ROYAL LONDON UK EQUITY INCOME FUND

Quarterly Report 31 March 2021

For professional clients only, not suitable for retail investors

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Asset split

	Fund (%)
Astrazeneca	5.1
British American Tobacco	4.2
Rio Tinto	3.8
Royal Dutch Shell	3.8
GlaxoSmithKline	3.6
IG Group	3.3
IMI Plc	3.0
Close Brothers	2.9
Dunelm Group	2.9
BP Plc	2.7
Total	**35.4**

Fund data

	Fund
No. of stocks	51
Fund size	£1,674.4m
Launch date	11.04.1984

Source: RLAM, based on the A share class.

Performance

	Fund (%)	Benchmark[1] (%)	Relative (%)
Q1 2021	**7.11**	**5.19**	**1.92**
Year-to-date	7.11	5.19	1.92
Rolling 12 months	29.66	26.71	2.95
3 years p.a.	3.52	3.19	0.33
5 years p.a.	6.06	6.29	-0.23
10 years p.a.	9.29	5.99	3.30
Since inception p.a. 30.06.2000	7.24	4.67	2.57

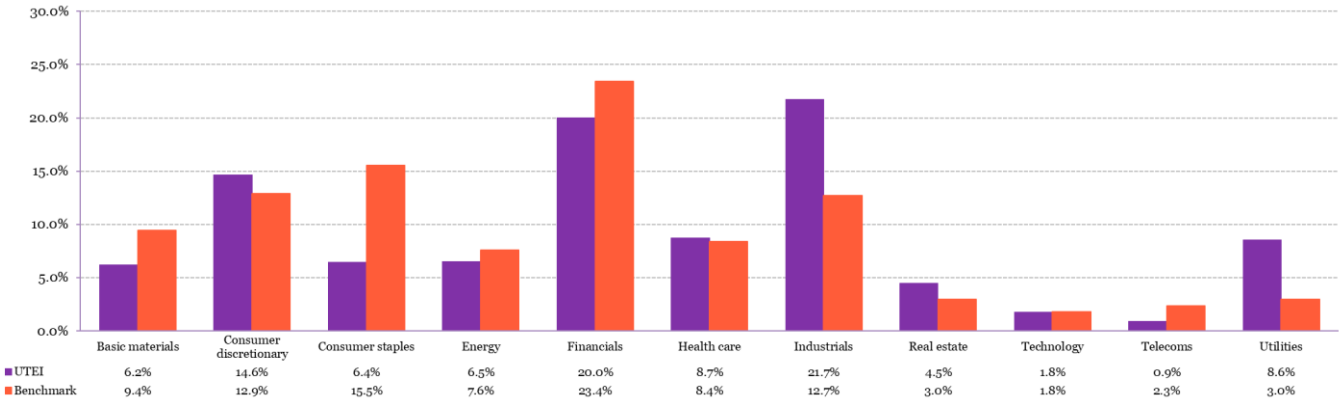
Past performance is not necessarily a reliable indicator of future performance. The value of investments and the income from them is not guaranteed and may go down as well as up and investors may not get back the amount originally invested.

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

Source: RLAM, as at 31 March 2021, based on the A Income share class.

[1]Benchmark: FTSE® All Share Index.

Sector breakdown



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

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Fund performance

- During the first quarter, the fund was ahead of both the FTSE All-Share index and competitors. Many of the stocks that benefited the fund the most in the quarter were among the biggest detractors to 2020 performance. The success to date of the UK's Covid vaccine programme and the prospect of the economy fully reopening produced a sharp rally in the share prices of many companies that were hit hardest last year. The main examples of this were Restaurant Group and WH Smith. Other notable contributors were Johnson Matthey, whose shares were strong after announcing a contract to supply critical components to a hydrogen production project and Aviva, who have shown good progress simplifying their business by selling off some of their overseas businesses.

Fund activity

- The main activity in the portfolio during the quarter has been to reduce the position in **Signature Aviation** and use the proceeds to establish new holdings in **Sage** and **National Grid**. After a protracted bidding battle, **Signature Aviation** agreed a takeover deal and rather than wait until later in the year for the deal to complete, we have started selling the holding in the market as the shares are now trading at a level very close to that offer.
- **Sage**, who supply accounting software to small and mid-size firms, have seen a relatively weak share price performance in recent months, with some investors worried about the competitive position of the business in its markets. However, we feel that these concerns are over-done 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.
- The **National Grid** position was established after the company announced the sale of some of its US assets, the purchase of a significant UK electricity distribution network and plans to dispose of its majority of UK gas assets. The deals make the company more heavily weighted to transmitting and distributing electricity, areas which are likely to see significant growth as the UK gradually transitions to reduce the carbon intensity of the energy system.

Market background and outlook

- The vaccine roll-out in the UK has been very encouraging, with the proportion of the population receiving at least one dose among the best in the world. The situation is less positive in other countries, where vaccine scepticism, worries vaccine side effects and wrangling over supplies have slowed progress. Indeed, some European countries have re-entered full lockdown measures. As a result, while the prospects for further easing of UK lockdown measures are good, any hopes of a near-term return to unfettered international travel may be misplaced. That could lead to the gradual reopening of the UK leisure sector seeing strong demand, as more people look to holiday in the UK. That extra demand could also be against the backdrop of reduced supply, as some businesses will have failed over the last year. Add to that the pent-up demand after lockdown from many households increasing savings over the last year, and it's not hard to understand concern over possible inflationary pressures. Those concerns are by no means confined to the UK. In the US we have seen bond yields edging up as commodity prices recover, spurred on by the prospects of huge economic stimulus packages. There are still plenty of deflationary forces at work, such as technological shifts and a likely rise in unemployment as government support packages introduced in response to Covid fall away, but it will be important to monitor the situation as inflation worries can be self-fulfilling. If people expect prices to rise, then that can get factored into things like wage negotiations and investment decisions.
- 2020 was characterised by the widespread cuts in UK dividends. In some cases this was mandated by regulators; in others due to uncertainty and a prudent "wait and see" approach and elsewhere as businesses battled to reduce cash burn as they battled for survival as their end markets ground to a halt. Many companies that have an accounting year that ends on 31 December have been reporting their 2020 results over the last few weeks – while the Covid impact has been apparent in all businesses, overall results have probably held up better than some might have feared and many are resuming dividends which were deferred or suspended last year.
- Takeover activity is likely to remain a theme in 2021. There is plenty of private equity money around, prepared to take advantage of depressed valuations, as evidenced by the takeovers the fund saw in McCarthy and Stone and Signature Aviation. Additionally, the fact that the Brexit process is now behind us and at the moment hasn't produced impacts on business that were quite a bad as some feared, this may have removed an uncertainty that may have dissuaded some potential bidders for UK assets.
- The fund's approach to investing in companies with sustainable dividends was seriously challenged in 2020 but we still believe that it is well positioned longer term through its focus on companies with strong market positions and sound finances. 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.

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ASSET MANAGEMENT