in these markets given the level of risk priced in and the absolute valuations, which have all trended to around a P/E of 10x and a dividend yield of 5%.

The long-term performance of the Fund is heavily correlated to the Fund's dividend growth and the resulting absolute level of the dividend. The delivery of 13.4% growth in 2017, which continues a track record of strong growth since the Fund's inception and the confidence (even allowing for some sterling appreciation) in the 2018 dividend outlook is an important driver of the unit price. As noted above, the Fund's prospective yield for 2018 is c. 4.35%. This yield, strong dividend growth and low valuations embedded across the portfolio, coupled with the shift in monetary policy, leave us cautiously optimistic in our outlook for the Fund.

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

This document is for professional investors only.

Issued and approved in the UK by J O Hambro Capital Management Limited (the "Investment Manager"), which is authorised and regulated by the Financial Conduct Authority. JOHCM® is a registered trademark of J O Hambro Capital Management Limited. J O Hambro® is a registered trademark of Wilton Holdings Limited. Registered address: Ground Floor, Ryder Court, 14 Ryder Street, London SW1Y 6QB. Registered in England and Wales under No: 2176004. Telephone calls may be recorded.

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 Funds 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.

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. Allocations and holdings are subject to change.

Recipients of this document who intend to subscribe to any of the Funds are reminded that any such purchase may only be made solely on the basis of the information contained in the prospectus in its final form, which may be different from the information contained in this document. No reliance may be placed for any purpose whatsoever on the information contained in this document or on the completeness, accuracy or fairness thereof.

No representation or warranty, express or implied, is made or given by or on behalf of the Firm or its partners or any other person as to the accuracy, completeness or fairness of the information or opinions contained in this document, and no responsibility or liability is accepted for any such information or opinions (but so that nothing in this paragraph shall exclude liability for any representation or warranty made fraudulently).

The distribution of this document in certain jurisdictions may be restricted by law; therefore, persons into whose possession this document comes should inform themselves about and observe any such restrictions. Any such distribution could result in a violation of the law of such jurisdictions.

The information contained in this presentation has been verified by the firm. It is possible that, from time to time, the Fund manager may choose to vary self imposed guidelines contained in this presentation in which case some statements may no longer remain valid. We recommend that prospective investors request confirmation of such changes prior to investment. Notwithstanding, all investment restrictions contained in specific Fund documentation such as prospectuses, supplements or placement memoranda or addenda thereto may be relied upon.

Investments fluctuate in value and may fall as well as rise. Investors may not get back the value of their original investment.

Past performance is not necessarily a guide to future performance. Dividend yield quoted is prospective and is not guaranteed.

Investors should note that there may be no recognised market for investments selected by the Investment Manager and it may, therefore, be difficult to deal in the investments or to obtain reliable information about their value or the extent of the risks to which they are exposed.

The Investment Manager may undertake investments on behalf of the Fund in countries other than the investors' own domicile. Investors should also note that changes in rates of exchange may cause the value of investments to go up or down.

J O Hambro Capital Management Ltd is licensed by FTSE to redistribute the FTSE All-Share TR Index, the "Index". All rights in and to the Index and trade mark vest in FTSE and/or its licensors (including the Financial Times Limited and the London Stock Exchange PLC), none of whom shall be responsible for any error or omission in the Index.