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Royal London UK Smaller Companies Fund

Quarterly Investment Report

31 December 2023

ROYAL LONDON

ASSET MANAGEMENT

Quarterly Report

The fund as at 31 December 2023

The purpose of this report is to provide an update on the Royal London UK Smaller Companies Fund. The report has been produced by Royal London Asset Management. The report starts with a summary dashboard showing key information about the fund. A glossary is located at the end of the report covering the description of some of the more technical terms used within the report. All data is as at the report date unless otherwise stated.

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ASSET MANAGEMENT

The fund

Fund performance objective and benchmark

The fund's investment objective is to achieve capital growth over the medium term (3-5 years) by investing at least 80% in the shares of UK smaller companies listed on the London Stock Exchange. The fund's performance target is to outperform. after the deduction of charges, the FTSE Small Cap ex-IT (investment trusts) Total Return GBP Index (the "Index") over rolling 5-year periods (3). For further information on the fund's index, please refer to the Prospectus.

Benchmark: FTSE Small Cap ex-IT (investment trusts) Total Return GBP Index

Fund analytics

	Fund
Fund launch date	1 May 2012
Base currency	GBP
Number of holdings	68

Fund value

	Total £m
31 December 2023	306.58

Performance and activity

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Quarter	10.42	6.50	3.93
1 Year	3.72	10.37	(6.66)
3 Years (p.a.)	(3.39)	6.21	(9.60)
5 Years (p.a.)	5.25	7.46	(2.21)
10 Years (p.a.)	5.89	5.86	0.04
Since inception (p.a.)	8.51	9.58	(1.06)

Past performance is not a guide to future performance. Please refer to the Glossary for the basis of calculation and impact of fees. Performance and since inception date based on Royal London UK Smaller Companies (M Acc). Source: Royal London Asset Management; Net performance; Since inception date of the shareclass is 1 May 2012.

Performance commentary

The fund had a strong final quarter of 2023, strongly outperforming the benchmark (FTSE Smaller Companies ex-IT index).

YouGov was the strongest contributor during the period, following a reassuring trading update. Management reiterated earnings expectations for the coming financial year and referenced sequentially improving demand from their large customers in the US tech sector. The share price had been very weak in advance of the trading update, as some investors anticipated declining revenue growth, and the shares had also been subject to technical selling due to fund outflows. In the event, the share price rallied by over 60% after the trading update, despite no change to earnings forecasts – demonstrating the extent of market irrationality during peak despondency in September and October.

Restaurant Group and Kin + Carta were subject to recommended all-cash takeover offers by private equity buyers in October, at substantial premiums to their undisturbed share prices. We commented at the time that while these clearly highlighted the significant value opportunity presented within in our investment universe, it was also frustrating to see good companies sold at prices which we do not feel necessarily reflect their long-term potential, instead valuing them off very short-term earnings expectations. As such it was notable that Apax chose to increase their bid for Kin & Carta in December, which was subsequently trumped by a higher offer from BC Partners.

City Pub Group was also a significant positive contributor, after announcing that it had reached an agreement for Youngs PLC to acquire the group at a 46% premium to its undisturbed share price. As part of the acquisition, City Pub Group shareholders will receive approximately 75% of the proceeds in cash and the remaining 25% in Youngs shares.

GlobalData shares rallied following news that Inflexion, a private equity company, will acquire a 40% minority stake in GlobalData's Healthcare division at a valuation of £1.1bn. Given that the company's Healthcare division represents approximately 36% of total revenue and the undisturbed market cap of the company was £1.4bn, this demonstrated that the public markets had vastly undervalued the business. The minority stake sale will also provide GlobalData with a significant net cash position which may be used for further M&A activity.

Performance and activity

Top 10 holdings

	Weighting (%)
Hollywood Bowl Group Plc	3.05
GlobalData Plc	2.63
Chemring Group PLC	2.43
Hill & Smith PLC	2.37
Porvair plc	2.36
YouGov plc	2.32
BOKU, Inc.	2.29
Treatt plc	2.22
Advanced Medical Solutions Group plc	2.14
Genus plc	2.12
Total	**23.93**

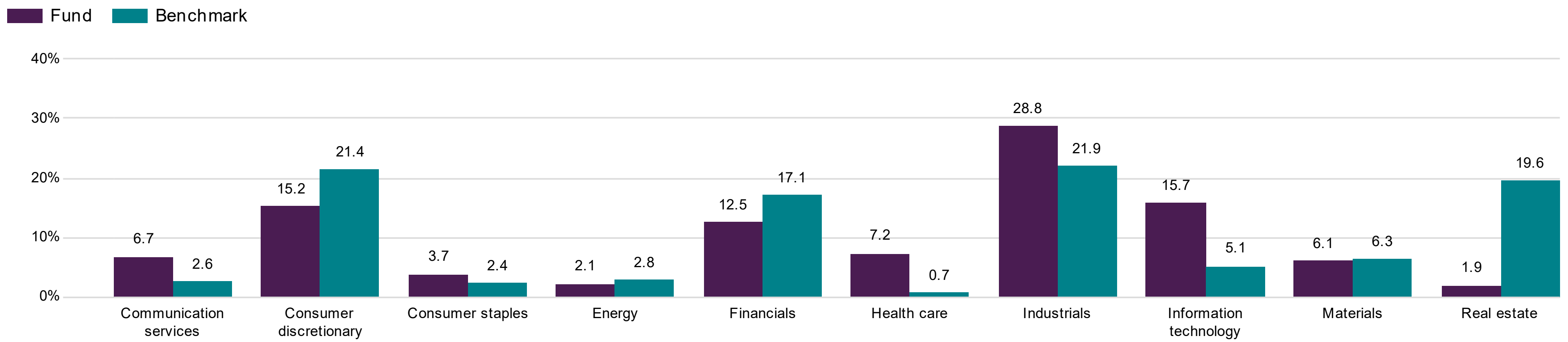
Fund activity

New positions were initiated in Cohort, a specialist provider of technology-based solutions to the defence & security markets, and Youngs, the pub group. Cohort is led by an experienced and incentivised management team, and the company's communications, intelligence and sensors solutions are both innovative and unique. Cohort should benefit from a backdrop of larger defence budgets following events in Ukraine and heightened geopolitical tensions. Indeed, at the recent interim results, order intake was up 34% and the company reported a record order book of £354m. Despite this, the valuation remains undemanding, in part due to the lack of analyst research coverage. Youngs is a high-quality managed pub operator that has a very well invested freehold estate. The acquisition of City Pub Group will provide significant value creation through operating and cost synergies and despite robust trading in 2023, the company was trading close to the bottom of its historical valuation range, which we believed made it an attractive entry point to start a position.

These were funded by the sale of Restaurant Group (following the bid approach), the proceeds from the takeover of Ergomed and Blancco, and a reduction of the position in Fuller Smith & Turner. The fund was also active in adding to a number of existing positions through the period, including Chemring, Advanced Medical Solutions, YouGov, DiscoverIE, and Bloomsbury.

Fund breakdown

Sector weights



Market commentary

Market overview

While financial markets began the quarter in volatile fashion following the tragic events in the Middle East, the release of benign inflation data in October across the UK, eurozone and the US sparked a sharp rally in risk assets through to the year end. Bond markets quickly reversed much of their 2023 decline, as economic data during November and December also pointed to receding inflationary pressures. Two-year Gilt yields fell to 4% at the end of December from almost 5% at the start of October, and investors now expect central bank rate cuts as early as March.

UK small and mid-cap equities rallied in response, with the FTSE 250 ex IT and FTSE Smaller Companies ex IT indices posting returns of 9.3% and 6.5% respectively. The rally was led by pro-cyclical sectors such as consumer discretionary and industrials, as well as interest rate sensitive sectors such as real estate. healthcare, consumer staples, and energy sectors underperformed.

Merger and acquisition activity continued at pace, bringing the total number of approaches for UK listed companies to 60 by the year end. In addition to the portfolio holdings mentioned earlier (Restaurant Group, Kin & Carta, City Pub Group and GlobalData), notable bids included Ten Entertainment and Smart Metering Systems (by private equity), and Hotel Chocolat, ScS and Sopheon (by industry). In all cases these deals were struck at meaningful premiums to their undisturbed share prices, highlighting the value on offer in the UK equity market.

Corporate earnings updates were generally less bad than expected through the quarter; while there were some notable profit warnings amid FTSE100 companies in October, in hindsight these appear to have been a case of getting bad news out early. By and large, the main results season in November was a story of operational resilience in a tricky environment and in many instances share prices rallied significantly on 'in-line' statements, indicating that investors had been expecting worse. Typically, this was due to effective cost control (higher margins) rather than due to improving sales, in part showing how many management teams have really got to grips with cost inflation. However, a number of early cycle industrial businesses, including portfolio holding DiscoverIE did report sequentially improving order patterns in the months running up to December. These suggested that the significant inventory de-stocking cycle by industrial companies may be coming to an end, which would bode well for improving demand in the coming year.

Outlook

For the time being it appears that central banks may have completed their fight against inflation without plunging western economies into recession; the so called 'soft landing' outcome appears to be an increasingly likely conclusion to this rate rise cycle. While there are likely to be signs of stress in developed economies in the first half of 2024 as the lagged impact of higher borrowing costs continues to constrain demand, corporate balance sheets remain healthy – as do those in the banking sector – and we'd expect investors to look through a tough first half to improving demand in the later stages of the year.

As illustrated by the stream of takeover approaches, we believe that small and mid-cap equities continue to offer good value relative to history, relative to international equity indices and relatively to other asset classes. Most of our portfolio companies have net cash balance sheets which could be deployed on acquisitions or organic investment to enhance earnings growth. We would expect this to be more of a feature in a stable economic and political environment. 2023 saw significant numbers of UK companies delivering enhanced shareholder returns by using their cash to buy back their own equity and accrete their earnings per share growth. In the event that management teams don't deploy capital on growth opportunities, we'd expect this to continue given the attractive valuations (equity earnings yields) on offer.

Despite the market's obsession with forecasting short-term macroeconomic data over the recent past, our focus has always been on investing over the long term. We continue to seek out companies with the key fundamental SIMBA attributes (Scaleability, Innovation, strong Management teams, Barriers to entry and unique Assets) that will allow them to take market share and prosper throughout economic cycles. We continue to believe that it is these fundamental attributes that drive stock prices over the long term and we remain excited by the opportunities currently on offer for UK mid and small cap company investors.

Further Information

Please click on the links below for further information:

Stewardship and responsible investment at RLAM

Royal London voting and engagement

TCFD climate report

Find out more

Royal London Asset Management's Outlook 2024 document and podcasts are both available on our website. In this year's Outlook document, our fund managers assess the challenges and opportunities in their respective asset classes for 2024. With an environment of falling inflation and modest recession, the benefits or risk for equities or credit is not so clear cut and knowing your companies is key. We analyse the areas of concern and potential growth within this environment.

In our Outlook 2024 podcast, Piers Hillier, CIO, looks ahead to 2024 and discusses the issues he believes will be prominent over the next 12 months, and where the key investment risks and opportunities may lie.

Articles, videos and webinars explaining our investment thinking can be found in the Our Views section of www.rlam.com, including regular updates from our Fixed Income, Global Equity, Sustainable and Multi Asset teams.

Disclaimers

Important information

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The Fund is a sub-fund of Royal London Equity Funds ICVC, an open-ended investment company with variable capital with segregated liability between sub-funds, incorporated in England and Wales under registered number IC000807.

The Authorised Corporate Director (ACD) is Royal London Unit Trust Managers Limited, authorised and regulated by the Financial Conduct Authority, with firm reference number 144037.

For more information on the fund or the risks of investing, please refer to the Prospectus or Key Investor Information Document (KIID), available via the relevant Fund Information page on www.rlam.com.

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FTSE makes no claim, prediction, warranty or representation either as to the results to be obtained from the Fund or the suitability of the Index for the purpose to which it is being put by Royal London Asset Management.

Risks and Warnings

Investment Risk

The value of investments and any income from them may go down as well as up and is not guaranteed. Investors may not get back the amount invested.

EPM Techniques

The Fund may engage in EPM techniques including holdings of derivative instruments. Whilst intended to reduce risk, the use of these instruments may expose the Fund to increased price volatility.

Liquidity Risk

In difficult market conditions the value of certain fund investments may be difficult to value and harder to sell, or sell at a fair price, resulting in unpredictable falls in the value of your holding.

Counterparty Risk

The insolvency of any institutions providing services such as safekeeping of assets or acting as counterparty to derivatives or other instruments, may expose the Fund to financial loss.

Smaller Companies

The Fund invests in smaller companies, the prices for which can be less liquid and be more volatile than those of larger companies and therefore may have a greater impact on the value of the Fund.

Performance to 31 December 2023

Cumulative (%)

	3 Month	6 Month	1 Year	3 Years	5 Years
Fund (gross)	10.63	8.45	4.51	(7.73)	34.17
Fund (net)	10.42	8.03	3.72	(9.83)	29.15

Annualised (%)

	3 Years (p.a.)	5 Years (p.a.)
Fund (gross)	(2.65)	6.05
Fund (net)	(3.39)	5.25

Year on year performance (%)

	31/12/2022 - 31/12/2023	31/12/2021 - 31/12/2022	31/12/2020 - 31/12/2021	31/12/2019 - 31/12/2020	31/12/2018 - 31/12/2019
Fund (gross)	4.51	(30.34)	26.74	6.46	36.58
Fund (net)	3.72	(30.88)	25.77	5.65	35.57

Past performance is not a guide to future performance. The impact of fees or other charges including tax, where applicable, can be material on the performance of your investment.

Source: RLAM as at 31 December 2023. All figures are mid-price to mid-price in GBP for the Royal London UK Smaller Companies (M Acc).

Glossary

Fund value

Total value of the fund as of the last business day of the calendar month. The fund value is as at close of business and on a mid-price basis.

Number of holdings

Total number of unique holdings of the Fund excluding cash, currency and derivatives.

Performance

Performance is calculated using the daily end of day NAV per share produced by HSBC based on the mid price.

Sector weights

Breakdown of holdings by FTSE ICB (Industry Classification Benchmark) sector relative to the benchmark index.

Top 10 holdings

Top 10 assets held by market value, excluding derivatives and cash.

ROYAL LONDON ASSET MANAGEMENT