ROYAL LONDON GLOBAL EQUITY SELECT

Quarterly Report 30 September 2020

For professional clients only, not suitable for retail investors

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Top 10 holdings

	Fund (%)
Microsoft	5.3
Amazon	5.0
Steel Dynamics	4.9
Visa	4.7
Reliance Steel & Aluminum Co.	4.4
Taiwan Semiconductor Manufacturing Co.	4.3
Church & Dwight Co.	4.2
Church and Dwight	4.1
Anglo American	4.1
Verizon Communications Inc.	3.9
Total	**44.9**

Source: RLAM, based on the M Acc share class, subject to rounding.

Fund data

	Fund
No. of stocks	32
Fund size	£236.3m
Launch date	10.10.2017
Active share	86.6%
Tracking error	3.9%

Performance

	Fund* (%)	Benchmark[1] (%)	Relative (%)
Q3 2020	**3.99**	**3.15**	**0.84**
Year-to-date	7.15	4.22	2.93
1 year p.a	8.79	5.24	3.55
Since inception p.a. 10.10.2017	10.96	8.22	2.74

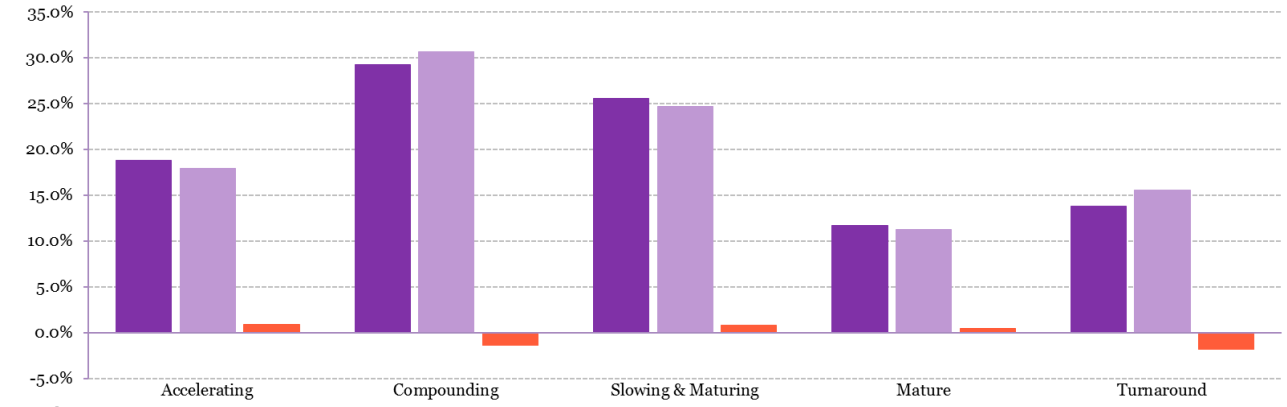
Past performance is not necessarily a reliable indicator of future performance. The value of investments and the income from them is not guaranteed and may go down as well as up and investors may not get back the amount originally invested.

Source RLAM. All performance figures stated gross of fees and tax unless otherwise stated, subject to rounding.

[1]Benchmark: MSCI World NDR Index.

**Performance refers to R Acc share class unless otherwise stated. M Acc share class launched on 05.03.2018. Initial share class at fund launch was R Acc.*

Holdings and Weights



	Accelerating	Compounding	Slowing & Maturing	Mature	Turnaround
% Select	18.8%	29.3%	25.6%	11.7%	13.8%
% Index	17.9%	30.6%	24.7%	11.2%	15.6%
% Active	0.9%	-1.4%	0.9%	0.5%	-1.8%

Source: RLAM as at 30 September 2020.

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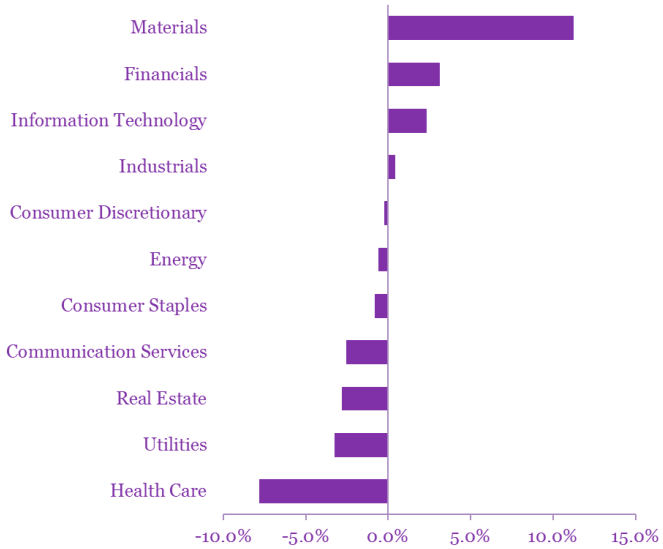
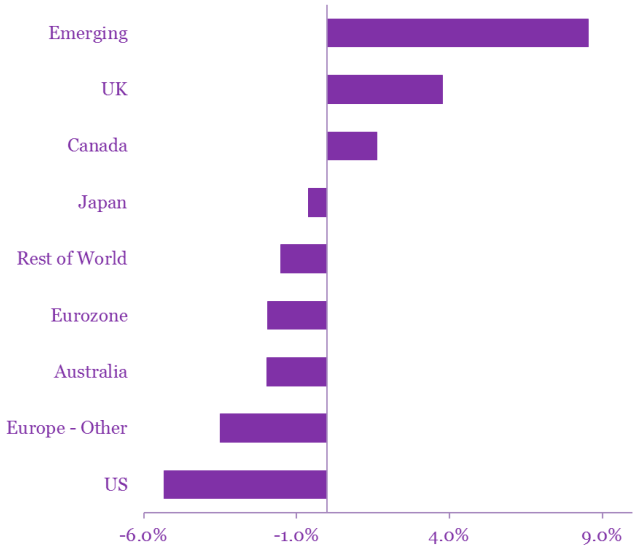
Sector Weights



Regional Weights



Source: RLAM as of 30 September 2020. Shows weight relative to index.

Executive summary – RLAM Global Equity strategies

- Our Global Equity strategies delivered good absolute and relative performance in the third quarter as equity markets continued to recover from their lows at the start of the Covid-19 crisis, albeit less explosively than in the previous quarter. Our pooled funds delivered net returns of +3.84% for the **RL Global Equity Select Fund** and +3.23% for the **RL Global Equity Diversified Fund**, compared with +3.15% for the benchmark (MSCI World Net Total Return in sterling). For the year-to-date, the funds have returned +6.60% and +2.98%, respectively, against +4.22% for the benchmark (fund returns net of fees, for M Acc share classes).
- The third quarter was far less dramatic than the first quarter, when the pandemic first hit global equities, or the second, in which unprecedented governmental and central bank action helped investors to look through the shocking economic impact of national lockdowns. It was instead characterised by the recovery in real economic activity as lockdowns continued to ease tempered by fragile consumer confidence and further spikes in Covid-19 cases, leading to local lockdowns and renewed travel restrictions. In addition, geopolitics re-emerged as an investment risk, with increasing concerns about the US presidential election in November and the possibility that negotiations between the UK and European Union will fail to deliver a mutually-acceptable trade deal.
- The strong recovery in global equity markets over the second and third quarters means that risk and return are more balanced in the shorter term. Uncertainty remains around both the speed and the shape of any economic recovery and this continues to create market volatility, which could be exacerbated by further lockdowns, a failure to agree a post-Brexit trade deal or political and social tension in the US during or after November's elections.
- Significant upside from here will require the global economy to recover more strongly and probably an effective vaccine and treatment regimen for Covid-19. There may be challenging periods over the next 12 months driven by further waves of the virus. However, it is clear that governments and central banks are committed to the long haul. In the longer term, we believe that equities offer significant value against bonds and the equity discount rate is not extended.
- Our preference is to own higher-quality companies with strong balance sheets and a conservative approach to credit diversified across regions, countries, industries and Corporate Life Cycle categories. No single model or analysis is a magic bullet for investing, but our Corporate Life Cycle model helps us to understand the world as management teams see it and identify those that are actively responding to the crisis. Owning companies that merely survive the pandemic won't deliver significant outperformance. We are looking for the 'Accelerators' that are increasing investment to take full advantage of the current environment, and 'Slowing & Maturing' or 'Turnaround' companies that are doubling down on restructuring.

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Market overview

- Major global stock markets were more muted in the third quarter after the previous quarter's dramatic recovery, but still posted positive aggregate returns in sterling terms. The MSCI benchmark rose +3.6%. However, within this there was a wide geographical dispersion, with the UK and many European markets falling, and the US once again proving robust (+5.1%).
- As with the last quarter, the market recovery may seem surprising given the ongoing Covid-19 crisis. Indeed, the pandemic has had clear negative impacts on corporate performance, which in some cases look to be structural rather than a shorter, cyclical hit. However, the monetary and fiscal responses have been equally dramatic, and have driven down fixed income yields to very low levels and equity discount rates to over 20-year lows.
- As we have seen in recent years, a falling equity discount rate favours long-duration, highly profitable, idiosyncratic growth businesses – and this was again the case in the third quarter. At a sector level, information technology is dominated by businesses like this and rose +7.3% in sterling terms in the quarter; some of the best consumer discretionary stocks also have these characteristics and they too performed strongly (+11.3%). At the opposite end of the spectrum, financials, which are often struggling to grow earnings from traditional loans, fell -2.3%; energy had another difficult quarter (-19.1%), despite oil prices remaining relatively stable. As described, the US, where most of the innovative technology companies are based, performed strongly over the quarter.
- With economic growth slowing and activity remaining below normal levels, and with so much monetary stimulus and government bond issuance, yields on benchmark 10-year government bonds fell over the quarter in nearly all major developed markets (apart from the UK, US and Canada, where they rose slightly from very low levels). Although the US 10-year treasury yield increased by 3 basis points to 0.68% over the quarter, this compares to c. 1.9% at the start of the year. In corporate bond markets, credit spreads tightened further reflecting increased economic activity and the support of central banks for struggling companies.
- Sterling was among the strongest major currencies over the quarter, strengthening over 4% against the US dollar as the Federal Reserve altered its inflation targeting methodology. It strengthened only marginally against the euro. Nonetheless, sterling strength tempered the returns for sterling investors in global equities. However, the MSCI benchmark has now recovered to its start-of-2020 levels, yet the FTSE All-Share Index is down -19.9% for the year to date: global diversification has been beneficial for UK-based investors.
- Oil prices were far more stable in the third quarter, having fallen by over -65% in the first quarter and recovered by +81% in the second quarter. Over the quarter, the price of Brent crude oil fell by -0.5%, although it was notably weaker in September, falling by -9.6% to under $42 a barrel. Copper continued to strengthen as economic activity picked up in China, rising +10.6% over the quarter. Gold rose +6.4% to $1,900/oz., despite weakness in September. It had reached multi-decade highs in early August of nearly $2,100/oz. as some investors sought a safe haven should markets fall.

Performance and activity

- The Fund outperformed its benchmark over the period. Taiwan Semiconductor (TSMC), Bandai Namco, Church & Dwight and Ocado contributed strongly to returns over the quarter. Semiconductor manufacturer **TSMC**, which is in the Compounding category of the corporate Life Cycle, reported strong quarterly results that confirmed that the semiconductor cycle has turned, leading to sales growth and market share gains. This confirmed our investment thesis. Intel subsequently announced that it is facing delays to its 7nm chip development, pushing large-scale production into 2022/23, and as a result is considering outsourcing production to TSMC. This would be game-changing and, despite the significant share price rise, we believe the valuation remains attractive. Japanese toys and gaming company **Bandai Namco** ('Compounding') reported better-than-expected quarterly results. Despite a material impact from Covid-19, there was no change to full-year guidance as poor performance from arcades was offset by strength in home gaming. Its extensive catalogue of IP across a wide range of formats, combined with a focus on new content creation and better monetisation of existing IP, should support steady wealth creation. This does not appear to be priced in to the current valuation. US household goods company **Church & Dwight** ('Slowing & Maturing') reported excellent quarterly earnings with organic sales growth, earnings and margins all significantly higher than analysts' forecasts. The high-quality management team continues to deliver in challenging circumstances. Food home delivery platform **Ocado** ('Accelerating') garnered extensive press coverage for its tie-up with Marks & Spencer in the UK – the first time that M&S food has been available online. However, the stock outperformed on increased appreciation of its world-leading logistics technology platform. At around USD22bn, its market capitalisation compares very favourably to US technology companies, particularly if its platform can be rolled out to non-food home deliveries.
- Detractors from performance included Suncor Energy, Eli Lilly and Handelsbanken. **Suncor Energy** ('Turnaround'), the Canadian oil sands producer, was hit by the weakness in global oil companies. Despite more stable oil prices, the sector was notably weak over the quarter as investors increasingly considered the risk of stranded assets in a carbon-neutral economy.

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Despite strong headline earnings per share, US healthcare giant **Eli Lilly** ('Compounding') reported disappointing quarterly results. Revenue and operating income were below consensus forecasts, with the shortfall being covered through other income with a rise in the value of the company's investment portfolio. The healthcare sector has also been affected by an unwinding of speculation about the imminent approval of a vaccine for Covid-19. The company had been a beneficiary of this earlier in the year. Swedish bank **Svenska Handelsbanken** ('Slowing & Maturing') had interesting quarterly results. While the environment is generally poor for banks, with ultra-low/negative interest rates impacting profitability and higher defaults likely on corporate and personal loans, Handelsbanken asserted that it isn't being affected by loan impairments due to the informational advantage of its decentralised and more personalised approach. The market was less convinced, despite its plan to cut significant costs through branch closures, but the valuation is compelling for an above-average bank with clear competitive advantages.

- The considerable disparities in share price and underlying business performance over recent months led to some repositioning of the portfolio during the quarter. Notable trades included switching **Bayer** into the Finnish paper manufacturer **UPM-Kymmene**, based on its wealth-creating strategy; switching from **Raytheon** into **Reliance Steel**, which we feel isn't properly appreciated by the market; selling **TJX Companies**, on concerns about its strategy and high valuation, and **Lloyds Banking Group**. We initiated a position in **Apple**, where we consider the compounding wealth-creation opportunity supported by services and wearables to be attractive; and added to holdings in **Safran**, **Berkshire Hathaway** and **Visa** on valuation grounds.

Outlook

- The remarkable recovery in global equity markets over the second and third quarters means that risk and return are more balanced in the shorter term. Uncertainty remains around both the speed and the shape of any economic recovery and this continues to create market volatility, which could be exacerbated by a failure to agree a post-Brexit trade deal or political and social tension in the US during or after November's elections.
- Significant upside from here requires the global economy to make a strong recovery and probably an effective vaccine and treatment regimen for the coronavirus. There may be challenging periods over the next 12-18 months driven by any resurgence in cases as lockdown restrictions continue to ease. However, it is clear that governments and central banks are committed to the long haul.
- The benefits of our disciplined investment approach – a focus on stronger business models combined with robust portfolio risk controls – enable superior stock wealth creation and valuation to drive long-term performance. In the longer term, equities offer significant value against bonds and the equity discount rate is not extended, particularly compared to the dotcom bubble in early 2000, for example.
- We believe that active equity managers, in particular, will perform well in the aftermath of the pandemic. The crisis will result in strong companies (high returns, strong balance sheets and good 'moats') getting stronger as they are better able to take advantage of opportunities, whether through new areas of demand or having better balance sheets to navigate through lower levels of cash generation in most industries.

Further insights from the Global Equity team

- To find out more about our investment approach to investing in global equities and our current thinking, please visit our website (rlam.co.uk).
- In *Value versus growth: a new perspective*, we consider the outperformance of growth stocks over the last decade, pushing the valuation differential against value stocks to an all-time high. Will this continue and how should investors position themselves? The **RL Global Select Fund** offers a very different approach to traditional growth and value exposures because the fund invests across the Life Cycle (from early stage growth through to deep value), but targets superior valuation metrics relative to the respective Life Cycle category. We identify companies with attractive, forward-looking, wealth creation prospects, especially compared to peers in the same stage of the Life Cycle, which helps us to find 'value without the traps'. This differentiated investment approach gives clients a selective value exposure.
- Similarly, in *Thinking like a CEO*, we explain how we are using our Corporate Life Cycle model to navigate the crisis. No single model or analysis is a magic bullet for investing, but this framework helps us to understand the world as a company's management sees it and identify those that are actively responding to the crisis. Owning companies that merely survive the pandemic won't deliver outperformance. We are looking for the 'Accelerators' that are increasing investment to take full advantage of the current environment, and 'Slowing & Maturing' or 'Turnaround' companies that are doubling down on restructuring.

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- High quality management will be crucial through the next 12-18 months. In *Stock picking through Covid – beyond the stay at home basket* we describe three how three very diverse companies that we hold in our portfolios (Old Dominion Freight Line, Reliance Steel and Amazon) are performing strongly despite the challenging economic circumstances.
- Lastly, talks from the online *RLAM Investment Series* that was held in the week of 28 September 2020 can be viewed on BrightTALK.com; including Will Kenney's *The growth vs. value debate: is it real or relevant anymore?* and James Clarke's and Carlota Garcia-Manas's *Responsible global equities*. Each presentation lasts for 30 minutes, including Q&A.

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