J O Hambro
Capital Management Group

News

What Emma Raducanu can teach us about process

Our main theme this quarter is the strong growth in our portfolio companies along with a word on what Emma Raducanu can teach us about process.

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What Emma Raducanu can teach us about process

Like millions of other people around the globe, we were gripped by the US Open final match between Emma Raducanu and Leylah Fernandez. There was a vital moment shortly before championship point when Emma cut her knee. A medical time out followed and in an interview after the match when asked what she was thinking in this time, Emma talked about the importance of her process. She said, “I think staying in the moment and focusing on what I had to do and keep my process really helped in those tough times”. During this time out her opponent occupied herself with disputing a line call with the umpire. It was a great reminder of the importance of having an easily repeatable process you can stick to and not to waste energy fighting the uncontrollable.

The quarter

The investment backdrop has continued to be driven by politics. There was a noticeable step up in the trend towards de-globalisation with supply chains straining as a result, the energy transition agenda remains of primary importance and governments continue to try and cure social inequality through minimum wage legislation, all of which are driving inflation. Businesses will need to be agile to adapt to these changes and position themselves to benefit from a greater degree of government-led spending. The quarter also saw around 70% of the portfolio report earnings, which despite the year on year weak comparatives, demonstrated good progress and support for the long term themes we're backing within the portfolio. One standout theme was the continued success of digital platforms.

Fund performance was flat over the quarter. Strong prices for commodities related to the energy transition drove the cashflows and share price of **Glencore**. Elsewhere, **RELX** reported double-digit growth, boosted by ongoing demand for its data and analytics-driven risk business. Housebuilder **Redrow** announced full-year profits that were more than double last year's and a pipeline of new sites that should drive further growth over the medium term. Our portfolio also benefitted from the private equity bids for **Morrisons**. **Smith and Nephew** negatively impacted performance as Covid-19 restrictions impacted the rate of hip and knee replacements. Patients who require surgery will not hobble on indefinitely and we anticipate demand to recover as restrictions ease. Shares in **Moneysupermarket** fell as the surge in energy prices reduced the availability of attractive consumer energy deals and thus the propensity to switch suppliers.

From UK-based services to global digital platforms

Whilst the London Stock Exchange isn't well known for its tech companies, investors miss the fact that the UK market offers access to some of the best leading edge global technology platforms. These companies offer real cash profits without the nose-bleed valuations. Many of the companies in our portfolio have spent the last couple of decades investing in their digital capabilities, building service offerings which are world-class and able to capture high rates of growth.

During the period, **Next** had to release an unscheduled positive trading update as sales were running materially ahead of their own and the market's expectations. At their unscheduled July update, online sales were 56% higher than in the same six month period in July 2019, despite the reopening of shops. 90% of Next's profit now comes from its very profitable online business where it has grown customers to 8.4m, a +40% increase in two years. This is the result of a decade plus of investment in both platform technology and logistics. This has resulted in competitors like Gap, handing over their online business in the UK for Next to run. The end result is an online business growing faster than Netflix, but with positive cashflow and at a fraction of the valuation.

RELX's Risk business, where 99% of its data provision is electronic, reported 10% revenue growth and a faster growth in profits. This business is benefitting from decades of investment in data and analytics. It owns three petabytes of data and tens of billions of records which it analyses with deep learning AI to prevent online fraud, help insurers predict driver risk and help companies assess corporate credit risk. It's recognised by Forbes as one of the most innovative companies in the world. Relx is another technology-driven, cash generative business, investing, growing and generating strong cashflow that UK investors can buy at a sensible valuation.

Our only new purchase during the period was **Future Plc**. Over the last few years, Future has built a digital content delivery and advertising platform that now reaches over 400m users across English-speaking countries. To best understand what Future actually does, we suggest readers try searching "which is the best digital camera" or "which laptop for school?" Future's search optimisation engine ensures they are at the top of the results, after the paid ads that tend to be ignored. The company owns sites such as Tech Radar, T3 and Digital Camera World. They have extended the concept across non-technology sectors with content ranging from health and beauty, caravans, boats, wine and musical instruments. These sites all offer independent advice on products and a much-needed cut through of the considerable choice available to consumers. The platform is scalable which means adding new content doesn't incur significant cost. Growth continues to be strong and cash generative.

UK index distortions

Next, RELX and Future are just a small snapshot of the technology and innovation that runs through the portfolio. The availability of these opportunities comes as a surprise to many observers who think of the UK market as full of banks, oils, tobacco and insurance stocks. The reason for the widespread misunderstanding of the UK opportunity set comes from those who focus on index weightings. It is indeed true that many of the biggest companies in the UK market are in sectors where long-term structural growth is limited and where the greatest source of return is a dividend. However, for investors that are not constrained by the index weights, this analysis is irrelevant. For the FTSE 350, there are more healthcare companies than banks, more companies selling software than oil and more media businesses than insurance companies. That means there is plenty of growth available, so long as you invest actively and ignore the benchmark weights.

Value and valuation

Another current market misconception is that an equity must be either a value or a growth stock. We are reminded of Warren Buffet's warning that "investment managers who glibly refer to "growth" and "value" styles as contrasting approaches to investment are displaying their ignorance, not their sophistication. Growth is simply a component - usually a plus, sometimes a minus - in the value equation".

The price at which we buy and sell is determined by our valuation of the company. That valuation is heavily influenced by our assessment of a company's long-term growth prospects. During the quarter we sold our position in Reckitt Benckiser. The company's growth prospects have diminished in part due to the failure of its expansion into emerging markets and the need to heavily reinvest in its product range whilst offsetting material input cost inflation. Our lower growth expectations have reduced our long-term valuation of the company and we sold the last of our shares in August.

Valuation control, alongside quality control, are our key weapons to protect clients from capital loss. We assess all companies on the same basis and are committed to selling even our fastest growing companies if the valuation fully reflects those good prospects.

Getting engaged

The confusion around exactly what anyone means by sustainable investing is becoming unsustainable. It is important that we are very clear about what we are and are not doing in this area.

Our focus is around engagement, defined as communicating with companies on specific topics in order to encourage change. The process starts by assessing a company's ESG policies and performance and identifying areas where we can see a missed opportunity or an unattended risk. To make an engagement meaningful necessitates focusing on specific issues that are not already being addressed. There is nothing to be gained by encouraging a company to reduce carbon emissions where it is clear that they are already focused on doing so, other than to increase the number of engagements reported to clients.

Our approach is to target our engagements on companies where there is the most room for improvement and the greatest positive impact to be had from change. We are not in the business of owning a portfolio of wind farms where the marginal impact of an engagement is minimal. Instead our portfolio reflects the world as it is and we use our influence as shareholders to encourage change that makes the business both more sustainable and more profitable.

A good example is our engagements with Ashtead on climate change. As a market leader in equipment hire, Ashtead's ability to win new business will only be enhanced by offering more environmentally friendly products to its customers. There is scope to hire more battery powered equipment to customers who are under pressure to reduce their own emissions. In addition, providing emissions data for their rental equipment makes them an attractive supplier for companies that need this information for their own reporting.

At the time of our initial purchase of the stock, Ashtead's carbon emissions strategy appeared to encompass only what was required for its regulatory reporting requirements. Over the course of our engagements, they have shifted from a position of "increased emissions are inevitable due to growth", to a commitment to reduce carbon intensity by 35% and to working with the Carbon Trust to map out science-based targets. They have showcased the work they are doing with suppliers to encourage the development of more environmentally friendly equipment and are partnering with academia to study the carbon benefits of renting equipment over ownership.

We don't claim our engagements directly change company behaviour. We are one voice among many shareholders. However, we can encourage and support management teams to make long-term commitments that can both improve sustainability and drive profitable growth. We believe that this approach has a far greater positive impact than just buying stock in another wind farm.

Idea inflation

We are often asked about improvements we have made to our investment process. Over recent years our biggest single improvement has been in expanding our watchlist of potential new ideas. This often means doing in-depth research on businesses we are unlikely to buy now, but might be good candidates should something change. That change might be valuation, balance sheet or management. It might be an external factor such as regulation or government policy. We have also boosted the depth of our research process with far more time spent interviewing industry participants, company competitors or former employees to get a detailed understanding of the company and its markets.

The expanded list of "ready to go" ideas has enabled us to move quickly during market dislocations and has resulted in a lower cash balance. We intend to build on this success by doubling our analyst resource to two people. We are delighted to announce that Eoghan Reid joined our existing analyst Roshni Bolton at the end of September to help further bolster our research process.

JOHCM UK Opportunities Fund
5 year discrete performance (%)

	30/09/21	30/09/20	30/09/19	30/09/18	30/09/17
A GBP Class	16.22	-7.24	5.68	2.89	4.16
FTSE All-Share TR Index	28.31	-16.51	2.72	5.84	12.62
Relative return	-9.42	11.10	2.89	-2.79	-7.51

Past performance is no guarantee of future performance.
Source: JOHCM/FTSE International/Bloomberg, NAV of Share Class A in GBP, net income reinvested, net of fees as at 30 June 2021. The A Acc GBP class was launched on 30 November 2005. Benchmark: FTSE All-Share TR (12pm adjusted). Performance of other share classes may vary and is available on request.

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