Professional Investors Only

JOHCM UK Equity Income Fund

Monthly Bulletin: November 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 October 2023:

Top five

Sector	% of Portfolio	% of FTSE All-Share	Active %
Construction and Materials	8.66	0.38	8.28
Life Insurance	9.36	2.37	6.99
Industrial Metals and Mining	11.49	6.65	4.84
Household Goods and Home Construction	5.28	1.02	4.26
Banks	13.13	8.94	4.19

Bottom five

Sector	% of Portfolio	% of FTSE All-Share	Active %
Pharmaceuticals & Biotechnology	0.00	10.98	-10.98
Personal Care, Drug and Grocery Stores	0.00	7.61	-7.61
Closed End Investments	0.00	5.97	-5.97
Beverages	0.00	3.48	-3.48
Tobacco	0.00	3.24	-3.24

Active stock bets as at 31 October 2023:

Top ten

Stock	% of Portfolio	% of FTSE All-Share	Active %
Aviva	3.51	0.50	3.01
DS Smith	3.13	0.17	2.96
Glencore	5.49	2.56	2.93
Phoenix	3.06	0.15	2.91
Paragon	2.82	0.05	2.77
Barclays	3.68	0.93	2.75
Standard Chartered	3.31	0.65	2.66
Bellway	2.72	0.11	2.61
ITV	2.65	0.11	2.54
NatWest	2.97	0.45	2.52

Bottom five

Stock	% of Portfolio	% of FTSE All-Share	Active %
HSBC	2.27	5.33	-3.06
Diageo	0.00	3.14	-3.14
Unilever	0.00	4.46	-4.46
Shell	2.36	8.29	-5.93
AstraZeneca	0.00	6.95	-6.95

Performance to 31 October 2023 (%):

	1 month	Year-to-date	Since inception	Fund size (£m)	Strategy size (£m)
Fund – A Acc GBP	**-8.23**	**-5.17**	**303.60**	**1,407**	**1,677**
Lipper UK Equity Income mean*	-4.55	-2.08	196.90		
FTSE All-Share TR Index (12pm adjusted)	-4.18	0.55	231.21		

Discrete 12-month performance (%) to:

	31.10.23	31.10.22	31.10.21	31.10.20	31.10.19
JOHCM UK Equity Income Fund – A Acc GBP	2.31	-7.50	63.60	-30.92	2.39
FTSE All-Share TR Index (12pm adjusted)	6.92	-3.11	35.48	-18.85	6.78

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 outbreak of significant hostilities in Israel and the Gaza Strip drove risk aversion across many asset markets during the month. However, the initial spike in the oil price did not sustain, and in fact, for the month as a whole, Brent was around 7% lower at $89 (having closed September at a high level following OPEC production cuts). In the past, a major increase in political tensions in the Middle East region has often led to a strong performance from government bond yields, but that did not generally prove to be the case, particularly in the US. For most of the month, longer duration bond yields rose, with the US 30-year adding around 30bps to finish at 4.99%. In contrast, shorter duration bond yields were little changed. The rise in yields at the long end was driven by a lingering concern around the growing US fiscal deficit combined with the quantum of new issuance required to find a home in the absence of the Central Bank as an automatic purchaser. Economic data in the US continued to show resilience despite the tighter monetary conditions, with payroll data noticeably firmer than expected and housing activity remaining steady. The Richmond Fed manufacturing index remained at a 12-month high. General inflationary pressures continued to subside, with the personal consumption expenditure index falling to 3.7% vs 4.9% at the start of the year.

In the UK, further evidence emerged of an employment market returning to equilibrium. The vacancies/unemployment ratio fell to 0.69 vs 1.02 a year ago, and regular pay growth eased slightly to 7.6% vs 8.0% in June. The September CPI print was flat at an annual rate of 6.7%, which surprised some commentators, with the rise in petrol prices offsetting falls in food and other items. However, the October CPI number will fall significantly as a 25% increase in gas and electricity prices last year falls out of the 12-month calculation and as food inflation continues to ease. These base effects are likely to see a 170-200bps fall in the annual rate of inflation when announced in mid-November which would see CPI below 5%. This event is likely to cement the view that the Bank of England tightening phase is over and may well boost consumer confidence as well as investors' perceptions of the UK economy, as it will no longer look like an extreme outlier. Retail sales in the UK have been somewhat distorted by extreme weather during August and September but will have reduced aggregate economic activity over the third quarter to be fairly flat. Activity in the housing market is subdued, but with 2-year bond yields having fallen from a peak of 5.84% in early July to 4.73%, this is likely to begin to stimulate higher levels of activity in due course.

The European inflation numbers for October are released earlier than the UK's, and showed a 140bps fall to 2.9% across the eurozone, much of it driven by similar base effects on energy. Similarly, a perception that the ECB tightening phase has now ended saw shorter duration bond yields fall, with the German 2-year yields down 11bps to 3.36%. Current economic activity across Europe is subdued, with growth having flatlined as economies adjust to higher interest rates and as manufacturing activity remains sluggish, with the composite PMI falling to 46.5 vs 47.2 in September. In the UK, the composite PMIs were a little firmer at 48.6, flat vs the previous month.

Countries that were early to raise rates to combat inflation have continued to ease monetary policy, with rate cuts from the likes of Chile, Poland and Hungary. In China, more economic stimulus was promised with President Xi announcing a mid-year increase in the proposed fiscal deficit to 3.8% vs the 3.0% target set in March. In

Japan, the Central Bank loosened its yield control mechanism in response to stronger activity.

Performance

October was a very difficult month for the Fund. The UK FTSE All Share was down -4.18% across the month. The Fund materially underperformed this (down -8.23%). Year-to-date, the Fund is down -5.17%, whilst the FTSE All Share is up 0.55%.

Looking at the peer group, the Fund is ranked in the 4th 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, 2nd quartile over 10 years and is the best Fund in the sector since inception in 2004.[1]

There were three generic drivers to market and Fund performance during the month:

1. October is always the worst month for negative earnings releases, as it and September tend to be important profit months, which, coupled with proximity to the year end, means companies that will not make their full-year forecast have to announce. The reporting season across the whole market was worse than we and consensus expected. We discuss this in more detail below;
2. Risk aversion moved from already elevated levels to extremities driven by the rise in long dated US yields, which stepped higher at the start of October as noted above and then continued to rise across the month coupled with the developments in Israel. We know this level of market dichotomy will revert at some point in the future;
3. There is, partly linked to 2) zero focus on valuation. <u>We can seldom remember a market more detached from valuation than we saw in October</u> (previous instances would include the week after the Brexit referendum result, the first month after Covid 19 became evident etc).

The two tables below show the top 10 and bottom 10 contributors to relative performance during the month (to 27th October).

JOHCM UK Equity Income Fund

From: 30 September 2023 To: 27 October 2023

Top 10 Contributors

Rank	Code	Name	Relative Return Contribution	Sector
1	0989529L	ASTRAZENECA	0.29	Health Care
2	BPQY8M8L	AVIVA	0.18	Financials
3	B082RF1L	RENTOKIL INITIAL	0.17	Industrials
4	0798059L	BP	0.12	Energy
5	B19NLV4L	EXPERIAN	0.07	Industrials
6	0540528L	HSBC HOLDINGS (GB)	0.07	Financials
7	B10RZP7L	UNILEVER PLC (GB)	0.06	Consumer Staples
8	0486622L	KELLER GROUP	0.05	Industrials
9	0287580L	BRITISH AMERICAN TOBACCO	0.05	Consumer Staples
10	BP41S21L	Savannah Petroleum PLC	0.05	Energy

Source: JOHCM

[1] Source: Lipper

Bottom 10 Contributors

Rank	Code	Name	Relative Return Contribution	Sector
1	BM8PJY7L	NATWEST GROUP	-0.54	Financials
2	0185929L	VISTRY GROUP	-0.43	Consumer Discretionary
3	AggShell	Shell	-0.43	Energy
4	AggBarclays	Barclays	-0.42	Financials
5	0408284L	STANDARD CHARTERED	-0.41	Financials
6	AggPetrofac	Petrofac	-0.31	Oil & Gas
7	BYX7JT7L	DIVERSIFIED ENERGY CO	-0.19	Energy
8	0263494L	BAE SYSTEMS	-0.19	Industrials
9	BG12Y04L	ENERGEAN	-0.17	Energy
10	AggEasyJet	EasyJet	-0.17	Consumer Discretionary

Source: JOHCM

There were few positives, with the lowest positive contributor being just 5bps positive. By implication the 44 stocks not on either of the two lists below in the main all had a small marginal contributions (between +5bps and -17bps – average c.-5/6bp). Collectively, these small on average negative contributions over a high number of stocks, created a large headwind (c.200bps). This is the risk aversion/valuation element discussed above that we would argue could and should revert as conditions normalise. Two of the stocks highlighted in red, on the top 10 contributor list we don't own (Experian and Rentokil) had profit warnings or competitor profit warnings). This is another indication of the extent of the difficult earnings season witnessed in the UK through October.

Stepping into more sectorial detail our four big sector exposures are mining, oil, banks and insurance. These amount to broadly 50% of the Fund. They should be looked at in an index context against our void in the long duration/defensives (which largely but not exclusively did well in the type of market in the month).

Looking at results and performance in October across these sectors. The insurance sector performed in line with the market, with **Aviva** up slightly, helped by bid rumours and a positive mini capital markets day focused on their wealth businesses, whilst the other two names were down slightly (**Phoenix**/**Legal & General**). The mining sector was also largely robust, particularly **Glencore**.

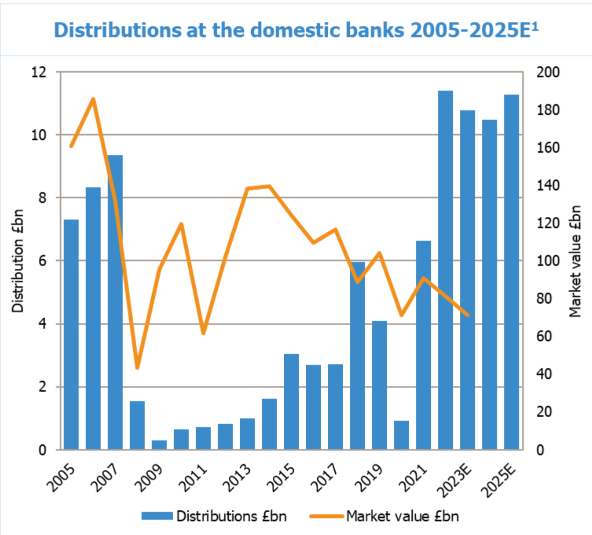
The two sectors that created a performance drag were oil and banks. The big oil names, including our largest absolute position **BP**, performed in line with the market (BP), or strongly (Shell) - on a relative basis, as can be seen from the combination of the two tables, the net of BP (which is one of our biggest positions) and **Shell** (where we are materially underweight) was a negative. We also own several smaller oil names, with two focused on the Middle East (**Energean**/**Petrofac**), which fell due to the issues in Israel. Energean produces gas which in turn produces half of Israeli electricity. It is offshore and north of the troubled areas. It is partly insured to cover current risks (which are not impacting yet, with no change to output). Directors acquired c.£1.5m worth of shares during the month. Consensus earnings per share for Energean for 2024 are c.375p placing the stock on PE of less than 2.5x. Petrofac is a contractor to the oil sector. In a strong year for new orders thus far, it announced a $600m contract with ADNOC (UAE) at the start of the month. Oil in total was a net negative 100bps contributor, with half, the specific Middle East element.

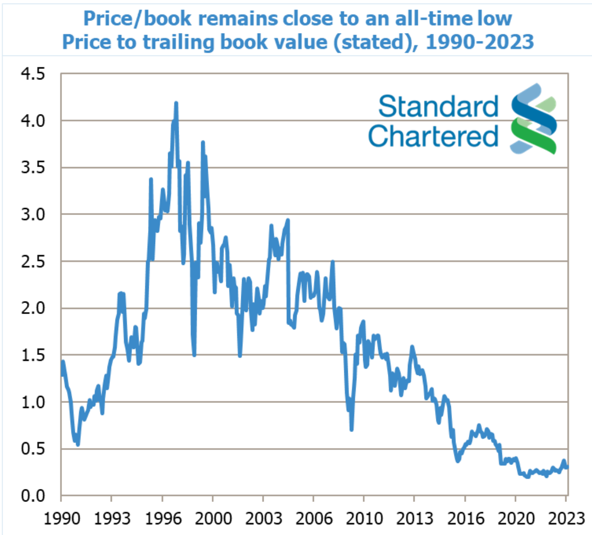
In the banks sector, the results season was disappointing. There were generic cross sector issues and some specific reasons – the main generic factor was disappointing net interest income/margin (NIM). This was offset in the quarter by better non-interest income and lower provisions (except for **Standard Chartered** (STAN), which topped up its provision against a small (vs the total assets) position in China real estate).

NIM was weak due to higher deposit migration than expected. There was a bigger shift amongst consumers from instant access accounts to long-term deposit accounts. This larger-than-expected shift outweighed the repricing of the structural hedge. The banks roll their liquidity on a five-year term (the structural hedge) – monies rolling off now are being repriced from c.1% (the interest rate 5 years ago) to 5% now. This is a material tailwind, sector-wide, equal to c.£8bn per annum once fully played through. It will come through, which is why bank Boards are confident in the medium-term returns profile of their businesses (e.g. NatWest 14-16% p.a.) but, in the short-term, this has been more than offset by the larger-than-expected deposit migration. This has led to downgrades throughout the results season. There have been some specific factors as well, e.g. a new FD at STAN and a new CEO at NatWest, setting the outlook lower as they take office and a poorly communicated strategic update at **Barclays**. On the latter, it was announced an exceptional cost would be taken in Q4 with the benefits outlined in February. We think the update will include a higher targeted ROTNAV (return on tangible net asset value) of c. 12% from more than 10% p.a., removal of structural costs and lower capital employed in the investment bank. All of these are positives but, they still need to be confirmed and quantified. Below, we show the valuation of our three main bank stocks, a chart that shows the current valuation of Standard Chartered in a historical context and a chart that shows distributions vs sector market capitalisation. They talk for themselves. The banks sector was a net cost of c.140bps.

	Mkt Cap	2024 PER	2024 Dividend Yield	2024 Price / TNAV	Targeted ROTNAV	Expected buyback in 2024
BARCLAYS	£19.5bn	4.0x	7.2% (25-30% payout ratio)	0.36x	Currently >10%	c.£1bn (c. 5% of mkt cap)
NatWest	£15.8bn	4.5x	9.2% (40% payout ratio)	0.58x	14-16%	c.£1bn (c. 7.5% of mkt cap)
Standard Chartered	£16.6bn	4.5x	5.3% (25% payout ratio)	0.50x	c. 12%	c.£1.5bn (c. 10% of mkt cap)

Source: JOHCM/Bloomberg





Source: [1]Numis as at 30 September 2023. [2]Standard Chartered, UBS as at 1 June 2023.

The two housebuilders (**Bellway** and **Vistry**) were underperformers with Vistry on the list above – they underperformed following a strong September (particularly for

Vistry), as rates rose. The points made above on the inflation trajectory coupled with rising real wages and potential government policy to stimulate housing demand ahead of the election, will likely change this. Housebuilders were a combined 60bps net negative contribution.

EasyJet is the other stock on the bottom 10 contributors we have not covered. It fell post results as they did not deliver an upgrade – why? In the year just finished, there were very high disruption costs in the £100m's (readers would likely have seen or experienced issues at Gatwick and air traffic control more generally) and in the outer period the rise in fuel costs, offset good cost control. The Israel situation also obviously does not help sentiment towards this part of the market in the near-term.

At the same time as the results publication, they also announced a new medium-term strategic plan. This included a new target, which equates to c.£1bn of profit, driven by lower cost (up-gauging on planes), the growth of the holidays business and rising fares (due to capacity reduction and control of their key airports). The market did not focus on this at all. We had a very good meeting with the CEO and Financial Director, talking through the long-term plan in detail, which we assess as very credible. The current market cap is £2.7bn against the £1bn EBIT target, i.e. another stock on a PE of 4x.

Portfolio activity

Most reductions were associated with keeping weights in check based on moves. BP, our largest absolute and one of the largest relative positions in the Fund, was held in the 6.5-7% range. We also reduced our Shell position as it rose. As noted above, Glencore was strong in the mining sector and we also reduced this so it remained at 300bps overweight, our maximum.

Likewise, in the insurance sector, Aviva as noted was buoyed by takeover rumours during the month. We also marked this position to 300bps overweight. Small caps tend to underperform during market conditions as outlined above, which was the case in aggregate, but a few made new recent highs, e.g. **International Personal Finance** posted a strong trading update and **Galliford**, following its strong results in the previous month. We marked both stocks towards their target weights.

Hipgnosis was volatile during the month. We voted against the announced sale of assets (c.20% of the business) to Blackstone, against the continuation vote and against three directors, including the Chairman, at the AGM/EGM during the month. A large majority of the shareholders voted the same way, which led to the immediate resignation of the Chairman and will now lead to a period of time during which a new board will be reconstituted and then a decision will be taken on how to move forward. A strong candidate is being discussed as a new Chairman. Our view is the business, which has a high quality portfolio, should be sold similarly to the sale of Round Hill Music (RHM) announced in September (a 63% premium, representing a c.12% discount to the last stated NAV). We added to the stock at 62p during the month, it closed the month at 72p. A 15% discount to NAV, i.e., a slightly higher discount than the RHM takeover read across would be 130p per share. The latter is our focus.

We added to EasyJet following the decline in the share price noted above. As well as the medium-term targets, the board also announced a return to the dividend list.

We selectively added to the banks, following the lower share prices post results as detailed above. The dividend profile of the sector remained intact post this results season – we kept our dividend forecasts for Standard Chartered, Barclays and **HSBC**, increased our forecast for **Lloyds**, and slightly cut our forecast for **NatWest** (from 17p to 16.5p per share).

We also increased our weight in recent addition **Inchcape**, which had a solid trading update during the quarter.

It is important during times of difficult performance to remain proactive and keep the door open to new ideas. We have been working on two new ideas over the last few months; one remains in the 'work room'; the other, **TI Fluid Systems**, was added to the Fund as a small position (c.30-35bps). TI Fluid is a market leader in the auto supply market (it has more than 30-35% market shares in its main niches). Similarly to EasyJet, it has recently announced a medium-term strategy and related detailed targets. On these targets, the stock would be on a PE of 3x. The current multiples are a PE of 5x and a yield of more than 5%. The board have also just started a share buyback. We will comment more on this stock in the months ahead as we build our position.

Outlook

October has often been a difficult month for equity markets to navigate, particularly as noted above it can often be seen as 'confession season' when companies must hold their hands up and admit that they will meet analysts' full-year earnings expectations. This has been a feature in parts of the market this year but has coincided with the outbreak of war in Israel and a somewhat destabilised bond market in the US. This combination has led to a severe outbreak of risk aversion and, critically, no focus on valuation within the equity market. We have spent much of the last 12 months writing about how modest valuations are across our portfolio, and yet, as we have seen, this has made little difference in the very short term. However, <u>valuation has to matter in the end, and it will do so again</u>.

What could be the catalyst for investors to focus on valuation again? Clearly a cessation of hostilities in Israel would help, but that is not something that can be assumed in the short term. The sheer number of black swan events that markets have had to grapple with over the last few years and indeed the 19 years we have managed this Fund, has probably made investors a little more immune to these uncertainties than they may have been previously.

However, more predictable is the looming offal in inflation in the UK, which we think could have a profound impact on the perceived risks around the UK economy. As outlined in the first section, the impact of base effects, particularly around energy and food, means that the headline rate of inflation will fall significantly this month to a level probably just below 5%.

Furthermore, the easing of price pressures in the food industry is likely to push the number lower still over the balance of the year towards 4%. The consequences of this outcome are that the Bank of England will not need to tighten policy any further, real wage inflation will accelerate towards 2.5%, and consumer confidence is subsequently likely to rise. Activity in the housing market is likely to pick up as funding costs fall back for new mortgages, and a more stable and predictable economic policy outlook is likely to encourage overseas corporates and private equity to take advantage of the very low valuations on offer in the UK equity market.

None of this is priced into stocks at this moment in time and presents an extraordinary opportunity for those willing to embrace it. The risks of an escalation of hostilities in the Middle East cannot be ignored, but neither should it be a central case either and even if it does occur, with stocks trading below asset value, on mid-single digit earnings multiples and offering high single digit dividend yields, the downside ought to be limited. The Fund dividend yield for 2023 is 6.1% - it has only been higher in a few months across the 19 year Fund history. We continue to see substantial upside from our portfolio.

The registrations of the funds described in this document may be terminated by JOHCM at its discretion from time to time.

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