COVID-19 INVESTMENT UPDATE: SUSTAINABLE TEAM UPDATE – 25 JUNE 2020

What is happening?

Equity markets have remained relatively resilient in the last two weeks, perhaps something of a surprise given there is plenty of evidence that Covid-19 is not yet under control in major countries such as Brazil and India, and seeing a resurgence in the United States. The most likely explanation for this resilience is that markets have been more focused on the shape of economic recovery as many regions come out of lockdown. The rate of economic recovery, albeit from very low levels and over a small time frame, has been better than expected. For the recent rally in asset prices to hold, corporate profitability needs to recover in a time frame of 12-18 months. We think this is a reasonable assumption, but wouldn't read too much into the recent economic data; at some point rate of change of economic activity will be replaced with consideration of its absolute level, and at what level that is. We do observe that there is no political will to re-enter lockdowns under all but the most extreme of scenarios. It may just be we all have to get used to living with this virus, rather than waiting for it to be eradicated by a vaccine.

There continues to be much discussion about the narrowness of equity markets, and their dependence on a small number of technology companies such as Amazon, Apple and Microsoft. We are often asked if this is a bubble, as we do own a number of technology companies in our sustainable funds. Our answer to this is a resounding 'no'. Fortunately (or unfortunately!) I started my career during the technology boom of 1999 and witnessed the subsequent bust. What is occurring now is nothing like what occurred back then. The size of technology companies back then, measured by market capitalisation, had become completely detached from their earnings and profits. Loss-making companies with unproven business models were valued at many billions of dollars. Today, technology accounts for about 26% of the US S&P 500, but critically also accounts for about 24% of the earnings of that index. Back in 1999, technology was 34% of the S&P Index and only 17% of earnings. The large technology companies are now hugely profitable and their increasing market capitalisations have, overall, followed their profits. The valuations, as measured by ratios such as free cashflow yield, of companies such Alphabet and Microsoft are similar to those ascribed to good quality UK mid-cap companies. Technology companies could turn out to be poor investments if their fundamentals deteriorate, due to maybe changing regulation or consumer trends, but I believe that their valuation today looks sensible relative to their fundamentals.

What will happen next?

As we look into the second half of 2020, there are no shortage of hurdles for economies and markets to overcome. Covid-19 and social unrest are notable as the issues of today, but we think the presidential election in the US and Brexit are two other factors to be considered too. It is easy to despair faced with this list of problems and wonder how on earth corporates, markets and economies can cope, but if investing was about buying when the sun is shining and selling when the rain comes then we would all be rich. In a long-term context, say the last 100 plus years, we have worked through world wars, pandemics, depressions, recessions and much much more. We have always come out the other side economically

stronger and wealthier as a society. I believe it will be no different this time, and that context is useful in thinking about the right mentality to have regarding investing right now. Economic problems and fear are the friend of long-term investing. They have provided us compelling opportunities to buy shares in companies some way below what we think they are worth this year, and may do so again. Investing is about buying when it is raining. Although the economic outlook is less clear, we can say with a high degree of certainty that society will become more digital, less carbon intensive and more health aware in the coming years. So if the rain comes again this year and offers the chance to buy into these areas at much reduced prices, like it did in March, we will be happy to grasp the opportunity.

What are we doing?

Activity has been mainly investing cashflows into existing positions in the last two weeks. We think the broad structure of our portfolios is correct and represents where we see the risk vs reward equation across our range of opportunities. Opportunity is not present at all times during the course of a year, so at times we need to show patience and confidence in what we own. Our portfolios are filled with high quality corporates which we believe will find a way to come out of the current crisis, not unscathed, but in a stronger position than they went in. We couldn't find the logic in investing in marginal business models and companies in the good times, so we are certainly not tempted to try owning them now given the long list of issues every company has to work through. We do expect a small number of the companies we own to come back to us asking for more capital. We think this will from a position of strength, as we saw with Segro and their recent equity issuance, with the current dislocation happening in the economy an opportunity for some to accelerate their development. Just this week Unite, a provider of student accommodation, has raised £300m to fund three new sites, all with the potential for higher returns than if they'd bought them a year ago. Our asset allocation, which is always fixed for the multi asset funds, remains pro equity relative to its peers. Credit and cash provide very low hurdle rates of return for equities to beat to be relatively more attractive.

How are we performing?

Performance has been very good in the last two weeks. There are occasional days when 'value' has outperformed strongly, and since 'value' seems to exist in sectors we think are impaired by key social and environmental trends, we have no intention of going there. Despite this, better quality companies have reasserted themselves as the main driver of markets, and that suits us. We would also note that we have been impressed with the operational performance of the companies we invest in. We never cease to be amazed about the ingenuity of management teams who, based in their homes, are still able to manoeuvre their businesses thoughtfully through current circumstances. Year-to-date performance is very strong. Of course every strategy is prone to the ebbs and flows of performance, the price of an identity is that we cannot perform in all markets, so it remains to be seen if we keep all our outperformance. We do think the reasons behind it thought are structural and we take confidence from that.

Anything else?

This is my 19th year as a fund manager, and my 17th working on the sustainable funds. It has not always been plain sailing; no one starts a career in fund management with all the knowledge they need to succeed and some lessons have to be learned the hard way. That said, the funds have been blessed with more good years than bad, and overtime have accrued outperformance and good returns for our investors. We have an intern program at Royal London, and constantly recruit new, young, talent into the business. Many of these people ask the same question I did when I started: what is the secret to

outperforming? Of course hard work is the answer no one wants to hear in their 20s, but beyond that we talk about is how far in life you can go making sensible decisions and avoiding disasters. The accumulation of long-term outperformance doesn't actually require outstanding decision making and significant risk taking. Indeed, those observing the Wirecard implosion can observe what reaching for the stars can sometimes do to fund managers. What is required however is an accumulation of sensible decisions over a long period of time, and the avoidance of disasters. We think that this approach manages risk well and accumulates reward for our investors.

Please note that this is a fast moving environment and markets and impacts on portfolios are changing. Opinions contained in this document represent views of our fund managers at time of writing, and performance numbers are estimates and not audited.

Reported yields reflect RLAM's current perception of market conventions around timing of bond cash flows. Heightened uncertainty due to the COVID 19 crisis may impact these timings for bonds with callable feature

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

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