# Royal London UK Opportunities Fund

## Quarterly Report 31 March 2022

## Asset split

| | Fund (%) |
|---|---|
| Ashstead Group | 5.8 |
| Royal Dutch Shell | 5.5 |
| Glencore Plc | 4.9 |
| Intermediate Capital Group | 4.6 |
| Rio Tinto | 4.4 |
| Watches of Switzerland Group | 4.3 |
| OSB Group Plc | 3.7 |
| Computacenter Plc | 3.6 |
| AstraZeneca | 3.6 |
| Melrose Industries | 3.5 |
| **Total** | **43.7** |

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

## Fund data

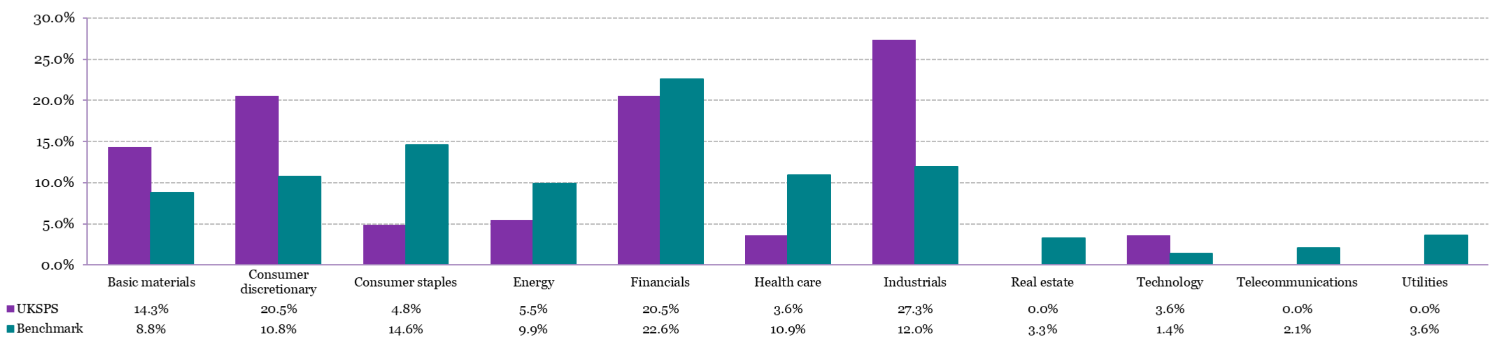
| | Fund |
|---|---|
| No. of stocks | 35 |
| Fund size | £873.4m |
| Launch date | 31.07.2007 |

## Performance

| | Fund (%) | Benchmark[1] (%) | Relative (%) |
|---|---|---|---|
| **Q1 2022** | **-8.37** | **0.49** | **-8.86** |
| Year-to-date | -8.37 | 0.49 | -8.86 |
| Rolling 12 months | 5.13 | 13.03 | -7.90 |
| 3 years p.a. | 7.30 | 5.31 | 1.99 |
| 5 years p.a. | 4.36 | 4.69 | -0.33 |
| 10 years p.a. | 6.95 | 7.15 | -0.21 |
| Since inception p.a. 31.12.2010 | 6.24 | 6.56 | -0.32 |

***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.***
*All performance figures stated gross of fees and tax unless otherwise stated.*
*Source: RLAM, as at 31 March 2022, based on the M Accumulation share class.*
*[1]Benchmark: FTSE® All Share Index.*
*As of 6 April 2017, the UK Government announced that funds paying interest distributions will be required to pay those distributions gross of tax.*

## Sector breakdown




*Source: RLAM. Figures in relation to your portfolio exclude the impact of cash held.*

## Market review

- 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 by elevated data in official inflation reports and monetary authorities have started raising 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 rated companies fell.
- The concerns surrounding inflation were overtaken in February when Russia sent troops into neighbouring Ukraine. Russia claims this is a special military operation, but it is generally seen as an invasion. The Ukrainian army has put up extremely resolute resistance and the conflict has seen fierce fighting and 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 such as 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.
- The Royal London U.K. Opportunities Fund underperformed its benchmark during the three months under review. Between January and March, the Fund returned -8.54% versus 1.16% for the FTSE All-Share (Total Return), placing it in the third quartile.
- It has been a most challenging start to the year for the Fund and reasons for that will be discussed later in the review. Times of underperformance, as we have recently witnessed, are uncomfortable for all concerned but we believe we are in good quality stocks although accept many of them are out of favour at present.

## Performance review

- The UK Opportunities Fund runs an 'all cap' structure which allows us to find the most exciting investments across the market cap spectrum.

### Positive contributors

- Over the course of the last quarter, the strongest performer was **Glencore** (+33%). As indicated earlier, commodity stocks have performed very strongly as geopolitical events have taken centre stage and there is no company better placed than Glencore. The business mines many different commodities and together with its marketing division, this places it in the box seat.
- **Rio Tinto** (+32%) also performed very robustly after reporting solid results together with a large special dividend. We believe mining companies are not looking to expand supply given the permitting constraints and ESG concerns and therefore we fully expect returns to remain at heightened levels.
- **AstraZeneca** (+19%) proved to be popular as investors looked for safe havens during these turbulent times. The company has proved adept at discovering new drugs over recent years and with a promising pipeline, particularly in the area of oncology, investors continue to favour the business.
- Another company which has benefited from increasing prices has been **Shell** (+17%). The company is throwing off heightened levels of free cashflow with the oil price north of $90 a barrel and with political tensions expected to remain, investors are viewing this sector as a safe haven. How times have changed.....
- **Chemring** (+11%) has seen its shares rally strongly as a direct result of the conflict in Ukraine. Defence companies will perhaps not be viewed as the pariahs they once were by the ESG community as it is clear the world relies on business like these to keep populations safe.
- Other stocks which are worthy of mention include **One Savings Bank** (+6%) following strong results and **Imperial Brands** (+2%), as the turnaround under the new CEO continues.

## Negative contributors

- The negative performers were unfortunately in the ascendancy over the three months under review as a tsunami of concerns swept the market. The poorest portfolio performer was **JD Sports** (-32%). We are at a loss to rationalise why the company should have lost a third of its market cap, particularly when it reported that results would be ahead of previous expectations. We fully acknowledge there is a cost-of-living crisis but nevertheless we think the fall is materially overdone.
- **Bellway** (-27%) suffered, alongside all other housebuilders, as Michael Gove, Minister for Housing, embarked on a confrontation course with the industry. Gove has demanded the industry pay retrospectively for the cost of replacing cladding, alongside other improvements such as a fire safety pledge he wishes implemented, which will cost the listed companies over £2bn. In addition, there is a 4% levy being applied as a residential property developer tax. Although this is most unhelpful, the industry is in a robust shape.
- **Ti Fluid System** (-25%) was caught in the eye of the storm as investors attention turned towards the automotive industry following the outbreak of war. With supply chains already under pressure, the invasion of Ukraine provided further problems and HIS downgraded the number of light vehicles they expect produced this year. This is clearly disappointing for the company, but we believe they are well placed to respond strongly when conditions improve. The news also dragged down **Melrose** to the tune of 22%.
- Other shares which ended the period in negative territory included **Integrafin** (-25%) on no new news and **Synthomer** (-24%) as confirmation was received that the nitrile price has normalised quicker than expected.

## Portfolio activity

- The Fund has 35 investments which are spread across a variety of market capitalisations. As at 31st March, the breakdown of the portfolio was as follows: 55% in the FTSE 100, 35% in the FTSE 250 and 8% in Small Cap/AIM. The Fund has 2% in cash and the active share is currently 77%.
- The split of the investments was as follows:

| | Weighting (%) |
|---|---|
| FTSE 100 | 55 |
| FTSE 250 | 35 |
| Small Cap/AIM | 8 |
| Cash | 2 |

## New holdings

- The fund added one new investment during the quarter, **Future**.
- We added the media company Future at the turn of the year, believing it was trading on an attractive rating relative to our growth expectations. The shares traded on a PE of c. 20x 2022E and management has been busy on the acquisition front over the last number of years. We believe they have built an attractive platform which will deliver organic growth, integration synergies and increasing margins. Since our initial foray into the stock, the shares have materially weakened, and we have been adding to our position consistently.

## Stocks sold

- The fund exited its positions in both **Victrex** and **Hargreaves Lansdown**.
- Victrex has been a long-standing holding in the fund, and this was not a decision taken lightly. We felt however that the rating was still extended, and any downgrade would be taken very badly by the market. In many ways, the decision to sell was like our sale of Fevertree the previous quarter. We like both business models, management teams etc but given the current risks feel the risk is to the downside.
- Hargreaves Lansdown proved to be an entirely disappointing investment. We liked the strong market position the business has but with more competition entering, their business model was coming under intense pressure. The CEO laid out a strategy update which included material sums of new money having to be spent on IT and margins were being squeezed, at least in the short to medium term. We decided therefore to cut our losses and move on.

### Additions

- The fund topped up many of our existing positions, including Glencore and Shell where we were looking to add further exposure to the sectors as we see meaningful upside but also stocks where we felt the market had treated them unfairly, as in the case of JD Sports and Weir Group.

### Sales

- The fund used its sale of **Hargreaves Lansdown** to fund the additions mentioned above.

## Outlook

- The financial uncertainty and commodity market disruption that is a by-product of the appalling situation in Ukraine 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.
- We have yet to see whether inflationary pressures are transitory or not but given the hikes we are seeing in energy costs and transportation together with wage inflation increasing sharply, it could be argued that it is here to stay. If inflation becomes more structural this normally favours sectors such as commodities and oils and we are ready to adapt to manage risks. The Bank of England has already increased rates from 0.25% to 0.75% so far in 2022 and we believe this sets the scene for further rises during this year.
- Our view remains that the FTSE All-Share still offers value, certainly relative to other markets, given its current rating which is demonstrably cheaper than the US or indeed many parts of Europe. We have mentioned on countless occasions M&A activity looms large in the background. With PE firms sitting on huge war chests, 2022 could prove to be another bonanza for M&A although we are not keen on losing quality names from the UK market. Many well-known companies were bought in 2021 and this year has started with bids for Pearson, Brewin Dolphin and MacKay Securities to name but three.
- To conclude we are confident the portfolio is well placed and are optimistic that economic activity will get back to something akin to normal over the medium term once supply chain issues and other areas of indigestion are behind us.

# IMPORTANT INFORMATION