

JOHCM UK DYNAMIC FUND



UNDER THE BONNET



Alex Savvides, Senior Fund Manager

AUGUST 2021 REVIEW

Tom Matthews, Analyst

INVESTMENT BACKGROUND

Global equity markets continued to move higher in August, led, once again, by large moves in indices with high exposure to growth stocks. The NASDAQ 100 and S&P 500 both made new all-time highs.

These moves came despite global bond yields stabilising after four months of declines (the US generic 10-year yield was +9bps over the month) and despite PMIs globally showing marked slowdowns in expansion amid mounting capacity constraints and the disruption caused by the Delta variant (the flash US composite output index fell to an eight-month low of 55.4).

Valuation dispersions remain marked in the UK. Analysis from Morgan Stanley continues to show UK valuation dispersions at 20-year pre-Covid-19 highs. In addition, the relative valuation of MSCI UK versus MSCI World is currently at a 46% discount across a blend of Price-to-Earnings, Dividend Yield and Price-to-Book value, versus a long run median reading of 18%. The largest discount in Morgan Stanley's 46-year data set.

STRATEGY UPDATE

The Fund outperformed the index in August, returning 3.39% versus a 2.65% return by its benchmark, the FTSE All-Share Total Return index (12pm adjusted). Performance was attributed to stock selection and was broad-based with strong trading updates and further positive M&A activity being the main drivers.

Shares in **Morrisons** moved higher reflecting a raised offer of 285p from CD&R, outbidding an already raised 272p offer from the Fortress-led private equity consortium. It has since been confirmed that this will be concluding via an auction process.

Stock Spirits also received an all-cash offer from private equity at 377p per share, a 41% premium to the previous day's share price. A good outcome for the Fund and a strong endorsement of the turnaround strategy executed by management over the last five years. The strategy, which this Fund backed from the start, delivered a recovery in the core Polish business leading to increases in market share and profitability notwithstanding Covid-19. This resulted in substantial cash generation enabling both bolt-on acquisitions and enhanced shareholder returns. The share price made a marked recovery as both earnings and multiple increased. From an initial entry price of c. 120p five years ago, the shares recently reached 280p, at which point, with questions over future growth being reliant on transformative and returns-dilutive M&A, we decided to exit much of the Fund's position. The bid, when it came, whilst not completely surprising, was a fair offer for the Fund's remaining shares (a 45bp position) and the position was sold in full at a price higher than the current offer.

Aviva's interims confirmed that "at least" £4bn of capital would be returned to shareholders, equivalent to over 25% of the current market capitalisation, with the immediate launch of a £750m share buyback. A significant milestone in the turnaround strategy actioned by the new CEO barely a year ago. Management also committed to reducing debt by £1bn and confirmed cash remittances from the core business were on track to be over £5bn from 2021 to 2023 demonstrating the de-risking profile of this business.

Interims from **TT Electronics** showed not only a step change in trading momentum, with management raising guidance, but also in the transformation of this business to a higher margin, higher visibility and therefore higher quality business. Underlying margins (excluding Virolens investment) increased +170bps to 8% year-on-year, on target to reach over 10%, and FY21 sales are now fully covered by orders with 25-30% cover for FY22. A marked change for one of the lower revenue visibility businesses within the Fund. With £3m invested in start-up costs for Virolens in H1 and a £19m investment in Group WCAP, including an increase in inventories of £9m, consensus estimates for EBIT to only increase c. £11m year-on-year in FY21 and a further £8m in FY22 look well underpinned. The Fund had increased its holding from 100bps to 135bps over the preceding six months as the market continued to underestimate the importance of the growing, higher quality order book being reported by management.

WPP also increased FY21 guidance at its interims to like-for-like (LFL) revenue growth of 9-10% versus c. 7% previously and margins to be at the upper end of the previous 13.5-14% range. Growth in Q2 like-for-like revenues less pass-through costs was WPP's highest on record and above 2019 levels, a year earlier than management expected, as clients reinvested in marketing, particularly in digital media, ecommerce and marketing technology. This activity demonstrates not just the scale of the cyclical bounce back but also the impact of new management's strategy on WPP's ability to continue to win new business dispelling concerns over the structural nature of revenue declines in previous years.

Offsetting this momentum was further weakness in **ConvaTec's** share price following the previous month's interim results. Despite increasing revenue guidance, management moderated expectations on near-term margin progress to reflect some transitory cost pressures. This could prove to be conservative guidance but, at this early stage in the turnaround, it is also demonstrates management's focus on the long term. Messaging has been clear on the importance of investing to create a platform that can deliver growth both globally and sustainably. We see this as just a minor misstep in what is one of the Fund's highest conviction turnaround stories and we have rebuilt the position in to weakness.

Finally, we believe the recent weakness in **Pearson's** share price is misplaced. Given the strategic progress outlined in the previous month's interim results the Fund has increased its position into this weakness.

FUND PERFORMANCE

JOHCM UK Dynamic Fund performance (%):

	1 month	3 months	1 year	5 years	10 years	SI annualised
Fund	3.39	4.49	45.39	38.71	167.43	9.51
Benchmark	2.65	2.89	26.19	32.64	113.13	6.28
Relative return ¹	0.72	1.55	15.21	4.58	25.48	3.05

Discrete 12 month performance (%):

	31.08.21	31.08.20	31.08.19	31.08.18	31.08.17
Fund	45.39	-23.33	-3.92	7.51	20.48
Benchmark	26.19	-12.55	0.18	5.71	13.49
Relative return ¹	15.21	-12.33	-4.10	1.70	6.16

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 August 2021. 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. ¹Geometric relative.

ONE MONTH STOCK RELATIVE CONTRIBUTORS

Top five

Rank	Stock	Relative Return Contribution %
1	Rio Tinto*	0.22
2	Morrisons	0.19
3	Stock Spirits	0.19
4	Centrica	0.18
5	Man Group	0.17

Bottom five

Rank	Stock	Relative Return Contribution %
1	Pearson	-0.41
2	Convatec	-0.36
3	Prudential*	-0.14
4	DMGT	-0.12
5	Meggitt*	-0.11

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 31 July 2021 to 31 August 2021. *Stock was not held during this period.

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FUND WEBINAR | Q3 2021



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The Fund’s investment includes 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.

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.

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