Evenlode Investment View

June 2021 – Unfashionable Resilience

The UK market started strongly in June but then erased most of its gains in the second half of the month. Covid cases are on the rise again in several regions, including Asia, and this has led to the reimposition of restrictions in several countries. Thoughts are also now beginning to turn to the gradual withdrawal of crisis-induced fiscal stimulus programmes, such as furlough schemes, over coming months. Meanwhile, leading indicators are hinting that the rate of the global economic recovery may be slowing.

We are very nearly at the halfway stage of 2021. So far this year, Evenlode Income has risen +10.0% compared to a rise of +11.9% for the FTSE All-Share[i]. As discussed in previous investment views, your fund's underperformance thus far in 2021 occurred in February's 'risk-on' rotation. Since the end of February the fund (+12.1%) has risen roughly in-line with the UK index (+10.6%)[ii].

The Swing of The Pendulum

It is worth noting how rapidly the pendulum of investor sentiment swung from panic to complacency over the last year or so. The fear that investors felt at the onset of the pandemic last spring quickly morphed into a 'fear-of-missing-out', an emotion that accelerated sharply after the announcement of successful vaccines. Back in March 2020, volatility measures were hitting extreme levels and global stock markets were in free-fall. Today, there are some signs of frothiness in investment markets, and a strong and prolonged economic recovery has become the consensual view.

Unfashionable Resilience

A side effect of Mr Market's buoyant mood has been the relative underperformance of the share prices of many stable, resilient companies, considered to be too unexciting for the current zeitgeist. In a quiet month for company news flow, I'd like to use this investment view to briefly discuss three examples of UK-listed, market-leading companies whose shares are not fashionable at present, but which we believe offer an interesting combination of resilient cash generation, growth prospects, and valuation appeal for the patient investor. All three have exposure, in different ways, to health and hygiene markets.

Reckitt Benckiser

Founded in Hull in 1840, Reckitt has become a global market leader in health and hygiene markets, with a diversified brand portfolio including Dettol, Finish, Nurofen and Durex. The company's shares have been out of favour over recent months. However, operational performance has been strong through the crisis, helped both by the repeat-purchase nature of its products and growth in demand for hygiene brands such as Dettol and Lysol. Reckitt grew organic revenue by more than +12% last year, and management expects the company to continue growing in 2021 and beyond. At the same time, the new management team has made significant strategic progress, both in terms of investing in the company's long-term growth opportunities and rationalising the portfolio. Looking ahead, Reckitt operates in attractive categories with good structural growth dynamics. Household penetration of dishwashers, for instance, is beginning to grow in emerging markets, but still represents less than 5% in Asia, Africa and Latin America, compared to 50% or more in Europe and the US. As penetration rates steadily increase in emerging markets, the Finish brand should benefit from a compelling growth runway over coming years. Dettol, meanwhile, enjoys a very trusted relationship with consumers in emerging markets such as India and Africa, and will benefit from long-term tailwinds in these regions as disposable income and hygiene awareness develops further over time.

Reckitt shares currently offer a dividend yield of 2.7%, backed by a 4.7% free cash flow yield[iii].

Smith & Nephew

Smith & Nephew is another British corporate success story with its origins in Hull. Founded in 1859, a culture of prudence and long-termism has built up in the organisation over time. The company minds its own business and sometimes goes a bit unnoticed in the FTSE 100. But today, the group enjoys strong global competitive positions in its key categories: advanced wound management, sports medicine and orthopaedic reconstruction. The pandemic had a severe impact on elective surgery volumes, and this has impacted Smith & Nephew's revenue over the last year (the company's share price, in sympathy, remains approximately -20% below its pre-Covid peak). Looking ahead, however, the catch-up in delayed surgeries is well under way, with the vast majority of procedures deferred rather than cancelled (if you needed orthopaedic surgery before the pandemic, you are highly likely to still need it now). Looking further ahead, Smith & Nephew's well-diversified portfolio offers attractive growth potential supported by incremental innovation, demographic trends, and increasing spend on medical technology in the emerging markets (which now generate nearly 20% of the company's overall revenues).

Smith & Nephew shares currently offer a dividend yield of 2.1%, which is comfortably covered by the company's free cash flow yield of 3.9%.

Bunzl

Bunzl is the global market-leading distributor of not-for-resale consumables, such as packaging items for the food service sector and Personal Protective Equipment (PPE) for industrial and healthcare sectors. Sounds dull and boring? Yes, perhaps it does on paper, and the company's share price hasn't gone anywhere over recent months, with investors seeking out excitement in other areas. For patient shareholders though, the company has a very strong record of capital allocation and long-term value creation, which has helped drive 28 years of dividend growth. This performance has been underpinned by the company's dominant global competitive position, a culture of long-termism, and a consistent strategy to invest back into the business to drive growth. A current example is Bunzl's investment in its sustainable products ranges and sustainability data, which are enabling Bunzl's customers to transform the environmental footprint of their procurement habits. This work is helping Bunzl build advantage, as competitors often lack the scale and knowledge to develop these products and services.

Bunzl had a strong crisis, growing organic revenue at +9% in 2020 as the company benefitted from sales in its grocery and health and hygiene divisions. This month's trading statement confirmed the group continues to perform steadily. Bunzl continues to take market share, whilst also making small incremental acquisitions to expand by geography and category, a consistent strategy that has worked very well for the company long-term.

Bunzl currently offers a dividend yield of 2.3%, backed by a very healthy free cash flow yield of 6.4%.

To sum up, we aim to manage risk over the long-term as economic cycles come-and-go in their somewhat irregular and unpredictable fashion. In order to achieve this, it is very helpful to retain a stable bedrock of cash flows in the portfolio at all times, generated from repeat-purchase business models whose prospects for compound growth are not overly dependent on the economic cycle. In the current stock market, we think many of these steady, resilient businesses are offering interesting valuation and dividend appeal, having underperformed significantly since last November.

Hugh and the Evenlode team
29th June 2021

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Please note, these views represent the opinions of Hugh Yarrow and the Evenlode Team as of 29th June 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). Recent performance information is also shown on factsheets, also available on the website.

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

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[i] *Source: Evenlode, Financial Express, total return, bid-to-bid, 31/12/2020 to 29/06/2021*
[ii] *Source: Evenlode, Financial Express, total return, bid-to-bid, 28/02/2021 to 29/06/2021*
[iii] *Source: Evenlode, Factset, 29/06/2021, forecast for next financial year (for all dividend yields and free cash flow yields used in this piece).*