ROYAL LONDON US GROWTH TRUST

Quarterly Report 30 September 2021

For professional clients only, not suitable for retail investors

CONTENTS

ROYAL LONDON US GROWTH TRUST

Top 10 holdings

	Trust (%)
Apple	7.3
Microsoft	6.7
Alphabet	5.7
Amazon	5.1
NVIDIA	2.8
JP Morgan Chase & Co.	2.6
Facebook	2.3
Home Depot	1.9
Visa	1.8
United Health Group	1.7
Total	**37.7**

Fund data

	Trust
No. of stocks	95
Fund size	£286.6m
Launch date	19.02.2001
Active share	57.6%
Tracking error	2.07%

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

Performance

	Trust(%)	Benchmark[1] (%)	Relative (%)
Q3 2021	**5.31**	**2.77**	**2.53**
Year-to-date	20.95	16.57	4.37
Rolling 12 months	29.55	24.60	4.95
3 years p.a.	15.76	14.95	0.81
5 years p.a.	15.77	16.13	-0.36
10 years p.a.	17.66	18.40	-0.74
Since inception p.a. 19.02.2001	8.26	8.94	-0.68

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.

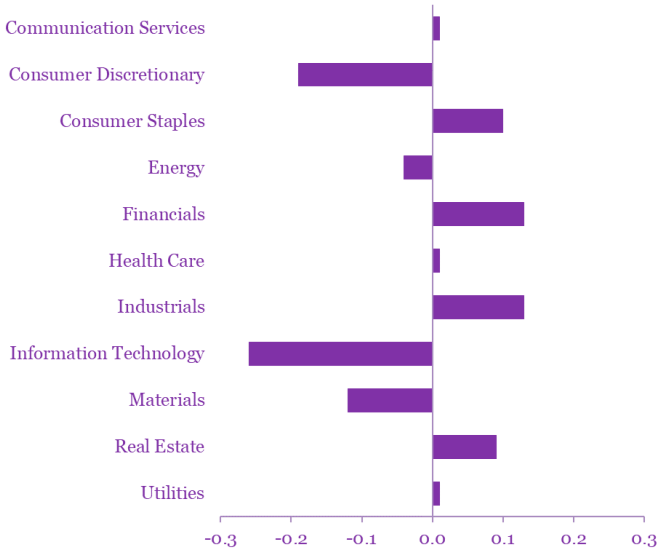
All performance figures stated gross of fees and tax unless otherwise stated, subject to rounding.

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

ROYAL LONDON US GROWTH TRUST

Holdings and weights

Sector weights



Source: RLAM as at 30 September 2021

Executive summary

- The fund recorded a net return (A Class, Income) of +5.31% for the third quarter, compared with +2.77% for the MSCI US Net Total Return Index (in sterling).
- We are conscious that following the remarkable recovery of global 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

- The quarter began with the Delta Covid variant increasingly prevalent across the US, eurozone, UK and Asia. Over the period, the global picture became more varied, with cases rising in the US and UK, but with waves in Europe, Japan and China seemingly more contained. With vaccine programmes continuing, governments were reluctant to maintain or tighten social distancing restrictions, particularly in the US and UK.
- Global economic data was mixed, with inflation still causing concern and economic growth appearing to slow in the third quarter. In September, the US Federal Reserve (Fed) made substantial changes to its economic forecasts, revising its growth outlook and increasing inflation expectations. Fed Chair Jerome Powell suggested it could "easily move ahead" with plans to taper its $120bn monthly asset purchases programme as early as November. The market expects inflation to peak at 4.2% this year before falling back to 2.2% in 2022. The Federal Open Market Committee also revised its interest rate path, signalling three potential interest rate rises of 25bps during 2022.

ROYAL LONDON US GROWTH TRUST

- The Bank of England (BoE) said Consumer Price Index (CPI) inflation could reach 4% over the winter months, largely due to rising energy and goods prices. However, it expects inflation will then fall back towards its 2% target in the medium term. Official data showed the eurozone economy came out of recession in the second quarter, with better than expected 2% quarterly growth from April to June. In July, the European Central Bank (ECB) raised its medium-term inflation target to 2%, giving the central bank greater flexibility in its use of stimulus measures. Annual eurozone inflation reportedly reached 3.0% in August, its highest level since 2011. The ECB voted to keep interest rates unchanged at its September meeting, but opted to slow the pace of net asset purchases through the pandemic emergency purchase program (PEPP). ECB President Christine Lagarde said the verdict was a "unanimous decision in all respects."
- Dominating all of this in terms of market reaction, as ever is the case, is messaging from the Fed which continues to signal its intention to taper off asset purchases and eventually raise rates as its pushes its economic recovery stance. The net result was a rise in bond yields in the second half of the month which, as usual, led to a sell-off in equites as the prospect of fixed income yield became more attractive and long-term cash flows from growth equities less so. Given this, under the bonnet of the headline fall, we have started to see evidence of rotation within equities similar to the first quarter of this year with traditionally cyclical and defensive sectors holding up better than their high growth counterparts. Looking forward, despite the recent pullback, the equity market still appears to offer value on a relative basis until/unless bond yields rise materially, with central bank liquidity still underpinning asset prices even as style leadership becomes tougher to call.
- The third quarter was a story of two halves for global government bond markets: global yields initially edged lower before rebounding in September following relatively high inflation numbers and central bank commentary around tapering. Yields rose most significantly in the UK – the 10-year UK gilt yield spiked in September to finish up by 31bps for the quarter. In comparison, US and core European market yields were broadly unchanged over the quarter. The relative spike in gilt yields was driven by concerns surrounding inflation related to supply chains difficulties resulting from both Brexit-related issues as well as the Covid related constraints being experienced globally.
- The US dollar was one of the strongest currencies globally in the third quarter, as more risk sensitive currencies weakened in relative terms – the US dollar spot price rose by 1.94% over the period. The euro weakened by 2.39% versus the dollar, while the sterling spot price fell by 2.53%.
- Commodities extended their rally, led by energy, towards the end of the quarter with heightened demand as the global economy opens up strongly. Brent crude oil prices rose by 4.5% to more than $78 a barrel in the quarter. In metals, copper futures fell in value by 4.5% to $419 (after a strong rally earlier in the year), while the gold spot price fell by 0.8% to $1,755/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.
- As with last year and the first quarter of this 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 year-to-date. Although question marks remain surrounding long-term vaccine efficacy, markets now appear cautiously optimistic about some form of recovery.
- Most major country markets rose during the quarter with dispersion in returns more a result of sector rotation; rising bond yields, inflation pressures and oil rising towards $80 were tailwinds for Financials and Energy but Q3 also saw Technology perform well – an unusual combination in recent times. Names related to recovery or Chinese demand were especially weak.
- Stock selection was notably strong in Communication Services and Real Estate with positions in **Alphabet** and **Jones Lang Lasalle** well rewarded. Elsewhere, active positions in **Snowflake** and **HCA Healthcare** contributed strongly to portfolio returns. This was partially offset by weakness in Consumer Discretionary – not holding Tesla was a headwind in over the quarter.
- The spread between **Alphabet** A and C class shares contracted in August vindicating the position the fund had taken in the second quarter in owning the A shares, that carry voting rights, at the expense of the C shares, which do not. While this was a valuation opportunity, it also ensures that the fund is able to engage and vote on its entire position in Alphabet.
- 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.

ROYAL LONDON US GROWTH TRUST

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

- The macro uncertainty stepped up a notch in September with supply chain issues seemingly worsening rather than improving. In addition to semiconductor and freight issues, labour shortages are emerging across multiple parts of the major economies, most problematically in the transportation sector. When combined with strong demand and large increase in money supply due to Covid, this is leading to inflationary behaviour such as panic buying, and it is quite possible that we will see corporates look to reverse the previous trend of ever tighter inventory levels. Given the general uncertainty, we feel that our approach of investing in a broad range of companies from different sectors and stages of their lifecycle has never been more appropriate and will allow performance to continue to be driven more by the success of our hunting for undervalued long term cashflows than by the prevailing winds of the macroeconomy, or factors such as growth or value styles being in vogue.
- 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

- Join us online for the 2021 RLAM Investment Series (our annual client conference) between 1st and 5th November. A range of our fund managers and other in-house specialists will address the macroeconomic environment and prospects for different asset classes, and the issues they are considering in positioning their funds. There will also be sessions on responsible and sustainable investing, addressing the latest developments in these fast-changing areas and considering their possible evolution. For more details and to register, please visit rlam.co.uk.
- To find out more about our investment approach and current thinking, please visit rlam.co.uk.

ROYAL LONDON
ASSET MANAGEMENT