# Royal London Global Equity Select Fund

## Quarterly Report 31 March 2022

## Top 10 holdings

| | Fund (%) |
|---|---|
| Microsoft | 7.8 |
| Steel Dynamics | 5.7 |
| Amazon | 5.6 |
| Suncor Energy | 5.0 |
| Anglo American | 4.8 |
| Reliance Steel & Aluminum Co. | 4.7 |
| United Health Group | 4.2 |
| Progressive Corporation | 4.2 |
| Alphabet Inc | 4.1 |
| Constellation Software | 3.4 |
| **Total** | **49.5** |

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

## Fund data

| | Fund |
|---|---|
| No. of stocks | 37 |
| Fund size | £477.4m |
| Launch date | 10.10.2017 |
| Active share | 85.1% |
| Tracking error | 5.42% |

## Performance

| | Fund* (%) | Benchmark[1] (%) | Relative (%) |
|---|---|---|---|
| **Q1 2022** | **4.75** | **-2.43** | **7.18** |
| Year-to-date | 4.75 | -2.43 | 7.18 |
| 1 year p.a. | 26.25 | 15.39 | 10.85 |
| 3 year p.a. | 21.28 | 14.58 | 6.70 |
| Since inception p.a. 10.10.2017 | 17.30 | 11.63 | 5.67 |

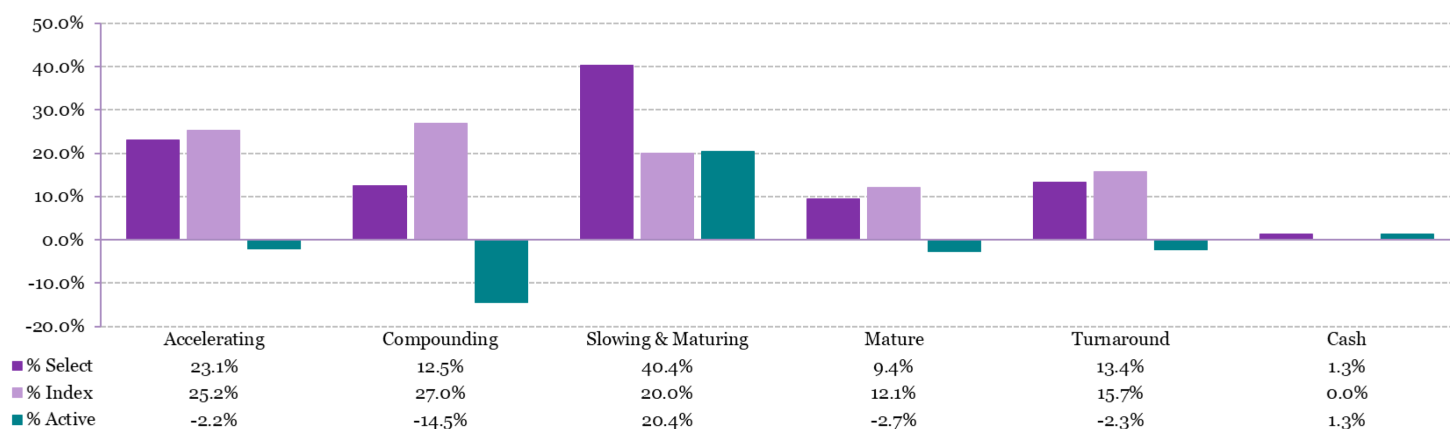
***Past performance is not necessarily a reliable indicator of future performance. The value of investments and the income from them is not guaranteed and may go down as well as up and investors may not get back the amount originally invested.***

*Source: RLAM. All performance figures stated gross of fees and tax unless otherwise stated, subject to rounding.*

*[1]Benchmark: MSCI World NDR Index.*

**Performance refers to R Acc share class unless otherwise stated. M Acc share class launched on 05.03.2018. Initial share class at fund launch was R Acc.*

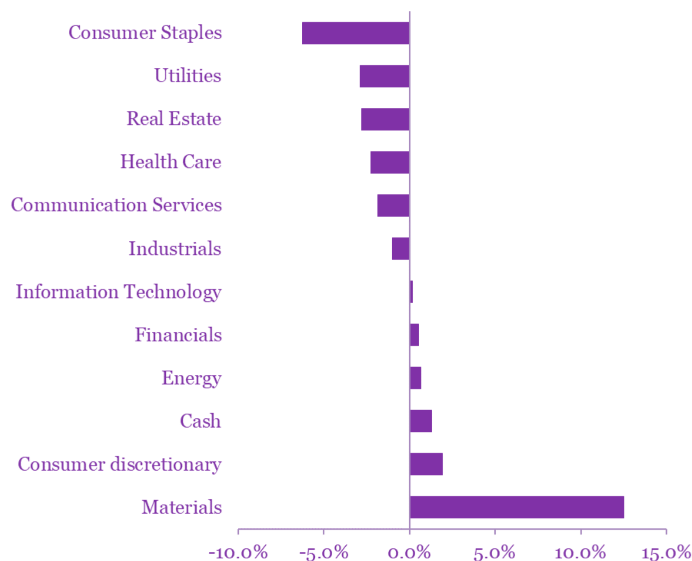
## Holdings and Weights



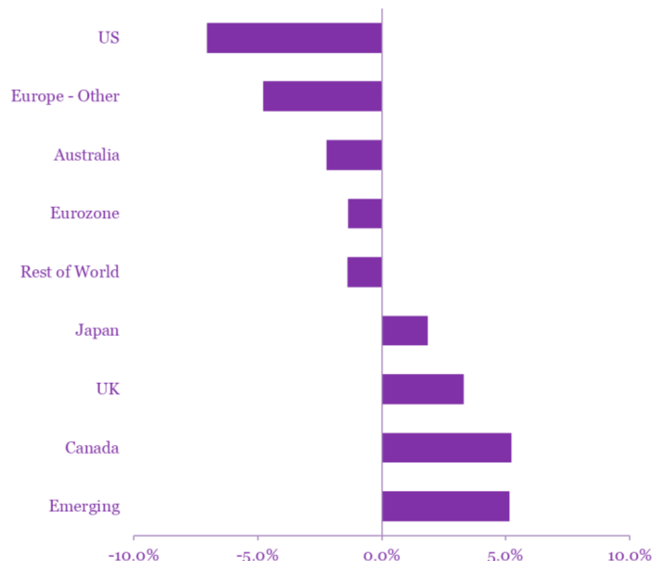

| | Accelerating | Compounding | Slowing & Maturing | Mature | Turnaround | Cash |
|---|---|---|---|---|---|---|
| % Select | 23.1% | 12.5% | 40.4% | 9.4% | 13.4% | 1.3% |
| % Index | 25.2% | 27.0% | 20.0% | 12.1% | 15.7% | 0.0% |
| % Active | -2.2% | -14.5% | 20.4% | -2.7% | -2.3% | 1.3% |

*Source: RLAM as at 31 March 2022.*

## Sector weights




## Regional weights




*Source: RLAM as of 31 March 2022. Shows weight relative to index.*

## Executive summary

- Over the first quarter our pooled funds delivered net outperformance compared to the -2.43% return for the benchmark (MSCI World Net Total Return in sterling). For the 12-month period, the funds have also outperformed.
- We entered 2022 with investor concerns focused on inflationary pressures and the likely upward trajectory of interest rates. These concerns are valid, as most companies are reporting upward pressure on costs in almost all areas, for example, wages, commodities, energy and transport. These pressures are being evidenced at an aggregate level through elevated data in official inflation reports while monetary authorities have started raising interest rates. This caused a rotation in the markets, with recent trends reversing. Larger companies, particularly financial stocks and commodities, performed strongly, while mid-sized and more highly valued companies fell.
- These concerns about inflation were overtaken by darker worries in February, when Russia invaded neighbouring Ukraine. The Ukrainian army has put up extremely resolute resistance and the conflict has seen fierce fighting at an appalling human cost. As well as military casualties on both sides, many civilians have been killed and millions of Ukrainian citizens have been displaced from their homes as they seek safety further west. Sadly, at time of writing the conflict shows little sign of resolution.
- Russia has been ostracized by most countries and severe economic sanctions have been imposed, and many companies have exited their Russian operations. However, sanctions have yet to extend to Russian energy exports. This situation is complicated in this area by the fact that many countries in Europe are reliant on Russian supplies of commodities – particularly gas. If the supply of gas were cut off countries like Germany would find themselves extremely short of energy. This risk and the high levels of general uncertainty have led to soaring gas and oil prices.
- While the Ukraine situation is predominantly a humanitarian crisis, its impact on financial markets is also profound. The key impact is upward pressure on commodity prices, stoking the existing inflationary pressures and leading to the much-discussed cost of living squeeze. In the UK this is particularly marked by the sharp rise in domestic energy costs.
- 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, diversified 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 identify those that are actively responding to the crisis. Owning companies that merely survive the pandemic won't deliver significant outperformance. We are looking for the 'Accelerators' that are increasing investment to take full advantage of the current environment, and 'Slowing & Maturing' or 'Turnaround' companies that pursue the correct strategy for their position in the Corporate Life Cycle, combined with an attractive valuation pay-off opportunity.

## Market overview

- For the first quarter global indices saw negative returns for sterling investors. The combined impact of Ukraine and concerns over the impact of potentially higher interest rates meant that most sectors produced negative returns, with consumer discretionary, communications and information technology sectors worst hit, while energy and materials sectors saw strong gains. Brent crude oil soared 38.7% during the first quarter as Russia-Ukraine tensions prompted supply concerns, while spot gold and front-month copper futures gained 6.3% and 6.7%, respectively.
- Currencies moves were sharp in the first quarter impacted by geopolitical tensions and the rise in commodity prices. The US dollar demonstrated its traditional role as a safe haven with the US dollar rising against other major world currencies. Though it was eclipsed by the currencies of countries with significant commodity exports. The Brazilian real appreciated 15% against the US dollar and the South African rand 8.2%.
- In financial markets, inflation had been the main focus at the turn of the year. After the relatively benign impact of the Omicron variant of Covid-19, central banks globally underwent a hawkish shift in policy to focus on tackling persistently higher than expected inflation rates. War in Ukraine has exacerbated inflationary pressures, especially in Europe, where there is a greater reliance on Russian energy. This has generated some opposing dynamics with respect to monetary policy – given that rising commodity prices are driving up the cost of energy, food, and materials, there is some concern around what potential impact the withdrawal of monetary support might have on general financial conditions and growth. Bank of England (BoE) Governor Bailey cited such concerns during the March Monetary Policy Committee (MPC) meeting, although interest rates were increased, nonetheless. The UK base rate stood at 0.75% at the end of the reporting period, after consecutive 25bps hikes in February and March.
- While the BoE took a softer tone towards the end of the quarter, the US Federal Reserve (the Fed) doubled down on its hawkish stance on inflation in March, highlighting the potential for a diversion in monetary policy between central banks going forward. The Fed ended its quantitative easing (QE) programme at the end of March as planned and has prepared investors for a strong cycle of rate rises throughout 2022 – markets are predicting seven rate hikes in 2022, raising the Fed Funds Rate to 2% or higher by the end of the year.
- Over the first quarter, the benchmark 10-year gilt yield rose from 0.97% to 1.61%, leading gilts to return -7.17% on an all-maturities basis (FTSE Actuaries). Yields began moving upwards towards the end of December last year, as the BoE ended its QE programme and increased interest rates for the first time since 2017, while also preparing markets for further rises to come. The Russian invasion of Ukraine drove a significant if temporary dip in yields in the period: 10-year gilt yields reached around 1.55% in late February but fell to around 1.20% following the onset of war. The flight to safety was temporary, however, as yields again trended higher from the first week of March. The same pattern is visible in the US and Germany, where yields rose throughout the period but temporarily dipped around the onset of war in Ukraine: in the US, the benchmark 10-year US treasury yield rose from 1.51% to 2.34% in the quarter, while the German 10-year bund yield rose from 0.14% to 0.55%.

## Performance and activity

- The Fund outperformed its benchmark over the quarter. The fund benefited from positive stock selection, with **Steel Dynamics**, **Anglo American** and **Suncor Energy** strong contributors to returns in the first quarter. Steel Dynamics, the US steel producer that is in the 'Slowing & Maturing' category of the corporate Life Cycle, has performed strongly as steel prices remained elevated. End-market demand is strong, yet domestic US steel production remains constrained, and the company is benefitting from the upswing in pricing. While Steel Dynamics is currently valued like a 'typical' steel company, we believe it has a far more interesting and resilient business model and has been gaining market share. Its latest results included record earnings for the quarter and calendar year. Anglo-American ('Mature') has gained from buoyant commodity prices. The standout divisional performance in the company's latest results was its copper division. The company's Quellaveco copper mine is scheduled to come online in the middle of the year and will further increase capacity at a time of strong demand. Calgary-based oil producer Suncor Energy announced during the period that its fourth quarter revenues surged on the back of soaring crude prices and refined product prices.

- **Meta Platforms**, **Ocado Group** and **Admiral Group** detracted from returns over the period. Meta Platforms is in the Slowing & Maturing category of the corporate Life Cycle. The company's latest set of results and forward-looking guidance suggested that Meta's family of apps might be Slowing and Maturing more rapidly than expected as a result of rising competition from alternative platforms, especially Tik Tok, and a more persistent impact on ROI from Apple's privacy changes and other investments to combat fade. In terms of our original thesis, these were a negative set of results. However, we have maintained the position for the following reasons: 1) The market seems to have interpreted 2022 headwinds as being entirely structural. There is a chance the impact from Apple's privacy changes and reels investments are more cyclical than what is currently implied 2) We remain cautiously optimistic about the long-term potential for the Metaverse; 3) We think there is strong valuation support for our thesis. Even with a higher probability applied to our bear scenario (on the back of these results) we believe that the valuation pay-off is skewed in excess of 2 to 1. Ocado group struggled during the quarter as consumers continued to revert back to pre-pandemic shopping trends. Furthermore, the business is spending heavily as it develops the next generation of robots. It recently rolled out the 500 series that enables more seamless maintenance. Meanwhile, we believe Admiral Group is a long-term compounder but the stock is temporarily depressed by investor over-reaction to the post-Covid normalisation in its profitability.

## Outlook

- The financial uncertainty and commodity market disruption is a by-product of the appalling situation in Ukraine and is rippling across the global economy, manifesting itself in sharp price rises across a wide range of products. Consumers are facing a significant cost of living squeeze, particularly as high gas prices feed through into domestic utility bills. Inflation is currently very high in the UK economy, with the most recent Consumer Price Inflation data at its highest level for 40 years. Higher inflation is not necessarily bad news for equities, but it will be a test of companies' cost control and pricing power as they seek to mitigate or pass on higher costs.
- 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.

## Further insights from the Global Equity team

- Our fund managers and other in-house specialists regularly address the issues that they consider in managing their funds via blogs, articles, webinars and video. Please visit the RLAM Digital Insight Hub, or the *Our Views* section of www.rlam.co.uk for further information.

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