Evenlode Investment View

April 2021 – Long-Term Themes

EVENLODE
INVESTMENTS FOR LIFE

Though coronavirus cases have been rising in certain geographies (India, Brazil etc.), investor sentiment remained very buoyant in April. Countries with advanced vaccination programmes are beginning to see significant falls in cases and hospitalisation rates whilst the global economy, propped up by low interest rates and massive government support, is bouncing back from the crisis-lows of a year ago (albeit in a somewhat uneven fashion by geography and sector).

The UK stock market and the Evenlode Income fund have both risen strongly during April, continuing the progress made in March. As I write, since the start of the year, Evenlode Income has returned +6.8% compared to +9.5% for the FTSE All-Share[i].

The Risk Rally

As discussed in our February investment view, Mr Market's preference over the last six months has been for riskier companies (whether one defines risk as economic sensitivity, financial leverage or capital intensity). The preference within the UK market has also been for domestic earners rather than multi-nationals given the recent strength in the pound and the head-start that the UK has made on vaccinations compared to most countries. These factors explain why the Evenlode Income portfolio has lagged this year's market rally so far. Our investment process emphasises high quality, competitively advantaged and globally diversified businesses, with economics that allow for compounding free cash flow over the long-term. It also deploys a risk management framework that carefully manages fundamental and valuation risk. Though these risk management factors have acted as a brake on relative performance in the recent and rapid 'risk on' rally, we think they are of great importance for our long-term, through-cycle investment philosophy.

Healthy Fundamentals

We continue to feel positive on the portfolio's fundamentals. April has been very busy for company results, with most of the underlying holdings having now reported on trading for the first quarter of the year. The picture remains in aggregate a healthy one. As discussed last month, financial performance for the portfolio held up well overall during 2020, given the backdrop, and the underlying companies are forecast to generate good growth over this year and next. For many holdings impacted by the crisis, the recovery is progressing at a rate that management teams would not have hoped for or expected a year ago.

The dividend situation for the portfolio is proceeding as expected, and we continue to forecast a rebound in the dividend stream for the coming year of +15% or more, which at the current unit price would translate to a forecast yield of 2.7% or more. After this initial rebound, we think the prospects for real dividend growth are good.

Portfolio Evolution

Recent market dynamics are also presenting some opportunities to make changes at the margin of the portfolio, enabling us to enhance the quality and long-term compounding ability of the portfolio without compromising valuation and dividend appeal. We will continue to update you on these changes in our monthly factsheets and in future investment views.

Inflation

Inflation has been a talking point during recent results. There are few signs of a pick-up in broad wage inflation, but input costs have risen due to recovering commodity prices and Covid-related supply shortages. We have recently had some questions from clients on how companies are feeling about this.

Though price is always a factor, Evenlode companies tend to sell products and services for which the customer purchase decision is primarily related to other factors such as quality, reputation, customer support, convenience, familiarity and reliability. Often their products and services also represent a relatively small portion of a customer's overall expenditure yet are considered mission-critical. Both these factors help to create pricing power and an ability to pass on rising costs. The following quote, from test and measurement company Spectris's recent results call, sums all this up well: *pricing is always a consideration for customers, but it's typically not in their top 3 or 4 buying criteria.... there are pressures on input costs for sure. But we would expect to be able to pass that through on pricing.* The consumer branded goods holdings in the portfolio, such as Unilever, Pepsi and P & G, have expressed a similar sentiment and are beginning to raise prices to reflect these higher input costs.

Long-Term Themes

The world is by no means out of the coronavirus woods yet, but much of the global economy is now recovering from the worst of the pandemic, and companies have adapted and become more used to operating in the 'new normal' post-crisis world. Conversations with management teams have therefore turned, increasingly, to post-crisis opportunities and investment plans. On this note, we think the Evenlode Income portfolio is well placed to benefit from several structural growth themes. In particular, the following five themes stand out to us over the next decade and beyond. We have discussed these themes many times over recent years, but in our view they remain as relevant as ever as we digest results and look ahead:

1) **The digitalisation of the global economy:** Microsoft exemplifies this theme. As management put it in this week's results, *over a year into the pandemic, digital adoption curves aren't slowing down. They're accelerating, and it's just the beginning.* The company continues to expect that technology spend as a percentage of global GDP will double over the next decade. They are confident that they can grow faster than this overall market opportunity, given the strength of the Microsoft Cloud. Other portfolio companies well placed to benefit from these trends include digital information companies Relx and Wolters Kluwer. Their increasingly sophisticated data analytics are helping business, legal, medical, academic and government clients make better decisions. And for consumer branded goods companies, growth from the digital channel continues at a rapid rate. Unilever saw e-commerce sales increase by +66% in

the latest quarter, now representing 11% of total group sales. The same figures for P & G were +50% and 15% respectively.

2) **Flexibility and effectiveness:** in some ways the economic world is globalising, in others it is localising. Supply chains are evolving and sustainability has become a top priority. Workforces are increasingly flexible and remote. As discussed above, everything, everywhere is becoming more digital rapidly. With this complex backdrop, specialist providers of outsourced ancillary services can help business customers focus on core strategic priorities and reduce operational complexity, whilst also improving the quality of these ancillary services. Companies in the portfolio that are well placed to benefit from these trends include Bunzl (in not-for-resale distribution), Compass (in food catering), Page Group and Hays (in recruitment) and Savills (in property services).
3) **Emerging market growth:** emerging markets do not grow in a straight line, but the structural growth opportunity for companies with well-entrenched positions in these regions remains compelling. We like the fact that approximately one third of the Evenlode Income portfolio's revenues are generated from emerging markets and think this exposure will generate attractive growth over time.
4) **Sustainability:** this theme has accelerated through the pandemic as companies have become increasingly attuned to their environmental and social responsibilities. There are many examples of opportunity in this area for portfolio holdings. For instance, test and inspection companies such as Intertek and SGS are benefitting from growing demand for sustainability verification, both from a supply chain and environmental perspective. Consumer branded goods companies are developing plant-based and minimal-waste products with a lower environmental footprint and engineering companies such as Spectris and Rotork are seeing strong growth from electric vehicle testing and more energy-efficient valves and actuators.
5) **Hygiene and healthcare:** long-term demand growth in hygiene and healthcare categories looked attractive before the crisis thanks to demographic and consumption trends. Though the crisis has created some disruption in healthcare markets, these long-term trends remain undimmed, and in some areas (such as hygiene, diagnostics and vaccines) are likely to accelerate. Companies such as Reckitt, Bunzl, Smith & Nephew, GSK, Astrazeneca, Roche and EMIS are well placed to benefit from and drive this growth.

Growth runways such as those highlighted above, when combined with competitive strength, asset-light economics, and a willingness to invest in future growth, tend to produce compound growth in long-term cash flows and dividends, and therefore desirable outcomes for long-term shareholders. We will remain focused on emphasising these quality-compounding opportunities within the portfolio.

Responsible Investment Report

Before signing off, I'd like to mention the recently published *2020 Evenlode Responsible Investment Report*, which is available on the Evenlode website[ii]. The report has been produced by my stewardship colleagues Sawan Kumar and Charlotte Freitag, with input from the wider Evenlode Investment team.

It provides an update on our environmental, social and governance (ESG) analysis and engagement activities, including a detailed explanation of our approach to carbon analysis within the portfolio.

We consider our ESG analysis to be a cornerstone of our investment approach. For a company to prosper over the decades, it must invest consistently for the long-term, put careful thought into its culture and governance structures, develop strong relationships with its customers, look after its employees well, and aim to have a positive impact on the wider society and environment in which it operates.

I hope you find it interesting! As ever, please do get in touch if you have any questions.

Hugh and the Evenlode team
29th April 2021

Please note, these views represent the opinions of Hugh Yarrow and the Evenlode Team as of 29th April 2021 and do not constitute investment advice.

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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/funds/document-library). Recent performance information is 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. Evenlode Investment Management Limited is authorised and regulated by the Financial Conduct Authority, No. 767844.

[i] Source: Evenlode, Financial Express, total return, bid-to-bid, 31/12/2020 to 28/04/2021
[ii] Evenlode-Annual-RI-Report-2020-Final.pdf (evenlodeinvestment.com)