JOHCM Funds

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International Select Fund Quarterly Report

Performance and transactions

The portfolio underperformed its benchmark index in Q3 and YTD. The MSCI EAFE (All Countries World index ex USA and ex EM) fell in Q3 and YTD by -9.36% and -27.09% respectively. This crisis is very different because previously "safe haven" government bonds have fallen along with equities. So much so, that this is the worst year for combined equity and bond losses in most investors memory. Inflation reached 40 year highs in many parts of the world, prompting Central Banks to hike interest rates much more than expected, leading to fears of a global recession and financial crisis.

During the quarter and year to date we have underperformed for 3 main reasons:-

1. We got interest rates wrong, expecting moderate, not near record, rises
2. Which meant we got the Net Present Value (NPV) wrong for our "offense" growth stocks (e.g. too much Duration in most sectors/regions)
3. Which also meant we picked the wrong type of "defensive" stocks (e.g. traditionally low beta Healthcare) as the classic 60/40 asset allocation model that our portfolio construction is based upon stopped working when bonds and equities crashed together.

As a result, we did not deliver our usual "relative downside protection."

What are we doing about it, and where are the new opportunities in this very different crisis?
During the 3rd quarter, we sold economically cyclical stocks with earnings risk due to increasing recession risk such as Hynix and ASML in the Semiconductor industry, plus DSM and First Quantum in the Materials sector. We purchased higher quality economically resilient stocks with less recessionary earnings risk such as Ono and Fanuc in Japan; plus Globant, EQT and Sartorius who are already down 50% YTD, plus Bank Rakyat and Bank Itau in Emerging Markets (Brazil and Indonesia respectively).

Outlook and strategy

International Select fund "4.0" has started tiptoeing slowly into the following new "neighbourhoods" where we see positive relative fundamentals and valuations, plus stabilising relative share price trends:-

a) Quality growth stocks are already down around 50% year to date
b) Emerging Markets that are surprisingly outperforming the S&P500 year to date despite the strong US$ (e.g. Brazil & Indonesia)
c) We will keep looking for the next opportunities when the US$ turns

We think most equity markets are in a bottoming process, followed by a Q4 rally, then range bound 2023-2025 with risk on/off rotations as the US$ peaks. Our base case scenario is that this interest rate shock/crisis "valuation" bear market is morphing into a recessionary "profits" bear market (with S&P500 already down 25% YTD) but not widespread financial crisis/contagion (when markets would fall by more than 50% like 2008).

Our current scenario analysis is 50% bullish and 50% bearish. Short term reasons to be bearish include a recession potentially becoming a financial crisis/contagion. Medium term reasons to be bullish include the Fed regaining credibility with inflation/interest rates stabilising next year.

Scenario 1 (35% probability) Equity markets rally led by "quality growth" stocks. It's probably nearer the end than the beginning of the Bear market for our Scenario 1 type of stocks, e.g. economically resilient quality growth stocks already down around 50% year to date.

Scenario 2 (15% probability) Equity markets rally led by "cyclical value" stocks. It's probably nearer the beginning than the end of the Bear market for Scenario 2 type of stocks because the recessionary earnings cuts are next for economically cyclical areas like commodities and the "last person standing" areas of the equity market.

Scenario 3 (50% probability) Equity markets keep falling if recession becomes financial crisis/contagion and policy makers do not react. Relative to benchmark, Healthcare is now the biggest position in the fund, as some of our Healthcare stocks are low beta (defensive) Scenario 3 type stocks, and some are high beta Scenario 1 type stocks.

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

The MSCI EAFE Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. Any indices mentioned are unmanaged statistical composites of stock market performance. Investing in an index is not possible. Source: MSCI. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This report is not approved, reviewed or produced by MSCI.

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Past performance is no guarantee of future results.

RISK CONSIDERATIONS:

The Fund invests in International and Emerging Markets. International investments involve special risks, including currency fluctuation, lower liquidity, different accounting methods and economic and political systems, and higher transaction costs. These risks typically are greater in Emerging Markets. Such risks include new and rapidly changing political and economic structures, which may cause instability; underdeveloped securities markets; and higher likelihood of high levels of inflation, deflation or currency devaluations.

Emerging Markets involve heightened risks related to the same factors, in addition to those associated with their relatively small size and lesser liquidity.

The small and mid cap companies the Fund may invest in may be more vulnerable to adverse business or economic events than larger companies and may be more volatile; the price movements of the Fund's shares may reflect that volatility.

The views expressed are those of the portfolio manager as of September 2022, are subject to change, and may differ from the views of other portfolio managers or the firm as a whole. These opinions are not intended to be a forecast of future events, a guarantee of future results, or investment advice.