JOHCM UK DYNAMIC FUND

UNDER THE BONNET

Q2 2022 REVIEW


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INVESTMENT BACKGROUND

This quarter marked a small anniversary. On June 16th it was 14 years since this Fund was launched. In that time we as managers have witnessed more extreme events and faced more uncertain periods than we would care to remember. Yet despite all that has gone before, none of it has felt as difficult from an investment perspective as the last few months.

As we entered this year there is no doubt that we were preparing for a change in the investment outlook as inflation took hold in a supply disrupted post COVID world. That change accelerated as the Russian army marched into Ukrainian territory sparking not just a military war but an economic one as well, fought around the battle lines of energy, materials and food supply.

The resulting inflation has been like nothing that many of us have seen since we joined the stock market. In March 2021 the CPI rate was just 0.7%. By the end of June 2021 it was 2.5% and then by September the highest for around 5 years at 3.1%. Having started this year with a CPI rate of 5.4% the data for May announced last month showed the level climbing to 9.1%. This is the highest rate since the series was adopted in 1997 and the Office for National Statistics suggests that, using modelling, the number would last have been higher in 1982. If we use CPIH (including owner housing costs), the rate of 7.9% in May was the highest since April 1991. This was when I got my first taste of the stock markets, doing work experience aged 16. The interest rate at that point was around 10%.

And therein lies the problem. The pace of change has been too fast. Central banks, having flooded the market with liquidity for the last 15 years have been behind the curve. The first small rate increase (15bps) in the UK came in December 2021. Then we had successive rises in February, March, May and June to leave the UK at the end of this quarter with rates at 1.25%. In the US the first move wasn't until March but the seriousness of the situation seems to be catching up with the Fed and in this quarter they moved first by 50bps in April and then in June by 75bps to c. 1.75%, targeting a year-end rate of c. 3.5%.

In this backdrop it is no wonder that markets are in freefall. US and UK 10-year bond yields rose by 67bps and 62bps respectively to end-June at 3.01% and 2.23%, although mid-month both were higher, peaking at 3.47% and 2.65%. The Nasdaq fell by 22% over the quarter, the S&P 500 by 16% and the Dow by 11%. The FTSE World index fell by 13%. In the UK, despite the indices faring relatively better with the FTSE All Share falling by 5%, supported by the relatively more defensive FTSE 100 which fell by just 3.7%, in US Dollar terms the picture was worse with GBP weakening by 7.3% against the dollar over the quarter. GFK UK consumer confidence hit an all-time low in June.

Macro-economic data for the developed world weakened over the quarter, in some cases quite dramatically. Early in June the UK services PMI for May came in at 53.4 down from 58.9, the largest month on month decline outside COVID enforced lockdowns since the survey began in 1996. In the US and Eurozone the PMI readings across both services and manufacturing showed similar slowdowns and the flash US manufacturing index for June fell to 49.6, below the key 50 level. Declining new order activity signalled further declines to come.

The debate is not if there is a recession, but when, for how long and how deep.

STRATEGY UPDATE

Despite the extremely challenging investment backdrop the Fund fared relatively well over the quarter delivering investors a positive relative return of 106bps albeit on an absolute return of -4.5% (against the FTSE All Share index return of -5.5%). Given the hostile conditions, increasingly defensive market positioning and some factor headwinds, we are pleased with the performance.

The positive relative performance was driven by some fairly idiosyncratic stock outcomes, particularly in the industrials sector, whilst the fund underweight to healthcare and consumer goods and general overweight to that same industrials sector provided a headwind as PMI's declined and defensive mindedness set-in.

Before getting on to the performance in detail it is worth noting how positioning of the Fund over Q2 and year-to-date has helped with performance:

1. FTSE 100 positioning: The highest for many years as we entered this year (c.65%). After outperforming in Q1 the FTSE 100 has again materially outperformed in Q2, falling by just 3.7% against 11% for the FTSE 250.
2. Sector positioning: In Q1 we were underweight eight of the top 10 outperforming sub-sectors yet still finished that quarter in-

line with the index. The benefit of that positioning showed through this quarter. As outperformance in basic materials and energy unwound, we did not carry as much of a performance drag.

3. Consumer exposure: Whilst overweight consumer cyclicals, particularly the advertising space via WPP and ITV, the Fund does not have a high direct exposure to general retail or travel & leisure, two sub-sectors that have recently struggled.

Turning to some individual performances, **Euromoney** within industrials was the biggest contributor to relative performance over the quarter, delivering 125bps of relative contribution as firstly interim results were ahead of expectations and secondly the company announced that it had been approached by a private consortium over a potential offer for the company. Regular readers will know that we have built a position based on the clear sum-of-the-parts value within the group. It is interesting that perhaps others have a similar view. This is the 13th potential takeover approach for a UK Dynamic investment since August 2020, covering c. 30% of the portfolio.

Staying within industrials but of a less idiosyncratic nature, **QinetiQ** continued to perform well in response to the invasion of Ukraine which has moved a number of countries to re-consider their defence expenditure in both scope and type. There is talk in the UK for example of increasing to expenditure to 2.5% of GDP. QinetiQ would be a natural beneficiary of increased expenditures. The shares contributed 77bps of relative performance.

Melrose was another industrial to perform reasonably well, bucking the general trend for airline and automotive exposed industrial stocks over the quarter. The shares rose in response to the announced sale of portfolio company Ergotron for £520m, followed by a capital markets day which saw upgraded margin target guidance for the aerospace business and then the confirmation of an accelerated £500m share buyback programme.

Other names worthy of note which positively contributed over the quarter were: **Convatec**, which continues to navigate the tough raw materials environment well and where the transformation programme is having a positive effect on revenue growth; **Vodafone**, which despite minor downgrades continues to be supported by expected portfolio transformation; **Man Group** where fund performance and AUM growth has exceeded expectations over the last year; **Beazley** which continues to grow ahead of expectations in the core cyber insurance business.

On the less positive side **AstraZeneca**, which is not owned by the Fund, was the biggest detractor from relative performance mostly due to its defensive characteristics. The shares have a lot of momentum currently and now represent 7.6% of the FTSE 100 index and trade near their all-time relative highs. It will be interesting to see how GSK's pharma and vaccines business trades post the consumer healthcare spin-out relative to AstraZeneca's c. 16x EV:EBITDA multiple.

Anglo American was the second largest negative contributor, falling with the rest of the sector later in the quarter as recessionary fears took hold leading to lower demand forecasts. However Q1 production numbers were also weaker than expected leading to some guidance cuts and cost increases earlier in the quarter, much of which we expect to be transitory.

Other negative contributors included a number of consumer exposed names, for example 3i Group, which majority owns discount retailer Action, **WPP** a global advertising and marketing communications company, **ITV** the advertising-funded content producer and broadcaster, **Cazoo Group**, the online second hand car retailer (which the Fund owns through the break-up and take-private of DMGT) and A**ston Martin Lagonda** the luxury car retailer (which the Fund had a small position in). Whilst there was little new news in any of these names, multiples applied to these companies have been taken lower in anticipation of trading difficulties to come.

Elsewhere the other situation worthy of note is that of **Shaftesbury**. After announcing talks over a potential merger with Capco in May (instigated by Capco, a c. 25% shareholder in Shaftesbury), the companies announced terms of their agreed all share merger (effectively a takeover of Shaftesbury by Capco) during June. As we have publicly made clear, the terms of the transaction are unattractive to us as Shaftesbury shareholders.

OUTLOOK

The Fund has performed reasonably well thus far in 2022 despite the various headwinds. Pricing power and cost management amongst the Fund's investments has been good and in general has been better than we would have predicted, partially due to a fairly co-ordinated response to put price through. However, the future, if costs stay high, will be trickier as companies balance declining volumes against further cost cuts which may prove more difficult. We expect competition to pick up from here and are aware of the dangers to earnings as we move forward.

To some degree the market is already discounting lower earnings, particularly in the more cyclically exposed sectors. Single digit PE ratios are now more normal to observe than they have been for a number of years. Understanding just how much pricing power and therefore earnings risk there is from here will be the key.

As we move into earnings season no doubt there will be wins and losses as companies discuss the outlook for the more challenging second half of the year. We head into this period with low financial leverage and a cohort of stocks that are performing reasonably well and fighting hard to become better versions of themselves. We face the future with overall confidence.

FUND PERFORMANCE

JOHCM UK Dynamic Fund performance (%):

	1 month	3 months	1 year	5 years	10 years	SI annualised
Fund	**-5.68**	**-4.50**	**1.03**	**12.62**	**138.38**	**8.65**
Benchmark	-6.15	-5.50	1.64	17.05	94.99	5.79
Relative return[1]	0.50	1.06	-0.59	-3.78	22.25	2.70

Discrete 12 month performance (%):

	30.06.22	30.06.21	30.06.20	30.06.19	30.06.18
Fund	**1.03**	**36.30**	**-24.00**	**-3.40**	**11.39**
Benchmark	1.64	21.04	-12.56	0.14	8.66
Relative return[1]	-0.59	12.60	-13.07	-3.53	2.51

Past performance is not necessarily a guide to future performance. The value of an investment can go down as well as up and investors may not get back the amount invested. For further information on risks please refer to the Fund's KIID and/or the Prospectus.

Source: JOHCM/Bloomberg/FTSE International. NAV of share class A in GBP, net income reinvested, net of fees, as at 30 June 2022. 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. Data representative of JOHCM UK Fund (U.K.) onshore OEIC. [1]Geometric relative.

ONE MONTH STOCK RELATIVE CONTRIBUTORS

Top five

Rank	Stock	Relative Return Contribution %
1	Euromoney	0.97
2	Convatec	0.48
3	Melrose	0.25
4	Glencore*	0.23
5	Vodafone	0.22

Bottom five

Rank	Stock	Relative Return Contribution %
1	AstraZeneca*	-0.63
2	Anglo American	-0.62
3	Essentra	-0.23
4	British American Tobacco*	-0.22
5	Land Securities	-0.20

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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. Data from 31 May 2022 to 30 June 2022. Data representative of JOHCM UK Fund (U.K.) onshore OEIC. *Stock was not held during this period.

Q2 2022 STOCK CONTRIBUTORS

Top five

Rank	Stock	Relative Return Contribution %
1	Euromoney	1.25
2	QinetiQ	0.77
3	Convatec	0.45
4	Rio Tinto*	0.39
5	Melrose	0.37

Bottom five

Rank	Stock	Relative Return Contribution %
1	AstraZeneca*	-0.78
2	Anglo American	-0.72
3	3i	-0.58
4	British American Tobacco*	-0.46
5	RS	-0.38

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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. Data from 31 March 2022 to 30 June 2022. Data representative of JOHCM UK Fund (U.K.) onshore OEIC.

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