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Capital Management Group

JOHCM UK DYNAMIC FUND

UNDER THE BONNET

Q1 2021 REVIEW

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INVESTMENT BACKGROUND

World equity markets continued their push higher in March as the economic recovery strengthened globally. The JP Morgan Global Composite Output index reached its second highest reading for two-and-a-half years. Growth was led by the US where output rose the most in six-and-a-half years. Both the S&P 500 and Dow Jones Industrial Average total-return indices reached new all-time highs in US dollar terms (+6.2% and +8.3% for Q1 2021, respectively).

Economic growth, high levels of business optimism and continued supply chain disruption put upward pressure on costs globally. Input cost inflation was particularly acute in the US with March's composite PMI recording the fastest increase on record. Correspondingly, US bond yields continued their rise reaching January 2020's levels thereby fully unwinding the declines experienced during the Covid-19 pandemic. These dynamics were a headwind to the valuations of global growth stocks with the NASDAQ 100 total-return index up just +1.5% in March and +1.8% for Q1 2021.

In the UK, flash PMIs showed business activity was back to growth as the roll-out of vaccinations led virus rates to fall to their lowest levels since September and the first phase of lockdown easings began. There were marked changes in confidence with GfK's UK Consumer Confidence index rising to -6.2 versus an expected -12.1 and, within this, confidence over future personal financial health reached its joint highest level ever since the Global Financial Crisis (March 2018 being the other time). Despite these rapidly changing dynamics, analysis from Morgan Stanley* shows that UK equity valuation dispersions remain at levels last seen in the 2000 tech boom.

*Using 10-year average Z-score of earnings-yield, dividend-yield and book-value-yield (UK Equity Strategy Monthly Data Gallery) – Morgan Stanley 7 April 2021

STRATEGY UPDATE

The Fund outperformed in March returning 5.10% versus a 3.73% return by its benchmark, the FTSE All-Share Total Return index (12pm adjusted), and outperformed in Q1 2021 returning 11.24% versus a 5.40% return by the benchmark as operating performance and share price momentum continued to build across the portfolio.

Whist the macro backdrop was a positive tailwind for the share prices of some of the Fund's holdings it was by no means felt across the whole portfolio. Of the Fund's top 20 holdings, eight stocks did not deliver a positive relative contribution in the quarter despite making significant strategic and operational progress. This provided opportunities for the Fund to increase allocations to some of its highest conviction positions and represents latent potential for outperformance going forward. The top 20 positions now account for 74% of the Fund's capital, versus 70% at year-end, reflecting our increasing confidence that this portfolio can continue to outperform.

Barclays and **Aviva** were among the top stock contributors in March and Q1 2021. Although both were beneficiaries of rising bond yields, Aviva's share price rise could also arguably be attributed to the value being unlocked by the new CEO's disposal programme. The announced sale of Aviva Poland in the month completed the planned refocus of the Group's portfolio, with an incredible eight transactions in eight months, generating over £7bn in cash proceeds – c.£1bn higher than some analyst's forecasts.

There were good share price performances from both **ITV** and **WPP** following encouraging Q4 2020 updates accompanied by positive trading outlooks. Importantly, there were also signs of significant progress in their respective digital strategies as both companies continued to demonstrate their ability to build off market-leading positions to create innovative new services, challenging long-standing market concerns of incumbency risk.

An unscheduled trading update from **Crest Nicholson** highlighted once again that analysts continue to underestimate the pace of the strategic turnaround and health of the UK housing market. The Group is now 70% forward sold for FY21 leading to new PBT guidance 15% ahead of consensus. Quite remarkably, shares in the Fund's other housebuilding exposed stock, **St Modwen Properties**, lagged the benchmark for the month and quarter. The Fund increased its position by 30bps over the quarter.

Outside of these, it was mainly idiosyncratic stock specific updates that drove Fund performance with a number of previously rumoured pieces of news flow confirmed. **Aggreko** had its bid from a private equity consortium confirmed at 880p. With the shareholder vote on this nearing, we continue to firmly believe that the price offered materially undervalues the company. Firstly, it lacks any premium to the share price immediately prior to Covid-19. Secondly, the balance sheet has materially improved (despite the pandemic) leaving the company under-levered and capable of material investment, M&A and share buybacks. Thirdly, the earnings growth profile is uniquely geared in, not only to the cyclical recovery, but also the structural growth market for temporary power globally. Lastly, the energy transition is creating further growth opportunities with Aggreko offering its clients innovative, more complex, renewables and battery storage based solutions to reduce their greenhouse gas emissions. We believe the company and management are well set up to add substantial value to all stakeholders by remaining a listed entity and pursuing the numerous strategic opportunities outlined at their capital markets day less than five months ago.

More surprising is that shares in **DMGT** were flat on the month despite confirming that Cazoo will list in the US via a SPAC at a valuation of £5bn. Our sum-of-the-parts valuation now estimates a share price for the group of 1498p, an incredible c.70% upside to today's share price. The Fund's position size has increased 75bps over the quarter through a blend of outperformance and additional share purchases. It remains a top three position for the Fund.

Likewise, it is remarkable to report that shares in **TT Electronics** closed up just 8% relative to the benchmark despite the UK regulator for medicines and healthcare products approving the use and sale of iAbra's rapid Covid-19 screening device, Virolens. Virolens will likely be pivotal in opening up the use of mass transit and large venues in a Covid-19 compliant manner and TT Electronics are the sole manufacturer. Prospective order volumes could be transformational to TT Electronics' earnings.

There was further progress at **Ricardo** with confirmation of the long-awaited US Army HMMWV contract award. This importantly underpins cash flows for the group for at least the next three years making it another important step in this turnaround story. Despite this, the shares unwound half their previous month's gains.

Presentation of the new direct-to-consumer (DTC) strategy at **Pearson** from the new CEO, Andy Bird, demonstrated a step change in the strategic ambitions of the company, putting it on a path to becoming a globally-leading sustainability-focused business. Although shares reacted well on the day, all gains eventually unwound and the shares ended the month flat as the market remained sceptical of the turnaround. The Fund increased its position by 39bps over the quarter.

There was further strategic progress at **Convatec** with significantly increased investment in R&D and a completed reorganisation already leading to Q4 sales ahead of analyst estimates. This also went unrecognised by the market with shares flat relative to the benchmark over the month and down 6% on the quarter. The Fund increased its position by 36bps over the quarter.

Finally, there was a disappointing update from **Provident Financial**, a more recent position for the Fund. It reported that its Consumer Credit Division had received a material increase in consumer complaints about affordability and that the division was being investigated by the FCA. This is a remarkable turn of events given the new management's turnaround strategy was based on there being a strong relationship with regulators following the conclusion of a multi-year review of product affordability and the enactment of a new customer-focused strategy. The Fund has sold its position.

FUND PERFORMANCE

JOHCM UK Dynamic Fund performance (%):

	1 month	3 months	1 year	5 years	10 years	SI annualised
Fund	**5.10**	**11.24**	**40.66**	**41.20**	**117.67**	**9.01**
Benchmark	3.73	5.40	28.76	36.40	79.08	5.83
Relative return[1]	1.33	5.54	9.24	3.52	21.55	3.00

Discrete 12 month performance (%):

	31.03.21	31.03.20	31.03.19	31.03.18	31.03.17
Fund	**40.66**	**-27.03**	**1.99**	**4.24**	**29.40**
Benchmark	28.76	-19.06	5.93	1.36	21.88
Relative return[1]	9.24	-9.85	-3.72	2.84	6.17

Past performance is not necessarily a guide to future performance
Source: JOHCM/Bloomberg/FTSE International. NAV of share class A in GBP, net income reinvested, net of fees, as at 31 March 2021. Inception date: 16 June 2008. Note: Performance data for the period 16 June 2008 to 22 October 2009 is for Ryder Court UK Dynamic Fund. From 23 October 2009 onwards, the Fund converted to JOHCM UK Dynamic Fund. All fund performance is shown against the FTSE All-Share TR Index (12pm adjusted). Performance of other share classes may vary and is available upon request. [1]Geometric relative.

ONE MONTH STOCK RELATIVE CONTRIBUTORS

Top five

Rank	Stock	Relative Return Contribution %
1	London Stock Exchange*	0.45
2	Barclays	0.44
3	Crest Nicholson	0.43
4	Aviva	0.38
5	Rio Tinto*	0.30

Bottom five

Rank	Stock	Relative Return Contribution %
1	British American Tobacco*	-0.26
2	Provident Financial	-0.25
3	Hyve	-0.19
4	Moneysupermarket.com	-0.17
5	DMGT	-0.16

Past performance is not necessarily a guide to future performance
Source: JOHCM/FTSE International/Bloomberg. Figures are at end of day and calculated gross of fees on an arithmetic basis in GBP. All performance is shown against the FTSE All-Share TR Index (12pm adjusted). Data from 28 February 2021 to 31 March 2021. *Stock was not held during this period.

Q1 STOCK CONTRIBUTORS

Top five

Rank	Stock	Relative Return Contribution %
1	Aviva	0.81
2	Aggreko	0.81
3	DMGT	0.78
4	Barclays	0.78
5	Restaurant Group	0.78

Bottom five

Rank	Stock	Relative Return Contribution %
1	Provident Financial	-0.33
2	Melrose	-0.27
3	3i	-0.26
4	Convatec	-0.26
5	Glencore*	-0.19

Past performance is not necessarily a guide to future performance
Source: JOHCM/FTSE International/Bloomberg. Figures are at end of day and calculated gross of fees on an arithmetic basis in GBP. All performance is shown against the FTSE All-Share TR Index (12pm adjusted). Data from 31 December 2020 to 31 March 2021.

FUND WEBINAR | Q1 2021