

Evenlode Investment View

December 2019 – The Opportunity Set Continues to Evolve



December is shaping up to be a positive month for the UK stock market. Two developments have improved investor sentiment towards the political and economic outlook: one local and one global.

On the local front, the election of a Conservative majority government last week makes the future of Brexit significantly clearer. The withdrawal agreement negotiated with the EU this autumn will now pass through parliament, leaving the UK on track to exit the EU at the end of January 2020. Some longer-term UK political uncertainties will remain in the background, including the UK's need to negotiate a reasonable trade deal with the EU by the end of next year, and the question of Scottish independence. However, investors have welcomed the clarity that is presented by a substantial majority for the UK government, a Brexit plan, the prospect of no further election in the UK for several years, and the potential relief that these factors should provide to the struggling UK economy.

On the international front, news that the US and China have negotiated the outlines of a trade deal has also been welcomed. This means the tariff hikes that were planned to take place last weekend have been postponed.

Helped by all of the above, the year-to-date return for both the market and the fund remains strong. Since the beginning of January, the FTSE All-Share has risen +18.7% and Evenlode Income +24.0%ⁱ.

Performance

Though relative performance has, overall, been positive year-to-date, Evenlode Income's performance has lagged the UK market over the last four months. This is primarily for two reasons. Firstly, although the fund will always have at least 80% of the portfolio in the shares of UK-listed companies (currently c.86%) it has a relatively high exposure to British-listed multinational companies, which have underperformed as the pound has rallied strongly. Secondly, the bedrock of the fund is, as usual, invested in relatively repeat-purchase companies whose shares have a tendency to lag a market in which investors are seeking more risk and higher exposure to economically sensitive businesses.

We acknowledge that our investment approach may seem a little unexciting and austere during periods like the last few weeks. But there is a good long-term reason for this. We are committed to 'remaining at the investment crease' over the years and through a wide range of conditions, and we think geographic diversification combined with resilient and steadily growing cash generation are important factors in delivering on this commitment. *Though stock markets are moved by short-term news over the short-term, the share prices of individual companies are moved by the long-term fundamental development of these businesses over the long-term, and it is on these fundamentals that we continue to focus.* Almost all the companies in the portfolio have updated the market since the beginning of October and we have been reassured by the aggregate progress they are making and the strategic investments they are making for the future. The portfolio's free cash flow yield for 2019 is 4.9% and this is forecast to grow to 5.5% next year, which provides good cover for the fund's 3.1% dividend yield.ⁱⁱ

Evenlode Investment View

December 2019 – The Opportunity Set Continues to Evolve



The Opportunity Set Continues to Evolve

In general, we are happy with the current shape of the portfolio and have made relatively few changes in recent weeks. However, we remain open to making changes as share prices bounce around, as they often do! To give a couple of recent examples, we were trimming Cisco and Unilever over the summer for valuation reasons. However, since then their share prices have fallen (down -21% and -18%, approximately, since their respective summer peaks) with sentiment not helped by both companies reporting a slowdown in growth over recent months (including an update from Unilever this week that revenue growth for 2019 will be slightly below the company's +3-4% guidance range for the year).

The fall in both share prices has materially improved their relative valuations, in a stock market in which many shares have risen very strongly over the same period. We are, therefore, now adding to the fund's positions in both Cisco and Unilever again. In our view, both companies are well placed to grow their free cash flow and dividends over coming years thanks to their cash-compounding business models, market-leading positions and attractive structural growth prospects. Here are their respective free cash flow yields and dividend yields.ⁱⁱⁱ

Cisco	2019	2020
Free Cash Flow Yield	7.2%	7.9%
Dividend Yield	3.1%	3.4%

Unilever	2019	2020
Free Cash Flow Yield	4.8%	5.6%
Dividend Yield	3.2%	3.4%

Onwards to a New Decade

I look forward to updating you on Evenlode Income's progress during 2020, the start of a new decade! In the meantime, I would like to thank all co-investors for your interest and support this year, and wish you an enjoyable, peaceful Christmas on behalf of all of us at Evenlode.

Hugh and the Evenlode Team 17th December 2019

Please note, these views represent the opinions of Hugh Yarrow as at 17th December 2019 and do not constitute investment advice.

ⁱ Source: Evenlode, Financial Express, total return, bid-to-bid, 31/12/2018 to 16/12/2019

ⁱⁱ Source: Evenlode, Factset

ⁱⁱⁱ Source: Evenlode, Factset