Professional Investors Only

JOHCM UK Equity Income Fund

Monthly Bulletin: November 2019

Active sector bets for the month ending 31 October 2019:

Top five

Sector	% of Portfolio	% of FTSE All-Share	Active %
Financial Services	9.78	3.82	+5.96
Life Insurance	8.69	3.38	+5.31
Mining Banks	9.34	6.18	+3.16
Oil & Gas Producers	15.62	12.76	+2.86
Media	6.67	3.83	+2.84

Bottom five

Sector	% of Portfolio	% of FTSE All-Share	Active %
Pharmaceuticals & Biotechnology	0.00	8.53	-8.53
Equity Investment Instruments	0.00	5.24	-5.24
Beverages	0.00	3.59	-3.59
Tobacco	0.00	3.46	-3.46
Support Services	2.62	5.40	-2.78

Active stock bets for the month ending 31 October 2019:

Top ten

Stock	% of Portfolio	% of FTSE All-Share	Active %
Standard Life Aberdeen	3.38	0.32	+3.06
Barclays	4.32	1.26	+3.06
Aviva	3.72	0.71	+3.01
BP	7.30	4.35	+2.95
DS Smith	3.14	0.20	+2.94
ITV	3.15	0.22	+2.93
Phoenix Group Holdings	3.08	0.16	+2.92
Lloyds Banking Group	4.38	1.77	+2.61
Glencore	3.72	1.14	+2.58
Hammerson	2.67	0.10	+2.57

Bottom five

Stock	% of Portfolio	% of FTSE All-Share	Active %
AstraZeneca	0.00	4.34	-4.34
GlaxoSmithKline	0.00	3.81	-3.81
Diageo	0.00	3.24	-3.24
HSBC	2.18	5.19	-3.01
British American Tobacco	0.00	2.73	-2.73

Performance to 31 October 2019 (%):

	1 month	Year to date	Since inception	Fund size
JOHCM UK Equity Income Fund – A Acc GBP	**0.99**	**10.93**	**277.40**	**£2,991mn**
Lipper UK Equity Income mean*	0.01	11.61	176.28	
FTSE All-Share TR Index (12pm adjusted)	-1.28	13.05	190.80	

Discrete 12-month performance (%) to:

	31.10.19	31.10.18	31.10.17	31.10.16	31.10.15
JOHCM UK Equity Income Fund – A Acc GBP	**2.39**	**-3.13**	**21.92**	**7.88**	**3.69**
FTSE All-Share TR Index (12pm adjusted)	6.78	-1.34	13.29	12.19	3.09

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

Finally, it feels like there is some light at the end of the Brexit tunnel. With 'no deal' ruled out, initially via Parliament and then subsequently through an agreed deal with Europe, sterling rallied strongly in October - it rose by 5¢ against the US dollar during the month. With an election set to take place on 12 December, it is likely, judging by the polls, we could see a Conservative party win followed by a quick enactment of Boris Johnson's deal. Were this to happen, sterling should continue to rally (looking at longer-term measures, US$1.40/£1.00 seems realistic), bond yields should rise and the rotation that we have seen in the UK equity market in September and October (see below) should continue apace.

The election arithmetic is, however, difficult and the drivers of the election result will differ to previous elections given the nature of the debate going into it. Common sense suggests this should assist the Conservative position but the mood in the country is fluid and volatile. Whilst polling data will likely move sterling and UK government bond yields between now and 12 December, the difficulty of the arithmetic and errors in polling in recent years mean any outcome cannot be discounted. A Corbyn-led government or a hung parliament would be negative for the Fund.

UK economic data remained sluggish. Looking past the Brexit malaise, though, the picture looks more solid. The employment market is strong, nominal wage growth is close to a 10-year high and real wages are growing. There is also pent up consumer demand, which should be released if we get any political clarity and Brexit resolution. Fiscal expansion under Boris Johnson has begun, with signs that we will see a key part of the election campaign being framed around an increase in public spending and investment in infrastructure. These factors, coupled with a recovery in business confidence post Brexit, mean the UK could be one of the strongest economies in the G7 next year were things to play out as above. This is a long way from consensus thinking and positioning, with the UK remaining one of the cheapest stock markets in the world versus its history. Anecdotal signs such as fund flow and interest in meetings across our UK product suite suggest this could change quickly were clarity achieved via the election.

Elsewhere, economic data remains poor, particularly in Europe and certain US data points. There are, however, signs that economic activity is bottoming and could see some sequential recovery as we move towards the turn of the year. Asian data has started to improve and lead indicators of economic activity, such as trends in money supply, are recovering. A stabilisation of activity, which should happen given the degree of monetary easing coupled with the increased use of fiscal policy in certain regions, would see a continuation of the rise in global bond yields. This should be positive for the Fund. A major factor in how this plays out is any resolution of the US / China trade war. Here, the tone improved again during October, and with the US presidential election now less than a year away, one would expect President Trump to look for some sort of trade war ceasefire in order to inject confidence and momentum back into the US economy.

Performance

October saw a continuation of the powerful market mix change as political developments translated into a material shift in market leadership. In contrast to September, where the main driver of change was the rise in global bond yields, the main influence in October was the positive developments on Brexit (noted above) and the consequent move in sterling. In this context, the Fund performed well in relative terms, returning 0.99% versus a -1.28% return for its benchmark, the FTSE All-Share Total Return index (12pm adjusted). As we show in the outlook section below, whilst this and September's performance has been useful for the Fund in relative return terms, it is a small move in the context of what we consider to be the Fund's material undervaluation. Year to date the Fund has returned 10.93% against the benchmark return of 13.05%. As we said last month, there remains much to be done.

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

The majority of the Fund performed well in October. Our small cap positions were up strongly (**Severfield**, **Morgan Sindall**, **Liontrust**, **Rank**, **Randall & Quilter** all rose meaningfully) and our financials holdings performed well, notably our banks and insurance names. Rank was the strongest performer in the Fund (up c. 30% relative). A strong trading update, coupled with a number of sell-side notes focusing on the positives of the Stride acquisition (announced earlier this year), helped propel the shares higher. The shares are now 60% higher than the day on which Rank announced the acquisition.

Some stocks that have been under pressure continued to bounce back strongly. This was particularly the case for domestic names such as **Lloyds Bank**, **Barclays**, **Hammerson**, our house builders and **ITV**, amongst others.

October has historically been a risky month for profit warnings as companies see their September performance (which tends to be a large month in revenue and profit terms) and assess whether they can perform in line with consensus expectations. Negative statements from the likes of Reckitt Benckiser, Pearson and SIG (none of which are held in the portfolio) saw material share price falls. The Fund had a lower than normal number of profit disappointments, with **Forterra** being the only notable issue. Sluggish repair and maintenance activity led to a c. 8-10% downgrade and a similar reaction in the share price. Outlook statements across the board were typically cautious given Brexit and trade war uncertainties.

Portfolio activity

The continued sharp rotation in the market, as described above, meant we made a number of changes to the Fund and added one new stock, **Costain**.

We have previously owned Costain, selling it for c. 460p in the first half of 2018 on valuation grounds. Brexit uncertainty and a profit warning earlier this year have enabled us to repurchase it at a price 65% cheaper at c. 160p. We believe it is the most innovative of all the UK contractors, with a superior mix of businesses which include consulting, technology solutions (like smart motorways) and asset utilisation engineering capabilities. It will be a key beneficiary of the likely fiscal investment in the UK noted above. It is trading on a P/E ratio of 6x, yields 8% and has around a third of its market cap in cash.

Costain is materially undervalued in our view and joins the c. 10% of the Fund that is in the contracting, housebuilding and construction materials sectors. All our stocks in this sector, in common with the rest of the Fund, have strong balance sheets. During October, one of these positions, Severfield Group, used its net cash balance sheet to acquire a business in a tangential area. This transaction was 10% earnings enhancing, which lifted the share price by a similar amount. Strong balance sheets reduce risk and create optionality, which seeps into the Fund's performance over time.

Elsewhere, we continued to reduce our position in **HSBC,** which had poor results during the month. We have reduced our position by about 300bp over the last 12 months, with the residual smaller position left to keep some portfolio balance given the extent of our domestic/sterling sensitivity. We continued to reduce our position in **National Express** during the month. It had strong results but is one of the more expensive stocks in the Fund. We also reduced the weights of a number of stocks that performed well during October, **Paragon** and **Lloyds Baking Group** being good examples. A number of other stocks, which performed well, reached our c. 300bp active position limit and we cut them back to this level – **Barclays**, **Aviva**, **ITV** and **Standard Life Aberdeen.** All of these stocks remain materially undervalued in our view.

On the addition side, we increased our weighting in our recent addition, **Legal & General,** to 1.9% of the Fund. This was largely funded from the HSBC reduction. Legal & General rallied slightly during the month but still trades on a P/E of 8x and yields 7%. We also added materially to **Tesco** following strong results and a good meeting with management. It is trading on a free cash flow yield of c. 9-10%, has excess capital and multiple growth drivers.

We continued to add to **Hipgnosis Songs**. A distressed seller sold 10% of the company at a discount. As we indicated last month, it held a compelling capital markets event highlighting its growth levers. Our combined small cap exposure, which has remained flat at c. 20% throughout the year, is performing well in share price terms (in aggregate +2/3% relative since the end of June).

We also trimmed **McCarthy & Stone**, which has performed well and where the dividend yield is now below 4%.

The mining and the oil sectors were weak. We added to **Anglo American**, **Rio Tinto**, **BP** and **Royal Dutch Shell**.

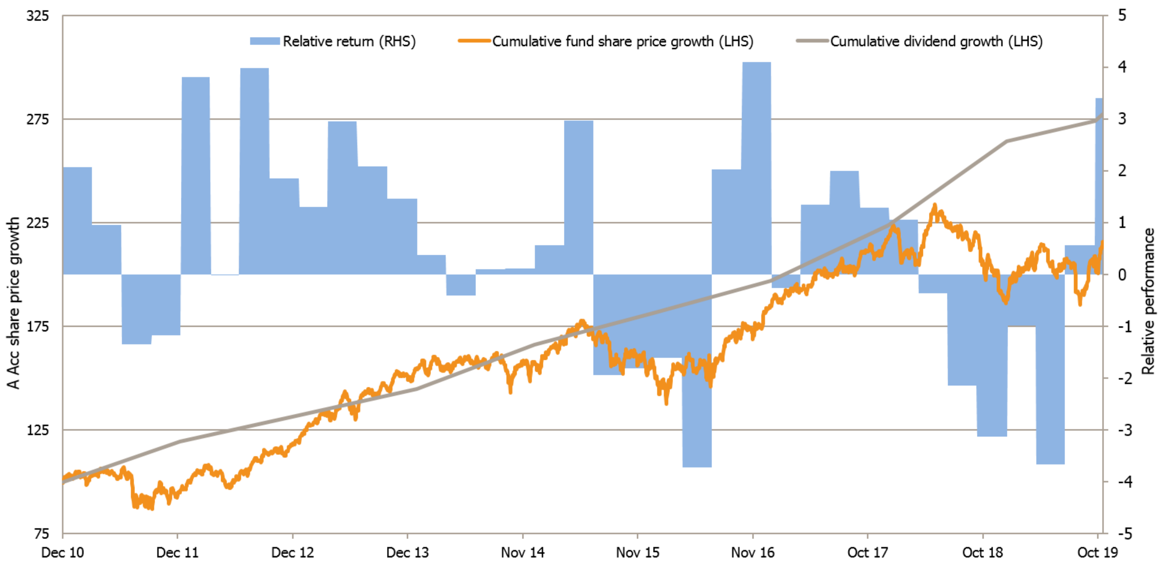
Outlook

As highlighted above, market leadership continued to see a marked change in October. This is critical and has fed through, as expected, to the Fund's relative performance. What has changed? Risk of a no deal Brexit reducing, Conservatives leading in the polls, US / China trade tensions easing, and fiscal loosening coupled with the prospect of a stabilisation in economic activity after a period of slowdown have all contributed. All these factors are still 'live', and we would hope they continue to play out. With valuations of growth/momentum stocks still at such extreme levels relative to value stocks, these are key developments and help explain the intra-market dynamic in September / October.

We have recently published some papers that highlight the parallels between the TMT stock market bubble of 2000 and today. They all suggest that the relative recovery of value will be very pronounced when it occurs. As such, September and October's performance should only be seen as the potential start of this process. Even after the moves seen thus far, the Fund still yields 5.35% prospectively. We will provide our final guidance for Fund dividend growth for 2019 next month, with the risk to the upside to the current guidance of 'mid single-digit growth'.

Below we include two charts that we have consistently used to show the valuation gap that currently exists within the market and the Fund. The first chart shows that the gap between the Fund's unit price and its dividend remains close to the widest ever.

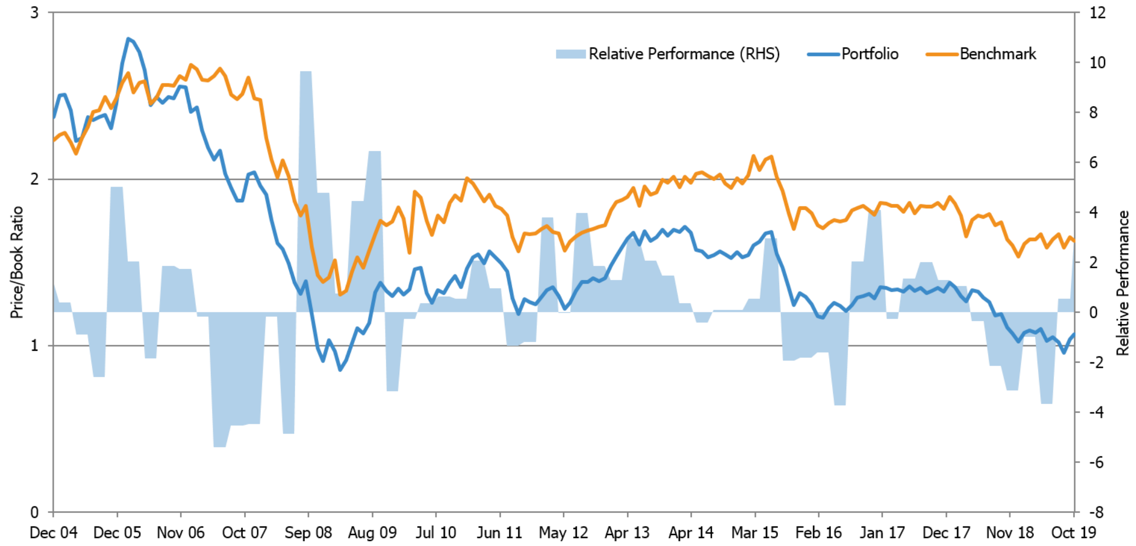
Mind the gap – the difference between the Fund's unit price and dividend remains close to record levels



Source: JOHCM/Bloomberg as at 25 October 2019. Dividend growth from 31 December 2010 to 25 October 2019 is based on a 5% annualised growth estimate.

This analysis suggests either the Fund dividend is going to drop by c. 33% or the Fund is materially undervalued. Whilst the portfolio's strong performance in September and October has been welcome, it has only closed a small part of the gap. The Fund remains significantly undervalued in our view. The chart below shows the Fund's price-to-book valuation (vs. market) is also close to its lowest ever level.

Mind the gap – Fund's price-to-book valuation versus market close to lowest ever level



Source: JOHCM/Fund analytics as at 25 October 2019 (price-to-book valuation, LHS) and 25 October 2019 (relative performance, RHS). Please note: the price to book data has been rolled from September 2019 to 25 October 2019, by indexing the September data by the Fund and benchmark performance to 25 October as this data is not yet available.

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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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.

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.