ROYAL LONDON MULTI ASSET STRATEGIES FUND

Quarterly Report 30 September 2020

For professional clients only, not suitable for retail investors

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Performance

	Fund (%) (M Acc)	Fund (%) (M Inc)
Q3 2020	**1.81**	**1.81**
Year-to-date	-8.49	-8.50
Rolling 12 months	-7.14	-7.15
Since Inception p.a	-1.18	-1.20

Fund data

	Fund
Fund size	£182.3m
Launch date	23.11.2018

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.

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.

Investment approach

- The Royal London Multi Asset Strategies Fund (MAST) is designed for investors looking to generate growth, over five-year rolling periods, through a diversified multi asset portfolio, while limiting losses during periods of financial market turbulence. MAST combines two complementary return drivers, each with its own separate in-built risk controls:
  1. Multi Asset Core portfolio strategies, which offer diversified exposure across a range of asset classes to capture upside during positive market trends; and
  2. Tactical asset allocation (TAA) strategies designed to generate additional return irrespective of market direction.
- Our TAA approach can reduce exposure to growth-sensitive assets as economic and market conditions deteriorate, and therefore works well alongside the Multi Asset Core portfolio, which we expect to add more value in bull markets. The combined approach is designed to generate consistent returns, over five-year rolling periods, while also being able to take advantage of opportunities as they arise.

Market performance

- 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 index 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, 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 while 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 large, listed 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 £470bn (c. 23% of GDP). The Bank of England (BoE) has continued to neutralise the impact of government bond issuance through asset purchases; this is due to end 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, 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 possibility 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.

Fund commentary

- As of 30 September, MAST is down a cumulative -10% from its early 2020 high point, compared to -21% for UK equities and -2% for global equities over the same period. The fund's relatively modest recovery since the market lows in March reflects the fact that a large proportion of the fund's downside risk control measures have remained in place given the choppy nature of the rebound.
- MAST aims to capture upside in positive market trends, while limiting downside during periods of market turbulence through diversification, active positioning and volatility management. We cut equity exposure significantly in March when the coronavirus crisis caused a spike in volatility. Global stocks have since recovered most of their losses but, with volatility remaining unusually high and the outlook uncertain, the fund retained a more cautious stance.
- In our backtesting of the strategy we modelled what would have happened in various historical crises and found MAST usually returned to its high water mark in about a year or so. The recent drawdown from high water mark is larger than those in the simulation and could take a proportionately longer time to heal, though we remain confident in MAST's ability to deliver against its objective of returning an annualised return of 4% in excess of SONIA gross of fees over the next five years.
- In the scenario of a sustained economic recovery, we would expect a drop in volatility and a positive shift in our tactical positioning to return equity exposure to more normal levels, allowing us to capture more of the upside. However, MAST's disciplined approach to risk management should act to limit further losses should further waves of infection or geopolitical issues trigger a market relapse.

Multi Asset Core strategies

- Multi Asset Core strategies aim to benefit from positive market trends, while reducing exposure to risk assets during market turbulence in order to reduce downside risk.
- We reduced equity exposure from a starting position of around 50% to a low of 7.5% in March. The bulk of this reduction reflected risk management in the core portfolio as volatility surged to levels last seen during the 2008 failure of Lehman Brothers. At the start of the third quarter, we had taken exposure back to 13.5% and this increased to 27% at the beginning of September. However, as virus case numbers began to rise across Europe and political risk in the US intensified, we reduced our tactical positions, leaving our total exposure to equities at 20.5%. While volatility has dropped markedly since March, two-way risks have increased and this suggests continued market fragility.

Tactical asset allocation strategies

- Tactical asset allocation strategies build on the core portfolio and operate within a separate risk budget. We take an active approach to tactical asset allocation with a view to adding value irrespective of market direction. While we are only moderately constructive on equities at present, we see good opportunities in a range of relative value trades within and between the broad range of asset classes at our disposal.

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- Regionally, our strongest conviction position has been to have more exposure to US stocks and more recently emerging markets relative to the UK. The US was relatively defensive during the sell-off and a strong performer in the recovery while emerging market equities have been helped by dollar weakness and China's apparent success in suppressing the virus. The UK has been a very poor performer given its larger exposure to resource sectors and ongoing concerns around both the handling of the pandemic and trade deal negotiations with the EU. However, before quarter end, we started to add to 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 probably fall sharply, boosting the value of overseas earnings.
- We have maintained a significant tactical position in global 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 huge financial support from governments and central banks. This allocation should be less volatile than equities. 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 had a low exposure to commodities and increased this during the period.
- We shrank currency positions as volatility rose earlier in the year, given uncertainty surrounding global growth prospects. Over the quarter, we have been relatively lightly positioned in sterling and the US dollar in favour of the euro, which strengthened on the back of improved eurozone fiscal coordination and the Fed's change to its inflation targeting approach.
- US sector positions: during this crisis we were helped by our positive position in technology relative to hard hit industrials, materials and financials. We are currently lightly positioned in energy but remain more constructive on the US technology and consumer discretionary sectors, areas which have shown relative resilience and strength.

Market 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 longer term but two-way risk remains. 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 better control of Covid-19, further volatility in global equity markets would represent an opportunity to increase our equity exposures. There may be challenging periods over the next 12 months driven by further waves of the virus or geopolitics. 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.
- Our investment process has weathered difficult markets in the past and we added significant value over the 2007-9 global financial crisis. We believe a disciplined and active approach to both risk control and tactical asset allocation will be crucial over the current period. The flexibility of MAST means it is well placed to respond as the situation evolves, avoiding concentration risk through diversification, de-risking quickly during a relapse and exploiting tactical opportunities as they arise.
- 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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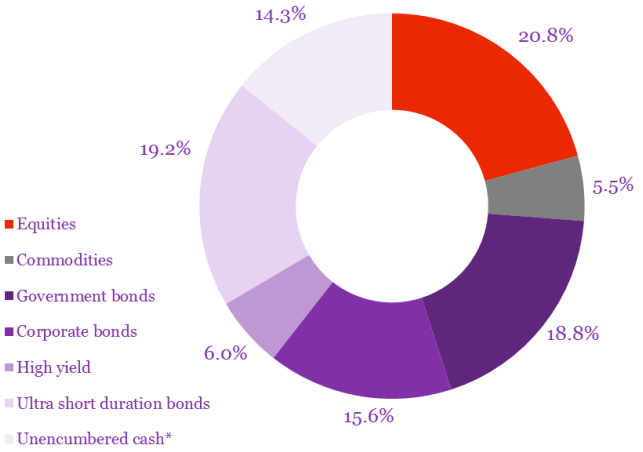
Asset split



Regional equity split

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.
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.
**Includes allocation to RL Short Term Money Market Fund R (Acc) and cash at margin account and excluding cash backing for Futures*

Ten largest holdings

	Asset type	Weighting (%)
RL Enhanced Cash Plus	UK Fixed Income	19.1
UK Treasury 1.50% 2021	UK Fixed Income	15.3
RL Investment Grade Short Dated Credit Fund	UK Fixed Income	9.9
RL Short Duration Gilts Fund	UK Fixed Income	9.9
RL Short-Term Money Market Fund	UK Fixed Income	6.4
Commodities ETF	Commodities	5.4
RL UK Government Bond Fund	UK Fixed Income	4.9
RL Global High Yield	Global High Yield	3.5
RL Ethical Bond Fund	UK Fixed Income	2.8
RL Sustainable Managed Income	UK Fixed Income	2.7
Total		**79.7**

Source: RLAM. Information as at 30 September 2020 and correct at that date, unless otherwise stated. Figures exclude derivatives where held, subject to rounding.

ROYAL LONDON
ASSET MANAGEMENT

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