Royal London GMAPs

Quarterly Report 30 September 2022

Executive Summary

- The macroeconomic factors that disrupted financial markets in the first half of 2022 continued to dominate in the third quarter – inflation high globally and resultant interest rate increases along with growing fears of global recession. Inflation first surfaced in the aftermath of the Covid-19 pandemic as lockdowns ended but was exacerbated by the Russian invasion of Ukraine in February which sharply increased the prices of oil & gas and other commodities. Although they have fallen back slightly, energy prices remain high and geopolitical events continue to affect sentiment as winter approaches. The apparent sabotage of the Nordstream gas pipelines from Russia to Germany suggests that energy will remain a key pawn in relations between NATO countries and Russia.
- Central banks have responded to the continued strength of inflation by further tightening monetary policy and reiterating that they will do whatever it takes to suppress rising prices. The US Federal Reserve (Fed) led the way, increasing rates by 1.50% over the quarter. Since March, the Fed has raised rates five times by an aggregate of 3% - its 0.75% increases in June, July and September were the biggest increases for nearly 30 years. The European Central Bank (ECB) has so far been slower to react, partly due to a more fragmented backdrop with a gap between Germany and 'peripheral' economies which have high unemployment. However, The ECB increased interest rates by 0.75% (it's first increase in 11 years and a bigger increase than the 0.50% expected by economists). The Bank of England (BoE) increased rates by 1.00% over the quarter to 2.25%, taking its tally to six increases so far in 2022 and seven in this cycle.

GMAP fund	Q3 2022 performance (M class, Acc – net of fee)	GMAP custom benchmark	IA sector	IA sector average performance
Conservative	-6.62%	-7.22%	£ Strategic Bond	-4.70%
Defensive	-2.88%	-3.50%	Mixed Investments: 0-35% shares	-3.72%
Balanced	-1.70%	-2.73%	Mixed Investments: 20-65% shares	-3.12%
Growth	-0.97%	-2.11%	Mixed Investments: 40-85% shares	-2.04%
Adventurous	-0.07%	-1.32%	Mixed Investments: 40-85% shares	-2.04%
Dynamic	0.49%	-0.73%	IA Global	1.70%

Market overview

- The key themes of central banks trying to contain high inflation and the cost-of-living squeeze that households are facing will continue to be a focus. However, 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.
- The MSCI World Index returned +2.2% to sterling investors in the third quarter. Consumer discretionary, energy and industrials were the strongest sectors, while consumer services, real estate and utilities lagged. Equities struggled as interest rate expectations rose and investors factored in the possibility of a Fed-induced recession in the next six to 12 months.
- The UK gilt market was the worst performing major government bond market over the quarter, delivering a return of -12.85% as the benchmark 10-year gilt yield rose by 186 basis points (bps) from 2.23% to 4.09%. However, all major government bond markets were impacted as the ongoing interest rate rises and hawkish commentary from central banks drove bond yields higher globally (prices move inversely to yields): the 10-year US treasury yield rose by 82bps to 3.83%; and the 10-year German bund yield rose by 77bps to 2.11%. Longer-dated bonds performed worst in the period due to their greater sensitivity to interest rates (duration risk). In the UK, for example, gilts with five years to maturity or less provided negative returns of just -4.93%, whereas the 15 years or more to maturity segment returned -18.77%.
- Currency movements had a notable impact in the quarter, following the volatility in the first half of the year. The Fed's more aggressive approach to raising interest rates compared to other central banks has pushed the dollar higher. It was again the strongest major currency: it appreciated by over 6% against the yen and euro, and over 8% against sterling. On a translational basis, sterling's weakness benefits sterling investors in overseas assets as it boosts the returns over the quarter. However, these movements will impact global trade over coming months, and dollar strength will also be a risk for any emerging markets countries and companies that have borrowed in dollars. The price of Brent

crude oil fell by 16.9%, but remains over $90 a barrel, and copper futures fell another 8.0% in dollar terms on fears of a slowdown in China and recession in the US, UK and Europe.

Asset allocation overview

- Our tactical asset allocation added value in our funds over the quarter. We have been defensively positioned, underweight stocks and bonds, while favouring more defensive equity regions and sectors. Our preference for the US dollar over sterling also added to performance. The benefits of the well-diversified multi asset approach used in our funds continued to show during the third quarter of the year.

What we thought	What we did	What happened	Effect on portfolio
With inflation high and central banks tightening policy , we remained underweight bonds, expecting yields to rise. Our Investment Clock has been in Stagflation (slowing growth with inflation), a phase that historically associated with negative returns for bonds.	We held an underweight position in bonds over the quarter.	Over the third quarter bonds continued to fall. High inflation and commentary from central bankers added to expectations that central banks will need to continue raising interest rates. Yields spiked higher in reaction to the unveiling of UK fiscal stimulus plans.	We continued to benefit from our underweight position in bonds.
We remained underweight equities given our pessimistic macro view, believing that markets may continue to move lower as company earnings deteriorate.	We held an underweight position in equities over the quarter.	Equites finished lower over the quarter, closing at their lowest level since November 2020 as rising recession fears, geopolitical worries and expectation of tighter policy weighed on the asset class.	Our underweight in equities was beneficial over the period given the losses of the asset class.
We continued to see value in the US dollar given US economic outperformance and tighter policy from the Fed. We saw risk to Sterling given the political uncertainty.	We maintained our overweight position in the US dollar and moved further underweight sterling.	Our positioning was beneficial for us as the US dollar continued to rally and the pound fell to its lowest value versus the dollar.	Our allocations were positive contributors to performance.
We expected that UK and Japanese equites would continue to be relatively resilient compared to other equity regions.	We remained tactically overweight the UK, given its more defensive sectoral composition and improving relative earnings picture. We maintained an overweight position in Japan, which benefitted from a weaker currency. We moved further underweight US equities which has struggled this year given its high exposure to expensive growth stocks.	UK and Japanese stocks were more resilient, falling by less than the broader market. US stocks led the broader market sell off, experiencing their worst September in over 50 years.	Our overweight was a positive contributor to performance.

Please note: This table details our main asset allocation decisions for the quarter across the GMAPs funds. Not all tactical allocations are relevant to the Conservative fund (fixed income-only) and Dynamic Fund (equity-only).

Outlook

- The Investment Clock has been in Stagflation (weak growth with high inflation) for the last year but it's likely to move to to Reflation as inflation peaks (assuming no further inflationary shocks to the world economy). After sharp falls in stocks and bonds, we see opportunities to begin to think about adding having benefited from being underweight. We would not be surprised by second phase of the bear market driven by earnings downgrades given weak global growth. The trough in the markets is usually marked by unemployment rates peaking, which could still be some time away.
- Please see our Investment Clock blog for our latest views.

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.

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