ROYAL LONDON SUSTAINABLE FUNDS

Fund Manager Commentary - November 2020

For professional clients only, not suitable for retail investors

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ROYAL LONDON SUSTAINABLE FUND PERFORMANCE

Fund Performance

	1 month (%)	Rolling 12 months (%)
RL Sustainable Managed Income Trust C Acc	**2.31**	**6.82**
IA Sterling Corporate Bond	1.90	6.21
iBoxx £ Non-Gilts All Maturities	1.47	6.08
RL Sustainable Managed Growth Trust C Acc	**2.78**	**8.90**
IA Mixed Investment 0-35%	3.26	3.71
RL Sustainable Diversified Trust C Inc	**3.84**	**11.86**
IA Mixed Investment 20-60% Shares sector	5.72	2.61
RL Sustainable World Trust C Acc	**3.82**	**18.81**
IA Mixed Investment 40-85% Shares sector	7.38	4.77
RL Sustainable Leaders Trust C Acc	**6.74**	**2.32**
IA UK All Companies	13.92	-8.19
FTSE All-Share Index	12.74	-10.29

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 and FE, correct as of 30 November 2020. Returns quoted are net of fees.

ROYAL LONDON SUSTAINABLE MANAGED INCOME TRUST

Portfolio commentary

- Net of fees, the trust strongly outperformed its benchmark (iBoxx Sterling Non-Gilt All Maturities Index) and the IA Sterling Corporate Bond sector in October and delivered top-quartile returns. For the year to date, the fund has outperformed the benchmark and IA peer group.
- The benchmark 10-year gilt yield increased four basis points to 0.31% by the end of the month. Sterling investment grade corporate debt returned 1.48%, outperforming the 0.08% return of UK government bonds. The average sterling investment grade credit spread (the average extra yield available from a corporate bond compared with government debt of equal maturity) tightened sharply by 21 basis points to 1.02%.
- The sustainable approach of the trust favours issuers that we believe offer a net benefit to society or show environmental, social and governance (ESG) leadership. This is reflected in the composition of the sterling credit portfolio, with up to three quarters aligning with five key themes: social housing (provision of housing for those on low or no income), the decarbonised economy (lending to companies playing a key role in the decarbonisation of the economy), infrastructure (vital infrastructure such as water and telecommunications), financial resilience (provision of insurance products to support individuals through shocks) and community funding (banks and building societies focused on individuals and small businesses). The remainder of the credit portfolio, while not aligning to one of the current themes, will still offer a net benefit to society or show ESG leadership.
- Holdings are focused on sectors that benefit from strong covenants (legal restrictions on what an issuer can do) and often offer enhanced security (offering assets as collateral). On sustainability grounds, we have no exposure to bonds of oil & gas companies or extractive industries. We are also underweight in the general industrial and consumer goods sectors, and to a lesser extent in consumer services.
- Total returns were positive across all sterling credit sectors. Within this, subordinated banks and insurance outperformed the wider market, as did asset-backed securities and real estate. The overweight positions in these sectors benefitted performance. Supranational bonds and consumer goods, in which sectors the fund is significantly underweight, both underperformed – indeed, supranationals was the worst-performing sector. Lower-rated bonds (BBB and below) strongly outperformed higher-rated issues, which was particularly positive for performance given our overweight position in BBB rated, sub-investment grade and unrated bonds.
- The trust's targeting in BBB is weighted to community funding (regulated banks and building societies), financial resilience (regulated insurance debt), decarbonisation and infrastructure debt, which have exhibited stable cashflows relative to the wider consumer, retail and industrial BBB areas and lower rating transition risk to sub-investment grade, which is a key risk in the current environment.
- We participated in seven new issues, including a senior opco bond from **Close Brothers**, the UK merchant bank, and a holdco bond issued by **Thames Water**. We also participated in a green bond issue from **Tritax Big Box**, the logistics and distribution real estate trust, and two longer-dated issues from housing associations **Orbit Capital** and **Clarion Group**. Otherwise, we bought a corporate hybrid new issue from **National Express**, the transport operator, and a new issue from builders merchant **Travis Perkins**, which had an attractive 3.75% coupon.

Investment outlook

- The recent lockdown measures in the UK may have jeopardised the economic recovery, which was already slowing, and rising unemployment seems likely. While the positive developments regarding a vaccine rollout may allow society to return to more normal conditions next year, the economy is likely to be compromised over the medium term given the surge in government debt. Interest rates look set to remain at very low levels over the next two or three years, with yield curves heavily managed by central banks.
- While the economic impact of the virus will have a detrimental impact on corporate profitability, we consider that the current credit spread offers sufficient compensation for default and other risks (e.g. liquidity and rating migration). We expect investment grade credit bonds will outperform UK government securities over the next three years.

ROYAL LONDON SUSTAINABLE MANAGED INCOME TRUST

- The sterling credit portfolio is highly diversified in order to improve overall portfolio liquidity and reduce the effect on overall performance of any deterioration in the creditworthiness of an individual holding or sector. The value of diversification in spreading risks is likely to become increasingly clear over the next few months. Our bias towards secured and covenanted debt should provide some mitigation and allow us to better protect our clients' interests. Our sustainable approach and a clear investment philosophy underpin our confidence in the fund's ability to meet the performance objective over the medium term despite the potential for further market volatility.

Shalin Shah
Senior Fund Manager

ROYAL LONDON SUSTAINABLE MANAGED GROWTH TRUST

Portfolio commentary

- Net of fees, the trust underperformed its composite benchmark and the IA Mixed Investment 0-35% Shares sector in November. For the year to date, however, it has significantly outperformed its benchmark and the IA sector, and remains top decile.
- While the credit portfolio performed particularly well, the trust's equity portfolio underperformed its peer group over the month, despite the strong performance of global equities. Relative returns were strong at the start of the month, driven by the US election. However, the positive initial announcements on Covid-19 vaccines subsequently started a rotation into sectors that had previously underperformed, such as energy and travel (including airlines, cruise operators and casinos). These are sectors in which the trust has no exposure; it instead favours growth and quality, which underperformed in the rotation. However, growth stocks started to pick up again towards the end of the month.
- The benchmark 10-year gilt yield increased four basis points to 0.31% by the end of the month. Sterling investment grade corporate debt returned 1.48%, outperforming the 0.08% return of UK government bonds. The average sterling investment grade credit spread (the average extra yield available from a corporate bond compared with government debt of equal maturity) tightened sharply by 21 basis points to 1.02%.
- The sustainable approach of the trust favours issuers that we believe offer a net benefit to society or show environmental, social and governance (ESG) leadership. This is reflected in the composition of the sterling credit portfolio, with up to three quarters aligning with five key themes: social housing (provision of housing for those on low or no income), the decarbonised economy (lending to companies playing a key role in the decarbonisation of the economy), infrastructure (vital infrastructure such as water and telecommunications), financial resilience (provision of insurance products to support individuals through shocks) and community funding (banks and building societies focused on individuals and small businesses). The remainder of the credit portfolio, while not aligning to one of the current themes, will still offer a net benefit to society or show ESG leadership.
- The trust's bond holdings are focused on sectors that benefit from strong covenants (legal restrictions on what an issuer can do) and often offer enhanced security (offering assets as collateral). On sustainability grounds, we have no exposure to bonds of oil & gas companies or extractive industries. We are also underweight in the general industrial and consumer goods sectors, and to a lesser extent in consumer services.
- Total returns were positive across all sterling credit sectors. Within this, subordinated banks and insurance outperformed the wider market, as did asset-backed securities and real estate. The overweight positions in these sectors benefitted performance. Supranational bonds and consumer goods, in which sectors the fund is significantly underweight, both underperformed – indeed, supranationals was the worst-performing sector. Lower-rated bonds (BBB and below) strongly outperformed higher-rated issues, which was particularly positive for performance given our overweight position in BBB rated, sub-investment grade and unrated bonds.
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- We participated in seven new issues, including a senior opco bond from **Close Brothers**, the UK merchant bank, and a holdco bond issued by **Thames Water**. We also participated in a green bond issue from **Tritax Big Box**, the logistics and distribution real estate trust, and two longer-dated issues from housing associations **Orbit Capital** and **Clarion Group**. Otherwise, we bought a corporate hybrid new issue from **National Express**, the transport operator, and a new issue from builders merchant **Travis Perkins**, which had an attractive 3.75% coupon.

Investment outlook

- The recent lockdown measures in the UK may have jeopardised the economic recovery, which was already slowing, and rising unemployment seems likely. While the positive developments regarding a vaccine rollout may allow society to return to more normal conditions next year, the economy is likely to be compromised over the medium term given the surge in government debt. Interest rates look set to remain at very low levels over the next two or three years, with yield curves heavily managed by central banks.
- While the economic impact of the virus will have a detrimental impact on corporate profitability, we consider that the current credit spread offers sufficient compensation for default and other risks (e.g. liquidity and rating migration). We expect investment grade credit bonds will outperform UK government securities over the next three years.
- The sterling credit portfolio is highly diversified in order to improve overall portfolio liquidity and reduce the effect on overall performance of any deterioration in the creditworthiness of an individual holding or sector. The value of diversification in spreading risks is likely to become increasingly clear over the next few months. Our bias towards secured

and covenanted debt should provide some mitigation and allow us to better protect our clients' interests. Our sustainable approach and a clear investment philosophy underpin our confidence in the fund's ability to meet the performance objective over the medium term despite the potential for further market volatility.

- We believe that the global economy will continue to recover, particularly if vaccines can be rolled out successfully in the first half of 2021, and retain a significant weighting in equities. In the equity portfolio, following the strong recovery in many stocks, we continue to think that it is important to maintain a balanced portfolio as the range of outcomes for markets remains uncertain. The fund continues to be invested in a broad range of innovative, well-managed businesses with durable competitive advantages and which are supporting the transition to a more sustainable world. We have confidence that that many of the companies we are invested in will come out of this crisis even stronger than they went in and impressive corporate results from many of our investments support this view.

Shalin Shah
Senior Fund Manager

ROYAL LONDON SUSTAINABLE DIVERSIFIED TRUST

Portfolio commentary

- November proved to be a momentous month for global equity markets. The announcement that three different vaccines have been successfully trialled with efficacy rates at the upper end of expectations provides hope that the world will return to a more normal path in a relatively short period of time. Equity markets responded very positively, with the FTSE All-Share Index rising by 12.7% and the MSCI All Countries World Index rising by nearly 9%. Understandably, the biggest gains were in those sectors that had been hit hardest since the onset of Covid-19, with oil & gas, banks and telecoms all rising significantly. The markets also benefitted from the US election not being contested as had been feared and, despite the Democrats winning the Presidency, there wasn't a 'clean sweep', reducing the likelihood of a range of radical policies being passed by Congress.
- Corporate bonds delivered strong positive returns in November, with credit spread tightening by over 20 basis points to reach new lows for the year. This has been driven by an improving global growth outlook due to the positive vaccine news. Gilt yields rose marginally, ending the month at 0.31%, sharply higher than the all-time low of 0.08% in August.
- The trust underperformed in November. Relative returns at the start of the month were strong, driven by the US election. However, the vaccine announcements subsequently started a rotation into sectors that had previously underperformed, such as energy and travel (including airlines, cruise operators and casinos). These are sectors in which the trust has no exposure; it instead favours growth and quality, which underperformed in the rotation. UK hygiene and pest control specialist **Rentokil,** US healthcare and life sciences laboratory equipment manufacturer **Thermo Fisher Scientific** and UK credit data specialist **Experian** fell in the month, reflecting their profile as high-quality, growth companies, all of which have performed well from the lows in March. On the other hand, UK baker **Greggs** and **Aptiv**, the US supplier of automotive electrical components, both performed well. Following the vaccine news, Greggs was a beneficiary of the increased optimism about the reopening of the economy. Automotive production (and electric vehicles in particular) has also seen an impressive recovery of late.
- During the month, we added to the holdings in German sportswear and 'athleisure' leader **Adidas** and UK green chemicals company **Croda**, where we participated in a share placing by the company to fund an acquisition. While we are monitoring the ongoing sector rotation, we have not materially altered the portfolio in response.

Mike Fox

Head of Sustainable Investments

ROYAL LONDON SUSTAINABLE WORLD TRUST

Portfolio commentary

- November proved to be a momentous month for global equity markets. The announcement that three different vaccines have been successfully trialled with efficacy rates at the upper end of expectations provides hope that the world will return to a more normal path in a relatively short period of time. Equity markets responded very positively, with the FTSE All-Share Index rising by 12.7% and the MSCI All Countries World Index rising by nearly 9%. Understandably, the biggest gains were in those sectors that had been hit hardest since the onset of Covid-19, with oil & gas, banks and telecoms all rising significantly. The markets also benefitted from the US election not being contested as had been feared and, despite the Democrats winning the Presidency, there wasn't a 'clean sweep', reducing the likelihood of a range of radical policies being passed by Congress.
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- During the month, we added to our holding in US railroad operator, **CSX**, and French cosmetics and personal care company **L'Oreal**. While we are monitoring the ongoing sector rotation, we have not materially altered the portfolio in response.

Mike Fox

Head of Sustainable Investments

ROYAL LONDON SUSTAINABLE LEADERS TRUST

Portfolio commentary

- November proved to be a momentous month for global equity markets. The announcement that three different vaccines have been successfully trialled with efficacy rates at the upper end of expectations provides hope that the world will return to a more normal path in a relatively short period of time. Equity markets responded very positively, with the FTSE All-Share Index rising by 12.7%. Understandably, the biggest gains were in those sectors that had been hit hardest since the onset of Covid-19, with oil & gas, banks and telecoms all rising significantly. The markets also benefitted from the US election not being contested as had been feared and, despite the Democrats winning the Presidency, there wasn't a 'clean sweep', reducing the likelihood of a range of radical policies being passed by Congress.
- The trust underperformed in November. Relative returns at the start of the month were strong, driven by the US election. However, the vaccine announcements subsequently started a rotation into sectors that had previously underperformed, such as energy and travel (including airlines, cruise operators and casinos). These are sectors in which the trust has no exposure; it instead favours growth and quality, which underperformed in the rotation. Hygiene and pest control specialist **Rentokil** and credit data specialist **Experian** were two UK names that fell in the month, reflecting their profile as high-quality, growth companies, which have both performed well from the lows in March. Enterprise software company **Sage** had a second month of underperformance. The company announced that it needs to invest more in research & development and sales, which will impact on its margins. In contrast, UK housebuilder **Vistry** and baker **Greggs** performed well, reflecting the rotation.
- During the month, we added to positions in **Compass**, the UK multinational food services operator, and insurer **Legal & General**. While we are monitoring the ongoing sector rotation, we have not materially altered the portfolio in response.

Mike Fox

Head of Sustainable Investments

ROYAL LONDON GLOBAL SUSTAINABLE EQUITY FUND

Portfolio commentary

- November proved to be a momentous month for global equity markets. The announcement that three different vaccines have been successfully trialled with efficacy rates at the upper end of expectations provides hope that the world will return to a more normal path in a relatively short period of time. Equity markets responded very positively, with the MSCI All Countries World Index rising by nearly 9%. Understandably, the biggest gains were in those sectors that had been hit hardest since the onset of Covid-19, with oil & gas, banks and travel-related companies all rising significantly. The markets also benefitted from the US election not being contested as had been feared and, despite the Democrats winning the Presidency, there wasn't a 'clean sweep', reducing the likelihood of a range of radical policies being passed by Congress.
- Relative returns at the start of the month were strong, driven by the US election. However, the vaccine announcements subsequently started a rotation into sectors that had previously underperformed, such as energy and travel (including airlines, cruise operators and casinos). These are sectors in which the trust has no exposure; it instead favours growth and quality, which underperformed in the rotation. UK hygiene and pest control specialist **Rentokil,** US healthcare and life sciences laboratory equipment manufacturer **Thermo Fisher Scientific** and UK credit data specialist **Experian** fell in the month, reflecting their profile as high-quality, growth companies, all of which have performed well from the lows in March. On the other hand, **MercadoLibre**, the Latin American ecommerce and digital payments platform, **Aptiv**, the US supplier of automotive electrical components, and **Wabtec**, the US manufacturer of rail locomotives and components, performed strongly.
- During the month, we took some profits from our position in **Orsted**, the Danish windfarms builder and operator, and initiated a new position in **Iqvia**. This US company is a leading information and technology service provider to the healthcare industry. Its strategy is based on greater and more effective use of data to helps its clients to improve their clinical, scientific and commercial results. While we are monitoring the ongoing sector rotation, we have not materially altered the portfolio in response.

Mike Fox

Head of Sustainable Investments

George Crowdy

Fund Manager

ROYAL LONDON
ASSET MANAGEMENT

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