Royal London Sustainable Funds

Fund Manager Commentary – October 2022

FOR PROFESSIONAL INVESTORS ONLY, NOT SUITABLE FOR RETAIL INVESTORS.

Contents

RLAM Sustainable Performance 3
Royal London Sustainable Managed Growth Trust 5
Royal London Sustainable Diversified Trust 6
Royal London Sustainable World Trust 7
Royal London Sustainable Leaders Trust 8
Royal London Global Sustainable Equity Fund 9
Royal London Global Sustainable Credit Fund 10

RLAM Sustainable Performance

	1 month (%)	Rolling 12 Months (%)
RL Sustainable Managed Income Trust C Acc	**3.84**	**-18.42**
IA Sterling Corporate Bond	3.74	-18.84
iBoxx Sterling Non-Gilts All Maturities	4.03	-19.11
RL Sustainable Managed Growth Trust C Acc	**3.53**	**-18.32**
IA Mixed Investment 0-35%	0.38	-12.30
RL Sustainable Diversified Trust C Inc	**3.34**	**-16.04**
IA Mixed Investment 20-60% Shares sector	0.41	-10.61
RL Sustainable World Trust C Acc	**2.19**	**-16.57**
IA Mixed Investment 40-85% Shares sector	0.57	-10.34
RL Sustainable Leaders Trust C Acc	**3.60**	**-12.02**
IA UK All Companies	2.99	-10.20
FTSE All-Share Index	3.11	-2.78
RL Global Sustainable Equity Fund M Acc	**1.57**	**-14.63**
IA Global	2.07	-7.95
MSCI World All Countries Net Index GBP	2.81	-4.70
RL Global Sustainable Credit Fund M Acc GBP Hedged	**-0.87**	**-19.04**
Bloomberg Global Aggregate Corporate Total Return Index	-0.61	-18.00

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 OCTOBER 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 marginally underperformed the iBoxx Sterling Non-Gilts All Maturities Index in October, and has outperformed the index over one, three and five-years.
- After the volatility that hit the UK and European markets in late September, government bond markets were mixed in October as some order was restored and investors looked ahead to the central bank meetings early in November. Further interest rate rises at these meetings were priced into market levels although there was increasing expectation of a peak by the first half of 2023.
- The benchmark 10-year gilt yield decreased by 58 basis points (bps) to 3.52% over the month, with gilts returning 3.12% to investors (FTSE Actuaries) on an all-maturities basis. In comparison, sterling investment grade markets returned 4.03% (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 14bps to 1.85%.
- Credit sector returns were positive across the board, but dispersions in return were wide. Healthcare, telecoms and retail were the strongest sectors, while subordinated financials (banks and insurance) also outperformed. Supranationals and covered bonds were the weakest sectors, with real estate and asset-backed securities also underperforming the broad market. Duration was positive as longer-dated bonds notably outperformed shorter-dated issues.
- Performance was helped by the underweight in supranationals, which underperformed, and the overweight in subordinated insurance. However, the structured sector lagged the October rally, reflecting its previous resilience and the reduced scope to bounce back. Overall, credit sector allocation was negative with social housing and real estate also acting as a drag. However, the relative underperformance mostly resulted from negative stock selection, particularly in the banks, social housing and structured sectors. Duration had a neutral impact.
- The LDI crisis and resultant selling of sterling investment grade credit caused exceptional market turmoil, so new issuance slipped to £1.0bn in October with only a handful of utility deals. We participated in only two issues, both in the utility sector, buying bonds of **Northumbrian Water** and **Northern Ireland Electric**.
- We took advantage of the volatile market conditions and good liquidity to add to our exposure in subordinated insurance, including bonds of **Legal & General**, **Aviva**, **M&G** and **BUPA**. Against these, we sold subordinated bonds of **Barclays** as this issuer no longer meets our sustainable criteria. Otherwise, we added to our holdings in the social housing and structured sectors. In social housing, we prefer old-style housing association debt with strong covenants, including **The Housing Finance Corporation**, **Poplar** and **Sunderland**. We also added to **Swan Housing** following a material widening in spreads. We also switched from **Sanctuary** into **Quadrant**, which we felt offered better value due to covenant superiority. Within structured, we added to existing holdings in **Telereal**, **Broadgate** and **White City Property**, selling **Brass No 7** – a mortgage-backed security that is close to its call date and providing a lower yield than is available elsewhere. Otherwise, to reduce the fund's duration, we sold longer-dated unsecured **Vodafone** debt that we felt was fully valued.

CITYWIRE AAA

Shalin Shah
Senior Fund Manager

Matt Franklin
Fund Manager

Royal London Sustainable Managed Growth Trust

Portfolio Commentary

- Net of fees, the fund marginally underperformed its composite benchmark in October, but 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.
- After the volatility that hit the UK and European markets in late September, government bond markets were mixed in October as some order was restored and investors looked ahead to the central bank meetings early in November. Further interest rate rises at these meetings were priced into market levels although there was increasing expectation of a peak by the first half of 2023.
- The benchmark 10-year gilt yield decreased by 58 basis points (bps) to 3.52% over the month, with gilts returning 3.12% to investors (FTSE Actuaries) on an all-maturities basis. In comparison, sterling investment grade markets returned 4.03% (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 14bps to 1.85%.
- Credit sector returns were positive across the board, but dispersions in return were wide. Healthcare, telecoms and retail were the strongest sectors, while subordinated financials (banks and insurance) also outperformed. Supranationals and covered bonds were the weakest sectors, with real estate and asset-backed securities also underperforming the broad market. Duration was positive as longer-dated bonds notably outperformed shorter-dated issues.
- October was a better month for equity markets as investors anticipated that central banks are close to the point where they may start to pivot away from rapid interest rate rises. The hike in interest rates to counteract high inflation, notably in the US, has been the dominant characteristic for markets in 2022 and a period of inactivity by central banks would be taken well by investors. Natural gas prices declined during October, which is helpful for both consumers and industrial users, and the UK government rescinded Kwasi Kwarteng's proposed tax reductions, which was received positively. The FTSE ALL-Share Index rose by 3.1%, and the MSCI World index rose by 3.9% in sterling terms, with the best performing sectors being energy, as the oil price rose by 8%, and industrials; financials was the worst as the bank reporting season disappointed, mainly through higher costs and rising impairments.
- Despite the negative impact of excluding companies in the energy sector (which outperformed), the equity portfolio made a positive contribution to performance as shares in a number of companies that we hold bounced back following weaker performance in recent months. Otherwise, for the credit portfolio, performance was mainly impacted by negative stock selection, particularly in the banks, consumer services, structured and social housing sectors – positive stock selection in real estate only partly offset this. Otherwise, duration had a positive impact.
- The LDI crisis and resultant selling of sterling investment grade credit caused exceptional market turmoil, so new issuance slipped to £1.0bn in October with only a handful of utility deals. We participated in only two issues, both in the utility sector, buying bonds of **Northumbrian Water** and **Northern Ireland Electric**.
- We took advantage of the volatile market conditions to add to our exposure in subordinated insurance, including bonds of **Legal & General**, **Aviva**, **M&G**, **Scottish Widows** and **BUPA**. We also bought subordinated banks bonds of **BPCE**. Against these, we sold subordinated bonds of **Barclays** as this issuer no longer meets our sustainable criteria. We also sold senior bonds of **BFCM** that were trading very tightly. Otherwise, we added to our holdings in the social housing and structured sectors. In social housing, we prefer old-style housing association debt with strong covenants, including **Harbour Funding**, **Sanctuary**, **Guinness Trust** and **Sunderland**. We also added to **Swan Housing** following a material widening in spreads. Within structured, we added to existing holdings in **Broadgate**, **Income Contingent Student Loans**, **Taurus** and **Unifund**. Otherwise, to manage liquidity, we sold a number of bonds that we felt were fully valued, including particular issues of **Vodafone**, **Orsted**, **Rentokil Initial** and **Saltire Finance**.

CITYWIRE AAA

Shalin Shah
Senior Fund Manager

Matt Franklin
Fund Manager

Royal London Sustainable Diversified Trust

Portfolio Commentary

- October was a better month for equity markets as investors anticipated that central banks are close to the point where they may start to pivot away from rapid interest rate rises. The hike in interest rates to counteract high inflation, notably in the US, has been the dominant characteristic for markets in 2022 and a period of inactivity by central banks would be taken well by investors. Natural gas prices declined during October, which is helpful for both consumers and industrial users, and the UK government rescinded Kwasi Kwarteng's proposed tax reductions, which was received positively by markets.
- The FTSE ALL-Share Index rose by 3.1%, and the MSCI World index rose by 3.9% in sterling terms, with the best performing sectors being energy, as the oil price rose by 8%, and industrials; financials was the worst as the bank reporting season disappointed, mainly through higher costs and rising impairments.
- The sterling credit market rebounded in October, rising by 4.5% – its strongest month since April 2020. This was primarily driven by falling government bond yields, with 10-year gilt yields falling by 45 basis points. Gilts were buoyed by the reversal of most of the 'mini-Budget', and the subsequent replacement of Liz Truss as Prime Minister. Credit spreads also tightened marginally, taking the index yield down to 5.4%.
- The trust outperformed its benchmark in October and was ranked in the first quartile relative to its peer group. The strongest performers during the month included pest control and hygiene specialist **Rentokil Initial**, along with several healthcare-focused businesses, including US surgical robot manufacturer **Intuitive Surgical**, instrument manufacturer **Agilent** and **Iqvia**, a health data company. US card and payments network **Visa** also performed strongly following a strong trading update. The most significant detractors from performance included Asia-focused insurer **Prudential**, as investors reflected on the impact of China's Communist Party Congress, along with German sportswear and 'athleisure' leader **Adidas**, which released a profit warning that was driven in part by its Chinese exposure.
- We continued to build our position in US rail equipment provider **Wabtec**, and further reduced our stakes in US technology-focused names, such as **Nvidia** and **Alphabet**. We also trimmed our position in US aluminium beverage can manufacturer **Ball Corporation**.

ALPHA MANAGER 2022
Mike Fox
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Mike Fox

Head of Sustainable Investments

George Crowdy

Fund Manager

Sebastien Beguelin

Assistant Fund Manager

Royal London Sustainable World Trust

Portfolio Commentary

- October was a better month for equity markets as investors anticipated that central banks are close to the point where they may start to pivot away from rapid interest rate rises. The hike in interest rates to counteract high inflation, notably in the US, has been the dominant characteristic for markets in 2022 and a period of inactivity by central banks would be taken well by investors. Natural gas prices declined during October, which is helpful for both consumers and industrial users, and the UK government rescinded Kwasi Kwarteng's proposed tax reductions, which was received positively by markets.
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- The trust outperformed its benchmark in October and was ranked in the first quartile relative to its peer group. The strongest performers included UK pest control and hygiene specialist **Rentokil Initial**, along with US surgical robot manufacturer **Intuitive Surgical**. US card and payments network **Visa** also performed strongly following a strong trading update. The most significant detractors from performance included Asian-based insurer **AIA Group**, as investors reflected on the impact of China's Communist Party Congress, along with Taiwanese semiconductor manufacturer **TSMC**.
- We initiated a position in **HDFC**, one of India's largest and fastest growing banking businesses. India remains a country where access to banking services is relatively low, with opportunities for companies such as HDFC to improve financial inclusion, particularly in rural areas. This purchase was partly funded by a reduction of a range of US-listed businesses such as **Nvidia**, **Alphabet** and **Intuitive Surgical** as we took advantage of the continued strength of the dollar, which has raised the valuation of these businesses in sterling terms.

ALPHA MANAGER 2022
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Royal London Sustainable Leaders Trust

Portfolio Commentary

- *(All companies are UK based, unless stated otherwise)*
- October was a better month for equity markets as investors anticipated that central banks are close to the point where they may start to pivot away from rapid interest rate rises. The hike in interest rates to counteract high inflation, notably in the US, has been the dominant characteristic for markets in 2022 and a period of inactivity by central banks would be taken well by investors. Natural gas prices declined during October, which is helpful for both consumers and industrial users, and the UK government rescinded Kwasi Kwarteng's proposed tax reductions, which was received positively by markets.
- The FTSE ALL-Share Index rose by 3.1%, and the MSCI World index rose by 3.9% in sterling terms, with the best performing sectors being energy, as the oil price rose by 8%, and industrials; financials was the worst as the bank reporting season disappointed, mainly through higher costs and rising impairments.
- The trust outperformed the FTSE All-Share Index over the month and was ranked in the second quartile in comparison to its peer group. The strongest performers came from a recovery in companies whose shares had performed less well during the challenging market backdrop so far this year, including leading food-on-the-go retailer **Greggs** and pest control and hygiene specialist **Rentokil Initial**. US card and payments network **Visa** also performed strongly following a strong trading update. The most significant detractors from performance came from Asia-focused insurer **Prudential**, as investors reflected on the impact of China's Communist Party Congress, along with US software and cloud computing leader **Microsoft**, where third quarter results were less positive.
- We added to the position in wound care and surgical equipment manufacturer **Convatec**, which we funded through reducing the position in insurer **Legal & General**. There were also small additions to holdings in several electric and water utility businesses, including **National Grid**, **SSE** and **Severn Trent**.

Mike Fox

Head of Sustainable Investments

George Crowdy

Fund Manager

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Assistant Fund Manager

Royal London Global Sustainable Equity Fund

Portfolio Commentary

- October was a better month for equity markets as investors anticipated that central banks are close to the point where they may start to pivot away from rapid interest rate rises. The hike in interest rates to counteract high inflation, notably in the US, has been the dominant characteristic for markets in 2022 and a period of inactivity by central banks would be taken well by investors. Natural gas prices declined during October, which is helpful for both consumers and industrial users, and the UK government rescinded Kwasi Kwarteng's proposed tax reductions, which was received positively by markets.
- The MSCI ACWI Index gained 2.8% in sterling terms with the best-performing sectors including energy, following an increase in the oil price, and industrials; the communication services and consumer discretionary sectors detracted from performance.
- The fund underperformed its benchmark during October and was ranked in the third quartile relative to its peer group. Having zero exposure to the energy sector, which we avoid for environmental reasons, continues to be a headwind to relative fund performance. Global pest control and hygiene specialist **Rentokil Initial** was the top contributor to performance as the company closed its transformative acquisition of Terminix, a competitor in the US pest control market. Global payment network **Visa** also positively contributed as the company reported better-than-expected results supported by the continued recovery in cross-border transactions. Leading Asian life insurer **AIA** and Taiwanese advanced semiconductor manufacturer **TSMC** both detracted from performance. In both cases the market reacted negatively to the reappointment of Xi Jinping as leader of the Chinese Communist Party and the removal of more market-friendly members of the Politburo, leading to a sell-off in companies that are exposed to China and Hong Kong.
- The main trade during the month was to continue to build up our new position in leading contract catering company **Compass Group** from the UK.

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Royal London Global Sustainable Credit Fund

Macroeconomics and market highlights

- There was no US Federal Reserve (Fed) monetary policy meeting in October (consensus expectations of a 75bps hike in early November proved correct – the key will be the speed and scale of future increases). September non-farm payrolls came in slightly above expectations and the unemployment rate dropped back to 3.5%. However, PMI business survey data indicated some worsening in hiring trends and consumers' labour market perceptions in October. The European Central Bank again hiked rates by 75bps. Preliminary CPI hit 10.7% in October, stronger than expected and with core CPI 0.2% higher at 5.0%. Third-quarter GDP rose 0.2%, but more timely survey indicators of economic activity were downbeat, indicating a contraction in private sector activity. In the UK, the new Chancellor reversed Kwasi Kwarteng's tax cuts, signalling a more stringent fiscal approach following September's poorly received mini-Budget. A full Autumn Statement will now be delivered on 17 November.
- The benchmark 10-year US treasury yield ended the month higher at 4.05% (an increase of 22bps). Meanwhile, the equivalent bund yield increased 3bps to 2.14%. Credit spreads tightened across all relevant markets.
- Despite the volatility in the UK government bond market disrupting supply in the first part of the month, euro credit issuance was much healthier at €38bn – only slightly lower than for the comparable month in 2021. It was the second month in a row when non-financial supply outpaced financials. In the UK, the LDI crisis and resultant selling of sterling investment grade credit caused exceptional market turmoil, so new issuance slipped to £1.0bn in October with only a handful of utility deals.

Portfolio commentary

- Net of fees, the fund (USD, Z, Acc) recorded a return of -0.75% (-0.72% gross) in October, marginally underperforming the -0.58% return of its benchmark (Bloomberg Global Aggregate - Corporate USD Hedged). For the rolling 12-month period, the fund has returned -18.87% net of fees (-18.54%), compared to the benchmark return of -17.09%.
- The fund participated in three new issues in October. We bought utilities issues from **National Rural Utilities** and **TenneT**, and a senior banks issue from **HSBC**.
- Secondary market activity was limited. We added to secured housing association exposure through **Harbour Funding** and bought **Finance for Residential Social Housing** (Fresh) mortgage-backed securities in a switch from insurance debt of **New York Life**. Otherwise, we sold bonds of **SEGRO** and **Welltower** to manage the fund's real estate exposure.

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 the rest of 2022 and 2023. The Fed continues 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, with domestic and commercial energy prices remaining high and geopolitical events continuing to affect sentiment as winter approaches. Meanwhile, China is experiencing a slowdown in growth with particular problems in its over-invested property sector.

- The best way to manage risk at times of rising 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.

Rachid Semaoune
Senior Fund Manager

Khuram Sharih
Senior Fund Manager

IMPORTANT INFORMATION