Royal London Equity Funds

Fund Manager Commentary – July 2022

FOR PROFESSIONAL INVESTORS ONLY, NOT SUITABLE FOR RETAIL INVESTORS.

Contents

RLAM Equity Performance

	1 month (%)	Rolling 12 Months (%)
RL UK Equity Income M Inc	**5.63**	**5.08**
IA UK Equity Income Sector	3.80	3.48
FTSE All Share Index	4.36	5.51
RL UK Dividend Growth Fund M Acc	**7.07**	**-2.97**
IA UK All Companies Sector	5.29	-3.06
FTSE All Share Index	4.36	5.51
RL UK Mid Cap Growth Fund M Acc	**11.43**	**-14.52**
IA UK All Companies Sector	5.29	-3.06
FTSE 250 ex-IT Index	9.13	-11.31
RL UK Opportunities Fund M Acc	**8.33**	**-12.58**
IA UK All Companies Sector	5.29	-3.06
FTSE All Share Index	4.36	5.51
RL UK Smaller Companies Fund M Acc	**5.63**	**-23.45**
IA UK Smaller Companies Sector	5.10	-20.47
FTSE Small Cap ex-IT Index	3.50	-12.73
RL Global Equity Income Fund M Inc	**4.80**	**7.35**
IA Global Equity Income	4.47	5.96
MSCI All Countries World Index	6.77	2.28
RL Global Equity Select Fund M acc	**5.98**	**10.30**
IA Global	7.01	-1.98
MSCI World Net Index	7.72	3.78

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 AND FE, CORRECT AS OF 31 JULY 2022. RETURNS QUOTED ARE NET OF FEES.

Royal London UK Equity Income

Portfolio Commentary

- Bouncing back from a tough June, the equity market had a strong month in July. The fund returned +5.63%, ahead of both the benchmark and peer group median, placing 19th percentile in the month and 38th percentile year to date.
- While inflation remains high, there was some relief in financial markets as investors speculated that the worst of the increase in inflation has now past, and that as economies start to slow so will the requirement for further material interest rate increases. It has also been a busy period for companies reporting results and trading statements. While almost all businesses are flagging inflationary pressures and tough economic conditions, in aggregate reported results have been a little better than many investors had feared.
- The holdings in the financial companies **3i** and **IG Group** were big contributors to performance, in both cases after reporting good results. Holdings in the industrial companies **IMI** and **Spectris**, which had been weak in the prior month, also bounced, helping performance.
- Following a bid for the company, the fund has reduced its holding in the media firm **Euromoney**, and the holding in **Tate and Lyle** was also exited. Following a sharp fall in **Anglo American**'s share price, the fund added to its holding.

Investment Outlook

- Consumers are facing a significant cost of living squeeze, as inflation is currently at its highest level for decades. This squeeze has probably not yet peaked, as energy costs will rise significantly again later this year. Likewise, companies are battling to defend margins, as their own input costs increase significantly, but most recent evidence from company results is that many are so far managing to do this. In this tricky background we 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

- Bouncing back from a tough June, the equity market had a strong month in July. The fund returned +7.07%, ahead of both the benchmark and peer group median, placing 33rd percentile in the month and 51st percentile year to date.
- While inflation remains high, there was some relief in financial markets as investors speculated that the worst of the increase in inflation has now past, and that as economies start to slow so will the requirement for further material interest rate increases. It has also been a busy period for companies reporting results and trading statements. While almost all businesses are flagging inflationary pressures and tough economic conditions, in aggregate, reported results have been a little better than many investors had feared.
- Holdings in the industrial companies **Ashtead** and **Spectris**, which had been weak in the prior month, bounced in July, boosting performance. There were also positive contributions from **Clarkson**, **IG Group**, **Bunzl** and **3i**, all of whom released positive trading news. The one notable drag on performance was the holding in the motor insurers **Sabre**, who issued a profits warning citing accident claims cost inflation running well ahead of insurance price increases, depressing profitability.
- During the month the fund continued to build the new position in **Drax**, as well adding to the holding in **Lloyds**.

Investment Outlook

- Consumers are facing a significant cost of living squeeze, as inflation is currently at its highest level for decades. This squeeze has probably not yet peaked, as energy costs will rise significantly again later this year. Likewise, companies are battling to defend margins, as their own input costs increase significantly, but most recent evidence from company results is that many are so far managing to do this. In this tricky background we 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.

CITYWIRE A

Richard Marwood

Head of Income Equities

CITYWIRE A

Niko de Walden

Fund Manager

Royal London UK Mid Cap Growth Fund

Portfolio Commentary

- Equity markets rallied during July as corporate results were generally better than markets feared, and the fund returned +11.4%, pleasingly ahead of the +9.1% from the FTSE 250 ex-IT index benchmark and +5.8% from the IA All Companies peer group. The FTSE 250 outperformed the large cap FTSE 100 index as commodity prices moderated, and higher growth sectors such as industrials, technology and consumer discretionary outperformed traditionally defensive sectors such as consumer stables and healthcare. The fund's relative outperformance vs the benchmark was driven by stock selection within the financials sector, as well as overweight allocations to the industrial and technology sectors.
- Inflation and the cost-of-living crisis continued to dominate macroeconomic headlines, as UK inflation reached 9.4% – the highest point since 1982 – and it now appears likely that the Bank of England will raise base rates further at its next meeting. The European Central Bank raised rates above zero for the first time since 2016, while the US Federal Reserve hiked by another 75bps. Despite this, dovish comments from the US central bank helped sentiment, suggesting a slowing rate of interest hikes in future which may reduce the severity and duration of a recession. Consequently, US and UK 10-year bond yields actually declined during the month, as yield curves shifted to reflect the fact that central bank monetary tightening has actually increased the probability of a recession. Against this backdrop and the uncertainty caused by a change of UK prime minister, it is somewhat counterintuitive that equity markets rallied. However, with the notable exception of consumer discretionary sectors, corporate earnings for the first half of 2022 have been more robust than feared and management teams generally indicate reasonable order strength for the second half.
- **GB Group**, the identity verification company, was a top contributor following a robust trading statement during July, reporting rebounding demand for fraud and location services as corporate customers continue investing in online customer security. Other top contributors included investment platforms **AJ Bell and Integrafin**. AJ Bell's third quarter trading update was better than expected with continued additions of new customers despite market turmoil, with both their financial advisor customer base and retail customer base proving more resilient than some had feared. Integrafin also reported strong net inflows from customers, demonstrating that they continue to outperform peers and take market share. In addition, after some uncertainty, management provided clear guidance on the extent and timing of cost investment in their technology team – the share price rallied sharply from recent lows. Specialist distributor **Diploma** also performed strongly following a strong trading update, shrugging off macroeconomic concerns as it reported record order books and impressive cash generation. The company reiterated guidance for the full year as its diversified end markets continued to benefit from recovering demand post-covid.
- The fund sold its holding in **SSP Group**. The shares bounced following a solid trading update, however we remain cautious of its high valuation and challenging expectations for margin expansion in the face of a tougher macroeconomic outlook as well as shorter term risks from a slowing recovery in passenger traffic as airports and airlines limit capacity due to staff shortages. The proceeds of the disposal have been partially used to increase our position in travel retailer **WHSmith**, which we believe has better end market exposure at a more attractive valuation. The fund also added to holdings in AJ Bell, Integrafin and Diploma following results.
- While we believe the next twelve months will be challenging from a short-term earnings perspective, we expect our companies' fundamental attributes to be more resilient than peers. This will enable them to gain share through a downturn. We believe that our approach of building a diversified, liquid 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.

Henry Lowson

Head of UK Alpha Equities

Royal London UK Opportunities Fund

Portfolio Commentary

- The UK Opportunities Fund had a much stronger month than it has so far enjoyed this year, returning 8.3%, meaningfully ahead of the benchmark return of 3.9%, placing it in the first quartile.
- It is fair to say we were pleasantly surprised at the robustness of the UK market during July given the issues it has had to contend with. Between ever higher inflation readings, the ongoing conflict in Ukraine and further interest rate rises, the market has taken a remarkably sanguine view. It is still too early to properly assess the implications on corporate earnings of eroding consumer spending power and how this plays out. The fear amongst investors is that ultimately the squeeze on consumer budgets and the rise in interest rates will result in a recession and corporate profits will decline.
- This months' top performer was **Ashtead**, up 33%, which rebounded strongly after enduring a difficult share price performance over the first six months. The company reported strong results, accompanied by an upbeat outlook statement. **Weir Group** jumped 22% following interim results which comfortably exceeded analyst expectation. **Integrafin**, the online financial platform added 21% as did **Spirax-Sarco**. Lastly, **Experian** grew its business 8% over the half year and was rewarded with a move up of 19%.
- On the downside, **Mattioli Woods** dropped 4%, **Imperial Brands** lost 2% and **Prudential** was 1% in the red.
- The fund had a quiet month in terms of trading. We took advantage of the relative strength in the price of **Chemring** and recycled the cash into **BP** and **Grafton Group**. BP is generating meaningful levels of free cash flow given the current oil price and we see no reason to believe this will not continue. Grafton Group announced its well respected CEO was to stand down and the share price dropped following the news.

Investment Outlook

- Consumers are facing a significant cost of living squeeze, as inflation is currently at its highest level for decades. Likewise, companies are battling to defend margins, as their own input costs increase significantly. We believe our approach of investing in a broad range of companies who are in control of their own fates, irrespective of market conditions is the right one. As well as looking for durable businesses, a willingness to look through short-term extremes of sentiment and buy stocks when they are out of favour, or take profits when sentiment becomes exuberant should drive longer-term performance. We remain excited about the outlook for our portfolio companies and believe that over the medium to long term, they can outperform the wider market.

Craig Yeaman

Senior Fund Manager

Royal London UK Smaller Companies Fund

Portfolio Commentary

- Equity markets rallied during July as corporate results were generally better than markets feared, and the fund returned +5.6%, which compared to +3.5% from the FTSE Small Cap ex-IT index benchmark and +4.8% from the IA UK Smaller Companies peer group. The relative outperformance was driven by stock selection within the technology, financials and consumer discretionary sectors.
- Inflation and the cost-of-living crisis continued to dominate macroeconomic headlines, as UK inflation reached 9.4% – the highest point since 1982 – and it now appears likely that the Bank of England will raise base rates further at its next meeting. The European Central Bank raised rates above zero for the first time since 2016, while the US Federal Reserve hiked by another 75bps. Despite this, dovish comments from the US central bank helped sentiment, suggesting a slowing rate of interest hikes in future which may reduce the severity and duration of a recession. Consequently, US and UK 10-year bond yields actually declined during the month, as yield curves shifted to reflect the fact that central bank monetary tightening has actually increased the probability of a recession. Against this backdrop and the uncertainty caused by a change of UK prime minister, it is somewhat counterintuitive that equity markets rallied. However, with the notable exception of consumer discretionary sectors, corporate earnings for the first half of 2022 have been more robust than feared and management teams generally indicate reasonable order strength for the second half.
- **Serica Energy**, the North Sea natural gas producer, was the top contributor during the month, following two takeover approaches from UK listed peer Kistos, both of which were rejected by the Serica board on the basis that they undervalued the company. **GB Group**, the identity verification company, was a top contributor following a robust trading statement during July, reporting rebounding demand for fraud and location services as corporate customers continue investing in online customer security. **Ergomed**, the biopharmaceutical services provider, also reported impressive levels of organic growth as biotech and big pharma companies push increasing numbers of new products through clinical trials after a hiatus during Covid. In addition, recent acquisitions are performing very well while management have a net cash balance sheet to deploy on further additions. Other top contributors included high quality ‘growth’ stocks which had underperformed during the year to date such as research and data group **YouGov** and video games publisher **Team17**, neither of which reported results.
- The fund sold its position in **Hotel Chocolat** following an abrupt change of strategy for their international expansion, notably a £25m impairment of their Japanese joint venture as well as the decision to reduce their growth plans in the US and close their final store. Management had re-iterated their growth strategy and ambitions for these territories as recently as their first half results announcement in March; this brings into question the scalability of the business model as well as the international growth opportunity. The fund recycled the proceeds into a range of existing positions including **Ergomed**, **GlobalData** and **Alfa Financial Software**.
- While we believe the next twelve months will be challenging from a short-term earnings perspective, we expect our companies’ fundamental attributes to be more resilient than peers. This will enable them to gain share through a downturn. We believe that our approach of building a diversified, liquid 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.

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 Income fund returned +4.80% in July (vs +6.77% MSCI ACWI). Year to date, the fund has returned +0.06% (vs -4.96% MSCI ACWI).
- Performance was pleasing during July, with many of the fund's core active positions having strong half year results and seeing positive share price performance in July. **Ashtead**, **Steel Dynamics** and **HCA Healthcare** all fell into this bucket and were the largest contributors to performance. The fund's underperformance versus the benchmark was largely due to a sharp rally in non-dividend paying early Life Cycle stocks in technology and consumer discretionary, as the long-term interest rates against which these stocks are valued fell significantly during the month. For example, **Tesla** and **Amazon** were up 32% and 27%, respectively. The two biggest detractors from performance were both China-related stocks, with **Travelsky** (flight booking data company) and **Lonking** (domestic machinery constructor) both weak in the face of China's Covid lockdown policy.
- July was a quiet month for trades within the fund, but we did take the decision to sell out of **Costco**. Costco is a high quality compounder with an unrivalled position in retailing, however these qualities have resulted in it becoming a safe haven for investors and, in our view, the valuation makes for a negative risk reward for the stock at current levels. As such we took the decision to exit the position. We also took some profit in **Travelsky** at the start of the month, and added to shipping company, **Maersk**, following significant weakness in that stock. Maersk has since bounced strongly as continued congestion within logistics markets have resulted in a significant upgrade to their full year guidance.

Investment Outlook

- The macroeconomic environment is currently volatile and very difficult to predict. Inflation is currently rife in all parts of society, exacerbated by Russia's war with Ukraine, and is causing consumers to lower their discretionary spend on goods. The impact it will have on corporate capex is still hard to assess, given that balance sheets are strong and many required investments are structural in areas like technology or climate transition. Meanwhile, long-term underinvestment in commodities provides potential for continued elevated prices caused by lack of supply, rather than particular strength in demand. Given these uncertainties, we are confident that a balanced approach to portfolio construction, where it is our stock picking that drives the majority of performance can hopefully continue to provide compounding outperformance, while delivering attractive income for stakeholders.

CITYWIRE A

Niko de Walden

Fund Manager

ROYAL LONDON
ASSET MANAGEMENT

Royal London Global Equity Select Fund

Portfolio Commentary

- Global equities rebounded in July as investors speculated that the worst of the increase in inflation has now past, and that as economies start to slow so will the requirement for further material interest rate increases. It has also been a busy period for companies reporting results and trading statements. While almost all businesses are flagging inflationary pressures and tough economic conditions, in aggregate reported results have been a little better than many investors had feared. The US was the strongest performing region in July in part linked to the outperformance of Growth stocks over the period. Consumer discretionary was the strongest performing sector.

Contributors to performance:

- **HCA Healthcare** a 'Compounding' company in the corporate Life Cycle framework gained after positive second quarter results surpassed analyst expectations. The hospital operator reported second quarter revenue of $14.8 billion, up from $14. 4 a year earlier. **Old Dominion Freight Line** 'Accelerating' also gained following positive second quarter results. The company is a less than truck load (LTL) US trucking company with c.10% and growing market share of a highly fragmented industry. As the only pure play company of its size, Old Dominion Freight Line (ODFL) has been consistently taking market share from peers. Share gains are the result of superior customer service and more efficient operations facilitated by ODFL's focus, dense network of 248 service centres and investment in technology. **Steel Dynamics**, 'Slowing & Maturing', reported record sales levels for the second quarter but also revealed a new investment. The company noted that it will be making a $2 billion investment in an aluminium rolling mill. The company's CEO added that the outlook for the third quarter also looks robust. While steel prices have come down some 50% from their 2021 highs, they are double to where they were pre-pandemic. Online retailing giant **Amazon**, 'Slowing & Maturing' also jumped owing to strong e-commerce sales during the month and stronger than expected earnings. Amazon Web Services – the cloud computing division – reported revenues of $19.7 billion, which came in better than expected.

Detractors from performance:

- **Suncor Energy**, 'Turnaround', came under pressure during July primarily due to general weakness in energy stocks. The resignation of Suncor's CEO Mark Little also impacted sentiment. His resignation was in response to mounting investor concerns regarding operational performance and workplace safety. **Progressive Corp**, 'Slowing & Maturing', declined after second quarter results highlighted a significant increase in year-on-year claims frequency for the insurer. **Lithia Motors** 'Slowing & Maturing' detracted after its second quarter earnings missed analyst expectations. UK insurance company **Admiral Group** 'Slowing & Maturing' meanwhile saw its shares fall in July after competitor Sabre Insurance reported a negative first half trading update owing to overwhelming inflationary pressures, signalling a wider weakness for the sector.

CITYWIRE AAA

Peter Rutter

Head of Equities

CITYWIRE A

James Clarke

Senior Fund Manager

CITYWIRE AAA

Will Kenney

Senior Fund Manager