ROYAL LONDON GLOBAL EQUITY SELECT

Quarterly Report 31 March 2021

For professional clients only, not suitable for retail investors

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Top 10 holdings

	Fund (%)
Microsoft	5.7
Steel Dynamics	5.6
Reliance Steel & Aluminum Co.	5.2
Amazon	5.0
Anglo American	4.9
Constellation Software Inc	4.0
Visa	3.8
HCA Healthcare	3.5
Safran	3.4
Bridgestone Corp	3.3
Total	**44.3**

Source: RLAM, based on the M Acc share class, subject to rounding.

Fund data

	Fund
No. of stocks	36
Fund size	£324.9m
Launch date	10.10.2017
Active share	87.2%
Tracking error	4.6%

Performance

	Fund* (%)	Benchmark[1] (%)	Relative (%)
Q1 2021	**8.34**	**3.95**	**4.39**
Year-to-date	8.34	3.95	4.39
1 year p.a	44.09	38.43	5.66
3 year p.a	17.90	13.44	4.46
Since inception p.a. 10.10.2017	14.83	10.56	4.27

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. All performance figures stated gross of fees and tax unless otherwise stated, subject to rounding.

[1]Benchmark: MSCI World NDR Index.

**Performance refers to R Acc share class unless otherwise stated. M Acc share class launched on 05.03.2018. Initial share class at fund launch was R Acc.*

Holdings and Weights

Source: RLAM as at 31 March 2021.

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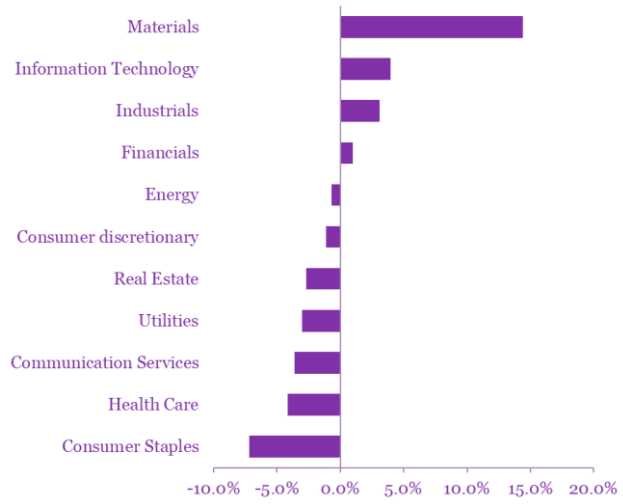
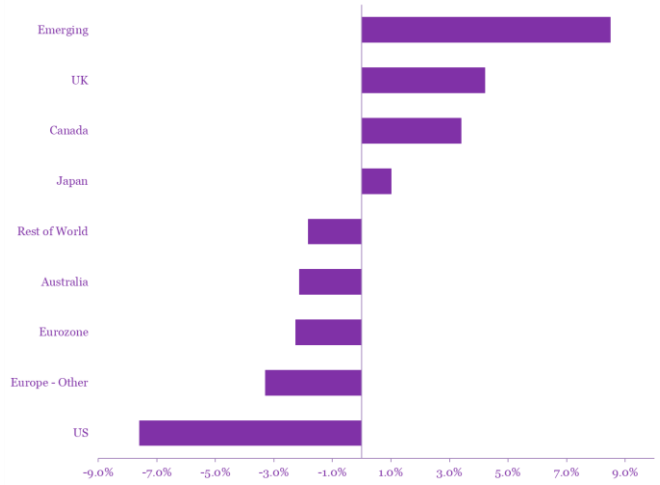
Sector Weights



Regional Weights



Source: RLAM as of 31 March 2021. Shows weight relative to index.

Executive summary

- The global equity strategies delivered good performance in the first quarter as equity markets rallied, delivering delivered net returns of +8.15% for the **RL Global Equity Select Fund** and +4.14% for the **RL Global Equity Diversified Fund**, compared to +3.95% for the benchmark (MSCI World Net Total Return in sterling). For the 12-month period, the funds have returned +43.05% and +35.76%, respectively, against +38.43% for the benchmark (fund returns net of fees, for M Acc share classes).
- As of April 4, the UK has the highest Covid-19 vaccination rate in Europe having administered 54.36 doses per 100 people in the country. The UK was first in Europe to approve the Pfizer/BioNTech vaccine and began its rollout in December. However, the AstraZeneca vaccine was banned in March in certain European countries for a short while due to concerns over safety, hindering vaccine rollout programmes in the region. Virus transmission rates remain very high across the continent. In the week ending March 28, there were over 1.7 million new cases of Covid-19 recorded in Europe.
- While certain European countries have high vaccination rates, many others have struggled to make headway. EU member states have struggled with vaccine delivery delays as well as political and production issues. The recent surge of Covid-19 throughout Europe has been linked to a highly infectious strain of coronavirus first detected in southeast England last September – formally identified as B.1.1.7, but commonly referred to the Kent or UK variant. This strain has now spread throughout most of Europe, meaning certain countries in the region have had to go back into lockdown such as France and Germany.
- Using some valuation metrics, equities are the most expensive for several decades, and are approaching valuation peaks reached in the dotcom boom in 1999/2000. Nonetheless, relative to bonds, while clearly more expensive than at points in 2020, equity valuations are still not extreme and are actually lower than in 2018. We also believe earnings momentum will remain favourable. We believe sectors will be a key point of volatility risk, with the rotation into more cyclical/Covid-recovery stocks in the autumn showing the potential for positive and negative effects on performance. We are addressing this risk by minimising factor exposure to sectors and focusing on stock-specific risk.
- Our preference is to own wealth creating companies with suitable balance sheets for their underlying business and a conservative approach to credit, diversified across regions, countries, industries and Corporate Life Cycle categories. No single model or analysis is a magic bullet for investing, but our Corporate Life Cycle model helps us to understand the world as management teams see it and identify those that are actively responding to the crisis. Owning companies that merely survive the pandemic won't deliver significant outperformance. We are looking for the 'Accelerators' that are increasing investment to take full advantage of the current environment, and 'Slowing & Maturing' or 'Turnaround' companies that are doubling down on restructuring with an attractive valuation pay-off opportunity.

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Market overview

- As with last year, the market recovery may seem surprising given the ongoing Covid-19 crisis. Indeed, 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, driving down fixed income yields to very low levels and equity discount rates to over 20-year lows, even considering the rising yields during the first quarter. Although question marks remain surrounding the long-term vaccine efficacy, markets now appear cautiously optimistic about some form of recovery.
- Most major country markets rose during the quarter, however dispersion in returns was more a result of sector rotation; there was a clear twist in the market in mid-February. In a reverse to the experience of most recent years it was the higher growth companies in the market, especially nascent IT disruptors, which tended to struggle (IT +1% in aggregate). Consumer staples was the weakest sector (-2%) impacted to some extent by rising fixed income yields. Energy posted strong returns (+17%) as did financials like banks (financials +10%) and this is a strong contrast to many recent periods. Quality cyclical materials companies often outperformed too (materials +5%).
- The $1.9 trillion of additional stimulus secured in President Biden's American Rescue Package was at the top of analysts' expectations. While the package underpinned positive sentiment for a long-term recovery, it also stoked concern for potential future inflation. Dovish monetary policy throughout the period has lent some weight to these concerns, as most central banks have remained relaxed on inflationary pressures, instead preferring to focus on growth: the Bank of England's (BoE) Monetary Policy Committee (MPC) confirmed in January that no rate rises would be implemented for six months; and Federal Reserve (the Fed) Chair Powell consistently played down government bond yields rise in the period. The European Central Bank (ECB) is the main exception, opting to increase the speed of its bond buying programme.
- The UK and the EU in December agreed a trade deal. A post-Brexit deal on financial services regulation between the UK and the EU was also agreed in March.
- Risk assets performed well in relative terms through the quarter; the ICE BofAML (BB-B) Global Non-Financial High Yield Index returned -0.03 % to sterling investors in Q1. The combination of loose fiscal policy and dovish monetary policy continued to benefit the asset class by making debt less likely to default. As such we still believe think that high yield credit spreads continue to overcompensate for the risks.
- Sterling remains among the stronger major currencies over the quarter, strengthening a further 1.1% against the US dollar, as the huge American rescue package has added to inflationary pressures. It strengthened more significantly against the euro and against the yen. This strength tempered the returns for sterling investors in global equities.
- Oil prices continued to recover strongly, reaching their highest levels since October 2018 in March following a surprise decision by OPEC+ to keep supply cuts fully in place at current levels. The price of Brent crude oil rose by +22.7% to almost $63 a barrel. Copper continued to strengthen as economic activity strengthened in China, rising +13.4% over the quarter. Gold fell -9.6% to $1,713/oz.

Performance and activity

- The fund strongly outperformed its benchmark over the quarter and 12-month period. Commodity companies led the outperformance as part of the wider revival seen in commodity prices. Since the Pfizer vaccine was announced last year in November, there has been an extreme rotation in stock and sector leadership within equity markets. Value stocks have significantly outperformed as investors rushed to participate in both a 're-opening' trade, i.e. buying companies who stand to benefit from a lifting of Covid-19 related restrictions, such as high street retailers and travel operators, and a 'reflation' trade, buying companies whose profits are likely to be supported by inflation and higher interest rates, such as commodity producers and banks. The consumer services sector, such as high street retailers, pubs & restaurants, and travel operators, have significantly outperformed during the last few months, as did the oil & gas sector.
- **Steel Dynamics**, **Anglo American** and **Reliance Steel** were strong contributors to returns in the first quarter. **Steel Dynamics**, the US steel producer that is in the 'Slowing & Maturing' category of the corporate Life Cycle, performed strongly as steel prices rose sharply to post-Global Financial Crisis highs. End-market demand is strong, yet domestic US steel production remains constrained and the company is benefitting from the upswing in pricing. While **Steel Dynamics** is currently valued like a 'typical' steel company, it has a far more interesting and resilient business model and has been gaining market share. **Anglo American** ('Mature') also benefitted from the general boost in sentiment as increased confidence in a near-term recovery boosted commodity prices still further. **Reliance Steel** gained on the back of a favourable metals pricing environment, mainly for carbon and stainless steel products amid improving demand and significant mill price hikes.

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- **Ocado**, **Bandai Namco**, **McCormick & Co.** and **Church & Dwight** detracted from returns over the period. Food home delivery platform Ocado ('Turnaround') despite its strong financial performance, did not announce any new international distribution centre agreements as potential partners couldn't travel to view its product and agree deals. However, more centres will open this year as previously signed contracts come on stream. We remain comfortable with the shares as Ocado has an unassailable first-mover advantage in a scale business against competitors that cannot replicate its technical knowhow. Japanese gaming and entertainment company **Bandai Namco** ('Compounding') also struggled. While its results were good, driven by their key divisions, Toys and Hobby and Network Entertainment, its gaming division had a setback as there were coding problems with a high-profile game release that Bandai was distributing. We continue to like the company, however, feeling that the potential for further international growth is undervalued. **McCormick & Co.**, the food spices and flavours manufacturer, and household goods company **Church & Dwight** (both 'Compounding') underperformed as investors rotated from defensive earnings to more cyclical Covid-recovery stocks. Both outperformed strongly last year as demand held up or even increased, despite the impact of the pandemic, as well as the positive impact of a lower discount rate on their cashflows.

Outlook

- We anticipate a period of synchronised global economic growth through the second half of 2021 and into 2022, as end market demand from both consumers and corporates picks up across the world. In the UK alone, consumer savings significantly increased through 2020 – analysts estimate an excess savings pool of £160bn, representing circa 7% of UK GDP. As the level of vaccines administered goes up, consumer confidence is likely to return followed by a significant rebound in spending.
- We are conscious, however, that following the remarkable recovery of global equity markets from their lows in late March, valuations are less compelling. They are challenged in many areas and using our global discount rate methodology are approaching the extremes seen in the Tech Bubble. Nonetheless, relative to bonds, while clearly more expensive than at points in 2020, equity valuations are still not extreme and are actually lower than in 2018. We also believe earnings momentum will remain favourable. We believe sectors will be a key point of volatility risk, with the rotation into more cyclical/Covid-recovery stocks in the autumn showing the potential for positive and negative effects on performance. We are addressing this risk by minimising factor exposure to sectors and focusing on stock-specific risk.
- There will be challenging periods in the year ahead. At a macro level, a reversal in the bond markets similar to 1994 would impact equity returns as would a change in perception around central bank support. In this respect, the sustained rallies in oil, copper and other commodities could create a headwind to the expectations of lower rates for longer as higher input prices could feed through to inflation if these are not absorbed by manufacturers. This may challenge the current low rate environment orthodoxy, which has been a contributor to the outperformance of growth stocks. There are also signs of increasing costs elsewhere with container rates from China to the Los Angeles having more than doubled since the start of 2020. Other than these risks, there will no doubt be stock-specific hits from earnings releases or trading statements for companies that fail to meet the high expectations of analysts and investors. Some technology stocks that pulled forward demand in lockdown could be vulnerable once we move to more normal conditions.
- The benefits of our disciplined investment approach – a focus on stronger business models combined with robust portfolio risk controls – enable superior stock wealth creation and valuation to drive long-term performance. As vaccination programmes roll out and economic conditions normalise, we see opportunities for the underlying stability of many of the businesses to be better reflected in valuations. We believe that active equity managers, in particular, will perform well in the recovery from the pandemic. The crisis will result in strong companies (high returns, strong balance sheets and good 'moats') getting stronger as they are better able to take advantage of opportunities, whether through new areas of demand or having better balance sheets to navigate through lower levels of cash generation in most industries.

Further insights from the Global Equity team

- To find out more about our investment approach to investing in global equities and our current thinking, please visit rlam.co.uk.

ROYAL LONDON
ASSET MANAGEMENT

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