ROYAL LONDON US GROWTH TRUST

Quarterly Report 31 March 2021

For professional clients only, not suitable for retail investors

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Top 10 holdings

	Trust (%)
Apple	6.7
Microsoft	5.9
Amazon	5.4
Alphabet	2.6
JP Morgan Chase & Co.	2.5
Alphabet	2.4
Facebook	2.3
Home Depot	2.0
Verizon Communications	1.9
Johnson & Johnson	1.8
Total	**33.3**

Fund data

	Trust
No. of stocks	95
Fund size	£241.4m
Launch date	19.02.2001
Active share	57%
Tracking error	1.84%

Source: RLAM, based on the A Inc share class.

Performance

	Trust(%)	Benchmark[1] (%)	Relative (%)
Q1 2021	**5.34**	**4.40**	**0.94**
Year-to-date	5.34	4.40	0.94
Rolling 12 months	38.97	42.49	-3.52
3 years p.a	16.34	17.64	-1.30
5 years p.a	17.34	17.43	-0.08
10 years p.a	14.68	15.60	-0.92
Since inception p.a. 19.02.2001	7.73	8.57	-0.84

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, based on the A Inc share class.

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

[1]Benchmark: MSCI US £ Net Total Return Index

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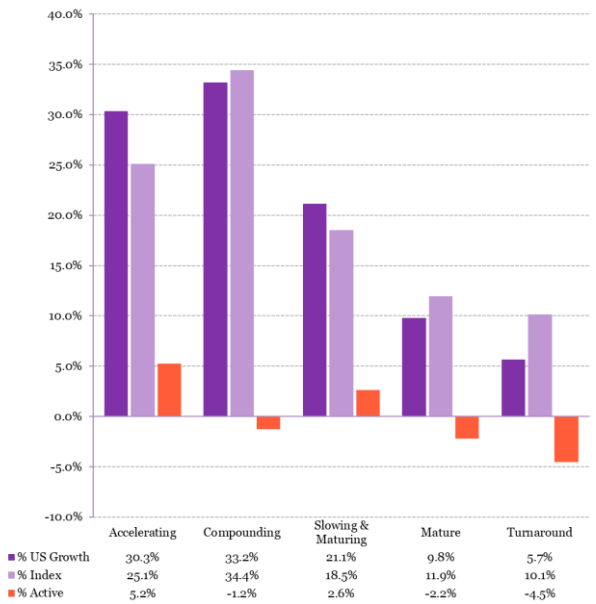
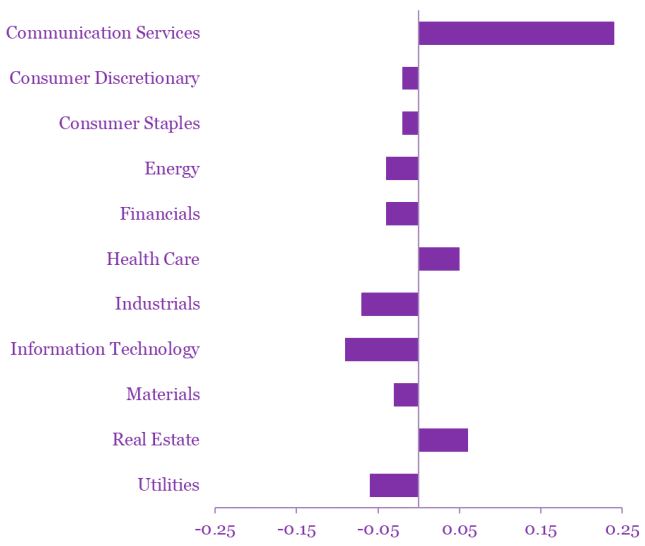
Holdings and weights



Sector weights



Source: RLAM as at 31 March 2021

Executive summary

- The fund recorded a net return (A Class, Income) of +5.02% for the first quarter, compared with +4.4% for the MSCI US Net Total Return Index (in sterling).
- The year started with cautious optimism about vaccination programmes that offered the prospect of the reopening of the global economy and a recovery from mid-year, tempered by concerns about new strains of Covid-19 and extended lockdown measures. This balance shifted sharply as vaccine rollouts exceeded expectations in the UK and US. Meanwhile, the Democrats' victory in the Senate runoffs in January and President Biden's $1.9tn fiscal package increased investors' expectations of a strong US recovery, leading to higher and steeper yield curves. In addition, there were concerns that friction in global supply chains and positive base effects will lead to higher inflation.
- The two primary equity trades this quarter (and indeed since 9 November – 'vaccine day') have been Covid recovery and reflation. The Covid recovery trade is to buy those stocks most affected by the pandemic, including retail, airlines, pubs, cinemas and certain types of property. It also involves selling the companies that benefited from the online shift last year; the 'stay-at-home' trade. The reflation trade is to buy commodities and financials, both of which benefit from inflation, and to sell growth stocks, which as long-duration assets are most impacted by rising bond yields, themselves a consequence of signs of higher levels of inflation. These trades resulted in a rapid and significant rotation in equity markets on a grand scale. As with previous quarters, the market recovery may seem surprising given the ongoing Covid-19 crisis and the economic impacts of lockdowns and other restrictions. 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, and have driven down fixed income yields to very low levels and equity discount rates to over 20-year lows. Although positive vaccines developments helped global markets, most were already up year-to-date before that news broke. While more transmittable strains of Covid-19 represent a near-term challenge with the need for tighter lockdowns, a number of other risks have lifted, including whether vaccines could be developed, US political risks and the UK-EU trade talks. While the first half of the year could be particularly volatile, governments and central banks remain committed to supportive monetary and fiscal policies, and we believe that equities will outperform bonds over the year with a strong economic recovery in the second half.
- We are conscious, however, that following the remarkable recovery of equity markets from their lows in late March, valuations are less compelling. 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.

Market commentary

- Major global stock markets delivered a strong first quarter. The MSCI World Index rose +3.9% in sterling terms. Among the major regions, the UK and North America were the stronger markets. The MSCI US Net Total Return Index returned +4.35% in sterling terms in the first quarter.
- 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 $1.9trillion 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 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.
- 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.

Fund performance and activity

- The portfolio's robust construction ensures a high level of idiosyncratic risk and reduces sensitivity to macroeconomic factors – such as credit spreads, rates and commodity prices. This is in line with the fund's objective of providing long-term alpha via a focus on wealth creation and valuation, rather than taking on shorter-term exposures to sectors and macro themes.

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- 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. A continued focus on idiosyncratic risk and tight sector constraints have immunised the fund to a significant proportion of this rotation.
- Stock selection was notably strong in information technology, healthcare and materials over the quarter with stocks like Steel Dynamics, Reliance Steel, HCA Healthcare and ON Semiconductor Corp leading the way. This was offset by not holding Intel and by relative weakness in Apple and Trade Desk.
- Following a review on exchanges, the fund has taken a position in S&P Global and slightly reduced our position in CME.
- Uncertainty remains around both the speed and the shape of any economic recovery and this continues to create market volatility. However, 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.

Key views within the fund

- The trust aims to deliver above average medium- to long-term capital growth by investing in a diversified portfolio of US equities, and will typically hold up to 100 stocks. The equities in which the fund invests may be from any sector, industry or market capitalisation. The fund aims to maximise the stock specific views from the US equities held in the Royal London Global Equity Diversified Fund, while minimising exposure to macroeconomic and sector influences using an optimisation strategy.
- We are fundamental, bottom-up investors and therefore don't invest according to top-down macroeconomics. The broad economic environment will have an effect, but we believe that good companies perform well across the economic cycle. What matters more is how the company is using its capital.
- Our Corporate Life Cycle model categorises companies according to their stage of development. We believe that corporate returns on productive capital and growth tend to progress along a cycle with five defined stages: Accelerating, Compounding, Slowing & Maturing, Mature and Turnaround. We seek portfolio diversification across the Corporate Life Cycle.
- Quantitative analysis helps us to identify potential opportunities by scoring stocks across a range detailed financial factors. We then apply our scoring system to rank characteristics to identify which companies to research further for possible inclusion in the portfolio.
- Stock selection really matters: looking at MSCI World Stock Returns between 2014 and 2019, the worst performing 80.2% of stocks performed behind the benchmark, with a third losing value, whereas the best performing 19.8% of stocks represented 99% of the excess return.

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 they're not absorbed by manufacturers. This may challenge the current low rate environment orthodoxy, which has been a contributor to the outperformance of growth stocks.

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- 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.

More from RLAM

- To find out more about our investment approach and current thinking, please visit www.rlam.co.uk

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