Royal London UK Opportunities Fund

Quarterly Report 30 September 2022

ROYAL LONDON
ASSET MANAGEMENT

Asset split

	Fund (%)
Royal Dutch Shell	7.7
Glencore Plc	6.2
Ashtead Group	6.0
BP Plc	5.8
AstraZeneca	5.3
Imperial Brands Plc	4.2
Rio Tinto	4.2
OSB Group Plc	3.5
Watches of Switzerland Group Plc	3.3
Prudential	3.2
Total	**49.5**

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

Fund data

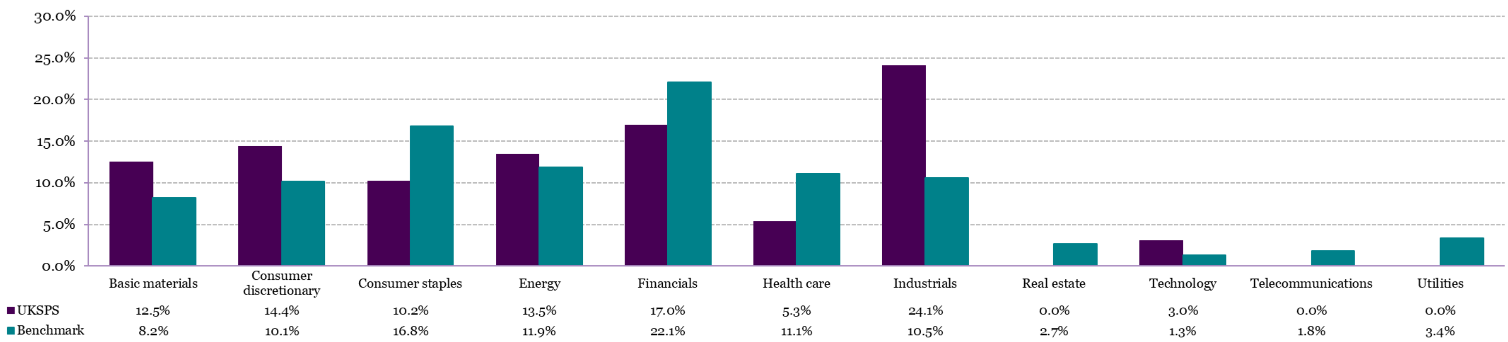
	Fund
No. of stocks	33
Fund size	£698.1m
Launch date	31.07.2007

Performance

	Fund (%)	Benchmark[1] (%)	Relative (%)
Q3 2022	**-6.11**	**-3.45**	**-2.66**
Year-to-date	-26.92	-7.87	-19.05
Rolling 12 months	-24.83	-4.00	-20.83
3 years p.a.	-2.49	0.80	-3.29
5 years p.a.	-0.77	2.17	-2.93
10 years p.a.	4.66	6.02	-1.37
Since inception p.a. 31.12.2010	3.95	5.49	-1.54

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. The impact of fees or other charges including tax, where applicable, can be material on the performance of your investment. The impact of fees reduces your return.
Source: RLAM, as at 30 June 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

- The third quarter proved to be another challenging period for the U.K. stock market as it continued to grapple with the issues which have dogged it year-to-date. The list of concerns includes the following: soaring levels of inflation, a cost-of-living crisis, increasing base rates and the conflict in Ukraine.
- The key theme in markets remains the current rate of inflation and how monetary authorities can realistically dampen this threat. The Bank of England is only concerned with containing the level of inflation and therefore there exists the possibility the Monetary Policy Committee uses the blunt weapon of increasing base rates which could send the economy into a deep recession. Although this is not our central case scenario, the UK economy is on the brink of entering a recession. The great unknown is how long this will last for and what are the implications for corporate profits.
- The cost-of-living squeeze that households are facing is having an extremely negative impact on many parts of the UK market such as general retailers and housebuilders. At the heart of this issue is the much higher cost of energy, driven by the severe disruption to the energy markets from Russia's invasion of Ukraine. That said, the pressures are by no means confined to energy. Others inflationary factors are also at play, such as supply chain disruption from Covid lockdowns in China, tight labour markets and sharp rises in many agricultural products feeding through into food prices.
- September was a truly momentous month for the U.K., historically, politically, and economically. Most notably, the month saw the death of our longest-ever serving monarch, Queen Elizabeth II, the only ruler that most of the population have ever known, and the start of the reign of her son, King Charles III.
- Following an acrimonious leadership contest, Conservative party members chose Liz Truss as their leader, over Rishi Sunak, and thus she became Prime Minister. In one of her first acts, she announced sweeping tax cuts and an ambitious plan to cap domestic energy costs, but these appeared to be fundable only by taking on large amounts of additional government debt. This in turn caused the pound to weaken materially and gilts to record one of their worst sells-offs ever. These moves had profound impacts on the financial markets with bonds selling off aggressively and domestic consumer facing companies such as housebuilders and retailers falling sharply. Real estate stocks also fell on the prospect of higher bond yields depressing valuations. Mid-sized and smaller companies that make up the FTSE 250 index significantly underperformed the larger companies in the FTSE 100 towards the end of the quarter.
- In a repeat of both the first and second quarters, the FTSE 250 fared worse than the FTSE 100 given its higher domestic exposure.
- The Royal London U.K. Opportunities Fund underperformed its benchmark during the three months under review. Between July and September, the Fund returned -6.3% versus -3.4% for the FTSE All-Share (Total Return), placing it in the third quartile.

Performance review

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

Positive contributors

- Over the course of the last quarter, the strongest performer was **Ashtead** (+20%). The company, a mainstay for the fund, reported strong quarterly results, together with an upbeat outlook statement. In addition, there is an ongoing share buyback programme currently being undertaken. The share price has been volatile over the course of this year but remain convinced in the long-term attractions as more customers pivot away from owning their equipment to leasing when required.
- **BP** (+13%) continued to perform strongly as the free cash flow generating abilities of the business impressed. The company has not been without its problems to seek ever since the Macondo disaster in the Gulf of Mexico in 2010 but is now most definitely on the front foot. The strong oil price has, of course, helped profitability, but we remain impressed with the long-term ambitions of management.
- The commodities giant **Glencore** continued its impressive share price performance 2022 by adding another 12% over the quarter. The company has pivoted from being uninvestible in the eyes of many market participants as new management has settled long running bribery enquiries. Their exposure to coal has most certainly helped earnings and has allowed directors to pay a special dividend.
- **Experian** (+11%) has been derated over the course of 2022 as quality growth stocks have been sold off. Following a strong trading update indicating the year had started well, the company began to pare back some of the underperformance. We believe the business to be world-leading in its areas of operation and remain excited about its prospects.

- **Shell** (+6%), along with BP, have obviously been large beneficiaries of the current oil price which has afforded these businesses the opportunity to generate meaningful levels of free cash flow. This is turn, with a disciplined view on capital expenditure, has allowed large share buy backs to take place. This phenomenon shows no signs of abating. We are no experts on the likely direction of oil prices but given geopolitical events, we see no correction for the time being.

Negative contributors

- As alluded to earlier, the movement in certain stocks has been challenging and the quarter's largest faller was **Marshalls**. This is a business we greatly admire: a first-class management team, market leading positions allied to a strong balance sheet. This did not prevent the market selling it off sharply (-33%) as worries grew over discretionary spending. We are supportive of management and their strategy but remain conscious that conditions will likely deteriorate before things improve.
- **Melrose Industries** (-31%) shocked the market by announcing they are looking to split the business into two separate companies, one focused on aerospace and the other on automotive. To us, this seems like a complete change in strategy and one we disagree with. The mantra of the business is "buy, improve, sell". The change of emphasis is obviously because they are unable to sell assets in the current environment, but we struggle to believe this is the right course of action.
- **Intermediate Capital Group** (-25%) dropped sharply over concerns the economic environment had changed quickly and write-downs of some assets would be required.
- **Future** (-24%), continues to endure a difficult year in terms of share price and the third quarter proved no different. Quality growth stocks have, as we are all aware, been derated thus far in 2022, but the main news is the rumoured departure of the CEO in 2023.

Portfolio activity

- The Fund has 33 investments which are spread across a variety of market capitalisations. As at 30 September, the breakdown of the portfolio was as follows: 69.5% in the FTSE 100, 25.5% in the FTSE 250 and 2.5% in Small Cap/AIM. The Fund has 2.5% in cash and the active share is currently 65%.
- The split of the investments was as follows:

	Weighting (%)
FTSE 100	69.5
FTSE 250	25.5
Small Cap/AIM	2.5
Cash	2.5

New holdings

- The fund added two new investments during the quarter, **Diageo,** and **Unilever**.
- Both stocks, we believe, exhibit good pricing power which is crucial at times such as these and both are large dollar earners which will benefit from the weakness in sterling. We are certainly no experts in currency and would never purport to be, but it must be a possibility that sterling could remain weak against the greenback for some time. **Diageo** is a company we have admired for some time and believe it to be amongst the highest quality consumer staples listed anywhere. **Unilever** has some tremendous assets and brand names but has proven a disappointing investment for shareholders in recent years. The CEO has recently announced his intention to retire at the end of 2023 and with the activist investor Nelson Peltz appointed a Non-Executive Director in recent months, there could be a wind of change within the boardroom.

Stocks sold

- The fund exited its positions in **B&M European Value, Tesco** and **Synthomer**.
- We have tried to take an objective view of which companies will find the current economic circumstances most challenging.
- **B&M** has recently announced the retirement of its well-respected CEO and major shareholder Simon Arora. With conditions deteriorating within general retail and margins likely to come under pressure, we felt it was best to look elsewhere where had more confidence in numbers.

The same argument was applied to **Tesco** as we reduced further our exposure to this area of the market. Although historic numbers were impressive and without doubt ahead of the competition, this year is likely to prove more difficult.

- **Synthomer** has proven to be a most disappointing investment for unit holders. Following two large acquisitions, the company is not only operationally geared but also financially. With conditions deteriorating and worries over the balance sheet, we exited. This has, thus far, proven the correct decision with shares almost halving since.

Additions

- The fund took advantage of weakness in many share prices to top up position sizes in existing holdings. We added to weighting in **Watches of Switzerland Group** where we remain convinced the market is underestimating the growth potential of the company. Hill and Smith has seen its share price coming under pressure following the removal of its previous CEO but once again feel a sizeable opportunity has presented itself. Other shares we were happy to add to over the quarter included **Computacenter**, **BP**, and **Glencore**.

Sales

- The fund trimmed its position in **Melrose Industries** over the course of the quarter.

Outlook

- The volatility which has coursed through markets this year sees no signs of abating as issues such as inflation, base rate increases, and the cost-of-living crisis continue to dominate. As we alluded to earlier, the speed and extent to which central bankers increase base rates is having a detrimental impact on quality growth stocks which have been severely de-rated. Our hope is the Monetary Policy Committee members can successfully walk the tightrope of reducing inflation whilst not plunging the economy into a prolonged recession.
- I have mentioned M&A in previous reports many times and the third quarter saw further bids for U.K. companies including Aveva, the FTSE 100 technology stock. With sterling languishing against the dollar, it would come as no surprise to see further companies being bid for from overseas competitors or indeed private equity firms.
- The FTSE 250 index has substantially underperformed the FTSE 100 thus far in 2022 as a lack of commodity plays together with a larger percentage of domestic earners has taken its toll. The fund is structurally overweight this out-of-favour area of the market as we are trying to invest in tomorrow's larger companies today. That said, we are of the view that our holdings, many of which are currently shunned by investors, offer substantial upside.
- To conclude, we are confident in our portfolio stocks and are optimistic that once the economy stabilises, and then activity gets back to something akin to normal over the medium term, we are well placed for recovery.

Additional information

- As we highlighted in our Annual Report, RLAM has ambitious targets for the next few years, notably in international growth as well as investment in infrastructure and people. This investment is to make sure that we continue to provide clients with the service they need and positioning us to for future regulation changes and market development.
- As part of that ambition, we are pleased to announce that we are moving to a new investment platform and have selected the industry leading 'Aladdin' platform. This decision has followed months of analysis and pre-implementation planning with the vendor BlackRock. Aladdin will help us improve our service offerings to our clients, as well as delivering operational efficiencies.
- As you would expect, implementation is an extended task, and the project is expected to complete in 2024, but we believe it is important to be transparent about such projects with our clients. Throughout the implementation, the project and management of your client portfolios will be closely monitored by our Board and Risk functions to ensure that this transition is achieved smoothly, and we will keep you updated on our progress. This is an important part of our long-term strategic goal to ensure that we continue to meet your needs today and into the future.

IMPORTANT INFORMATION

For professional clients only, not suitable for retail investors. The views expressed are the author's own and do not constitute investment advice.
This document is a financial promotion. It does not provide, and should not be relied on for, accounting, legal or tax advice, or investment recommendations. For more information on the fund or the risks of investing, please refer to the fund factsheet, Prospectus or Key Investor Information Document (KIID), available on www.rlam.com.
Past performance is not a reliable indicator of future results. The value of investments and any income from them may go down as well as up and is not guaranteed. Investors may not get back the amount invested.
Portfolio characteristics and holdings are subject to change without notice. This does not constitute an investment recommendation. For information purposes only, methodology available on request. Unless otherwise noted, the information in this document has been derived from sources believed to be accurate. Information derived from sources other than Royal London Asset Management is believed to be reliable; however, we do not independently verify or guarantee its accuracy or validity.
All rights in the FTSE All Stocks Gilt Index, FTSE Over 15 Year Gilts Index, FTSE A Index Linked Over 5 Years Gilt Index and FTSE A Maturities Gilt Index (the "Index") vest in FTSE International Limited ("FTSE"). All rights in the FTSE 350, FTSE All Share, FTSE 100, FTSE 250, FTSE 350 Higher Yield and FTSE Small Cap (the "Index") vest in FTSE International Limited ("FTSE"). "FTSE®" is a trade mark of the London Stock Exchange Group companies and is used by FTSE under licence. The Royal London Funds (the "funds") have been developed solely by Royal London Asset Management. The Index is calculated by FTSE or its agent. FTSE and its licensors are not connected to and do not sponsor, advise, recommend, endorse or promote the fund and do not accept any liability whatsoever to any person arising out of (a) the use of, reliance on or any error in the Index or (b) investment in or operation of the fund. FTSE makes no claim, prediction, warranty or representation either as to the results to be obtained from the Funds or the suitability of the Index for the purpose to which it is being put by Royal London Asset Management.
All confidential information relating to any Royal London Group company must be treated by you in the strictest confidence. It may only be used for the purposes of assessing the proposal to engage Royal London Asset Management Limited (RLAM). Confidential information should not be disclosed to any third party and should only be disclosed to those of your employees and professional advisers who are required to see such information for the purpose set out above. You should ensure that these persons are made aware of the confidential nature of such information and treat it accordingly. You agree to return and/ or destroy all confidential information on receipt of our written request to do so.
Telephone calls may be recorded. For further information please see the Legals notice at www.rlam.com.
The Funds are sub-funds of Royal London Equity Funds ICVC, an open-ended investment company with variable capital with segregated liability between sub-funds, incorporated in England and Wales under registered number IC000807. The Authorised Corporate Director (ACD) is Royal London Unit Trust Managers Limited, authorised and regulated by the Financial Conduct Authority, with firm reference number 144037. For more information on the fund or the risks of investing, please refer to the Prospectus or Key Investor Information Document (KIID), available via the relevant Fund Information page on www.rlam.com.
Issued by Royal London Asset Management Limited, Firm Registration Number: 141665, registered in England and Wales number 2244297; Royal London Unit Trust Managers Limited, Firm Registration Number: 144037, registered in England and Wales number 2372439; RLUM Limited, Firm Registration Number: 144032, registered in England and Wales number 2369965. All of these companies are authorised and regulated by the Financial Conduct Authority. Royal London Asset Management Bond Funds Plc, an umbrella company with segregated liability between sub-funds, authorised and regulated by the Central Bank of Ireland, registered in Ireland number 364259. Registered office: 70 Sir John Rogerson's Quay, Dublin 2, Ireland.
All of these companies are subsidiaries of The Royal London Mutual Insurance Society Limited, registered in England and Wales number 99064. Registered Office: 55 Gracechurch Street, London, EC3V 0RL. The Royal London Mutual Insurance Society Limited is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. The Royal London Mutual Insurance Society Limited is on the Financial Services Register, registration number 117672. Registered in England and Wales number 99064. FQR RLAM EM 1416.