



# POSITIONED FOR RECOVERY



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Undeniably performance of the Fund, in both an absolute and relative sense, has been extremely disappointing in recent months. This is primarily due to the material Covid-19 sell-off, which has proved to be significantly less punishing for quality/growth managers than value followers.

This paper aims to provide some context to the Fund's underperformance year to date and underscore the remarkable value in the portfolio. Later in June we will publish a second paper that looks at the profile of the Fund by sector, highlight the repositioning we have done through the crisis (towards better quality stocks but still within the value universe) and show examples of the bottom-up value in the Fund.

## Fund performance – a difficult backdrop

We have never sought to be 'deep value' investors but our investment style has always had a value tilt. The clamour for growth/low volatility/quality stocks and disregard for valuation metrics have meant we have been swimming against the tide for much of the last five years. And yet, at the end of 2019, the Fund was just 4% below its high watermark and up 308% since its inception in November 2004. From its launch to 31 December 2019, the Fund was ranked 2/39 in the Lipper UK Equity Income sector. We have been able to deliver that as stock selection has helped offset the headwind from the value vs growth negative mix. Nevertheless, year-to-date performance, most notably during the Covid-19 sell-off, has been unambiguously poor.

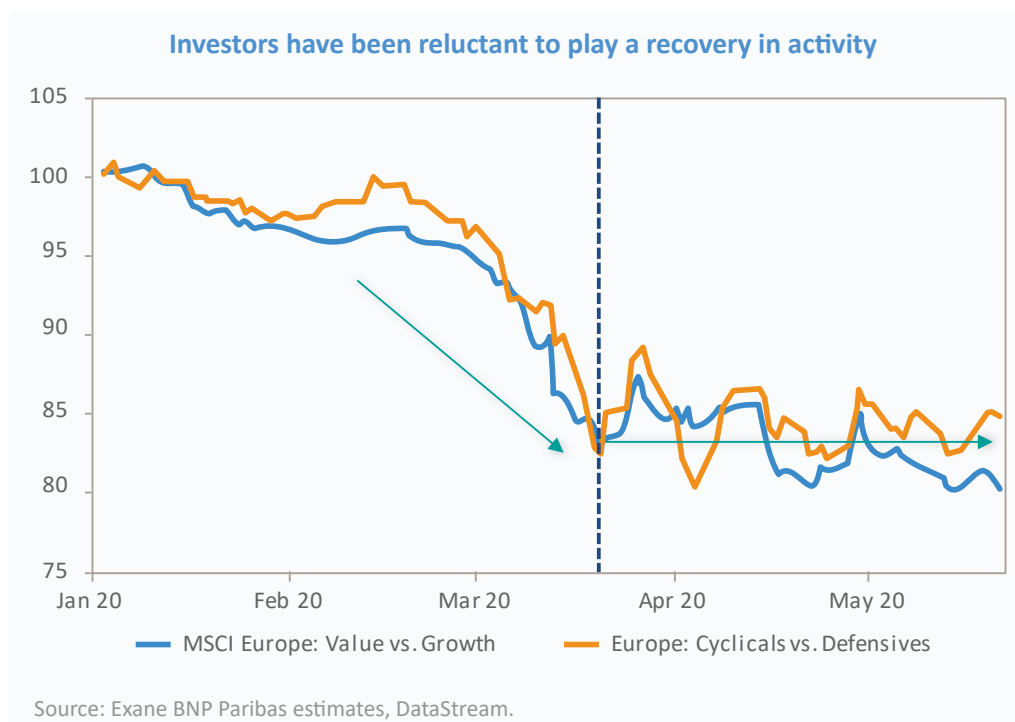
Since the end of February when the crisis started, the Fund dropped to a nadir on 19 March, down 45% in absolute terms. Since that point it has rallied 27% to the end of May, leaving it down 31% year to date in absolute terms compared to the market which is down 18%. In the initial phase of the downswing (to 19 March), the main driver of our underperformance was our own holdings falling. Since that point, whilst these holdings have rallied somewhat, the elements of the market that we do not own have continued to lead. AstraZeneca (up c. 40% relative), a Covid-19 winner but not held in the portfolio, is a good example, while the wider pharmaceuticals sector, where we are zero-weighted (due to eye-watering valuations), now accounts for c. 10% of the market. Elsewhere, our other portfolio voids (e.g. consumer staples) now also represent a much larger part of the market and keep trending upwards. This has added to the relative performance headwind.

Towards the end of May we have started to see the growth (vs. value) headwind abate a little with value starting to outperform. Given the valuation thesis we show below, we hope this is the starting point of a move in our direction.

## Growth vs. Value redux

The impact from Coronavirus lockdowns around the world and the associated hit to corporate earnings in certain sectors have certainly made for an arduous stock picking environment, but the main challenge has been the extension of the polarisation between value and growth share price performance and valuation differentials. The chart on the right shows how value significantly underperformed during the initial phase of the crisis and has lagged the recovery since the mid-March lows. One has to remember, as we show later in this paper, that even before the starting point in this graph, growth was already very expensive versus value after years of outperformance.

Over the last few months, the performance differential between value and growth has reached close to its widest ever level. The table below shows the stark contrast in metrics



between value and growth/quality – in both recent performance on the left hand side and valuation versus history on the right hand side. We started to see an improvement in these metrics in Europe in May as lockdowns eased but this has not yet translated across to the UK.

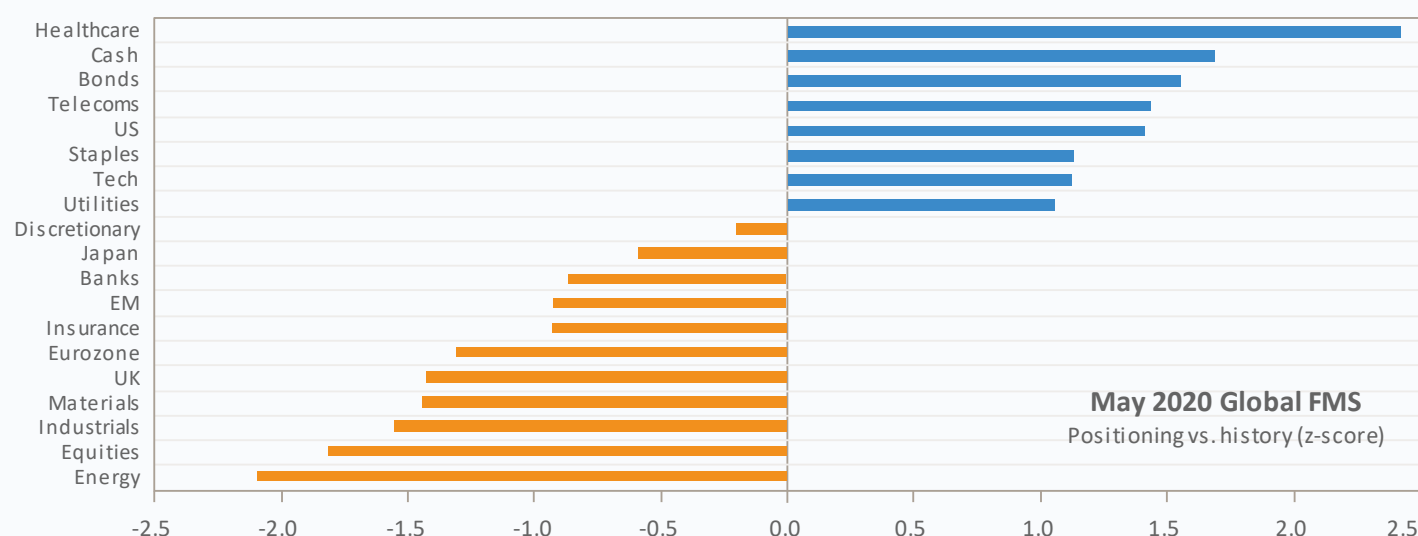
### The resultant value differential growth to value is stark

Returns Top vs. Bottom Quartile by Factor											
Europe factor performance Q4 vs. Q1	May 2020	Apr 2020	Mar 2020	Feb 2020	Jan 2020	Q4 2019	FY 2019	5 Years	10 Years	Since 1995	PE Valuation Percentile vs. History
Value	4.7	0.3	-17.1	-3.7	-5.9	-8.6	-19.2	-10.3	-7.3	1.0	13
...PE	4.3	0.9	-18.0	-3.4	-6.1	-8.8	-19.2	-10.2	-5.7	1.3	14
...PB	4.0	-0.8	-15.7	-2.0	-4.7	-6.8	-12.5	-8.5	-7.7	-0.6	6
...DY	4.2	-0.7	-12.9	-4.7	-3.3	-6.9	-15.2	-6.4	-3.4	1.9	17
...FCF	0.0	1.8	-5.3	-3.1	-2.7	-6.4	-11.1	-3.8	1.9	6.0	3
Quality	-1.8	0.5	11.2	0.4	2.8	3.9	13.8	8.1	8.3	5.4	100
...ROE	-1.9	-0.3	10.8	-0.6	1.5	0.5	4.6	5.8	6.1	4.0	100
...Leverage	-1.2	3.6	1.9	-0.9	0.3	0.9	5.2	4.2	3.8	2.6	75
...Ern Stability	-0.5	0.2	8.1	1.2	2.3	2.8	13.1	5.2	4.2	2.3	100
Growth (eps)	-2.3	4.1	3.5	1.6	2.7	2.5	11.9	3.7	4.7	2.1	97
Growth (sales)	-3.1	5.0	8.2	1.6	3.9	6.3	25.0	5.4	3.6	-2.0	91
Earnings Management	-2.3	0.7	7.4	2.2	6.1	6.3	15.8	6.5	10.3	8.0	100
Price Management	-2.9	1.5	8.2	2.1	5.5	7.9	27.3	7.9	9.5	8.9	96
Low Vol	0.0	-7.8	13.9	0.2	5.0	4.6	28.4	7.7	5.8	5.0	93
Nifty 50 vs. Mkt	0.5	-1.3	10.4	1.8	2.7	4.8	17.0	15.1	12.1	10.2	70
Shifty 50 vs. Mkt	0.5	0.3	-4.7	-1.0	-1.0	-0.8	-5.4	-1.2	2.0	4.2	1

Source: Exane as at May 2020.

Over time, and as a result of the long-term continued outperformance of growth, many of our competitors have tilted portfolios away from value. Only a small proportion of the UK equity income sector is still truly value-orientated. The table below shows overall (at a global level) sector positioning. It is heavily skewed into sectors viewed as safe and dependable. Our positioning is in the main in sectors / markets in the bottom half of this table.

### FMS positioning vs. history



Source: BofA Global Fund Manager Survey.

Our process has not changed. The volatility in our performance is a function of the skew in sector performance (close to the widest it has ever been) and macroeconomic events, such as Brexit, President Trump's election, the UK general election and now Covid-19. The market and sector differentials have become much more volatile.

### History repeating: asset allocation matters

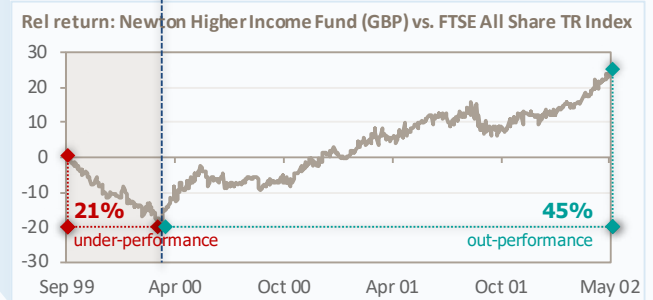
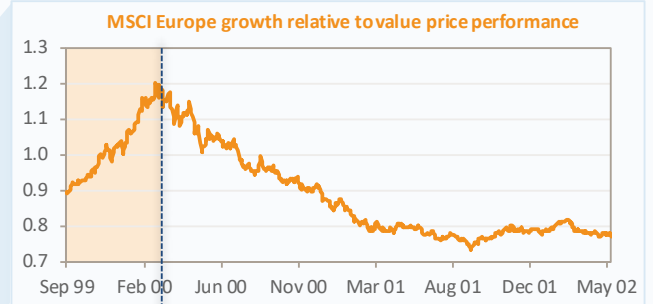
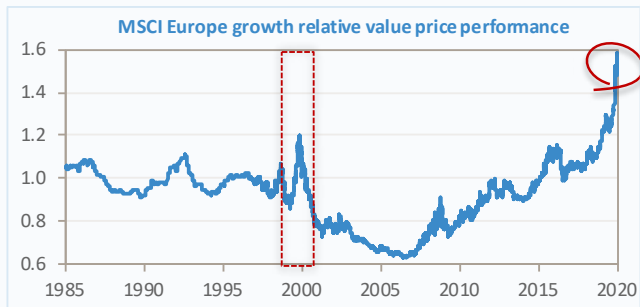
We'd like to cite two historic examples where we see parallels with today's distorted market:

#### 1. The peak in growth stocks during the TMT bubble in 2000

The chart overleaf shows how quickly and powerfully the Newton Higher Income Fund, which Clive managed between 2001 and 2004, outperformed following the peak in growth names during the TMT bubble. This is why asset allocation decisions are so important now. The four most dangerous words in investing are 'this time is different'. We heard this a lot at the time of the TMT bubble and are hearing it used now to justify the ratings in some parts of the market.

## The equity market is more polarised than it has ever been

Way beyond the TMT bubble: The stark valuation gap between growth and value stocks



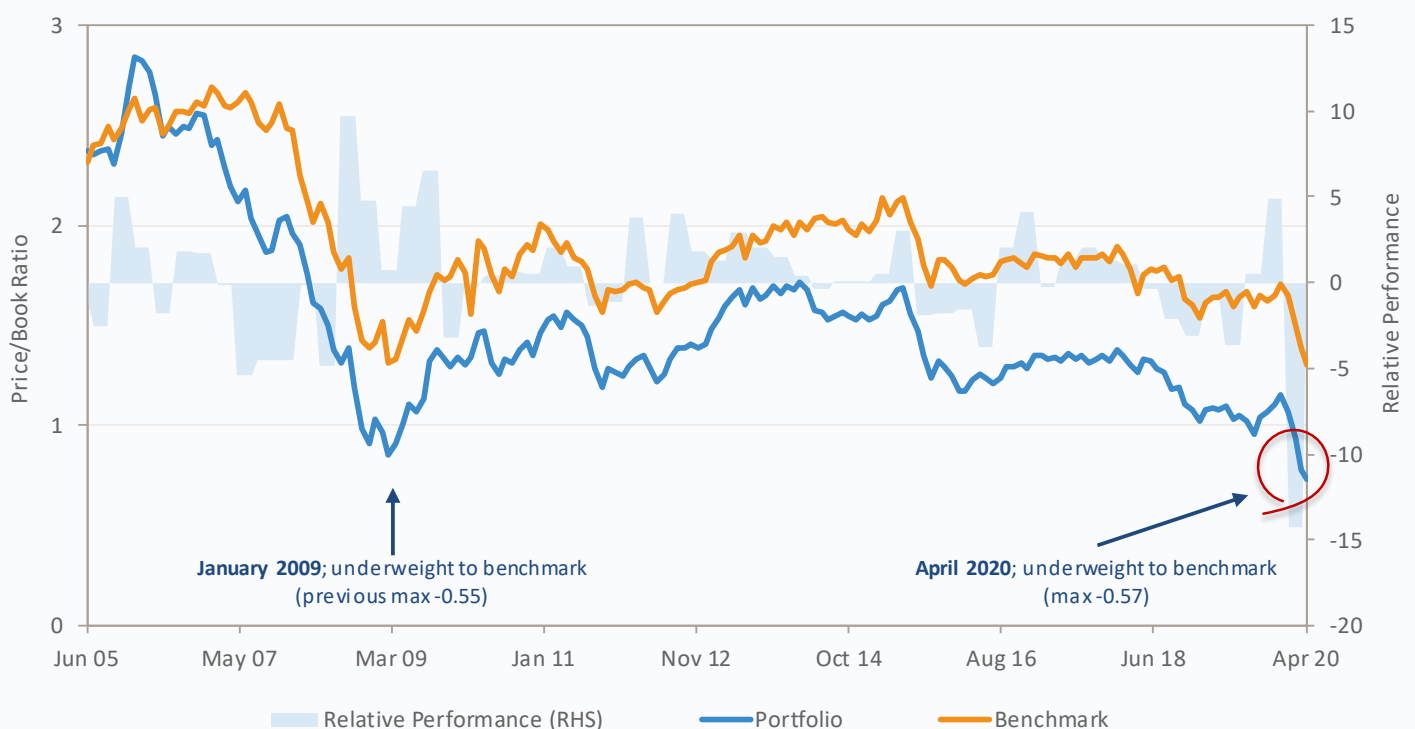
Source: Credit Suisse as at 8 May 2020 (LHS). JOHCM/Bloomberg (RHS).

## 2. The extended period of the Fund's low price-to-book ratio in 2008-2009

The Coronavirus crisis has left the Fund the cheapest it has ever been, with its price-to-book ratio at the lowest level in its 14-year history. The chart below shows the last significant low point in the Fund's price-to-book value came following the Global Financial Crisis. This was followed by a powerful relative showing from the Fund in 2009 when it returned 40.4% for the calendar year versus a 29.9% return for its benchmark, the FTSE All-Share Total Return Index (12pm adjusted).

We see a similar situation playing out now (from an even more polarised starting point) and anticipate a powerful recovery in the Fund's relative performance as the market shockwaves subside and economies revive, just as we saw in 2009.

### Price to book – Uncharted waters



Source: JOHCM/Fund analytics as at 22 April 2020.

## How are we positioned?

As we mention above, we will produce a more detailed paper later in June showing our sector positioning, with some stock examples to bring to life the low valuations we show at an aggregate Fund level in the price-to-book chart.

As we show in our monthly bulletin, published on the same day as this report, we have continued to reposition the Fund within the value area of the market. Just as we did in the Global Financial Crisis, we have used this crisis to improve the composition of the Fund, exploiting indiscriminate share price falls to access better quality value stocks, stocks that will grow quicker across the next economic cycle and which will take market share as we exit the Covid-19 crisis.

We had a small tail of portfolio holdings that could potentially have been permanently impaired as a result of the crisis. We have sold or reduced position sizes in these names, the main sector being property and the main stock being Hammerson. We have used the proceeds to move capital into sectors and stocks that are on the front foot, have robust balance sheets and will be able to exit this crisis strongly.

Unlike during the GFC, we have significantly less stock-specific concerns. This is primarily due to the strong balance sheets that run through the Fund. Our 'worry basket' is now just c. 2% of the Fund.

We believe we have significantly improved the quality of the Fund (while avoiding taking on additional valuation risk), while also upgrading the growth prospects of the Fund through the market cycle. As we indicate above this strategy worked well for us following past crises (particularly in 2008-2009), and we have adopted the same tactics this time around. But there are differences between now and 2008-2009: there is less debt in the portfolio, fewer company-specific risks and the majority of our holdings are resetting to come out of this crisis strongly. We strongly believe that a number of the cyclical/value orientated sectors look highly attractive and have the scope to produce very meaningful returns from here (in our view, many of our holdings could rise 50-100% as the pandemic fades). In the past these stocks have performed strongly when PMI surveys begin to improve (as they did in 2009) and we believe that a similar phase has already started this time around.

Thank you for your support of the Fund and particularly your patience during this uncomfortable period.

### JOHCM UK Equity Income Fund

#### 5 year discrete performance (%)

##### Discrete 12 month performance (%):

	31.05.20	31.05.19	31.05.18	31.05.17	31.05.16
A GBP Class	-21.03	-12.19	12.60	27.70	-11.02
Benchmark	-10.02	-3.52	6.41	24.51	-6.80
Relative return	-12.23	-8.99	5.82	2.56	-4.54

#### Past performance is no guarantee of future performance.

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.

Past performance is no guarantee of future performance. Source: JOHCM/Bloomberg unless otherwise stated. Fund launch date 30 November 2004. Issued by J O Hambro Capital Management Limited authorised and regulated by the Financial Conduct Authority. The value of investments and the income from them may go down as well as up and you may not get back your original investment. Any forecasted dividend yield quoted is prospective and not guaranteed. 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. 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. Source: JOHCM/Bloomberg/FTSE International. Note for return history: NAV of share class A in GBP, net income reinvested. Benchmark: FTSE All-Share TR Index. Performance of other share classes may vary and is available on request. FTSE International Limited ("FTSE") © FTSE 2017. The Industry Classification Benchmark ("ICB") and all rights in it are owned by and vest in FTSE and/or its licensors. "FTSE" ® is a trademark of the London Stock Exchange Group companies and is used by FTSE International Limited under licence. Neither FTSE or its licensors accept any liability for errors or omissions in the ICV. No further distribution of ICB is permitted without FTSE's express written consent. JOHCM® is a registered trademark of J O Hambro Capital Management Ltd. J O Hambro® is a registered trademark of Barnham Broom Holdings Ltd. Registered in England and Wales under No: 2176004. Registered address: Level 3, 1 St James's Market, London SW1Y 4AH, United Kingdom.