

JOHCM UK DYNAMIC FUND



UNDER THE BONNET



Q1 2020 REVIEW

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INVESTMENT BACKGROUND

Global equity markets moved sharply lower in March as investors contended with unprecedented conditions: over a third of the world's population in lockdown as total Coronavirus deaths globally rose from 2,977 to 42,309; the largest fall in the oil price since the 1970s as Saudi Arabia entered a price war with Russia; and US jobless claims of 3.3 million versus a previous all-time high of 0.7m in 1982. US equities fell from peak to bear market in just 16 days, quicker than the Great Depression or Great Recession, and the CBOE Volatility Index (VIX) experienced its sharpest rise in history, leading investors to crowd into perceived safe havens and driving the yield on the US generic 10-year Treasury to a new all-time low of 0.32%.

Global policy responses were synchronised and significant, with a combined total of US\$7 trillion in monetary stimulus and US\$5 trillion in fiscal stimulus. Measures were aimed at softening economic hardship and reducing volatility and credit spreads in the debt markets as yields began to rise. Equity markets reacted positively, with the S&P 500 making its largest three-day gain since the 1930s, retracing some of March's losses. In the UK, the FTSE All-Share Total Return index had its worst quarter since 1987 (-25.1%). The FTSE 250 Total Return index significantly underperformed its large-cap counterpart, with its worst quarter on record (-30.7%), as investors unwound post-general election positions. The Bank of England's sterling trade-weighted exchange rate dipped sharply in March to its lowest ever recorded level, only to recover to -1.8% over the month.

STRATEGY UPDATE

The Fund underperformed the index in March, returning -23.33% versus a -15.89% return by its benchmark, the FTSE All-Share Total Return index (12pm adjusted). This closed off the worst quarterly performance for the Fund in its near 12-year history, with a return of -34.85% versus a -25.94% return by the benchmark.

Whilst the FTSE 250 Total Return index underperforming the benchmark (-5.6%) was a significant headwind to the Fund's performance, it was the collapse in valuations of stocks with perceived balance sheet risk, the continued outperformance of earnings momentum stocks, and the lack of general regard for asset valuations that caused the greatest headwinds to performance. At quarter end, 63% of the Fund's holdings had price-to-book ratios of less than or equal to 1.0x, 21% of less than or equal to 0.5x, and no holdings were in breach of covenants.

With 66% of the Fund's holdings having October-January year-ends, we had met with many of the portfolio's management teams over the quarter. We were pleased with strategic progress across the portfolio. But the outbreak of Covid-19 represented a material change of circumstances. The subsequent withdrawal of dividends and guidance by many companies illustrates the unprecedented nature of this situation and, in particular, the uncertainty in forecasting future earnings and cash flows available for distribution.

Predictably the Fund's most indebted holdings (e.g. **Melrose**: -48% versus benchmark in March, 0.6x price-to-book value), and especially those exposed to travel and leisure (**The Restaurant Group**: -53%, 0.5x) and oil and gas (**Wood Group**: -50%, 0.3x) were the most severely punished by the market.

Fund underperformance was mainly attributed to stock selection, with financials accounting for over half of negative stock picking effects over the month and quarter. Within financials it was the Fund's real estate holdings that provided the greatest headwind to performance. The portfolio's two largest holdings, **St Modwen** and **Urban & Civic**, account for c.4% of capital and are now valued at 25-30% discounts to book value, despite being predominantly land-backed, the former having the UK's largest pipeline of logistics 'sheds' and the latter being the most significant partner in helping Homes England achieve its housing targets.

The Fund's marginal overweight in banks (+24bps) also hurt returns. Shares in **Barclays** and **Lloyds Banking Group** fell 24-25% relative to the benchmark over the month, to valuations of 0.3x and 0.7x price-to-book, respectively, as bank equity prices suffered their largest collapse outside of the Global Financial Crisis, according to analysis by Exane BNP.

With so many unknowns remaining with regard to the financial impact of the virus (the length and shape of any recovery, sector-by-sector, country-by-country), we spoke again with another half of our portfolio companies in March to assess management, balance sheet and business model levels of preparedness for all eventualities. We are pleased to see an intense focus on cash throughout and good progress made on extending liquidity headroom and covenants. Whilst we are cognisant of how quickly things are changing, the market's clear disregard for the valuation of the underlying assets of some companies is presenting valuable opportunities for those investors with patience. We will keep you updated with our thinking and encourage you to listen to [our recent update call](#) and [forthcoming Q1 call](#).



## FUND PERFORMANCE

### JOHCM UK Dynamic Fund performance (%):

	1 month	3 months	1 year	5 years	10 years	SI annualised
<b>Fund</b>	<b>-23.33</b>	<b>-34.85</b>	<b>-27.03</b>	<b>-5.62</b>	<b>74.46</b>	<b>6.68</b>
Benchmark	-15.89	-25.94	-19.06	1.25	52.00	4.08
Relative return <sup>1</sup>	-8.85	-12.04	-9.85	-6.79	14.78	2.49

### Discrete 12 month performance (%):

	31.03.20	31.03.19	31.03.18	31.03.17	31.03.16
<b>Fund</b>	<b>-27.03</b>	<b>1.99</b>	<b>4.24</b>	<b>29.40</b>	<b>-5.98</b>
Benchmark	-19.06	5.93	1.36	21.88	-4.42
Relative return <sup>1</sup>	-9.85	-3.72	2.84	6.17	-1.64

#### 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 March 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. <sup>1</sup>Geometric relative.

## ONE MONTH STOCK CONTRIBUTORS

Top five			Bottom five		
Rank	Stock	Relative Return Contribution %	Rank	Stock	Relative Return Contribution %
1	Morrisons	0.72	1	Restaurant Group	-0.97
2	Tesco	0.28	2	AstraZeneca*	-0.89
3	DMGT	0.23	3	Melrose	-0.78
4	QinetiQ	0.21	4	Barclays	-0.73
5	Glencore*	0.20	5	Wood Group	-0.65

#### 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 29 February 2020 to 31 March 2020. \*Stock was not held during this period.

## Q1 STOCK CONTRIBUTORS

Top five			Bottom five		
Rank	Stock	Relative Return Contribution %	Rank	Stock	Relative Return Contribution %
1	Morrisons	0.55	1	Restaurant Group	-1.35
2	QinetiQ	0.40	2	AstraZeneca*	-0.86
3	Royal Dutch Shell	0.40	3	ITV	-0.72
4	Tesco	0.26	4	Melrose	-0.68
5	DMGT	0.23	5	Barclays	-0.67

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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 December 2019 to 31 March 2020. \*Stock was not held during this period.

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