ROYAL LONDON UK OPPORTUNITIES FUND

Quarterly Report 30 June 2021

For professional clients only, not suitable for retail investors

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Asset split

	Fund (%)
Ashstead Group	7.5
Intermediate Capital Group	5.3
Rio Tinto	4.5
Melrose Industries	4.2
Prudential	3.8
Synthomer	3.4
Watches of Switzerland Group	3.2
DCC	3.1
Computacenter Plc	3.0
OSB Group Plc	3.0
Total	**41.0**

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

Fund data

	Fund
No. of stocks	36
Fund size	£894.9m
Launch date	31.07.2007

Performance

	Fund (%)	Benchmark[1] (%)	Relative (%)
Q2 2021	**7.19**	**5.60**	**1.59**
Year-to-date	12.53	11.09	1.44
Rolling 12 months	32.96	21.45	11.51
3 years p.a.	4.66	2.05	2.61
5 years p.a.	8.12	6.48	1.64
10 years p.a.	7.34	6.37	0.97
Since inception p.a. 31.12.2010	6.90	6.36	0.55

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.

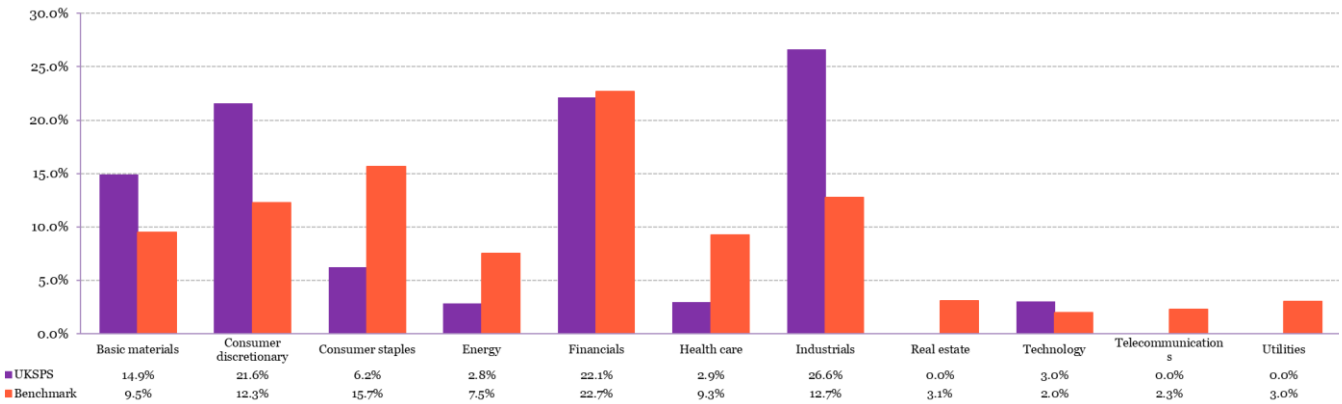
All performance figures stated gross of fees and tax unless otherwise stated.

Source: RLAM, as at 31 March 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.

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Background

- The UK stock market continued the positive momentum witnessed over the last year as once again it made progress during the three months under review. There is most definitely a feeling amongst market participants that the worst of the pandemic is behind us and we can, at last, look forward to better times ahead.
- It is not just in the UK where markets are on the march but around the world. The rise witnessed can be attributed to several factors: a successful vaccination programme, ongoing stimulus from central banks and the "V" shaped recovery globally. The strong pace of recovery has resulted in sharp upward moves in the price of a range of commodities and a concern that inflation will rise to a level not seen for many years.
- We believe it is likely that inflation will rise and as companies input costs surge which tends to lead to higher prices. Add into the mix wage increases due, for example, a lack of immigrant labour from Europe and you have a heady mix of reasons. Pay growth in the UK during the first quarter was just shy of 5%, a level not seen for some considerable time.
- The Royal London UK Opportunities Fund had a solid quarter and outperformed its benchmark during the three months under review. Between April and June, the fund returned 7.0% versus 5.1% for the FTSE All-Share (Total Return), placing it in the first quartile. Year to date, the fund is positioned in the second quartile having returned 12.1% versus 10.8% for the benchmark.

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** (+26%) a new holding for the fund. We first bought this stock at the beginning of this year and we have been delighted at the performance of it, both operationally and in share price terms. The company has a dominant share of the luxury swiss watch market in the UK and has begun its foray into the US market with promising early signs.
- **Ashtead** (+24%) continues to perform strongly and the share price performance of it since the nadir of the market in March 2020 has been outstanding. The company remains the largest position within the fund and the outlook for its end market continues to look very positive.
- **Fevertree** (+21%), the premium mixer company, had a stronger quarter after having been the largest faller over the first three months. There was no specific news which we could point to other than the reopening of pubs and restaurants in the UK and Europe would be a material benefit for the company.
- **Spirax-Sarco Engineering** (+20%) has proven itself over many different cycles to be a quality operator, consistently outperforming the underlying market. The company released its Q1 trading update which led to analysts upgrading their full year expectations.
- **AstraZeneca** (+20%) had a strong quarter after having lagged at the beginning of the year. The company has a very strong pipeline and with the commercialisation of many new drugs, particularly within the oncology sphere, the company is likely to deliver double-digit growth in earnings for the next number of years.
- Other stocks which are worthy of mention include **St James Place**, the wealth management company (+19%) and **Intermediate Capital Group** (+17%), the global alternative asset manager.

Negative contributors

- The poorest performer over the course of the last three months was **Prudential** (-11%), the Asian focused life assurer. The shares have proven to be volatile over the course of the last 18 months but we very much like the direction of travel insofar as focusing on Asia and preparing to spin off Jackson National in the US.
- **WH Smith**, a leading retailer for news, books, and convenience, has suffered as the imposed travel bans severely affects their operations within airports and stations. Thankfully, the US has opened up and with a large proportion of domestic travel, we are hopeful normality will return quickly. The shares finished the period under review off 11%.
- **Melrose Industries**, one of the fund's largest positions, had a frustrating quarter as it fell 7%. Having spoken again at length with management, we remain comfortable with how the business is performing operationally and we are hopeful of a re-rating.
- Other shares which ended the period in negative territory included **DCC**, **Abrdn** (formerly known as Standard Life Aberdeen) and **Bellway**, the national housebuilder, all down 4%.

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Portfolio activity

- The fund has 36 investments which are spread across a variety of market capitalisations. As at 30th June, the breakdown of the portfolio was as follows: 64% in the FTSE 100, 29% in the FTSE 250 and 6% in Small Cap/AIM. The fund has 1% in cash and the active share is currently 81%.
- The split of the investments was as follows:

	Weighting (%)
FTSE 100	64
FTSE 250	29
Small Cap/AIM	6
Cash	1

New holdings

- Two new investments were added during the quarter, these being **Mattioli Woods** and **Restaurant Group**.
- Mattioli Woods is one of the UK's leading and fastest growing consultancies in the provision of pensions and wealth management services for directors, professional people, owner-managed businesses, and small-to-medium-sized PLCs. The company has recently acquired Maven Capital Partners and Ludlow Wealth Management Group which will materially add to the profitability of the group. The company undertook a fund raise to help with the acquisition costs and we were able to take a stake in the business.
- The second company added to the portfolio was **The Restaurant Group** as a recovery play on the re-opening of the UK economy. The company has raised fresh equity to reduce its net debt and is therefore in a stronger position relative to twelve months ago. In addition, the pandemic has allowed management to overhaul its estate, close several unprofitable sites and focus on its Wagamama brand, together with its pub division, Brunning and Price. The casual dining space has seen a material reduction in capacity, which we believe will materially benefit the company.

Stocks sold

- The fund exited positions in **Restore** and **Rentokil Initial** during the last three months.
- The fund had a small position in Restore and to make it a reasonable sized holding we would have needed to allocate more cash to it. Given it was no longer a best idea, the decision was made to sell.
- The second position we exited was Rentokil Initial. Rentokil was a long-standing holding in the fund and is a business we very much admire but we felt the rating was very full and didn't offer the requisite upside.

Additions

- There are no additions worth highlighting this quarter as all were very small.

Sales

- The fund took the weightings down in three stocks over the quarter, these being **Abrdn**, **Lloyds Banking Group** and **Ashtead**.
- We have a self-imposed limit of 7.5% on any stock held and Ashtead, due to its exceptional performance, was bumping up against that figure. Reluctantly therefore, the position size has been trimmed on three occasions to keep the stock below that figure.

Outlook

- As we look back not just over the last quarter, but rather the twelve months, it is probably fair to say that given what the market has had to absorb, most commentators would not only be delighted by the resilience but also surprised. This leads us to think about the outlook for not only the second half of the year but also the medium term. Does the market, given the strength witnessed over the last 15 months, still offer value? We believe the answer is most certainly yes.
- 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. Very important issues have either been resolved or are in the process of being sorted. As mentioned earlier in the report, the successful roll-out of vaccines sets a positive tone for the UK equity market. It is likely, given the progress made, the UK economy will open quicker than most European countries although the US is ahead. Earnings momentum is positive for many stocks, particularly for the more cyclical companies, many of which we hold in the fund.

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- We have mentioned on countless occasions M&A activity looms large in the background. With private equity firms sitting on huge war chests, 2021 could prove to be a golden year in terms of M&A although we are not keen on losing quality names from the UK market. Many well-known names have been bid for already this year and the number of deals shows no signs of abating.
- To conclude we are confident the portfolio is well placed for the second half of the year and are optimistic that economic activity will get back to something akin to normal over the short to medium term.

ROYAL LONDON
ASSET MANAGEMENT

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