JOHCM UK Equity Income Fund

Monthly Bulletin: April 2023

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 March 2023:

Top five

Sector	% of Portfolio	% of FTSE All-Share	Active %
Life Insurance	9.00	2.61	6.39
Construction and Materials	7.46	1.66	5.80
Household Goods & Home Construction	6.50	1.07	5.43
Banks	13.21	8.68	4.53
Industrial Metals and Mining	10.88	6.76	4.12

Bottom five

Sector	% of Portfolio	% of FTSE All-Share	Active %
Pharmaceuticals & Biotechnology	0.00	10.67	-10.67
Personal Care, Drug and Grocery Stores	0.00	7.69	-7.69
Closed End Investments	0.00	6.09	-6.09
Beverages	0.00	3.76	-3.76
Tobacco	0.00	3.46	-3.46

Active stock bets as at 31 March 2023:

Top ten

Stock	% of Portfolio	% of FTSE All-Share	Active %
Vistry Group	3.12	0.12	3.00
BP	6.82	3.87	2.95
DS Smith	3.10	0.17	2.93
Barclays	3.90	0.99	2.91
NatWest	3.52	0.61	2.91
Aviva	3.38	0.48	2.90
Phoenix	3.05	0.17	2.88
ITV	2.99	0.13	2.86
Glencore	5.31	2.51	2.80
Bellway	2.88	0.12	2.76

Bottom five

Stock	% of Portfolio	% of FTSE All-Share	Active %
HSBC	1.60	4.74	-3.14
Diageo	0.00	3.44	-3.44
Shell	2.46	6.88	-4.42
Unilever	0.00	4.50	-4.50
AstraZeneca	0.00	7.10	-7.10

Performance to 31 March 2023 (%):

	1 month	Year-to-date	Since inception	Fund size (£m)	Strategy size (£m)
Fund – A Acc GBP	**-7.35**	**1.03**	**330.00**	**1,617**	**1,925**
Lipper UK Equity Income mean*	-4.12	1.84	208.93		
FTSE All-Share TR Index (12pm adjusted)	-3.00	2.83	238.71		

Discrete 12-month performance (%) to:

	31.03.23	31.03.22	31.03.21	31.03.20	31.03.19
JOHCM UK Equity Income Fund – A Acc GBP	-0.46	11.20	49.88	-29.51	-0.92
FTSE All-Share TR Index (12pm adjusted)	2.40	13.03	28.76	-19.06	5.93

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 collapse of Silicon Valley Bank (SVB) on 9 March dominated asset price moves during the month. Much has been written about the cause of the business model weaknesses in several US mid-sized banks and the degree to which weak regulation and oversight played their part. Clearly the combination of concentrated deposits, low short term liquidity and large maturity mismatches created a high degree of vulnerability which was exposed by the cumulative rate tightening carried about by the Federal Reserve over the last few months. The sudden acceleration in deposit outflows caused a short term crisis of confidence in the sector and left other poorly capitalised banks exposed, and drove the subsequent shotgun marriage of Credit Suisse and UBS.

It is very clear that the vast majority of UK and European banks are not exposed to the issues which drove SVB's demise; in particular, maturity mismatches are very limited in scale and deposit bases are far more diversified. The unfortunate coincidence of Credit Suisse's issues did not help this perception; the bank has had persistent problems with ongoing litigation and conduct fines for several years, which has meant that it has not generated significant or regular levels of profitability over the last decade. The treatment of Credit Suisse's AT1 instruments during the hastily agreed deal caused further short term share price turbulence for UK and European banks, but again, the Swiss central bank's treatment looks specific to this transaction and these instruments are perpetual, and therefore there is no requirement for other banks to refinance them or replace them if they do not wish to do so.

The impact of the issues in the banking sector was marked on the bond market in particular. Earlier in March, Governor Jay Powell indicated that the evidence of persistent inflationary pressures meant the Fed was inclined to tighten rates by 50bps at its next meeting. However, the fear that the issues in the banking sector would lead to a sharp fall in credit availability and drive an economic slowdown saw US 10 bond yields fall from above 4% in early March to around 3.3% on the 24 March, to then close the month at around 3.5%. Even sharper adjustments were seen in shorter duration bonds, with markets now pricing in one or two rate cuts during the balance of 2023. This is despite evidence emerging during the month that some inflationary pressures are proving more persistent, particularly in the service sector, driven by low unemployment and wage growth.

These persistent inflationary pressures have been observed in the UK, with the February CPI rising to 10.4% compared to 10.1% in January and its peak of 11.1% in October 2022. This slight re-acceleration was driven mainly by food prices which rose by 18.3% year on year in contrast to other goods prices, which are seeing fading annual increases, including fuel (only 5% YoY) and second hand cars (down 6% YoY). Whilst wage pressures are driving services inflation higher in the short term, once the economy annualises against the 25% increase in energy prices seen in April 2022, CPI will begin to move sharply lower, probably to a range of 6-7% during the second quarter. However, driving it lower still towards 3% may prove more difficult in the second half due to the sticky nature of wage inflation.

Elsewhere, China's post-COVID reopening continues to gather pace without a clear and obvious healthcare crisis (we have limited visibility on the real underlying COVID case development). The composite PMI rose to 57, its highest reading in over five years. At the end of the month, OPEC+ agreed to a further production cut which saw oil prices regain all their prior falls.

Performance

After a strong start to the year in January and February, markets pulled back in March. The UK FTSE All Share was down 3.00% and the Fund significantly underperformed the market, down 7.35%. Year-to-date, the Fund is up 1.03%, whilst the FTSE All Share is up 2.83% - an underperformance of 1.74%. Looking at the peer group, the fund is ranked 3rd quartile within the UK Equity Income sector year to date. On a longer-term basis, the fund is ranked 1st quartile over three years, 3rd quartile over five years, 1st quartile over 10 years and remains the best Fund in the sector since inception in 2004.[1]

Financial stocks bore the brunt of the market's concerns about contagion from the collapse of SVB and issues at other US regional banks, as well as Credit Suisse's takeover by UBS. **Barclays** (-11% relative) and **Standard Chartered** (-18% relative) were the most severely impacted, with the latter losing the modest bid premium that had emerged following the revelation of bid interest from First Abu Dubai Bank earlier in the year. Our other banks were down more moderately, between 4-9% in relative terms. Many of our insurance stocks were also weak as factor-based investors just sold financial stocks in general. Despite posting strong results during the month, **Aviva** and **Phoenix** were down 4-8% relative after adjusting for ex-Dividends.

Commodity sectors were also weak this month, partly due to concerns about an economic slowdown and partly due to investor overweight positioning, which saw them sold as investors sought to de-risk during the month. **Glencore** and **Anglo American** both underperformed by 7-8% and the two major oil stocks, **BP** and **Shell**, also fell relatively by 4-6%. Elsewhere in oil, **Energean** performed well (+11% relative) due to a strong operational update and robust corporate activity in the Eastern Mediterranean gas fields.

Some of our mid-cap names were weak on nervousness about an economic slowdown despite no specific news, such as **Redde Northgate** (-12% relative) and **Sthree** (-8% relative). **Currys** revealed better UK trading but weaker performance in the Nordics saw the shares fall 23% relatively. Housebuilders reported a further improvement in reservation activity and, combined with a commitment to a share buyback, saw **Bellway** deliver 7% relative outperformance.

The Fund's lack of positioning in perceived defensive sectors such as Pharmaceuticals and consumer staples detracted from the relative performance, with Astra Zeneca, Diageo, RELX and Unilever all outperforming by 5-8% despite the US dollar being weak during the period.

Portfolio activity

During March, we sold one stock we have held for close to a decade – **ABRDN** (previously Aberdeen Standard Life and before that Standard Life). Whilst this has been a challenging investment in recent years, over the 10 years we owned the stock it was a material positive contributor. The company owns two good operating assets that are performing well – Interactive Investor and the adviser platform, and one challenged asset – the asset management business. The former two business units have benefitted materially from higher interest rates, on cash balances held for clients. ABDRN also owns a number of equity stakes eg in **Phoenix** and two Indian

[1] Source: Lipper

financial services companies. The stock rallied c 50% off its lows of last year, in the first part of this year, which moved the valuation to a 'full level'. We consequently sold the holding. We added one new name during March, which we will discuss when a full position has been established.

With performance trends challenging there were limited stocks to reduce. Most of the additions, discussed below, were funded from the sale of ABRDN. We also reduced our position in **Conduit**, to a new target weight of c 100bp. This stock is up 50% in relative terms from its 2022 lows as it has become clear insurance pricing is rising materially. We also marked **Costain** towards its target weight and **TP ICAP**.

As the bank sector and wider financials weakened, as discussed above, we added to some of our positions. This was specifically the case for certain life insurance stocks eg **Aviva** and Phoenix. These two stocks had excellent results during the month and now yield 9% and 10% respectively. Aviva is also conducting a newly announced share buyback. We added to recent new addition **HSBC** and to most of the other banks we own.

Elsewhere we added to **Kier** following strong results and two good meetings with the executive side of the board and the chairman. This stock trades on a PE of 3-4x. The management share our view that small cap construction stocks should consolidate as the synergies, the scale benefits and the liquidity benefits would create a step change in shareholder value optionality. We also added to **Currys** on weakness.

Dividend Update

The Fund dividend ended 2022 13% above its pre-Covid (end-2019) level and our guidance on dividend growth for 2023 has previously been 15%.

The results season has been, in the main robust, as noted above. There were a number of positive dividend surprises, such as **BP** delivering 10% growth (vs our forecast of 5%), while all of the banks delivered higher dividends than expected. Partly offsetting this, several of our portfolio changes have diluted the dividend, including the reduction in our weight in **Legal & General** (see our January Bulletin for a discussion of the reasons) and the sale of **ABRDN**, covered above. The net result of these factors is that we are running towards the top half of our anticipated dividend growth range.

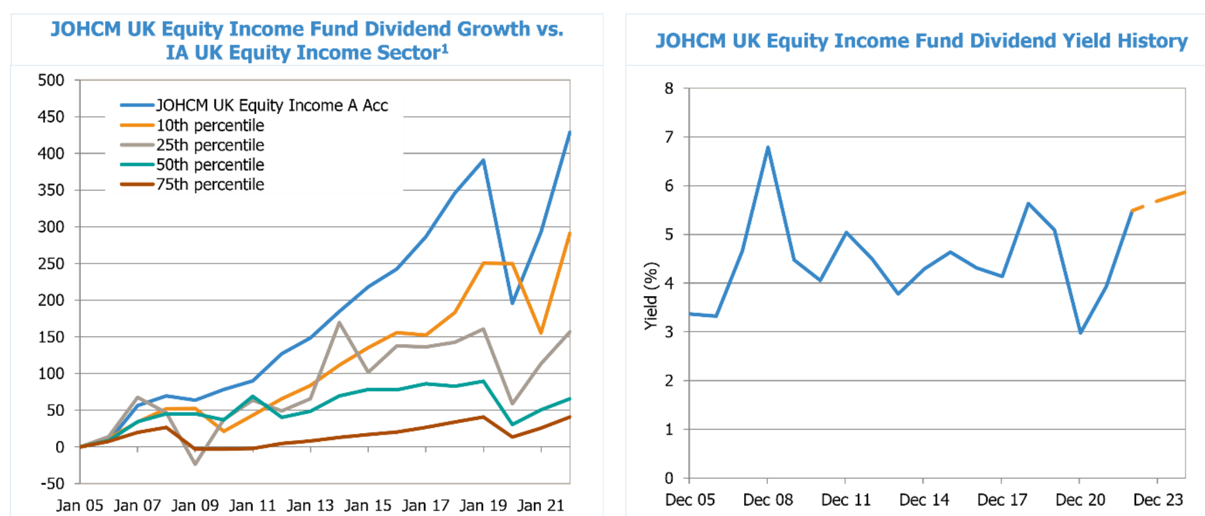
The discrete Q1 2023 dividend, which went ex on 31 March, was more than 10% above Q4 2022. The prospective calendar year 2023 dividend yield is c.6%, which we would expect to grow further in 2024.

At times when performance has been challenging, as in March, it is useful to stand back and look at longer-term trends and current valuation versus its history.

The first chart (LHS) below shows our dividend growth track record compared to the wider Lipper UK Equity Income universe. We are in the top decile of income growth delivered over the Fund's history – which is approaching two decades. The CAGR over this time has been c.9% a year. Given this has included close to 15 years of zero inflation, the Global Financial Crisis, Brexit and Covid, amongst other challenges, it seems fair to say that this is a strong outcome. This income track

record is the main driver behind the Fund being ranked top, in the Lipper UK Equity Income sector, since inception on a total return basis.

The second chart (RHS) shows the Fund dividend yield since inception. It was only higher for a brief period during the GFC. The two following years were among the best in the Fund's history, with an absolute return of 87.68%, 11.37% above the benchmark.



Source: JOHCM/Lipper as of 31 December 2022. Data to 31 December 2023 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 30 December 2022 (426p). [1]Thomson Reuters Lipper, JOHCM UK Equity Income A Acc vs. IA UK Equity Income sector.

Outlook

This month's banking 'crisis' is the first major global risk event where the US dollar has weakened rather than strengthened. This is entirely appropriate because, in many respects, the issues have been caused by weak US banking regulations, and any subsequent impact on credit availability should be more material there than elsewhere in the world. Conversely, the US and the Nasdaq have proven to be some of the best performing equity markets in March, which seems somewhat counterintuitive. The rationale would appear to be that t-dihese events will drive monetary easing in the next few months. Still, that view looks optimistic to us as service sector inflation, in particular, is proving much stickier than was hoped, and we believe there is a reasonable chance that the Fed will keep rates unchanged for the balance of 2023. Clearly there is a risk that credit availability shrinks and the cumulative impact of the monetary tightening we have already seen causes a sharper economic deterioration, but for now, that risk looks to be less likely than the central case driving a plateau in rates. Credit conditions may loosen again as stability and confidence return to the banking system, which we expect to happen progressively over the coming weeks and months.

It was disappointing to see many of the share prices of our financial companies severely hit during March. Whilst markets became calmer during the last week of the month, the damage done earlier in March was too significant to recover by the end of the period. As highlighted in this monthly, we expect UK financial shares to progressively recover in the next few weeks and months. Whilst the cost of equity has risen for these sectors in the short term, in many respects, the events in the US highlight how well capitalised and regulated the UK banks are in comparison. Even if

AT1s were to be fully replaced by common equity in due course, or if the coupon required for new AT1 bonds is 100-150 bps higher, it would have minimal impact on the upside we see from these depressed valuations. With all UK banks likely to return 12-20% of their market capitalisations in dividends and buybacks every year, we feel they are materially undervalued. There is a risk that impairments may rise from here relative to consensus expectations, but in that regard, it should be noted that UK GDP estimates continue to surprise to the upside. In the March budget, the Office for Budget Responsibility increased its 2023 real GDP expectation from -1.4% to -0.2% and given the consistent beats from retail sales and other parts of the services sector so far in Q1, we still believe those estimates will move into positive territory during 2023. Furthermore, as inflation fades during the year, real wage growth will turn positive during H2 2023, further helping consumer confidence.

As well as our view that economic performance is likely to prove more resilient than the consensus expects during 2023, we also continue to see tremendous valuations on offer from many parts of the UK stock market, particularly across most of the more cyclical sectors. The valuation gap between defensive sectors, such as pharmaceuticals and consumer staples and those with some degree of cyclicality, including financials, commodities and consumer cyclicals, has widened back to its 50 year wide once again. Many investors are missing the fact that many cyclical sectors have still not recovered from the de-rating suffered during COVID and the start of the war in Ukraine. Furthermore, many of these sectors are capital intensive and have seen very little new capacity added over the last few years, in complete contrast to the capital-lite, sometimes technology orientated sectors which have dominated global stock markets over the last decade. Furthermore, the free cash flow yield attractions of many stocks in these areas are extreme, and that manifests itself in a fund dividend yield which has only ever been higher during the Global Financial Crisis. This is despite balance sheets and dividend covers being in a much better place than they were during 2008. It is frustrating to see our strong start to the year completely reversed in March, but valuations will matter again before too long, and once they do, we are very confident that our Fund will re-discover its poise and that the combination of a high dividend yield and likely dividend growth will prove to be highly attractive.

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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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.

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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.

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