May 2018
FOR PROFESSIONAL INVESTORS ONLY

J O Hambro Capital Management Group

Under the Bonnet

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Investment background

Equity markets moved higher in April recovering some of the weakness experienced over the prior months. UK indices were particularly strong with the FTSE All-Share Total Return index posting its best monthly performance in almost five years. Strength in the UK was initially led by the consumer services stocks as data showed the first increase in real wages since the financial crisis. The squeeze on real wages ended as UK employment reached its highest level since comparable records began in 1971, pushing year-on-year nominal wage growth up to 2.8% versus a consumer price inflation (CPI) figure of 2.5%, 20bps lower than the prior month. This was a landmark moment for UK consumers.

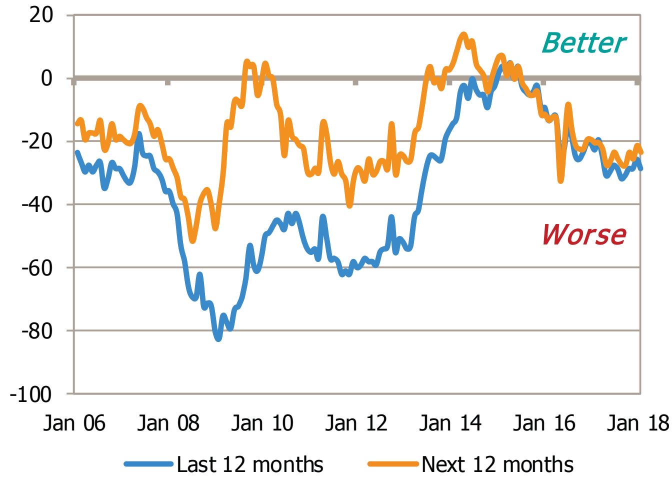
Sadly, though, it proved to be the high point for UK economic data in the month, with the majority of other releases proving to be a little disappointing, albeit heavily weather-affected. Both the UK services and construction PMIs fell short of expectations whilst manufacturing held steady. The Markit services PMI fell to 51.7 in March from 54.5 in February, representing a large slowdown and the weakest performance since July 2016. PMI construction data was even worse, falling to 47.0 from 51.4, being badly hit by the poor weather, although also continuing the weak trend that has been in evidence for much of 2018. In manufacturing, the main bright spot for the UK post the Brexit vote, the PMI was broadly flat month-on-month.

This weak PMI data was followed by poor retail sales data for March, which reported a decline in volumes over the prior month of 1.2%, although fuel sales were down heavily, suggesting a lack of travel activity given snow disruption. Soon after this release Bank of England Governor Mark Carney suggested that there might be "other meetings this year" to raise rates rather than the forthcoming May meeting and as a result sterling began a major reversal from its April high (against the US dollar) of US$1.438.

This reversal accelerated sharply later in the month when Q1 GDP figures were released and indicated a sharp slowdown, coming through at just 0.1% growth for the quarter and lower than recently downgraded expectations of 0.3%. Sterling closed the month 4.3% lower than the mid-month peak at 1.377 in anticipation of GDP forecast downgrades and of no interest rate rise in May.

Whilst it is tempting to blame the data on the very poor weather in March and more generally through Q1, there is undoubtedly a continuing impact from an uncertain UK economic outlook. This uncertainty continues to negatively affect spending patterns in both the corporate and non-corporate sectors. GFK consumer confidence levels dipped lower again in April (having nudged higher in March) and consumers remain pessimistic about the economy over the next 12 months.

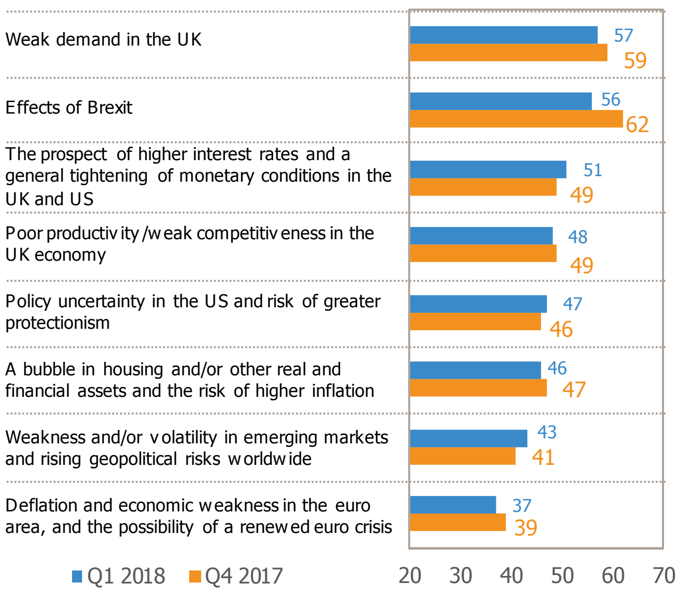
General economic situation of the country



Source: GFK, Consumer Confidence Barometer as at March 2018.

In the UK corporate space the latest Deloitte barometer of CFO spend intentions showed a continuing malaise in corporate risk appetite, with a further decline in the quarter. Interestingly, the report also shows that business optimism has edged up towards its long-term average and following the EU transition deal in March CFOs no longer rate Brexit as the main risk facing their business – the first time in two years – concerns have now been replaced with fears over a weak demand environment in the UK (see below). As we have stated in the last two months' 'Under the Bonnets', confidence remains the missing link for the UK economy.

Risk to business posed by the following factors



Source: Deloitte, The Deloitte CFO Survey as at April 2018.
Note: Weighted average ratings on a scale of 0-100 where 0 stands for no risk and 100 stands for the highest possible risk.

Strategy update

The Fund performed well in April, rising by 7.40% and representing outperformance of 0.58% against the benchmark FTSE All-Share Total Return index (adjusted), which rose by 6.78%. Pleasingly, performance was predominantly driven by stock selection and led by our consumer services holdings, where the Fund has its largest sector overweight. **The Restaurant Group** rose 20% over the month and has now unwound all its year-to-date losses as investors have begun to take note of the changing real wage environment in the UK. As the Fund's sixth largest active position, The Restaurant Group was the largest contributor to performance in the month, aside from the Fund not holding British American Tobacco. The latter's shares significantly underperformed over the month following a profit warning from US peer Philip Morris which highlighted building investor concerns over the sector as sales growth in its next generation product, iQOS, came below expectations and failed to offset declines in traditional combustibles.

Other consumer services stocks that provided a significant contribution to the Fund's performance included **Morrisons** (the Fund's largest active position) and **Tesco**. Tesco shares reached a three-year absolute high following strong full-year results and a re-rating in response to strengthening conviction over longer-term margin targets and potential cash returns, sure signs that the long-awaited turnaround is now on track. Morrison shares recovered from a strangely weak March performance.

It was also a strong month for the oil & gas sector, with the Brent Crude price rising by 7% over the month. The Fund benefited from an overweight position in **BP** and oil services business Hunting, although this was partially offset by an underweight in Royal Dutch Shell. Additionally, **Hunting** posted a strong Q1 trading statement in the month, which detailed activity levels across the core North American onshore markets continuing to strengthen. Offshore markets are also starting to show signs of improvement. Due to continued strong volume growth and pricing improvements and continued tight control of costs, operational gearing was higher than expected and results for the year are expected at the top end of analyst expectations.

QinetiQ had a reasonably strong month after the announcement of an acquisition in Germany – in line with plans to internationalise the business. The acquisition of EIS Aircraft Operations for €70m was marginally earnings accretive and looks a reasonable addition to the group given its exposure to a core existing business line of pilot and aircrew training.

Electrocomponents was the biggest negative contributor (albeit just -19bps) over the month on general profit taking. There were no material negative announcements across the Fund in April.

JOHCM UK Dynamic Fund
5 year discrete performance (%)

Discrete 12 month performance to

	30.04.2018	30.04.2017	30.04.2016	30.04.2015	30.04.2014
JOHCM UK Dynamic Fund	11.48	25.54	-5.98	8.72	19.25
Benchmark	8.40	19.78	-4.99	7.35	10.10
Relative return	2.85	4.81	-1.04	1.28	8.31

Past performance is no guarantee of future performance.

Source: JOHCM/Bloomberg/FTSE International. NAV of share class A in GBP, net income reinvested, net of fees, as 30 April 2018. 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.