ROYAL LONDON SUSTAINABLE LEADERS TRUST

Quarterly Report 30 September 2020

For professional clients only, not suitable for retail investors

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Top ten holdings

	Fund (%)
AstraZeneca	5.2
Experian Group Ltd	4.5
Rentokil Initial	4.3
London Stock Exchange	4.2
Croda International	4.1
SSE Plc	4.0
Sage Group	4.0
Unilever	4.0
Prudential	3.9
Segro	3.8
Total	**41.9**

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

Fund data

	Fund
No. of stocks	40
Fund size	£2,175.3m
Launch date	25.05.1990

Performance

	Fund (C Acc) (%)	Benchmark[1] (%)	Relative (%)
Q3 2020	**1.17**	**-2.92**	**4.09**
Year-to-date	-1.27	-19.92	18.65
Rolling 12 months	2.48	-16.59	19.07
3 years p.a.	10.05	-3.21	13.26
5 years p.a.	11.82	3.46	8.36
10 years p.a	11.72	5.06	6.66
Since inception p.a. 25.05.1990	9.04	7.34	1.70

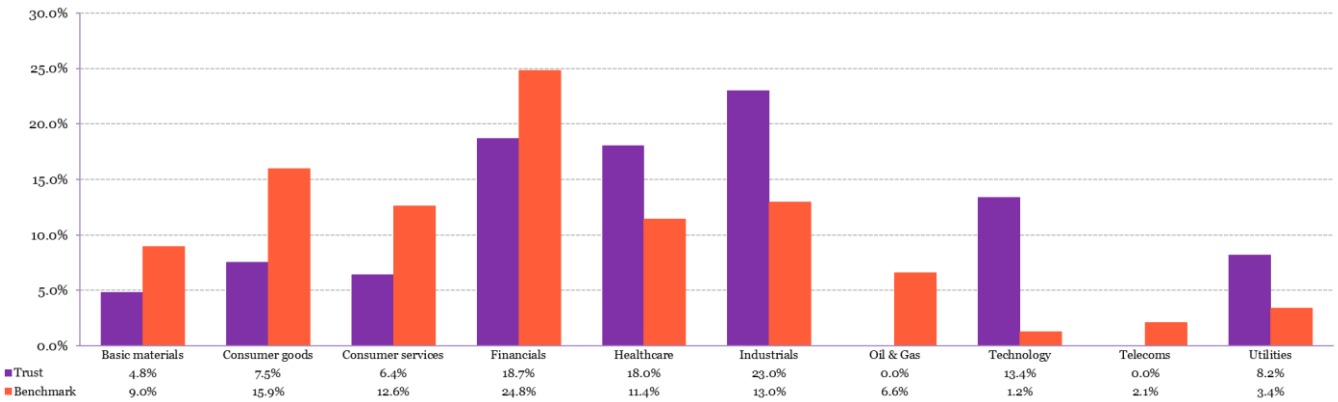
Past performance is not necessarily a reliable indicator of future performance. The value of investments and the income from them is not guaranteed and may go down as well as up and investors may not get back the amount originally invested.

All performance figures stated gross of fees and tax unless otherwise stated.

Source: RLAM, gross of standard management fees.

[1]Benchmark: FTSE All Share Index.

Sector breakdown



Source: RLAM. Figures in relation to your portfolio exclude the impact of cash held.

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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 ACWI index (covering major developed and emerging markets) rose +3.8%. 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. 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 growth businesses – and this was again the case in the third quarter. The MSCI ACWI information technology sector is dominated by such businesses and rose +7% in sterling terms in the quarter; some of the best consumer discretionary stocks also have these characteristics and they too performed strongly (+13%). At the other end of the spectrum, financials, which are struggling to grow earnings from traditional loans, fell -3%; energy had another difficult quarter (-16%), despite oil prices remaining relatively stable.
- 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 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.
- 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 third 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. 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. The strategies have no exposure to the commodity sectors, i.e. oil & gas and mining. These have a poor track record of creating value for shareholders and are long-term losers from the trend towards a lower-carbon, environmentally-aware society.

Performance and activity

- The sustainable strategies are orientated to those companies that have a positive impact on society and create value for investors through access to long-term growth markets and innovation. Areas such as healthcare and technology remain at the core of the equity portfolios, complemented by engineering, utilities, selected financial services, and companies that lead their industries in ESG performance.
- Global equity exposure has been beneficial for UK-based investors. While the MSCI and MSCI ACWI indices have recovered to their start-of-2020 levels, the FTSE All-Share Index is still down -20% for the year to date on sector composition, the impact of Covid-19 and concerns about a 'no deal' Brexit. The fund benefitted from its c. 18% allocation to overseas equities, which again outperformed UK equities; and zero exposure to oil & gas and underweight position in banks, which notably underperformed.
- Within the fund, stocks that are economically sensitive (although not necessarily typical 'cyclicals') benefitted from the return to more normal levels of activity, particularly in the US, China and Asia as a whole. Although it had coped well with lockdown through a strong online presence, **Adidas** benefitted from the recovery in store-based retail sales. In the UK, **Croda**, the specialty chemicals leader, and **Intertek** performed well, despite the slower pickup in economic activity. For

Intertek, which offers product testing, inspection and certification, the company's long-term prospects and opportunity are greater as supply chains become more complex due to various factors such as trade wars and sustainability.

- Detractors from performance included a range of companies including **Greggs**, **Vistry**, **Lloyds Banking Group** and **Unite**, the student accommodation operator.
- Notable trades this quarter included adding to the fund's holding in **Croda**. As the company increasingly moves into healthcare niches, we believe its future growth prospects improve. We also added to **Bunzl** and **Unilever**. The strength of Bunzl's business model was highlighted in its results and the greater emphasis being placed on sustainability is encouraging. While already a leader in sustainability, Unilever has been announcing new and impressive initiatives around this. We also added to **Prudential**, who provide health insurance in countries with no government safety net; **Rentokil**, whose health and hygiene services, will see rising demand as we, eventually, return to the physical world; and **SSE**, the largest developer of renewable energy in the UK, as investment in this area will support a green recovery.

Outlook

- Two key short-term risks for equity markets are seen to be a second wave of Covid-19, and politics in the UK and US. We believe that there will be meaningful progress with a Covid-19 vaccine in the coming months. We invest in both AstraZeneca and GlaxoSmithKline, which are at the forefront of vaccine development. Their view is that we should have a working vaccine by the first quarter of 2021, with mass roll-out depending on manufacturing, how fast governments are prepared to approve it and then roll it out via healthcare systems. While there is much we still do not know about Covid-19, one positive has been the virus does not seem to mutate much, which is important in vaccine development.
- Perversely a 'no-deal' Brexit would probably benefit UK equity prices overall. This reflects the high proportion of profits coming from overseas, which would become more valuable if sterling were to devalue following a hard Brexit. Equally, the US presidential election may not have the impact that many investors fear. Mr Trump's election in 2016 saw equity markets rise strongly, yet while Mr Biden is seen to be less positive for business given his plans for tax increases, his administration would likely be more stable regarding international trade and climate change. We feel, therefore, that commentators may be overstating the risks of the election beyond some short-term uncertainty about the result from postal voting, not least as 'foreseeable risks' tend not to affect stock markets as badly as genuine shocks.
- The portfolio is invested in a range of innovative, well-managed businesses with durable competitive advantages and which are supporting the transition to a more sustainable world. We believe that many of the companies we are invested in will come out of this crisis even stronger than they went in. The recent market volatility gave us the opportunity to add to some excellent businesses at extremely attractive valuations and we remain focused on managing balanced portfolios that will provide resilience during periods of volatility and be well positioned to perform as economies recover.
- Longer term, we believe sustainable strategies will be a net beneficiary from the changes that could come from this crisis and our funds are well positioned to benefit from this. While it is too early to draw grand conclusions about structural and societal shifts, we feel that this pandemic and the responses of governments, companies and individuals could lead to a step change in real-world sustainability and in the trend to sustainable investing. The strategies are invested number of the key social and environmental trends we see as being key investment areas for the foreseeable future, such as decarbonisation, digitisation and healthcare.

A long history of sustainable investing

- The **RL Sustainable Diversified Trust** and **RL Sustainable World Trust** celebrated their 10th anniversaries last year. Similarly, 2020 marks the 30th anniversary of our flagship **RL Sustainable Leaders Trust**. You can find out more about our full range of sustainable funds, including the recently-launched **RL Global Sustainable Equity Fund**, on our website (rlam.co.uk/sustainable), which also has a range of articles and other information about sustainable investing.
- Talks from the online *RLAM Investment Series* that was held in the week of 28 September 2020 can be viewed on BrightTALK.com; including *30 years and counting* by Mike Fox; *Who was responsible?* By Ashley Hamilton Claxton; *Climate change and disclosure requirements for asset owners* by Carlota Garcia-Manas; and *Responsible global equities* by James Clarke and Carlota Garcia-Manas. Each presentation lasts for 30 minutes, including Q&A.

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