J O Hambro Capital Management Group

Under the Bonnet

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Investment background

Equity markets climbed higher in April amid early signs of improving economic conditions in China and as the globally synchronised central bank action of the previous month continued to take hold. Both the S&P 500 and NASDAQ 100 reached all-time highs in the month.

The Caixin China composite output index showed business activity rising at its quickest pace in nine months as manufacturing retuned to expansionary territory and growth in services accelerated. Whilst an upturn in foreign client demand was cited for much of the uplift, the loosening of fiscal and monetary policy in the preceding months plus increasing hopes of a softening in US trade tensions would likely have been significant factors. Hopes of a pick-up in global growth led bond yields to retrace much of their declines from the previous month, with the yield on the US generic 10-year Treasury touching 2.6%, a near 30bp move in less than three weeks.

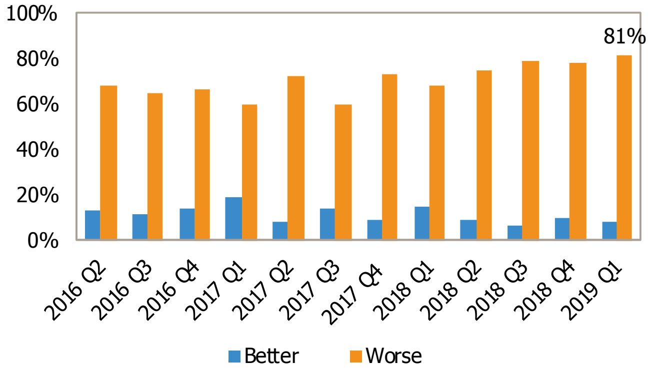
Globally, manufacturing continued to be weak, with no change on the prior month's JP Morgan global manufacturing PMI, which remained just fractionally above neutral at 50.6. The eurozone was once again the source of much of this weakness, with PMIs coming in fractionally below flash estimates and both France, Italy and Germany recording sub-50.0 readings. Operating conditions in Germany deteriorated to the greatest degree in over six years. Likewise in Japan manufacturing demand remained sluggish and output fell at the fastest rate in nearly three years.

The picture was more positive in global services. Recent momentum continued, with the JP Morgan global services PMI reaching its highest level since November 2018 and only France, Australia and the UK seeing decreases in activity. However, there were signs at the end of the month that this growth could also be moderating, with the US flash services PMI falling to a 25-month low as a softer rise in new orders led companies to slow their hiring. This put pressure on global bond yields, leading the US generic 10-year Treasury to close the month with a 2.5% yield.

March's UK services PMI fell to a two-and-a-half year low, demonstrating the marked impact of Brexit uncertainty running up to the 29 March deadline. We openly wondered in October 2018 if negative Brexit sentiment had peaked ('Under the Bonnet', November 2018) as the Q3 2018 Deloitte CFO survey showed 79% of CFOs believing the environment for business would be worse if the UK left the EU. Having fallen in Q4, the percentage rose again to reach 81% in Q1 2019 (see chart below) highlighting quite how marked the worsening in business sentiment was during the survey period (26 March to 7 April 2019). Subsequent news flow in April provided some relief, with Prime Minister Theresa May inviting Labour's Jeremy Corbyn to help find a cross-party solution to the Brexit impasse and EU27 leaders granting an extension to Article 50 until 31 October, thereby defusing nearly all 'hard Brexit' outcomes. This all came against a backdrop of continued UK consumer resilience: ONS UK labour market data showed record breaking employment and activity levels for the three months to the end of February, with regular real pay growth returning to pre-EU referendum levels; IHS Markit's Household Finance index recorded household earnings rising at the fastest rate since the survey began in 2009; and April's GfK consumer confidence index remained unchanged for the second month in a row. Whilst sterling closed the month flat against the euro and the US dollar the more domestically focused FTSE 250 total return index gained 4.2%, outperforming the FTSE 100 total return index's 2.3%. UK gilt yields also followed global bond markets higher but retained much of their gains, closing the month 19bps higher at 1.19%.

Long-term impact of Brexit

% of CFOs who think the overall environment for business in the long term will be better/worse if the UK leaves the EU (excluding those who expect no material change)



Sources: The Deloitte CFO Survey Q1 2019.

Strategy update

The Fund outperformed in April, rising 5.02% versus a 3.16% return by its benchmark, the FTSE All-Share Total Return index (12pm adjusted), representing (geometric) outperformance of 181bps. Performance was equally split between sector allocation and stock selection. The Fund benefited from having large underweight positions in bond-like sectors of healthcare and consumer goods, which underperformed the benchmark as a result of rising global bond yields. Rising bond yields also benefited a number of the Fund's holdings in financials, including **3i, Aviva** (which announced a new CEO) and **Man Group**. Man Group's share price also reacted well to its full-year results announcement that showed assets under management (AUM) ahead of expectations as positive investment performance more than offset a rise in redemptions. **The Restaurant Group** was the Fund's best performing holding in the month as the share price retraced the last two-and-a-half months of decline, aided by an improving investor appetite for UK domestic stocks, two analyst recommendation upgrades and the announcement of a new CEO.

A strong trading update at **Electrocomponents** also helped the Fund. This showed like-for-like revenue growth re-accelerating from 6% in Q3 to 8% in Q4. As detailed previously ('Under the Bonnet', March 2019), whilst cognisant of the Fund's overweight position in industrials, holdings are selected due to their ability to deliver shareholder value through idiosyncratic, self-help characteristics rather than any reliance on the economic cycle. Electrocomponents' results demonstrate not only how it is positioned in structurally growing markets but how management action is enabling the business to outperform in its markets, thereby delivering growth whilst many global peers are experiencing headwinds. The shares have underperformed the Fund's benchmark by near 8% since the end of September 2018, having touched a low of near 25% underperformance in January. Despite this price volatility, FY20 forecasts earnings have actually increased 1% over the same period.

In this context it is disappointing to report that **Elementis**, although technically in chemicals rather than industrials, delivered further downgrades to earnings. A Q1 trading update showed the company continuing to struggle to offset cyclical headwinds in its coatings division, albeit the share price ended the month flat having previously rallied with the sector. A capital markets day for one of the Fund's newer industrial holdings, **Melrose**, was more encouraging, with management raising margin targets in the Auto and Aero divisions of the recently acquired GKN as their confidence has increased over the turnaround potential, irrespective of any cyclical headwinds.

Outside of industrials, there was a strong trading update from **Moneysupermarket,** where revenue growth continued to increase, reaching 12% organic for Q1, due to a good energy switching performance. This is the third consecutive trading statement to show notable progress towards returning the group to above market growth and demonstrates that the strategy laid out by new CEO Mark Lewis is gathering momentum. As we have outlined before (see 'Under the Bonnet', August 2018), there are a significant number of new growth opportunities within this strategy, so we are encouraged to see them beginning to play out.

Full-year results at **Tesco** were also very encouraging, with clear evidence of the cash generation profile of this business continuing to build and with it management's confidence about outlining their capital allocation framework and thus potential for cash returns to shareholders. Shares in **WPP**, a recent position for the Fund, also reacted well to a Q1 trading update that showed signs that trading was beginning to stabilise, albeit it is still very early days in this turnaround story.

Morrisons was the Fund's worst performing stock over the period as the shares continued to soften following the news in February that the Competition and Markets Authority (CMA) was likely to block the merger between Sainsburys and Asda - later confirmed in April. The Fund's ownership of Morrisons has never been predicated on any particular outcome of the Sainsbury's and Asda merger and therefore we so no reason for the shares to be acting as they are. The shares today are now 7% lower against the Fund's benchmark than they were at the time the deal was announced back in April 2018.

Finally, the Fund sold its remaining position in **Britvic** on valuation grounds after holding it for near six years and the stock generating 169bps of relative return over this period.

JOHCM UK Dynamic Fund
5 year discrete performance (%)

Discrete 12-month performance to:

	30.04.2019	30.04.2018	30.04.2017	30.04.2016	30.04.2015
A GBP class	-0.27	11.48	25.54	-5.98	8.72
Benchmark	2.34	8.40	19.78	-4.99	7.35
Relative return	-2.54	2.85	4.81	-1.04	1.28

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 at 30 April 2019. 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.