



UK OPPORTUNITIES



13 MARCH 2020

Michael Ulrich, Senior Fund Manager

Rachel Reutter, Senior Fund Manager

Be calm, considered and patient

The covid-19 outbreak is leaving no part of the world untouched.

Whilst the pandemic will pass, companies with weak balance sheets may not survive the period of materially lower demand. We have long been concerned that levels of corporate indebtedness have made the whole system vulnerable to the sort of shock we are now witnessing.

The highly political fallout between members of OPEC+ last week has greatly exacerbated the risk of a serious problem in the corporate credit market. We have noted over the last 5-6 years the bubble building in corporate credit. Now with a significant proportion of the sub-prime market at risk of default, companies with bonds to renew soon and poor credit ratings will be in trouble. Flows out of corporate credit funds cannot be controlled by central bankers who are managing the situation for the 2008 banking crisis.

Our focus in recent years has been on owning companies with strong balance sheets. At the aggregate level, gearing in UK Plc is at all time highs (2.5x net debt-to-EBITDA, on average, excluding financials at the start of 2020). We have lost count of the number of times we have rejected an investment idea having met with a finance director of a cyclical business who thinks a leverage ratio of 2.5x net debt-to-EBITDA is an acceptable number. When earnings fall, debt soon becomes toxic. We await a raft of very dilutive rights issues.

We have so far deployed cash into companies in the Fund where valuation opportunities arose and where there are strong balance sheets which can get to the other side, for example, Morrison's, Serco and DCC. We have also started a position in Travis Perkins.

Our shopping list is well-prepared. We know the assets we'd like to own, but on that list the quality / growth companies in particular remain stubbornly expensive. We await the shock in the market when well-loved 'defensive' names suddenly turn out to be more cyclical than people thought.

Controlling emotions and subsequent human behaviour is very important when the herd is lost. A clear investment process and discipline is a big part of staying on track. We believe that having a plan in these challenging times will serve our investors well.

To summarise, our focus remains on:

- Strong balance sheets that can get to the other side
- Businesses which are self-funding and where management have been investing
- Avoiding over valuation

As of today, the cash balance of the Fund is 15%, and you can expect us to continue to patiently 'lean in' to buying opportunities. As these opportunities arise, you should expect the shape of our portfolio to change as we seek out well-managed businesses that can deliver healthy capital growth in the years to come.

Please get in touch if you have any questions.

Michael & Rachel

Past performance is no guarantee of future performance. The value of an investment and the income from it can fall as well as rise as a result of market and currency fluctuations and you may not get back the amount originally invested. Investing in companies in emerging markets involves higher risk than investing in established economies or securities markets. Emerging Markets may have less stable legal and political systems, which could affect the safe-keeping or value of assets. The Fund's investment 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. We recommend that you read the Prospectus and Key Investor Information Document available from the address overleaf or from our website. Information on how JOHCM handles personal data which it receives can be found in the JOHCM Privacy Statement on our website: www.johcm.com. The information contained herein including any expression of opinion is for information purposes only and is given on the understanding that it is not a recommendation. Issued and approved in the UK by J O Hambro Capital Management Limited, which is authorised and regulated by the Financial Conduct Authority. JOHCM® is a registered trademark of J O Hambro Capital Management Ltd. J O Hambro® is a registered trademark of Barnham Broom Ltd. Registered in England and Wales under No:2176004. Registered office: Level 3, 1 St James's Market, London SW1Y 4AH.
