J O Hambro
Capital Management Group

JOHCM UK DYNAMIC FUND

UNDER THE BONNET

OCTOBER 2020 REVIEW

Alex Savvides, Senior Fund Manager

Tom Matthews, Analyst

STRATEGY UPDATE

October provided a reasonable start to the fourth quarter despite tough market conditions. The Fund outperformed its benchmark, the FTSE All-Share Total Return index (12pm adjusted), by 219bps. This outperformance was driven by a marked pick-up in positive news flow amongst the Fund's stocks and some tentative signs of a more favourable market backdrop.

Notable share price performances over the month included **McCarthy & Stone**, which was bid for at a c. 45% premium; **Barclays**, which had good Q3 results; **DMGT**, which benefited from both a resilient full-year trading statement and interesting news from its portfolio company Cazoo; **ITV**, which was supported by growing evidence of an advertising market recovery; and **Aggreko**, which bounced back from a pointlessly weak September.

However, it must be noted that there were a number of other materially positive updates that were not recognised in the monthly performance numbers, as a result of either a strangely fickle and overly picky market and/or being subsumed by certain factor exposures.

Convatec is a great case in point. The company reported a strong third quarter where revenue and margins were ahead of expectations, driving upgrades of c. 7% for the full year. The shares are not particularly expensive in our view, certainly not for what they represent, yet after initially moving higher, they closed the month broadly flat. Whilst this is not a problem per se as they became cheaper for us, it is indicative of an odd market. Perhaps investors had concerns over the US dollar, or healthcare pricing in the US, or maybe it was an expression of disappointment that 2021 wasn't upgraded more. Who knows? In our view, the management team seems to be doing all the right things and the investment characteristics seem to be getting better not worse, so we remain more constructive than the fairly sceptical set of analysts.

WPP is another strange example. Starting the month at 608p, the shares rallied to 669p before closing roughly where they started. This was despite a third quarter that was again ahead of expectations and which again saw some earnings upgrades from the analyst community. Most regions (except China) showed strong recovery trends whilst divisionally, GroupM was a standout performer. Forward guidance, whilst still cautious given ongoing lockdowns, was improved and cost saving targets were upgraded. Shorter-term cash flow may have been a slight disappointment after a marginal downgrade, but this was mostly a timing issue. Again, this offered an opportunity for us to add to our position slightly.

Stock Spirits was also noteworthy for a strong trading performance which was seemingly ignored by the market. Its results for the year to September 2020 were ahead of expectations. The premium spirits manufacturer and distributor focuses on Central Europe, Eastern Europe and Italy and has a good management team that have navigated various challenges well over the last few years. A particular feature of their tenure has been resilient cash flow management. This has seen Stock Spirits' balance sheet end the 2020 financial year essentially ungeared (except for a small amount of leases), despite a bolt-on acquisition programme and increased organic investment. This gives optionality for future M&A but also, we think, an enhanced dividend programme. Being a consumer goods company, the shares are, in our view, cheap on a P/E ratio of c. 12x and EV/EBITDA of c. 7.5x, even adjusting for a higher-than-average beta for their sector.

Elsewhere **Man Group** had strong third quarter numbers, again, ahead of expectations but its shares finished the month lower. Likely this was in response to the news that Stephen Harker, their celebrated Japan large cap equities fund manager, is set to retire next year. Hopefully they are prepared.

The three worst relative performers for the Fund in October were **QinetiQ** (-27bps relative), **Aviva** (-23bps relative) and **The Restaurant Group** (-19bps relative).

Of the three, the performance of The Restaurant Group is perhaps the more easily understood. Interim results released over the month had much to like with the post lockdown performance of its pubs, leisure and Wagamama estate being better-than-expected, and the forward-looking market trends looking much more interesting given a sector-wide supply decline of c. 30%, potentially spelling the end of aggressive price competition and discounting. However, the ongoing weakness in the airports business, combined with the costly restructuring and a set of stale analyst forecasts meant that market EBITDA forecasts, on average, continued to decline after results. With uncertainty remaining over how the business refinances the Wagamama bond in 2022 and renewed lockdowns starting to be implemented nationwide, the shares inevitably fell. Our preference at the moment remains the sale of the pubs business when conditions normalise, in order to focus on the synergies across Wagamama, the leisure estate and concessions.

Aviva's performance in October was very strange. It shares spent much of the month responding to noise around trade negotiations with the EU and general market sentiment around financials rather than anything to do with the company. As we have previously described, Aviva looks to be accelerating its restructuring at pace and is therefore highly attractive to us.

QinetiQ had no news in October but released interim results on the last day of September which broadly confirmed that the business was trading ahead of prior expectations (slightly downgraded post-Covid-19 outbreak) and that the normalisation in their outlook meant that they could reintroduce dividend payments. That the shares were subsequently the worst relative performers for the Fund in October speaks more to sentiment around government spending in the defence sector (assumed to be under pressure given the levels of borrowing to deal with Covid-19) than anything to do with the company.

There were no major portfolio construction changes over the month. Short of cash, given high conviction in the Fund's value credentials, we reluctantly sold the Fund's holding in McCarthy & Stone (after the bid) to reallocate capital elsewhere in the portfolio, but broadly to the same economic exposures. That was c. 150bps of capital reallocation. We also sold some supermarket exposure to buy a little **Unilever**. That represented c. 100bps of capital reallocation on each side.

Other than the portfolio construction element there are a number of things that interest us about Unilever. A new CEO in the last 18 months or so; more change than the market perceives; a re-focus on organic growth; a recovery in emerging markets, food and deodorants; portfolio high-grading work offers margin and valuation upside; underlying margin stability, if not outright growth; the fact that should the legal structure be consolidated in the UK, it would become c. 5-6% of the index; and finally its strong ESG credentials. However, with a c. 1% position the Fund remains underweight.

Extensive value remains in the portfolio. The bid for McCarthy & Stone in October follows a bid for SDL in late August, and, as we write, we have had a bid for **Urban & Civic** in early November. Three bids in 10 weeks is interesting and indicative of how cheap the market for what we do has become.

FUND PERFORMANCE

JOHCM UK Dynamic Fund performance (%):

	1 month	3 months	1 year	5 years	10 years	SI annualised
Fund	**-1.93**	**-3.44**	**-31.02**	**-1.51**	**64.91**	**6.33**
Benchmark	-4.04	-4.56	-18.85	8.66	54.01	4.20
Relative return[1]	2.19	1.17	-15.00	-9.36	7.08	2.04

Discrete 12 month performance (%):

	31.10.20	31.10.19	31.10.18	31.10.17	31.10.16
Fund	**-31.02**	**5.92**	**-2.00**	**20.00**	**14.62**
Benchmark	-18.85	6.78	-1.34	13.29	12.19
Relative return[1]	-15.00	-0.80	-0.67	5.92	2.16

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 October 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. [1]Geometric relative.

ONE MONTH STOCK CONTRIBUTORS

Top five

Rank	Stock	Relative Return Contribution %
1	McCarthy & Stone	0.64
2	Barclays	0.36
3	Aggreko	0.35
4	DMGT	0.29
5	AstraZeneca*	0.26

Bottom five

Rank	Stock	Relative Return Contribution %
1	QinetiQ	-0.27
2	Aviva	-0.23
3	Restaurant Group	-0.19
4	GlaxoSmithKline	-0.17
5	HSBC	-0.15

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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 30 September 2020 to 31 October 2020. *Stock was not held during this period.