JOHCM UK Equity Income Fund

Monthly Bulletin: June 2022

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.
- The Fund promotes environmental and social characteristics throughout the investment decision making process, please see the following link for further details: https://www.johcm.com/uk/our-funds/fund-details-JOH-UK-EI/johcm-uk-equity-income-fund#sustainability
- Benchmark: FTSE All-Share Total Return Index.

Active sector bets for the month ending 31 May 2022:

Top five

Sector	% of Portfolio	% of FTSE All-Share	Active %
Life Insurance	9.61	2.60	7.01
Industrial Metals and Mining	14.62	7.71	6.91
Household Goods & Home Construction	5.72	1.26	4.46
Construction and Materials	5.35	1.20	4.15
Media	6.50	3.04	3.47

Bottom five

Sector	% of Portfolio	% of FTSE All-Share	Active %
Pharmaceuticals & Biotechnology	0.00	10.67	-10.67
Closed End Investments	0.00	6.21	-6.21
Personal Care, Drug and Grocery Stores	0.99	6.55	-5.57
Tobacco	0.00	3.94	-3.94
Beverages	0.00	3.76	-3.76

Active stock bets for the month ending 31 May 2022:

Top ten

Stock	% of Portfolio	% of FTSE All-Share	Active %
Vistry	3.24	0.08	3.15
Barclays	4.23	1.17	3.06
Standard Chartered	3.66	0.65	3.01
Phoenix	3.18	0.20	2.98
Glencore	5.83	2.85	2.98
BP	6.39	3.43	2.96
Legal & General	3.60	0.64	2.96
NatWest	3.32	0.48	2.84
ITV	2.86	0.11	2.75
Anglo American	4.62	1.93	2.74

Bottom five

Stock	% of Portfolio	% of FTSE All-Share	Active %
AstraZeneca	0.00	6.69	-6.69
Shell	2.54	7.48	-4.94
HSBC	0.00	4.46	-4.46
Unilever	0.00	4.01	-4.01
GSK	0.00	3.52	-3.52

Performance to 31 May 2022 (%):

	1 month	Year-to-date	Since inception	Fund size (£m)	Strategy size (£m)
Fund – A Acc GBP	**3.03**	**2.19**	**338.70**	**£2,030m**	**£2,390m**
Lipper UK Equity Income mean*	1.01	0.72	206.68		
FTSE All-Share TR Index (12pm adjusted)	1.26	1.86	233.05		

Discrete 12-month performance (%) to:

	31.05.22	31.05.21	31.05.20	31.05.19	31.05.18
JOHCM UK Equity Income Fund – A Acc GBP	6.84	44.88	-20.99	-12.21	12.66
FTSE All-Share TR Index (12pm adjusted)	8.15	22.07	-10.02	-3.52	6.41

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

The narrative around the 'cost of living crisis' in the UK has been unrelenting in the media over the last 3 months and, as such, it is worth spending some time on the interplay between inflation, wage growth and Government policy.

Firstly, there is no dispute that Inflation is running at historically elevated levels. In April, CPI rose by 9% year on year and notably increased by 2.5% between March and April alone. Over 50% of this monthly increase was driven by energy prices with electricity up 54% and gas 96%, though motor fuels contributed a more modest increase. Energy directly contributed 3.5% of the 9% annual rise although it will have indirectly driven prices elsewhere, in areas such as manufactured goods and food. The latter makes up 10% of the inflation basket and rose 6.7% in April.. It is likely that CPI inflation will average around 8.5% for the whole of 2022.

Secondly, nominal wage growth continues to accelerate, reaching 7% annual increase in Q1 2022. In March alone, nominal wages rose at a 10% annual rate, with an almost 12% rise in the private sector. The difference between the private and public sector was 8.2% vs 1.6% during Q1 and at some stage may begin to close as public sector unions demand higher settlements. With vacancies still running at elevated levels and the HMRC data showing a further 0.4% increase in payroll employment in April, it seems highly likely that nominal wage growth will accelerate further over the summer. As such, the real wage squeeze may not prove to be as material as many media commentators suggest. If CPI does indeed average 8.5% for the year but wage growth accelerates to 6-6.5%, then the 2-2.5% real reduction would be less than the 3.25% increase in real wages that was recorded (but barely commented on) in 2021.

Thirdly, the whole debate had assumed no offsetting Government action but this was proven incorrect by Rishi Sunak's announcement on 26 May which amounted to a £15bn injection into household finances, equivalent to around a 1% increase in the average household's disposable income. Of course, this is likely to be required to offset a further rise in domestic energy bills in October, but the inflationary impact of that was already included in the assumptions above.

Clearly, real economic growth will continue to slow, but here again you need to be careful about the raw data being reported. Whilst the UK March GDP data showed a 0.1% reduction, this was entirely driven by the reduction in the vaccine programme and in test and trace; without this effect GDP would have been +0.2%. Indeed for Q1 overall, the reduction in these COVID related activities had reduced the underlying GDP growth from around 2.2% to 0.6%. Retail sales rose by 1.4% in April, reversing the declines of the previous 2 months. As regular readers will know, we believe consumer activity will hold up better than expected, helped by the c. £240bn of accumulated savings, but that progressively the spend will switch from goods towards services and experiences. Barclaycard data suggests that is already beginning to happen.

Performance

The UK market continued to outperform other developed market indices as the clear valuation attractions are beginning to be recognised in an era of rising interest rates, registering a positive return of 1.26% in May. The fund outperformed during the month, recording a return of 3.03%. Year to date the fund is up 2.19%, ahead of the Index return of 1.86% and the peer group of 0.72%. Looking at that peer group, the fund is ranked 2nd quartile within the UK Equity Income sector so far in 2022. On a longer-term basis, the fund is ranked 1st quartile over three, five and ten years and since launch (Nov 2004).

During May, particularly the last two weeks, markets began to focus on valuation once again, rather than just the slowing momentum of economies and this led to a recovery for some of our stocks. Within financials, all of the banks were positive contributors, with **Barclays** up around 15%, helped by the resolution of their administrative filing error and the commensurate start of their share buyback. **Standard Chartered** was also up more than 10%, assisted by the expectation of further US rate rises. Our life assurance stocks were also healthy contributors, responding to higher bond yields as well as very low valuations.

First Group received a conditional offer from a private equity group which saw the stock up around 20% - the offer is both relatively low and includes a conditional element dependent upon realisation of some assets in North America. Given this is the second private equity move in the sector this year, other stocks in the bus and rail sector moved higher too, including **National Express**. Elsewhere, **Vodafone** continued to recover, despite uneventful results, as investors focused upon the potential for consolidation in some of their operating jurisdictions. **Vistry** also rose by around 10% in response to a strong AGM update and the announcement of a modest share buyback.

On the negative side, **Drax** fell around 20% due to the imposition of the windfall tax on the oil and gas industry in the UK and the open-ended question of whether a tax will also be applied to the electricity generation industry in due course. The relative impact on the fund was somewhat mitigated by a lack of ownership of SSE and Centrica which also fell on the news. **Randall & Quilter** was down around 35% as the bidder for the group withdrew their offer and the company re-iterated its requirement to raise capital; however, they also revealed that trading in the core programme management business remains extremely strong. **ITV** and **WPP** were both weak due to the warning from SNAP, which suggested a slowing in advertising growth on their digital platform.

Portfolio activity

As we highlighted last month, it is hard to find sell ideas given the materiality of the upside that resides in the Fund which itself is a function of the ultra-low valuations across the parts of the market we are invested in. It is however important to release capital, to fund additions to stocks in the Fund that have fallen and also new ideas.

The reductions this month included (a) **Aviva** where we received a c. 100p special dividend (which is counted as a capital return and not income, from a Fund dividend perspective) – post this c. 80bp return of capital, Aviva remains in our top 15 active positions, and despite being close to a 4 year absolute high remains on a PE yield crossover of c. 7x / 7% respectively, (b) the continued sell down of **Rio Tinto** driven by our view that the iron ore price is above its likely normalised level (i.e. Rio Tinto is over-earning), a desire to shift the end commodity exposure in the Fund towards clean energy metals and also residual ESG concerns and (c) **Tesco**, which during the first half of the month, remained close to a relative high despite evidence of earnings pressure across the food retail sector. A number of stocks that performed well hit our 300bp maximum position and we top-sliced accordingly (Standard Chartered, Barclays, **Phoenix**).

We increased our position in **Kier** before and after an excellent capital markets event. This and a similar event by **Galliford Try** (also owned) earlier in the month highlighted that the construction sector is in good health. Increased spending on roads, rail (HS2), clean energy, schools etc is underpinning rising order books and good financial terms. The sector is also managing inflation well. Despite mounting evidence that we could be in a golden decade for infrastructure spending these stocks languish on low valuations e.g. Kier is on a PE of 4x and Galliford trades below its average net cash position. Both stocks could double from here. We continue to push our view that there should be and there would be material upside from consolidation in this subsector (where we also own **Costain**).

We also added to a number of stocks that were weak – namely **ITV**, **Page**, **DS Smith**, and **Hipgnosis**.

We also added to **Ashmore**, a recent new addition. We have taken it slowly in building up this position given the (well known) prevailing headwinds. At around 220p half the market cap equates to cash / seed investments leaving just c. £800m of market cap for the c. $80bn of assets under management which should at a trough level make c. £150m of EBIT. The stock yields more than 7%.

We also re-established a position in Land Securities which under new management have articulated a new strategy of selling 'dry' fully priced assets like London Offices (which are at record levels) and reinvesting in mixed use urban regeneration assets. Our entry prices range from 700-740p vs a current net asset value of c. 1060p and our expectation that this will rise towards 1200p on a 2-year view.

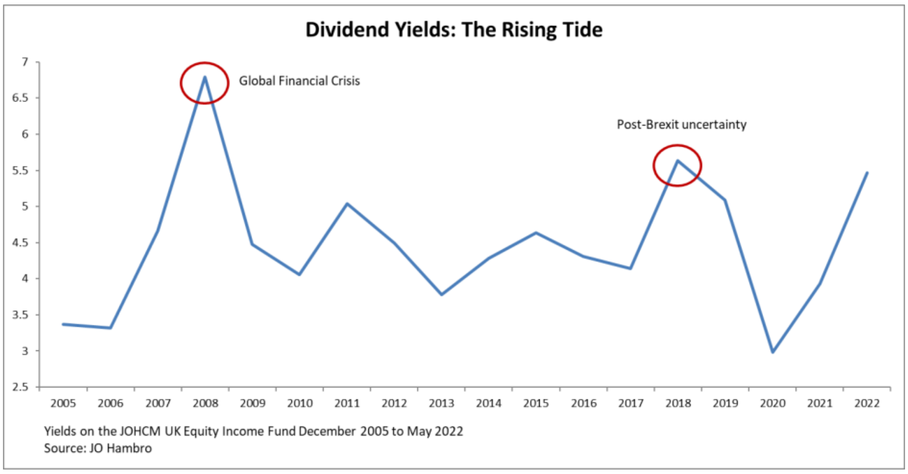
Outlook

Talking about dividend yield in recent years has often felt futile. Companies that paid good dividends were seen as being somehow limping along in the past, as though they couldn't think of anything better to do with their earnings than distribute them to their owners.

The high-water mark of this attitude was expressed in an article published in the Financial Times in December 2021. The predominance of dividend-paying stocks in the UK was seen as a weakness. The UK equity market was described as the financial equivalent of Jurassic Park – a landscape of dinosaurs that had outlived their time. Investors seeking income from equities were told they were hardly more than parasites, sucking out cashflow rather than giving management the scope to reinvest earnings in … *growth*.

The Jurassic Park FT article marked the nadir of the UK equity market relative performance – so far this year the UK has been one of the few markets to broadly hold its ground, compared with large falls elsewhere e.g. c. 28% for the tech-heavy Nasdaq[*].

The dividend yield of the Fund for 2022 is currently forecast to be 5.5%. This would leave the Fund dividend per unit higher than it was pre Covid. The graph below shows the Fund dividend across the 18 years of the Fund's life – it has only been higher during the financial crisis and as Brexit negotiation reached the point of maximum pessimism under the Theresa May government. Compared to both of those points in time, the yield on the Fund feels very robust – balance sheets are materially better, dividend cover ratios more prudent and as we have noted before around half the Fund is currently buying back shares reflective of these circumstances.



Dividends used to be considered the vanguard of annual returns. The table below shows the split in total returns between dividends and capital appreciation over three time periods. Two

[*] Refinitiv 1 January to 25 May 2022

points stand out immediately. One is that over the long-term – in this case over nearly 50 years – three-quarters of returns derive from dividends. The other is that this has changed over more recent timeframes, to just under half in the past 20 years and to a mere 16% in the two years to the end of 2021.

Global market	Returns			% accrual	
	Total	Price	Dividends	Price	Dividends
Since Jan 1973	8971.8%	2276.7%	6695.1%	25.4%	74.6%
Last 20y	352.3%	177.6%	174.7%	50.4%	49.6%
Jan 20 to Dec 21	33.9%	28.4%	5.5%	83.8%	16.2%

Source: Credit Suisse

The decline in the importance of dividends over the last two decades due to the suppression of interest rates since the Global Financial Crisis (GFC). Cheap, practically free, debt capital has encouraged investors to pursue long-duration stocks.

The reversal of this trend has come suddenly, and to a large extent unexpectedly, but it has shattered consensus positioning around growth stocks Investors are having to re-think a generation of received wisdom. The suppression of interest rates driven by central bank activity, in particular, quantitative easing, led to a radical distortion of capital allocation. Our previous paper (see here) discussed why these growth stocks – which had reached the highest valuations they had ever got to - have fallen so much as real interest rates have risen.

This regime-shift, in our view, has only just started.

In these conditions, far from being a paleontological zoo, the UK equity market with a high starting dividend yield, strong companies, a heavy weight in real assets (eg mining, oil, property etc) starts looking very much in tune with current trends – more normal interest rate structures – and its outperformance year-to-date makes perfect sense.

A cash yield also provides protection against inflation – it is feasible that the average rate of inflation over 2022 and 2023 will be c. 5-6% as inflation peaks this year and falls as energy price increases are lapped. The dividend yield on the Fund – at 5.5% - noted above – offsets this - protecting value in real terms.

We have previously observed that valuations within the Fund are close to all-time lows on an absolute basis. On a relative basis, due to a rush to safety, we are also back to the widest gap in valuation terms between the type of stock the Fund owns and defensives that now dominate the FTSE indices. There is material upside in the Fund and significant valuation risk lurking under the surface in certain large index components. Whilst waiting for this upside to feed through the yield both provides protection against inflation and as it has done, over the longer term, the majority of total return. The ongoing regime change should lead to a renaissance of both the UK and the UK Equity Income Sector.

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

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.

This is a marketing communication.

Please refer to the fund prospectus and to the KIID 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.

The investment promoted concerns the acquisition of shares in a fund and not the underlying assets.

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.

Investments 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 annual management charge is deducted from the capital of the Fund. This will increase the income from the Fund but may constrain or erode potential for capital growth.

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 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.

Sources for all data: JOHCM/Bloomberg (unless otherwise stated).