



# UNDER THE BONNET



JULY 2020 REVIEW

Alex Savvides, Senior Fund Manager

Tom Matthews, Analyst

## INVESTMENT BACKGROUND

Concerns over the pace of the US economy's recovery led the dollar lower in July and, with it, most non-dollar denominated equity markets. JP Morgan's US dollar tradeable currency index (JPMQUSD) fell 2.5% over the month, unwinding all its gains since the Covid-19 outbreak began as US Flash PMIs showed new business demand faltering. Investors sought alternative safe havens leading the gold price to rise 11.0% (+30% year-to-date) and global bond yields to fall with the average bond yield of the 12 largest equity nations (.YLD12 G) reaching an all-time month-end low of 0.96%.

Risk aversion pushed stock correlations to historic highs. Analysis from Bernstein<sup>1</sup> notes the correlation between momentum, growth, quality and low vol factors in the US is approaching +1, whilst their correlation with value is approaching -1. Ironically, they write "this makes the investment outlook fragile."

Outside the US, composite PMIs reached multi-year highs in both China (decade high) and the Eurozone (two-year high). In the UK the flash composite PMI reached a five-year high as new orders rebounded, particularly from domestic customers. Over the month UK domestics were supported further by business-friendly measures in the Chancellor's Summer Budget, UK inflation came in ahead of expectations and Oxford University had breakthrough results in its Covid-19 vaccine trial. Despite this, UK 10-year gilts closed the month at an all-time-low yield of 0.1%.

<sup>1</sup>Source: Portfolio Strategy: We are converging on only one trade – Bernstein (7 August 2020)

## STRATEGY UPDATE

The Fund underperformed the index in July, returning -4.93% versus a -2.68% return by its benchmark, the FTSE All-Share Total Return index (12pm adjusted). With 23 of the Fund's holdings (over 50% of total capital) reporting results over the month, it is quite remarkable only three of these were top five or bottom five contributors to performance, highlighting the wider effect of sentiment on the Fund.

Q1 results from **3i**, the Fund's largest position, were particularly strong. NAV growth was ahead of analysts' forecasts, reflecting a resilient performance across the portfolio. Trading at Action was standout with sales over the last 12 months surpassing those of FY19. 3i have reverted to using a multiple of EBITDA to value its stake in Action meaning future earnings growth will directly translate to NAV growth. The uplift in NAV from Action for Q1 only reflected the cash it generated in the period.

Signs of resilient trading elsewhere in the portfolio went largely unrewarded by the market. Interims from **Travis Perkins** showed strong cash generation and improving end markets with sales run-rates in July close to those of last year. Likewise, **Essentra** had one of its best trading statements in its four-year turnaround with sales run-rates back to previous year levels, further improvements in cash generation and a landmark contract win for its healthcare packaging division to supply the world's leading Covid-19 vaccine.

**Electrocomponents'** Q1 trading showed signs of sequential improvement with June's exit sales rate at -7% versus the -11% for Q1. At **QinetiQ**, despite Q1 trading being impacted, the order book and cash generation remained strong. The strategy also continued to progress as evidenced by the signing of an agreement with the US Defense Counterintelligence & Security Agency (DCSA) to operate all of its US operations under a new Special Security Agreement (SSA) allowing deeper collaborations going forward.

News that **Centrica** will sell Direct Energy at a valuation 50-75% higher than most analysts' sum-of-the-parts valuations was particularly noteworthy. Not only does this underline the hidden value in this company but it also shows decisive action from the new Chair, CEO and CFO in unlocking this for shareholders.

Offsetting this, shares in **Barclays** fell 9% relative to the benchmark despite Q2 results being ahead of expectations on earnings and capital generation. The market chose instead to worry about potential consumer spending headwinds, a scenario that had already led shares to become deeply discounted. Quite remarkably its shares now trade at an all-time low valuation of just 0.3x tangible book value. Shares at **Melrose** declined 22% relative to the benchmark, tracking the decline in FY21 earnings implied by management pushing out their expectations of a recovery in the macro environment, particularly in aerospace. The share price decline ignored that the downgrade to FY22 earnings was only half as severe and cash generation had improved over the period. Shares ended the month trading at 0.65x book value despite no covenant tests until June 2021. On 4th August, this test was waived for another six months. Elsewhere, **ITV's** shares fell 22% relative to the benchmark on no news flow.

## FUND PERFORMANCE

### JOHCM UK Dynamic Fund performance (%):

|                              | 1 month      | 3 months     | 1 year        | 5 years      | 10 years     | SI annualised |
|------------------------------|--------------|--------------|---------------|--------------|--------------|---------------|
| <b>Fund</b>                  | <b>-4.93</b> | <b>-3.17</b> | <b>-28.15</b> | <b>-3.67</b> | <b>87.23</b> | <b>6.77</b>   |
| Benchmark                    | -2.68        | 0.15         | -16.81        | 10.44        | 74.08        | 4.69          |
| Relative return <sup>1</sup> | -2.31        | -3.32        | -13.64        | -12.78       | 7.55         | 1.99          |

### Discrete 12 month performance (%):

|                              | 31.07.20      | 31.07.19     | 31.07.18     | 31.07.17     | 31.07.16    |
|------------------------------|---------------|--------------|--------------|--------------|-------------|
| <b>Fund</b>                  | <b>-28.15</b> | <b>-2.81</b> | <b>10.31</b> | <b>23.86</b> | <b>0.97</b> |
| Benchmark                    | -16.81        | 1.33         | 9.17         | 15.33        | 4.06        |
| Relative return <sup>1</sup> | -13.64        | -4.08        | 1.04         | 7.40         | -2.97       |

#### 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 July 2020. 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. <sup>1</sup>Geometric relative.

## ONE MONTH STOCK CONTRIBUTORS

| Top five |                           |                                | Bottom five |                  |                                |
|----------|---------------------------|--------------------------------|-------------|------------------|--------------------------------|
| Rank     | Stock                     | Relative Return Contribution % | Rank        | Stock            | Relative Return Contribution % |
| 1        | British American Tobacco* | 0.49                           | 1           | ITV              | -0.41                          |
| 2        | 3i                        | 0.44                           | 2           | Melrose          | -0.38                          |
| 3        | Direct Line Insurance     | 0.19                           | 3           | AstraZeneca*     | -0.28                          |
| 4        | Convatec                  | 0.17                           | 4           | Restaurant Group | -0.27                          |
| 5        | Royal Dutch Shell         | 0.17                           | 5           | Barclays         | -0.26                          |

#### 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 30 June 2020 to 31 July 2020. \*Stock was not held during this period.

Source: JOHCM/Bloomberg unless otherwise stated. Issued by J O Hambro Capital Management Limited authorised and regulated by the Financial Conduct Authority. Past performance is no guarantee of future performance. 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. 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 and anyone who acts on it, or changes their opinion thereon, does so entirely at their own risk. The opinions expressed are based on information which we believe to be accurate and reliable, however, these opinions may change without notice. 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.

