JOHCM Continental European Fund APRIL 2023

Q1 2023 MARKET REVIEW

Fund Literature	Fund Facts	Latest Fund Webinar

Rock and roil: Positive returns from challenging markets

The first quarter was a melting pot of significant events, which overall led to another positive return for both the market and the strategy.

Market Review

No free lunch from rising interest rates

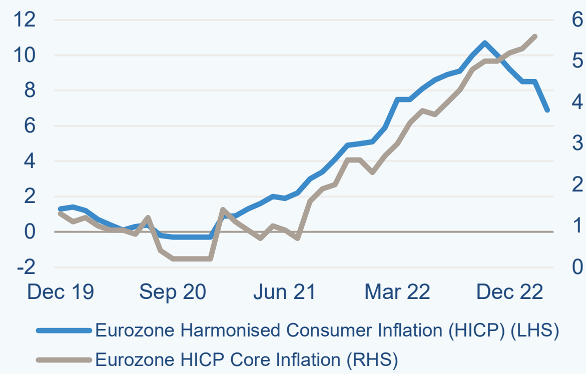
January began with one of the strongest ever starts to the year, with the index rallying by some 7% in euros. European equities have continued to outperform the US and the investor flow picture, after a dire 2022, has seen some increasing signs of optimism.

The focus on inflation and interest rates remained the enduring theme through the quarter. Over the period, we saw the European Central Bank (ECB) raise rates from 2% to 3%, whilst the Federal Reserve increased rates by 50bps to 4.75% at the lower bound. European inflation remained stubbornly high, falling from a 9.2% headline reading in December to 6.9% in March. Meanwhile, there was an ever-greater focus on the core inflation reading, which grew from 5.2% in December to 5.7% in March. When looking at the key moving parts of inflation, we have the falling away of the energy impact but continued strong food price inflation, and most significantly, a growing wages component. Negative real wage growth is naturally encouraging higher wage demands with a particular focus on the public sector, where an increasing number of strikes have been seen. With unemployment remaining at the lows of 6.7%, employers can't bear to risk losing key skilled workers, however, how this develops in the second half of the year remains a key focus.

Up and Over

Headline inflation has peaked but core is still rising.

(% change annualised)



Source: Bloomberg.

Economic momentum has seen a pickup from the fourth quarter and the game changer over more recent times has been the fall in the price of natural gas. Wholesale Dutch one-day forward gas prices having fallen some 50% in December, started the year at €73.5 per MWh and further fell during the quarter to close at €46.9. A combination of a warmer winter, declining gas demand and continued strong LNG imports has led to a remarkable outcome where Europe has exited the winter period with storage levels at around 55% as compared to 26% in March 2022. Therefore, the restocking that needs to take place over the spring and summer months looks

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modest to reach full winter storage for 2023/24. Indeed the situation is so remarkable in its outcome that European storage may become saturated, leading to further falls in gas prices. Naturally, it will take longer for the gas price fall to be seen everywhere in lower electricity prices, not least with the carbon price at high levels, but German baseload prices have fallen from €172 per MWh at the end of 2022 to €107 per MWh now. Arguably, Europe has, in a meteorological sense, been lucky in that it has been able to replace the Russian dependency with such ease, but the good fortune will be replaced by the growing number of new LNG terminals.

Gasping for Gas

Dutch Wholesale Natural Gas. *(Euro/Mwh)*

Source: Bloomberg.

European survey data has been further buoyed by the full post-covid reopening in China at the beginning of January. The message from corporates remains optimistic about China's outlook, and the reopening significantly contributed to the strong market in January. The Eurozone Composite PMI has jumped some 4.4 points YTD to 53.7, driven by the improvement in the services outlook, whilst manufacturing has seen more modest gains. Eurozone GDP forecasts have seen positive momentum through the quarter, after the better-than-expected Q4 reading, from an expectation of the full year 2023 outcome at -0.1% to a current expectation of 0.5% GDP growth. Indeed, in the latest ECB staff forecasts, the expected outcome is 1% for this year and 1.6% for 2024. The combination of the energy tailwind buoying confidence levels, continued strong labour markets and the China reopening have led to a much more positive economic outlook. Market momentum has been helped by the expectation that interest rates are now close to their peak. The earnings picture has moved in step with the optimism, with earnings momentum in Europe moving slightly positive.

March proved to be a much more volatile month, with the effects of quickly rising interest rates moving to the fore. In the US, the vagaries of regulatory laxity became evident with the implosion at Silicon Valley Bank (SVB), Silvergate and Signature, with depositor contagion spreading to the likes of First Republic. The core issue was a lack of access to high quality liquid assets, due to over-exposure to held-to-maturity bonds, at a time of deposit flight from a concentrated depositor base. SVB had approximately 70% of deposits invested in bonds and 80% of these were held-to-maturity, therefore unmarked against equity or capital. SVB had a hugely concentrated, tech-focused, deposit base where 88% of SVB deposits were uninsured and thus over-exposed to depositor flight. We have to be thankful that European regulations apply to both bigger and smaller banks, whilst the strides made on liquidity coverage and stable funding ratios leave the sector in a much more resilient position. Despite this, Europe could not escape the issues at Credit Suisse, a bank not lacking in capital or even particularly liquidity but experiencing a business sustainability issue after client confidence had been impaired. The hastily arranged UBS takeover of Credit Suisse, engineered by the Swiss National Bank and regulator to preserve financial stability, had been much expected, although the wipe-out of the contingent convertible (AT1) debtholders using the Swiss 'viability event clause' caused ructions in funding markets. European bank regulators were quick to emphasise in the credit hierarchy that core Tier 1 equity would take losses ahead of AT1. Ironically both of these incidents occurred when European sector profitability was quickly rebounding, and the

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sector had performed well until early March.

The bond market has shown increasing volatility as the quarter progressed. In the US, we saw significant gyrations with the 2—10 year US Treasury yield curve inverting below 100bps early in March and later in the month, the market saw the largest decline in the 2 year yield since 1987. In the Eurozone, the curve remains slightly inverted, whilst interest rate futures expect rates to be 25bps higher in a year's time versus a rather more significant fall expected in the US.

Q1 saw a highly polarised sector performance. The benchmark was driven by technology & consumer discretionary outperforming by 11% each, communications by 6% and industrials by 3%. Whereas real estate underperformed by 19%, energy by 18%, and both financials and healthcare by 5.5%.

Performance and Key Decisions

Short-term angst, longer-term optimism

Overall, the first quarter was a good one for stock picking for the fund, even though this was reduced by the sell-off in a number of financial positions in March. Allocation was weighed down by our underweight in consumer discretionary, a sector that benefited from China reopening and perceptions that interest rates are at or near a peak. Technology performed well, the Nasdaq saw its best quarter since 2000.

Unicredit made the greatest impact stock wise, after having strong fourth quarter results and benefited from a commitment to a 2023 shareholder distribution similar in size to 2022. Elsewhere ASML was positive, with no substantial change in its robust outlook despite the China export restrictions. CRH performed well, helped by its US infrastructure exposure, which is already seeing a fiscal-led pickup, and the announcement of its desire to have a primary listing in the US.

The contagion in financials in March and concerns over commercial real estate led to a selloff in ASR, but this remains unjustified given its low and largely rural exposure. RWE was weak despite increasing full year profit guidance, mainly driven down by the decline in gas prices.

The largest buys over the quarter were Swatch, Intesa, STMicroelectronics and Orange. The latter remains a key defensive pick against a tougher market backdrop. Trading on 9x PE and a 7% dividend yield, the valuation attraction is set to be realised by the inflection in its cashflow and returns profile. Capex is set to fall from elevated levels as fibre-to-the-home penetration is reaching high levels. The overall sector pricing power is showing some strength, whilst the burden from wage increases is alleviated by the continued cost cutting program.

The key sells were Euronext, ING, Deutsche Bank and Societe Generale. Euronext was sold after management's offer for Allfunds, which we consider a poor strategic choice. Coming on the heels of Euronext's acquisition of Borsa Italiana, we believe neither the balance sheet nor management capacity would be well served by a highly valued pivot of direction at this point in time.

Current Positioning

A Move to a More Defensive Posture

Overall during the quarter, we moved in a more defensive direction. The health care weighting was increased, as were consumer staples and consumer discretionary. Opportunities were presented to buy more Novo Nordisk, Roche and Heineken at attractive valuations.

The financials overweight was reduced to a more neutral position by the end of the quarter. A little more than half of this was undertaken in February, benefitting from the strong run-up in bank share prices. The energy weighting was reduced to an underweight early in the quarter.

Outlook

More alpha than beta

The first quarter has ended with less optimism than the way it began, which is something we all need to

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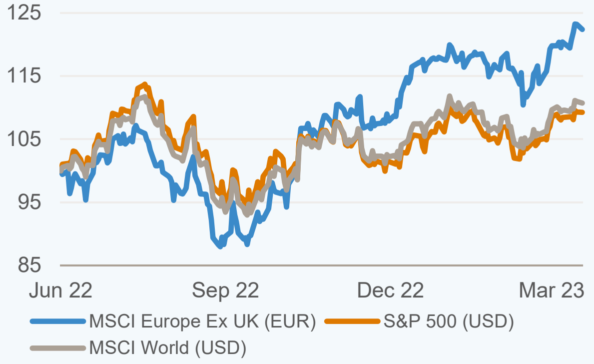
be aware of. Our biggest takeaway of all over recent weeks is the belief that GDP growth will stay constrained for quite some time to come (2023 and 2024) in the developed world. The ECB chief economist recently stated that the rate increase impacts, before the March hike, would weigh on growth by 1.5% per year in 2023 and 2024. The speed of rate rises after such a long period of ultra-low rates will not be without continued casualties. At the margin, Europe will benefit from the fact that the peak rate level will be way below the likes of the US and the UK. The consumer has some cushion from the €900bn (according to the ECB) of post-covid excess savings, but the inflationary picture remains a significant headwind.

Quite Continental

Europe ex UK has outperformed for two quarters running. *(Index: June = 100 USD)*



Source: Bloomberg.

Therefore, we believe one does need to be careful about what type of cyclical stocks are owned. We strongly prefer stocks with a structural, thematic backing, specific policy drivers or particular geographic macroeconomic backing. The Green Deal and the overwhelming focus on energy efficiency are set to be with us for a prolonged period, and the likes of Schneider and Infineon will keep benefitting. CRH will specifically benefit from the policy driven by an uplift in US infrastructure spending, as well as being a terrifically managed company with an engrained mentality of continuous business improvement. On the macroeconomic side, we have sympathy for beneficiaries of China's post-covid reopening; with mobility having been restricted for so long, we expect a leveraged uptick on spending on luxury and entertainment. The overall point is the need to be specific, and this is a time where the choice of the neighbourhood and stock picking itself, are all important.

On the basis that interest rates will keep GDP and earnings lower for longer, we do think buying some reasonably priced defensive exposure to balance the portfolio is a good idea. Over recent weeks we have added to both consumer staples, health care and communications. The overall beta of the portfolio has fallen, and we are taking our risk very selectively at the stock level where fundamentals meet valuation opportunities.

Given recent events, financials remain trickier. On the one hand, Credit Suisse can be viewed as a one-off, the tightness of European regulation has left the sector in a much better place ten years on and rates will probably stay higher for longer. Despite this, we are close to the peak in rates, depositors may get more demanding and events in the US which may continue, would unsettle overall bank appetite. We were fortunate to reduce bank exposure before the recent gyrations and for now, are happy to stay slightly underweight. For choice, we think the insurance sector offers a better risk/reward skew at this point.

I still find the turnaround in the European gas supply situation one of the biggest surprises in my career; for many, Europe had become untouchable, but sentiment has changed. Valuation will remain paramount given interest rate levels, whilst the market is unlikely to be sympathetic to earnings misses. Overall, I see far lower risk in Europe from a market and valuation point of view than I do in the US. The pragmatism embedded in our investment process is paying off and we will continue to seek out reasonably valued European opportunities.

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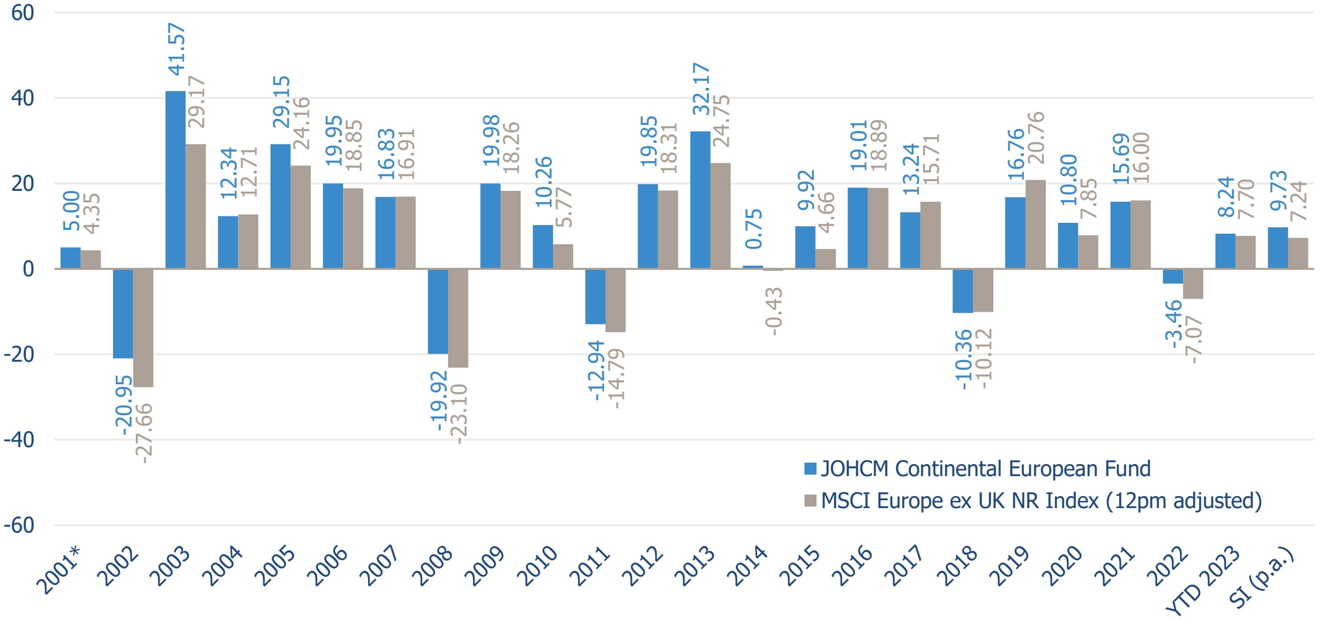
FUND PERFORMANCE

JOHCM Continental European Fund (GBP) (%): 4 November 2001 – 31 March 2023



Periodic performance (%)	1 month	3 month	1 year	3 years	5 years	Since Inception	SI annualised
Fund	**-0.48**	**8.24**	**9.89**	**67.43**	**46.06**	**630.24**	**9.73**
Benchmark	0.18	7.70	7.26	53.17	43.12	346.82	7.24
Relative return[1]	-0.66	0.50	2.45	9.31	2.05	63.43	2.32

Discrete performance (%)	31 Mar 23	31 Mar 22	31 Mar 21	31 Mar 20	31 Mar 19
Fund	**9.89**	**4.86**	**45.30**	**-12.18**	**-0.67**
Benchmark	7.26	5.92	34.81	-8.06	1.64
Relative return[1]	2.45	-1.01	7.78	-4.47	-2.27

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