ROYAL LONDON EQUITIES

Fund Manager Commentary – February 2021

For professional clients only, not suitable for retail investors

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RLAM EQUITY PERFORMANCE

Fund Performance

	1 month (%)	Rolling 12 months (%)
RL UK Equity Income M Inc	**2.03**	**0.47**
IA UK Equity Income Sector	2.29	2.65
FTSE All Share Index	1.99	3.50
RL UK Dividend Growth Fund M Acc	**1.89**	**13.43**
IA UK All Companies Sector	2.50	5.34
FTSE All Share Index	1.99	3.50
RL UK Mid Cap Growth Fund M Acc	**1.32**	**6.60**
IA UK All Companies Sector	2.50	5.34
FTSE 250 ex-IT Index	4.57	7.71
RL UK Opportunities Fund M Acc	**2.58**	**9.15**
IA UK All Companies Sector	2.50	5.34
FTSE All Share Index	1.99	3.50
RL UK Smaller Companies Fund M Acc	**2.39**	**19.23**
IA UK Smaller Companies Sector	3.64	20.43
FTSE Small Cap ex-IT Index	7.18	21.54
RL Global Equity Income Fund M Inc	**0.62**	**23.77**
IA Global Equity Income	-0.25	10.41
MSCI All Countries World Index	0.49	19.00

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 and FE, correct as of 28 February 2021. Returns quoted are net of fees.

ROYAL LONDON UK EQUITY INCOME FUND

Portfolio Commentary

- During February, the fund performed in line with the All Share index and was slightly behind competitor funds, placing in the 59th percentile. The biggest drivers of performance were **WH Smith** and **Restaurant Group**, both of whom were spurred on by the prospect of the UK's Covid restrictions being eased over the coming months. **DMGT**, the owner of the Daily Mail was also a strong contributor to performance on news that Cazoo, a used car business that DMGT owns a 20% stake in, could look to float on the stock market.
- During the month the fund trimmed the position in **Restaurant Group**, locking in some of the strong recent gains in the share price. A new holding was established in the accounting software business **Sage**. Sage shares have been relatively weak, with some investors worried about the competitive position of the business in its markets. However, we feel that these concerns are overdone and overlook Sage's strong existing customer base. The business is cash generative, has a very strong balance sheet and offers an attractive dividend yield at current prices.

Investment Outlook

- The Covid vaccine rollout in the UK continues to make good progress, supporting the government's proposed timetable for Covid restriction easing. However, we remain conscious that this timetable could still slip if the virus reasserts itself and it is likely to be some time before life returns to normal. We look to invest in a broad range of companies who are in control of their own fates, irrespective of market conditions. As well as looking for durable businesses, a willingness to look through short term extremes of sentiment and buy stocks when they are out of favour, or take profits when sentiment becomes exuberant should drive longer term performance.

Martin Cholwill

Head of UK Income Equities

ROYAL LONDON UK DIVIDEND GROWTH FUND

Portfolio Commentary

- Fund performance slightly lagged the index in February (+1.9% versus 2.1%) and was 68th percentile versus the peer group.
- The reflation and 'opening up' trade was in full swing in February, with strong performance from sectors such as financials and commodities, but contrastingly weak performance from more defensive, discount rate sensitive areas such as healthcare and consumer staples. The balance within the fund means that we are well sheltered, relatively, from such a macro led market. Unsurprisingly, stocks such as **Restaurant group** and **WH Smith**, both of which have seen their cashflows damaged by lockdowns, were the strongest contributors to performance, but **Daily Mail and General Trust** (DMGT)is worth calling out, up 16% on news that their online car selling platform, Cazoo, may be going to IPO soon at lofty valuations. Part of our thesis for owning DMGT is their ability to grow and sell early stage businesses, something which the earnings focused market repeatedly undervalues.
- During the month, we started a new position in homewares retailer, **Dunelm**. It is a company we know well and has made a highly impressive transition to being a true omnichannel retailer in recent years. In addition, their competitively advantaged sourcing operations provides runway for continued market share gains in attractive end markets. This was partly funded by continuing to reduce exposure to **B&M European Value Retail**, where the company continues to perform superbly but valuation provides a more balanced risk reward than was the case a few months ago. We also continued to build our position in defence product manufacturer, **Avon Rubber**. Avon has faced some short-term headwinds due to the retendering of a contract, but this is giving us the opportunity to start a position at an attractive valuation given their potential to gain market share in the long term through superior R&D in niche areas. We also reduced exposure to **TI Fluids** and **Restaurant Group** which have both performed strongly recently.

Investment Outlook

- Although Covid restrictions remain very tight in the UK, the vaccination programme seems to be progressing effectively, offering hope of more normality later in the year. As consistently stated, we look to invest in a range of companies who are in control of their own fates, irrespective of market conditions. The Covid-19 shock is proving a stern test of this process, and the resilience of those companies, but we continue to believe that the approach is serving investors well. As well as looking for durable businesses, a willingness to look through short term extremes of sentiment and buy stocks when they are out of favour, or take profits when sentiment becomes exuberant should drive longer term performance.

Richard Marwood

Senior Fund Manager

Niko De Walden

Fund Manager

ROYAL LONDON UK MID CAP GROWTH FUND

Portfolio Commentary

- During February equity markets made modest returns as positive data from vaccine efficacy and roll-out programs were weighed up against rising bond yields amid suggestions of increasing inflation. The fund returned +1.3% versus the benchmark (the FTSE 250 ex-IT index) return of +4.6% and the peer group median return of +2.5%.
- In a trend that has now been a feature since the first vaccine announcements in November, value stocks significantly outperformed growth stocks. Companies with higher valuation multiples and often lower levels of financial gearing typically underperformed, despite many announcing results which were ahead of forecasts. The consumer services sector, which includes some of the businesses most affected by Covid such as high street retailers, pubs & restaurants and travel operators, significantly outperformed. The fund's underperformance relative to its benchmark was due to both sector allocation and stock selection, but at a high level this style rotation from growth to value was the root cause.
- The most significant positive contributors included retailer **WH Smith** and food travel operator **SSP Group**, which should stand to benefit from the easing of Covid restrictions, specifically domestic and international travel. Other significant contributors included brokerage **TP ICAP**, following the completion of its acquisition of Liquidnet. The position was bought in the second half of 2020 and the fund supported the rights issue in February. Historically an interdealer broker, the group has been investing in its high margin, scalable data & analytics business as well as driving electronification of trading and settlement within its broking business. The acquisition of Liquidnet, the global equities electronic trading platform, provides ample cost synergies as well as opportunities to accelerate TP ICAP's nascent electronic bond and rates trading platforms. These initiatives should allow for faster growth, higher margins and less volatile earnings in time, supporting a higher valuation.
- Negative contributors were generally high-quality companies with long term growth prospects and lowly geared balance sheets, such as investment platform **Integrafin**, industrial software group **Aveva** and asset-light utility provider **Telecom Plus**. None of these announced negative results or changed their outlook for future growth. However all were subject to the style rotation described above.

Investment Outlook

- The macroeconomic outlook remains promising for a period of synchronised global economic growth through the second half of 2021 and into 2022 as end market demand and inventory levels pick up across the world. Consumer savings rates remain elevated setting the stage for a significant rebound in consumer spending in 2021 and beyond. Corporate balance sheets have been repaired, with management teams ready to deploy cash on business efficiency initiatives or acquisitions. While there is some inflation within supply chains in areas such as raw materials, structural factors are likely to limit inflation over the long term. As a result, we are excited about the earnings growth prospects for portfolio companies, while outside of subsectors such as Biotech and early stage technology companies, valuations – especially within the UK market - are attractive.

Henry Lowson

Head of UK Alpha Equities

ALPHA MANAGER 2020
Henry Lowson
citywire AA

ROYAL LONDON UK OPPORTUNITIES FUND

Portfolio Commentary

- Over the month the UK Opportunities Fund, with a return of 2.58%, outperformed the FTSE All-Share Index (2.06%) and relative to the peer group was positioned in the second quartile**. WH Smith** was this month's stand out performer after rising a quarter. **Prudential**, which has been out of favour for a while, rose 20% over the month. **Lloyds Banking Group** saw its shares rise 18% and **MJ Gleeson** added 11% during February. **Experian**, along with many other 'quality growth' stocks suffered, finishing the month 11% weaker.
- During February the fund added one new holding, **Glencore**. Following a very positive meeting with management and with commodity prices increasing, we took the opportunity to add to our sector weighting. We took the opportunity to reduce our exposure to some of the Covid winners in the shape of **B&M European Value** and **JD Sports**. In addition, we also took the weighting down in **Restore**.

Investment Outlook

- February proved to be a positive month with the FTSE All-Share index gaining over 2%, however there was much underlying volatility as investors grew concerned that the extent of the global stimulus will result in higher inflation. This belief caused a significant sell-off in sovereign bonds and was accentuated by evidence that the economic recovery from Covid will be better than anticipated. How significant the rise in inflation turns out to be remains uncertain, however those areas of the market that could benefit from a stronger recovery such as commodities and financials performed strongly during the month. In the UK the best performing sectors were oil & gas and mining. While an economic recovery is clearly welcomed, a supportive feature of markets over the last ten years has been low inflation with declining bond yields and it remains to be seen how central banks deal with the rising cost of financing government deficits.

Craig Yeaman

Senior Fund Manager

ROYAL LONDON UK SMALLER COMPANIES FUND

Portfolio Commentary

- During February equity markets made modest returns, as positive data from vaccine efficacy and roll-out programs were weighed up against rising bond yields amid suggestions of increasing inflation. The fund returned +2.4%, which compares to the benchmark (the FTSE Small Cap ex-IT index) return of +7.2% and the peer group median return of +3.6%.
- In a trend that has been a feature since the first vaccine announcements in November, value stocks significantly outperformed growth stocks. Companies with higher valuation multiples and often lower levels of financial gearing typically underperformed, despite many announcing results which were ahead of forecasts. The consumer services sector, which includes some of the businesses most affected by Covid such as high street retailers, pubs & restaurants and travel operators, significantly outperformed. The fund's underperformance relative to its benchmark was due to both sector allocation and stock selection, but at a high level this style rotation from growth to value was the root cause.
- Holdings exposed to the Travel & Leisure sector typically performed well; linen rental specialist **Johnson Service Group**, online travel agent **On The Beach** and **City Pub Group** all saw their share prices rise by over 20% as investor confidence in the recovery in earnings grew. **Ergomed**, the specialist clinical services group, was the single largest contributor after issuing a very positive trading update at the end of January. Despite headwinds due to Covid disrupting customer clinical trials, they achieved over 15% organic revenue growth through 2020 and entered 2021 with a record order book.
- Negative contributors were generally high-quality companies with long term growth prospects and lowly geared balance sheets, such as video games publisher **Team17**, specialist engineering group **Oxford Instruments** and corporate research and data provider **Globaldata**. None of these announced negative results or changed their outlook for future growth. However all were subject to the style rotation described above.

Investment Outlook

- The macroeconomic outlook remains promising for a period of synchronised global economic growth through the second half of 2021 and into 2022 as end market demand and inventory levels pick up across the world. Consumer savings rates remain elevated setting the stage for a significant rebound in consumer spending in 2021 and beyond. Corporate balance sheets have been repaired, with management teams ready to deploy cash on business efficiency initiatives or acquisitions. While there is some inflation within supply chains in areas such as raw materials, structural factors are likely to limit inflation over the long term. As a result, we are excited about the earnings growth prospects for portfolio companies, while outside of subsectors such as Biotech and early stage technology companies, valuations – especially within the UK market - are attractive.

ALPHA MANAGER 2020
Henry Lowson
citywire AA

Henry Lowson

Head of UK Alpha Equities

Henry Burrell

Fund Manager

ROYAL LONDON GLOBAL EQUITY INCOME FUND

Portfolio commentary

- The Royal London Global Equity Income fund finished ahead of the MSCI ACWI in February, returning 0.62% versus 0.49%.
- The fund continued to benefit from our exposure to basic materials companies, where strong performances from **Steel Dynamics** and **Anglo American** led the way. Despite share prices having moved up sharply in these companies, valuations continue to assume a relatively sharp mean reversion from current commodity prices, assumptions that we feel may prove wide of the mark thanks to high levels of stimulus and more supply constraint than has historically plagued these industries. Gold miner **Northern Star** and Printed Circuit Board design software company **Altium** were both weak during the month. Northern star was weak as the gold price trickled lower and then were removed from a major index following the completion of their merger with SAR. Altium had softish numbers as their SME customers have been more impacted by Covid than other tech end markets. Both companies continue to exhibit strong internal characteristics which we believe will drive superior wealth creation relative to their competitors.
- During the month, the fund started a position in **Sanwa Holdings**, a Japanese manufacturer of shutters for doors and windows with a global footprint. Sanwa have an impressive management strategy focused on cash return on investment and a net cash balance sheet, characteristics which are highly undervalued relative to global peers. We also started a holding in **KB Financial**, a well-capitalised Korean bank with a low risk lending book, trading at 0.5x BV. Management have a clear strategy to increase distributions to shareholders, which we believe is the correct strategy and can help narrow the valuation discount. We sold out of our **Visa** holding, where the blocking of the Plaid acquisition suggests that the former's strong market position is firmly in the sights of regulators, making the low yield not worthy of a holding for this mandate.

Investment outlook

- Markets are in a state of flux, with fears over inflation driving bond yields higher in recent weeks. This is causing change in market leadership with high quality growth stocks seeing their valuations come under pressure and price takers such as commodities and banks benefitting from higher earnings on low valuations. We continue to believe that our balanced approach by not only sector and country, but more importantly, stage of the lifecycle enables us to manage our exposure to these macro factors, allowing stock selection to drive the majority of relative performance.

Niko De Walden

Fund Manager

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