ROYAL LONDON EQUITIES

Fund Manager Commentary – October 2020

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CONTENTS

RLAM EQUITY PERFORMANCE

Fund Performance

	1 month (%)	Rolling 12 months (%)
RL UK Equity Income M Inc	**-3.57**	**-22.56**
IA UK Equity Income Sector	-3.83	-21.05
FTSE All Share Index	-3.82	-18.64
RL UK Dividend Growth Fund M Acc	**-3.76**	**-12.54**
IA UK All Companies Sector	-3.70	-16.28
FTSE All Share Index	-3.82	-18.64
RL UK Mid Cap Growth Fund M Acc	**-0.37**	**-10.05**
IA UK All Companies Sector	-3.70	-16.28
FTSE 250 ex-IT Index	-1.03	-16.98
RL UK Opportunities Fund M Acc	**-2.39**	**-15.67**
IA UK All Companies Sector	-3.70	-16.28
FTSE All Share Index	-3.82	-18.64
RL UK Smaller Companies Fund M Acc	**1.17**	**1.13**
IA UK Smaller Companies Sector	0.57	-0.74
FTSE Small Cap ex-IT Index	1.89	-11.52

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 31 October 2020. Returns quoted are net of fees.

ROYAL LONDON UK EQUITY INCOME FUND

Portfolio Commentary

- During October, the fund was ahead of both the FTSE All Share index and competitor funds. Positive contributors to performance included **McCarthy & Stone** and **Close Brothers**. Detractors included **Hargreaves Lansdown** and **Paragon**. McCarthy & Stone agreed an all-cash bid from private equity group Lone Star, at a significant premium to the prevailing share price. The bid is both well timed and opportunistic, and the shares are currently trading slightly above the bid price, reflecting the possibility that a trade buyer with synergies may now look at the business. We would not be surprised to see more such opportunistic bids over the winter.
- During October the shape of the portfolio has not changed materially, maintaining a balance between domestic and international earnings, with activity largely focussed on broadly-based trades to cover client activity. The fund is maintaining liquidity so that it has the flexibility to participate in any fund raisings that result from the current challenging economic conditions.

Investment Outlook

- The national lockdown of the UK, combined with similar moves by large European countries such as France and Germany, means European economies face a challenging winter. In addition, we face uncertainty over Brexit and the results of the US presidential election, which could result in elevated market volatility. However, more encouragingly, we have seen a range of companies reinstate their dividends, including a number held by the equity income fund. We believe companies are now much more on the front foot and planning for the future, but longer-term economic scarring from the pandemic feels inevitable. We will continue to target those companies which we believe possess good medium- and longer-term dividend paying capacity, without chasing dividend in the short term, and will retain a breadth and depth of industry exposure. We are very much sticking to our investment process and using it to guide us through the crisis.

Martin Cholwill

Head of UK Income Equities

ROYAL LONDON UK DIVIDEND GROWTH FUND

Portfolio Commentary

- The fund performed better than the benchmark index but behind its peer group during October, returning -3.76% and ranking in the 52nd percentile. Performance benefitted from the holdings in **Dechra Pharmaceuticals** and **TI Fluid**. Dechra published a trading statement that showed trading was going better than expectations and TI Fluid was boosted by a positive broker recommendation. The fund's holding in the pork producer **Cranswick** was relatively weak, following an announcement that production was disrupted by a Covid-19 outbreak among the staff at one of its factories.
- During the month, we reduced holdings in **Ascential** and **Hikma**, in both cases after strong share price performance. We also added to holdings in the oil sector, from **Royal Dutch Shell** and **BP**. The oil sector has been under great pressure for some time, facing the twin issues of weak oil prices and the need to reposition towards less carbon-intensive energy sources. Both companies have now announced strategies to tackle this challenge, as well as cutting dividend payments to a more sustainable level. The sector remains deeply out of favour with many investors, and does not seem to be pricing in the possibility of the companies seeing any success from their plans, but with sentiment so extreme, there could be significant share price upside should the companies make any headway towards their goals.

Investment Outlook

- Equity markets remain volatile as sentiment ebbs and flows about the trajectory of the Covid-19 impacts, potential consequences of negotiations around Brexit, and the outcome of the US presidential race between Donald Trump and Joe Biden. As consistently stated, we look to invest in a range of companies that are in control of their own fates, irrespective of market conditions. The Covid-19 shock is proving a stern test of this process, and the resilience of those companies, but we continue to believe that the approach is serving investors well. As well as looking for durable businesses, a willingness to look through short-term extremes of sentiment and buy stocks when they are out of favour, or take profits when sentiment becomes exuberant, should drive longer-term performance.

Richard Marwood

Senior Fund Manager

Niko De Walden

Fund Manager

ROYAL LONDON UK MID CAP GROWTH FUND

Portfolio Commentary

- October saw a modest decline in UK equity markets as the government announced further restrictions on activity due to Covid-19, as well as uncertainty related to the US election. The fund returned -0.4%, ahead of both the benchmark (the FTSE 250 ex-IT index) return of -1.0%, and the peer group median return of -3.7%. This relative outperformance was driven by stock selection within the technology and industrials sectors, as well as sector allocation from the overweight positions in the healthcare and telecoms sectors.
- **GB Group**, the digital identity verification company, and **Watches of Switzerland**, the specialist retailer, were among the top positive contributors in the month. GB Group provided a trading update for its first half results, which detailed double-digit organic revenue and profit growth; materially better than market expectations for the period which included peak Covid-19 disruption. While some of this growth was a result of a large one-off project for the US Treasury, underlying revenue growth was still significantly ahead of expectations, and demonstrates the resilience of the group's positioning in attractive end markets. Watches of Switzerland also announced a first half trading update which was much better than expected, driven by strong sales performance in the US. After successfully launching new online sales channels, management now expects to grow revenues by double digits for the full year, despite the declines in international tourists through its airport stores, and the impact of lockdowns in the UK.

Investment Outlook

- With much of Western Europe imposing new lockdowns or increased restrictions on non-essential retail, travel and leisure activity, it is unsurprising that these sectors bore the brunt of the modest selloff in global equity markets. Uncertainty over the looming US presidential election, as well as the UK's approaching deadline to announce a trade deal with the EU before the 31 December, also reduced investor risk appetite. Nevertheless, the theme of corporate earnings recovering faster than expected continued, with expectations for significant earnings growth in the FTSE 250 in 2021 now looking well underpinned. We continue to expect a period of better economic activity and synchronised growth across major markets next year, and are optimistic that our portfolio companies will typically outperform their end markets.
- We focus our efforts on investing in cash-generative small- and medium-sized companies, with strong balance sheets, structural earnings growth opportunities and valuation optionality.

Henry Lowson

Head of UK Alpha Equities

CITYWIRE AAA

FE ALPHA MANAGER 2018 HENRY LOWSON

ROYAL LONDON UK OPPORTUNITIES FUND

Portfolio Commentary

- October proved to be a difficult month for global markets as sentiment turned following an increase in Covid-19 cases. Germany and France placed further restrictions upon activity levels and they were followed by Westminster's decision to impose a further lockdown in England. Inevitably, this will impact swathes of the economy and GDP in general. In the UK, the FTSE All-Share Index declined 3.8%.
- The fund performed well on a relative basis during October, returning -2.4%. The FTSE 100 declined by 4.8% over the month, whereas the FTSE 250 and Small Cap indices were broadly flat. The strongest performers on a stock basis were **TI Fluid** and **Synthomer**, up by 25% and 20% respectively. The change in sentiment towards auto-related stocks was marked, helping TI in particular. Synthomer upgraded expectations for the year and flagged it would be paying a dividend. Other stocks which performed admirably included **OneSavings Bank** and **Lloyds**, as well as **Chemring**. On the downside, **Prudential** proved friendless, falling 15%, and **Hargreaves Lansdown** dropped 13%.

Investment Outlook

- October was a busy month for the fund as we added two new stocks and disposed one. We sold our stake in **Compass Group** because we thought the road back to previous levels of profitability was going to take longer and prove more problematic than we first had envisaged. The two new stocks we bought were **Computacenter** and **Tesco**. Computacenter is a leading provider of IT infrastructure services. The company advises organisations on their IT strategies and implements the most appropriate technologies whilst optimising performance. We added Tesco as we believe it has done the right thing in exiting its Asian businesses, strengthening its balance sheet and returning excess capital to shareholders. On a very undemanding rating, we believe the company is materially undervalued.

Craig Yeaman

Senior Fund Manager

ROYAL LONDON UK SMALLER COMPANIES FUND

Portfolio Commentary

- The UK Smaller Companies universe outperformed other UK equity markets during October, as most global markets declined in advance of the US election, amid tightening restrictions on activity in Europe due to Covid-19. The fund returned 1.2%, behind the benchmark (the FTSE Small Cap ex-IT index) return of 1.9%, but ahead of the peer group median return of 0.6%. The relative underperformance compared to the benchmark was predominantly a result of stock selection within the healthcare sector, partly offset by a strong performance within the technology sector. Overall, sector allocation provided a positive contribution to relative returns.
- **GB Group**, the digital identity verification company, and **Boku**, the mobile payments provider, were among the top positive contributors in the month. GB Group provided a trading update ahead of its interim results, which detailed double-digit organic revenue and profit growth; materially better than market expectations for the period including peak Covid-19 disruption. While some of this growth was a result of a large one-off project for the US Treasury, underlying revenue growth was still significantly ahead of expectations which were recalibrated in April, and demonstrates the resilience of the group's positioning in attractive end markets. Boku did not make any announcements, however two new analysts initiated coverage during September (doubling the total) after impressive updates earlier in the year, and this helped drive the share price higher.
- **Clinigen**, the specialty pharmaceutical and clinical services company, was the largest detractor from performance during the month. One of its products is being used as part of a new cancer therapy (currently in clinical trials) by US biotech Iovance; the trial results were delayed by 6 months. While this had no effect on Clinigen's current or forecast earnings, it did remove a potential positive catalyst and the share price declined.

Investment Outlook

- With much of Western Europe imposing new lockdowns or increased restrictions on non-essential retail, travel and leisure activity, it is unsurprising that these sectors bore the brunt of the modest selloff in global equity markets. Uncertainty over the looming US presidential election, as well as the UK's approaching deadline to announce a trade deal with the EU before the 31 December, also reduced investor risk appetite. Nevertheless, the theme of corporate earnings recovering faster than expected continued, with expectations for significant earnings growth in the FTSE Small Cap Index in 2021 now looking well underpinned. We continue to expect a period of better economic activity and synchronised growth across major markets next year, and are optimistic that our portfolio companies will typically outperform their end markets.
- We focus our efforts on investing in cash-generative smaller companies with strong balance sheets, structural earnings growth opportunities and valuation optionality.

FE ALPHA MANAGER 2018 HENRY LOWSON CITYWIRE AAA

Henry Lowson

Head of UK Alpha Equities

Henry Burrell

Fund Manager

ROYAL LONDON GLOBAL EQUITY INCOME FUND

Portfolio commentary

- Key drivers of performance were the fund's financial holdings, where not only did the sector overweight benefit, but strong stock selection also helped. **Truist** performed particularly strongly as it, and other banks, exhibited strong capital market revenue trends, as well as much lower provisions than the market was expecting. We remain overweight US banks in the belief that their revenue streams are less interest rate sensitive and their loan losses are likely lower than valuations assume. The former reflects their diversified fee-driven revenue streams and the latter is due to cautious lending pre-Covid and government stimulus inflating assets against which loans are secured and supporting consumer cashflows. **Fuyao Glass** continued its strong momentum, being one of the top performers for the second successive month on the back of strong results showing the structural market share gains of glass within car roofs. The fund's healthcare stocks continued to drag on performance as fears of a 'Blue wave' in the US election continued to grow.
- October was a quiet month for trading activity. The only trades of note were our continual addition to **Royal Dutch Shell** to reduce the fund's underweight to oil; which has been a large benefit to relative performance. While the structural demand outlook is negative, supply could easily remain in tandem and valuations are at extremely low levels on a cashflow basis, as oil companies run their upstream operations for cash. This was funded by reductions in **Lear**, which has bounced back strongly in recent months, and Norwegian Telecoms operator **Telenor**.

Investment outlook

- Markets increasingly appear to be pricing in low discount rates forever, and while we see no catalyst for this to change, quality growth stocks within the fund remain vulnerable should the economic backdrop improve due to their high valuations. As a result, we feel a balanced approach, holding a diverse range of companies from different sectors, regions and stages of life cycle, is the correct one and can deliver consistent outperformance over time, across a range of macro scenarios.

Niko De Walden

Fund Manager

ROYAL LONDON
ASSET MANAGEMENT

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