Royal London Global Equity Select Fund

Quarterly Report 30 June 2022

ROYAL LONDON
ASSET MANAGEMENT

Top 10 holdings

	Fund (%)
Microsoft	7.2
Amazon	5.4
Reliance Steel & Aluminum Co.	5.1
Suncor Energy	5.1
Progressive Corporation	4.7
Constellation Software	4.3
Anglo American	4.1
United Health Group	4.1
Lithia Motors	4.1
Alphabet Inc	4.1
Total	**48.4**

Source: RLAM, based on the M Acc share class.

Fund data

	Fund
No. of stocks	32
Fund size	£650.5m
Launch date	05.03.2018
Active share	86.2%
Tracking error	6.2%

Performance

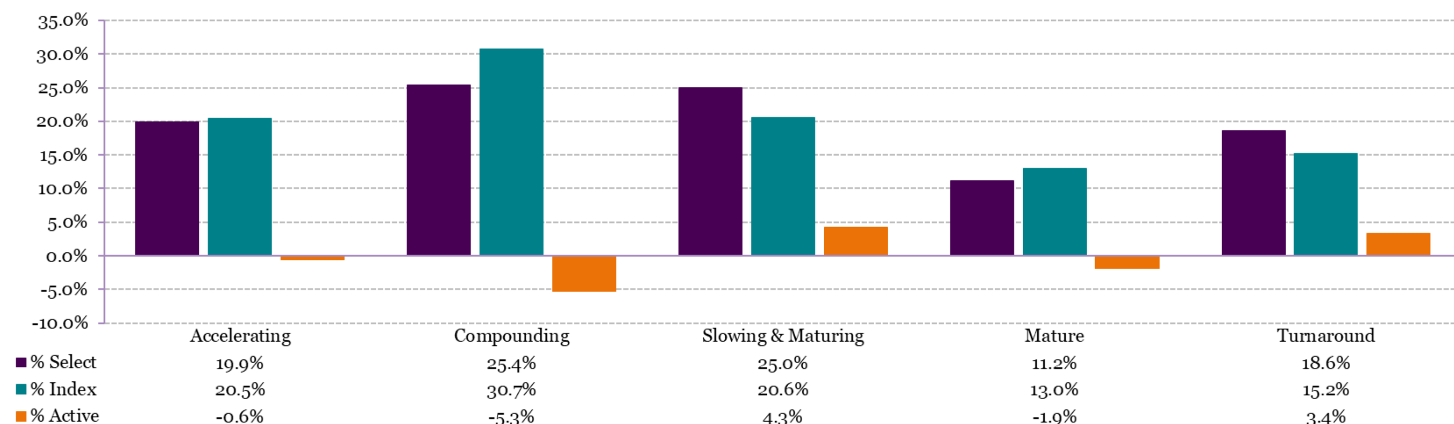
	Fund (%)	Benchmark[1] (%)	Relative (%)
Q2 2022	**-8.75**	**-9.13**	**0.38**
Year-to-date	-4.41	-11.34	6.93
1 year p.a.	7.38	-2.56	9.93
3 year p.a.	15.58	8.68	6.90
Since inception p.a. 05.03.2018	15.13	9.59	5.54

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 Acc share class. All performance figures stated gross of fees and tax unless otherwise stated, subject to rounding. The impact of fees or other charges including tax, where applicable, can be material on the performance of your investment. The impact of fees reduces your return.

[1]Benchmark: MSCI World NDR Index.

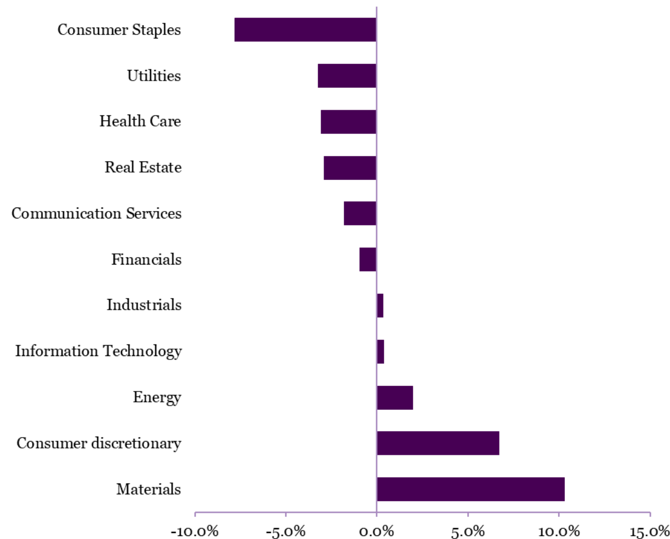
Holdings and Weights



Source: RLAM as at 30 June 2022.

ROYAL LONDON
ASSET MANAGEMENT

Sector weights



Regional weights

Source: RLAM as of 30 June 2022. Shows weight relative to index.

Executive summary

- Over the second quarter our pooled funds delivered net returns of -8.91% for the **RL Global Equity Select Fund** and -9.84% for the **RL Global Equity Diversified Fund**, compared to -9.13% for the benchmark (MSCI World Net Total Return in sterling). For the 12-month period, the funds have returned 6.62% and 0.52%, respectively, against -2.56% for the benchmark (fund returns net of fees, for M Acc share classes).
- Inflation has been the headline macroeconomic market influence over the quarter. Sharp increases in energy and commodity prices have added to the natural increase seen as the global economy continued to emerge from its Covid-induced slowdown of 2020 and 2021. Geopolitical events continued to weigh on sentiment as well, as Ukrainian resistance to the Russian invasion continued.
- The key theme of high inflation will continue to be a focus and the cost-of-living squeeze that households are facing. However, the pressures are by no means confined to energy. Others inflationary factors are also at play, such as supply chain disruption from Covid lockdowns in China, tight labour markets and sharp rises in many agricultural products feeding through into food prices.
- Central banks have responded to rising inflation by tightening monetary policy and indicating that there is more to come. The US Federal Reserve (Fed) has led the way, increasing rates by 1.25% over the quarter – its clear threat to do more has led markets to price in a further 2% of hikes in 2022. The European Central Bank (ECB) was less aggressive but confirmed that it will end its bond buying programme in July and signalled that a 25bps hike in July and even another 50bps in September will both be possible. The Bank of England (BoE) has increased rates by 25bps at every meeting since December 2021 and this continued through the quarter, with the fifth consecutive increase in June taking the UK base rate to 1.25%.
- Global Covid case numbers increased towards the end of the quarter as China reduced quarantine times for inbound visitors by half. However, President Xi reiterated that China's zero tolerance approach was the most "economic and effective" policy. ONS data showed rates of infection across the UK have risen to around 4% (people testing positive for Covid) in the week ending 24 June.
- Using some valuation metrics, equities are the most expensive for several decades, and are approaching valuation peaks reached in the dotcom boom in 1999/2000. Nonetheless, relative to bonds, while clearly more expensive than at points in 2020, equity valuations are still not extreme and are actually lower than in 2018. We also believe earnings momentum will remain favourable. We believe sectors will be a key point of volatility risk, with the rotation into more cyclical/Covid-recovery stocks in the autumn showing the potential for positive and negative effects on performance. We are addressing this risk by limiting factor and sector exposure whilst focusing on stock-specific risk in the portfolios.

- Our preference is to own wealth creating companies with suitable balance sheets for their underlying business and a conservative approach to credit. We diversify the portfolio across regions, countries, industries and Corporate Life Cycle categories. No single model or analysis is a magic bullet for investing, but our Corporate Life Cycle model helps us to understand the world as management teams see it and are pursuing an appropriate strategy for their position in the Life Cycle.

Market overview

- Equities struggled as interest rate expectations rose and investors factored in the possibility of a Fed-induced recession in the next six to 12 months. As a result, the first half of 2022 was the worst start to a year for US equities since 1970. For the second quarter the FTSE-All Share, MSCI World and MSCI All Countries World Index (ACWI – which also includes 26 emerging markets) returned -5.0%, -16.1% and -15.5% to sterling investors, respectively. Regional returns were again widely dispersed. According to MSCI regional data, Asia-Pacific (ex-Japan) was the best-performing region, returning -0.9%. Otherwise, the UK and emerging markets returned -3.0% and -4.4%, respectively, while the returns for Japan, Europe (ex-UK) and the US lagged at -7.7%, -8.1% and -10.2%, respectively.
- Within equity markets, the significant inflation-related rotation out of 'growth' and into 'value' that started in the first quarter continued. The MSCI World Value Index returned -4.4% versus -14.9% for the MSCI World Growth Index, outperformance of 10.5%. Energy again led the MSCI World sector returns (+2.6%), with consumer staples, healthcare and utilities the only other sectors with positive returns (+1.2%, +0.3% and +0.1%, respectively). Consumer discretionary (-17.7%), technology (-15.5%) and materials (-13.25%) were the weakest sectors.
- We are at what appears to be an important fork in the road for the global economy and financial markets. It all comes back to the ever-looming question: Is inflation transient or here to stay? Much like the bowls of porridge from the story of Goldilocks, is the economy 'too hot' with inflation unabated by central bank action and becoming structurally embedded, or is it – as Jamie Dimon recently predicted – about to get very cold and hit the buffers with interest rate rises, inflationary pressure and consumers running out of the Covid savings surplus leading to a big slow down or economic 'hurricane'? Some (including central banks) are predicting that things will be 'just right' with rising interest rates, quantitative tightening and rising bond yields helping to bring inflation and the economy into a soft landing. It is one of three scenarios; too hot and inflation entrenched, about to get very cold with a recession, or just right. As you can imagine, each of these environments might lead to very different financial market outcomes increasing the importance of asset allocation and equity portfolio construction (style risk).
- What can investors do in the meantime? We focus on three things. First, balance portfolios that cover the different scenarios (unless you have a strong view on which one will emerge); second, look to pick up individual stocks in the volatility where their long-term fundamentals are mispriced in a moment of extreme sentiment; and third, be fleet of foot reacting to the incoming data and evidence. The next six months will see a lot more data and evidence emerge as to which outcome is correct – a hot economy and entrenched inflation, an ice bath of a recession slowing the economy and inflationary pressures, or the soft landing down the middle with central banks bringing inflation down without ushering in a recession.
- Currency swings were notable in the quarter, following the volatility of the first quarter. The sharp rise in US interest rate expectations meant that the US dollar was the strongest global currency: it appreciated significantly against the Swiss franc, euro and sterling, and rose over 11% against the yen. These movements will impact global trade and overseas earnings over coming months, and dollar strength will also be a risk for any emerging markets countries and companies that have borrowed in dollars. The price of brent crude oil rose by another 6.4% to nearly $112 a barrel, but copper futures fell 21.9% on fears of recession and renewed Covid restrictions in China during the quarter.
- Technology and consumer discretionary shares remained under derating pressure amid rising yields. UK equity outperformance persisted through the quarter, with Japanese stocks – boosted by a weak yen and higher export demand – following suit.
- The macroeconomy is currently volatile and very difficult to predict. Inflation is currently rife in all parts of society, enhanced 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.

Performance and activity

- The fund outperformed its benchmark over the quarter. **Eli Lilly, Progressive, Ollie's Bargain Outlet, United Health and Reliance Steel** were strong contributors to returns in the second quarter. Eli Lilly, the American pharmaceutical company in the Compounding stage of the corporate Life Cycle, gained on the back of a positive reception to its recently FDA-approved drug Mounjaro, having demonstrated market leading efficacy in terms of weight loss. The drug has a strong ability to gain market share from the current GLP-1 drugs in obesity. The

US pharma's new drug also poses a threat to Novo Nordisk's Ozempic drug, which has a dominant share of the GLP-1 market. Progressive, in the Slowing & Maturing category of the Life Cycle, should continue to take share of the US auto insurance market. We believe this will be driven by higher insurance premiums which help Progressive take market share. High prices are in part due to the cost of used cars and spare parts spurring higher claims costs. Higher interest rates should also improve returns on the investment side for Progressive. Ollie's Bargain outlet, in the Slowing & Maturing category of the corporate Life Cycle, gained in the aftermath of their first-quarter results – in particular, the market reacted well to the guidance the company offered. It is a highly scalable business model delivering consistently strong sales in the past. While there have been challenges, management has acted in a nimble way to ensure it can ride out the current era of uncertainty. United Health, in the Slowing & Maturing category, amid defensive cash flows has held up well in a volatile market. The company also made a number of small acquisitions helping to continue to grow its network. Reliance Steel, in the Slowing & Maturing category, has seen its stock price gain more than 25% in the six months to June-end. Reliance Steel is reaping the benefits of strong demand across key end markets and a diverse product base. We feel optimistic on the outlook of the company for the remainder of the year owing to robust demand in end markets amid improving demand in the non-residential construction sector.

- **Anglo American, HCA Healthcare, Amazon, Nvidia and KB Financial** detracted from returns over the quarter. Anglo American, in the Slowing & Maturing category, pulled back as fears mount for weaker commodity prices amid looming fears of a recession. Miners are also vulnerable to higher energy costs as well as navigating the territory of decarbonisation. This has created in turn the perfect storm where various issues are hitting the commodity sector all at once. HCA Healthcare, the hospital giant in the Compounding phase, pulled back owing to ongoing high labour costs amid a realisation that these could continue for some time to come. In a recent call with analysts and investors, the company's CFO said the company which runs 182 hospitals and some 2300 ambulatory care sites, saw high contract labour costs trend 1.5% higher than expected. In turn, this will cost the company some USD 400-500 million more of the course of the year. Online retail giant Amazon in the Slowing & Maturing category detracted as customers continued to revert back to pre-pandemic shopping trends. Elevated capex levels have also become an issue. Amazon's CFO Brian Olsavsky noted that AWS accounts for just under 40% of total capex, of which the company is a large customer. He added that 30% of capex is also for building warehouses. Nvidia, in the Compounding phase of the Life Cycle, saw losses on the back of the recent woes in cryptocurrency. Nvidia's graphic cards are popular with gaming fans and have benefitted during the crypto boom because they are an essential component of the systems that generate digital coins. Concerns over the level of ongoing data centre capex and unclear level of crypto exposure will need to be monitored. Asian banking group, KB Financial, in the mature category detracted as banking stocks extended their losses on growing fears of a recession as well as the magnified risk exposure of their asset viability as rates rise. KB Financial is a mature business and over the next 3-4 years can remain so while returning significant amounts of capital to shareholders, we feel. KB Financial Group is a diversified financial services firm in Korea with 95% exposure to the domestic market. About 70% of net profit is from banking (80:20 net interest versus fee income), the remainder is from diversified financial services.
- **Trades in the period:** The decision was made to exit the position in **Otsuka Corporation** in June. Milestones-wise the business has been on the weak side with covid impacted lower growth rates, though margins had remained strong. We were disappointed that there has not been a more proactive approach to distributing the excess cash on the balance sheet.
- The fund initiated a position in energy company **Shell** in May. Our corporate wealth creation assessment is that Shell is significantly advantaged relative to other 'Turnarounds' in our Life Cycle framework. The company is committed to permanently reduced investment in hydrocarbons, this is freeing up large amounts of cash as oil and gas prices are at high levels and these returns are not being reinvested into growth. The valuation remains attractive, and the company has returned 15% of its market capitalisation in dividends, share buybacks and debt reduction in the last 12 months.

Outlook

- Inflation is continuing to rise, reflecting higher raw material costs, energy price increases and tight labour markets. However, central bank interest rate increases are already showing signs of slowing down activity and we believe that inflation will peak in major economies during the second half of 2022. Weaker GDP growth and recession in some areas will impact the corporate sector.
- Equity markets are unlikely to recover until we have a better view of the duration and severity of the downturn. In the meantime, we expect our companies' fundamental attributes should enable them to be more resilient than peers and gain share through a downturn; but we will have to be patient and await proof. 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.

Further insights from the Global Equity team

- You can find more of our regular updates on our investment thinking in the Our Views section of www.rlam.com

IMPORTANT INFORMATION

For professional clients only, not suitable for retail investors. The views expressed are the author's own and do not constitute investment advice. This document is a financial promotion. It does not provide, and should not be relied on for, accounting, legal or tax advice, or investment recommendations. 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 on www.rlam.com.

Past performance is not a reliable indicator of future results. 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.

Portfolio characteristics and holdings are subject to change without notice. This does not constitute an investment recommendation. For information purposes only, methodology available on request. Unless otherwise noted, the information in this document has been derived from sources believed to be accurate. Information derived from sources other than Royal London Asset Management is believed to be reliable; however, we do not independently verify or guarantee its accuracy or validity.

All rights in the FTSE All Stocks Gilt Index, FTSE Over 15 Year Gilts Index, FTSE A Index Linked Over 5 Years Gilt Index and FTSE A Maturities Gilt Index (the "Index") vest in FTSE International Limited ("FTSE"). All rights in the FTSE 350, FTSE All Share, FTSE 100, FTSE 250, FTSE 350 Higher Yield and FTSE Small Cap (the "Index") vest in FTSE International Limited ("FTSE"). "FTSE®" is a trade mark of the London Stock Exchange Group companies and is used by FTSE under licence. The Royal London Funds (the "funds") have been developed solely by Royal London Asset Management. The Index is calculated by FTSE or its agent. FTSE and its licensors are not connected to and do not sponsor, advise, recommend, endorse or promote the fund and do not accept any liability whatsoever to any person arising out of (a) the use of, reliance on or any error in the Index or (b) investment in or operation of the fund. FTSE makes no claim, prediction, warranty or representation either as to the results to be obtained from the Funds or the suitability of the Index for the purpose to which it is being put by Royal London Asset Management.

All confidential information relating to any Royal London Group company must be treated by you in the strictest confidence. It may only be used for the purposes of assessing the proposal to engage Royal London Asset Management Limited (RLAM). Confidential information should not be disclosed to any third party and should only be disclosed to those of your employees and professional advisers who are required to see such information for the purpose set out above. You should ensure that these persons are made aware of the confidential nature of such information and treat it accordingly. You agree to return and/ or destroy all confidential information on receipt of our written request to do so.

Telephone calls may be recorded. For further information please see the Legals notice at www.rlam.com.

The Funds are sub-funds 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.

Issued by Royal London Asset Management Limited, Firm Registration Number: 141665, registered in England and Wales number 2244297; Royal London Unit Trust Managers Limited, Firm Registration Number: 144037, registered in England and Wales number 2372439; RLUM Limited, Firm Registration Number: 144032, registered in England and Wales number 2369965. All of these companies are authorised and regulated by the Financial Conduct Authority. Royal London Asset Management Bond Funds Plc, an umbrella company with segregated liability between sub-funds, authorised and regulated by the Central Bank of Ireland, registered in Ireland number 364259. Registered office: 70 Sir John Rogerson's Quay, Dublin 2, Ireland.

All of these companies are subsidiaries of The Royal London Mutual Insurance Society Limited, registered in England and Wales number 99064. Registered Office: 55 Gracechurch Street, London, EC3V 0RL. The Royal London Mutual Insurance Society Limited is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. The Royal London Mutual Insurance Society Limited is on the Financial Services Register, registration number 117672. Registered in England and Wales number 99064. FQR RLAM EM 1317.