Professional Investors Only

JOHCM UK Equity Income Fund

Monthly Bulletin: December 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.
- Benchmark: FTSE All-Share Total Return Index.

Active sector bets as at 30 November 2022:

Top five

Sector	% of Portfolio	% of FTSE All-Share	Active %
Life Insurance	10.03	2.54	7.49
Construction and Materials	6.99	1.40	5.59
Industrial Metals and Mining	12.70	7.79	4.91
Household Goods & Home Construction	5.43	0.94	4.49
Media	6.95	3.18	3.77

Bottom five

Sector	% of Portfolio	% of FTSE All-Share	Active %
Pharmaceuticals & Biotechnology	0.00	10.43	-10.43
Personal Care, Drug and Grocery Stores	0.00	7.42	-7.42
Closed End Investments	0.00	6.24	-6.24
Tobacco	0.00	4.08	-4.08
Beverages	0.00	3.95	-3.95

Active stock bets as at 30 November 2022:

Top ten

Stock	% of Portfolio	% of FTSE All-Share	Active %
NatWest	3.59	0.57	3.02
Legal & General	3.61	0.63	2.98
Barclays	4.08	1.11	2.97
Phoenix	3.14	0.18	2.96
Standard Chartered	3.57	0.64	2.93
Glencore	6.00	3.13	2.87
ITV	2.97	0.12	2.85
Aviva	3.28	0.53	2.75
DS Smith	2.91	0.16	2.74
Diversified Energy	2.69	0.04	2.65

Bottom five

Stock	% of Portfolio	% of FTSE All-Share	Active %
Diageo	0.00	3.65	-3.65
HSBC	0.00	4.36	-4.36
Unilever	0.00	4.47	-4.47
Shell	2.71	7.60	-4.89
AstraZeneca	0.00	7.01	-7.01

Performance to 30 November 2022 (%):

	1 month	Year-to-date	Since inception	Fund size (£m)	Strategy size (£m)
Fund – A Acc GBP	**8.92**	**0.09**	**329.70**	**1,656.00**	**1,980.00**
Lipper UK Equity Income mean*	7.49	-1.49	201.06		
FTSE All-Share TR Index (12pm adjusted)	7.56	1.90	233.19		

Discrete 12-month performance (%) to:

	30.11.22	30.11.21	30.11.20	30.11.19	30.11.18
JOHCM UK Equity Income Fund – A Acc GBP	5.27	24.60	-16.49	9.83	-5.90
FTSE All-Share TR Index (12pm adjusted)	6.67	15.71	-9.72	11.67	-2.33

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

"A substantial majority of participants judged that a slowing in the pace of increases would likely soon be appropriate ".
Federal Open Market Committee minutes Nov 23rd 2022.

So despite several Fed members attempting to water down expectations that they will soon slow down the pace of monetary tightening, the official minutes of the latest Fed meeting suggested the opposite. Specifically, a number of policymakers highlighted that a period of more modest tightening would allow them time to assess the impact of the rate increases already delivered, given the usual lengthy time lags between policy change and real economy consequences. The release of these minutes came only a week after a small but significantly lower than expected US CPI release for October of 7.7% year on year, and 0.4% month on month against an expectation of 0.6%. Furthermore, producer prices only grew by 0.2% month on month in October as some supply chain bottlenecks began to ease. Slowing inflation prints have not been confined to the USA either; in Germany, the November annual increase slowed from 11.6% to 11.3% and in Spain, from 7.3% to 6.6%. Whilst expectations of peak Fed rates have only fallen back by around 30-35 bps so far, bond yields have moved more substantially at the longer durations, with the 10 year falling around 50 bps in November to 3.61%. On the last day of the month, Fed Governor Powell publicly confirmed that the time for moderating the pace of rate increases was likely to begin in December.

The UK's Autumn Statement from Jeremy Hunt confirmed a shift in policy towards a more predictable and cautious approach compared to the previous Chancellor. Whilst a lot of the focus was on the fiscal tightening, it was notable that the Office of Budget Responsibilities' economic projections were much less cautious than anticipated. Whilst they predict a 1.5% real GDP contraction in 2023, a similarly sized rebound is expected in 2024. Compared to the Bank of England, they assume that consumers will draw down on their COVID accumulated savings during the next two years, offsetting some of the drag from cost of living issues and higher taxes. Regular readers will know this is a view we share. The overriding aim of Mr Hunt's budget was to extend the period of rehabilitation of the UK in the eyes of international investors and in that regard he has thus far succeeded. The Pound to US dollar closed the month at around 1.21 compared to 1.126 on Sept 22 and 1.07 on Sept 26. Similarly, UK 10 year bond yields are currently 3.10% compared to 3.5% on Sept 22 and 4.5% on Sept 27. Mortgage rates have begun to move lower, and in time we would expect them to fall back to below 5%, having peaked above 6% a few weeks ago. Inflation in the UK may prove a little stickier than some of the countries listed above, with the October print of 11.1% possibly marking the peak; notably, core inflation (excluding food and energy) was flat month on month in October.

Despite the political shambles of late September, consumer activity has thus far proven to be resilient in most areas apart from the housing market, where the spike in mortgage rates curbed demand. The GFK November consumer confidence index rose 3 points in November to -44, and a number of companies across the hospitality and retail sectors have reported somewhat stronger demand over the last 6 to 8 weeks.

In China, pressures continue to build for a substantial easing of COVID restrictions. Despite an official attempt to hold the line until the winter has passed, it feels inevitable that many of the more draconian measures will be somewhat loosened over the coming months. Furthermore, with the Fed beginning to slow down its pace of monetary tightening, an era of a weaker dollar may well have already begun, which will have positive consequences for many emerging market economies.

Performance

November was a strong month for markets as investors responded to the growing likelihood that the pace of monetary tightening would soon slow down. The UK FTSE All Share was up

7.56%, and the Fund outperformed this, rising by 8.92%. Notably, this means that year to date, the Fund has delivered a small positive total return of 0.09%, which although slightly below the market return of 1.90%, is still a decent outcome compared to most other global asset classes. Looking at the peer group, the fund was ranked 1st quartile in November and is ranked 2nd quartile within the UK Equity Income sector so far in 2022. On a longer-term basis, the fund is ranked 2nd quartile over three and five years, and ranked 1st quartile over ten years and since launch (Nov 2004)[1].

Many stocks and sectors that have meaningfully underperformed over the last six months staged a recovery as fears about Central Banks over-tightening to combat short term inflation somewhat dissipated. Retailers such as **DFS** and **Currys** outperformed by more than 10%. They were helped by the fact that many UK consumer facing companies reported that trading had slightly strengthened over the last two months, in contrast to perceptions that it would have weakened. These companies included **Fullers**, **Kingfisher**, **Topps Tiles** and **SCS Furniture**. Elsewhere amongst the somewhat cyclically exposed sectors, both advertising exposed stocks, such as **ITV** and **WPP** and recruitment agencies **Page** and **S3,** all outperformed by more than 5%.

Whilst expectations for further rate rises have been reducing, all our banks outperformed during the month, with **Standard Chartered** (+12% relative) in the vanguard, as concerns about the quantum of impairments started to fade a little. We expect this process to continue in the coming months. Elsewhere amongst financials, some of our asset managers recovered somewhat, with **Abrdn** (+14 relative) and **Polar** (+7% relative) following a resilient set of results. Insurers were more of a mixed bag – **Conduit** outperformed by more than 10% as further evidence emerged of a very strong rating environment for catastrophe and casualty writers, but **R&Q** underperformed by 20% due to a stock overhang. Finally, our three life assurers only modestly outperformed despite the UK Budget confirming a positive reform of the Solvency 2 rules.

Petrofac was very weak in the oil sector, underperforming by 30% during the month. The only material news was the announcement of a change of CEO, which, whilst mildly disappointing, should not have led to the scale of the share price correction. **Savannah Energy** (-16% relative) was also sluggish despite confirming that their major transaction in West Africa is likely to finally close in December. **Vodafone** (-15% relative) produced a sluggish set of interim results with positive price increases struggling to match the rise in input costs such as energy.

Portfolio activity

We sold our small position in **Lancashire** in November. This non-life assurer performed well across our ownership, contributing 10bp to relative performance. The strong dollar and accelerating insurance pricing helped deliver a strong share price. The strength in industry pricing and higher reinvestment rates due to the rise in interest rates means this sector should return to making superior returns on capital. We have retained our position in **Conduit** and let the weighting drift higher to maintain exposure to this area.

The other reduction was in **ABRDN**, up 36% relative over three months. We marked our active position towards c. 125bp. The stock remains cheap with significant excess capital, valuable stakes (eg in **Phoenix**), not valued by the market and significant value in the personal and advisor vectors. The market is solely focused on the issue-riddled asset management business whilst missing the other key factors.

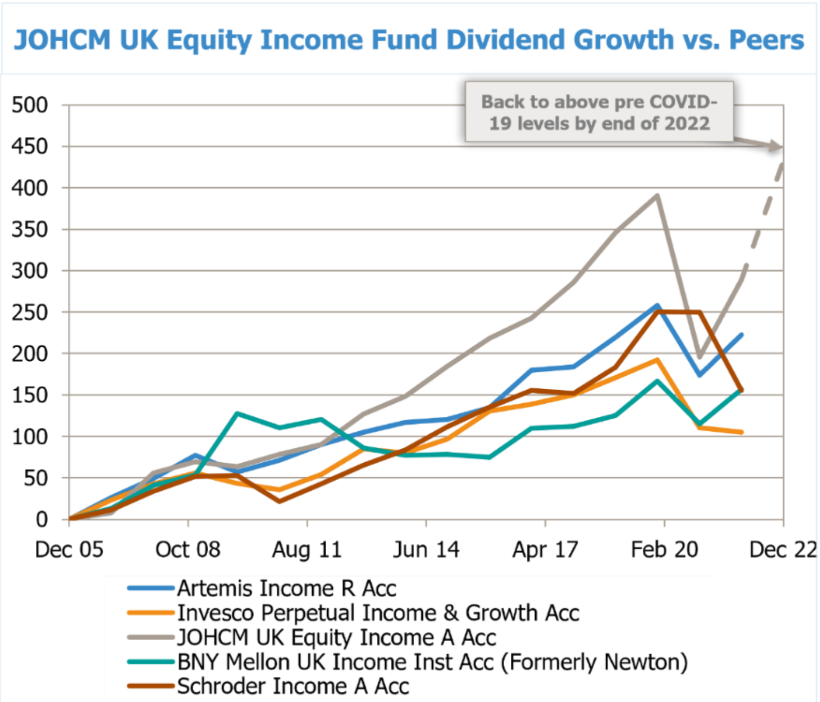
Most sales were driven by stocks performing well and hitting our 300bps maximum active position, including **ITV**, **NatWest Group** and **Legal & General**. In the middle of the month, the dramatic market shift created outsized moves, which meant numerous stocks moved away from target weights and released additional capital to invest in dawdling stocks (see below).

When a market mix shift starts, the most noticeable area is small caps, so we let the weighting drift higher for **Kier**, **Lookers**, Conduit (noted above) and **Wickes**. We should see some additional performance feed through as small cap valuations catch up and normalise.

As we said last month, 2022 will be the year we have added the least number of new holdings, and November was no different. This is a function of strong operational execution from the majority of stocks (meaning less reason to reassess) coupled with the ultra-low valuation picture, perpetuated by ongoing events which heighten risk aversion, such as the Ukraine War, government change in the UK and material outflows from the UK market. So now is the time to put the 'foot on the ball' and be patient, as most stocks have 75-300% upside.

Dividend Update

Since its launch 18 years ago, the Fund dividend has grown by an average of c.9% every year. This includes navigating two of the most significant 'risk' events in the last 50 years, namely the Global Financial Crisis (GFC) and COVID. Our first full year dividend was 4.3p in 2005, in 2022 the equivalent number is 23p, a fivefold increase. This cashflow increase is one of the main reasons why the Fund has performed strongly in an absolute sense since launch (up c. 329.7%) and is one of the best performing funds in its peer group. The graph below shows our dividend growth against some larger sector peers. The outperformance pre-COVID is clear and when the 2022 figures are available, the pre-COVID gap is likely to be re-established.



Source: JOHCM/Lipper as of 31 October 2022. Data to 31 December 2022 includes JOHCM estimates. The dividend yield forecast was an estimate of future performance based on evidence from the past on how the value of this investment varies. [1]Based on 'A' Accumulation share class price on 30 September (376p).

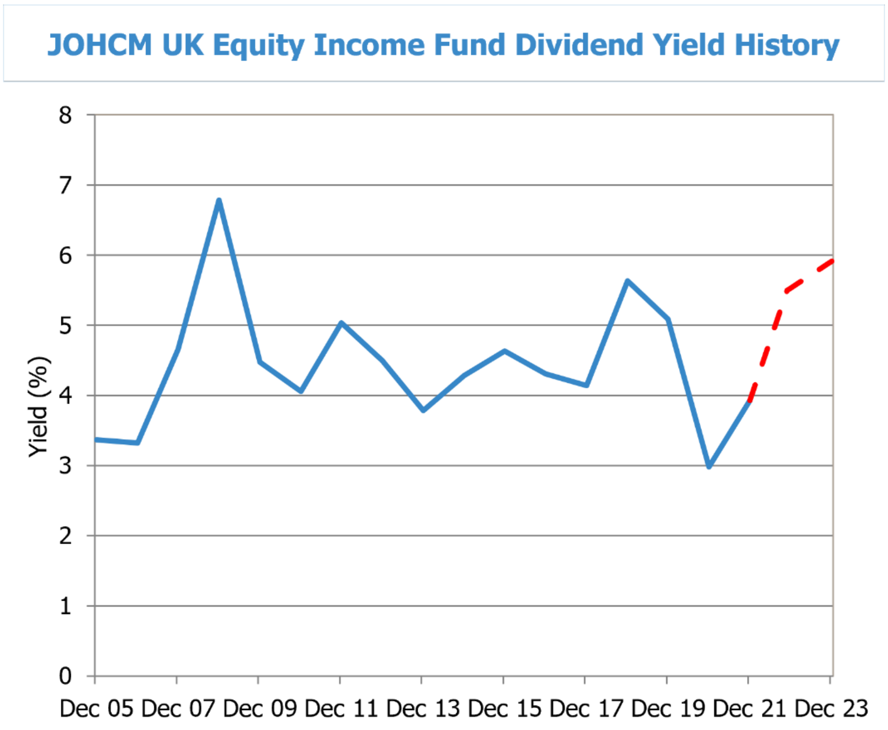
The actual growth in 2022 will be c.37%, with the recovery and normalisation post-COVID continuing to manifest itself. As a result, the Fund dividend will be 10% above its pre-COVID level at the end 2022. The Fund dividend yield for 2022 is 5.5%. We are confident that the Fund dividend will grow in 2023, with our detailed bottom-up modelling suggesting growth of between 3% and 7%. As usual, we have prudently modelled dividends on a stock-by-stock basis to reflect the more challenging current economic outlook. There are clear pockets of strength such as the Oil, mining, banking and insurance sectors. These sectors make up most of our large cap holdings, approximately 50% of the Fund. More broadly, post-COVID aggregate dividend cover is very strong and over half of the Fund is currently engaged in share buybacks, reflecting strong balance sheets. Share buybacks create a safety buffer before any dividend adjustment is needed, if the current economic environment becomes more challenging. Share buybacks also help stimulate future dividend growth. The table below reveals the extent of the share buyback activity in 2022 from some of our largest holdings. All else being equal, the same billion-pound dividend cost would equate to a 9-10% dividend per share growth, due to the lower number of shares in issue. This is a powerful second derivative effect.

Stock	% age of Fund	% age of share cap announced to be acquired in 2022	Forecast Dividend %	Total Distributions
bp	6.5%	12.5%	4.9%	17.4%
SHELL	2.7%	10.6%	4.3%	14.9%
GLENCORE	5.7%	4.8%	10.5%	15.3%
BARCLAYS	4.3%	5.6%	6%	11.6%
NatWest	3.8%	13.9%	5.5%	19.4%
Standard Chartered	3.6%	5.6%	4%	9.6%
Total / average	**c. 27% of Fund**	**9%**	**6.2%**	**15.2%**

Source: JOHCM as at 17 October 2022. *Natwest buyback includes the special dividend / B share consolidation

Whilst the economic outlook is difficult, the most significant risk to UK aggregate dividend flow and our Fund 2023 dividend forecast in is the direction of currency rates. We have used a GBPUSD rate of 1.20 in our forecasts. The sensitivity of the Fund dividend to a further $0.05 recovery in GBPUSD is c. -1.5%. We have included a small buffer in the official 2023 guidance for strengthening sterling, which we believe is likely.

Despite a strong track record on dividend growth, robust balance sheets and strong dividend cover, the 2023 Fund dividend yield at just under 6% is close to the highest it has ever been. In fact, as the chart below shows, the dividend yield has only ever been higher during one timeframe – the GFC. It did not stay high for long, as the Fund performed very strongly in 2009/10 (combined +64.59% in absolute terms and +9.93% in relative terms), the Fund dividend yield re-rated / fell to c. 4%. We believe we are at a similar point now.



Source: JOHCM/Lipper as of 31 September 2022. Data to 31 December 2023 includes JOHCM estimates. The dividend yield forecast and commentary are estimates of future performance based on evidence from the past on how the value of this investment varies and current market conditions and is not an exact indicator. Returns will vary depending on how the market performs and how long the investment is held. [1]Based on 'A' Accumulation share class price on 30 September (376p).

Outlook

As regular readers will know, we have felt for a couple of months now that we are entering the final furlong of monetary tightening and events in November reinforced that view. Underlying inflationary pressures are already showing signs of deceleration in many parts of the world. This situation will be accentuated in February next year once we annualise against the energy price spike following the invasion of Ukraine.

Furthermore, most central banks realise there is a significant time lag between tightening monetary policy and the full impact manifesting itself within the economy. As such, they are very likely to slow and then pause the policy of further tightening in the coming months in order to assess the landscape.

This environment is likely to prove helpful for equities in general and cyclically exposed stocks in particular, where earnings estimates are assuming a significant earnings collapse which looks increasingly unlikely.

This process began in earnest in November, with all equity markets generating strong returns but is likely to continue as we exit 2022, with valuations still very accommodating in many markets, particularly outside North America. As we have been saying for many months, we have rarely seen dividend yields as attractive as they are at present, which along with very strong balance sheets across our portfolio, suggest a highly favourable risk/reward set up. With the UK government having calmed investors' nerves with a pragmatic policy shift, there is every chance that the UK will prove to be one of the better performing markets in this scenario. We continue to be optimistic about potential returns from our strategy.

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

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