JOHCM UK DYNAMIC FUND

UNDER THE BONNET

JANUARY 2021

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REFLECTIONS ON 2020

The global pandemic means 2020 will undoubtedly go down as one of the most remarkable years in modern history, including for financial markets, albeit the wild ride for stocks was of only secondary consequence versus Covid's human cost. On a professional level, 2020 will disappointingly be remembered as the Fund's worst annual performance in its 13-year lifetime.

The year ended on a brighter note: the portfolio outperformed in Q4, returning 24.27% versus a 12.90% return by its benchmark, the FTSE All-Share Total Return index (12pm adjusted), with outperformance also in December (4.56% versus 2.85%). However, the overall year was an unhappy one, with the Fund returning -17.62% versus -9.52% for the index.

Reflecting on the Fund's underperformance in 2020 as a whole, we think it was as much about a lack of enough notable winners as it was about the presence of outsized losers. The difference between the total of the top ten and bottom ten stocks contributing to the Fund's performance in 2020 was just -96bps, a fraction of the total underperformance. We are confident that the underperformance experienced in 2020 represents a matter of timing, rather than a measure of the quality of the portfolio's holdings, and we believe that the Fund is well set up to provide strong outperformance in time.

This is only the fourth time this Fund has underperformed its benchmark on an annual basis. As a measure of how outsized 2020's underperformance was, the *total* of the other three years the Fund underperformed (-403bps in 2011, -102bps in 2015, -136bps in 2017) is equivalent to just 60% of 2020's -895bps. The impact of the outbreak of Covid on the Fund's performance was so marked that Q1's underperformance was 135% of the total underperformance for the whole year. Whilst these numbers by no means serve as an excuse for the Fund's underperformance, they do frame its context. It is worth noting that 2012 and 2016 proved to be some of the Fund's best years at +1296bps and +422 bps, respectively, whilst 2018 was +128bps in what was a very tough market for UK stocks. The darkest hour is often before dawn.

Q1: A FALSE START

2020 did not start well for the Fund, even pre-Covid. There was a profit warning from one of its smallest positions, **SIG**, (subsequently sold), further downgrades at **Elementis** and strong Christmas trading from **Morrisons** that fell on deaf ears as the market worried about continued price deflation. Whilst disappointing with the exception of SIG the effect these had on the Fund's annual performance was only temporary, with concerns over food deflation post-Covid largely evaporating and Elementis receiving three bids in Q4 from Minerals Technologies, albeit these were rejected by the board and the bidder walked away. Whilst it was a poor start, the real impact on performance in Q1 came from the huge divergence in stock prices following the outbreak as the market sought to sift 'winners' from 'losers.'

The Fund's pro-cyclical and pro-UK tilt into this period was undoubtedly unhelpful but by no means outsized. The portfolio positioning resulted not so much from the Conservative Party winning its largest majority in over 30 years two months before, but from the number of under-priced, idiosyncratic business transformation stories that had fallen in to the Fund's investable universe following four years of uncertainty from the US-China trade war *and* Brexit. Having looked like this uncertainty was coming to an end at the beginning of 2020, the pandemic put this in immediate reverse, accelerating in the other direction, with the VIX index, a measure of volatility, closing at its highest ever level on 16 March.

Markets immediately took a dim view of any stock that might be deemed less than high quality and particularly if it had high debt levels and/or was cyclical, both common characteristics of many recovery stories at the time. As we outlined in our Q1 presentation, the share price declines in some of the Fund's stocks suggested the market thought they were un-investable. As it was, only one of the bottom five contributors to the Fund's performance in Q1 actually ended up being a bottom five for the whole year (**The Restaurant Group**).

Q2 & Q3: NO 'WINNERS'

The Fund's continued underperformance in Q2 and Q3 was disappointing, not least because material progress and, in many cases, important strategic announcements by portfolio companies were being ignored by the market. Setting aside the randomness of the Fund not holding a single stock that proved to be a beneficiary of the pandemic and its resultant lockdowns, nearly all the perceived 'winners' in the market resided in more growth oriented digital, ecommerce, technology and biotechnology related areas – not the standard preserve of a business transformation strategy – and therefore difficult for the Fund to even add exposure to during the year. 'Lockdown' winners outside of these sectors might have included Premier Foods, Halfords, Kingfisher, Pets at Home and the gambling stocks. All were considered, but for their own reasons did not meet the Fund's criteria on valuation, quality or liquidity. After all, this is not a fund whose process is to just invest thematically.

With 7% of the Fund's capital in supermarkets **Morrisons** and **Tesco**, there was also already good exposure to abnormal lockdown trading conditions in the Fund. Despite the record like-for-like sales over the period earnings did not follow as management teams, rightly, did not want be seen to be profiteering leading outsized earnings to be reinvested into improving online delivery, safety, wages and repaying the business rates relief. Quite remarkably, both Morrisons and Tesco saw their share prices end 2020 lower in absolute terms whilst Ocado, an elected 'winner' by the market, saw its shares up an extraordinary 80%.

The example of Ocado versus the supermarkets is absurd but by no means unique in 2020. To understand quite how distortive the 'winner/loser' voting machine mentality of the market has become look no further than the UK-listed airline sector. You might ask yourself how the crisis could result in the shares of an airline hitting a new absolute *and* relative high despite EBITDA forecasts for the year falling from £925m to a loss of £25m and capacity in the sector still running at just c30%? Well, this is exactly what has happened at Wizzair. We are sure someone will tell us we don't understand how it is a structural 'winner', but how can this be the correct share price reaction? The executives and board certainly cannot believe their luck and have continued to be large net sellers of their own shares, having done so throughout 2018 and 2019. More stock market millionaires in yet another great misallocation of capital.

KEEPING ACTIVE

Although it is clear Covid has made the world a different place, we do question the depth and duration of some of these changes. As such, we ask how can the market deduce the correct earnings growth rate for any company that is perceived to be a winner from these changes? These are dangerous conditions. There is every chance this is just speculation masquerading, at best, as thematic investing. The outsized returns of the AIM (+22%) and NASDAQ 100 (+49%) over the year illustrate quite how stretched this speculation may have got. Stocks are increasingly being grouped into binary baskets of winners/losers, haves/have-nots, value/growth. The methodology as to how these categories are created is opaque, top-down and purely quantitive, in stark contrast to a Fund that selects stocks from the bottom up and spends much of its time assessing relevant qualitive factors. This thematic/speculative investing has become so distortive that analysis from Morgan Stanley* shows UK equity valuation dispersions in 2020 reached levels last seen in the dotcom boom some 20 years ago. They remain at these levels today.

This Fund has never invested speculatively, thematically or stylistically. As such, this Fund does not invest in just traditional value stocks, having always looked for what it terms Value*plus*; value plus change. Backing relatively cheap companies where management are acting to increase stakeholder value through strategic and business improvements, thereby delivering idiosyncratic returns broadly irrespective of wider macro conditions. It has worked for many years, and we are confident it will work again, but it does mean that these returns often take time to be delivered and, potentially, may lag a pure 'value' recovery. This was the case in 2009, but again, it was just a matter of timing. After all, this is an actively managed Fund and not a value ETF.

The Fund was highly active in 2020. Actively engaged, with 100 meetings with executive teams, 50 meetings with board members – and this does not include meetings with prospective portfolio companies. And, of course highly active in allocating capital. The number of stocks in the portfolio fell from 48 to 45 (44 if we excluded **Urban & Civic**, which is being acquired by Wellcome Trust) and the top 10 positions now account for c. 41% of absolute capital, up from 34% at the beginning of 2020. This process of portfolio concentration will continue and will be the route to this Fund's recovery, just as it was following prior periods of underperformance.

* UK Equity Strategy Monthly Data Gallery – Morgan Stanley 5 January 2021

BUILDING MOMENTUM

The Fund may not have had enough 'winners' in 2020 but that does not mean its future winners have not already been plotting their path to that success. The Fund's outperformance in Q4 demonstrates that momentum is already beginning to rebuild and, most notably, that the undue under-valuation of good companies cannot go on ignored. The Fund received an all-time record three bids in Q4 (**McCarthy & Stone**, Urban & Civic and Elementis). But, it is the strategic momentum exhibited by the Fund's holdings in the year we are most excited about.

They say never waste a good crisis. Whilst Covid can by no means be portrayed as good, the strategic developments delivered by some of the management teams of the Fund's holdings throughout the crisis have been nothing short of exemplary. Demonstrable stakeholder value has been created in the year, and whilst this remains ignored by the market, it represents the possibility of latent performance for this Fund. **DMGT**, **Pearson**, **Convatec**, **Centrica**, **Aviva**, and **St Modwen** may not yet be seen as the market's 'winners', but with their new purposeful management teams and clear strategies we believe it will just be a matter of time. In the meantime, we can only increase your exposure to these names.

TEAM UPDATE

Before we close we would like to update on some developments on UK Dynamic by officially welcoming Siddarth Sukumar (Sid) and Stephanie Geary (Steph) to the team. Sid has been working with us on contract for nearly two years as a junior analyst and has proven himself to be an intelligent, diligent and thought provoking individual. He now becomes a full member of the team as an Analyst. Steph has worked at JOHCM since 2008 and for the past year has been working ever closer with this team in the field of portfolio construction, risk management and data integration. She brings a broad range of skills and to the team and has now joined permanently as an Analyst.

Both are talented individuals, and we are excited and lucky to have them and believe they will drive real value to the Fund and to you as clients. Together we are working to make UK Dynamic better than it has ever been and look forward to the future with confidence; more about this in our forthcoming quarterly update.

We all thank you for your patience during a difficult 2020 and for your continued support.

Alex, Tom, Sid & Steph

FUND PERFORMANCE

JOHCM UK Dynamic Fund performance (%):

	1 month	3 months	1 year	5 years	10 years	SI annualised
Fund	**4.56**	**24.27**	**-17.62**	**25.28**	**99.34**	**8.27**
Benchmark	2.85	12.90	-9.52	28.83	71.56	5.50
Relative return[1]	1.67	10.08	-8.95	-2.75	16.19	2.62

Discrete 12 month performance (%):

	31.12.20	31.12.19	31.12.18	31.12.17	31.12.16
Fund	**-17.62**	**20.82**	**-10.30**	**16.03**	**20.95**
Benchmark	-9.52	19.29	-9.06	13.10	16.05
Relative return[1]	-8.95	1.28	-1.36	2.59	4.22

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 December 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. Inception date: 16 June 2008. [1]Geometric relative.

ONE MONTH STOCK CONTRIBUTORS

Top five

Rank	Stock	Relative Return Contribution %
1	AstraZeneca*	0.49
2	Unilever	0.36
3	DMGT	0.30
4	3i	0.26
5	ITV	0.25

Bottom five

Rank	Stock	Relative Return Contribution %
1	Convatec	-0.27
2	Rio Tinto*	-0.24
3	Prudential*	-0.17
4	BHP*	-0.16
5	Elementis	-0.15

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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 November 2020 to 31 December 2020. *Stock was not held during this period.

Q4 STOCK CONTRIBUTORS

Top five

Rank	Stock	Relative Return Contribution %
1	AstraZeneca*	1.61
2	Barclays	1.01
3	ITV	0.99
4	Urban & Civic	0.95
5	Aggreko	0.88

Bottom five

Rank	Stock	Relative Return Contribution %
1	Royal Dutch Shell	-0.43
2	GlaxoSmithKline	-0.39
3	Glencore*	-0.32
4	Lloyds*	-0.26
5	Morrisons	-0.25

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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 September 2020 to 31 December 2020.