Professional Investors Only

JOHCM UK Equity Income Fund

Monthly Bulletin: February 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 January 2024:

Top five

Sector	% of Portfolio	% of FTSE All-Share	Active %
Construction and Materials	9.32	0.45	8.87
Life Insurance	9.90	2.40	7.50
Banks	14.40	8.99	5.41
Industrial Metals and Mining	9.82	6.24	3.58
Household Goods and Home Construction	4.74	1.28	3.46

Bottom five

Sector	% of Portfolio	% of FTSE All-Share	Active %
Pharmaceuticals & Biotechnology	0.00	10.67	-10.67
Closed End Investments	0.00	6.28	-6.28
Personal Care, Drug and Grocery Stores	1.36	7.62	-6.26
Aerospace and Defence	0.00	3.31	-3.31
Beverages	0.00	3.11	-3.11

Active stock bets as at 31 January 2024:

Top ten

Stock	% of Portfolio	% of FTSE All-Share	Active %
Barclays	4.05	0.99	3.06
NatWest	3.59	0.55	3.04
Phoenix	3.15	0.16	2.99
Aviva	3.50	0.52	2.98
DS Smith	2.92	0.16	2.76
Standard Chartered	3.20	0.58	2.62
Legal & General	3.25	0.66	2.59
Paragon	2.52	0.07	2.45
ITV	2.47	0.10	2.37
Glencore	4.59	2.27	2.32

Bottom five

Stock	% of Portfolio	% of FTSE All-Share	Active %
Diageo	0.00	2.76	-2.76
HSBC	2.38	5.29	-2.91
Unilever	0.00	4.23	-4.23
Shell	1.91	7.15	-5.42
AstraZeneca	0.00	6.84	-6.84

Performance to 31 January 2024 (%):

	1 month	Year-to-date	Since inception	Fund size (£m)	Strategy size (£m)
Fund – A Acc GBP	**-2.19**	**-2.19**	**341.20**	**1,479**	**1,750**
Lipper UK Equity Income mean*	-1.43	-1.43	218.88		
FTSE All-Share TR Index (12pm adjusted)	-0.99	-0.99	251.20		

Discrete 12-month performance (%) to:

	31.01.24	31.01.23	31.01.22	31.01.21	31.01.20
JOHCM UK Equity Income Fund – A Acc GBP	-2.73	3.23	28.55	-12.40	8.18
FTSE All-Share TR Index (12pm adjusted)	2.95	4.58	18.01	-7.28	10.81

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

After experiencing a greater-than-anticipated decline in inflation in October and November in the UK, there was a modest increase in the December data to 4% year-on-year, compared to 3.9% the previous month. Although we anticipate a marginal increase in January, we think that inflation will then continue its steep fall. With household energy bills expected to decrease again in April and food price inflation now receding, it is likely that inflation will be in the range of 2-2.5% by the second quarter of this year.

The British Retail Consortium shop price index, a reliable indicator of future inflation, dropped to 2.9% (from 4.3% the previous month), marking the lowest level of growth in nearly two years. The labour market, a key factor that has kept the Bank of England Monetary Policy Committee hawkish (for instance, in the end of January 24 meeting, two members voted, in our opinion, incorrectly, for an increase in interest rates), continues to show signs of slowing momentum. Wage inflation is running at 6.5%, a decline from a peak of 8.5% in the middle of 2023. As we discussed last month, base effects mean that official wage inflation will continue to fall over the next few months. We would expect wage growth to be c.5% this year, supported by the minimum wage increases and their knock-on effects on other lower pay grades. Most of our stocks are indicating 3-5% is in their budgets for wage growth this year.

This analysis clearly shows that real wages are poised for strong growth this year, helped by the National Insurance tax cut implemented at the start of the year. This could be accreted further by additional tax cuts in the upcoming March budget. Part of the reason the Chancellor has more room to manoeuvre is the decline in borrowing costs, due to the reduction in inflation over the last year, reflected in a c80bps decrease in 10-year yields. Mortgage rates have also dropped, with 2-5 year fixed rates currently ranging between 4-5%, as opposed to the previous high of 6%. This shift has led to early signs of a strong increase in housing activity at the beginning of this year.

Given these trends, it comes as no surprise that UK consumer confidence measures continue to improve. The January data was at a two year high, notably reflecting movement, for the first time, in indices such as major purchase intentions. Apart from a few exceptions (eg JD Sports, which we do not own), most retailers reported solid trading during the crucial Christmas period. Additionally, a couple of our holdings (**Wickes** / **Currys**) even upgraded expectations.

Other leading indicators for UK economic activity, such as the PMI indices, also rose in January. Our central case remains that economic activity will outperform consensus expectations, and coupled with lower inflation, this scenario will allow the Bank of England to gradually reduce interest rates later in the year. As we indicated last month, we believed the market had priced in rate cuts too aggressively, both in terms of timing and magnitude at the end of last year, given the likely strength of the economy. Some of this expectation has moderated in January.

Performance

Following two stronger months for the market and the Fund, January saw a market pull back and the Fund underperform. The FTSE All Share fell -0.99% over the period, with the Fund down -2.19%.

Looking at the peer group, the Fund was ranked in the 4th quartile within the UK Equity Income sector in January. On a longer-term basis, the Fund is ranked 2nd quartile over three years, 3rd quartile over five years, 2nd quartile over 10 years and is the best Fund in the sector since inception in 2004.[1]

The main detractors in the month were in the commodity sectors. Our largest holding in this area, **BP**, was up slightly in relative terms, but all other holdings underperformed. In the mining sector, **Glencore** fell 10% relative, whilst **Kenmare** (see below) fell 20% relative. The prevailing negative sentiment towards China significantly influenced both the former and the sector overall. Within the oil sector, **Diversified Energy** continued to remain weak.

UK domestic assets have shown increasingly positive performance, particularly in the last few months of 2023; for example, housebuilders were up c.30% last year. This started to broaden out in January. Stocks like **Ibstock**, which had been a laggard, rose in January despite a sluggish trading update. It is very encouraging that the market is starting to look through earnings weakness towards valuation. The other feature is forecasts are, in the main, very prudent. This has meant we have not seen many large ‘misses’, and in some places, we are seeing upgrades (eg **Wickes** rose 10% following a trading update that guided to the top of a previously wide range of profit expectations).

Our construction/contracting stocks all performed well; **Kier** was up 21% relative, **Galliford** was up 14% relative and **Costain** was up 8% relative. All three stocks had strong trading updates. Housebuilders remained well bid.

There are still some anomalies in UK domestics and small caps, mainly driven by liquidity issues such as share overhangs. For example, **Severfield** was down 6% relative, and **Eurocell** was down 3% relative, despite being the most recent stock to announce a share buyback.

Elsewhere, **EasyJet** was strong following good results. It is very clear pricing trends will be strong across the next 18 months due to supply issues with various Boeing planes. The newly established holiday business continues to thrive, with profits growing strongly. Based on our normalised earnings, EasyJet is on a PE of less than 5x. **Drax** outperformed as the government announced a consultation on a bridging mechanism up to 2030 for the Drax power station, when its new proposed carbon capture power facilities would be ready. The importance of Drax increased following the announcement by EDF of delays to the new Hinkley nuclear facility coming online. Drax remains on a PE of less than 5x. **Mobico** and **Vodafone** were also strong.

In the financials sector, insurance stocks were up slightly, and banks were down slightly. **Standard Chartered** (down 7% relative) was weak, influenced by a few

[1] Source: Lipper

brokers who reduced forecasts by 2-3%. On the other hand, **Paragon**, the Fund's top performer in December due to strong results, continued to rise (up 3% relative).

Real Estate Investors rose c.10% relative following the announcement of a new strategy, of an orderly sale of the groups' assets over up to three years. The management is incentivised to do this earlier via a new short-term incentive scheme which rewards finality in 2024 twice as much as in the third year. This is a welcome change in strategy, which we have been calling for, for several years. We had also written to the board regarding remuneration arrangements, with the new approach now incentivising management to realise value. The shares were trading at c.50% of book value, which means they would have to go up by 100% if book value were to be realised. In our view, a realistic central case outcome would be c.75-85% upside. We have discussed before that the low valuation of the UK market overall and most of the Fund's holdings has led to an increase in our constructive activism and board engagement. Real Estate Investors is a good example of this, with the value locked in the stock now being actively released.

This month, one of the Fund's worst performers was **Kenmare**. The shares fell in a delayed reaction to a pre-Christmas announcement that detailed (a) lower production expectations in 2024, (b) higher costs on their main capex project and (c) the likelihood that the dividend policy would focus on the payout ratio of 20-40% rather than trying to keep it at a flat absolute level, which had been previously noted. This was disappointing in an absolute sense but was magnified by its proximity to the capital markets day held in Q2 last year, which detailed confident guidance on these points. This has impaired credibility and likely new interest in the stock, which trades on a c.33% underlying free cashflow yield once growth capex, is stripped out (ie it pays for itself in three years).

We wrote to the board in late 2022, expressing our view that stocks focused on a single country and a single commodity were unlikely to be accurately valued by the stock market in the aftermath of the Russian invasion of Ukraine. This is exacerbated by broader issues in the UK market, especially in small caps.

Our preferred solution at the time was for these companies to merge, to diversify country and commodity risk, and improve liquidity. Currently, our preference is an outright sale of the company to a larger group where the cashflows would be valued more appropriately. The assets with a 100-year lifespan and high market shares have strategic value, and in our view, would attract significant interest. We believe large elements of the shareholder base would agree with this view, and as a result, we have written to the board calling on them to assess strategic options.

Portfolio activity

As described above, there were several large price changes under what appeared on the surface to be a sluggish market.

We marked to target weight our construction/contractor holdings - this meant reasonably sized sales in **Kier** and **Galliford**, given the extent of the share price moves. We also trimmed our housebuilding exposure as the stocks continued to move higher. **Bellway** is up 90% from the 'Truss' lows, including dividends, and is now hovering just below book value. Whilst we still think there is 20-30% upside, a lower weighting is appropriate. We now have c.4% in this stock and **Vistry** combined versus a peak of c.5.5%. The proceeds were recycled at the start of the month to stocks that had not started rising, such as Ibstock and those that have still not, e.g. Eurocell.

We continued to add to **Hammerson**, which is now sized at 1% of the Fund. We laid out the fundamental case on the stock in a previous commentary (Read Here) As noted above, Real Estate Investors has joined **Palace Capital** in the wind-up phase. The capital from this process will ultimately move to cash, and the Hammerson adds should be regarded as a staggered switch within this sector.

We also added to other recent addition, **TI Fluid Systems,** which also had a strong trading update and **Page** and **SThree**, which were modestly down after the former (and Hays – not owned) had downgrade statements. They are trading on trough multiples, and as with Ibstock, as noted above, have rebounded from the initial share price falls seen on the days of the updates.

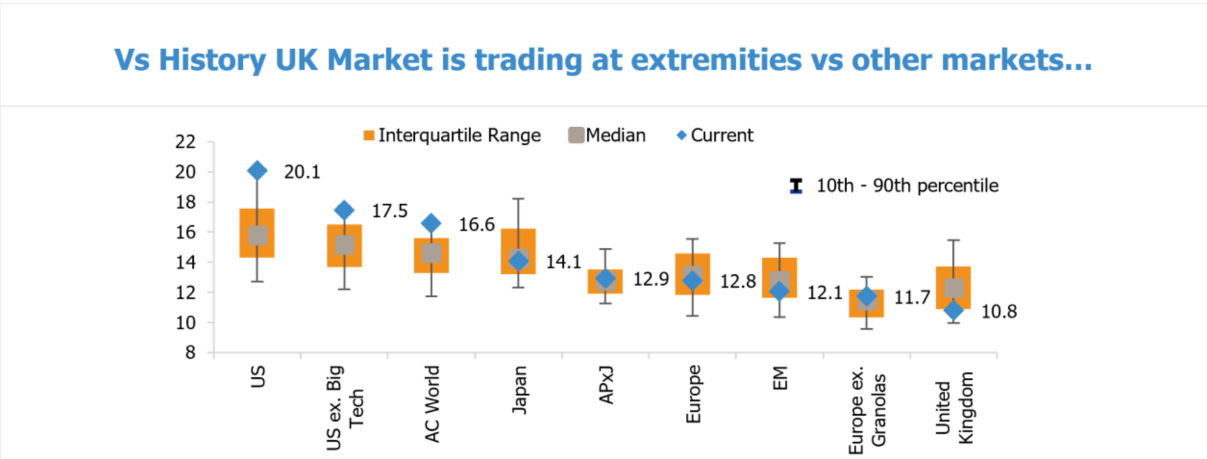
We added to **Currys**. This particular stock was the one we were most concerned about as we approached its trading update, but in the event it announced it was trading above consensus forecasts. The sale of its Greek operation, announced in Q4 2023, has created a net cash balance sheet, and there are now several themes developing (eg implications of AI on the business – which could be very positive, the recovery of the Nordics business, a potential return to the dividend list, etc) that could create material upside. We also added to **ITV**.

EasyJet was strong as noted above. Whilst the upside is material, we marked this position to our target weight which is 200bps.

As noted, Paragon has been one of the Fund's strongest stocks over the last two months. Like the housebuilders, it still has upside (c.25/30%), but we reduced the weight from being the largest stock in the Fund (c.300bps) to c.250bps. We rotated some of this value into the larger banks that have not been re-rated like Paragon (e.g. **Lloyds**/**Standard Chartered**).

Outlook

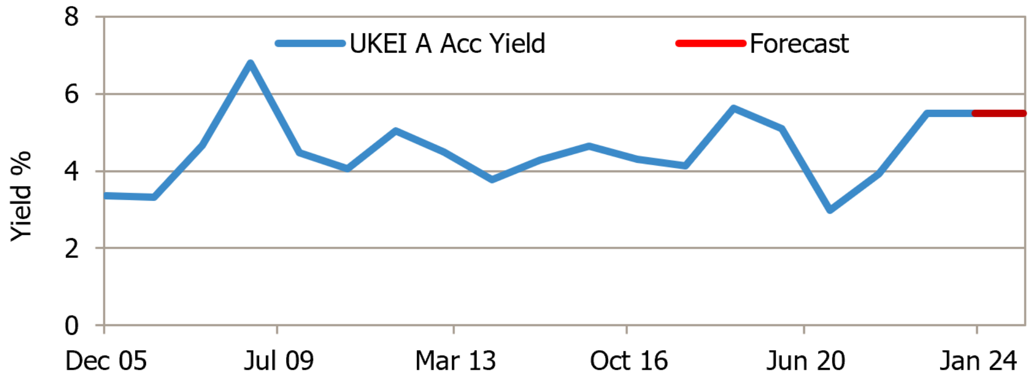
We believe that the UK continues to be one of the cheapest asset classes globally and is also cheap when compared to its most recent historical valuation range. The chart below from Goldman Sachs clearly illustrates this.



Source: Factset, Goldman Sachs Global Investment Research as of 23 January 2024.

This cheapness is evident when we compare the Fund, now in its 20th year, to its own history. Regardless of the metric used, the Fund is currently around its lowest valuation since the depths of the Global Financial Crisis. One of these measures is the Fund dividend yield, which is displayed on the first graph below. On the second graph, we display the discount at which some of our holdings trade compared to their global equivalents, highlighting the significant difference in valuation.

Fund Dividend yield only higher for a few months during the GFC...



Source: JOHCM/Lipper as of 31 December 2023. Data to 31 December 2024 includes JOHCM estimates. JOHCM estimates of future performance based on evidence from the past performance and current market conditions and is not an exact indicator. Based on 'A' Accumulation share class price on 31 December 2023 (451.1p).

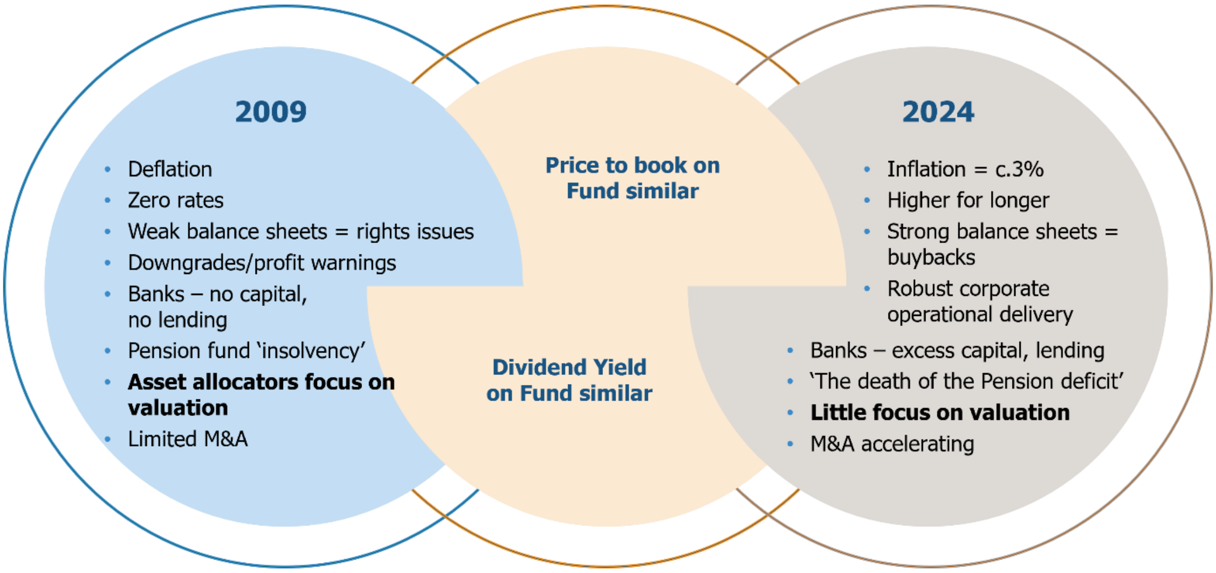
Our stocks remain much cheaper than global equivalents...

UK Stock	Global Peer	UK Valuation	Global Valuation	UK Discount
standard chartered	DBS Bank	5.5x PER / 0.4x PTNAV	8.5x PER / 1.4x PTNAV	35-75%
bp	Exxon	6.4x PER	11x PER	42%
DS Smith	International Paper	8.8x PER	17x PER	50%
	Lennar Corp	0.8x PTNAV	1.2x PTNAV	33%
AVIVA	AXA	8.4% Dividend Yield	5.7% Dividend Yield	33%

Source: JOHCM/Fund analytics as of 31 December 2023

The response to this trend has been evident in the boardroom. On average, 5% of each of our companies were acquired through share buybacks last year. This represents a colossal amount of de-equitisation that will enhance future earnings and dividends. With this year expected to see another large number (we estimate slightly less at c.3-4%), the cumulative impact of these actions is material. Additionally, we anticipate an increase in M&A, with boards increasingly exploring strategic changes to unlock value, such as the Real Estate Investors example, described above. These actions will continue to percolate under the surface, driving value incrementally over time.

Post 2009, when valuations were comparable to their current levels, was one of the most potent periods in the Fund's history in performance terms. The following graphic below illustrates the differences between then and now. Despite the inherent risks, such as the current situation in the Middle East, the current foundations are considerably more robust than they were at that time.



Source: JOHCM/Bloomberg

The convergence of low valuations, our optimistic prospects for both the domestic and global economy, and interest rates that have peaked is a very attractive combination. With a Fund dividend yield of 5.65% and the compellingly low valuations outlined in this report, we remain confident in the outlook.

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.

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