

Evenlode Income Investment View



April 2022 – First quarter results

Macro-economic and geopolitical factors converged to create a complex backdrop for financial markets in April. The Russia-Ukraine conflict has dragged on inexorably, food and energy prices remain very high, interest rates and bond yields are rising globally, and Covid-related lockdowns continue to impact a significant proportion of China's population. Global stock markets fell, not helped by this confluence of challenges. The US stock market (and technology shares in particular) led the way lower.

The UK stock market (and Evenlode Income) bucked this global trend somewhat. Evenlode Income rose +1.9% during the month compared to a rise of +0.3% for the FTSE All-Share and a fall of -1.2% for the IA UK All Companies sector.

Year-to-date, Evenlode Income has fallen -3.0% compared to a rise of +0.8% for the FTSE All-Share and a fall of -6.0% for the IA UK All Companies sectorⁱ

First quarter results

In last month's investment view we discussed 2021 results for portfolio holdings, which we found reassuring given the many complex operational challenges that the year presented. During April, most of the portfolio has subsequently released first quarter trading updates which, in aggregate, continue to paint a healthy picture. More than half of portfolio holdings have released a trading statement, with average year-on-year revenue growth for the quarter running at +15%.

Structural tailwinds

What is driving this performance? First, structural growth drivers (and the investments that portfolio holdings are making behind these growth opportunities) continue to provide a helpful tailwind. Digitalisation trends remain strong for instance, with Microsoft's +18% revenue growth an example of this opportunity. As Microsoft management puts it, all companies are software companies now. On Microsoft's results call, CEO Satya Nadella also noted that software investment remains a key investment priority in a more inflationary environment: *"I don't hear of businesses looking to their IT budgets or digital transformation projects as the place for cuts. If anything, some of these projects are the way they're going to accelerate their transformation because in an inflationary environment, the only deflationary force is software"*.

Economic recovery

Second, current levels of growth are being helped by the ongoing post-Covid economic recovery, which has been broad-based but has been particularly noticeable in sectors that were more impacted by the crisis. Specialist global recruiter Hays, for instance, saw quarterly fees rise 32% year-on-year, leaving fees at a level +11% higher than the equivalent pre-Covid quarter in 2019. Management noted that client and candidate confidence remained strong with continued skill shortages and rising wage inflation globally. Skills in certain sectors such as technology, life sciences, sustainability and supply chains are in particularly high demand.

Evenlode Income Investment View



April 2022 – First quarter results

Pricing power

Third, companies are raising prices to help offset input cost inflation. Only about 20% of the portfolio released trading updates that included profit growth as well as revenue growth. The sample size is therefore low, but to help give a flavour of current profitability dynamics, this subset of holdings posted revenue growth averaging +20%, with profit lagging behind at the (albeit still healthy) level of +16%.

In last month's investment view, we discussed some 'Evenlode' characteristics that are helpful in an inflationary environment (including high gross margins, loyal customers, low product cost relative to customer expenditure, and asset-light economics). It has been reassuring to see this 'theory' translate into 'practice' during recent results. In the consumer branded goods sector PepsiCo, for instance, posted organic revenue growth of +14% as prices were raised and volumes remained robust. For the three other main holdings in the sector releasing April trading updates, quarterly organic revenue growth was +10% for Procter & Gamble, +7% for Unilever and +6% for Reckitt. PepsiCo management noted at recent results that: *"...our categories have always performed pretty well during inflationary times...as a result our performance has been pretty inflation-resistant as well as recession-resistant"*. PepsiCo's 50 years of consecutive dividend increases underlines this point in a more quantitative manner.

Resilience and long-term growth

It is worth mentioning this characteristic of economic resilience with reference to the broader portfolio.

In the context of the recent slowdown in global economic indicators, we find the bedrock of repeat-purchase cash generation that underpins the fund's cash generation a comfort. 77% of the Evenlode Income portfolio is invested in businesses that the Evenlode Team categorises as having below average economic sensitivity. Only 14% of the portfolio is invested in businesses that are categorised as having above average economic sensitivity, with these more cyclical businesses having, on average, a very strong balance sheet with no net debt. The portfolio's current construction does not reflect a short-term prediction on how the economic environment will unfold. Rather, it reflects our through-cycle, long-term approach to risk management: we like the bedrock of the portfolio's cash generation to be produced by relatively stable cash generators at *all times*.

Interestingly, stable cash generation has not been particularly in-fashion with investors over the last eighteen months, as the global economy recovered from Covid and Mr Market looked to take on more risk and economic sensitivity. We discussed this dynamic in, for instance, our June 2021 investment view *Unfashionable Resilience*. We think the portfolio's current free cash flow yield of 4.8% and dividend yield of 2.6% help to illustrate this point.ⁱⁱ

Looking ahead, our focus remains on curating a portfolio of competitively advantaged businesses with the ability to produce resilient compounding free cash flow growth over the long-term, and through a wide variety of economic conditions.

Hugh, Ben P, Chris M, and the Evenlode Team
30 April 2022

Evenlode Income Investment View



April 2022 – First quarter results

Please note, these views represent the opinions of Hugh Yarrow and the Evenlode Team as of 30 April 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.

Source: Evenlode Investment Management Limited, authorised and regulated by the Financial Conduct Authority, No. 767844.

ⁱ Source: Evenlode Investment, Financial Express, total return, bid-to-bid, 31 December 2021 to 30 April 2022.

ⁱⁱ Source: Evenlode Investment, FactSet.