

Evenlode Income Investment View

January 2023 – Review and Outlook



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.

From a political and economic perspective 2022 was a difficult, turbulent year. Inflation and war were the two signature motifs. Inflationary pressure had already picked up in 2021, thanks to pandemic-related supply chain shortages. Putin's invasion of Ukraine in February 2022 then added fuel to this inflationary fire, leading to a sharp rise in energy and food prices in the immediate aftermath of the invasion. Central banks increased interest rates, the cost of living began to hit consumer pockets, and economic leading indicators deteriorated. Closer to home, UK political turmoil added to the general sense of instability and uncertainty.

Performance

For the 2022 calendar year, Evenlode Income fell -2.8% compared to a fall of -9.1% for the IA UK All Companies Sector and a rise of +0.3% for the FTSE All-Shareⁱ.

With another year on the clock, Evenlode Income (launched in October 2009) is now a little over 13 years old. During this period, the fund has produced a total return of +279% compared to a return of +139% for the FTSE All-Share. This represents a compound return (after fees) of +10.6% per annum, compared to +6.8% per annum for the FTSE All-Shareⁱ.

Performance Drivers

The fund's underperformance relative to the FTSE All-Share in 2022 was more than explained by the fund's sector positioning, with the fund's lack of exposure to oil and mining stocks the key factor. Rising +45% and +21% respectively, these two commodity sectors propped up the UK market's weighted aggregate return, in a year in which the median stock in the FTSE All-Share fell -14%.

In terms of individual holdings, the most positive contributors to Evenlode Income's return for the year were Euromoney, Unilever and Astrazeneca. Euromoney was subject to a takeover during the year – as were EMIS and AVEVA, which were also notably strong contributors to return. All three businesses possess leading software and data analytics capabilities and highly cash generative business models. EMIS and AVEVA were acquired by industry buyers, whilst Euromoney was acquired by a private equity consortium. Unilever's portfolio of leading household brands coped well with elevated inflation in 2022, with strong pricing more than offsetting cost pressures. The aborted takeover for GSK's consumer healthcare business at the beginning of the year may have been a helpful catalyst for progress, with an encouraging investor day in November highlighting a sharpened focus on internally-funded organic investment and growth. A significant step up in research and development expenditure in recent years, along with astute partnerships and acquisitions, have successfully expanded Astrazeneca's drug portfolio into the high growth oncology and rare disease franchises. Double digit revenue and profit growth in 2022 highlights the progress made.

The most negative contributors to fund performance were Savills, Diageo and Hargreaves Lansdown. Following a record year in 2021, rising interest rates and the prospect of weakening global growth impacted Savills's core business in commercial and residential property

Evenlode Income Investment View

January 2023 – Review and Outlook



transactions. Medium-term prospects are promising as management deepen the franchise's global footprint, supported by a strong net cash balance sheet. Diageo continues to benefit from "premiumisation" trends in the spirits market, while its strong brand portfolio provides significant pricing power, which is particularly helpful during periods of higher inflation. Despite strong results in 2022, the share price was not immune to the market contraction in more highly rated shares. Hargreaves Lansdown announced increased investments into its technology platform and advice offering at the beginning of 2022. While this reduces profit in the near-term, we believe these are sensible investments for the health of the franchise and prospects over coming years remain interesting, thanks to the company's market-leading position in a sector that continues to grow strongly.

Reassuring Operational Performance

In the context of high input cost inflation and a slowing global economy, we have been very reassured with the healthy fundamental progress that underlying portfolio holdings made in aggregate during 2022. The essentials, little-luxuries and mission-critical items that most of the portfolio holdings sell, help to underpin demand in tougher times. Meanwhile, pricing power and attractive margin structures are providing relative insulation from input cost inflation.

Full year results to end-December will be released over the next few weeks, which will give the full picture. The most up-to-date results period as I write are year-to-date results to end-September. For portfolio companies reporting for this period, organic revenue growth averaged +15%. Not many companies report earnings progress at the third quarter stage, but management commentary suggested a similar trend to that seen at half year results, with earnings growth running a little behind revenue growth in aggregate (due to high input cost inflation), but still posting healthy profit growth in absolute terms.

Nudging the Portfolio

In terms of portfolio changes, we saw some interesting opportunities to broaden out the portfolio during 2022. The fund fell -2.8% in 2022, but if you take the average stock within the universe of 80-or-so companies, the median performance saw a fall of -13%, with several stocks falling -20% or more. This created an interesting situation, with new valuation opportunities emerging. We added several positions to the portfolio in high quality, market-leading compounding businesses, further enhancing the diversification of the portfolio's free cash flow stream. These included three new mid-cap holdings - Diploma, IntegraFin and Games Workshop - taking advantage of the record underperformance of the FTSE 250 versus the FTSE 100 in 2022. Diploma is a specialist distribution business with a portfolio ranging from electrical connectors to medical equipment to industrial valves. High-touch sales and next day delivery capabilities add value for customers, driving strong margins and growth. IntegraFin provides a leading investment platform, Transact, to UK financial advisers, driving sticky recurring revenue in a growing market. Games Workshop sells fantasy miniature models to a loyal and growing hobbyist customer base. In December it announced an agreement with

Evenlode Income Investment View

January 2023 – Review and Outlook



Amazon for streaming TV and movies of its Warhammer franchise, highlighting significant potential to broaden the franchise globally. We also re-introduced Halma, a specialist engineering business, in October. It has leading positions in niche industrial and healthcare markets, where safety and regulatory standards underpin consistent replacement cycles and growth.

We also added some larger business whose valuations were impacted by rising interest rates. Experian, a leading credit bureau, has difficult to replicate data assets and strong growth prospects as banks and corporates look to digitise and automate operations. LVMH is the global leader in luxury goods, a market where brand heritage is hugely important for customers, and which LVMH's stable of over 70 brands has in spades. Louis Vuitton was founded in 1854 while cognac brand, Hennessy, was founded in 1765.

In terms of disposals, we exited positions in EMIS, Euromoney and AVEVA following their takeover approaches. We also finished exiting holdings in AB Inbev and WPP earlier in the year, to make way for other opportunities where we considered the combination of quality, financial strength and forward return potential more interesting. We also exited the fund's small position in Haleon during the fourth quarter, which had entered the portfolio as a result of its demerger from GSK earlier in the year. We think Haleon is a high-quality company, but it is carrying a significant amount of debt following the demerger, and we are seeing other opportunities with similar cash compounding attractions and dividend yields, but with stronger balance sheets.

Outlook

Looking ahead, the outlook for the year is (as normal) complicated. The consensus view is that interest rates will continue to increase, and the global economy will slow over coming months – but the quantum of this slowdown is a big unanswered question. The inflation outlook is also uncertain – some easing is expected from the current extreme levels, but many investors suspect that we may have entered an era in which inflation rates average something more akin to long-term mid-single-digit averages, rather than the very low 1-2% annual rates that the developed world saw in the decade between the Great Financial Crisis and the pandemic. Meanwhile, global politics remains tricky as uncertainty persists over both the Russia/Ukraine conflict and China's relationship with Western liberal democracies.

Healthy Cash Generation

We are not complacent about this backdrop – it presents a variety of challenges. We are though, reassured by the combination of quality, valuation appeal and growth potential within the portfolio. Market-leadership, cash-generative economics and pricing power are all helpful characteristics for long-term cash compounding. The bedrock of the portfolio's cash flow stream is also generated by repeat-purchase business models, providing a helpful safety buffer in more difficult economic times. From a valuation perspective, the fund's free cash flow yield stands at a healthy 5.4% (and represents an increase relative to the 4.8% level of a year ago).

Evenlode Income Investment View

January 2023 – Review and Outlook



This strong free cash flow stream provides a nice safety buffer for the fund's 2.8% dividend yield, and we think prospects for dividend growth are goodⁱⁱ.

I'd like to wish you all the best for the coming year, and we look forward to updating you regularly as the year progresses. Please do get in touch if you have any questions.

Hugh, Ben, Chris M. and the Evenlode Team

17 January 2023

Please note, these views represent the opinions of Hugh Yarrow and the Evenlode Team as of 17 January 2023 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.

ⁱTB Evenlode Income B Inc class. Source: Evenlode, Financial Express, total return, bid-to-bid, GBP terms. TB Evenlode Income launch date: 19 October 2009.

ⁱⁱSource: Evenlode. Free Cash Flow Yield as at 31 December 2022, based on FactSet estimates for 2022 calendar year. Dividend yield is historic yield as at 31 December 2022.