ROYAL LONDON GMAP CONSERVATIVE FUND

Quarterly Report 30 September 2021

For professional clients only, not suitable for retail investors

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Fund data

	Fund
Fund size	£264.6m
Launch date	14.03.2016

Source: RLAM. Based on the M Inc share class.

Performance

	Fund (%) (M Acc)	Fund (%) (M Inc)	Benchmark (%)	Relative (%) (as compared to M Inc)
Q3 2021	**0.15**	**0.11**	**-0.18**	**0.30**
Year-to-date	-0.71	-0.57	-2.07	1.50
Rolling 12 months	1.10	1.26	-1.09	2.34
3 years p.a.	4.22	4.28	3.52	0.76
5 years p.a.	2.64	2.70	2.03	0.67
Since Inception p.a. 14.03.2016	3.90	3.96	3.41	0.55

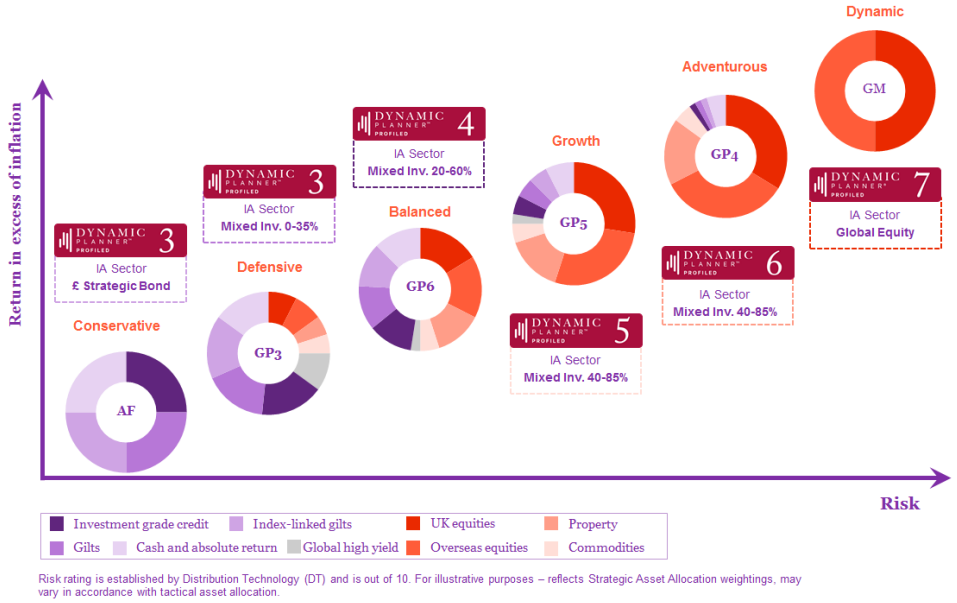
Past performance is not necessarily a reliable indicator of future performance. The value of investments and the income from them is not guaranteed and may go down as well as up and investors may not get back the amount originally invested.

Source: RLAM, based on the M share classes. Performance for the fund is calculated on a mid basis with income re-invested. All performance figures stated gross of fees and tax unless otherwise stated.

[1]GMAP Conservative Composite Benchmark. The benchmark has been designed with the aim of maximising long run return in excess of inflation for a given level of risk.

As of 6 April 2017, the UK Government announced that funds paying interest distributions (funds more than 60% in interest bearing assets, such as fixed income securities/bonds and cash) will be required to pay those distributions gross of tax. As a result, all performance figures provided within the quarterly report will conform to gross of tax, effective from this date onwards.

RL GMAP range



Risk rating is established by Distribution Technology (DT) and is out of 10. For illustrative purposes – reflects Strategic Asset Allocation weightings, may vary in accordance with tactical asset allocation.

Our GMAPs fund range is designed to span the risk return spectrum, with each fund aiming to maximise the long-term real return for its given level of risk through a broadly diversified portfolio of investments.

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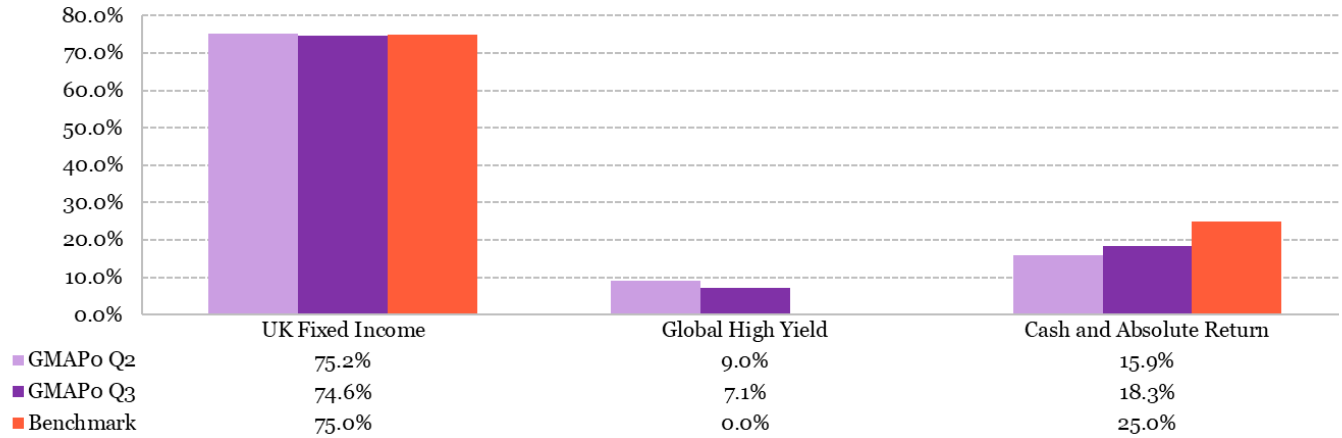
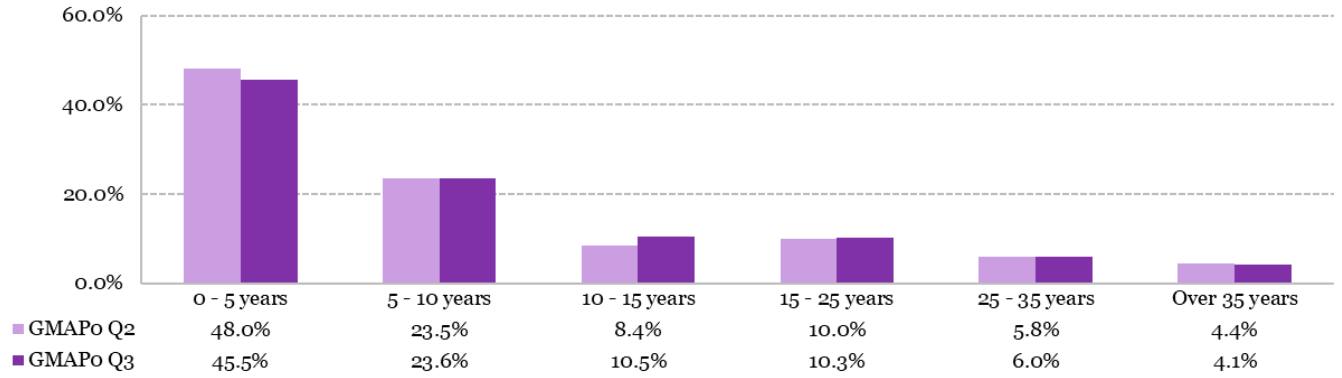
Asset split



Source: RLAM. We take a holistic approach to fixed income management and fund weights relative to their respective benchmarks may not reflect tactical exposures. Figures calculated on a 'look through' basis, reflecting underlying assets, not fund component weights.

Yield curve positions



Source: Figures calculated on a 'look through' basis, reflecting underlying assets, not fund component weights.

Largest holdings

	Asset type	Weighting (%)
RL UK Government Bond Fund	UK Fixed Income	22.4
RL Short Duration Global Index Linked Fund	UK Fixed Income	18.8
RL Sustainable Managed Income	UK Fixed Income	17.4
RL Ethical Bond Fund	UK Fixed Income	10.0
RL Short Duration Global High Yield Bond Fund	High Yield	7.1
RL Enhanced Cash Plus Fund	Cash	7.0
RL Index Linked Fund	UK Fixed Income	6.0
RL Short-Term Money Market Fund	Cash	4.0
RL Absolute Return Government Bond Fund	Cash and Absolute Return	3.7
RL Sterling Credit Fund	UK Fixed Income	3.7
Total		**96.5**

Source: RLAM. Information as at 30 September 2021 and correct at that date, unless otherwise stated. Total weight reflects rounding.

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Executive summary

- Global economic data was mixed in the third quarter as the strong, post pandemic, global recovery bounce began to peak (growth began to slow down), but inflation was causing concern as it rose to relatively high levels, driven by commodity prices and wages rising. Central bank policymakers were notably more hawkish towards the end of the period, with the Federal Reserve (Fed), the Bank of England (BoE), and the European Central Bank (ECB) all highlighting their intensions to taper their asset purchasing regimes. The quarter began with the Delta Covid variant increasingly prevalent across the world but vaccines showing success in containing deaths.
- Concerns regarding inflation, valuations and Chinese government policy towards certain sectors and companies drove negative returns in September, although returns were positive for the quarter overall. The MSCI World Index posted positive returns of 2.62% in the third quarter. We built a slight positive tilt to equities in the period across the relevant GMAP funds, which benefited performance. Our regional market tilts added value, especially our overweight in Japanese stocks, which outperformed on the resignation of Prime Minister Suga. Our tactical positioning in sectors was light, as we were wary of volatility in cyclical stocks – our sector tilts slightly detracted from performance in the period with more volatility in September, and as value overtook growth as the main driver of returns.
- Global government bond yields edged lower at the beginning of the quarter but later rose on more hawkish central bank commentary. By quarter-end, 10-year US treasuries and core European government bond yields had risen back to levels seen at the start of the quarter (bond prices fall when yields rise), however the UK 10-year gilt yield finished the quarter higher by 31 basis points (bps). We remained underweight bonds in the relevant GMAP funds given low nominal and negative real yields, as well as the prospect of higher inflation in the medium term. We also maintained our view that corporate credit will outperform government bonds as the global economy recovers and cashflows remain strong. We remained overweight credit, particularly short duration global high yield bonds, which was positive for the performance of relevant GMAP funds.
- We participated in the ongoing rally in risk assets, remaining overweight in equities, global high yield bonds and commodities through the quarter. The strong global recovery helped high yield hold its position as the best performing asset class in fixed income and commodity prices continued to be strong in the quarter, led by energy, as natural gas and oil prices have surged on strong global demand: Brent crude oil rose by 4.5% to more than $78 a barrel.
- While slowing global growth, inflation and interest rate worries, and geopolitical concerns could weigh further on global indices, monetary and fiscal policy remain supportive, and we expect the world economy to continue to be strong in 2022. However, some "growth" sectors such as technology are likely to be challenged with potential higher interest rates, and "value" sectors such as financials and energy can outperform with steepening yield curves – we have moved overweight value sectors from growth sectors. In regions, we remain underweight emerging markets and Asia Pacific which continue to lag given political and corporate issues in China. We remain more positive on US, UK and European equities but have moderate positions currently.

GMAP fund	Q3 2021 performance (M class, Acc – net of fee)	GMAP custom benchmark	IA sector	IA sector average performance
Conservative	0.00%	-0.18%	£ Strategic Bond	0.39%
Defensive	1.33%	1.05%	Mixed Investments: 0-35% shares	0.15%
Balanced	1.62%	1.42%	Mixed Investments: 20-65% shares	0.80%
Growth	2.42%	1.74%	Mixed Investments: 40-85% shares	1.36%
Adventurous	2.72%	2.05%	Mixed Investments: 40-85% shares	1.36%
Dynamic	2.24%	1.26%	IA Global	1.91%

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Market overview

- The quarter began with the Delta Covid variant increasingly prevalent across the US, eurozone, the 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 to be successful in containing deaths from the virus, governments were reluctant to maintain or tighten social distancing restrictions, particularly in the US and UK.
- Global economic data was mixed in the third quarter, with inflation still causing concern – inflation across G7 markets rose significantly in the period driven by wages and commodity costs. In September, the US Federal Reserve (Fed) made substantial changes to its economic forecasts, revising its growth outlook (still expecting growth) and increasing inflation expectations (but analysis still suggesting inflation is a temporary problem resulting from the global reopening). Fed Chair Jerome Powell suggested it could "easily move ahead" with plans to taper its $120bn monthly asset purchases programme as early as November. In September, the Fed, BoE, and ECB all highlighted their intension to taper their asset purchasing regimes gradually.
- The BoE said Consumer Price Index (CPI) inflation could reach 4% over the winter months, largely due to rising energy and goods prices, although it expects inflation will then fall back towards its 2% target in the medium term. BoE commentary was also more pessimistic on near-term growth prospects and more worried on inflation. The Monetary Policy Committee (MPC) voted unanimously in September to keep rates steady but voted just 7-2 to continue with their existing asset purchase programme.
- The MSCI World Index posted positive returns of 2.62% in the third quarter. Although performance was strong in July and August, global stock markets contracted in September, as more hawkish central bank commentary indicated that policy tapering could come earlier than had been expected. Japan was the strongest regional market following the resignation of Prime Minister Suga, returning 7.43% to investors in sterling terms. The US was next strongest (2.94%), followed by the UK (2.11%), and Europe (0.95%). Emerging market equities lagged dramatically over the period, returning -5.71% to investors in sterling terms; slowing growth, problems in the real estate sector and government interventions in China weighed on valuations in the region.
- For the period as a whole, the MSCI World Growth Index returned 3.38% versus 1.85% for the MSCI World Value Index. Financials led sector returns (4.79%) followed by energy (4.21%) and information technology (4.03%). Materials was the worst performing sector (-2.39%), while consumer discretionary, consumer staples and industrials sectors also lagged the broader market.
- 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 average sterling investment grade spread (the average extra yield available from a corporate bond compared with government debt of equal maturity) ended the quarter 4bps tighter at 0.87%, while the sterling high yield spread ended 19bps tighter for the quarter with a spread of 3.53%. The Merrill Lynch Sterling Non-Gilt index delivered total returns of -0.96% for the quarter, while its sister Sterling High Yield Index returned 1.03% for the quarter, outperforming gilts which returned -0.84% on an all-maturities basis.
- 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.

Asset allocation overview

- After eleven consecutive months in 'Overheat', our proprietary Investment Clock model edged into 'Stagflation' during the third quarter, characterised by rising inflation momentum, and the slowing pace of economic growth – it is likely that this will be temporary as inflation eases and as growth positively rebounds once the global economy has fully reopened. The stagflation phase would usually be positive for commodities and cash versus bonds and stocks; we held only a small equity overweight, wary of potential volatility and slowing growth momentum. We maintained our preference for high yield bonds

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over government bonds (with negative real yields), especially those of shorter maturities, due to the risk of potential future interest rate rises. We continued to favour commodities, which have been the best performing asset class this year, benefitting from the global recovery and ongoing supply constraints.

What we thought	What we did	What happened	Effect on portfolio
Summers can be choppy for stock markets, however our base case is for a strong economic recovery into 2022, supported by monetary and fiscal stimulus and the continued rollout of vaccines across the globe.	We remained moderately overweight stocks on the back of strong earnings revisions and lightly positioned on a sector basis, wary of potential seasonal volatility. We did, however, slightly reduce our tilts towards value sectors early in the period, as markets entered a more stagflationary environment. We were lightly positioned in sectors in the quarter, wary of volatility in more cyclical sectors. We remained underweight consumer discretionary and consumer staples sectors, moved underweight in technology and utilities, and tilted positively to sectors including financials and energy.	The MSCI World index posted positive returns of 2.62% in the third quarter. However, although global stock markets had reached all-time highs in August, they contracted in September on hawkish central bank commentary related to inflation and tapering "QE". The S&P 500 fell by 1.69% across five consecutive days of losses in mid-September, the longest run of consecutive losses since February.	The marginal overweight in equities was positive for performance in the period. as US equity sectors slightly detracted from performance, however we were lightly positioned in sectors,
With countries responding to the pandemic differently, we have seen dispersion in economic fundamentals this year, and macro momentum has been more impressive in developed than emerging markets. In emerging markets and Asia, we were wary government interventions in China would weigh on valuations in the region.	We remained tactically overweight US and European stocks on the back of strong earnings revisions in quarter. We also moved overweight in Japan with political change taken positively by markets. In emerging markets and Asia Pacific ex. Japan we maintained a moderate negative tilt.	Japan was the strongest regional market following the resignation of Prime Minister Suga, returning 7.43% to investors in sterling terms. The US was next strongest (2.94%), followed by the UK (2.11%), and Europe (0.95%). Emerging market stocks contracted, falling by -5.71%.	Our regional tactical allocations in equity were beneficial across the board. Our positive tilts to US and Japanese stocks were particularly beneficial.
We maintained our view that corporate credit will outperform government bonds as the global economy recovers strongly. High yield bonds have continued to provide strong returns relative to investment grade. The asset class has been supported by loose fiscal and monetary policy, which have made the default on debt less likely. Because of this, we still think that high yield credit spreads continue to overcompensate for their risks.	We remained overweight credit, particularly global high yield bonds, and particularly short duration high yield.	Gilts (all maturities) returned -1.84% in the period compared to -0.96% for the Merrill Lynch Sterling Investment Grade Index – the respective spread tightened by 4bps. Global high yield bonds continued to perform strongly over the quarter and the high yield spread tightened by a further 19bps. Global high yield funds returned 1.03%, for the quarter.	Staying underweight in government bonds and overweight in credit was positive for performance. The overweight allocation to global high yield was positive for performance.
Supportive fiscal policy and further new stimulus, alongside consumer and corporate spending power, should push inflation higher, which benefits commodities.	We maintained our overweight in commodities throughout the quarter	Commodities were strong in the third quarter, led by energy and natural gas. Brent crude oil prices also rose, while gold and copper process fell. The Thompson Reuters Core Commodity index rose by 7.28% in the period.	The overweight exposure to commodities was positive for performance.

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What we thought	What we did	What happened	Effect on portfolio
With our property team buying high quality assets, we remain positive on long term prospects for the sector despite some areas (such as retail) being challenged currently. Property gives diversification and inflation resilience benefits to the portfolios.	Given post covid challenges, we have maintained a marginal underweight to property in diversified portfolios.	Commercial property performed well over the quarter as global activity and confidence continued to improve.	Our slight underweight to property had a marginally negative impact on performance.

Please note: This table details our main asset allocation decisions for the quarter across the GMAPs funds. Not all tactical allocations are relevant to the Conservative fund (fixed income-only) and Dynamic Fund (equity-only).

Outlook

- Equity market volatility could be evident as we enter the fourth quarter, as October has tended to be the month in which volatility peaks. With fiscal and monetary policy uncertainty and geopolitical issues present, we would not be surprised by sentiment becoming negative in markets, especially given equities are not far from all-time highs and valuations are relatively full. However, we have a moderate overweight in stocks on the basis that the dominant factor is robust global growth while inflation is widely deemed to be a temporary problem. We remain more confident in companies enjoying strong cash flows and therefore favour global high yield bonds (which are less volatile than stocks); we see the potential for further losses in government bonds which give negative real yields owing to central bank quantitative easing policies and which will not react well to interest rates rising as economies normalise. With global recovery remaining strong, we retain our overweight in commodities. In the absence of major shocks (such as any vaccine resistant covid variant), and as long as central banks are correct that current inflation rates are transitory, we remain constructive on prospects for equities over the medium to longer term.
- Please see our Investment Clock blog for our latest views.
- 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.

ROYAL LONDON
ASSET MANAGEMENT

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