Evenlode Investment View

January 2022 – Review and Outlook

EVENLODE
INCOME FUND

We will, as usual, use this January investment view to discuss the year just passed and share some thoughts on the outlook for the year ahead.

During 2021, trends within the UK stock market were quite choppy but, when all was said and done, vaccination programmes progressed at a rapid rate, the world started to live with the pandemic, the global economy recovered, investor sentiment was positive, and returns were strong. Evenlode Income rose +17.7%, compared to a +18.3% rise for the FTSE All-Share Index and +17.3% for the IA UK All Companies Sector. With another calendar year added to Evenlode Income's life, below are both the fund's year-by-year and cumulative total returns versus the FTSE All-Share.

Year	TB Evenlode Income (B Acc) GBP (%)	FTSE All Share TR (%)	Relative (%)
2009*	+3.2	+2.3	*+0.9*
2010	+20.1	+14.5	*+5.6*
2011	+2.6	-3.5	*+6.1*
2012	+12.5	+12.3	*+0.2*
2013	+26.7	+20.8	*+5.9*
2014	+8.2	+1.2	*+7.0*
2015	+8.4	+1.0	*+7.4*
2016	+17.1	+16.8	*+0.3*
2017	+15.2	+13.1	*+2.1*
2018	+0.4	-9.5	*+9.9*
2019	+24.3	+19.2	*+5.1*
2020	-7.4	-9.8	*+2.4*
2021	+17.7	+18.3	*-0.6*
Total Cumulative	**+290.0**	**+138.3**	***+151.7***
Total Annualised	**+11.8**	**+7.4**	***+4.4***

** From launch (19 October 2009)*

Source: Evenlode, Financial Express, total return, bid-to-bid. Past performance is not a reliable indicator of future results.

Evenlode Income slightly lagged its comparator index, the FTSE All-Share, in 2021: the first calendar year of underperformance since the fund was launched in October 2009. As we have often said before, there is nothing about the strategy that guarantees outperformance every year. The fund is managed using a long-term philosophy, investing in market-leading companies with cash compounding economic characteristics. We think this approach is well suited to long-term income and growth investing across the economic cycle, and we view an appropriate holding period for the fund as five years or more. In periods such as 2021, when the economy is growing strongly, investors are taking on more risk, and asset-intensive sectors such as oil and mining producers are performing well, the fund will tend to struggle to keep up with the UK index. Conversely, in more difficult times, we find that the quality and resilience of Evenlode companies are appreciated by investors, which tends to help the fund's relative performance during such phases.

As the fund bobs around in these waves, we think it's important to keep our eyes on the horizon: remaining focused on the long-term cash compounding potential of the underlying holdings, always within the context of our risk and valuation management framework.

Healthy Operational Performance

Operational progress was good in 2021, with the recovery from the pandemic developing ahead of expectations. Current forecasts suggest that earnings for the aggregate portfolio, having fallen by approximately -10% in 2020, are set to grow by +21% cumulatively over the 2021-2022 two-year period. We have been impressed with the adaptability that portfolio holdings are demonstrating in terms of dealing with recent issues with supply chains and input cost inflation. Few companies are immune from these pandemic-related distortions but the microeconomics, global scale and operational flexibility that the portfolio's holdings enjoy are all helpful when trading through such a volatile period.

The Dividend Recovery

In terms of dividends, the recovery has continued and we now expect the fund's full year dividend growth (to end-February 2022) to be in the high-teens (versus our expectation of around +15% earlier in the year). This suggests a forecast dividend yield of 2.7% (based on current prices) and will bring the fund's dividend stream back to approximately 90% of its pre-Covid level (for context, the UK market's dividend stream is back to approximately 75% of its pre-Covid level at this point). The fund's income stream is well covered by cash generation and this, combined with growth opportunities for underlying holdings, should bode well for real dividend growth prospects over coming years.

Performance Drivers

The most positive contributors to the fund's return for the year were Diageo, RELX and Sage Group. Diageo traded resiliently through the pandemic, despite the impact it saw from intermittent closures of bars and restaurants during the period. The company is also well placed to deal with input cost inflation, thanks to its global leadership in the spirits category and its highly profitable, cash generative business model. RELX and Sage both continued to benefit from structural demand growth for their software and data analytics services, with recent growth accelerating as digitalisation remains a key trend in the global economy. Other notably strong performers within the fund included more economically sensitive businesses such as Savills, Page Group, Howden, Spectris and IMI, and other business models benefiting from structural growth in digital services such as Wolters Kluwer and Microsoft.

The most negative contributors to fund performance were Euromoney, Ashmore and Unilever. Euromoney owns a portfolio of business-to-business media companies. Before the pandemic, approximately 30% of its revenue came from events and this remained a drag during 2021 as Covid restrictions persisted in many regions. Euromoney's events revenues are gradually beginning to recover, and the rest of the company's portfolio is mainly composed of high-quality digital subscription businesses that have performed resiliently through the pandemic. Ashmore has a strong niche in emerging market fixed income management, a very strong balance sheet and good long-term growth prospects. During 2021, sentiment towards emerging market fixed income assets (particularly in China) was depressed, which weighed on the shares.

Unilever shares fell approximately -10% during 2021. The rotation out of more defensive companies and a rapid increase in input cost inflation both contributed to underperformance. The company has subsequently risen to the top of the business pages during January, with management announcing the intention to accelerate its shift towards health, beauty and hygiene categories, and confirming it had approached GSK with an offer for its consumer healthcare business before Christmas (GSK is another large holding in the Evenlode Income fund). Unilever have since announced they will not pursue the deal further, a sensible decision in our view. These events, and subsequent conversations with shareholders, may ultimately prove to be a helpful catalyst for progress at Unilever. Renovating one's product portfolio over the decades is essential for any company (Unilever was mostly a soap and frozen foods company back in the 1960s, for instance). Our preference, though, is for this renovation to be driven by consistent, internally-funded organic investment and focused acquisitions that can be scaled through Unilever's difficult-to-replicate global distribution network.

From a GSK shareholder's perspective, the news is a reminder that an attractive asset will soon be unveiled from its portfolio one way or another, probably via GSK's default plan of a UK-listed demerger in mid-2022. GSK Consumer Healthcare is the market-leader in its industry, with number one global positions in pain relief, respiratory relief and therapeutic oral care (think Panadol, Beechams and Sensodyne).

Nudging the Portfolio

To generalise, we have seen some opportunities during 2021 to use the rotation away from more stable, high-quality companies (which was particularly notable in the first few months of the year) to upgrade the cash compounding potential and resilience of the portfolio without diluting its overall valuation and dividend appeal. The new additions brought in during April and March last year (SGS, Wolters Kluwer and LSE) are good examples of this. They are all highly cash generative, asset-light business models with strong competitive positions and interesting structural growth potential over coming years. On the sell-side, we exited positions in IBM and Intel (April), Paypoint (June), IMI (July) and DMGT (November).

We also made several changes to the weightings of individual holdings during the year. One notable example was increasing the position size of Compass. In our view, Compass has weathered the pandemic's impact very well and is emerging with both a strengthened competitive position and healthy growth potential. Despite pandemic disruptions, the company is back to its normal cash generative ways and has announced a return to dividend payments. Compass is a good case study of 'the strong growing stronger' during a period of adversity.

These changes are examples of our ongoing valuation and fundamental risk management, which results in gradually evolving the portfolio. We call this process 'nudging' the portfolio. We believe it is an important discipline which helps to both optimise return potential and manage risk over time and across the market cycle.

In the first three weeks of 2022, there has been another significant rotation away from more stable, high-quality companies, not dissimilar from the just-mentioned period early in 2021. We are nudging the portfolio to reflect this changing opportunity set and are also monitoring and researching an interesting watchlist of potential new ideas for the fund.

Outlook

Looking ahead, the outlook for the year is as normal complicated. The economic recovery from the pandemic looks set to continue. However, there are question marks. Uncertainty remains over the ways and degree to which the pandemic will disrupt the global economy in 2022. Interest rates are set to rise in many regions of the world which, given global debt levels, may begin to impact recovery, and global economic indicators begun to see a slowdown in recent weeks. Perhaps the biggest discussion point is to what degree current inflationary pressures will ease as Covid-related supply-chain bottlenecks and workforce disruptions begin to resolve themselves.

As normal we do not aim to make any big predictions on the macro-economic outlook. However, it is worth noting that the companies in the Evenlode portfolio tend to enjoy some useful characteristics if inflation were set to remain higher over coming years, including the following:

- Products and services that have enduring and resilient value to customers, whatever the price level and economic situation.
- A strong, embedded relationship with customers (particularly where a change to an alternative product may represent a big hassle and also result in an inferior product).
- Products and/or services that represent a small proportion of the customer's overall expenditure (so any price increases matter less to the customer).
- High gross profit margins (the higher the gross profit margin, the less prices need to be put up to offset input cost inflation).
- Asset-light economics (to avoid any price increases being absorbed by a commensurate increase in inflating capital expenditure and working capital requirements).

Evenlode Income also has a bedrock of repeat-purchase cash flow, a helpful characteristic if inflation and global economic growth don't turn out to be as strong as consensus opinion is currently expecting.

Evenlode Investment View

January 2022 – Review and Outlook

EVENLODE
INCOME FUND

Growth Opportunities and Valuation Appeal

We think our portfolio holdings are exposed to several attractive multi-year structural themes and we will continue to emphasise companies that can harness these growth opportunities within the portfolio. They include, among others: the drive for digitalisation and data analytics; efficiency and adaptability; sustainability; health and safety; hygiene; and the continuing rise of the global middle-class.

UK-listed global companies, with exposure to growth opportunities such as these, remain modestly valued in general. The global stock market (and particularly certain areas of the US market which represents a large percentage of it) has been driven in part by earnings but, in the most part, by rising valuations during the course of the pandemic. In contrast, the Evenlode Income portfolio's current free cash flow yield is 4.8%, unchanged relative to December 2019. This feels to us like a healthy starting point for the long-term investor.

I'd like to wish you all the best for the coming year and let's hope we see a continuation of the 'return to normality' over coming months. We look forward to updating you regularly as the year progresses, and please do get in touch if you have any questions.

Hugh, Ben, Chris M and the Evenlode Team
19th January 2022

Please note, these views represent the opinions of Hugh Yarrow as of 19th January 2022 and do not constitute investment advice.

Where opinions are expressed they are based on current market conditions, they may differ from those of other investment professionals and are subject to change without notice. This document is not intended as a recommendation to invest in any particular asset class, security or strategy. The information provided is for illustrative purposes only and should not be relied upon as a recommendation to buy or sell securities.

For full information on fund risks and costs and charges, please refer to the Key Investor Information Documents, Annual & Interim Reports and the Prospectus, which are available on the Evenlode Investment Management website (https://evenlodeinvestment.com). Recent performance information is also shown on factsheets, also available on the website.

Past performance is not a guide to future returns. The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested. Fund performance figures are shown in Pound Sterling, inclusive of reinvested income and net of the ongoing charges and portfolio transaction costs unless otherwise stated. The figures do not reflect any entry charge paid by individual investors.