Royal London Equity Funds

Fund Manager Commentary

October 2023

FOR PROFESSIONAL CLIENTS ONLY, NOT SUITABLE FOR RETAIL CLIENTS.

ROYAL LONDON
ASSET MANAGEMENT

Contents

Royal London Asset Management Equity Performance

	1 month (%)	Rolling 12 Months (%)
RL UK Equity Income M Inc	**-4.10**	**7.35**
IA UK Equity Income Sector	-4.24	5.61
FTSE All Share Index	-4.09	5.89
RL UK Dividend Growth Fund M Acc	**-3.96**	**8.37**
IA UK All Companies Sector	-4.77	5.33
FTSE All Share Index	-4.09	5.89
RL UK Mid Cap Growth Fund M Acc	**-6.15**	**-0.63**
IA UK All Companies Sector	-4.77	5.33
FTSE 250 ex-IT Index	-6.90	0.14
RL UK Opportunities Fund M Acc	**-5.06**	**6.21**
IA UK All Companies Sector	-4.77	5.33
FTSE All Share Index	-4.09	5.89
RL UK Smaller Companies Fund M Acc	**-3.53**	**-4.30**
IA UK Smaller Companies Sector	-5.97	-5.64
FTSE Small Cap ex-IT Index	-5.88	5.30

PAST PERFORMANCE IS NOT A GUIDE TO 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 AND FE, CORRECT AS OF 30 SEPTEMBER 2023. RETURNS QUOTED ARE NET OF FEES.

Royal London UK Equity Income Fund

Portfolio Commentary

- During October the fund returned -4.10%, which was in slightly ahead of its benchmark and the peer group, placing 45th percentile. So far in 2023 the fund has returned +0.04%, placing 38th percentile.
- Bond market worries and the events in the middle east put downward pressure on the UK equity market in October. Defensive sectors such as consumer staples and utilities held up relatively well and oil stocks were strong. A number of banks reported results and the reaction to those announcements was generally negative, as banks saw their interest margins squeezed. Shares in the FTSE 100 company **Rentokil** were very weak after the company flagged softer trading in its US business.
- The most notable positive contribution to performance came from the holding in **Restaurant Group**, whose shares jumped after the company accepted a takeover offer for the company from the private equity firm **Apollo**. The holding in **NatWest** was weak after the company lowered its profits guidance due to customers moving their deposits into high interest rate accounts.
- The fund sold out of its holding in **Restaurant Group**, following the takeover offer, and also reduced the positions in **Sage** and **BP**. The position in **Drax** was added to and the recently established holding in the ship broking company **Clarkson** was added to.

Investment Outlook

- We continue to feel that our approach of investing in a broad range of companies from different sectors and stages of their lifecycle is very appropriate and will allow performance to continue to be driven more by the success of our hunting for undervalued long term cashflows than by the prevailing winds of the macroeconomy, or factors such as growth or value styles being in vogue.

Richard Marwood

Head of Income Equities

Royal London UK Dividend Growth Fund

Portfolio Commentary

- During October the fund returned -3.96%, which was better than its benchmark and ahead of the peer group, placing 21st percentile. So far in 2023 the fund has returned +1.20%, which is ahead of the benchmark and places the fund in the top quartile of the peer group.
- Bond market worries and the events in the middle east put downward pressure on the UK equity market in October. Defensive sectors such as consumer staples and utilities held up relatively well and oil stocks were strong. A number of banks reported results and the reaction to those announcements was generally negative, as banks saw their interest margins squeezed.
- The holdings in **Ascential** and **Restaurant Group** were positive for performance, in both cases on the back of corporate activity. **Ascential** has been working on a break-up of the company for some time, and sales of two of their divisions were finally announced in the month, with a large chunk of the proceeds earmarked to be returned to shareholders. **Restaurant Group** accepted a takeover bid from a private equity firm **Apollo**.
- During the month the fund established a position in **Spirax Sarco**, a company that the fund has held previously, but which was sold last year on concerns about the shares being excessively valued. Following a period of share price weakness, the shares now appear more reasonable value for a company with attractive longer-term prospects. The fund also added to existing holdings in **Rentokil**, **Croda** and **Drax**. The fund sold out of its holding in **Restaurant Group**, into the bid for the company, and trimmed the weighting in **Sage**.

Investment Outlook

- We continue to feel that our approach of investing in a broad range of companies from different sectors and stages of their lifecycle is very appropriate and will allow performance to continue to be driven more by the success of our hunting for undervalued long term cashflows than by the prevailing winds of the macroeconomy, or factors such as growth or value styles being in vogue.

Richard Marwood

Head of Income Equities

Niko de Walden

Fund Manager

Royal London UK Mid Cap Growth Fund

Portfolio Commentary

- The UK Mid Cap Growth fund outperformed the benchmark (FTSE 250 ex IT) during October, with the fund returning -6.2% relative to the benchmark's return of -6.9%.
- Global equity markets posted negative returns over the month, global bond yields surged higher. In the US, the 10-year treasury yield rose above 5% for the first time since 2007 as 'higher for longer' central bank policy rates were priced in, in response to a number of robust macroeconomic data points. The tragic events in the Middle East and outbreak of war between Israel and Hamas also caused a general "risk off" trade. In the UK equity market, a number of companies reported lower-than-expected earnings, and defensive sectors such as consumer staples and utilities performed better than other sectors. Once again, several takeover bids were made for UK small and mid-cap companies during the month.
- **Ascential** and **Restaurant Group** were top contributors during the period. Ascential announced that it had agreed terms to sell both **WGSN**, its trend forecasting business, and **Flywheel**, its digital commerce businesses, for cash proceeds of £1.2bn. Most of the proceeds will be returns to shareholders, and the resulting simplified group will remain listed in the UK, operating their high quality Cannes Lions and Money 20/20 events. While the valuations achieved on the two divestments is below the top end of analyst expectations, it nevertheless compares favourably to the market capitalisation of the group before the deal, while the transaction also removes the risk and cost of prior plans to spin out the Digital Commerce business unit onto the US stock market. **Restaurant Group** was subject to a takeover approach by private equity firm **Apollo**, at a substantial premium to the undisturbed share price.
- Detractors to performance included pest control group **Rentokil,** and specialist telecoms and network testing group **Spirent Communications**. **Rentokil** reported lower-than-expected growth in its North American pest control division, and while this was somewhat disappointing, the region still grew organically and management reiterated expectations for synergies from last year's acquisition of **Terminix**. Results outside of North America were in fact better than expected. **Spirent Communications** issued a profits warning, as some large US telecoms customers delayed capital expenditure due to macro uncertainty. This is a timing issue rather than a fundamental change in their end market, however as **Spirent** continue investing significant amounts into research and development, the impact on profits is material. Their Telecoms customers will resume spending in time, to support 5G and fibre network expansion, and Spirent's significant net cash balance sheet provides them the flexibility to maintain headcount and product investment through this period of softness.
- The fund initiated a new position in Trainline, the market leading online ticket retailer in the UK and Europe. **Trainline** has developed a market leading technology platform, high brand awareness and has a track record of product innovation. The technology stack is extremely scalable, enabling high profit margins and cash conversion, while their end market continues to grow as UK and European travellers increasingly purchase tickets online rather than at stations. Despite making significant operational progress in the last three years, the share price is valuing the company at a significant discount to historical valuation multiples, while the business remains capable of growing earnings at mid teens percentage rates over the medium term.

ALPHA MANAGER 2022
Henry Lowson

Henry Lowson

Head of UK Alpha Equities

Royal London UK Opportunities Fund

Portfolio Commentary

- The UK Opportunities fund produced a return of -5.1% during the month and underperformed the benchmark (FTSE All Share). To some extent this was attributable to the fund's overweight to small and mid-cap equities as these companies underperformed their larger FTSE 100 peers.
- Global equity markets posted negative returns over the month, global bond yields surged higher. In the US, the 10-year treasury yield rose above 5% for the first time since 2007 as 'higher for longer' central bank policy rates were priced in, in response to a number of robust macroeconomic data points. The tragic events in the Middle East and outbreak of war between Israel and Hamas also caused a general "risk off" trade. In the UK equity market, a number of companies reported lower-than-expected earnings, and defensive sectors such as consumer staples and utilities performed better than other sectors. Once again, several takeover bids were made for UK small and mid-cap companies during the month.
- **Ascential** was a significant contributor to performance. The company announced that it had agreed terms to sell both **WGSN**, its trend forecasting business, and **Flywheel**, its digital commerce businesses, for cash proceeds of £1.2bn. Most of the proceeds will be returns to shareholders, and the resulting simplified group will remain listed in the UK, operating their high quality Cannes Lions and Money 20/20 events. While the valuations achieved on the two divestments is below the top end of analyst expectations, it nevertheless compares favourably to the market capitalisation of the group before the deal, while the transaction also removes the risk and cost of prior plans to spin out the Digital Commerce business unit onto the US stock market. **Imperial Brands** also contributed to the performance of the fund following an update revealing in-line trading and that the company was going to conduct another significant share buyback.
- **Rentokil** and **St James' Place** were detractors to performance during the month. **Rentokil** reported lower-than-expected growth in its North American pest control division, and while this was somewhat disappointing, the region still grew organically and management reiterated expectations for synergies from last year's acquisition of **Terminix**. Results outside of North America were in fact better than expected. **St James' Place** was a detractor as the business confirmed it was overhauling its fee structure. Whilst this is likely to constrain earnings growth in the short term, **St James' Place** is a market leader in a structurally growing market and a significant opportunity remains in the medium to longer term.
- In terms of trading activity, the fund initiated a new position in **Boku**. **Boku** is a leading provider of mobile payment solutions which enable consumers to easily transact with merchants, and the company has a blue-chip customer base which includes **Netflix** and **Amazon**. Going forward the business should deliver strong revenue growth from greater adoption of these payment methods as well as from new merchants signing up to use **Boku's** services. The business remains attractively valued for the growth on offer and the economic moat it has developed. The position in Boku was partially funded by trimming a number of holdings, including **Intermediate Capital Group**, following our concerns about the implications of a higher interest rate environment on private markets.

Royal London UK Smaller Companies Fund

Portfolio Commentary

- The UK Smaller Companies fund comfortably outperformed its benchmark (FTSE Small Cap ex IT) by 2.4% during the month. The fund also performed strongly relative to its peer group, with the fund placing 7th percentile for the month of October.
- Global equity markets posted negative returns over the month, global bond yields surged higher. In the US, the 10-year treasury yield rose above 5% for the first time since 2007 as 'higher for longer' central bank policy rates were priced in, in response to a number of robust macroeconomic data points. The tragic events in the Middle East and outbreak of war between Israel and Hamas also caused a general "risk off" trade. In the UK equity market, a number of companies reported lower-than-expected earnings, and defensive sectors such as consumer staples and utilities performed better than other sectors. Once again, several takeover bids were made for UK small and mid-cap companies during the month.
- **Kin + Carta**, **Restaurant Group** and **YouGov** were contributors to performance during the month. Both **Restaurant Group** and **Kin + Carta** were subject to recommended all cash takeover offers by private equity buyers, substantial premiums to their undisturbed share prices. While it is encouraging to see that some buyers see the significant value opportunity we're presented with in our investment universe, it is also frustrating to see good companies sold at prices which don't necessarily reflect their long term earnings potential, but rather valuing them off very short term expectations. **YouGov's** shares performed strongly following a robust trading update, reiterating earnings expectations for this coming financial year. This was particularly pleasing as the company's share price had declined significantly prior to the results, as investors had been concerned about the spending patterns of their large US technology customers.
- **Alfa Financial Software** and **Oxford Instruments** were detractors to performance. **Alfa Financial Software's** share price fell following news that the company had terminated discussions with private equity, who had been considering a takeover offer for the company. **Oxford Instruments** issued a trading update which slightly reduced earnings expectations for the year. Nevertheless, their order intake had remained robust as customer demand generally held up, and their net cash balance sheet leaves them with significant positive optionality to invest into M&A or organic expansion.
- Trading activity during the month was quiet, although the fund added to a range of holdings including **Advanced Medical Solutions**, **Gamma Communications** and **Chemring.**

ALPHA MANAGER 2022
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