J O Hambro Capital Management Group

Leyland's Global Look

Ben Leyland, JOHCM Global Opportunities Fund

Ben Leyland, CFA
Senior Fund Manager
Ben has managed the Fund since launch. He joined JOHCM in 2006 and has 16 years' industry experience.

Robert Lancastle, CFA
Senior Fund Manager
Robert has worked on the Fund since launch. He joined JOHCM in 2012 and has 10 years' industry experience.

Jasmeet Munday, ACA
Analyst
Jasmeet had worked on the Fund since August 2016. He joined JOHCM in 2016 and has 7 years' industry experience.

Caution but not capitulation

An experienced financial journalist put three very sensible questions to me last week: "Why should I own a global equities fund right now? Shouldn't I just avoid the stock market all together? Isn't that why you have nearly 20% cash in your fund? " I have been hearing such questions with increasing frequency on recent marketing trips.

It is certainly a time for investors to exercise caution. But it is too heroic to avoid risk assets altogether in the hope of investing everything at the bottom. The best approach to investing takes a medium to long-term horizon, and the first priority should be to maintain the purchasing power of both capital and income. At a time when inflation is picking up, the protection offered by ownership of a carefully-selected list of high quality companies with pricing power is not to be underestimated. It is preferable, in our view, than having an investment portfolio dominated by bonds, after a long period of spread compression as investors have chased yield in a low rate world.

Overvaluation and overleverage

These are undeniably challenging times to invest in equities. Developed stock markets are close to multi-year highs, led by a euphoric US stock market, which by some measures is now in the longest ever bull market in history. Valuations are stretched, and what is even more problematic is that this is true across the board, unlike say 1999 when it was concentrated in particular sectors. There is no equivalent of the 'old economy' stocks which were genuinely cheap (and defensive) in 1999.

And this is despite there being plenty of reasons to be concerned. The US economy is in distinctly late cycle territory, with the Federal Reserve in interest rate-raising mode while at the same time engaging in quantitative tightening. We have mounting global trade tensions stoked by a highly unpredictable US president, winner-takes-all technology platforms destroying established business models and disrupting industries, economic and political volatility across emerging markets, and the ongoing sweep of political populism in the West. Could any one of these issues explode and be the catalyst to crack developed markets?

Perhaps, but the underlying cause of capital destruction will be the same as it always is: a lack of discipline in financial markets during the good times leading to overleveraged companies and overvalued financial assets. The right question is not "when exactly will this lead to a market downturn?" – it is rather "what insurance can I take out now to protect me from the consequences when (not if) one happens?"

The appeal of asymmetric returns

In this kind of environment it is important to behave cautiously. We don't try to predict what the market is going to do in the next month, quarter or even year – rather we build a portfolio capable of surviving in all environments and thriving in many. Our objective is to participate in rising markets and protect capital in falling ones – and our track record bears this out. Even with a double-digit cash balance there have been phases when we have outperformed rising markets as our alpha has outweighed our low beta. Our motto is "heads we win, tails we don't lose too much". So if markets continue to rally we will do fine, although the narrower the leadership the more likely we are to lag a little. Meanwhile we have a well-established track record of avoiding the areas which lead a downturn.

We find that clients value a performance profile which has a very low correlation with other investment styles, offering something different in their portfolio rather than doubling down on similar strategies to ones they already own.

What clients also appreciate is our highly active approach and our concentrated portfolio. We live in a world increasingly dominated by blunt, passive investment tools which are used to express simplistic, top-down opinions. Anyone who wants solely to time markets is better off using cheap ETFs. Equally it is too difficult to get your market timing right when trading between the two extremes of the equity market: extremely expensive growth stock darlings on one end of the see-saw, and deeply discounted but heavily leveraged and structurally challenged companies on the other. Again, there are now plenty of passive vehicles to allow you to do that.

What we offer is something very different: not just a portfolio of carefully selected, high quality franchises with strong balance sheets and trading at sensible valuations justified by their future cash generation potential, but also a commitment to deploying our cash balance into similar investments as and when opportunities present themselves. Just as it is impossible to call the top of the market, it is equally impossible to call the bottom. The sensible long-term investor uses periods of volatility as a chance to lay down capital for many years to come.

The implications of inflation

What we look for in particular is companies with pricing power. We focus on industries with high barriers to entry, who have in-demand products with few or no substitutes, who can pass on higher prices to their customer base without significantly undermining market share. They will typically have a powerful brand or leading intellectual property, perhaps a dominant distribution network or a set of unique assets, and consequently a sticky customer base.

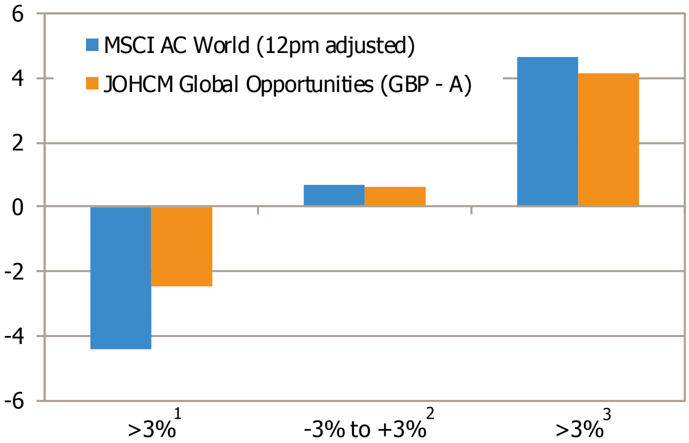
The ability to pass through price is essential in an environment where inflation is picking up. Most companies experience margin compression in a real inflationary environment, such as we saw in the late 1960s and 1970s. This compounds the negative impact of rising discount rates (falling multiples) on equity values.

Meanwhile the impact of inflation on portfolio volatility is profound. Most investors have forgotten this because we have been in a disinflationary environment for so long, in which equities and bonds are negatively correlated – so there is a natural hedge in a balanced portfolio of two asset classes. But for much of history equities and bonds have been positively correlated, because rising inflation and rates were bad for growth and bad for margins. Hence it becomes much more difficult to create a balanced, low-volatility portfolio with two passive asset classes.

The pendulum is slowly turning away from a world which favours passive market timers to one which favours selective, disciplined, active equity managers. As volatility picks up it will become increasingly clear which approach is better at protecting capital in market drawdowns and deploying capital into a world of rising pain but also rising opportunity.

Participation in rising markets, protection in falling markets

JOHCM Global Opportunities Fund performance in different market environments (%)



Downside capture = **64.21%** Upside capture = **81.55%**

Source: JOHCM/Stat Pro as at 30 June 2018 – institutional GBP performance net of fees based on JOHCM Global Opportunities A GBP share class and against the MSCI All Country World NR Index.
[1]Market fall greater than 3%.
[2]Market return between -3% to +3%.
[3]Market gain greater than 3%.

JOHCM Global Opportunities Fund

5 year discrete performance (%)

Discrete 12 month performance to

	31.08.2018	31.08.2017	31.08.2016	31.08.2015	31.08.2014
A GBP Class	7.03	11.25	31.88	10.26	10.56
Benchmark	10.97	18.52	25.64	1.55	12.36
Relative Return	-3.55	-6.13	4.97	8.58	-1.61

Past performance is no guarantee of future performance.

Source: JOHCM/MSCI Barra. NAV of share class A in GBP, net income reinvested, net of fees, as at 31 August 2018. All fund performance has been shown against the MSCI ACWI NR Index (12pm adjusted). Performance of other share classes may vary and is available on request.

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. Issued and approved in the UK by J O Hambro Capital Management Limited, which is authorised and regulated by the Financial Conduct Authority. 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. Registered address: Ground Floor, Ryder Court, 14 Ryder Street, London SW1Y 6QB.