# Taking a global multi-asset approach - the J O Hambro way

*In contrast to most top-down approaches to multi-asset investing, we have a differentiated bottom-up strategy. The team follows a 'value' philosophy that focuses first and foremost on the preservation of capital by investing with a margin of safety.*

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"**AROUND THE WORLD, INSTITUTIONS, FINANCIAL ADVISERS AND INDIVIDUALS ALIKE** are all grappling with the same basic challenge: how to generate income for today while growing capital ahead of inflation to preserve purchasing power for tomorrow." That's Robert Hordon speaking, a fund manager with J O Hambro Capital Management's New York-based Multi-Asset Value team, presenting a workshop on the need to produce income today and capital growth for tomorrow while also protecting capital.

ROBERT HORDON
J O Hambro Capital Management

## Bottom-up approach across asset classes

Speaking at the Hubbis Thailand Wealth Management Forum in Bangkok, Hordon highlighted the JOHCM Global Income Builder strategy as a solution that seeks to offer recurrent income and a dynamic multi-asset approach to achieve capital gains, while aiming to provide resilience in market weakness.

Hordon believes that J O Hambro Capital Management (JOHCM) has a sensible answer with its Global Income Builder approach, launched

## 4. Process – The seven point persistence scorecard

| | | |
|---|---|---|
| 1 | Financial Leverage | • Debt magnifies business risks and can lead to dilutive rights offerings, equity raises and debt restructuring; focus on debt ahead of our claim |
| 2 | Operating Leverage | • Significant fixed costs can render operating profits more volatile, and require an appropriately conservative capital structure |
| 3 | Cyclicality | • Strong businesses with solid balance sheets can improve competitive positions in a cyclical downturn, but the cycles must be managed |
| 4 | Disruption Threat | • Review of disruptive technologies that risk disintermediation of the enterprise and assessment of social license and ESG risks |
| 5 | Management Quality | • Poor capital allocation can impair essentially any investment<br>• Management's operating skill is a key source of risk that must be assessed as well |
| 6 | Barriers to Entry | • The key to earning returns above the cost of capital; also evidenced by strong market share, profit margins, value chain dominance |
| 7 | Secular Growth | • Favourable long-term growth dynamics can create a tailwind for business persistence, while headwinds can lead to damaging pressure |

last year. "In contrast to most top-down approaches to multi-asset investing, we have a differentiated bottom-up strategy. The team follows a 'value' philosophy that focuses first and foremost on the preservation of capital by investing with a margin of safety."

### Follow Buffett's first rule

"Capital preservation is really the hallmark of our strategy and the attribute that we emphasize most," he stated. "As Warren Buffet said, 'Rule number one: never lose money. Rule number two: never forget rule number 1.'"

"Our downside protection comes from trying to pay low prices relative to what we see as the intrinsic value of the companies in which we invest. By holding high persistence businesses when they are underappreciated by others, we believe the strategy is positioned for long-term upside potential as well. And we are flexible, which means our portfolios do not have to track any benchmarks or indices, and we don't need to own securities where we are uncomfortable with the valuation or level of business risk."

For the JOHCM Global Income Builder strategy, the approach is to include a mixture of market cap sizes. Currently within the equity holdings, small and mid-cap names represent about 30%. And the portfolio includes credit investments, a number of which are smaller issues that the team finds attractive. Hordon noted that JOHCM's commitment to restricting the capacity of its strategies should help ensure that his team stays nimble and retains access to these smaller opportunities in the future.

### Ignore the benchmarks, pick value and resilience

"We like to describe the approach as an endowment style. We have a target yield of 5%, which we look to achieve by investing in global equities and various credit instruments with an emphasis at the moment on higher quality, high yield bonds. Our equity portfolio has an average yield of approximately 3.7%, which is higher than that of the MSCI World Index at around 2.5%, but similar to certain global value indices."

As to the selection of the investments, the approach is bottom-up, security by security. "We focus on two major variables: margin of safety and persistence. Margin of safety is ensuring that we buy at below the intrinsic value. Persistence refers to the durability of the business, or the sustainability of the cash flows. In short, we only want exposure to resilient companies that should perform well over the long term, and we want to buy into these companies when they are available at attractive prices."

### Diversification and sustainability

Hordon gave more information on the diversified portfolio, which could include 100 or more hold-

## 4. Process – The investment decision lifecycle

**Business review and analysis**

- Assess barriers to entry / competitive advantage and examine industry dynamics
- Study financial data/reports
- Review industry prospects and risk of obsolescence
- Review management history and incentive structure
- Conduct confirmatory due diligence and primary research
- **Work towards overall assessment of persistence**

**Valuation and purchase decision**

- Select most appropriate valuation methods* and estimate business value
- Assess income sustainability
- Avoid being subordinate to significant financial leverage or environmental or other claims
- Invest only with a significant Margin of Safety (MOS) to help avoid permanent loss of capital
- **Lower persistence usually requires a greater MOS**

**Position sizing and sell discipline**

- Largest allocation to investments that offer most attractive combination of persistence and MOS.
- Position sizes limited to ensure portfolio diversification.
- Continuous monitoring of business fundamentals and price/value relationship.
- Add or remove capital to individual positions as price/value evolves.
- **Exit positions that no longer offer acceptable MOS.**

ings, with typically between 40% and 65% in equities and the balance in fixed income and hedge assets at between 35% and 60%.

"A famous investor said buy when there is blood in the streets," Hordon noted. "Well, we may not be that extreme, but we prefer to buy when sentiment is negative rather than when everyone feels euphoric about a company or asset class. We balance three main components—equity, fixed income and our reserve buying power, which consists of cash, US Treasury instruments and also an allocation to gold."

On the role of gold, he noted that in a portfolio focused on downside protection, there is room for some gold exposure, particularly as a way of preparing for extreme environments where there might be geopolitical stress or real macro-economic uncertainty. "That could be an environment where our gold investments appreciate significantly and, along with our cash, can be selectively redeployed into risk assets like equities that are available at excessive discounts."

### On credit

On the credit side, the multi-asset team is effectively looking to lend money to businesses where there is significant incremental value beneath their position in the capital structure, which may offer protection in the event that the business comes under some strain.

Typically, they invest in BB, or sometimes BBB-rated, bonds. "We currently have approximately 40 different credit issues with yields typically in the 4% to 7% range, sometimes higher. In one or two cases, we will own CCC-rated securities that we find attractively priced. They have more of an equity-like character, but may represent an interesting idiosyncratic risk/reward opportunity."

He highlighted the Aramark bond, offering a 5% yield. Aramark's total debt issuance is estimated at just about one-third of the total enterprise value of the company. "That implies that there is two-thirds equity value beneath us, and in a sense, protecting us as a form of collateral."

Hordon also cited some stock examples, including Asian names such as Hong Kong's Hang Lung Properties. "For a variety of reasons we believe the intrinsic value discount here is at least 40% to 50%. With a dividend yield above 4%, it provides meaningful current income, but has significant capital appreciation potential as well."

As for risk management: "We think about risk as capital impairment, not volatility, so security selection is our first line of defense."

### Still committed to active management

JOHCM is looking to expand across Asia, spreading the message that it remains committed to careful fundamental investing by experienced managers despite the current vogue for passive and quantitative strategies. "We have autonomous teams and freedom of thought to exercise our best judgment. That message is being well received here in Asia." ■