Royal London Equity Funds

Fund Manager Commentary – December 2022

FOR PROFESSIONAL INVESTORS ONLY, NOT SUITABLE FOR RETAIL CLIENTS.

Contents

RLAM Equity Performance

	1 month (%)	Rolling 12 Months (%)
RL UK Equity Income M Inc	**-0.68**	**2.35**
IA UK Equity Income Sector	-0.62	-0.60
FTSE All Share Index	-1.42	0.34
RL UK Dividend Growth Fund M Acc	**-1.53**	**-5.02**
IA UK All Companies Sector	-1.24	-5.86
FTSE All Share Index	-1.42	0.34
RL UK Mid Cap Growth Fund M Acc	**-1.35**	**-22.70**
IA UK All Companies Sector	-1.24	-5.86
FTSE 250 ex-IT Index	-1.60	-18.44
RL UK Opportunities Fund M Acc	**-2.43**	**-17.96**
IA UK All Companies Sector	-1.24	-5.86
FTSE All Share Index	-1.42	0.34
RL UK Smaller Companies Fund M Acc	**-0.95**	**-30.88**
IA UK Smaller Companies Sector	-0.59	-26.00
FTSE Small Cap ex-IT Index	1.26	-17.31
RL Global Equity Income Fund M Inc	**-1.64**	**2.62**
IA Global Equity Income	-0.89	-0.77
MSCI All Countries World Index	-4.89	-8.08
RL Global Equity Select Fund M acc	**-2.42**	**1.12**
IA Global	-2.55	-10.16
MSCI World Net Index	-5.20	-7.83

PAST PERFORMANCE IS NOT A GUIDE TO 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 AND FE, CORRECT AS OF 31 DECEMBER 2022. RETURNS QUOTED ARE NET OF FEES.

Royal London UK Equity Income

Portfolio Commentary

- During December the fund returned -0.68%, better than the benchmark but very slightly behind the peer group median, placing 54th percentile in the month. For 2022 the fund was 25th percentile, with a return of +2.35%.
- The themes of recent months continue to dominate markets. Inflation is still high, although some companies are now reporting falls in the prices of some raw materials and freight costs. Food price inflation remains high, putting further pressure on consumers who are already grappling with high energy bills and higher interest costs on borrowings. The Monetary Policy Committee again raised UK interest rates, taking them from 3% to 3.5% and there is evidence that the increased costs of borrowing is putting downward pressure on house prices The cost of living crisis is stoking a good deal of labour unrest, with the UK seeing extensive strike action across sectors such as healthcare and transport. While the investment backdrop is undoubtedly very difficult it must be remembered that in many sectors share and bond prices have already been weak, pre-empting expected earnings downgrades. Typically, asset prices bottom before earnings revisions do.
- The biggest contributors to the fund's outperformance of the market were **Paragon**, who reported good results and **Hikma** whose shares reacted positively to a presentation to analysts.
- During the month the fund continued to reduce the weighting in the water sector and also trimmed the position in **Rio Tinto**. The mining sector continues to have long term attractions, but near-term operational issues and operating cost increases could mean the sector is less able to make the bumper shareholder distributions seen in recent years. A new holding was started in **Nat West Bank**. While there are risks of greater loan book impairments for banks as the economy slows, the sector is well capitalised, and the increased levels of interest rates are driving significantly higher income on their balance sheets.

Investment Outlook

- We continue to feel that our approach of investing in a broad range of companies from different sectors and stages of their lifecycle is very 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.

Richard Marwood

Head of Income Equities

Royal London UK Dividend Growth Fund

Portfolio Commentary

- During December the fund returned -1.53%, trailing the benchmark and peer group median, placing 69th percentile in the month. For 2022 the fund was 47th percentile, with a return of -5.02%. Over 3 and 5 years the fund ranks in the top decile of performance within its peer group.
- The themes of recent months continue to dominate markets. Inflation is still high, although some companies are now reporting falls in the prices of some raw materials and freight costs. Food price inflation remains high, putting further pressure on consumers who are already grappling with high energy bills and higher interest costs on borrowings. The Monetary Policy Committee again raised UK interest rates, taking them from 3% to 3.5% and there is evidence that the increased cost of borrowing is putting downward pressure on house prices The cost-of-living crisis is stoking a good deal of labour unrest, with the UK seeing extensive strike action across sectors such as healthcare and transport. While the investment backdrop is undoubtedly very difficult it must be remembered that in many sectors share prices have already been weak, pre-empting expected earnings downgrades. Typically, asset prices bottom before earnings revisions do.
- Share price weakness in a number of higher growth companies (**Sage**, **Bunzl**, **As**htead and **Spectris**) were the main detractors to relative performance. The holding in **Drax** was the biggest positive contributor after the company released a good trading statement.
- During the month the fund trimmed the position in **Rio Tinto**. The mining sector continues to have long term attractions, but near-term operational issues, operating cost increases and some early signs of less disciplined capital allocation make us a little more wary. A new holding was started in **Dr Martens**. The shares have had a period of significant share price weakness and while the company is not immune to depressed consumer spending, the valuation of the stock now compensates for those risks.

Investment Outlook

- We continue to feel that our approach of investing in a broad range of companies from different sectors and stages of their lifecycle is very 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.

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Richard Marwood

Head of Income Equities

CITYWIRE A

Niko de Walden

Fund Manager

Royal London UK Mid Cap Growth Fund

Portfolio Commentary

- During the month of December, the fund returned -1.4% which compared to -1.6% from the benchmark (FTSE 250 ex-IT index) and -1.2% from the IA All Companies peer group. 2022 has been a tough year for UK mid cap equities (as it has been for most asset classes), and signals are increasingly pointing to a worsening economic outlook for UK businesses to grapple with. It is important to note, however, that equity prices, which typically reflect the future earnings outlook for companies, should bottom before earnings do. As we move forward into 2023, we remain committed to our investment philosophy and process, and we continue to believe that our approach of building a diversified portfolio, invested in profitable and cash generative companies with strong balance sheets, is the best way to mitigate some of the risks faced as investors in this asset class
- UK headlines in December were largely dominated by the intensified strike action taken by workers across a range of sectors, largely in response to the continued cost-of-living crisis. Data released during December showed that the UK inflation rate dipped to 10.7%, coming off a high of 11.1% recorded in the prior month, and provided some encouragement to economists that inflation might have passed its peak. Despite this, the Bank of England's Monetary Policy Committee continued to respond to the high inflation rate by hiking interest rates by 0.5% to 3.5%. One consequence of rising interest rates has been the effect on the housing market, as data revealed that December was the fourth consecutive month of declines in house prices.
- **Paragon**, the specialist banking group, was a significant contributor to the performance of the fund following the release of its full year results. The company announced strong growth in its operating profit and net loan book, with a record Net Interest Margin being driven by higher interest rates and a greater allocation to commercial lending. Credit quality also remains robust, and the bank retains a healthy capital position. **Games Workshop**, the designer, manufacturer, and seller of Warhammer content, was another contributor to the performance of the fund during the month. The company's share price rose as investors reacted positively following the announcement that an agreement had been reached with Amazon to develop the company's IP into film and TV content. Whilst details of the deal haven't been announced yet, this has the potential to deliver royalties to the business and grow the reach of Warhammer, with the latter likely to benefit the business in the medium to long-run.
- **Watches of Switzerland**, the luxury watch retailer, was a detractor to the performance of the fund following the release of its interim results. Whilst its results were as expected and in line with the trading update released in November, investors reacted negatively primarily due to the build-up of inventory on its balance sheet. We remain confident however, that the inventory has minimal valuation risk as the vast majority of sales are from supply constrained brands, such as Rolex.
- Trading activity was relatively quiet in December. The fund topped up its existing positions in **Intermediate Capital Group** and **JTC** (following share price weakness), whilst trimming exposure to **Paragon** following the release of its strong results.

ALPHA MANAGER 2022
Henry Lowson

Henry Lowson

Head of UK Alpha Equities

Royal London UK Opportunities Fund

Portfolio Commentary

- During December the fund returned -2.4%, behind both the benchmark and peer group median, placing 90th percentile over the month. However, over the last quarter, the fund has substantially outperformed the FTSE All-Share benchmark index (12.2% vs 8.9%) and peer group.
- UK headlines in December were largely dominated by the intensified strike action taken by workers across a range of sectors, largely in response to the continued cost-of-living crisis. Data released during December showed that the UK inflation rate dipped to 10.7%, coming off a high of 11.1% recorded in the prior month, and provided some encouragement to economists that inflation might have passed its peak. Despite this, the Bank of England's Monetary Policy Committee continued to respond to the high inflation rate by hiking interest rates by 0.5% to 3.5%. One consequence of rising interest rates has been the effect on the housing market, as data revealed that December was the fourth consecutive month of declines in house prices.
- **IntegraFin**, the investment platform provider for financial advisors, was a positive contributor to the performance of the fund. During the month the company announced its full year results, which revealed positive net inflows, which was pleasing given the challenging market backdrop, as well as growth in its market share. The company has a strong business model operates in a structurally growing industry (as investments increasingly flow onto platforms and from defined benefit pension plans into defined contribution schemes), leaving it well-placed to continue taking market share. **Prudential**, the insurance provider, was another significant contributor to performance during the month as the share price rallied significantly with the imminent reopening of China and Hong Kong, important regions for sales.
- **Watches of Switzerland**, the luxury watch retailer, was a detractor to the performance of the fund following the release of its interim results. Whilst its results were as expected and in line with the trading update released in November, investors reacted negatively primarily due to the build-up of inventory on its balance sheet. We remain confident however, that the inventory has minimal valuation risk as the vast majority of sales are from supply constrained brands, such as Rolex.
- The fund has been restructured in order to optimize the risk adjusted returns and add some further stock and sector diversification. From a sector perspective, exposure has been increased in real estate, financials and healthcare. On the other hand, housebuilding and consumer cyclical exposure has been reduced. Secondly, we have reduced some position sizes and thus the stock specific risk of some of the larger positions in the portfolio, while maintaining conviction in the underlying holdings. Thirdly, we have slightly broadened the list of portfolio names by introducing some new high quality and well capitalised companies into the portfolio, exposed to attractive economic/structural tailwinds. Examples of holdings which exhibit these characteristics include **London Stock Exchange**, **Croda**, and **Rentokil** and **RELX**.

Royal London UK Smaller Companies Fund

Portfolio Commentary

- During the month of December, the fund returned -0.9% which compared to 1.3% from the benchmark (FTSE Small Cap ex-IT index) and -0.6% from the IA UK Smaller Companies peer group. 2022 has been a tough year for UK small cap equities (as it has been for most asset classes), and signals are increasingly pointing to a worsening economic outlook for UK businesses to grapple with. It is important to note, however, that equity prices, which typically reflect the future earnings outlook for companies, should bottom before earnings do. As we move forward into 2023, we remain committed to our investment philosophy and process, and we continue to believe that our approach of building a diversified portfolio, invested in profitable and cash generative companies with strong balance sheets, is the best way to mitigate some of the risks faced as investors in this asset class.
- UK headlines in December were largely dominated by the intensified strike action taken by workers across a range of sectors, largely in response to the continued cost-of-living crisis. Data released during December showed that the UK inflation rate dipped to 10.7%, coming off a high of 11.1% recorded in the prior month, and provided some encouragement to economists that inflation might have passed its peak. Despite this, the Bank of England's Monetary Policy Committee continued to respond to the high inflation rate by hiking interest rates by 0.5% to 3.5%. One consequence of rising interest rates has been the effect on the housing market, as data revealed that December was the fourth consecutive month of declines in house prices.
- **Hollywood Bowl**, the ten-pin bowling & mini-golf operator, was a positive contributor to performance during the month. The company released a positive set of full year results, with strong revenue and margin growth, with minimal exposure to cost inflation. Management flag that the business has had a strong start to the current financial year, and with a healthy pipeline of site openings to come, we believe Hollywood Bowl will be well placed to continue to grow in the UK and Canada. **Porvair,** the specialist filtration group, was another contributor to performance during the month. The company released a trading update ahead of the release of its full year results stating that revenue was expected to be significantly higher than the prior year, with all three of its divisions ahead. In our view, the trading update provides further evidence that Porvair is a high-quality business which continues to be underpinned by long-term growth thematics.
- **Auction Technology Group**, the operator of online auction marketplaces, was a detractor to performance over the month as investors reacted negatively to the release of its full year results. Despite the company announcing solid revenue and profit growth, investors reacted negatively to the cautious forward guidance, given the macroeconomic uncertainty. Nevertheless, we believe the business has multiple levers to grow its top line revenues and market share as the company seeks to integrate payment, logistics and warehousing solutions into its offering to auction houses.
- In terms of trading activity during the month, the fund disposed of its position in **Access Intelligence**, the digital marketing software provider, following the release of a disappointing trading statement. The business is currently operating in a challenging environment for advertising spend, and the decision to reduce its sales team in the US was disappointing given we had expected this to be an area of growth for the business. The acquisition of **Isentia** has also proved more complicated than expected to integrate. Other trades completed for the fund during the month included trimming the positions in **Ergomed** and **Alpha Financial Markets Consulting** (to reduce position size below 3% stock limit) and adding to existing holdings in **Gooch & Housego** and **Serica** (post announcement of material North Sea acquisition of Tailwind Investments).

ALPHA MANAGER 2022
Henry Lowson

Henry Lowson

Head of UK Alpha Equities

Henry Burrell

Fund Manager

Royal London Global Equity Income Fund

Portfolio Commentary

- The Royal London Global Equity Income fund returned -1.64% in December (vs -4.89% MSCI ACWI). In 2022, the fund returned +2.62% (vs -8.08% MSCI ACWI).
- December was notable for significant underperformance from technology and other early Life Cycle stocks. This aided the performance of the fund relative to the benchmark, but was likely a slight negative versus other Global Income funds, as our focus on portfolio balance, combined with the positive risk rewards we see in many of these structurally growing investments, means that we have more exposure than many funds within the space. In our view, 2022 has revealed that many technology companies were not only benefitting from low interest rates from a valuation standpoint in 2021, but that low interest rates were actually enhancing their earnings as well, as the cheap money flowing through venture capital was funding thousands of new businesses who either advertised through them or used their software. Stockpicking was positive across every sector in December, and there were not any major stand-outs from a stock specific point of view.
- During the month, the fund continued to build its new holding in European bank, **BNP Paribas**, which helps bring the funds to a neutral weighting in banks, which feel is appropriate given the cheap valuations and growing earnings partly offset by increased risks of defaults in coming years. We sold out of **Travelsky Solutions**, a provider of the data behind flight booking in China, which had rallied strongly into reopening potential and no longer offered a positive risk reward, when factoring in governance concerns around China alongside the new valuation. Towards the end of the month, we added to positions in **Thor Industries, Applied Materials** and **Amazon**, which had all been weak and offered improved long-term payoffs.

.Investment Outlook

- With geopolitical issues with China and Russia, combined with central bank tightening, continuing to drive markets we continue to try hard to achieve balance by Region, Sector and Life Cycle within the fund, so that it is our stock picking that drives the majority of relative performance, rather than the outcomes to these various issues.

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Niko de Walden

Fund Manager

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