Royal London Sustainable Funds

Fund Manager Commentary – November 2022

Contents

ROYAL LONDON
ASSET MANAGEMENT

RLAM Sustainable Performance

	1 month (%)	Rolling 12 Months (%)
RL Sustainable Managed Income Trust C Acc	**3.53**	**-16.60**
IA Sterling Corporate Bond	3.96	-16.63
iBoxx Sterling Non-Gilts All Maturities	3.39	-17.29
RL Sustainable Managed Growth Trust C Acc	**4.08**	**-16.35**
IA Mixed Investment 0-35%	2.75	-9.43
RL Sustainable Diversified Trust C Inc	**3.60**	**-14.80**
IA Mixed Investment 20-60% Shares sector	3.33	-7.79
RL Sustainable World Trust C Acc	**3.47**	**-15.52**
IA Mixed Investment 40-85% Shares sector	3.78	-7.58
RL Sustainable Leaders Trust C Acc	**5.48**	**-6.94**
IA UK All Companies	7.53	-0.96
FTSE All-Share Index	7.14	6.54
RL Global Sustainable Equity Fund M Acc	**2.79**	**-14.78**
IA Global	3.26	-6.15
MSCI World All Countries Net Index GBP	4.18	-1.82
RL Global Sustainable Credit Fund M Acc GBP Hedged	**4.17**	**-16.10**
Bloomberg Global Aggregate Corporate Total Return Index	4.18	-14.72

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SOURCE: RLAM, CORRECT AS OF 30 NOVEMBER 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 outperformed the iBoxx Sterling Non-Gilts All Maturities Index in November, and has also outperformed the index over one, three and five-years.
- Government bond yields fell (and prices rose) in November as investors increasingly discounted a recession in 2023 following further increases in interest rates after the central bank meetings early in the month. Although these were widely expected, the tone around future guidance remained hawkish.
- The benchmark 10-year gilt yield decreased by 36 basis points (bps) to 3.16% over the month, with gilts returning 2.82% to investors (FTSE Actuaries) on an all-maturities basis. In comparison, sterling investment grade markets returned 3.39% (iBoxx). The average investment grade credit spread (the average extra yield available from a corporate bond compared with government debt of equal maturity) narrowed by 16bps to 1.70%.
- Credit sector returns were positive across the board, but dispersions in return were wide. Subordinated insurance, utilities, healthcare and real estate were the strongest sectors. Supranationals and covered bonds were the weakest sectors, with senior banks also underperforming the broad market. Duration was positive as longer-dated bonds notably outperformed shorter-dated issues. The A and BBB ratings bands were the strongest, outperforming higher-rated issues: however, the sterling high yield index outperformed all the investment grade ratings bands.
- Relative performance was boosted by the significant underweight in supranationals, which underperformed, and the overweight allocations in social housing and subordinated insurance. Stock selection within sectors was marginally negative driven by the structured, social housing and utilities sectors – positive stock selection in the banks and insurance sectors was insufficient to offset this. Duration was neutral for performance.
- With the end of the LDI crisis and the Autumn Statement helping to stabilise UK bond markets, sterling issuance hit £9.5bn in November, the busiest month since January 2020. With the sharp recovery in primary activity, we participated in eight new issues – seven of which were from issuers in the banks sector. We bought senior banks issues by **NatWest**, **Santander UK**, **Morgan Stanley** and **Crédit Agricole**, and subordinated banks issues from **HSBC**, **Investec** and **NatWest**. The HSBC and Investec new issues funded tenders (at a premium to market pricing) of existing bonds held by the fund. Otherwise, we bought a new issue by **GreenSquareAccord**, the social housing provider.
- In the secondary market, we took advantage of higher yields in some sectors following the market volatility of recent months. In financials, other than participating in new banks issues, we bought senior banks bonds of **Yorkshire Building Society**, **Skipton Building Society** and **Santander UK**, and subordinated banks bonds of **Lloyds**. We also increased our exposure to subordinated insurance by buying bonds of **M&G, Aviva** and **AXA**. We sold senior banks bonds of **DNB** and **Close Brothers**, and senior insurance bonds of **New York Life** that had held up well in the volatility over recent months. In the structured sector, we bought bonds of **Finance for Residential Housing** (FRESH), **Equity Release Funding** and **Meadowhall**, and sold bonds of **Premier Transmission** and **Anglian Water Osprey**. We switched between real estate bonds of **Annington** on attractive terms, increasing spread whilst reducing duration. We also bought social housing bonds of **The Housing Finance Corporation**, **Sunderland** and **Saxon Weald**, selling bonds of **Penarian** and **Jigsaw**. Lastly, we sold bonds of Danish windfarms constructor and operator **Orsted** that we believe are now fully valued.

Shalin Shah
Senior Fund Manager

Matt Franklin
Fund Manager

Royal London Sustainable Managed Growth Trust

Portfolio Commentary

- Net of fees, the fund outperformed its composite benchmark in November and significantly outperformed the average return for its peer group (IA Mixed Investment 0-35% Shares). It has underperformed the benchmark over the rolling 12-month period, but has outperformed over three and five years.
- Government bond yields fell (and prices rose) in November as investors increasingly discounted a recession in 2023 following further increases in interest rates after the central bank meetings early in the month. Although these were widely expected, the tone around future guidance remained hawkish.
- The benchmark 10-year gilt yield decreased by 36 basis points (bps) to 3.16% over the month, with gilts returning 2.82% to investors (FTSE Actuaries) on an all-maturities basis. In comparison, sterling investment grade markets returned 3.39% (iBoxx). The average investment grade credit spread (the average extra yield available from a corporate bond compared with government debt of equal maturity) narrowed by 16bps to 1.70%.
- Credit sector returns were positive across the board, but dispersions in return were wide. Subordinated insurance, utilities, healthcare and real estate were the strongest sectors. Supranationals and covered bonds were the weakest sectors, with senior banks also underperforming the broad market. Duration was positive as longer-dated bonds notably outperformed shorter-dated issues. The A and BBB ratings bands were the strongest, outperforming higher-rated issues: however, the sterling high yield index outperformed all the investment grade ratings bands.
- A broad-based rally in equities resulted from the announcement of lower inflation data from the US and hopes that China will reopen fully following Covid-related lockdowns. Although inflation remains elevated in an historical context, it raises the question whether we close to the peak in interest rates. Investors took comfort from the economic data and the MSCI World Index rose 3.5% in sterling terms. The best performing sectors were dominated by those with cyclical exposure to the global economy, notably mining, industrials and financials.
- Despite the negative impact of excluding companies in the mining sector and being underweight in financials (many of which have poor sustainability scores), the equity portfolio made a marginally positive contribution to performance as shares in a number of companies that we hold performed strongly. Otherwise, for the credit portfolio, relative performance was boosted by the significant underweight in supranationals, which underperformed, and the overweight allocations in social housing and subordinated insurance. Stock selection within sectors was positive, driven by the banks and insurance sectors – negative stock selection in the structured and utilities sectors was insufficient to offset this. Duration made a small positive contribution to performance.
- With the end of the LDI crisis and the Autumn Statement helping to stabilise UK bond markets, sterling issuance hit £9.5bn in November, the busiest month since January 2020. With the sharp recovery in primary activity, we participated in eight new issues – seven of which were from issuers in the banks sector. We bought senior banks issues by **NatWest**, **Santander UK**, **Morgan Stanley** and **Crédit Agricole**, and subordinated banks issues from **HSBC**, **Investec** and **NatWest**. The HSBC and Investec new issues funded tenders (at a premium to market pricing) of existing bonds held by the fund. Otherwise, we bought a new issue by **GreenSquareAccord**, the social housing provider.
- In the secondary market, we took advantage of higher yields in some sectors following the market volatility of recent months. In financials, other than participating in new banks issues, we bought senior banks bonds of **Santander UK**, and subordinated banks bonds of **Lloyds**. We also increased our exposure to subordinated insurance by buying bonds of **AXA**. We sold senior banks bonds of **Skipton Building Society**, **DNB** and **Close Brothers**, and senior insurance bonds of **New York Life** and **MetLife** that had held up well in the volatility over recent months. We also sold covered bonds of **Bank of Scotland**. In the structured sector, we sold bonds of **Anglian Water Osprey**. In the social housing sector, we bought bonds of **Sunderland** and sold bonds of several operators, including **Orbit**, **Yorkshire Housing** and **Jigsaw**.

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Shalin Shah
Senior Fund Manager

Matt Franklin
Fund Manager

Royal London Sustainable Diversified Trust

Portfolio Commentary

- November was a positive month for financial assets with a broad-based rally in equities, debt and commodities markets. These upward moves resulted from the announcement of lower inflation data from the US and hopes that China will reopen fully following Covid-related lockdowns. Although inflation remains elevated in an historical context, it raises the question whether we close to the peak in interest rates. In the UK, the new Chancellor's Autumn Statement reassured the debt markets and yields on government bonds continued to fall from their recent high in September. Investors took comfort from the economic data and the FTSE All-Share Index rose by 7.1% over the month, while the MSCI World Index rose 3.5% in sterling terms. The best performing sectors were dominated by those with cyclical exposure to the global economy, notably mining, industrials and financials.
- The sterling credit market continued to perform strongly in November, returning 3.4% (which took year-to-date returns to -16.3%). This was primarily driven by the fall in government bond yields, with 10-year gilt yields dropping by 36 basis points (bps). Credit spreads also tightened 16bps over the month, reducing the yield on the index to 5.04%, which is back to the levels seen before Kwasi Kwarteng's 'mini- Budget'.
- The Trust outperformed in November and was ranked in the second quartile relative to its peer group. The strongest performers included oncology-focused pharmaceutical company **AstraZeneca**, along with businesses connected to financial services, such as Asian-focused life insurer **Prudential** and financial data and trading business **London Stock Exchange Group**. The most significant detractors from performance were US software businesses **Autodesk and Intuit**.
- We initiated a new position in **Canadian National**, the largest freight railway network in Canada, funded through a reduction in our holding in US railroad operator **CSX**. Canadian National should be a faster growing railroad in time, thanks to investments made in port and track infrastructure, and the underlying mix of freight that it moves. Another new addition was US medical sterilisation business Steris, a medical technology company with a leading position in sterilisation across hospitals, healthcare and outsourced processes. We fully exited our position in Swiss contract drug manufacturer **Lonza**. Other trades included further reducing holdings in several US technology-focused businesses, along with US aluminium can manufacturer **Ball Corporation**.

Mike Fox

Head of Sustainable Investments

George Crowdy

Fund Manager

Sebastien Beguelin

Assistant Fund Manager

Royal London Sustainable World Trust

Portfolio Commentary

- November was a positive month for financial assets with a broad-based rally in equities, debt and commodities markets. These upward moves resulted from the announcement of lower inflation data from the US and hopes that China will reopen fully following Covid-related lockdowns. Although inflation remains elevated in an historical context, it raises the question whether we close to the peak in interest rates. In the UK, the new Chancellor's Autumn Statement reassured the debt markets and yields on government bonds continued to fall from their recent high in September. Investors took comfort from the economic data and the MSCI World Index rose 3.5% in sterling terms. The best performing sectors were dominated by those with cyclical exposure to the global economy, notably mining, industrials and financials.
- The sterling credit market continued to perform strongly in November, returning 3.4% (which took year-to-date returns to -16.3%). This was primarily driven by the fall in government bond yields, with 10-year gilt yields dropping by 36 basis points (bps). Credit spreads also tightened 16bps over the month, reducing the yield on the index to 5.04%, which is back to the levels seen before Kwasi Kwarteng's 'mini- Budget'.
- The trust underperformed in November and was ranked in the third quartile relative to its peer group. Key detractors over the period included US software businesses **Autodesk** and **Intuit** – both stocks fell over concerns that their growth outlook was slowing due to macroeconomic pressures. Positives included Asian-focused life insurer **AIA**, which rebounded ahead of the potential reopening of the Chinese economy, along with companies exposed to semiconductor manufacturing, including **TSMC** and **ASML**.
- We initiated a new position in **Canadian National**, the largest freight railway network in Canada, funded through a reduction in our holding in US railroad operator **CSX**. Canadian National should be a faster growing railroad in time, thanks to investments made in port and track infrastructure, and the underlying mix of freight that it moves. We fully exited our position in Swiss contract drug manufacturer Lonza. Other trades included adding to positions in Indian bank **HDFC** and US medical sterilisation business Steris, while further reducing holdings in several US technology-focused businesses, along with US aluminium can manufacturer **Ball Corporation**.

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)*
- November was a positive month for financial assets with a broad-based rally in equities, debt and commodities markets. These upward moves resulted from the announcement of lower inflation data from the US and hopes that China will reopen fully following Covid-related lockdowns. Although inflation remains elevated in an historical context, it raises the question whether we close to the peak in interest rates. In the UK, the new Chancellor's Autumn Statement reassured the debt markets and yields on government bonds continued to fall from their recent high in September. Investors took comfort from the economic data and the FTSE All-Share Index rose by 7.1% over the month, while the MSCI World Index rose 3.5% in sterling terms. The best performing sectors were dominated by those with cyclical exposure to the global economy, notably mining and banking. In contrast, telecoms was by far the worst performing sector, reflecting a poor outlook for future profitability.
- The trust underperformed the FTSE All-Share Index in November and was positioned in the fourth quartile in comparison to its peer group.
- The strongest performers during the month mainly came from businesses connected to financial services, such as Asian-focused life insurer **Prudential** and financial data and trading business **London Stock Exchange Group**. In addition, accounting software company **Sage** and renewable energy and networks-focused utility **SSE** both performed well having reported strong financial results. The most significant detraction from performance came from the fund's lack of exposure to the mining sector, which rose sharply on hopes of a recovery in Chinese demand for metals. A number of larger, more defensive holdings such as **Compass**, **Rentokil** and **Croda** also underperformed.
- We added to our positions in **Unilever**, along with **Standard Chartered** and **Lloyds Banking Group**. There were small reductions to positions including utility companies **Severn Trent** and **National Grid**, along with US software behemoth **Microsoft**.

ALPHA MANAGER 2022
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Royal London Global Sustainable Equity Fund

Portfolio Commentary

- November was a positive month for financial assets with a broad-based rally in equities, debt and commodities markets. These upward moves resulted from the announcement of lower inflation data from the US and hopes that China will reopen fully following Covid-related lockdowns. The fall in the rate of core inflation in the US was particularly welcome and, although it remains elevated in an historical context, it raises the question whether we are close to the peak in interest rates. The MSCI All-Countries World Index (ACWI) rose 4.2% in sterling terms over the month. The best-performing sectors being materials, real estate and industrials, while the weakest were energy, healthcare and information technology.
- The fund underperformed the benchmark in November and was ranked in the second quartile relative to its peer group. Our underweight position in the materials sector, while being overweight in healthcare and technology, was a headwind to performance. At a stock level, Asian life insurer **AIA** was the top contributor as the stock benefitted from excitement around the easing of restrictive Covid policies in China. Much of AIA's historical growth has come from mainland Chinese consumers being able to travel to Hong Kong to buy US dollar-denominated insurance products, so a relaxation of travel restrictions should see this market recover quickly. Asian semiconductor manufacturer **TSMC** was another positive contributor as its shares rose after Warren Buffet disclosed a c.$4bn stake in the company. US design software company **Autodesk** detracted from performance as the company continues to navigate its transition of moving users from multi-year to annual contracts, which is resulting in volatility in the business. As a result, it reported quarterly results that were below expectations. US building insulation installer **TopBuild** also detracted as, although the company reported results ahead of expectations, management said that it was seeing some push back from customers on prices as a result of a slowing US residential housing market.
- Significant transactions included exiting Swiss contract drug manufacturer **Lonza** on valuation grounds and initiating a new position in Unilever. We consider **Unileve**r to be an ESG leader with a product set that should prove to resilient in a period of lower economic growth and the company trades at an attractive valuation given our expectations of its future growth.

ALPHA MANAGER 2022
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Royal London Global Sustainable Credit Fund

Macroeconomics and market highlights

- The US mid-terms resulted in the Republicans taking the House by a smaller margin than expected, while the Democrats retained control of the Senate. Monetary policy was tightened again with the FOMC raising the Fed Funds target range by 75 basis points (bps) to 3.75%-4%. Inflation fell more than expected in October to 7.7%, although October non-farm payrolls came in stronger than expected. There was no European Central Bank meeting in November, but policymakers continued to signal further rate hikes. Eurozone CPI fell to 10.0%, though core was stable at 5.0%. The new UK Chancellor's Autumn Statement involved significant fiscal tightening, albeit the measures were backloaded. With high inflation (11.1% in October) and a tight labour market in the UK, the Bank of England hiked interest rates again.
- The benchmark 10-year US treasury yield ended the month lower at 3.61% (a decrease of 44bps). Meanwhile, the equivalent bund yield decreased by 21bps to 1.93%. Credit spreads tightened across all relevant markets.
- Euro investment grade issuance rebounded, reaching €70.6bn. With UK bond markets stabilising, sterling issuance hit £9.5bn in November, the busiest month since January 2020. In both markets, issuance was dominated by banks, which were particularly active before year end. The euro market also saw significant issuance from real estate companies, suggesting that investors are less worried about the outlook for this sector after several challenging months.

Portfolio commentary

- Net of fees, the fund (USD, Z, Acc) recorded a return of 4.38% (4.41% gross) in November, in line with the 4.39% return of its benchmark (Bloomberg Global Aggregate - Corporate USD Hedged). For the rolling 12-month period, the fund has returned -15.31% net of fees (-14.96% gross), compared to the benchmark return of -13.60%.
- With the sharp recovery in primary activity, we participated in 11 new issues – eight of which were from issuers in the financials sectors. We bought senior banks issues by **NatWest** (two separate issues), **Santander UK**, **Nationwide** and **Crédit Agricole**, and subordinated banks issues from **HSBC**, **Lloyds** and **Investec**. Otherwise, we bought a new issue by **GreenSquareAccord**, the social housing provider; a hybrid issue from Danish windfarms builder and operator **Orsted**; and an issue from **Zoetis**, the US veterinary pharmaceutical company.
- In the secondary market, we took advantage of higher yields in some sectors following the market volatility of recent months. In financials, other than participating in new issues (particularly in the banks sector), we bought senior banks bonds of **HSBC** and **NatWest**, and senior insurance debt of **New York Life**. We sold senior bonds of Natwest Markets and subordinated bonds of **Svenska Handelsbanken**. Otherwise, we sold bonds of **Jigsaw** and **Penarian** in the social housing sector, and **Tyco Electronics** and **Vestas Wind Systems** in the general industrials sector.

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

- We will continue to invest in bonds that meet both our demanding financial and sustainable criteria, and which fit into the sustainable themes that we think will endure and offer long-term solutions to the challenges that the world faces.

- There is considerable uncertainty about the outlook for 2023. The Federal Reserve and other major central banks continue to raise interest rates and many investors fear that this could tip the US into a hard-landing recession. The picture is only marginally different in Europe, although lower domestic and commercial energy prices are helping with the onset of winter. Meanwhile, China has been experiencing a slowdown in growth with particular problems in its over-invested property sector, but moves to relax the state's unpopular 'zero Covid' policy suggest that growth rates may recover in 2023.
- The best way to manage risk at times of economic uncertainty and potential recession is to conduct thorough in-house research and identify the full range of risks for specific sectors, and individual issuers and credits; and to construct a portfolio that is diversified across different sectors of the economy and different potential risk events.
- Nonetheless, defaults are very rare in investment-grade credit. Furthermore. we believe that the widening in credit spreads this year has taken valuations to attractive levels, on both a relative basis compared to government bonds and in absolute terms. Credit spreads discount a significant portion of bad news, and investors are being paid well to take credit over government bond risk.
- The fund is constructed to yield more than the benchmark index. We believe that this positioning will be beneficial in the medium term, given the current valuation of credit markets and attractive opportunities we see.

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Rachid Semaoune
Senior Fund Manager

Khuram Sharih
Senior Fund Manager

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