Professional Investors Only

JOHCM UK Equity Income Fund

Monthly Bulletin: March 2019

Active sector bets for the month ending 28 February 2019:

Top five

Sector	% of Portfolio	% of FTSE All-Share	Active %
Financial Services	9.01	3.05	+5.96
Banks	15.66	10.42	+5.24
Construction & Materials	5.50	1.63	+3.87
Mining	10.48	6.93	+3.55
Oil & Gas Producers	17.21	13.75	+3.46

Bottom five

Sector	% of Portfolio	% of FTSE All-Share	Active %
Pharmaceuticals & Biotechnology	0.00	7.36	-7.36
Equity Investment Instruments	0.26	5.12	-4.86
Tobacco	0.00	3.95	-3.95
Beverages	0.00	3.57	-3.57
Personal Goods	0.00	2.37	-2.37

Active stock bets for the month ending 28 February 2019:

Top ten

Stock	% of Portfolio	% of FTSE All-Share	Active %
Barclays	4.31	1.28	+3.03
Lloyds Banking Group	4.96	2.01	+2.95
Aviva	3.67	0.75	+2.92
BP	7.56	4.69	+2.87
DS Smith	3.03	0.20	+2.83
ITV	2.99	0.21	+2.78
Glencore	4.27	1.58	+2.69
Standard Life Aberdeen	2.87	0.27	+2.60
Phoenix Group	2.74	0.16	+2.58
Morgan Sindall Group	1.96	0.02	+1.94

Bottom five

Stock	% of Portfolio	% of FTSE All-Share	Active %
AstraZeneca	0.00	3.58	-3.58
GlaxoSmithKline	0.00	3.29	-3.29
Diageo	0.00	3.19	-3.19
British American Tobacco	0.00	2.87	-2.87
Unilever	0.00	1.96	-1.96

Performance to 28 February 2019 (%):

	1 month	Year to date	Since inception	Fund size
JOHCM UK Equity Income Fund – A Acc GBP	**1.03**	**7.11**	**264.40**	**£3,452mn**
Lipper UK Equity Income mean*	1.80	6.81	163.15	
FTSE All-Share TR Index (12pm adjusted)	1.65	6.32	173.48	

Discrete 12-month performance (%) to:

	28.02.19	28.02.18	28.02.17	29.02.16	27.02.15
JOHCM UK Equity Income Fund – A Acc GBP	**-3.73**	**10.67**	**25.69**	**-8.60**	**3.76**
FTSE All-Share TR Index (12pm adjusted)	0.93	4.96	23.09	-7.53	5.70

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

Federal Reserve Chairman Jerome Powell's monetary policy testimony confirmed the Fed's "patient" approach to future tightening. As discussed last month, markets had very quickly priced out the prospect of future Fed rate increases due to the slowing global growth environment combined with the shorter-term impacts of the US government shutdown. However, as February progressed, data points suggested a resilient domestic performance from the US economy. Q4 GDP growth surprised moderately to the upside at 2.6%, particularly driven by strong consumer spending which offset a small fall in net trade. Most strikingly, business confidence indicators began to improve again, with the Chicago February PMI rising to 64.7, its highest level since December 2017. This improving tone reflected itself in a 10bps rise in 10-year bond yields to 2.73%, suggesting that some of the more sensationalist commentary that the Fed might quickly move from monetary tightening to easing is somewhat premature.

In the UK, the impact of depressed business confidence from the protracted Brexit process manifested itself in a slower GDP print for Q4 of only +0.2% quarter-on-quarter. Some of the PMI surveys are distorted by some pre-Brexit stockpiling impacts, but there is no doubt that new orders for both manufacturing and services are weakening and there is a slower pace of hiring. This increased caution from the corporate community is somewhat in contrast to the consumer, who continues to prove relatively resilient to the Brexit commentary malaise. In February, the GFK UK consumer confidence indicator actually rose slightly, reflecting an environment of full employment and rising wages. Indeed, at +27, the GFK reading for households' personal current financial situation is at the highest level since the referendum in 2016 and both retail sales and new home reservations from housebuilders have surprised positively. However, at -38, the same GKF survey for UK consumer confidence in the prospects for the economy in the next 12 months is at an eight-year low and reflects the barrage of negative media coverage around the Brexit process. Once again, sterling made progress this month against all of the major currencies, particularly in the last week as the prospects of a 'no deal' outcome diminished.

Despite increasing government stimulus in terms of tax cuts for both corporates and consumers, economic momentum in China remains sluggish, partly due to the ongoing trade dispute with President Trump. Nevertheless, a strong pick up in the January credit growth metric suggests that easier policy may be beginning to have an impact. In Europe, economic progress has continued to slow further, particularly for the manufacturing sector. At 47.6, the German new orders PMI reflects negative impacts from both the Chinese trade dispute and issues within the auto sector. As discussed previously, the ECB has limited policy tools at its disposal at this moment in time.

Elsewhere, the copper price continued to recover strongly, now having risen more than 10% in 2019 to hit a nine-month high, and unlike iron ore, this was not driven by any major supply shocks.

The oil price also rose during the month. Year to date, it has recovered around half of its fall in Q4 2018.

Performance

Equity markets continued to rally in February, extending the gains registered in January. The FTSE All-Share Total Return Index (12pm adjusted) returned 1.65% during the month. Relative performance trends were volatile, with performance heavily influenced by Brexit news flow and the related movements in sterling. Accordingly, the Fund had a difficult start but ended on a stronger note, slightly underperforming over the month. Year to date the Fund is up 7.11%, versus the FTSE All-Share Total Return Index, which is up 6.32%.

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

The results season, which remains ongoing, has largely delivered strong results across the Fund. Particular bright spots at the smaller-cap end of the portfolio have been **Morgan Sindall** (up 14% relative[*]) and **Sthree** (up 12% relative[*]). At the larger end of the market cap scale, both of our UK large-cap banks produced strong results. These stocks illustrate the dividend growth dynamic in the Fund: Morgan Sindall remains a consistent strong dividend grower, up 18% year-on-year; **Barclays** doubled its final dividend as it normalises its payout ratio now that legacy issues have been resolved; **Lloyds,** which has already returned to a normalised payout ratio, saw low single-digit growth but launched a large share buyback programme; whilst Sthree increased its dividend for the first time in nearly a decade.

Domestic stocks also performed well, particularly towards the end of the month. Noteworthy performances came from the housebuilders and some of the wider construction sector.

There were two negative stock-specific issues during the month. **Petrofac**, which had shown a strong recovery (strengthened balance sheet, contract performance and contract win rate) fell c. 20% relative[*] following the announcement that the SFO had charged a former employee with bribery. This setback is disappointing given the recovery we have seen in the business. The other stock, **CMC** (down 30% relative[*]), issued a profit warning related to lower market volatility and ongoing regulatory change. Despite holding steady its forecasts for the following year (the period to March 2020), the market focused on the nearer-term trajectory. Both of these stocks are materially undervalued in our view.

In the (historically) defensive elements of the Fund (where we remain very underweight), **National Express** performed very well and is now one of the lowest yielding names in the Fund, whilst **Vodafone** remained under pressure.

Portfolio activity

We committed to placings in two of our existing holdings during the month, **Low & Bonar** and **Randall & Quilter**. Low & Bonar has been a poor performer in the Fund over the last two years as poor management led to balance sheet pressure and subsequently, a placing. With the balance sheet now stronger and with a new chairman, CEO and FD, the business should be well set to deliver the profit margins that its market positions should sustain. Were it to do this, we believe there is significant upside (> 50%). Randall & Quilter, in contrast, has been a strong performer over the last year, benefiting from regulatory change and the impact of Brexit on the insurance sector. This fund raising was a positive move, accelerating the growth into incremental demand created by these trends.

In banks, we moved underweight in **HSBC** for the first time in over six years. This was driven by the change in the global interest rate structure, increased competition in Hong Kong and the probability that the board would miss its revenue targets due to the aforementioned pressures (amongst others). It is also the most expensive bank in the Fund when comparing its price-to-book to its return on book. Whilst **Standard Chartered** is materially cheaper, we also trimmed as a result of similar revenue pressures. Some of the proceeds were moved into **Barclays**, which, as

[*] Relative to the Fund's benchmark, the FTSE All-Share index (12pm adjusted).

mentioned, had strong results and where the valuation, as we have articulated before, looks anomalous.

In the wider financials sector, we continued to trim **TP ICAP**, a strong performer of late, and added to **Brewin Dolphin**, which had a difficult trading update reflecting the market falls in Q4 2018. The market has seemingly not noted the somewhat offsetting bounce in global markets year to date.

We continued to add to last month's new addition **Easyjet**, whilst reducing **National Express**, which is now one of our lowest yielding stocks.

Elsewhere, the mining sector performed well. To keep the weighting in the Fund broadly similar, we continued to trim **Anglo American**, which has the lowest yield in the sector, and also **Rio Tinto**, with its share price at an eight-year high.

Outlook

Only three months ago, markets were anticipating a continued path of monetary tightening from the Federal Reserve and were fearful that its actions might tip the global economy into a major slowdown or recession. Governor Powell's more balanced stance recently has calmed these fears and allowed investors to rediscover their risk appetite somewhat. However, many uncertainties remain including the conflict between Trump and China and the limited armoury that central banks have in some parts of the world to respond to the current weaker economic picture.

In the UK, the path of Brexit may be becoming a little clearer. This has begun to manifest itself in a recovery in both the currency and selected domestically orientated stocks. However, valuations in many of these areas have been depressed for three years now. As such, the potential upside from a clearer political backdrop remains considerable. The UK economy remains in a curious place; business confidence is understandably low and manifests itself in limited investment decisions being made. However, the consumer is in a more positive position and frame of mind and continues to drive modest growth for the overall economy. Ironically, January 2019 saw the UK government report its largest ever budget surplus at £15bn, driven by strong income tax and CGT receipts which means that the public-sector borrowing requirement (PSBR) will significantly beat expectations for the year and provides plenty of scope for the Treasury to stimulate the economy if it is required post-Brexit.

As ever, we will remain focused upon valuations. In this regard, we remain very optimistic about our portfolio. Assuming low to mid single-digit dividend growth in 2019, the Fund's yield remains around 5.5% prospectively, which looks highly attractive for a diversified portfolio of around 60 stocks.

Further information

If you would like further information about the Fund, please call our Investor Relations team on
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