J O Hambro
Capital Management Group

JOHCM UK DYNAMIC FUND

UNDER THE BONNET

NOVEMBER 2021 REVIEW

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INVESTMENT BACKGROUND

If asset prices were dominated by talk of rate rises in October, November brought a surprise reversal as policy makers, particularly in the UK, adopted a wait and see approach.

Despite mounting evidence that the current bout of inflation might be more than transitory, both the US FOMC and more surprisingly the UK MPC voted against rate rises at their early November meetings. As a result, both the US and UK 10-year bond yields reversed recent course and closed the month at 1.44% and 0.81%, down 11bps and 22 bps respectively and in both cases, at their lows for the month. Sterling, in turn, was weak, falling by c. 4% against the US Dollar.

Macroeconomic data across the globe continued the recent themes of strong customer demand, labour tightness, supply chain difficulties, rising input costs and rising output prices. In the UK, the IHS Markit / CIPS data suggested input prices rose at the fastest rate since the survey began in 1998 and output prices also rose at the steepest rate for c. 20 years. CPI inflation in the UK rose to 4.2% in the 12 months to October, up markedly from the 3.1% reading in September and the highest rate since November 2011. UK labour markets remained extremely tight with unemployment in November falling to 4.3% and vacancies rising to a new record of 1,172,000.

Yet despite all of this, the combination of tightening restrictions in Europe, driven by the current wave of virus infections and the emergence of a new and apparently more mutated strain of Covid-19 meant that interest rate expectations remained in check and markets became more subdued as the month wore on.

STRATEGY UPDATE

Given the wider macro challenges, the difficulty in reading policy makers and the re-emergence of coronavirus fears, November was a tough month for stock markets. The FTSE All-Share TR Index (12pm adjusted) fell 2.3% with a similarly negative performance across most the sub-indices. The Fund fared relatively well, outperforming the index by c. 14bps.

Given falling bond yields and the general 'risk-off' environment, commodity prices fell with Brent crude falling 16% over the month and iron ore falling 14%. Unsurprisingly therefore, the value factor, dominated by Energy and Banks as measured by the MSCI UK Value index, gave back prior month relative gains whilst low volatility and quality factors outperformed. Style trends, volatile all year, are likely to remain unpredictable.

For UK Dynamic, whilst the increase in style volatility has translated into a small increase in the percentage risk contribution from factors in the fund, idiosyncratic risk remains by far the dominant feature. This was evidenced once again in the fund's delivery of a modest relative outperformance, despite what could be viewed as a set of factor headwind conditions (albeit the fund is not currently particularly exposed to energy and financials).

Turning to underlying drivers of performance, **DMGT**, the Fund's largest position at the beginning of the month, was the biggest positive contributor to performance as the Rothermere family settled all pre-conditions to their proposed offer and finally launched the official bid to take the business private. For those unaware, we publically came out against the offer as being too low. On the 2nd December the offer was increased by c. 6% to 270p from 255p (for the remaining assets post cash and Cazoo share distributions) and the acceptance condition was lowered to 50%. We are currently assessing the new offer.

Electrocomponents, **Landsec**, **Vodafone** and **3i Group**, all reasonably large positions (in combination c. 16% of the Fund) contributed a further 79bps of positive relative performance as they all responded to good interim results and strategic developments over the month.

Earnings momentum at **Electrocomponents** continued to surprise to the upside with the company performing well across the globe as a result of an ongoing strategy over a number of years of investing to grow. This investment has paid off extremely well during the pandemic period with evidence of the company continuing to take share in a number of markets as they broaden and deepen their customer offer. The strong performance has recently seen the shares enter the FTSE 100, a position the company has not been in since 2002. This is testament to the fantastic strategic delivery under this management team and board. Having been invested since the very beginning of the turnaround we often ask ourselves if it is time to walk away, but there are very few other management teams that have offered the consistency of delivery of this team (3i Group is the other one in the fund). Despite a valuation now firmly above 20x, strategic momentum remains extremely strong and whilst it is a slightly smaller position than it was (3% vs c. 4%) we remain firm holders.

Landsec, a newer and rather more contrarian position (Electrocomponents and 3i were also highly contrarian when we bought them) performed well in November even despite the re-emergence of lockdown risk. Two major strategic initiatives funded via a strong balance sheet and a set of interim results that showed stability in the tangible NAV were the main drivers of performance. The strategic initiatives were the purchase of an urban mixed-use development business called U+I for an EV of c. £250m and the purchase of a £426m stake (equity and debt) in a highly regarded development in Salford called Media City. Whilst small at first sight, U+I brings with it a number of interesting development projects with a gross development value of c. £6bn and which offer IRR's of low double digits. Landsec also announced the £196m sale of Harbour exchange, a data centre asset in London, to Blackstone at a yield of 3.99%. Combined with stability in the core office and retail portfolio and increasing evidence of a nascent recovery in values for both asset classes, the rational, on message strategic reallocations of capital have fired the starting gun on the Mark Allan strategy for the future of Landsec. The shift to take more, targeted development risk and to recycle capital out of drier assets that are interesting to longer-term capital providers with a lower cost of capital is one we support. With prime office assets in London seeing yields tighten and with evidence building in the UK of both a stabilising environment for retail property assets and potentially increasing values for prime retail assets, the shares (at a continuing 30% discount to NAV) offer both margin of safety and real upside.

On the negative side, **Convatec** was the worst relative contributor at -34bps. There was no negative news flow and, in fact, its Q3 results at the end of October were somewhat better-than-feared after a slight margin warning in September. However, the market remains concerned over the sector's ability to offset ongoing inflationary pressures given the regulated markets of some products. The shares have underperformed materially over the last few months (c.-35% relative) and in combination with big share price falls in Pearson (c. -35% relative) and QinetiQ (c. -25% relative) have presented a c. 300 bps relative performance headwind since the summer. For what it's worth the underlying FY1 EPS forecasts for the three stocks over that period are -6%, -5% and -2%. Hardly the stuff of nightmares.

FUND PERFORMANCE

JOHCM UK Dynamic Fund performance (%):

	1 month	3 months	1 year	5 years	10 years	SI annualised
Fund	**-2.16**	**-4.26**	**22.77**	**27.92**	**155.50**	**8.98**
Benchmark	-2.30	-1.42	15.71	29.55	107.33	6.04
Relative return[1]	0.14	-2.89	6.10	-1.26	23.23	2.77

Discrete 12 month performance (%):

	30.11.21	30.11.20	30.11.19	30.11.18	30.11.17
Fund	**22.77**	**-18.28**	**11.03**	**-3.52**	**19.02**
Benchmark	15.71	-9.72	11.67	-2.33	13.70
Relative return[1]	6.10	-9.48	-0.57	-1.22	4.68

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 November 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. [1]Geometric relative.

ONE MONTH STOCK RELATIVE CONTRIBUTORS

Top five

Rank	Stock	Relative Return Contribution %
1	DMGT	0.47
2	AstraZeneca*	0.39
3	Electrocomponents	0.29
4	Flutter Entertainment*	0.22
5	Prudential*	0.21

Bottom five

Rank	Stock	Relative Return Contribution %
1	Convatec	-0.34
2	Barclays	-0.26
3	Diageo*	-0.23
4	BHP*	-0.15
5	Crest Nicholson	-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 31 October 2021 to 30 November 2021. *Stock was not held during this period.

FUND WEBINAR | Q3 2021

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The Fund's investment includes 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.

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.

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Sources for all data: JOHCM/Bloomberg unless otherwise stated.