ROYAL LONDON US GROWTH TRUST

Quarterly Report 30 September 2020

For professional clients only, not suitable for retail investors

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Top 10 holdings

	Trust (%)
Apple	8.1
Microsoft	6.7
Amazon	6.1
Visa	2.3
Facebook	2.2
Alphabet	2.2
Verizon Communications	2.2
American Tower	2.1
Johnson & Johnson	2.1
Alphabet	2.0
Total	**35.8**

Fund data

	Trust
No. of stocks	92
Fund size	£225.8m
Launch date	19.02.2001
Active share	55%
Tracking error	1.6%

Source: RLAM, based on the A Inc share class.

Performance

	Trust(%)	Benchmark[1] (%)	Relative (%)
Q3 2020	**3.77**	**4.67**	**-0.89**
Year-to-date	8.24	9.47	-1.22
Rolling 12 months	11.43	10.96	0.47
3 years p.a	11.07	13.89	-2.81
5 years p.a	16.60	17.84	-1.24
10 years p.a	14.83	16.06	-1.24
Since inception p.a. 19.02.2001	7.27	8.19	-0.92

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 A Inc share class.

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

[1]Benchmark: MSCI US £ Net Total Return Index

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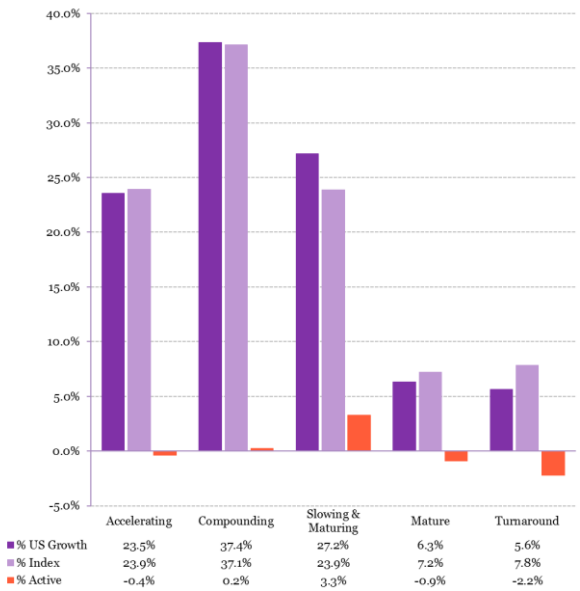
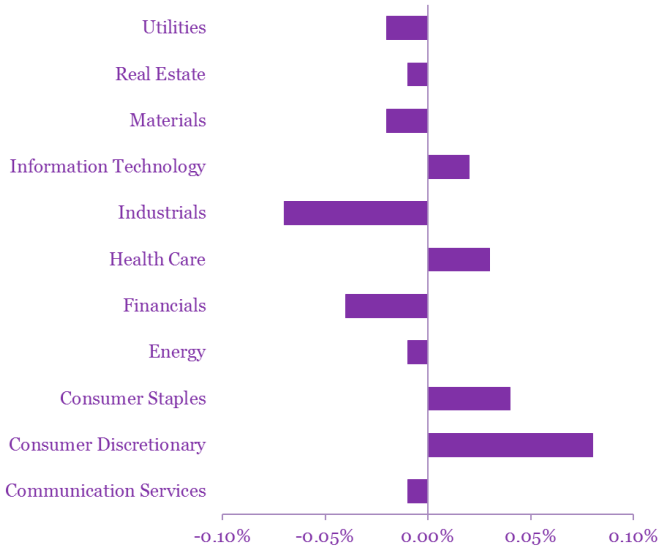
Holdings and weights



Sector weights



Source: RLAM as at 30 September 2020

Executive summary

- On a reported basis, the fund recorded a net return (A Class, Income) of +3.65% for the third quarter, compared with +4.67% for the MSCI US Net Total Return Index (in sterling). However, this was distorted by timing differences between the fund and the index. Adjusting for this, on a like-for-like basis the fund underperformed by -1.48%.
- 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, politics re-emerged as an investment risk, with increasing concerns about the US elections in November.
- The strong recovery in 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 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, 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.

Market commentary

- 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.

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- 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 over the quarter; some of the best consumer discretionary stocks also have these characteristics and they too performed strongly. At the opposite end of the spectrum, financials, which are often struggling to grow earnings from traditional loans, fell; energy had another difficult quarter, despite oil prices remaining relatively stable.
- 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. This tempered the returns for sterling investors in US equities.
- Oil prices were far more stable in the third 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.

Fund performance and activity

- The portfolio's robust construction ensures a high level of idiosyncratic risk and reduces sensitivity to macroeconomic factors – such as credit spreads, rates and commodity prices – that were dominant across equity markets all last year. This is in line with the fund's objective of providing long-term alpha via a focus on wealth creation and valuation, rather than taking on shorter-term exposures to sectors and macro themes.
- As in recent quarters, sector dispersion was wide. Consumer discretionary (+13.9%), materials (+8.1%) and information technology (+7.5%) were the strongest sectors over the quarter. After bouncing strongly in the second quarter as oil and gas prices recovered, energy was notably weak (-23.4%) in spite of relatively stable oil prices, while real estate (-2.7%) and financials (-1.0%) also delivered negative returns.
- Over the quarter, **Apple**, **Thermo Fisher Scientific** and **Danaher** contributed strongly to returns. Conversely, the biggest detractors from performance were **Exxon Mobil, American Tower Corporation** and **Eli Lilly**. Otherwise, not owning **Tesla** detracted from relative performance as its shares continued to perform strongly.
- 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 buying **Stryker** and adding to **HCA**; initiating positions in **Shopify**, **MercadoLibre** and **CoStar** following an online technology review, and selling **Walgreens Boots Alliance**; reallocating from fading or cyclical names in favour of better early- or late-cycle opportunities; and adjusting our holdings after a review of the corporate software and high-performance computing sectors.

Key views within the fund

- The trust aims to deliver above average medium- to long-term capital growth by investing in a diversified portfolio of US equities, and will typically hold up to 100 stocks. The equities in which the fund invests may be from any sector, industry or market capitalisation. The fund aims to maximise the stock specific views from the US equities held in the Royal London Global Equity Diversified Fund, while minimising exposure to macroeconomic and sector influences using an optimisation strategy.
- We are fundamental, bottom-up investors and therefore don't invest according to top-down macroeconomics. The broad economic environment will have an effect, but we believe that good companies perform well across the economic cycle. What matters more is how the company is using its capital.
- Our Corporate Life Cycle model categorises companies according to their stage of development. We believe that corporate returns on productive capital and growth tend to progress along a cycle with five defined stages: Accelerating, Compounding, Slowing & Maturing, Mature and Turnaround. We seek portfolio diversification across the Corporate Life Cycle.

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- Quantitative analysis helps us to identify potential opportunities by scoring stocks across a range detailed financial factors. We then apply our scoring system to rank characteristics to identify which companies to research further for possible inclusion in the portfolio.
- Stock selection really matters: looking at MSCI World Stock Returns between 2014 and 2019, the worst performing 80.2% of stocks performed behind the benchmark, with a third losing value, whereas the best performing 19.8% of stocks represented 99% of the excess return.

Outlook

- The remarkable recovery in 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 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.

More from RLAM

- To find out more about our investment approach and current thinking, please visit our website (rlam.co.uk).
- 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?*; James Clarke's and Carlota Garcia-Manas's *Responsible global equities*; and *Developing the equity solutions of the future* by Matt Burgess. Each presentation lasts for 30 minutes, including Q&A.

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