Professional Investors Only

J O Hambro Capital Management Group

JOHCM UK Equity Income Fund

Monthly Bulletin: January 2016

Active sector bets for the month ending 31 December 2015

Top five

Sector	% of Portfolio	% of FTSE All-Share	Active %
Financial services	7.89	2.84	+5.05
Construction & materials	6.06	1.15	+4.91
Banks	14.81	10.59	+4.22
Oil & gas producers	13.18	9.83	+3.35
Mining	6.56	3.24	+3.32

Bottom five

Sector	% of Portfolio	% of FTSE All-Share	Active %
Tobacco	0.00	5.16	-5.16
Beverages	0.00	4.46	-4.46
Household goods & home const.	0.59	3.59	-3.00
Equity investment trusts	0.90	3.89	-2.99
Pharmaceuticals & biotechnology	5.38	8.04	-2.66

Active stock bets for the month ending 31 December 2015

Top ten

Stock	% of Portfolio	% of FTSE All-Share	Active %
Aviva	3.95	1.03	+2.92
Vodafone Group	5.45	2.89	+2.56
BP	5.73	3.18	+2.55
AstraZeneca	5.38	2.87	+2.51
Rio Tinto	3.64	1.20	+2.44
DS Smith	2.50	0.18	+2.32
Sainsbury (J)	2.33	0.18	+2.15
HSBC Holdings	7.25	5.15	+2.10
3i Group	2.25	0.23	+2.02
Esure Group	1.90	0.03	+1.87

Bottom five

Stock	% of Portfolio	% of FTSE All-Share	Active %
British American Tobacco	0.00	3.46	-3.46
GlaxoSmithKline	0.00	3.28	-3.28
Diageo	0.00	2.96	-2.96
Reckitt Benckiser Group	0.00	2.30	-2.30
BT Group	0.00	1.96	-1.96

Performance to 31 December 2015

	1 month (%)	Year to date (%)	Since inception (%)	Fund size
JOHCM UK Equity Income Fund	**-1.71**	**0.52**	**170.00**	**£2,524 mn**
Lipper UK Equity Income Median*	-0.47	6.02	125.96	
FTSE All-Share TR Index (adjusted)	-1.39	1.25	115.51	

Source: JOHCM / Lipper Hindsight. NAV per share calculated net of fees, net income reinvested, 'B' accumulating share class in GBP. Performance of other share classes may vary and is available on request. Inception date: 30 November 2004. Index return is net income reinvested, adjusted for 12pm. * Initial estimate for the Investment Association's UK Equity Income sector.

Economic developments

After nine years and a number of false starts, the Federal Reserve finally increased US interest rates. Despite this much-telegraphed and long overdue move, financial markets seem almost as confused about the pace of further monetary tightening as they were beforehand. Most commentators have dismissed the Fed's implied rate of tightening from the path of their published dots as unrealistic, and yet Yellen's language at the press conference was reasonably measured, suggesting that she is determined to move rates back towards 2% in fairly short order unless the economy weakens significantly. She is clearly keen to remove the effective zero rate policy due to the distortions that it has created in capital allocation in many sectors and amongst many asset classes. The US 10-year Treasury yield rose c. 25bp in Q4 to 2.25%.

Interestingly, the US banks immediately increased their borrowing rates but left their deposit rates unchanged, which shows that they already have more deposits than they need and are happy to shed some if necessary. In many respects, this shows how far the banking sector has come in the last few years from a capital and liquidity point of view, which is still not reflected in their modest valuations. US banks like JP Morgan ended the year close to their highs, unlike their UK peers. In the UK, the bank stress tests were, in our view, a major positive that should have been given more credence. The comments by Governor Carney at the press conference after they were published were very transparent:

"All should be clear: there is no new wave of capital regulation coming. There is no Basel IV and the key point again – just to repeat – is they (the banks) are within sight. We're talking about less than one percentage point of capital, arguably 50 basis points of capital that they need to build, the system needs to build, over the course of the next three years. And they've built twice that over the course of the last three quarters…this is a well-capitalised system and it's time to provide that clarity and the clarity of message so that we can focus on other priorities."

The environment for UK banks should be more favourable in 2016 than it has been for the past five years.

Staying with the UK, there appears to have been a moderate slowing of activity in the last few months, particularly in the consumer discretionary sector. Whilst the unseasonably warm weather explains weakness in the clothing sector, elsewhere the reason is less obvious, but trends need to be watched carefully. Employment markets also continue to send slightly contradictory signals. On the one hand, unemployment hit a new low for this cycle at 5.2% (albeit partly boosted by a larger than normal increase in self-employment), but wage growth continued to slow. Wage growth has been restrained by the continued influx of labour from Continental Europe, which has led to a continual increase in supply, partly driven by the relative growth rates and recent currency moves. However, at some stage we would expect this supply to dry up somewhat and for wage growth to re-accelerate during 2016.

Chinese economic data continued to paint an unclear picture: manufacturing surveys remained weak whilst the services PMI hit a 12-month high. China's money supply is also rising strongly (+10%) following the implementation of various stimulus measures. This normally correlates with increased industrial output, which would be a positive given the high degree of negative sentiment around China and dependent sectors (e.g. mining).

Our long-term investment themes are listed below:

1. Implications and response to falling commodity prices;
2. Financials: significantly overweight;
3. Overweight small caps;
4. Domestic UK exposure: remixing exposure;
5. 2014 and 2015 have left a much distorted market: valuation risks;
6. Low leverage still underpriced;
7. Continuing to move slowly 'East' in 2016;
8. Rising bond yields: the winners;
9. Technological change: beware of 'discontinuities' in established business models

Portfolio performance

The market finished the year on a downbeat note, with the FTSE All-Share Total Return Index (12pm adjusted) returning -1.39% in December. The Fund slightly underperformed over the month, returning -1.71%. For the calendar year 2015 the Fund returned 0.52%. This was slightly behind the index return of 1.25%. Relative to its peer group, the Investment Association's UK Equity Income sector, the Fund is ranked top quartile over 10 years and since its launch (November 2004) and second quartile over five years.

The market mix continued to adversely affect our relative performance. Despite bond yields rising over the month, defensive stocks modestly outperformed and mining and oil stocks modestly underperformed. Our own defensives, **Vodafone Group** and **AstraZeneca**, both fared well. In mining, relative performance was helped by not owning Anglo American, which was the weakest name in the sector.

Elsewhere, our two South African-exposed stocks, **Investec** and **Old Mutual**, underperformed by c. 8% following the chaotic changes in finance minister (twice in a matter of days). This reduced confidence in the South African economy and led to a depreciation of the rand. We added to Investec on its share price weakness. Staying within the wider sector, our property names were strong and certain banks started to show some form (**HSBC** being the best example).

Domestic UK exposure performed well, with **ITV**, our bus company stocks **Go Ahead Group** and **National Express Group**, **Sainsbury** and a number of our construction names (e.g. **Ibstock** and **Kier Group**) being notable. **Halfords's** share price was weak on expectations of poor trading resulting from the warm weather (less car maintenance, cleaning, de-icing activity). The likely downgrade should be a one-off event and should normalise next year.

Portfolio activity

We have changed our positioning in the property sector over the last two years in recognition of a maturing cycle and to ensure we stay on top of the valuation risk associated with our residual holdings. The former has meant our aggregate positioning has drifted lower, which is likely to continue to be the case as we move through 2016. In December, we participated in the **New River Retail** placing (which will be consummated early in 2016). New River Retail remains cheap versus its assets, its income flow and the consequent dividend yield. We reduced other holdings to offset this addition.

We continued to increase our banks weighting. As touched on above, the comments by Governor Carney following the results of the bank stress tests that the banking system had enough core tier 1 capital was further evidence that UK banks face a more favourable regulatory and political framework in 2016. We added to our positions in **Barclays** and **Lloyds Banking Group**. We continued to reduce **Intermediate Capital**, one of the Fund's best performers in 2015. We also took some profit in **Aviva**, the Fund's largest position at c. 300bp overweight, and used the proceeds to add to **Standard Life**, which has been weak.

In the construction & building sector we slightly lowered our weighting in brick maker **Ibstock** (to 100bp), reflecting the stock's strong relative performance since the IPO (partly caused by its entry into the FTSE 250 index in mid-December). We also modestly reduced our position in building materials company **Marshalls**.

In mining and oil, we added modestly to our positions in **BG Group** and **BHP Billiton**. Our aggregate overweight in the mining and oil sectors remained around 300bp in each.

In our domestic UK consumer-facing stocks we continued to remix our holdings to lower valuation risk. We reduced our positions in **National Express**, **Headlam** and **ITV**, all of which have performed well and are trading near relative highs. Marshalls, mentioned above, also fits into this category. We also exited our active position in the former **TUI Travel**. We had held this stock for eight years during which time it generated over 300bp of relative performance. The stock has performed well since the merger with TUI AG in December 2014 and now looks fair to full value. A changing capital allocation and dividend framework and a management structure that is shifting away from the old UK management towards a German-centric structure also raise the risk profile. Whilst we reduced our UK consumer exposure on a net basis, partly offsetting these reductions was an increase in our **Halfords** position following continued poor share price performance.

Dividend update

The dividend for calendar 2015 grew by 8.7% ('B' accumulating share class). This is marginally above the last guidance we gave a month ago. Given the more challenging conditions over the last 12 months, we view this as a strong outcome. As regular readers will remember, we generated c. 14% growth in the Fund dividend in 2014, albeit some of this growth was ‘borrowed’ from 2015 because TUI AG paid its 2015 dividend in December 2014 for tax reasons following its merger with TUI Travel. Adjusting for this factor, growth in each of 2014 and 2015 would have been above 10% p.a.

As we highlighted last month, the discrete Q4 dividend (which went ex on 31 December) was lower year-on-year by c. 2%. As we mentioned then, this is entirely a function of phasing intra-year.

Based on the Fund's ('B' accumulating share class) unit price of 270p (as at 31 December 2015), the historic yield for 2015 was 4.7%.

As we discussed in detail last month, our initial guidance for Fund dividend growth for 2016 is for low single-digit growth on the 2015 base.

Outlook

As commented upon in our previous bulletin, 2015 was a frustrating year for the Fund. Performance for the year was slightly below the market return (the size of the relative underperformance varying depending on the unit class). Whilst this is not a materially negative outcome, and in some ways to be roughly in line with the index given the magnitude of the two headwinds highlighted below is a good effort, it is certainly not in line with our aspirations.

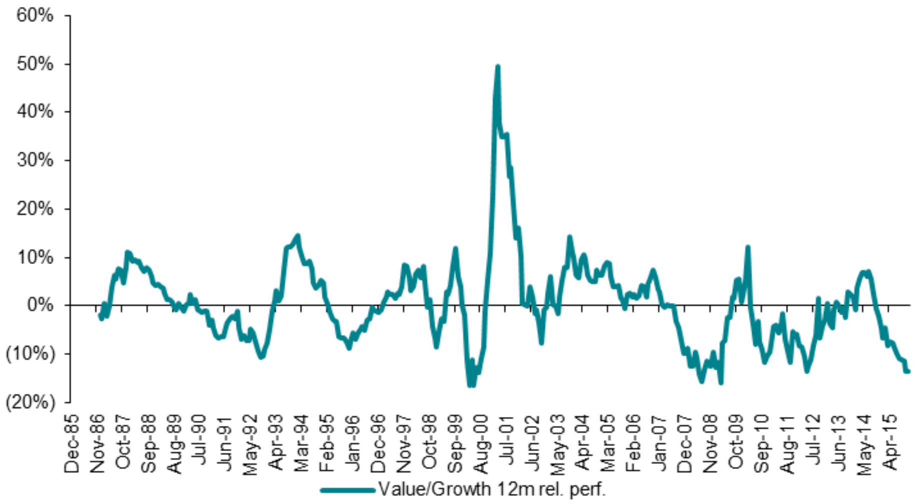
As we said in December, performance has suffered on two fronts: firstly, our underweight exposure to defensive stocks, whose performance was enhanced by the bid for SABMiller (not owned), and, secondly, our overweight position in oil and mining, which we have grown from a neutral position as share prices have fallen over the last 18 months. Taken together, these headwinds more than cancelled out all the positive performance we have generated from stock selection elsewhere in the Fund (which was in line with historic trends at c. 5%).

So why are we feeling measured optimism as we look to 2016?

Firstly, as mentioned earlier, at an aggregate level and adjusting for potential risks, the Fund currently yields 4.7%. This is high in an absolute sense and high relative to the Fund's history and versus other asset classes.

Secondly, the (non-yield based) valuation agenda embedded in what we own is also very attractive on an absolute and relative basis. The chart below shows the relative performance of value versus growth styles using the MSCI Europe Value and MSCI Europe Growth indices. We are at a low point for value versus growth that is similar in magnitude to the distortions seen during the TMT bubble in Q1 2000, post the financial crisis in 2008 and at the height of the eurozone debt crisis. The Fund's relative performance fits very well around this chart, which highlights the headwind faced over the course of 2015.

Growth trumps value in 2015 - relative performance of the MSCI Europe Value vs MSCI Europe Growth



Source: MSCI and BNP Paribas

Thirdly, we expect bond yields to move higher as monetary policy begins the slow and overdue process of normalisation. This will have significant implications for the market mix, when it happens, given the current distortion in the market valuation structure. Specifically, defensive stocks should underperform and financials (especially the banks, where we have a material overweight) and cyclicals should begin to outperform. On banks, the low valuation of the sector, as well as the clear end to 'bank bashing', has finally created a line in the sand from a capital-raising perspective.

Fourthly, we have built our oil and mining overweight as valuations in this part of the market have fallen to multi-decade lows on numerous measures. Along with the valuation angle, our attraction here is based on the market overlooking management actions on capital and operating expenditure. These moves will bring corporate cash flows back into balance at the current lower commodity price levels by 2017. Meanwhile the impact of significant reductions in capex on the supply and demand balance in certain commodities over the next five years is being ignored. On oil specifically, it is worth noting that the sharp fall in oil prices caused by OPEC's decision to increase output exactly a year ago has had a much more severe impact on individual OPEC producers than they would have anticipated at the time (e.g. Saudi Arabia's budget deficit is now running at c.15-20%), even if in some ways the OPEC producers have won the battle, with US$250bn of capex being cut, deferred or cancelled. At some point in the next 12 months, we may see a changed approach from OPEC, but we will definitely start to see the decline in production elsewhere due to the cuts in capex (e.g. US production).

The Fund is full of very cheap, well-placed companies. This is particularly true in small caps, where we remain at our highest weight since the Fund's launch in late 2004; our mid cap exposure, in contrast, is currently somewhat modest.

Collectively, the above points mean that despite, as usual, there being many macro issues to navigate and for the market to fret about – the current list could include China, wider emerging markets, ISIS, Middle East tension and the Brexit vote, amongst others – we view 2016 with cautious optimism. It will always feel wrong to add to positions at the point it is right – for valuation reasons – to do so. We will continue to slowly reposition the Fund out of those areas that have started to look fully priced (e.g. parts of UK property sector and UK domestic exposure), towards more modestly priced parts of the market.

Further information

If you would like further information about the Fund, please call our Investor Relations team on +44 (0) 20 7747 5679, email us at info@johcm.co.uk or visit our website at www.johcm.co.uk.

This document is for professional investors only.

Issued and approved in the UK by J O Hambro Capital Management Limited (the "Investment Manager"), which is authorised and regulated by the Financial Conduct Authority. JOHCM® is a registered trademark of J O Hambro Capital Management Limited. J O Hambro® is a registered trademark of Wilton Holdings Limited. Registered address: Ground Floor, Ryder Court, 14 Ryder Street, London SW1Y 6QB. Registered in England and Wales under No: 2176004. Telephone calls may be recorded.

The information in this document does not constitute, or form part of, any offer to sell or issue, or any solicitation of an offer to purchase or subscribe for Funds described in this document; nor shall this document, or any part of it, or the fact of its distribution form the basis of, or be relied on, in connection with any contract.

Recipients of this document who intend to subscribe to any of the Funds are reminded that any such purchase may only be made solely on the basis of the information contained in the prospectus in its final form, which may be different from the information contained in this document. No reliance may be placed for any purpose whatsoever on the information contained in this document or on the completeness, accuracy or fairness thereof.

No representation or warranty, express or implied, is made or given by or on behalf of the Firm or its partners or any other person as to the accuracy, completeness or fairness of the information or opinions contained in this document, and no responsibility or liability is accepted for any such information or opinions (but so that nothing in this paragraph shall exclude liability for any representation or warranty made fraudulently).

The distribution of this document in certain jurisdictions may be restricted by law; therefore, persons into whose possession this document comes should inform themselves about and observe any such restrictions. Any such distribution could result in a violation of the law of such jurisdictions.

The information contained in this presentation has been verified by the firm. It is possible that, from time to time, the Fund manager may choose to vary self imposed guidelines contained in this presentation in which case some statements may no longer remain valid. We recommend that prospective investors request confirmation of such changes prior to investment. Notwithstanding, all investment restrictions contained in specific Fund documentation such as prospectuses, supplements or placement memoranda or addenda thereto may be relied upon.

Investments fluctuate in value and may fall as well as rise. Investors may not get back the value of their original investment.

Past performance is not necessarily a guide to future performance. Dividend yield quoted is prospective and is not guaranteed.

Investors should note that there may be no recognised market for investments selected by the Investment Manager and it may, therefore, be difficult to deal in the investments or to obtain reliable information about their value or the extent of the risks to which they are exposed.

The Investment Manager may undertake investments on behalf of the Fund in countries other than the investors' own domicile. Investors should also note that changes in rates of exchange may cause the value of investments to go up or down.