Royal London UK Opportunities Fund

Quarterly Report 31 December 2021

Asset split

	Fund (%)
Ashstead Group	6.8
Intermediate Capital Group	5.1
Watches of Switzerland Group	4.8
Melrose Industries	4.1
Royal Dutch Shell	3.6
Prudential	3.5
OSB Group Plc	3.3
Rio Tinto	3.3
Computacenter Plc	3.2
JD Sports Fashion Plc	3.2
Total	**41.0**

Source: RLAM, based on the M Accumulation share class.

Fund data

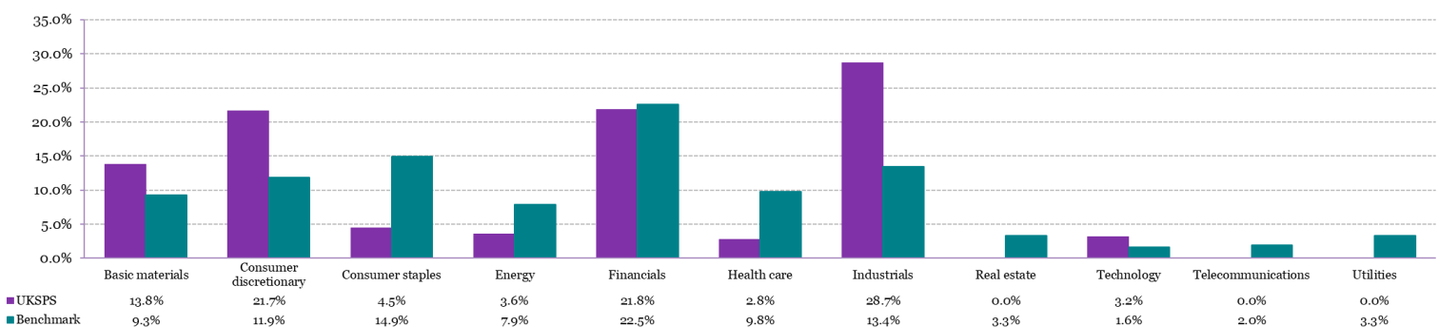
	Fund
No. of stocks	36
Fund size	£951.2m
Launch date	31.07.2007

Performance

	Fund (%)	Benchmark[1] (%)	Relative (%)
Q4 2021	**2.85**	**4.20**	**-1.34**
Year-to-date	20.44	18.32	2.12
Rolling 12 months	20.44	18.32	2.12
3 years p.a.	14.96	8.34	6.62
5 years p.a.	7.12	5.42	1.70
10 years p.a.	8.95	7.74	1.21
Since inception p.a. 31.12.2010	7.24	6.67	0.57

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, as at 31 December 2021, based on the M Accumulation share class.
[1]Benchmark: FTSE® All Share Index.
As of 6 April 2017, the UK Government announced that funds paying interest distributions will be required to pay those distributions gross of tax.

Sector breakdown



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

Market review

- The UK stock market proved to be remarkably robust over the quarter given the emergence of Omicron, a new variant of Covid. I wrote last time that there was a view amongst analysts and investors the worst is behind us in relation to the pandemic, but the recent news flow reminds market participants that unwelcome developments can appear from leftfield at any point.
- The good news is this latest variant, although highly contagious, if caught appears less serious, and together with the successful vaccination programme in the UK has led to the market shrugging off the initial worry. Of course, with administrations across the United Kingdom making policy up on the hoof, it has led to many problems in the short-term, for several companies across different sectors.
- The final quarter of 2021 saw the start of interest rates rises in the UK. Although the increase was very modest, the direction of travel appears clear as the MPC grapple with trying to control inflation. Although the Federal Reserve in the US has yet to increase rates, the perceived wisdom would indicate that 2022 will see the start of the rate tightening cycle.
- Regarding inflation, we believe it is likely to rise as companies input costs surge leading to higher prices. Add into the mix, wage increases, and you have a heady mix of reasons. Pay growth in the UK has increased sharply as certain pinch points have begun to take hold. There is unquestionably a shortage of lorry drivers in the UK, and this is leading to problems within the system. Fuel shortages have been a common theme and many supermarkets are being unable to fill their shelves with certain products being unavailable.
- The Royal London UK Opportunities Fund underperformed its benchmark during the three months under review. Between October and December, the fund returned 2.65% versus 3.55% for the FTSE All-Share (Total Return), placing it in the second quartile. For 2021, the fund finished in the first quartile having returned 19.5% versus 17.8% for the benchmark. It is also pleasing to note that over 3 years, the UK Opportunities Fund is also placed in the top quartile.

Performance review

- The UK Opportunities Fund runs an 'all cap' structure which allows us to find the most exciting investments across the market cap spectrum.

Positive contributors

- Over the course of the last quarter, the strongest performer was **Watches of Switzerland Group** (+50%). Although the fund only bought into the stock at the start of the year, WOSG has proven to be the stand-out performer of 2021, jumping by 133% since we made our initial investment. The news flow during the last quarter continued to be positive with yet another earnings upgrade following stronger than expected results.
- **Experian** (+17%) performed strongly over the final three months of the year after reporting robust interim results which were accompanied by an upgrade to full year expectations. Management remains enthused by the opportunities for further growth for the business in different parts of the world, particularly in some South American countries.
- **Tesco** (+16%) hiked full year profit forecasts at the beginning of the quarter and announced the commencement of a £500m share buy-back. The business, after several years of losing market share, is now very much on the front foot and has been winning back customers over the course of the last 18 months. This is leading to a glut of free cash flow and we are hopeful of further share buy backs and increased dividends in future.
- Another general retailer, **B&M European Value** (+13%) produced solid results during the quarter, accompanied by a further special dividend. Post the quarter end, management have confirmed a profit upgrade for the full year.
- **St James Place** (+12%) finished the year on the front foot and at last we feel the company is being afforded the rating it deserves. Net inflows for the quarter, and for the year, were ahead of management expectations and we believe the business is well set to continue to outperform its peers.
- Other stocks which are worthy of mention include **One Savings Bank** (+11%) and **Berkeley Group** (+9%), the London and South-East focused housebuilder.

Negative contributors

- The poorest performer over the course of the last three months was **Synthomer** (-18%). The company has recently appointed a new CEO following the departure of the highly respected previous incumbent. In addition, Synthomer announced its largest ever acquisition and although this was taken well, worries about the strength of the nitrile price weighed on the stock price towards the end of the period.

- **Prudential** (-13%), remained out of favour with investors as covid concerns in Asia remained front of mind.
- **Melrose** (-8%), a stalwart of the fund, continued to prove friendless over supply chain concerns within their automotive division. Chip shortages are proving problematic for the company, but the good news is there is pent up demand which will eventually be satisfied. Realistically, the sale of their Powder Metallurgy division could be pushed to the right but there should be no erosion whatsoever to the valuation of that business. We continue to remain highly impressed with management actions taken over the last couple of years.
- Other shares which ended the period in negative territory included **Chemring** and **Marshalls**, both down 7%. Both businesses are very much on the front foot operationally and we remain enthused about opportunities for both.

Portfolio activity

- The fund has 36 investments which are spread across a variety of market capitalisations. As at 31st December, the breakdown of the portfolio was as follows: 57% in the FTSE 100, 35% in the FTSE 250 and 6% in Small Cap/AIM. The fund has 2% in cash and the active share is currently 80%.
- The split of the investments was as follows:

	Weighting (%)
FTSE 100	57
FTSE 250	35
Small Cap/AIM	6
Cash	2

New holdings

- The fund added two new investments during the quarter, these being **IntegraFin** and **Weir Group**.
- **IntegraFin**, through its subsidiary Transact, is a B2B technology platform for financial advisers, designed to help them manage complex plans for multiple groups of clients. The business owns all its proprietary technology which helps it keep ahead of its competition. The business has very successfully added clients onto its platform over the last number of years and we are confident it can continue this for the foreseeable future.
- The second stock purchased was **Weir Group**. The fund has previously owned Weir but sold in 2020 over concerns the business would need to raise equity during the pandemic. Since then, management has sold its Oil & Gas division, therefore it is now a pure play on the mining industry. The business produces equipment for the large miners and in addition has a healthy aftermarket division. The mining division has historically earned margins in the high teens and we see no reason why this shouldn't continue. Given its dedicated focus to the mining arena, it might prove highly attractive for an overseas competitor in due course.

Stocks sold

- The fund exited positions in **Fevertree** and **Abrdn**.
- **Fevertree** is a company the fund has held for a couple of years and is one we very much admire. Management has done a very solid job of pivoting the business more towards the off trade during the pandemic and this has proven the right strategy. In addition, the company has taken more control of its US business away from distributors and although we believe this is the correct strategy, it is not without risk in the short-term. Given the raw material cost pressures and supply chain concerns, we decided the risk/reward was not in one favour and therefore the decision was taken to exit the stock. We continue to watch the stock closely and if there is a setback in the share price, we remain ready to act.
- **Abrdn** (formerly Standard Life Aberdeen) was sold from the fund as we had become increasingly concerned at the scale of the task the new CEO has it turning around the business. Although initial steps have been taken, we think it will be a couple of years until we could be sure it is working. Allied to this a dividend cut and a very expensive purchase of Interactive Investor and therefore we feel there are better uses for unit holders' capital.

Additions

- The fund topped up its position in **Synthomer** following the announcement of its purchase of the adhesives business from Eastman. Other additions worthy of highlight include **Prudential** and **Glencore**. Although Glencore was the best performing of the mining majors during 2021, we feel there is still much more to go for as it transitions itself under its new CEO. The company is generating meaningful free cash flow and we expect a large percentage of this to be returned to shareholders in one form or another.

Sales

- The fund trimmed its position in **Hargreaves Lansdown** and **Rio Tinto**. We used Hargreaves Lansdown as a source of cash for the purchase of **IntegraFin** and the same was true of Rio Tinto as we increased the exposure to **Glencore**.

Outlook

- As we turn our attention to 2022 and wave goodbye to the year just gone, my feeling is one of a hamster, getting back on its wheel and starting all over again!
- We do look to the future with confidence however, for several reasons. Firstly, we hope the worst of the pandemic is behind us. Of course, the likelihood of new variants arriving at some point in the future is always there but as populations across the globe are vaccinated, we are hopeful the situation will improve, and life will return to something akin to normal. This will be a massive shot in the arm to stock markets.
- We have yet to see whether inflationary pressures are transitory or not but given the hikes we are seeing in energy costs and transportation together with wage inflation increasing sharply, it could be argued that it is here to stay. If inflation becomes more structural this normally favours sectors such as banks and oils and we are ready to adapt to manage risks. After the Bank of England increased rates from 0.1% to 0.25% in December, we think this sets the scene for further rises during this coming year. The unknown surrounds the timing and quantum of a future rises.
- Our view remains that the FTSE All-Share still offers value, certainly relative to other markets, given its current rating which is demonstrably cheaper than the US or indeed many parts of Europe. We have mentioned on countless occasions M&A activity looms large in the background. With PE firms sitting on huge war chests, 2022 could prove to be another bonanza for M&A although we are not keen on losing quality names from the UK market. Many well-known companies were bought in 2021 and it will be interesting to see whether this continues this year.
- To conclude we are confident the portfolio is well placed and are optimistic that economic activity will get back to something akin to normal over the medium term once supply chain issues and other areas of indigestion are behind us.

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