

Evenlode Investment View

September 2019

More Themes from the Corporate World



After a weak August, stock markets have recovered some of their ground so far this month. Leading economic indicators remain quite weak globally, but hopes have risen over the possibility of a tariff deal between the US and China. The pound has also strengthened as investor perception of the chances of a 'no deal Brexit' receded.

Returns for the year remain strong. As I write, the Evenlode Income fund has risen +21.5% since the start of January and the FTSE All-Share +13.3%ⁱ.

Wobbly Share Prices

September's rising market has been accompanied by an 'under the bonnet' change in performance trends. Some of the better performing stocks this year have pulled back, and some of the more unfashionable shares have rallied. This has been apparent at both the market level and within the Evenlode investable universe. The share prices of many of the more stable, reliable stocks (several of which we had been reducing over the summer for valuation reasons) have retreated. These include Unilever, Diageo, Compass, Sage and Smith & Nephew. On the other hand, some of the more economically sensitive holdings, whose shares have been in the doldrums, have perked up (Schroders, Hays, Spectris and Victrex etc.)

We continue to 'nudge' the portfolio towards stocks that look most interesting to us from a valuation perspective, and have carried on adding to holdings such as Hays, Spectris and WPP this month. However, we have also started topping up holdings such as Unilever and Sage for the first time in a while.

We remain reassured by the portfolio's free cash flow stream which is 5.0% for 2019 and forecast to be 5.7% for 2020. This comfortably covers the fund's current 3.0% dividend yieldⁱⁱ.

More Themes from Results

Over the last two months the majority of the Evenlode Income portfolio has reported results. Last month I discussed some observations from the consumer branded goods sector. This month I will discuss three themes of note from the broader Evenlode Income portfolio.

Theme 1: The Strong Grow Stronger

Whilst the global economic picture is not awful, it is quite patchy and in some geographies and sectors it is particularly challenging (global industrial production markets, the automotive sector, the UK, China, Hong Kong etc.).

We like it when we observe companies acknowledging this adversity and adapting to it, but simultaneously planning for the future and investing to strengthen their competitive position. Businesses with a conservative balance sheet, a cash generative business model and a culture of long-termism tend to be best placed to take this approach. Real estate support services company

Evenlode Investment View

September 2019

More Themes from the Corporate World



Savills is facing very tough markets in two of its key geographies, the UK and Hong Kong. However, the company gained market share during the first six months of the year and continued to invest in both its global diversification strategy and the development of its more defensive businesses (property management, consultancy and investment management) which now collectively make up 59% of sales. Howden Joinery is also operating through difficult times, but cash generation is good and the company continues to pursue its long-term investment plans. Howden gained market share in the first half of 2019, growing sales +5.4% despite a fall in the overall UK kitchen market.

The strong often grow stronger in adversity, even if it's not always obvious in the financial results at the time.

Theme 2: The Onward March of Digitalisation

In a world where every company is a software company, developers will play an increasingly vital role in value creation across every organisation.

Satya Nadella, Microsoft

The drive to a more digital economy continues relentlessly, with all companies in all industries harnessing software and data analytics not just to run their operations more flexibly and efficiently, but also to help drive improved and more targeted innovation, customer feedback and marketing. Last month I discussed the huge investment that consumer branded goods companies are making in their digital workforce and infrastructure. Similar trends are apparent across the Evenlode Income portfolio. In the healthcare sector, Glaxosmithkline are utilising 'big data' and machine learning to help improve the process of drug discovery, as well as shortening the time it takes both to develop new therapies and bring them to market. In July, Smith & Nephew launched the latest version of its robotics-assisted surgical system, Navio. This platform is helping surgeons to perform operations more quickly and more safely, and sales are growing strongly. In the traditionally hardware-led engineering sector, Smiths Group has increased its research and development (R & D) expenditure by +25% over the last three years with much of the emphasis on digital capabilities such as connectivity-enabled medical pumps and increasingly sophisticated airport security software. Similarly, actuator-supplier Rotork has increased R & D spend by +30% over the last two years with a portion of this spend focused on real-time data analytics to predict and prevent equipment failures before they happen. This has the potential to save considerable cost and hassle for customers. Even kitchen-supplier Howden Joinery is making a large investment in its digital capabilities, both in terms of its operational and customer-facing technology. The recent launch of its new web platform drove a +42% increase in site traffic over the first half of 2019 and a +30% increase in depot contacts made via the website.

If you are a company selling digital services to businesses such as these, the structural growth opportunity is very compelling. Media and software holdings such as Relx, Sage, Informa, Euromoney, Microsoft, DMGT and Cisco all fit into this category and collectively make up more than 20% of the portfolio. The trend is also evident in other business-to-business sectors such as recruitment. While Evenlode holdings Hays and Page Group have seen a slowdown in overall global

Evenlode Investment View

September 2019

More Themes from the Corporate World



sales growth recently, their IT businesses remain on a strong growth trend. For Hays, digital and technology placements are now its largest global specialism.

Theme 3: Hidden Champions

The drive towards more digitalisation is part of a wider trend for all companies to make themselves more flexible, adaptable and efficient. I suppose this theme is not new at all, companies have been looking to improve in these areas for at least the last two hundred years! But in a world of currency volatility, trade tariffs, political uncertainty and an increased focus on waste and carbon emissions, it remains a key one.

Niche business-to-business franchises that help their customers achieve these aims are well placed to benefit from structural growth. These 'hidden champions' are not necessarily familiar brand names to the consumer, but they become trusted partners to their business customers and often enjoy a very strong market position. I have mentioned above several holdings that fit this template in the software and media sectors, and Hays and Page Group do too. Other companies that fall into this category include Compass (food catering), Intertek (testing and inspection) and Bunzl (not-for-resale distribution). In the markets these businesses operate in specialist suppliers can often provide a better service at a lower price and with less hassle than the in-house alternative. The trend to outsource more to specialists is therefore steady and clear.

Hugh and the Evenlode Team

19th September 2019

Please note, these views represent the opinions of Hugh Yarrow as at 19th September 2019 and do not constitute investment advice.

ⁱ Source: Evenlode, Financial Express, total return, bid-to-bid, 31/12/2018 to 18/09/2019

ⁱⁱ Source: Evenlode, Factset.