ROYAL LONDON GMAP GROWTH FUND

Quarterly Report 30 September 2020

For professional clients only, not suitable for retail investors

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ROYAL LONDON GMAP GROWTH FUND

Fund data

	Fund
Distribution yield	2.26%
Underlying yield	1.66%
Fund size	£227.4m
Launch date	14.03.2016

Source: RLAM. Based on the M Inc share class.

Reported yields reflect RLAM's current perception of market conventions around timing of bond cash flows. Heightened uncertainty due to the COVID 19 crisis may impact these timings for bonds with callable feature.

Performance

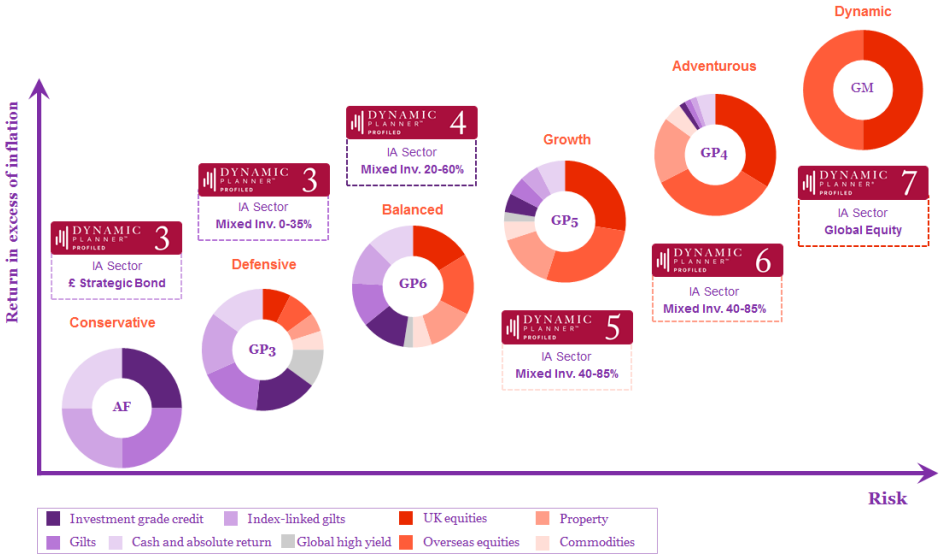
	Fund (%) (M Acc)	Fund (%) (M Inc)	Benchmark (%)	Relative (%) (as compared to M Inc)
Q3 2020	**1.04**	**1.12**	**0.72**	**0.40**
Year-to-date	-7.29	-7.27	-3.65	-3.62
Rolling 12 months	-5.61	-5.58	-2.71	-2.88
3 years p.a	1.70	1.69	3.42	-1.74
Since Inception p.a. 14.03.2016	5.47	5.47	6.83	-1.36

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 M share classes. Performance for the fund is calculated on a mid basis with income re-invested. The fund returns in the table above are gross of standard management fees. All performance figures stated gross of fees and tax unless otherwise stated.

[1]GMAP Growth Composite Benchmark. The benchmark has been designed with the aim of maximising long run return in excess of inflation for a given level of risk.

RL GMAP range



Risk rating is established by Distribution Technology (DT) and is out of 10. For illustrative purposes – reflects Strategic Asset Allocation weightings, may vary in accordance with tactical asset allocation.

Our GMAPs fund range is designed to span the risk return spectrum, with each fund aiming to maximise the long-term real return for its given level of risk through a broadly diversified portfolio of investments.

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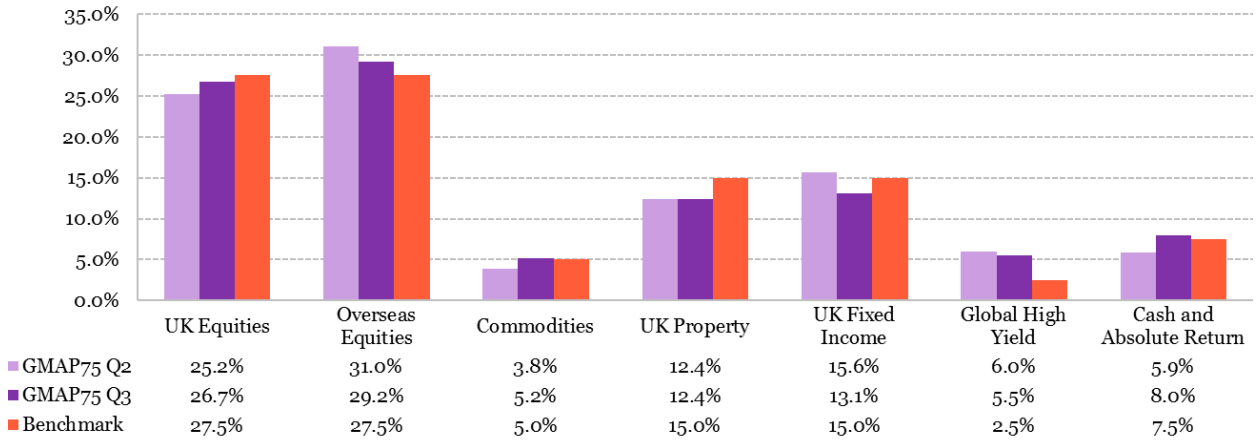
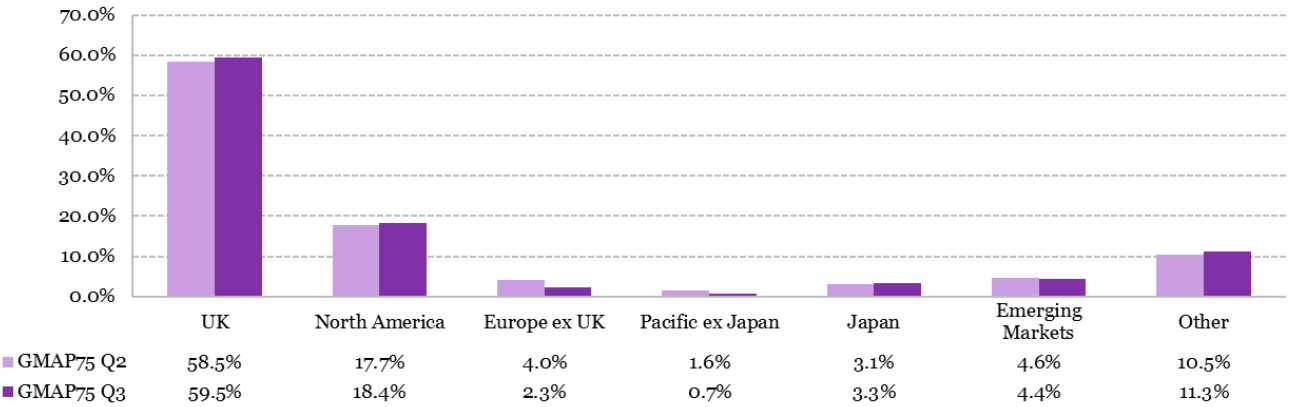
Asset split



Source: RLAM. We take a holistic approach to fixed income management and fund weights relative to their respective benchmarks may not reflect tactical exposures. Figures calculated on a 'look through' basis, reflecting underlying assets, not fund component weights.

Geographical breakdown



Source: RLAM. 'Other' region includes global fixed income exposures, which are sterling hedged and commodity exposures. Figures calculated on a 'look through' basis, reflecting underlying assets, not fund component weights.

Ten largest holdings

	Asset type	Weighting (%)
RL UK All Share Tracker Fund	UK Equities	23.5
RL US Index Tracker Fund	Overseas Equities	12.4
RL Property (PAIF) Feeder Fund	UK Property	12.4
RL Short-Term Money Market Fund	Cash	6.2
Commodities ETF	Commodities	5.2
RL Global High Yield	Global High Yield	4.2
RL Europe Ex UK Tracker Fund	Overseas Equities	3.9
RL Ethical Bond Fund	UK Fixed Income	3.8
RL Index Linked Fund	UK Fixed Income	3.4
RL UK Government Bond Fund	UK Fixed Income	2.9
Total		**77.9**

Source: RLAM. Information as at 30 September 2020 and correct at that date, unless otherwise stated. Total weight reflects rounding.

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Executive summary – GMAP range

- The third quarter was far less dramatic than the first quarter, when the Covid-19 pandemic first hit global financial markets, or the second, in which unprecedented governmental and central bank actions helped investors to look through the 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, which led to some local restrictions and renewed travel restrictions. In addition, geopolitics re-emerged as an investment risk, with increasing concerns about volatility around the US presidential election in November and the possibility that negotiations between the UK and European Union (EU) will fail to deliver a mutually-acceptable trade deal.
- Equity markets were more muted as the bullish optimism of the second quarter fizzled out as investors faced the reality of renewed Covid-19 cases and increasing geopolitical risks. Nonetheless, global equities still posted positive aggregate returns in sterling terms. However, there was a wide geographical dispersion, with the UK and many European markets falling, and the US once again proving robust. Government bond yields remained at historically low levels, reflecting uncertainty about the shorter-term prospects for economic recovery with a second wave in Covid-19 cases in September and concerns about redundancies once furlough schemes end. Speculation around the UK-EU negotiations caused gilts to whipsaw on concerns about the inflationary impact of weaker sterling. Commodity prices continued to rise as economic activity strengthened, particularly in China. Oil prices were relatively stable this quarter; however, the energy sector was notably weak as investors increasingly considered the risk of stranded assets in a carbon-neutral economy.

GMAP fund	Q3 2020 performance (M class, Acc – net of fee)	GMAP custom benchmark	IA sector	IA sector average performance
Conservative	0.67%	0.21%	£ Strategic Bond	1.94%
Defensive	1.36%	1.09%	Mixed Investments: 0-35% shares	0.93%
Balanced	1.13%	0.84%	Mixed Investments: 20-65% shares	1.31%
Growth	0.89%	0.72%	Mixed Investments: 40-85% shares	1.84%
Adventurous	0.95%	0.61%	Mixed Investments: 40-85% shares	1.84%
Dynamic	1.01%	0.43%	IA Global	4.08%

- We participated in the ongoing equity rally, holding modest overweight positions in stocks and commodities through most of the quarter. Our equity positions were tilted towards the US and emerging markets (as Covid-19 appears to be well-managed in China and neighbouring countries, and economic activity is recovering strongly) and we were underweight UK equities (a long-term underperformer hampered by heavy resource and financials sector weightings); and tilted towards the technology and consumer discretionary sectors and away from energy and financials. We also remained overweight in high yield bonds, particularly short duration high yield, as we expect the asset class to be resilient over the medium term and it would give upside exposure to the recovery. These positions all proved very positive for performance over the quarter with all the funds outperforming their respective benchmarks (see table – above).
- The strong recovery in global equity markets from the lows of March means that risk and return are more balanced in the shorter term. Uncertainty remains around both the speed and the shape of the 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.
- We remain constructive on global equities, but moved to a more neutral position as two-way risk increased in late August. While we continue to favour the US and emerging markets over the UK, and technology and consumer discretionary over energy, we have dialled down our weightings. In particular, UK equities could benefit from more clarity around a trade deal with the EU, although perversely they could also perform well if sterling fell sharply as the value of overseas revenues would increase.
- While significant upside from here will require the global economy to recover more strongly and probably an effective vaccine for Covid-19, further volatility in global equity markets would represent an opportunity to increase our equity weightings. 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 in our view.

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 and economies are gradually opening up.
- 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.
- The scale of the impact of the pandemic on government finances became clearer. UK government borrowing in the current year is now estimated to be £370bn (c. 18% of GDP). The Bank of England (BoE) has continued to neutralise the impact of government bond issuance through asset purchases; this is due to be complete in November, although a further extension of quantitative easing is expected. With the economic recovery 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. The yield on 10-year gilts increased 6 basis points (bps) to 0.23% and short-dated government bond yields remained negative at maturities of less than seven years, although the BoE played down the imminent likelihood of negative base rates. Conventional gilts returned -1.23% (FTSE Actuaries – all maturities).
- Total returns for UK index linked gilts were -2.18% for the period (FTSE Actuaries UK Index Linked Gilts Index – all maturities), driven by weakness at the longer end. The yield on the 10-year index linked gilt fell 9bps to -2.93%. The 10-year breakeven (implied) inflation rate increased 16bps to 3.06%. The yield spread between UK index linked gilts and US TIPS tightened by 16bps to 198bps. At the annual Jackson Hole symposium in late August, Federal Reserve (Fed) Chair Jerome Powell announced a revised approach to US monetary policy – average inflation targeting – under which inflation and employment will be allowed to run higher. This is likely to keep interest rates low for several years, causing dollar weakness.
- In corporate bond markets, credit spreads tightened further reflecting increased economic activity and the support of central banks for struggling companies. The average sterling investment grade spread (the average extra yield available from a corporate bond compared with government debt of equal maturity) ended the quarter a further 18bps tighter at 1.29% – it was well over 2.0% in March. The tightening of credit spreads boosted the performance of sterling credit with the Markit iBoxx Sterling Non-Gilt All Maturities Index delivering total returns of 1.16% for the quarter.
- 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.
- Oil prices were far more stable in the quarter than earlier in the year. 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. Despite this stability, however, energy stocks were notably weak over the quarter as investors increasingly considered the risk of stranded assets in a carbon-neutral economy. 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 on renewed Covid-19 fears.

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Asset allocation overview – GMAP range

What we thought	What we did	What happened	Effect on portfolio
Following the sharp recovery in global equity markets in the second quarter, we felt that two-way risks had increased. However, with unprecedented support from governments and central banks and the easing of lockdowns as virus cases fell, we felt that there was scope for further performance.	At the start of the quarter, we retained a modest overweight position in global equities. We focused on the US, given its more dynamic qualities with high growth, long duration technology companies; and emerging markets, as we felt that China was showing positive signs of emerging from lockdown. Within sectors, we favoured technology and consumer discretionary over financials and energy. We moved more neutral in late August to reflect two-way risks.	Global equities returned +3.6% to sterling investors (MSCI World). Within this, the US (+5.0%) and emerging markets (+5.1%) outperformed. Consumer discretionary and technology were the strongest sectors, delivering returns of +11.3% and +7.3%, in contrast to financials (-2.3%) and energy (-19.1%). Equities traded broadly sideways in September as the economic recovery slowed and Covid-19 cases spiked again in Europe and the UK.	Our regional and sectoral allocation was very positive for performance over the quarter. We enhanced this effect with a tactical allocation to Japanese equities during the quarter as the economy picked up there and by moving underweight in Europe (ex-UK) as the virus led to local lockdowns. Moving back to neutral equities in September, following the equity rally, was positive on a risk-adjusted basis.
While UK equities appeared to offer value after significant underperformance, we noted the index's heavy weightings to the resources and financials sectors. The UK also emerged more slowly from lockdown than other economies.	We maintained a significant underweight allocation to UK equities over the quarter, although we reduced this position towards the end of the period as the risks increased of sterling weakness in the case of a 'no deal' Brexit.	UK equities notably lagged against global equities over the quarter, returning -4.7%.	The underweight position in UK equities was very positive for performance.
Having been more positive on gilts in the second quarter given the volatility in markets and considerable risks involving Covid-19, we returned to our view that corporate credit will outperform government bonds as the global economy recovers.	We re-established the moderate underweight position in gilts and moved further underweight as the quarter unfolded.	Total returns for conventional gilts were -1.23%, with the weakness driven by the long end, while index-linked gilts returned -2.18%. In contrast, sterling credit returned +1.16%.	Re-establishing our underweight in government bonds and staying overweight in investment grade credit was positive for performance.
As with the constructive equities allocation, we felt that high yield bonds offered potential for further outperformance given the huge financial support from governments and central banks.	We remained overweight global high yield bonds, particularly short duration high yield, as this asset class should be less volatile than equities, yet give upside exposure to any recovery. Having fallen sharply in the crisis as investors feared defaults, high yield had further recovery potential. We reduced this overweight slightly in late August as the rate of economic recovery slowed.	Global high yield bonds continued to perform strongly over the quarter and the high yield spread contracted by 64bps, ending September at 496bps. Global high yield funds returned +3.2%, with short duration delivering +1.6%. High yield spreads widened by 45bps in September due to outflows from high yield ETFs.	The overweight allocation to global high yield was positive for performance, particularly short duration high yield on a risk-adjusted basis.
As the recovery in the real economy started to come through, particularly in industrial production in China, we felt increasingly constructive on commodities.	At the start of the quarter, we were neutral in commodities and moved overweight during the period.	Commodities performed strongly over the period.	The overweight exposure to commodities was positive for performance.
With the economic shock, we believed UK commercial property would underperform, at least until there is a sustained economic recovery.	While recognising its diversifying benefits, we maintained an underweight position in property through the quarter, and increased this over the period.	Commercial property performed poorly over the quarter as tenants missed rental payments and the retail and hospitality sectors continued to struggle.	Our underweight position had a positive impact on performance.

Please note: This table details our main asset allocation decisions for the quarter across the GMAPs funds. Clearly only some of the allocations are relevant to the Conservative fund (fixed income-only) and Dynamic Fund (equity-only).

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Performance and activity

- Our proprietary Investment Clock model registered growth improving as lockdowns eased and moved back into its 'Recovery' zone with better growth, but still low inflation and interest rates; this should be constructive for equities and corporate bonds. We are some way away from the Investment Clock returning to its 'Overheat' zone, with growth and inflation rising, but there are medium-term inflation risks, which would be negative for government bonds.
- After the strong performance of global equities in the second quarter, we retained a modest overweight in global equities as the third quarter started, other than in the Conservative portfolio (which has no equity exposure) and the Dynamic portfolio (equity only). We were overweight US equities (including the technology and consumer discretionary sectors) given the relatively defensive nature of that market and overweight in emerging markets, as China and other countries in the region had coped well with the pandemic and had emerged strongly from lockdown. Conversely, we were underweight UK equities, a long-term underperformer hampered by heavy resource and financials sector weightings, which was slower to exit lockdown than many other countries. These positions were all very positive performance as US and emerging markets equities outperformed over the quarter (+5.0% and +5.1%, respectively) with the US driven by the consumer discretionary and technology sectors. The UK was one of the worst-performing global markets, returning -4.7%.
- During the quarter, we tactically increased our exposure to Japanese equities as the economic data started to look more favourable there and benefitted from the political changes as the new prime minister Yoshihide Suga, who replaced the long-serving Shinzo Abe, promised increased regulatory reform and digitisation of the economy. We also moved underweight in Europe (ex-UK) as Covid-19 cases picked up and local lockdowns and travel restrictions were imposed. In late August, after strong performance from global equities from their lows in March, we felt that two-way risks had increased as the initial economic bounce slowed, early signs of a Covid-19 second wave emerged and political risks increased (UK-EU trade deal negotiations and US elections), and we slightly reduced our equities exposure, particularly in the US. Against this, we started to reduce the underweight in UK equities as there are scenarios in which the UK could outperform in a global recovery, particularly once there is clarity around the trading terms or otherwise with the EU. Not agreeing a trade deal could benefit UK stocks as sterling would likely fall sharply, boosting the value of overseas earnings.
- We remained overweight high yield bonds, particularly short duration high yield, as we expected the asset class to be resilient over the medium term and felt that high yield bonds offered potential for further outperformance given the huge financial support from governments and central banks. This allocation should be less volatile than equities. Otherwise in fixed income, having been more positive on gilts in the second quarter given the volatility in markets and considerable risks involving Covid-19, we returned to our view that corporate credit will outperform government bonds as the global economy recovers. These allocations contributed positively to performance over the quarter.
- As the recovery in the real economy started to come through, particularly in industrial production in China, we felt increasingly constructive on commodities. At the start of the quarter, we were neutral in commodities and moved overweight during the period. This was positive for performance as commodity prices rose strongly in the quarter.
- We were underweight in UK commercial property; this was positive for performance given the asset class's economic sensitivity, but the diversification benefits of this asset class relative to equities are beneficial.

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Outlook

- The strong recovery in global equity markets from the lows of March means that risk and return are more balanced in the shorter term. Uncertainty remains around both the speed and the shape of the 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.
- We remain constructive on global equities, but moved to a more neutral position as two-way risk increased in late August. While we continue to favour the US and emerging markets over the UK, and technology and consumer discretionary over energy, we have dialled down our stronger weightings. In particular, UK equities could benefit from more clarity around a trade deal with the EU, although perversely they could also perform well if sterling fell sharply as the value of overseas revenues would increase.
- While significant upside from here will require the global economy to recover more strongly and probably an effective vaccine for Covid-19, further volatility in global equity markets would represent an opportunity to increase our equity weightings. 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.
- Please see our Investment Clock blog for the latest information on our active strategies. Also, talks from the online *RLAM Investment Series* that was held in the week of 28 September 2020 can be viewed on BrightTALK.com, including *A multi asset view of the Covid crisis* by Trevor Greetham. Each presentation lasts for 30 minutes, including Q&A.

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ASSET MANAGEMENT