Royal London Sustainable Funds

Fund Manager Commentary – May 2022

FOR PROFESSIONAL INVESTORS ONLY, NOT SUITABLE FOR RETAIL INVESTORS.

ROYAL LONDON
ASSET MANAGEMENT

Contents

RLAM Sustainable Performance

	1 month (%)	Rolling 12 Months (%)
RL Sustainable Managed Income Trust C Acc	**-0.87**	**-7.57**
IA Sterling Corporate Bond	-0.92	-8.70
iBoxx Sterling Non-Gilts All Maturities	-1.37	-9.87
RL Sustainable Managed Growth Trust C Acc	**-1.85**	**-6.37**
IA Mixed Investment 0-35%	-0.66	-4.39
RL Sustainable Diversified Trust C Inc	**-2.78**	**-3.70**
IA Mixed Investment 20-60% Shares sector	-0.55	-1.78
RL Sustainable World Trust C Acc	**-3.42**	**-1.98**
IA Mixed Investment 40-85% Shares sector	-0.71	-0.80
RL Sustainable Leaders Trust C Acc	**-3.61**	**2.16**
IA UK All Companies	0.32	0.27
FTSE All-Share Index	0.69	8.27
RL Global Sustainable Equity Fund M Acc	**-3.84**	**0.76**
IA Global	-1.34	1.29
MSCI World All Countries Net Index GBP	-0.26	5.14
RL Global Sustainable Credit Fund M Acc GBP Hedged	**-0.40**	**-10.40**
IA Global Corporate Bond	0.30	-17.76
Bloomberg Global Aggregate Corporate Total Return Index	0.20	-9.76

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, CORRECT AS OF 31 MAY 2022. RETURNS QUOTED ARE NET OF FEES.
ALL IA SECTOR PERFORMANCE SHOWN IS FOR THE MEDIAN.

Royal London Sustainable Managed Income Trust

Portfolio Commentary

- Net of fees, the fund delivered a return of -0.87% in May (C class, Accumulation), outperforming the -1.37% return of the iBoxx Sterling Non-Gilts All Maturities Index and the -0.97% average return for its peer group (IA Sterling Corporate Bond). The fund has significantly outperformed both the benchmark and peer group on a rolling 12-month basis.
- The prevailing themes in financial markets were unchanged in May, as the inflationary impact of war in Ukraine continued to drive both headlines and the policy agenda. Central banks remained very hawkish and bond yields continued to rise, leading to negative returns for bond markets. Longer-dated fixed income securities were the weakest performers globally given their greater sensitivity to changes in rate expectations, which turned even more aggressive in May.
- The benchmark 10-year gilt yield rose by 20 basis points to 2.10%, with gilts returning -2.97% to investors on an all-maturities basis. In comparison, sterling investment grade credit returned -1.37%. The total return for gilts was below that of sterling credit due the longer duration of the gilt market – on a spread basis, however, which compares the performance of bonds of equal maturity, sterling credit marginally underperformed gilts. In May, the average investment grade credit spread (the average extra yield available from a corporate bond compared with government debt of equal maturity) widened by 2 basis points to 1.47%.
- Total returns remained negative for all sterling credit sectors in May. Defensive sectors such as supranational and covered bonds were the strongest relative performers, while financials (banks and insurance) also performed well on a relative basis, following a period of weakness. Longer duration sectors, such as utilities and real estate, were weak. The AAA rated band was the strongest in the period on a total returns basis, while A rated bonds lagged investment grade returns. However, when looking at excess returns – which removes the impact of duration on performance – returns across ratings bands was less dispersed, with the BBB sector lagging overall.
- Sterling investment grade issuance fell significantly in May to just £1.4bn, far below the £6.1bn of issuance in May 2021, reflecting the elevated levels of volatility in markets. Net issuance for the period was -£0.8bn (i.e. £2.2bn of debt matured). The fund participated in just one new issue in May – a 2031 secured bond issue from **Telsec** (Telereal Securitisation), which are secured against BT telephone exchanges.
- In the secondary market we purchased some subordinated bonds of **Lloyds Bank**, for which the yield was particularly attractive versus very long-dated gilts, and **Coventry Building Society** in a switch from **BNP Paribas** senior debt. We also bought bonds of **HSBC**, **Virgin Money** and **NatWest Group**. Later in the month, we sold a number of bonds to manage exposure to financials. Otherwise, we switched between issues of **Pensions Insurance Corporation** to enhance terms. We also sold covered bonds of **TSB** and **Sparebank**. Elsewhere, to manage liquidity, we sold fully-valued unsecured bonds of **Sage** and **Motability**; and sold structured bonds, including **Land Securities**, **Yorkshire Water** and **Dali Capital**.

CITYWIRE AA

Shalin Shah
Senior Fund Manager

Matt Franklin
Fund Manager

ROYAL LONDON
ASSET MANAGEMENT

Royal London Sustainable Managed Growth Trust

Portfolio Commentary

- Net of fees, the fund delivered a return of -1.85% in May (C class, Accumulation), underperforming its composite benchmark (-0.93%) and the -0.74% average return for its peer group (IA Mixed Investment 0-35% Shares). It has underperformed the benchmark and peer group on a rolling 12-month basis, but has still strongly outperformed over three and five years.
- The prevailing themes in financial markets were unchanged in May, as the inflationary impact of war in Ukraine continued to drive both headlines and the policy agenda. Central banks remained very hawkish and bond yields continued to rise, leading to negative returns for bond markets. Longer-dated fixed income securities were the weakest performers globally given their greater sensitivity to changes in rate expectations, which turned even more aggressive in May.
- While the sterling credit portfolio delivered negative absolute returns, it nonetheless outperformed the iBoxx Sterling Non-Gilts All Maturities Index. The trust's underperformance in May was again due to the equity portfolio, which is orientated towards growth sectors. The period demonstrated a degree of volatility that has been a constant so far in 2022. Interest rates were increased in both the UK and US during May and markets initially sold off: yet improved sentiment regarding a softening of future expectations in global interest rates plus a degree of 'Covid reopening' in China led stocks to rally.
- Putting the year to date into context, however, the US S&P 500 has had its worst start to the year since 1970 and this has been a major influence on sentiment across all global equity markets. In the UK, the best-performing sector was yet again energy as the oil price moved higher; the worst-performing sector was real estate, reflecting fears of an economic slowdown. In general, however, companies in the portfolio have continued to deliver strong financial performance, despite the recent market volatility that has been particularly acute for longer-duration growth companies, which are more negatively impacted by rising interest rates.
- The benchmark 10-year gilt yield rose by 20 basis points to 2.10%, with gilts returning -2.97% to investors on an all-maturities basis. In comparison, sterling investment grade credit returned -1.37%. The total return for gilts was below that of sterling credit due the longer duration of the gilt market – on a spread basis, however, which compares the performance of bonds of equal maturity, sterling credit marginally underperformed gilts. In May, the average investment grade credit spread (the average extra yield available from a corporate bond compared with government debt of equal maturity) widened by 2 basis points to 1.47%.
- Total returns remained negative for all sterling credit sectors in May. Defensive sectors such as supranational and covered bonds were the strongest relative performers, while financials (banks and insurance) also performed well on a relative basis, following a period of weakness. Longer duration sectors, such as utilities and real estate, were weak. The AAA rated band was the strongest in the period on a total returns basis, while A rated bonds lagged investment grade returns. However, when looking at excess returns – which removes the impact of duration on performance – returns across ratings bands was less dispersed, with the BBB sector lagging overall.
- Sterling investment grade issuance fell significantly in May to just £1.4bn, far below the £6.1bn of issuance in May 2021, reflecting the elevated levels of volatility in markets. Net issuance for the period was -£0.8bn (i.e. £2.2bn of debt matured). The fund participated in just one new issue in May – a 2031 secured bond issue from **Telsec** (Telereal Securitisation), which are secured against BT telephone exchanges.
- In the secondary market we purchased some subordinated bonds of **Lloyds Bank**, for which the yield was particularly attractive versus very long-dated gilts, and **Coventry Building Society** in a switch from **BNP Paribas** senior debt. We also bought bonds of **HSBC**, **Virgin Money** and **NatWest Group**. Later in the month, we sold a number of bonds to manage exposure to financials. Otherwise, we switched between issues of **Pensions Insurance Corporation** to enhance terms. We sold a number of covered bonds to reduce exposure to this sector ahead of expected supply as central bank schemes roll off, preferring alternative asset-backed securities at wider spreads. We also sold very long-dated of **Wellcome Trust** and the **University of Oxford**. These 'century bonds' were relatively fully valued for AAA assets, allowing us to effectively reduce duration without losing much yield.

CITYWIRE AA

Shalin Shah
Senior Fund Manager

ADVISER INVESTMENT 100 CLUB
Winner
Mixed Asset Income: Royal London Sustainable Managed Growth

Matt Franklin
Fund Manager

Royal London Sustainable Diversified Trust

Portfolio Commentary

- May demonstrated a degree of volatility that has been a constant so far in 2022, with the MSCI ACWI Index finishing the month 0.3% lower in sterling terms and the FTSE All-Share Index 0.7% higher. Interest rates were increased in both the UK and US during May and markets initially sold off: yet improved sentiment regarding a softening of future expectations in global interest rates plus a degree of Covid reopening in China led stocks to rally. Putting the year to date into context, however, the US S&P 500 has had its worst start to the year since 1970 and this has been a major influence on sentiment across all global equity markets. In the UK, the best-performing sector was yet again energy as the oil price moved higher; the worst-performing sector was real estate, reflecting fears of an economic slowdown.
- The sterling investment grade credit market continued to be weak, falling by another 1.4% in the month, and giving a -10% year-to-date return for 2022. This was primarily driven by a rise in underlying gilt yields, with the 10-year gilt yield rising 20 basis points over the month to 2.1%, as inflationary concerns continued to unsettle global bond markets.
- The Trust continued to underperform in May and ranked in the fourth quartile relative to its peer group given its relatively high equity exposure. In general, companies in the portfolio have continued to deliver strong financial performance despite the recent market volatility that has been particularly acute for longer-duration growth companies, which are more negatively impacted by rising interest rates. The strongest contributions to performance in the month came from UK catering supplier **Compass Group** and US medical technology business **Agilent Technologies** following its recent financial results. The most significant detractors to performance came from UK urban logistics provider **Segro**, reflecting investor concern in a slowdown for warehouse demand following results from ecommerce giant Amazon. Other significant weakness came from **Croda**, a specialty chemicals company focused on providing natural solutions to the life sciences and consumer sectors, which fell despite a strong trading update, along with pest control leader **Rentokil**. Both companies are listed in the UK.
- During the month, the trust added to several positions in companies with attractive long-term growth prospects, including US robotic surgery provider **Intuitive Surgical**, accounting software businesses **Sage** (UK) and **Intuit** (US), and UK credit bureau and data provider Experian. These sales were funded in part by reducing our exposure to UK testing firm **Intertek**.

ALPHA MANAGER 2022
Mike Fox
CITYWIRE AA

Mike Fox

Head of Sustainable Investments

George Crowdy

Fund Manager

Sebastien Beguelin

Assistant Fund Manager

Royal London Sustainable World Trust

Portfolio Commentary

- May demonstrated a degree of volatility that has been a constant so far in 2022, with the MSCI ACWI Index finishing the month 0.3% lower in sterling terms. Interest rates were increased in both the UK and US during May and markets initially sold off: yet improved sentiment regarding a softening of future expectations in global interest rates plus a degree of Covid reopening in China led stocks to rally. Putting the year to date into context, however, the US S&P 500 has had its worst start to the year since 1970 and this has been a major influence on sentiment across all global equity markets. In the UK, the best-performing sector was yet again energy as the oil price moved higher; the worst-performing sector was real estate, reflecting fears of an economic slowdown.
- The sterling investment grade credit market continued to be weak, falling by another 1.4% in the month, and giving a -10% year-to-date return for 2022. This was primarily driven by a rise in underlying gilt yields, with the 10-year gilt yield rising 20 basis points over the month to 2.1%, as inflationary concerns continued to unsettle global bond markets.
- The Trust continued to underperform in May and ranked in the fourth quartile relative to its peer group given its relatively high equity exposure. In general, companies in the portfolio have continued to deliver strong financial performance despite the recent market volatility that has been particularly acute for longer-duration growth companies, which are more negatively impacted by rising interest rates. The strongest contributions to performance in the month came from US medical technology business **Agilent Technologies** following its recent financial results. US engineering software company **Autodesk** also provided a reassuring trading update, beating investors' expectations, while management also commented positively on the underlying macroeconomic environment for the company. US design and graphics software business **Adobe** also performed well during the month. The most significant detractors to performance came from UK urban logistics provider **Segro**, reflecting investor concern in a slowdown for warehouse demand following results from Amazon, along with Latin American payments and eCommerce provider **MercadoLibre**, which fell despite a strong trading update.
- During the month, the Trust began a new position in Asia-focused life insurer **AIA Group**, the market leader in a region where personal and corporate insurance and savings products should demonstrate strong long-term growth. The Trust exited its position in Dutch electricals and electronics conglomerate **Philips**, where we have had increased concerns around the long-term outlook for the business.

Mike Fox

Head of Sustainable Investments

George Crowdy

Fund Manager

Sebastien Beguelin

Assistant Fund Manager

Royal London Sustainable Leaders Trust

Portfolio Commentary

- *(All companies are UK based, unless stated otherwise)*
- May demonstrated a degree of volatility that has been a constant so far in 2022, with the FTSE All-Share Index 0.7% higher over the month. Interest rates were increased in both the UK and US during May and markets initially sold off: yet improved sentiment regarding a softening of future expectations in global interest rates plus a degree of Covid reopening in China led stocks to rally. Putting the year to date into context, however, the US S&P 500 has had its worst start to the year since 1970 and this has been a major influence on sentiment across all global equity markets. In the UK, the best-performing sector was yet again energy as the oil price moved higher; the worst-performing sector was real estate, reflecting fears of an economic slowdown.
- The Trust underperformed the FTSE All-Share Index during the month and was ranked in the fourth quartile relative to its peer group. In general, companies in the portfolio have continued to deliver strong financial performance despite the recent market volatility that has been particularly acute for longer-duration growth companies, which are more negatively impacted by rising interest rates. The strongest contributions to performance in the month came from homebuilding firm **Vistry Group**, along with catering supplier **Compass Group** and US medical technology business **Agilent Technologies**, following its recent financial results. The most significant detractors to performance came from urban logistics provider **Segro**, reflecting investor concern about a slowdown in warehouse demand following results from ecommerce giant Amazon. Other significant weakness came from accounting software provider **Sage** and **Croda**, a specialty chemicals company focused on providing natural solutions to the life sciences and consumer sectors, both of which fell despite strong trading updates.
- There were no new buys or sells during the month. The Trust used continued market volatility to further build its position in low-carbon engineering firm **Spirax Sarco**, which offers a number of technologies to help businesses to decarbonise their use of industrial heat. The Trust also added to its positions in Asia-focused life insurer **Prudential** and credit bureau and data provider **Experian**.

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Royal London Global Sustainable Equity Fund

Portfolio Commentary

- May demonstrated a degree of volatility that has been a constant so far in 2022, with the MSCI ACWI Index finishing the month 0.3% lower in sterling terms. Interest rates were increased in both the UK and US during May and markets initially sold off: yet improved sentiment regarding a softening of future expectations in global interest rates plus a degree of Covid reopening in China led stocks to rally. Putting the year to date into context, however, the US S&P 500 has had its worst start to the year since 1970 and this has been a major influence on sentiment across all global equity markets. In the UK, the best-performing sector was yet again energy as the oil price moved higher; the worst-performing sector was real estate, reflecting fears of an economic slowdown.
- The fund underperformed the MSCI ACWI Index and was ranked in the fourth quartile relative to its peer group during May. Performance was negatively impacted by having zero exposure to the energy sector, which we avoid for sustainability reasons, and from underperformance in higher-quality and longer-duration growth companies, which were negatively impacted by rising interest rates. US design software company **Autodesk** was the fund's top contributor as it reported quarterly results that beat investors' expectations, combined with reassuring comments on the macroeconomic backdrop from the management team. Asian life insurance group **AIA** was another positive contributor and benefitted from an improving situation in China regarding Covid-19 cases and associated lockdowns. Latin American ecommerce and payments platform **MercadoLibre** was the fund's largest detractor from performance: despite reporting very strong results in the prior month, it was caught up in the investor rotation out of higher growth businesses. **Prologis**, a global real estate investment trust that focuses on warehousing and logistics came under pressure following Amazon's quarterly results, in which the ecommerce giant said it had more warehouse space than it currently needed, given the slowdown in growth compared to 2020 and 2021.
- During the month, we reduced our position in **Amazon** to reflect our more cautious view of the global consumer and reallocated the proceeds into continuing to build up our position in UK specialty chemicals provider **Croda**.

ALPHA MANAGER 2022
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Royal London Global Sustainable Credit Fund

Macroeconomics and market highlights

- The themes driving markets were unchanged in May, as the inflationary impact of war in Ukraine continued to drive both headlines and the policy agenda. Central banks remained very hawkish. Bond yields continued to rise, leading to negative returns for bond markets other than in the US, where they had been particularly weak in April.
- In the US, the Federal Reserve (Fed) raised interest rates 50 basis points (bps). Activity data were mixed: while the unemployment rate remained 3.6%, the May composite PMI business survey indicator deteriorated, consumer confidence remained well below pre-pandemic levels and housing activity data has disappointed consensus. Inflation remains high, with CPI higher than expected at 8.3%Y in April. High inflation and central bank hawkishness were also a theme in the euro area. CPI hit 8.1%Y, stronger than expected, with core inflation also surprising on the upside. European Central Bank (ECB) President Lagarde outlined expectations for winding down the Asset Purchase Program: she also commented on the ECB exiting negative interest rates by the end of the third quarter, implying multiple 25bps hikes in the period. As expected, the Bank of England (BoE) raised rates 25bps to 1.00%. April saw the highest inflation since the 1980s as CPI jumped to 9.0%Y. A £15bln fiscal package alleviated some of the worries about the outlook for consumer spending, while making further interest rate hikes more likely.
- After the sharp rise in April, the benchmark 10-year US treasury yield ended the month slightly lower at 2.84% (a decrease of 9bp) over the month). Meanwhile, the equivalent bund yield rose another 18bps to 1.12% - it's only a matter of months since this was still in negative territory. The 10-year gilt yield was also higher, rising to 2.10% - an increase of 20bps.

Portfolio commentary

- Net of fees, the fund (USD, Z, Acc) recorded a return of -0.39% in May, underperforming the 0.20% return of its benchmark (Bloomberg Global Aggregate - Corporate USD Hedged). This was due to the fund's allocation to high yield bonds as high yield underperformed investment grade credit over the month.
- Investment grade credit issuance in the eurozone recovered to €60.4bn in May, above what might have otherwise been expected given that spreads continued to widen and markets remained volatile. Issuers had to pay up for this level of access, however – resulting in elevated new issue concessions. Conversely, after last month's recovery, sterling investment grade issuance fell significantly in May to just £1.4bn. The fund participated in just one new issue in May – a 2031 issue from **Telsec** (Telereal Securitisation), which is secured against BT telephone exchanges.
- While new issuance has been subdued in the volatile market conditions, we are seeing increasing issuance of labelled bonds, such as 'green' and 'sustainable' bonds. While we will consider buying such bonds, they are not a panacea and we remain cautious about them as they sometimes lack clarity of objective and don't automatically offer value. We will continue to assess each individual credit on its particular merits, remaining focused on adding value in underserved or inefficient areas of the market.
- Secondary market activity mainly focused on maintaining liquidity and managing the shape of the fund. Within financials, we took profits in subordinated bonds of **Santander UK Group** and added to existing positions in **Achmea** and **New York Life** (both insurance). We reduced our exposure to utilities, selling bonds of **Enexis**, **SSE** and **ESB Finance**. We were busy in the telecoms sector, reducing exposure to short-dated hybrids of **Vodafone** that had outperformed the global IG index on a total returns basis, and selling **Verizon** debt against the new Telsec issue. We also bought bonds of **AT&T** and **Deutsche Telekom**. Otherwise, we added to a number of existing holdings in the consumer goods, consumer services and general industrials sectors. Lastly, we switched between different issues of **Ecolab** to enhance terms.
- In corporate actions, there was a partial tender of an **AT&T** bond at an attractive spread level, which we accepted.

Fund characteristics

- Our sustainable credit proposition provides access to sectors that address today's environmental and societal challenges in a geographically diverse investment universe. The fund only invests in issuers that meet both our demanding financial and sustainable criteria, which include offering a net benefit to society and observing good governance practices.
- Such issuers are most likely to be found in certain sustainable themes, including energy transition, the decarbonised economy, social and environmental infrastructure, the circular economy and environmental efficiency, social housing, and financial inclusion and resilience (such as insurance products to support individuals through shocks). On

sustainability grounds, the fund follows rigorous exclusion criteria, which prohibit investment in fossil fuel extraction, mining, tobacco production, nuclear power generation, armaments manufacture, animal and fur products, and pornography.

- The fund remains well diversified with over 200 holdings split around two-thirds in US dollar credit, one quarter in euro credit and the remainder in sterling credit. As well as reducing risk, we seek out opportunities that are under-researched e.g., bonds that do not fall into mainstream indices or benchmarks and/or are unrated by ratings agencies. Duration is broadly in line with benchmark and the fund has an attractive underlying yield that should support income generation.

Investment outlook

- There is considerable uncertainty about the outlook for the rest of 2022. The invasion of Ukraine and subsequent sanctions gave central banks a dilemma: tighten policy to address inflation or give some slack on further policy moves until the growth consequences become more evident? Having already raised interest rates in March and early May, the Fed has raised rates again – with inflation rising at its fastest rate since 1981, the 75bps increase in mid-June was the largest for nearly 30 years. Some investors fear that this could tip the US into a hard-landing recession.
- The picture is only marginally different in the UK, although the BoE increased rates sooner and seems aware that the UK is more vulnerable to recession. Nonetheless, it raised rates again in June to 1.25%. There has also been a significant shift in the eurozone, with tightening now expected in the third quarter. Although we expect a slowdown in medium term, we believe that market expectations may be too aggressive at present. However, we must highlight the uncertainty of any market forecasts at present, given the unpredictability of the situation in Ukraine.
- Some see the longer-term risk of recession as the key driver for credit markets over the rest of 2022. However, at a macroeconomic level, the US economy is better insulated from rising commodity prices as it is a net energy exporter. Meanwhile, credit spreads on euro and sterling investment grade credit indices have widened sharply this year and now offer even better compensation for the risk of default: it is still expected that credit will outperform government debt over the medium term.

CITYWIRE A

Rachid Semaoune
Senior Fund Manager

CITYWIRE A

Khuram Sharih
Senior Fund Manager

IMPORTANT INFORMATION