ROYAL LONDON SUSTAINABLE FUNDS

Fund Manager Commentary - October 2020

For professional clients only, not suitable for retail investors

CONTENTS

ROYAL LONDON SUSTAINABLE FUND PERFORMANCE

Fund Performance

	1 month (%)	Rolling 12 months (%)
RL Sustainable Managed Income Trust C Acc	**0.14**	**5.08**
IA Sterling Corporate Bond	0.20	4.39
iBoxx £ Non-Gilts All Maturities	0.12	4.35
RL Sustainable Managed Growth Trust C Acc	**-0.59**	**6.89**
IA Mixed Investment 0-35%	-0.71	0.92
RL Sustainable Diversified Trust C Inc	**-1.87**	**9.83**
IA Mixed Investment 20-60% Shares sector	-1.23	-1.81
RL Sustainable World Trust C Acc	**-2.88**	**17.54**
IA Mixed Investment 40-85% Shares sector	-1.75	-0.65
RL Sustainable Leaders Trust C Acc	**-4.42**	**-1.43**
IA UK All Companies	-3.70	-16.28
FTSE All-Share Index	-3.82	-18.64

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 SUSTAINABLE MANAGED INCOME TRUST

Portfolio commentary

- Net of fees, the trust marginally underperformed its benchmark (iBoxx Sterling Non-Gilt All Maturities Index) and the IA Sterling Corporate Bond sector in October. For the year to date, the fund is slightly lagging the benchmark and IA peer group, but is still second quartile.
- The benchmark 10-year gilt yield increased three basis points to 0.26% by the end of the month. Sterling investment grade corporate debt returned 0.14%, outperforming the -0.56% 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 by six basis points to 1.23%.
- Our sustainable approach 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 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 portfolio, while not aligning to one of the current themes, will still offer a net benefit to society or show ESG leadership.
- The trust is 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 generally positive across sterling credit sectors. Subordinated banks outperformed, although this was offset by underperformance in subordinated insurance. Covered bonds also outperformed, which marginally benefitted performance. Conversely, secured and structured bonds were relatively weak, with real estate markedly underperforming, which adversely affected performance. Supranationals marginally underperformed the broad market, which supported performance given our significant underweight in this large sector. Lower-rated bonds (BBB and below) strongly outperformed higher-rated issues, which was positive for performance given our overweight positions in 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 six new issues, including subordinated insurance issues from **Just Group** and **Pension Insurance Corporation**, and a senior banks issue from **Barclays**. We also bought a new issue from the social housing aggregator **Blend Funding**. We also bought bonds from packaging and PPE supplier **Bunzl**. Lastly, we participated in the issue of AAA rated structured bonds from **SGSHR 1X,** secured on social housing with a low loan-to-value ratio.

Investment outlook

- The UK's economic recovery, which had already been slowing during the summer, may be jeopardised by recent lockdown measures and rising unemployment seems likely. Even if the measures succeed in curtailing the spread of Covid-19 and society can return to more normal conditions, 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 governments.
- 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 trust 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 in October, but outperformed the IA Mixed Investment 0-35% Shares sector. For the year to date, it has significantly outperformed its benchmark and the IA sector, and is top decile. The trust's equity portfolio underperformed its peer group over the month, while the credit portfolio performed broadly in line with the IA Sterling Corporate Bond sector.
- The benchmark 10-year gilt yield increased three basis points to 0.26% by the end of the month. Sterling investment grade corporate debt returned 0.14%, outperforming the -0.56% 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 by six basis points to 1.23%.
- Global equities were weaker in October, reflecting the impact of renewed national lockdowns in Europe, rising Covid-19 cases in the UK and US, and increased political risks. The normal uncertainty that surrounds the potential outcome for the US election has also added to the downbeat sentiment and hopefully, once this is resolved, investors will welcome greater certainty. At the sector level during October, banks performed well reflecting improved trading news coupled with very low valuations, while healthcare was one of the worst performers, relating to uncertainty about US healthcare policy, which will be resolved after the election.
- 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 generally positive across sterling credit sectors. Subordinated banks outperformed, although this was offset by underperformance in subordinated insurance. Covered bonds also outperformed, which marginally benefitted performance. Conversely, secured and structured bonds were relatively weak, with real estate markedly underperforming, which adversely affected performance. Supranationals marginally underperformed the broad market, which supported performance given our significant underweight in this large sector. Lower-rated bonds (BBB and below) strongly outperformed higher-rated issues, which was positive for performance given our overweight positions in sub-investment grade and unrated bonds.
- The fund'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 six new issues, including subordinated insurance issues from **Just Group** and **Pension Insurance Corporation**, and a senior banks issue from **Barclays**. We also bought a new issue from the social housing aggregator **Blend Funding**. We also bought bonds from packaging and PPE supplier **Bunzl**. Lastly, we participated in the issue of AAA rated structured bonds from **SGSHR 1X,** secured on social housing with a low loan-to-value ratio.

Investment outlook

- The UK's economic recovery, which had already been slowing during the summer, may be jeopardised by recent lockdown measures and rising unemployment seems likely. Even if the measures succeed in curtailing the spread of Covid-19 and society can return to more normal conditions, 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 governments.
- 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 a vaccine 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

- October saw a further decline in equity markets as Covid-19 cases continued to rise. Large economies such as Germany and France placed further restrictions upon activity levels to try to stem the rise in cases and the UK government followed after month end. This will inevitably have an impact on economies and rates of growth: as a result, the MSCI ACWI Index declined by 2.5% in sterling terms during the month. The normal uncertainty that surrounds the potential outcome for the US election has also added to the downbeat backdrop for markets and hopefully, once this is resolved, investors will welcome greater certainty. At the sector level during October, banks performed well reflecting improved trading news coupled with very low valuations, while healthcare was one of the worst performers, relating to uncertainty about US healthcare policy, which will be resolved after the election.
- Within fixed income, the ML Sterling Non Gilt Index returned 0.14% for October, outperforming gilts, which posted negative returns of 0.56%, in a generally risk-on month. The best-performing large sector was capital goods, which returned 1.13% during the month, followed by media and consumer goods. The worst performing sectors included ABS, insurance and telecommunications, with flat month-on-month returns.
- The trust underperformed in October. Two key stock detractors from returns were **Sage** and **Adobe**. Sage, the UK enterprise software company, fell after its German peer, SAP, issued a profit warning. Adobe, a US provider of software tools to the creative industries, was caught up in profit taking in the information technology sector ahead of the US election. On the other hand, **Alphabet**, the US parent company of Google, reported results that exceeded the market's expectations, with particular strength in its search and cloud businesses. **Thermo Fisher**, a US life sciences company, also performed strongly following impressive quarterly results.
- During the month we added to our holding in **Nordson**, a US company which makes precision parts for industrial applications. Its products facilitate meaningful energy and materials savings for customers, which makes it a good fit from a sustainability perspective.

Mike Fox

Head of Sustainable Investments

ROYAL LONDON SUSTAINABLE WORLD TRUST

Portfolio commentary

- October saw a further decline in equity markets as Covid-19 cases continued to rise. Large economies such as Germany and France placed further restrictions upon activity levels to try to stem the rise in cases and the UK government followed after month end. This will inevitably have an impact on economies and rates of growth: as a result, the MSCI ACWI Index declined by 2.5% in sterling terms during the month. The normal uncertainty that surrounds the potential outcome for the US election has also added to the downbeat backdrop for markets and hopefully, once this is resolved, investors will welcome greater certainty. At the sector level during October, banks performed well reflecting improved trading news coupled with very low valuations, while healthcare was one of the worst performers, relating to uncertainty about US healthcare policy, which will be resolved after the election.
- Within fixed income, the ML Sterling Non Gilt Index returned 0.14% for October, outperforming gilts, which posted negative returns of 0.56%, in a generally risk-on month. The best-performing large sector was capital goods, which returned 1.13% during the month, followed by media and consumer goods. The worst performing sectors included ABS, insurance and telecommunications, with flat month-on-month returns.
- The trust underperformed in October. The key stock positive contributors to performance included **Orsted** and **Alphabet**. Danish wind farm builder and operator Orsted reported solid results and continues to benefit as more countries adopt offshore wind as a key solution to meeting decarbonisation targets. Alphabet, the US parent company of Google, reported results that exceeded the market's expectations, with particular strength in its search and cloud businesses. The key detractor during the month was **Adobe**, a US provider of software tools to the creative industries, was caught up in profit taking in the information technology sector ahead of the US election.
- During the month we added to our holding in **Nordson**, a US company which makes precision parts for industrial applications. Its products facilitate meaningful energy and materials savings for customers, which makes it a good fit from a sustainability perspective.

Mike Fox

Head of Sustainable Investments

ROYAL LONDON SUSTAINABLE LEADERS TRUST

Portfolio commentary

- October saw a further decline in equity markets as Covid-19 cases continued to rise. Large economies such as Germany and France placed further restrictions upon activity levels to try to stem the rise in cases and the UK government followed after month end. This will inevitably have an impact on economies and rates of growth. In the UK, the FTSE All-Share Index declined by 3.8% as markets continued to fall from the recent post-Covid high in May. The normal uncertainty that surrounds the potential outcome for the US election has also added to the downbeat backdrop for markets and hopefully, once this is resolved, investors will welcome greater certainty. At the sector level during October, banks performed well reflecting improved trading news coupled with very low valuations, while healthcare was one of the worst performers, relating to uncertainty about US healthcare policy, which will be resolved after the election.
- UK enterprise software company, **Sage**, and **Prudential**, the UK insurer, were two of the bigger detractors from returns. Sage fell after its German peer, SAP, issued a profit warning and Prudential suffered from market weakness. Despite this, we believe that it remains well placed to benefit from trends in its key Asian markets. On the positive, **Alphabet**, the US parent company of Google, reported results that exceeded the market's expectations, with particular strength in its search and cloud businesses. As such, it performed strongly during the month.
- During the month, we added to positions in **Prudential** and **London Stock Exchange**, whose share prices declined for no apparent reason, and reduced the position in Alphabet, following its strong results.

Mike Fox

Head of Sustainable Investments

ROYAL LONDON GLOBAL SUSTAINABLE EQUITY FUND

Portfolio commentary

- October saw a further decline in equity markets as Covid-19 cases continued to rise. Large economies such as Germany and France placed further restrictions upon activity levels to try to stem the rise in cases and the UK government followed after month end. This will inevitably have an impact on economies and rates of growth. The normal uncertainty that surrounds the potential outcome for the US election has also added to the downbeat backdrop for markets and hopefully, once this is resolved, investors will welcome greater certainty. The MSCI ACWI Index declined by 2.5% in sterling during the month.
- Despite health care and information technology, in which the fund is overweight, being among the weakest-performing sectors, the fund outperformed the index. The key contributors to performance included **Orsted** and **Alphabet**. Danish wind farm builder and operator Orsted reported solid results and continues to benefit as more countries adopt offshore wind as a key solution to meeting decarbonisation targets. Alphabet, the US parent company of Google, reported results that exceeded the market's expectations, with particular strength in its search and cloud businesses. The key detractor was **Adobe**, a US provider of software tools to the creative industries, was caught up in profit taking in the information technology sector ahead of the US election.
- Our primary transaction during the month was to continue to build up our new positon in **Rentokil Initial**. This UK company is at the forefront of providing health and hygiene solutions to a broad range of industries, and should provide an attractive investment opportunity as it continues to execute well and deliver solid organic growth, which will likely be supplemented by M&A.

CITYWIRE AAA

Mike Fox

Head of Sustainable Investments

George Crowdy

Fund Manager

ROYAL LONDON
ASSET MANAGEMENT