



UNDER THE BONNET



Q3 2021 REVIEW

Alex Savvides, Senior Fund Manager

Tom Matthews, Analyst

INVESTMENT BACKGROUND

The macro debate over the month and quarter remained dominated by supply chain disruption, employee shortages and the resulting fears over inflation both real and expected. These issues were augmented in the UK by an energy crisis on two levels – shortages of fuel on the back of distribution bottlenecks but also rising gas prices, which has caused a working capital crisis in the UK energy supply market.

Inflation figures released over the month showed CPIH in the UK rising by 3.0% year-on-year in August, up 0.9% from the month earlier. This is the largest ever recorded change in the CPIH inflation data. Whilst much of the rise was to do with base effects of last August's 'eat out to help out' scheme, underlying inflationary pressures in the UK, and globally, remains high. Employment indicators remain strong with record vacancies, low unemployment (4.5%) and little evidence that the end of the furlough scheme will cause a spike in unemployment. PMI output data globally (as measured by IHS Markit/CIPS) continues to indicate output price pressures with selling price inflation hitting a record high in the UK and rising by the second highest rate on record in the US. The UK MPC continues to see inflation rising to c. 4% but with pressure now slightly to the upside.

Bond yield movements were a strong feature over the quarter, particularly in September and particularly in the UK. 10-year Gilts rose by 31bps or c. 43% to close the month at 102bps. Sterling fell by 2.3% over the month and 2.5% over the quarter with the shorter-term output and inflationary pressures causing shorter-term weakness in GDP expectations and fears of stagflation.

STRATEGY UPDATE

The fund suffered a poor month in September, falling by 2.11% and underperforming the benchmark by 1.71%. Over the quarter the fund marginally underperformed the index by 0.13%. Whilst there were some idiosyncratic issues (**Convatec**, **Pearson** and **Moneysupermarket**), factor movements over the month and quarter are worthy of note.

Growth and Value were the leading style factors in Q3 2021, both rising +0.9%. At the other end of the scale, Dividend Yield, ESG and Quality factors finished the quarter down -4.4%, -1.7% and -1.7% respectively.* The divergence between factor performance was most noteworthy in September, with Quality and Dividend yield finishing the month in deeply negative territory versus a flat return for Value. During September, the fund gave back relative gains made in July and August to end the quarter flat, despite a broadly supportive style factor backdrop from being overweight Value and underweight Quality.

Fund performance in September was affected by three things. Firstly, the energy crisis. Whilst price rises for both oil and gas were supportive of the Fund's holdings in **BP** and **Centrica**, an underweight position in **Royal Dutch Shell**, **Glencore** (which benefitted from the gas crisis through steeply rising coal prices) and the fund's holding in **Moneysupermarket** more than offset the benefits. There was a net 40bps of relative underperformance from these combined positions. Whilst Centrica should be a long-term beneficiary of the gas supply crisis, which has seen an almost halving of the number of suppliers in the last few months, it is likely that Moneysupermarket may suffer from a lost or shrunken profit pool in the energy switching market.

Secondly, performance in September was affected by commodity price declines. This impacted the fund's position in **Anglo American**. Whilst the iron ore spot price 62% index fell by 21.4% affecting the whole sector (and therefore having offsetting benefits for us), the falls in platinum group metals prices caused by the ongoing automotive market crisis had a further negative effect on Anglo American.

Thirdly, performance was impacted by the shorter-term subdued returns from a number of the fund's larger positions (an issue over the quarter as well) for no major reason. This, coupled with a lack of offsetting stock-specific positives, hurt relative returns. **Pearson**, **Vodafone**, **QinetiQ**, **ITV** and **3i Group**, together c. 18% of the fund, all underperformed over the month despite no major news flow. The moves were driven either by shorter-term factor preferences, or by what we think will prove to be minor and fairly transitory items.

Taking into account the broader fund performance over the quarter there were some good strategic positives and results updates, some highly interesting M&A activity but again some shorter-term offsets driven by either cautious guidance, factor preferences or what we consider to be minor or transitory issues.

Dealing first with the M&A, the combination of the bids for **Morrisons**, **Ultra Electronics** and **Stock Spirits** and the potential take private of the rump of **DMGT** were a positive 160bps. The fund has exited positions in all of these names, with the exception of DMGT, where we remain major shareholders and await confirmation of the bidder's intentions before making further comment.

Also worthy of note over the quarter was the performance of **Man Group** and **Tesco** both of which have performed well strategically and upgraded guidance for the year ahead. In the case of Man Group we hope and expect this to be based on more sustainable factors as years of restructuring and investment for growth finally pay-off with the firm positioned in areas of the fund management market that are both differentiated and in-demand. For Tesco, we hope and expect the company to perform well as the powerful combination of a strong

market position in both retail and wholesale combines with elevated demand, competitor pressures and rising food inflation. When you also take into account its strong balance sheet, resilient and strong cash flows, rapidly improving sustainability characteristics and a more shareholder-friendly capital allocation policy, the outlook looks better now than it has for a number of years.

Offsetting these positives were tough performances from **Convatec** and **Pearson** over the quarter, which, in combination, cost the fund 111bps of performance. In both cases, after generally good strategic news flow in the last 6-12 months (particularly for Convatec) expectations were high going into the interim results period. Whilst both companies beat market expectations for the reporting period, cautious commentary over the second half and therefore a lack of an upgrade in earnings had a damaging effect on the share prices of what are two of the fund's higher rated stocks. For Convatec the story was one of increasing revenue growth guidance but distribution and raw material cost headwinds tempering their shorter-term margin expectations. Whilst not dismissing or ignoring the importance of shorter-term cost headwinds, these are more of a general phenomenon and say nothing about the impressive, ongoing turnaround and future growth opportunity. Our conviction remains high on this multi-year turnaround and growth story. For Pearson the issue was one of caution around international enrolment numbers given ongoing Covid-19 lockdowns in some markets and general expectations management from what is still a new management team with a new and, as yet, unproven strategy.

Finally, the quarter saw strangely subdued performances from **ITV**, **Vodafone**, **QinetiQ** and **Crest Nicholson**, which, in combination, cost the fund c.113bps of relative performance. For Crest Nicholson and ITV there may have been a small UK effect. For QinetiQ, concerns over US DOD budgets and general government funding may have weighed on sentiment while Vodafone potentially suffered on the back of fears over rising German capital expenditure, but also an exposure to the dividend yield factor mentioned above. In each case, however, even if these were the issues affecting the stocks, we think they are minor, transient and in most cases borderline wrong or irrelevant. We are particularly interested in the current performance and perceptions of Vodafone. We have engaged deeply with the company and analysts recently (both in the UK and in some important overseas markets) to try to understand market perceptions of the company and the likely outcome of a number of big capital allocation decisions which could have profound implications for both the perception and valuation of the company. Nothing we have learned dissuades us from the view that this is a very cheap and misunderstood share.

*Based on MSCI UK Style Factor Series. Bloomberg tickers: M1GBDY, M1GBES, M1GBEW, M1GBQU, M1GBVOG, M1GBVW, NDUGUK.

FUND PERFORMANCE

JOHCM UK Dynamic Fund performance (%):

	1 month	3 months	1 year	5 years	10 years	SI annualised
Fund	-2.11	2.47	49.19	34.46	175.92	9.28
Benchmark	-0.41	2.60	28.31	31.15	120.62	6.20
Relative return ¹	-1.71	-0.13	16.28	2.52	25.07	2.89

Discrete 12 month performance (%):

	30.09.21	30.09.20	30.09.19	30.09.18	30.09.17
Fund	49.19	-30.55	0.83	6.57	20.76
Benchmark	28.31	-16.51	2.72	5.84	12.62
Relative return ¹	16.28	-16.81	-1.84	0.69	7.24

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 30 September 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	BP	0.26
2	Rio Tinto*	0.18
3	Centrica	0.17
4	BHP*	0.17
5	Barclays	0.13

Bottom five

Rank	Stock	Relative Return Contribution %
1	Anglo American	-0.47
2	Royal Dutch Shell	-0.41
3	AstraZeneca*	-0.33
4	Moneysupermarket.com	-0.24
5	Pearson	-0.20

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 August 2021 to 30 September 2021. *Stock was not held during this period.

Q3 STOCK CONTRIBUTORS

Top five

Rank	Stock	Relative Return Contribution %
1	Morrisons	0.56
2	DMGT	0.49
3	Ultra Electronics	0.37
4	Rio Tinto*	0.35
5	Barclays	0.33

Bottom five

Rank	Stock	Relative Return Contribution %
1	Convatec	-0.60
2	Pearson	-0.51
3	ITV	-0.46
4	Royal Dutch Shell	-0.36
5	Moneysupermarket.com	-0.30

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 30 June 2020 to 30 September 2021.



Find out why we're personally invested in UK equities

Download the J O Hambro UK Profit Index 



J O Hambro
Capital Management Group 

Source: JOHCM/Bloomberg unless otherwise stated. Past performance is no guarantee of future performance. The value of investments and the income from them may go down as well as up and you may not get back your original investment. The information contained herein including any expression of opinion is for information purposes only and is given on the understanding that it is not a recommendation and anyone who acts on it, or changes their opinion thereon, does so entirely at their own risk. The opinions expressed are based on information which we believe to be accurate and reliable, however, these opinions may change without notice. The Fund's investment include 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. Source: JOHCM/Bloomberg/FTSE International. 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. FTSE International Limited ("FTSE") © FTSE 2017. The Industry Classification Benchmark ("ICB") and all rights in it are owned by and vest in FTSE and/or its licensors. "FTSE"® is a trademark of the London Stock Exchange Group companies and is used by FTSE International Limited under licence. Neither FTSE or its licensors accept any liability for errors or omissions in the ICV. No further distribution of ICB is permitted without FTSE's express written consent. JOHCM® is a registered trademark of J O Hambro Capital Management Ltd. Issued and approved in the UK by J O Hambro Capital Management Limited ("JOHCLM") which is authorised and regulated by the Financial Conduct Authority. Registered office: Level 3, 1 St James's Market, London SW1Y 4AH. Issued in the European Union by JOHCM Funds (Ireland) Limited ("JOHCMFI") which is authorised by the Central Bank of Ireland. Registered office: Riverside One, Sir John Rogerson's Quay, Dublin 2, Ireland. JOHCM® is a registered trademark of J O Hambro Capital Management Ltd. J O Hambro® is a registered trademark of Barnham Broom Ltd. Registered in England and Wales under No: 2176004.