# ROYAL LONDON MULTI ASSET STRATEGIES FUND

## Quarterly Report 31 December 2020

For professional clients only, not suitable for retail investors

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# ROYAL LONDON MULTI ASSET STRATEGIES FUND

## Performance

| | Fund (%) (M Acc) | Fund (%) (M Inc) |
|---|---|---|
| **Q4 2020** | **3.88** | **3.87** |
| Year-to-date | -4.94 | -4.96 |
| Rolling 12 months | -4.94 | -4.96 |
| Since Inception p.a | 0.76 | 0.75 |

## Fund data

| | Fund |
|---|---|
| Fund size | £190.7m |
| Launch date | 23.11.2018 |

***Past performance is not necessarily a reliable indicator of future performance. The value of investments and the income from them is not guaranteed and may go down as well as up and investors may not get back the amount originally invested.***

*Source: RLAM, based on the M share classes. Performance for the fund is calculated on a mid basis with income re-invested. The fund returns in the table above are gross of standard management fees. All performance figures stated gross of fees and tax unless otherwise stated.*

*Reported yields reflect RLAM's current perception of market conventions around timing of bond cash flows. Heightened uncertainty due to the COVID 19 crisis may impact these timings for bonds with callable feature.*

## Investment approach

- The Royal London Multi Asset Strategies Fund (MAST) is designed for investors looking to generate growth, over five-year rolling periods, through a diversified multi asset portfolio, while limiting losses during periods of financial market turbulence. MAST combines two complementary return drivers, each with its own separate in-built risk controls:
  1. Multi Asset Core portfolio strategies, which offer diversified exposure across a range of asset classes to capture upside during positive market trends; and
  2. Tactical asset allocation (TAA) strategies designed to generate additional return irrespective of market direction.
- Our TAA approach can reduce exposure to growth-sensitive assets as economic and market conditions deteriorate, and therefore works well alongside the Multi Asset Core portfolio, which we expect to add more value in bull markets. The combined approach is designed to generate consistent returns, over five-year rolling periods, while also being able to take advantage of opportunities as they arise.

## Market performance

- Major global stock markets delivered a strong fourth quarter. The MSCI World Index rose +7.8% in sterling terms. Remarkably, despite the pandemic, 2020 as a whole posted positive returns (+12.3%). All major markets rose during the quarter with the dispersion in returns resulting more from sector rotation. Among the major regions, emerging markets, Asia Pacific excluding Japan and the UK were the stronger markets, whereas Japan, Europe (ex UK) and the US were slightly more pedestrian.
- Companies that had been struggling because of Covid-19 tended to perform well on the Pfizer vaccine news, while several sectors rose on the prospect of a more traditional US president and more stimulus to come. Unlike prior quarters, it was not technology that led sectors (+6.8% in sterling terms during quarter), but a strong recovery in energy (+20.3%) and financials (+17.4%), which had previously underperformed. For the full year, however, energy was still down -36.3%, despite the strong final quarter.
- The Bank of England (BoE) has continued to neutralise the impact of government bond issuance through asset purchases, which were extended in the quarter. The Federal Reserve (Fed) and European Central Bank are operating similar QE programmes. In addition, the removal of roadblocks to the dispersal of the €750bn EU Recovery Fund was a significant positive for European economies.
- With renewed lockdowns in many countries and activity remaining below normal levels, yields on benchmark 10-year government bonds fell over the quarter in most major developed markets, apart from the US, Canada, Sweden and Japan. The yield on 10-year gilts decreased 3 basis points (bps) to 0.20% and shorter-dated government bond yields remained negative, although the BoE continued to eschew the policy option of negative base rates. The yield spread between index linked gilts and US TIPS tightened by another 17bps to 181bps at the end of the quarter as the Fed's revised approach to US monetary policy – under which inflation will be allowed to run higher – continued to drive up inflation expectations, also causing the dollar to weaken further. The US currency suffered its second weakest year since the global financial crisis.
- Credit spreads tightened further reflecting positive developments on vaccines and short-term support for struggling companies. The average sterling investment grade spread (the average extra yield available from a corporate bond compared with government debt of equal maturity) ended the quarter a further 30bps tighter at 0.99%, which compares with an

average spread of 1.14% at the end of 2019. This is remarkable considering that the average spread was as wide as 2.25% at the peak of the market sell-off in March. The Markit iBoxx Sterling Non-Gilt All Maturities Index delivered total returns of +3.12% for the quarter.

- It was a very positive quarter for global high yield corporate bonds, with many key negative risks getting diminished. In particular, the US energy sector benefitted from the election results, which suggested that more extreme policies are unlikely to pass through Congress. The market has factored these improvements by reducing default rate expectations; though we think that high yield credit spreads continue to overcompensate for the risks. The ICE BofAML (BB-B) Global Non-Financial High Yield Index returned 5.68% to sterling investors over the quarter.
- Sterling was among the stronger major currencies over the quarter, rising 5.4% against the US dollar following the recent decision by the Fed to alter its inflation targeting methodology. It also strengthened marginally against the euro and against the yen. This strength tempered the returns for sterling investors in global equities.
- Oil prices recovered strongly in the quarter as global economy continued to grow and Saudi Arabia announced production cuts. The price of Brent crude oil rose by +26.5% to over $52 a barrel. Copper continued to strengthen as economic activity strengthened in China, rising +15.8% over the quarter. Gold fell -0.2% to $1,933/oz., although this masked its volatility across the quarter as some investors sought a safe haven on renewed fears about Covid-19 and political risks.

## Fund commentary

- At year end, MAST was down a cumulative -6.8% from its high point in early 2020, compared to -11.2% for UK equities and -0.9% for global equities over the same period. The fund's relatively modest recovery since the market lows in March reflects the fact that a large proportion of the fund's downside risk control measures have remained in place given the choppy nature of the rebound.
- MAST aims to capture upside in positive market trends, while limiting downside during periods of market turbulence through diversification, active positioning and volatility management. We cut equity exposure significantly in March when the coronavirus crisis caused a spike in volatility. Global stocks have since recovered but, while volatility remained unusually high and the outlook uncertain, the fund retained a more cautious stance. Since the positive vaccine trial data and US election results in early November, we have steadily added back to stock exposure as volatility has reduced.
- In our backtesting of the strategy, we modelled what would have happened in various historical crises and found MAST usually returned to its high water mark in about a year or so. The recent drawdown from high water mark is larger than those in the simulation and could take proportionately longer to heal, though we remain confident in MAST's ability to deliver against its objective of returning an annualised return of 4% in excess of SONIA gross of fees over the next five years.
- In the scenario of a sustained economic recovery, we would expect a further drop in volatility and a further increase in our positive tactical positioning, allowing us to capture more of the upside. However, MAST's disciplined approach to risk management should act to limit further losses should new strains of the virus or significant problems with vaccination programmes cause market volatility in the short term.

**Multi Asset Core strategies**

- Multi Asset Core strategies aim to benefit from positive market trends, while reducing exposure to risk assets during market turbulence in order to reduce downside risk.
- We reduced equity exposure from a starting position of around 50% to a low of 7.5% in March. The bulk of this reduction reflected risk management in the core portfolio as volatility surged to levels last seen during the 2008 failure of Lehman Brothers. By the start of the third quarter, we had taken exposure back to 13.5% and this increased to 27% at the beginning of September. However, as virus case numbers began to rise across Europe and political risk in the US intensified, we reduced our tactical positions, leaving our total exposure to equities at 20.5% at the start of the fourth quarter, comprising a 19% core portfolio weighting and 1.5% tactical weighting. Having recovered strongly through the summer, global equities retrenched in October. With the positive vaccines trial data and US elections results in early November, we increased the core portfolio weighting as volatility gradually dropped as well as the tactical weighting as we became more confident on the outlook for recovery in 2021. We ended the year with equity exposure of 33.5%, comprising a 22.5% core portfolio weighting and 11% tactical weighting.

**Tactical asset allocation strategies**

- Tactical asset allocation strategies build on the core portfolio and operate within a separate risk budget. We take an active approach to tactical asset allocation with a view to adding value irrespective of market direction and continue to see opportunities in relative value trades within and between the broad range of asset classes at our disposal.

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- We are constructive on equities, but remain vigilant around corrections in the short term and would seek to add further on significant weakness. Regionally, our strongest conviction position has been to have more exposure to US stocks, and more recently emerging markets relative to the UK. The US was relatively defensive during the sell-off and a strong performer in the recovery while emerging market equities have been helped by dollar weakness and China's apparent success in suppressing the virus. The UK had been a very poor performer given its larger exposure to resource sectors and ongoing concerns around both the handling of the pandemic and trade deal negotiations with the EU in 2020. However, later in the third quarter, we started to add to UK equities as there are scenarios in which the UK could outperform in a global recovery, particularly once there was clarity around the trading terms or otherwise with the EU. In the fourth quarter, we maintained our constructive position on emerging markets and continued to add to UK equities. We dialled down the US mid-quarter as the balance of risks shifted and the sectors that have driven that market (technology and consumer discretionary) started to appear expensive after outperforming strongly.
- We have maintained a significant tactical position in global high yield bonds, particularly short duration high yield, as we expected the asset class to be resilient over the medium term and felt that high yield bonds offered potential for further outperformance given huge financial support from governments and central banks. This allocation should be less volatile than equities. As the recovery in the real economy started to come through, particularly in industrial production in China, we felt increasingly constructive on commodities. We maintained this positive view across the quarter.
- We shrank currency positions as volatility rose earlier in the year, given uncertainty surrounding global growth prospects. Over the quarter, we have been relatively lightly positioned in currencies due to low interest rate dispersion, except for a weak US dollar trend following the Fed's change to its inflation targeting approach. Against this, we favoured the Singaporean dollar, euro and, to a lesser extent given the UK's Covid-19 challenges, sterling.
- US sector positions: during the crisis we were helped by our positive position in technology relative to hard hit industrials, materials and financials. We adjusted our sector positioning through the particularly dynamic quarter, most notably becoming more constructive on financials and energy which had been badly hit through the year. We ended the quarter again favouring the technology and consumer discretionary sectors, largely compared to utilities.

## Market outlook

- Stock markets continued to climb towards year end on the back of very loose policy that is likely to remain in force given a benign inflation picture. Sentiment has remained positive since the vaccine announcements in early November. Markets could be vulnerable to a short term correction, but we remain constructive on the longer-term recovery.
- We expect 2021 to be a year of global economic recovery. At the broad asset class level, we are positive on global high yield and constructive on equities, and would view a short term sell-off as an opportunity to add further given the good prospects for post-Covid recovery in 2021 as vaccine programmes are rolled out. US breakeven inflation is back to around 2%, but nominal bond yields have stayed low, supporting multiples of growth stocks like US technology. Emerging markets could continue to outperform on dollar weakness and have strong long-term growth prospects.
- Please see our Investment Clock blog for the latest information on our active strategies. Also, talks from the online *RLAM Investment Series* that was held in September/October 2020 can be viewed on BrightTALK.com, including *A multi asset view of the Covid crisis* by Trevor Greetham. Each presentation lasts for 30 minutes, including Q&A.

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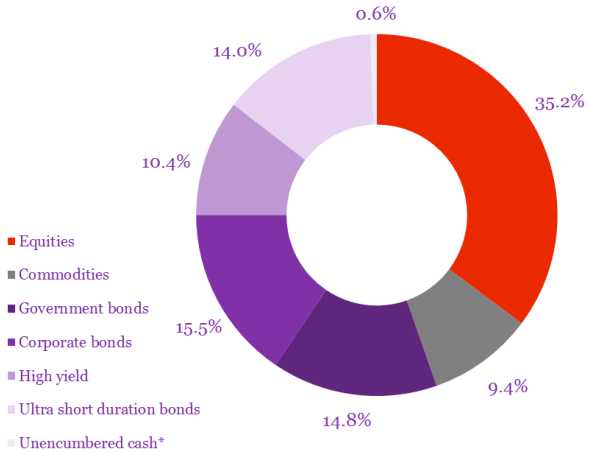
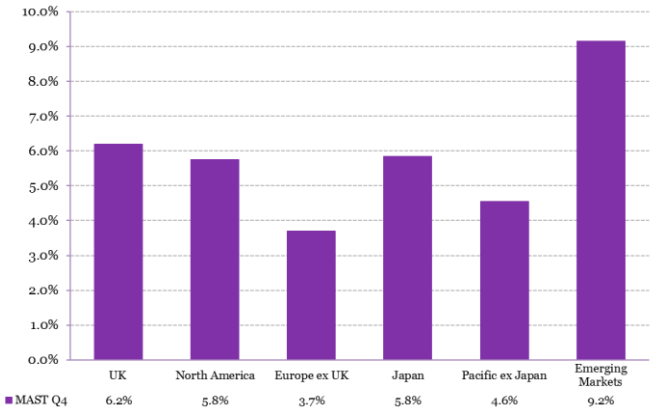
## Asset split




## Regional equity split




*Source: RLAM. 'Other' region includes global fixed income exposures, which are sterling hedged and commodity exposures. Figures calculated on a 'look through' basis, reflecting underlying assets, not fund component weights.*
*We take a holistic approach to fixed income management and fund weights relative to their respective benchmarks may not reflect tactical exposures. Figures calculated on a 'look through' basis, reflecting underlying assets, not fund component weights.*
**Includes allocation to RL Short Term Money Market Fund R (Acc) and cash at margin account and excluding cash backing for Futures*

## Ten largest holdings

| | Asset type | Weighting (%) |
|---|---|---|
| UK Treasury 1.50% 2021 | UK Fixed Income | 13.7 |
| RL Enhanced Cash Plus | UK Fixed Income | 13.3 |
| RL Investment Grade Short Dated Credit Fund | UK Fixed Income | 9.6 |
| RL Short Duration Gilts Fund | UK Fixed Income | 9.5 |
| Commodities ETF | Commodities | 9.0 |
| RL Short-Term Money Market Fund | UK Fixed Income | 8.6 |
| RL Global High Yield | Global High Yield | 8.0 |
| RL UK Government Bond Fund | UK Fixed Income | 4.7 |
| RL Asia Pacific Ex Japan Tracker | Overseas Equities | 2.7 |
| RL Emerging Markets Equity Tracker | Overseas Equities | 2.7 |
| **Total** | | **81.6** |

*Source: RLAM. Information as at 31 December 2020 and correct at that date, unless otherwise stated. Figures exclude derivatives where held, subject to rounding.*

ROYAL LONDON
ASSET MANAGEMENT