Royal London US Growth Trust

Quarterly Report 31 March 2022

Top 10 holdings

	Trust (%)
Apple Inc	8.9
Microsoft	7.3
Amazon	5.4
Alphabet	5.3
Nvidia Corporation	3.4
United Health Group	2.1
Meta Platforms	1.9
JP Morgan Chase and Company	1.8
Visa	1.7
Berkshire Hathaway	1.7
Total	**39.5**

Source: RLAM, based on the A Inc share class.

Trust data

	Trust
No. of stocks	102
Fund size	£291.9m
Launch date	19.02.2001
Active share	56.6%
Tracking error	2.3%

Performance

	Trust (%)	Benchmark[1] (%)	Relative (%)
Q1 2022	**-1.93**	**-2.59**	**0.66**
Year-to-date	-1.93	-2.59	0.66
1 year p.a.	24.20	19.08	5.12
3 year p.a.	19.99	18.08	1.92
5 year p.a.	13.81	14.52	-0.71
10 year p.a.	16.43	16.71	-0.28
Since inception p.a. 19.02.2001	8.46	9.05	-0.59

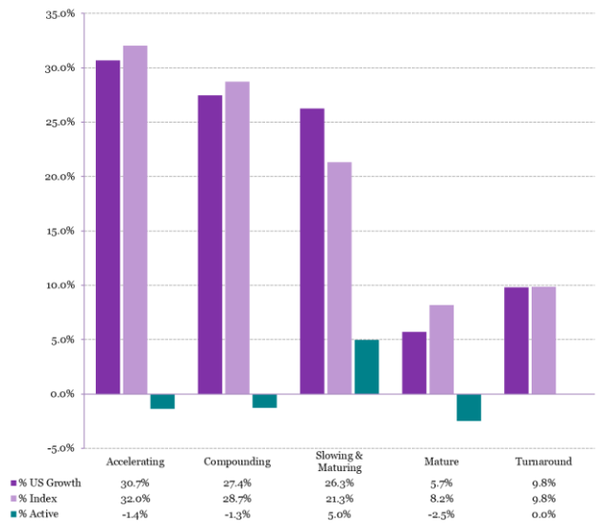
Past performance is not necessarily a reliable indicator of future performance. The value of investments and the income from them is not guaranteed and may go down as well as up and investors may not get back the amount originally invested.

Source: RLAM, based on the A Inc share class.

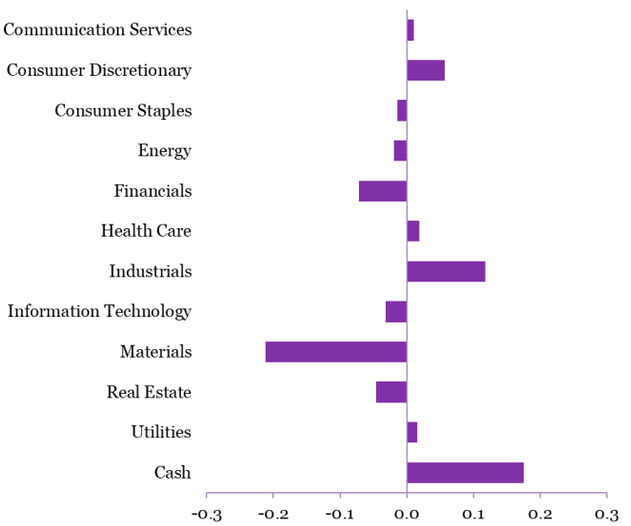
All performance figures stated gross of fees and tax unless otherwise stated, subject to rounding.

[1]Benchmark: MSCI US £ Net Total Return Index

Holdings and weights



Sector weights



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

Executive summary

- The fund recorded a net return (A Class, Income) of -2.23% for the first quarter, compared with -2.59% for the MSCI US Net Total Return Index (in sterling).
- 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 Cvcle, combined with an attractive valuation pay-off opportunity.

Market commentary

- 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.
- While some such as the Bank of England 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.

Fund performance and activity

- The world continues to be impacted by the Covid-19 pandemic, although to a continuing lesser, but macroeconomic concerns have shifted sharply to other areas. Supply chain and inflation concerns remain significant and perception of inflation being more than transitory has seen government and central bank policy become less accommodating. Markets pricing in multiple rate hikes through 2022 and US 10-year bond yields have hit 2.5% from 1.5% at the end of 2021. The geopolitical situation in Ukraine has also contributed to increased volatility and reduced risk appetite, seeing the US market lose 5% (2% in sterling terms) in the first quarter having gained more than 10% in Q4 2021.
- Changes in sentiment and rates expectations have a knock-on effect on discount rates and have brought about some contraction in the longstanding outperformance of Growth over Value, with Value outperforming Growth by upwards of 7% in the US in Q1. it should be noted that over the previous five years Growth had outperformed Value by 25% p.a. in the US. From a sector perspective energy/utilities and consumer staples have led the way YTD at the expense of technology and consumer discretionary. Large caps like Chevron, Exxon Mobil and ConocoPhilips had the largest contribution to benchmark returns at the expense of Meta Platforms, Microsoft and Netflix.
- Rising discount rates and the changing economic landscape have been a headwind to the US Growth Trust strategy, with the fund having a longer term focus on Shareholder Wealth Creation. Materials (+23bps), health care (+11bps) and energy (3bps) contributed positive returns at the sector level with Baker Hughes, Exxon Mobil, Steel Dynamics and Abbvie outperforming.
- These gains were offset at the sector level in Consumer Discretionary (-38bps), Real Estate (-19bps) and Financials (-18bps). At the stock level Meta Platforms, Five Below, Paypal and Home Depot were the largest contributors to underperformance. Not holding Chevron – which was up 40% in Q1 – was also a headwind for the fund.

Key views within the fund

- The trust aims to deliver above average medium- to long-term capital growth by investing in a diversified portfolio of US equities and will typically hold up to 100 stocks. The equities in which the fund invests may be from any sector, industry or market capitalisation. The fund aims to maximise the stock specific views from the US equities held in the Royal London Global Equity Diversified Fund, while minimising exposure to macroeconomic and sector influences using an optimisation strategy.
- We are fundamental, bottom-up investors and therefore don't invest according to top-down macroeconomics. The broad economic environment will have an effect, but we believe that good companies perform well across the economic cycle. What matters more is how the company is using its capital.
- Our Corporate Life Cycle model categorises companies according to their stage of development. We believe that corporate returns on productive capital and growth tend to progress along a cycle with five defined stages: Accelerating, Compounding, Slowing & Maturing, Mature and Turnaround. We seek portfolio diversification across the Corporate Life Cycle.
- Quantitative analysis helps us to identify potential opportunities by scoring stocks across a range detailed financial factors. We then apply our scoring system to rank characteristics to identify which companies to research further for possible inclusion in the portfolio.
- Stock selection really matters: looking at MSCI World Stock Returns between 2014 and 2019, the worst performing 80.2% of stocks performed behind the benchmark, with a third losing value, whereas the best performing 19.8% of stocks represented 99% of the excess return.

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.
- The benefits of our disciplined investment approach – a focus on superior wealth creating business models combined with robust portfolio risk controls – enable superior stock wealth creation and valuation to drive long-term performance. As vaccination programmes roll out and economic conditions normalise, we see opportunities for the underlying stability of many of the businesses to be better reflected in valuations. The crisis will result in strong companies (high returns, strong balance sheets and good 'moats') getting stronger as they are better able to take advantage of opportunities, whether through new areas of demand or having better balance sheets to navigate through lower levels of cash generation in most industries.

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- 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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