ROYAL LONDON SUSTAINABLE FUNDS

Fund Manager Commentary - January 2021

For professional clients only, not suitable for retail investors

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ROYAL LONDON SUSTAINABLE FUND PERFORMANCE

Fund Performance

	1 month (%)	Rolling 12 months (%)
RL Sustainable Managed Income Trust C Acc	**-0.66**	**4.73**
IA Sterling Corporate Bond	-0.76	4.28
iBoxx £ Non-Gilts All Maturities	-0.91	3.99
RL Sustainable Managed Growth Trust C Acc	**-1.02**	**7.29**
IA Mixed Investment 0-35%	-0.38	2.78
RL Sustainable Diversified Trust C Inc	**-1.42**	**9.56**
IA Mixed Investment 20-60% Shares sector	-0.43	2.83
RL Sustainable World Trust C Acc	**-1.49**	**15.58**
IA Mixed Investment 40-85% Shares sector	-0.31	5.63
RL Sustainable Leaders Trust C Acc	**-1.68**	**0.86**
IA UK All Companies	-0.86	-6.22
FTSE All-Share Index	-0.81	-7.55

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 31 January 2021. Returns quoted are net of fees.

ROYAL LONDON SUSTAINABLE MANAGED INCOME TRUST

Portfolio commentary

- Net of fees, the trust outperformed its benchmark (iBoxx Sterling Non-Gilt All Maturities Index) and the IA Sterling Corporate Bond sector in January, delivering second-quartile returns. For the rolling 12-month period, the fund has also outperformed the benchmark and IA peer group.
- The benchmark 10-year gilt yield increased 13 basis points to 0.33% by the end of the month. Sterling investment grade corporate debt returned -0.93%, outperforming the -1.70% return from UK government bonds. The average sterling investment grade credit spread (the average extra yield available from a corporate bond compared with government debt of equal maturity) tightened by 1 basis point to 0.98%.
- Total returns were negative for nearly all sterling credit sectors. The outperformance of covered bonds and the insurance sector, particularly subordinated insurance, was positive for performance. The strong returns from the portfolio's sub-investment grade bonds were also beneficial.
- The sustainable approach of the trust favours issuers that we believe offer a net benefit to society or show environmental, social and governance (ESG) leadership. This is reflected in the composition of the sterling credit portfolio, with up to three quarters aligning with five key themes: social housing (provision of housing for those on low or no income), the decarbonised economy (lending to companies playing a key role in the decarbonisation of the economy), infrastructure (vital infrastructure such as water and telecommunications), financial resilience (provision of insurance products to support individuals through shocks) and community funding (banks and building societies focused on individuals and small businesses). The remainder of the credit portfolio, while not aligning to one of the current themes, will still offer a net benefit to society or show ESG leadership.
- Holdings are focused on sectors that benefit from strong covenants (legal restrictions on what an issuer can do) and often offer enhanced security (offering assets as collateral). On sustainability grounds, we have no exposure to bonds of oil & gas companies or extractive industries. We are also underweight in the general industrial and consumer goods sectors, and to a lesser extent in consumer services.
- The trust's targeting in BBB is weighted to community funding (regulated banks and building societies), financial resilience (regulated insurance debt), decarbonisation and infrastructure debt, which have exhibited stable cashflows relative to the wider consumer, retail and industrial BBB areas and lower rating transition risk to sub-investment grade, which is a key risk in the current environment.
- We participated in seven new issues during the month. We bought senior secured bonds from **MetLife** and **New York Life**, the US life insurance companies; and a 10-year senior non-preferred issue from **BNP Paribas**. We also bought a longer-dated bond from **Great Places**, a housing association with over 19,000 homes mostly in North West England; a tap of a subordinated holding company bond from **Thames Water**; a tap of **Retail Charity Bonds** in the social housing sector, lending to Golden Lane Housing; and bonds of **Deutsche Bahn**, the German public transport operator.

Investment outlook

- Viral mutations and extended lockdown measures have jeopardised the economic recovery in the short term and rising unemployment seems likely. Against this, the positive start for the UK vaccination programme raises hopes of a return to more normal social and economic conditions later this year. However, the economy is likely to be compromised over the medium term given the surge in government debt. Interest rates look set to remain at very low levels over the next two or three years, with yield curves heavily managed by central banks.
- While the economic impact of the virus will have a detrimental impact on corporate profitability, we consider that the current credit spread still offers sufficient compensation for default and other risks (e.g. liquidity and rating migration). We expect investment grade credit bonds will outperform UK government securities over the next three years, although the magnitude of this outperformance is expected to be lower than our previous projections.

ROYAL LONDON SUSTAINABLE MANAGED INCOME TRUST

- The portfolio is highly diversified in order to improve overall portfolio liquidity and reduce the effect on overall performance of any deterioration in the creditworthiness of an individual holding or sector. The value of diversification in spreading risks is likely to become increasingly clear over the next few months. Our bias towards secured and covenanted debt should provide some mitigation and allow us to better protect our clients' interests. Our sustainable approach and a clear investment philosophy underpin our confidence in the fund's ability to meet the performance objective over the medium term despite the potential for further market volatility.

Shalin Shah
Senior Fund Manager

ROYAL LONDON SUSTAINABLE MANAGED GROWTH TRUST

Portfolio commentary

- Net of fees, the trust underperformed its composite benchmark and the IA Mixed Investment 0-35% Shares sector in January. For the rolling 12-month period, however, the fund has significantly outperformed its benchmark and the IA sector, and remains top decile.
- The benchmark 10-year gilt yield increased 13 basis points to 0.33% by the end of the month. Sterling investment grade corporate debt returned -0.93%, outperforming the -1.70% return from UK government bonds. The average sterling investment grade credit spread (the average extra yield available from a corporate bond compared with government debt of equal maturity) tightened by 1 basis point to 0.98%.
- Total returns were negative for nearly all sterling credit sectors. The outperformance of covered bonds and the insurance sector, particularly subordinated insurance, was positive for performance. The strong returns from the portfolio's sub-investment grade bonds were also beneficial.
- Equity markets started the year navigating a fine line between enthusiasm, as the roll out of the vaccines across the world began in earnest, and caution, as a new wave of infections resulted in a further number of lockdown measures. Reflecting this uncertainty, equity markets continued to oscillate around short-term news and demonstrated increased volatility. However for January as a whole, they remained largely unchanged with the FTSE All-Share falling by 0.8% following a strong finish to the year in 2020. The MSCI World All Countries Index was down nearly 1% in sterling terms.
- While the credit portfolio performed well, the trust's equity portfolio underperformed its peer group over the month. Sector allocation was again relevant, with mining and oil & gas companies having a good month – the trust has zero exposure to these sectors. Stock-specific moves also played a part. Notable detractors in the month were **Adidas**, **Nordson** and **Visa**, all of which have performed very strongly since the lows of last March and saw some profit taking.
- The sustainable approach of the trust favours issuers that we believe offer a net benefit to society or show environmental, social and governance (ESG) leadership. This is reflected in the composition of the sterling credit portfolio, with up to three quarters aligning with five key themes: social housing (provision of housing for those on low or no income), the decarbonised economy (lending to companies playing a key role in the decarbonisation of the economy), infrastructure (vital infrastructure such as water and telecommunications), financial resilience (provision of insurance products to support individuals through shocks) and community funding (banks and building societies focused on individuals and small businesses). The remainder of the credit portfolio, while not aligning to one of the current themes, will still offer a net benefit to society or show ESG leadership.
- The trust's bond holdings are focused on sectors that benefit from strong covenants (legal restrictions on what an issuer can do) and often offer enhanced security (offering assets as collateral). On sustainability grounds, we have no exposure to bonds of oil & gas companies or extractive industries. We are also underweight in the general industrial and consumer goods sectors, and to a lesser extent in consumer services.
- The trust's targeting in BBB is weighted to community funding (regulated banks and building societies), financial resilience (regulated insurance debt), decarbonisation and infrastructure debt, which have exhibited stable cashflows relative to the wider consumer, retail and industrial BBB areas and lower rating transition risk to sub-investment grade, which is a key risk in the current environment.
- We participated in seven new issues during the month. We bought senior secured bonds from **MetLife** and **New York Life**, the US life insurance companies; and a 10-year senior non-preferred issue from **BNP Paribas**. We also bought a longer-dated bond from **Great Places**, a housing association with over 19,000 homes mostly in North West England; a tap of a subordinated holding company bond from **Thames Water**; a tap of **Retail Charity Bonds** in the social housing sector, lending to Golden Lane Housing; and bonds of **Deutsche Bahn**, the German public transport operator.

Investment outlook

- Viral mutations and extended lockdown measures have jeopardised the economic recovery in the short term and rising unemployment seems likely. Against this, the positive start for the UK vaccination programme raises hopes of a return to more normal social and economic conditions later this year. However, the economy is likely to be compromised over the medium term given the surge in government debt. Interest rates look set to remain at very low levels over the next two or three years, with yield curves heavily managed by central banks.
- While the economic impact of the virus will have a detrimental impact on corporate profitability, we consider that the current credit spread still offers sufficient compensation for default and other risks (e.g. liquidity and rating migration). We expect investment grade credit bonds will outperform UK government securities over the next three years, although the magnitude of this outperformance is expected to be lower than our previous projections.
- The credit portfolio is highly diversified in order to improve overall portfolio liquidity and reduce the effect on overall performance of any deterioration in the creditworthiness of an individual holding or sector. The value of diversification in

spreading risks is likely to become increasingly clear over the next few months. Our bias towards secured and covenanted debt should provide some mitigation and allow us to better protect our clients' interests. Our sustainable approach and a clear investment philosophy underpin our confidence in the fund's ability to meet the performance objective over the medium term despite the potential for further market volatility.

- In spite of the two-way pull in equity markets in January, we are confident that central banks will remain dovish in their support for the global economy and, at some stage this year, the positive impact of vaccines should result in an improvement in economic activity. Therefore we remain optimistic regarding the ability of corporate earnings to improve, and retain a significant weighting in equities. The equity portfolio continues to be invested in a broad range of innovative, well-managed businesses with durable competitive advantages and which are supporting the transition to a more sustainable world. We have confidence that that many of the companies we are invested in will come out of this crisis even stronger than they went in and impressive corporate results from many of our investments support this view.

Shalin Shah
Senior Fund Manager

ROYAL LONDON SUSTAINABLE DIVERSIFIED TRUST

Portfolio commentary

- Equity markets started the year with a difficult balance between enthusiasm, as the roll out of the vaccines across the world began in earnest, and caution, as a new wave of infections resulted in a further number of lockdown measures, notably in the UK. Reflecting the uncertainty, equity markets continued to oscillate around short-term news and demonstrated increased volatility. However for January as a whole, they remained largely unchanged with the FTSE All-Share falling by 0.8% following a strong finish to the year in 2020. The MSCI World All Countries Index was down nearly 1% in January in sterling terms. We are confident that central banks will remain dovish in their support for the global economy and, at some stage this year, the positive impact of vaccines should result in an improvement in economic activity. Therefore we remain optimistic regarding the ability of corporate earnings to improve. Credit delivered negative returns in January, driven entirely by rising gilt yields. The yield on the benchmark 10-year gilt rose 0.13%, with large movements in early January following the Senate runoffs in Georgia, which saw Democrat victories and increased the likelihood of further US fiscal stimulus. Credit spreads were broadly unchanged, with the average sterling investment-grade credit spread ending January at 0.98%.
- The trust underperformed its peer group in January and was ranked in the fourth quartile. Sector allocation was again relevant, with mining and oil & gas companies having a good month. The trust does not have exposure to these sectors. Stock-specific moves also played a part. Key detractors in the month were **Adidas**, **Nordson** and **Visa**, all of which have performed very strongly since the lows of last March and may have seen some profit taking. On the other hand, Greggs and Thermo Fisher contributed positively to returns. UK baker **Greggs** issued a trading update in the period that was better than expectations. **Thermo Fisher**, the US life sciences company, preannounced its fourth quarter results, saying that it expected even higher revenue growth than its guidance in December. The company supplies the broad healthcare industry and has been hugely successful during the pandemic.
- During the month, we made no significant changes to the portfolio.

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Mike Fox

Head of Sustainable Investments

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ROYAL LONDON SUSTAINABLE WORLD TRUST

Portfolio commentary

- Equity markets started the year with a difficult balance between enthusiasm, as the roll out of the vaccines across the world began in earnest, and caution, as a new wave of infections resulted in a further number of lockdown measures, notably in the UK. Reflecting the uncertainty, equity markets continued to oscillate around short-term news and demonstrated increased volatility. However for January as a whole, they remained largely unchanged with the FTSE All-Share falling by 0.8% following a strong finish to the year in 2020. The MSCI World All Countries Index was down nearly 1% in January in sterling terms. We are confident that central banks will remain dovish in their support for the global economy and, at some stage this year, the positive impact of vaccines should result in an improvement in economic activity. Therefore we remain optimistic regarding the ability of corporate earnings to improve. Credit delivered negative returns in January, driven entirely by rising gilt yields. The yield on the benchmark 10-year gilt rose 0.13%, with large movements in early January following the Senate runoffs in Georgia, which saw Democrat victories and increased the likelihood of further US fiscal stimulus. Credit spreads were broadly unchanged, with the average sterling investment-grade credit spread ending January at 0.98%.
- The trust underperformed its peer group in January and was ranked in the fourth quartile. Sector allocation was again relevant, with mining and oil & gas companies having a good month. The trust does not have exposure to these sectors. Stock-specific moves also played a part. Key detractors in the month were **Adidas**, **Nordson** and **Visa**, all of which have performed very strongly since the lows of last March and may have seen some profit taking. On the other hand, ASML and Thermo Fisher contributed positively to returns. **ASML**, the Dutch semiconductor equipment manufacturer, released its fourth-quarter results, which were ahead of expectations, and the record size of its order book shows that the company remains well positioned with strong demand across the board. **Thermo Fisher**, the US life sciences company, preannounced its fourth quarter results, saying that it expected even higher revenue growth than its guidance in December. The company supplies the broad healthcare industry and has been hugely successful during the pandemic.
- During the month, we added to the holding in **Taiwan Semiconductor Manufacturing Co** (TSMC) following share price weakness. TSMC remains exceptionally well positioned to facilitate and benefit from semiconductor growth coming from end markets such as 5G, electric and autonomous vehicles, the internet-of-things (IoT) and artificial intelligence, and will be a key beneficiary of Intel's likely decision to outsource CPU manufacturing.

ALPHA MANAGER 2020 Mike Fox

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Mike Fox

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ROYAL LONDON SUSTAINABLE LEADERS TRUST

Portfolio commentary

- Equity markets started the year with a difficult balance between enthusiasm, as the roll out of the vaccines across the world began in earnest, and caution, as a new wave of infections resulted in a further number of lockdown measures, notably in the UK. Reflecting the uncertainty, equity markets continued to oscillate around short-term news and demonstrated increased volatility. However for January as a whole, they remained largely unchanged with the FTSE All-Share falling by 0.8% following a strong finish to the year in 2020. We are confident that central banks will remain dovish in their support for the global economy and, at some stage this year, the positive impact of vaccines should result in an improvement in economic activity. Therefore we remain optimistic regarding the ability of corporate earnings to improve and for the UK equity market to recover some or all of the falls experienced last year.
- The trust underperformed its peer group in January and was ranked in the fourth quartile. Sector allocation was again relevant, with mining and oil & gas companies having a good month. The trust does not have exposure to these sectors. Stock-specific moves also played a part. Key detractors in the month were Prudential, Adidas and Vistry. **Prudential**, the life insurer, announced that it will demerge rather than list its US business. This will be a quicker process, enabling the company to focus on its key market, Asia, but meant that it would also be raising new equity. The shares fell for this reason, but we saw the news as positive. German sporting goods and 'athleisure' clothing company **Adidas** fell after having had a strong few months and **Vistry**, the housebuilder, issued a trading update that was reassuring, although the end of the stamp duty holiday will affect the whole sector. On the other hand, **Greggs**, the baker, and **Genus**, the animal genetics company, contributed positively to returns. Both companies issued better than expected trading updates in the period.
- During the month, we reduced the position in **Ansys**, which offers high-end engineering and simulation software. The shares have performed very well, making the valuation seem high.

Mike Fox

Head of Sustainable Investments

ROYAL LONDON GLOBAL SUSTAINABLE EQUITY FUND

Portfolio commentary

- Equity markets started the year with a difficult balance between enthusiasm, as the roll out of the vaccines across the world began in earnest, and caution, as a new wave of infections resulted in a further number of lockdown measures, notably in the UK. This dynamic and uncertainty resulted in equity markets oscillating around short-term news and showing increased volatility. The MSCI ACWI Index declined by 0.9% in sterling terms in January, after a strong finish to the year in 2020. We expect central banks to remain dovish in their support for the global economy and, at some stage this year, the positive impact of the global vaccine rollout should result in an improvement in economic activity.
- **Taiwan Semiconductor Manufacturing Co** (TSMC), ASML and Thermo Fisher were the key contributors to performance in January. **TSMC**, the world's largest and most advanced semiconductor manufacturer, announced strong fourth-quarter results with bullish commentary around the future growth outlook for semiconductors over the coming years across key end markets, including high-performance computing, 5G, autos and the internet-of-things (IoT). Dutch company **ASML**, the leading provider of EUV tools, which are used to manufacture the most advanced chips, rose in part due to TSMC's strong results and after its own results showed a robust order backlog as customers such as TSMC plan to spend more on EUV tools to keep up with accelerating demand for the most advanced chips. **Thermo Fisher**, the US life sciences company, rose after pre-announcing fourth-quarter results ahead of expectations as it continues to experience tailwinds to its business following the Covid-19 pandemic. **Adidas**, the German global leader in sporting goods and 'athleisure' clothing, and **Nordson**, a US precision engineering equipment manufacturer, detracted from performance, but on no specific news. We have taken advantage of the weakness and added to both positions.
- In other transactions, we initiated a position in **Trane Technologies**. Trane is a US company and a global leader in heating, ventilation and air-conditioning (HVAC) systems and in refrigerated transport. Its solutions bring efficient and sustainable climate innovations to buildings, homes and transport. We see an attractive growth outlook for the company and room for margins to expand over the coming years.

Mike Fox

Head of Sustainable Investments

George Crowdy

Fund Manager

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