

JOHCM UK DYNAMIC FUND



UNDER THE BONNET



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Q2 2020 REVIEW

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INVESTMENT BACKGROUND

The stock market recovery faltered in June after a reacceleration of coronavirus case growth, primarily in the US and to a lesser extent elsewhere. This led to local lockdowns being reintroduced in some of the worst affected areas. The dreaded second wave has therefore become a reality, although, importantly, death rates remain under control and are not particularly rising with case growth as treatment options continue to improve. The market, being very sensitive to case growth and lockdowns, predictably turned lower as the month progressed and the same trends re-asserted themselves in the market: long Covid-19 winners, short Covid-19 losers.

Global economic data improved as the month progressed and lockdowns eased, with retail spending in particular bouncing back strongly in many countries. Flash PMI data towards the end of the month confirmed a solid recovery in many regions including China, the US, the UK and the eurozone, with some sectors of the economies moving back into expansion. Higher frequency spot data, e.g. payments data and housing transactions, seemed to confirm the recovery. However, given the increased case count, monetary and fiscal policy remained extremely accommodative.

Specific to the UK, trade talks with the EU became an agenda item again as the end of June was the date at which an extension could be requested if necessary. No request was made and talks over the month, although creating a lot of noise, seemed to make progress in the background. Sterling closed the month broadly flat, as did UK 10-year gilt yields despite an increase in QE announced by the Bank of England.

STRATEGY UPDATE

Performance for the quarter as a whole (-278bps relative to FTSE All-Share TR index, 12pm adjusted) although disappointing was unreflective of underlying strategic progress within the Fund at a stock level. It was also somewhat strange when set against the stock market recovery as the quarter began and the early signs of macro recovery as it ended.

Whilst the performance trend did improve through Q2 (-176bps in April, -57bps in May and -46bps in June), the Fund still ended the quarter below where we thought it might.

There were no overwhelming negatives at a stock level to be called out and which would explain the underperformance. Indeed, for the quarter the worst performer was **QinetiQ** (-51bps), which was nothing more than profit taking. Interestingly, the balance of top 10 positive relative contributors minus top 10 relative detractors was a positive 128bps. Typically this would then lead to an outperformance quarter, but not this time.

Anglo American, **Electrocomponents** and **Stock Spirits** were particular positive highlights, but elsewhere there were a long tail of smaller relative underperformers that meant in aggregate the Fund underperformed. The composition of the portfolio has not changed dramatically since the start of the year and is still somewhat sensitive to the economic impact of Covid-19, which is yet to unwind. We believe that this is delayed, not lost, outperformance, not because we are calling the end of coronavirus but because of our confidence in the inherent cash-generating qualities of the assets that sit behind this underperformance.

Turning to June specifically, a month that saw a large number of corporate updates for the Fund, performance again was underwhelming. This was quite surprising given the positive backdrop of re-opening, low valuations and some encouraging current trading statements, albeit in the context of tougher lockdown trading and continued earnings declines.

Crest Nicholson provided the largest stock hit (-40bps relative). Disappointing interim results led to a c.20% share price decline. Numbers missed due to low transactional activity during lockdown, part of which we expect to unwind in H2. Forward price and mix assumptions and associated asset write-downs (despite reasonably strong current trading) also disappointed. NAV estimates fell c. 5%-7%, leaving the shares trading at c.0.6x book value.

Urban & Civic, **St Modwen Properties** and **McCarthy & Stone**, the Fund's other residential property developers, also released trading statements or results over the month. Urban & Civic showed strong strategic progress (even gaining two large new sites during the last few months), but again this was offset by short-term transactional weakness. St Modwen's housing business suffered similarly, but its industrial logistics business continued to outperform and confirms the inherent value in this division. McCarthy & Stone performed admirably during the pandemic to keep its homeowners safe, and we believe as a result will be seen as a net beneficiary from this Covid-19 crisis. None of these share prices has yet to meaningfully recover.

DMGT shares also suffered after slightly disappointing interims where transactional volumes in its property business, advertising sales and circulation within its media business and cancellations in its events business all combined to create short-term earnings downgrades. Whilst the short-term earnings falls from these transactional businesses are disappointing, they are almost completely irrelevant when set against our buy thesis and the inherent value in the overall portfolio, particularly in hidden or undervalued assets like RMS, Trepp and Cazoo.



Indeed the most important piece of news relating to DMGT in June was the fundraising carried out by Cazoo (DMGT holds a 23% stake). The recent fundraising valued the business in excess of US\$1bn. If correctly valued, we need to measure that against the current enterprise value (EV) of the whole of DMGT (c. £1.2bn). More pertinently, if successful, we expect the stake in Cazoo alone to grow to account for the majority of DMGT's current EV over the next few years. Another hidden asset at DMGT.

Electrocomponents's full-year results and outlook statement were both better than expected. The company continues to operate effectively and is taking share in its markets despite the downturn. Analysts had to upgrade forecasts as a result, and we remain high conviction backers of the management.

Euromoney's interim results were better than expected and, for us, draw a line under a turbulent nine month-period that has seen the shares broadly halve. The company has high recurring revenue streams, interesting digital assets, a strong balance sheet, recovery potential from both the events and asset management divisions and a growth division called Fastmarkets that is materially undervalued within the group.

3i Group gave an update on key asset, Action, the leading non-food discount retailer in Europe, at its AGM presentation in late June. After the enforced lockdowns came to an end in Europe, Action's like-for-like trading performance bounced back strongly, being in the mid-teens for the six weeks from May 11th, the date at which all stores were fully reopen. That is four times higher than the budget set for this period at the time of the Action shareholder transaction in November last year. As a reminder, the valuation was taken lower at the full-year results in March (announced in May) given the Covid-19 issues. We believe there is ample evidence for the valuation to move higher again. 3i Group has a solid portfolio of assets that are not excessively geared, anchored around Action and 3i Infrastructure (in combination worth c. £4.5bn, over half the value of the balance sheet), both of which are performing well. There is every reason to believe that the shares should be trading at a premium rather than the current discount to NAV.

In the oil and gas space, despite the strong oil price recovery over the quarter, the Fund's holdings are still suffering from the weak operating environment. **BP** management reduced long-term price assumptions leading to an asset write-off, whilst **Wood** and **Hunting** both had reasonably solid trading statements given the tough environment. The extremely low asset valuations in each case and the rapid transitions of the business models are reasons for optimism.

We are slowly introducing some newer ideas into the portfolio. **SDCL Energy Efficiency Trust** and **Ultra Electronics** over the month, and **PZ Cussons** in addition over the quarter. In the main the capital used to build these positions was taken from cash balances.

There were no major sales over the month, although over the quarter **Lloyds** was sold in order to reallocate to four stocks where we might get the same or similar exposures but with more upside and higher conviction. **Aviva**, **Crest Nicholson**, **Barclays** and **Travis Perkins** were the main beneficiaries of the reallocation.

Whilst the performance outturn for June and for the second quarter was somewhat disappointing, it must be re-emphasised that the outcomes from this portfolio of business transformation investments will be heavily driven by the idiosyncratic effects of longer-term capital allocation and business management decisions rather than the shorter-term earnings effects of Covid-19.

Indeed with the concentration of capital within the portfolio over the last few months, which has seen the effective number of stocks within the portfolio reduce to 31, shorter-term performance against the index may be more volatile. Fund performance may indeed not be defined by the short-term performance of certain external factors, e.g. value or growth, but instead by true underlying business improvements becoming visible to the market. These have their own timeline.

In the meantime, we are engaged at a deeper level than ever with the Fund's investments, particularly where there are issues that need to be addressed. This engagement is to serve various purposes including furthering our own understanding, helping support tough courses of management action, encouraging more dynamic leadership and, in some cases, starting the process of post-Covid-19 board evolution.

We continue to believe that the current portfolio will recover as the year progresses.

FUND PERFORMANCE

JOHCM UK Dynamic Fund performance (%):

	1 month	3 months	1 year	5 years	10 years	SI annualised
Fund	0.25	8.69	-24.00	1.02	112.25	7.27
Benchmark	0.72	11.79	-12.56	14.79	91.61	4.96
Relative return ¹	-0.46	-2.78	-13.07	-12.00	10.77	2.20

Discrete 12 month performance (%):

	30.06.20	30.06.19	30.06.18	30.06.17	30.06.16
Fund	-24.00	-3.40	11.39	31.53	-6.09
Benchmark	-12.56	0.14	8.66	21.37	-0.60
Relative return ¹	-13.07	-3.53	2.51	8.37	-5.53

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 30 June 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. ¹Geometric relative.

ONE MONTH STOCK CONTRIBUTORS

Top five

Rank	Stock	Relative Return Contribution %
1	Anglo American	0.31
2	Aviva	0.25
3	Pearson	0.22
4	AstraZeneca*	0.20
5	Diageo*	0.18

Bottom five

Rank	Stock	Relative Return Contribution %
1	Crest Nicholson	-0.40
2	Prudential*	-0.21
3	Man Group	-0.20
4	ITV	-0.18
5	DMGT	-0.16

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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 31 May 2020 to 30 June 2020. *Stock was not held during this period.

Q2 STOCK CONTRIBUTORS

Top five

Rank	Stock	Relative Return Contribution %
1	Anglo American	0.74
2	HSBC	0.71
3	Electrocomponents	0.62
4	Stocks Spirits Group	0.46
5	Royal Dutch Shell	0.41

Bottom five

Rank	Stock	Relative Return Contribution %
1	QinetiQ	-0.51
2	AstraZeneca*	-0.37
3	BHP*	-0.32
4	DMGT	-0.30
5	Reckitt Benckiser*	-0.28

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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 31 March 2020 to 30 June 2020. *Stock was not held during this period.

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