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Royal London Global Equity Income Fund

Quarterly Investment Report

30 September 2023

Quarterly Report

The fund as at 30 September 2023

The purpose of this report is to provide an update on the Royal London Global Equity Income Fund. The report has been produced by Royal London Asset Management. The report starts with a summary dashboard showing key information about the fund. A glossary is located at the end of the report covering the description of some of the more technical terms used within the report. All data is as at the report date unless otherwise stated.

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ROYAL LONDON ASSET MANAGEMENT

The fund

Fund performance objective and benchmark

The fund's investment objective is to achieve a combination of income and capital growth (a total return) over the medium term, which should be considered as a period of 3-5 years. The fund's performance target is to outperform, after the deduction of charges, the MSCI World (the 'Index') by 2% p.a. over rolling 3-year periods, whilst delivering an income 20% higher p.a. than the Index's income, after the deduction of any charges, over rolling 3-year periods.

Benchmark: MSCI World

Fund value

	Total £m
30 September 2023	591.27

Fund analytics

	Fund
Fund launch date	25 February 2020
Base currency	GBP
Number of holdings	60
Active share (%)	83.8
Tracking error (%)	5.0

Ex-post tracking error calculated since inception to 30 September 2023. Please refer to the glossary for a description of the tracking error used.

Performance and activity

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Quarter	3.86	0.57	3.28
YTD	9.82	8.42	1.40
1 Year	16.92	10.44	6.48
3 Years (p.a.)	16.04	8.95	7.10
5 Years (p.a.)	-	-	-
10 Years (p.a.)	-	-	-
Since inception (p.a.)	13.85	9.18	4.67

Past performance is not a guide to future performance. Please refer to the Glossary for the basis of calculation and impact of fees. Performance and since inception date based on Royal London Global Equity Income Fund M Income. Source: Royal London Asset Management; Net performance; Since inception date of the shareclass is 25 February 2020.

Performance commentary

The fund posted strong returns in the quarter, comfortably beating the benchmark. It was two of the fund's healthcare stocks, Eli Lilly and AbbVie, up 19% and 16% respectively, that were the chief contributors to performance, although the correlation between the two is not high. Eli Lilly, as pioneer, alongside Novo Nordisk (not held in the fund), in the nascent weight loss drug market, has seen its share price climb 68% year to date, as the benefits of Mounjaro continue to exceed initial thoughts, in both weight loss and improving general health, such as heart disease. Demand for these drugs continues to surprise to the upside, although Eli Lilly is now a true Accelerator with a wide range of outcomes given the amount of future growth that is factored into current valuations. We have trimmed our position of late. AbbVie is in a transition year as its key arthritis drug, Humira, comes off patent, and the strong performance in the quarter was more simply a retracing of the ground lost following the markets disappointment to the initial Q1 earnings, as key new drug Skyrizi disappointed expectations before showing better data recently.

Despite technology being one of the weakest sectors, Cisco was also a strong performer, as the company had good results as they monetise their long backlog now that supply chains are functioning better. Cisco announced the acquisition of early-stage Cyber software company, Splunk, for $28bn in late September. We are doubtful as to whether the deal itself will create significant wealth, given the high purchase price, but it may open the markets eyes to the fact that Cisco is now a relatively powerful force in software around hyper scaling and cyber security, a key tenet to our investment thesis.

The only notable disappointment amongst our holdings, during the quarter was HCA, the US hospital operator, as shares fell c.15%. It is hard to pinpoint an exact cause of weakness, but in general, stocks and sectors with high leverage were noticeably weaker and this applies to HCA, for all that its leverage is asset backed. The subtle negative performance of leverage as a factor has been a source of positive alpha for the fund, overall – for example, utilities and real estate were the worst performing sectors in the quarter and are areas where we have no exposure. The largest negative contribution to alpha came from stocks we did not own, with Nvidia and Alphabet both up strongly in the quarter.

Performance and activity

Top 10 holdings

	Weighting (%)
Microsoft Corporation	5.63
Gilead Sciences, Inc.	3.84
Steel Dynamics, Inc.	3.74
UnitedHealth Group Incorporated	3.54
Shell Plc	3.32
Cisco Systems, Inc.	3.24
Applied Materials, Inc.	3.10
A.P. Moller - Maersk A/S Class B	3.06
3i Group plc	2.71
Eli Lilly and Company	2.70
Total	**34.88**

Fund activity

Purchases

The third quarter was a productive time for new ideas, with five additions to the fund. Sylvamo a paper company with operations in the US and Europe, is a stock that we have been following for a while as a Turnaround with an attractive capital cycle industry dynamic. Paper is a commodity experiencing consistent declines in demand, but the supply side is highly consolidated now and as a low-cost provider, with its own renewable energy supply, Sylvamo, can benefit from this disciplined industry set up. We commenced a position following a 16% fall in the share price, after the company warned on profits due to destocking and weak demand in Q2.

We also started a holding in Kinsale Capital, a genuine Accelerator within the world of insurance, who are using data analytics and technology to attempt to disrupt parts of the industry through avoiding the bureaucracy of incumbents and focusing on hard to insure parts of the market. Kinsale are managing to take significant market share currently, and despite a low starting dividend yield, offer strong Accelerating wealth creation at a fair valuation.

Kenvue, the spinout of Johnson & Johnson’s consumer brands, is not a new holding per se, but we took advantage of generous terms to exchange part of our holding in Johnson & Johnson, to establish a more significant position. Kenvue have strong market positions in skincare and protection, oral hygiene and pain relief, all categories which should be defensive and grow at least as fast as GDP. The valuation makes for a positive risk reward, particularly relative to other consumer staples valuations.

Towards the end of the quarter, we also started positions in Constellation Software and Delta Airlines. Constellation Software is a high growth compounder, creating wealth by buying software businesses across many different industry verticals and achieving cost and revenue synergies. They compete for deals with private equity firms, so the higher cost of interest should reduce competition and allow them to potentially reinvest more capital at higher rates of return. Delta Airlines has an appropriate strategy for a Turnaround stock, prioritising service and premiumisation over capacity growth. Despite significant deleveraging this year, the company has more debt than we would typically like for a cyclical business, but we felt that the valuation provides such a positive risk reward, that a small position could be warranted - particularly given the overall ‘low leverage’ nature of our portfolio.

Performance and activity

Disposals

Over the same period, we exited holdings in Cognizant Technology, Admiral, Novartis, Sika and UPM. The decisions to exit Cognizant, Admiral and Novartis were all made to reduce our exposure to businesses truly in the 'Slowing & Maturing' phase of the Life cycle, where the fund is overweight. These holdings were sold in favour of stocks with better wealth creation for their stage of life cycle. Sika and UPM are both in the materials sector, an area where the fund is significantly overweight, and the holdings were ultimately sold in order to maintain the balance in the fund, with preference for stocks with similar cyclicality and materials exposure, but superior risk rewards from a valuation perspective.

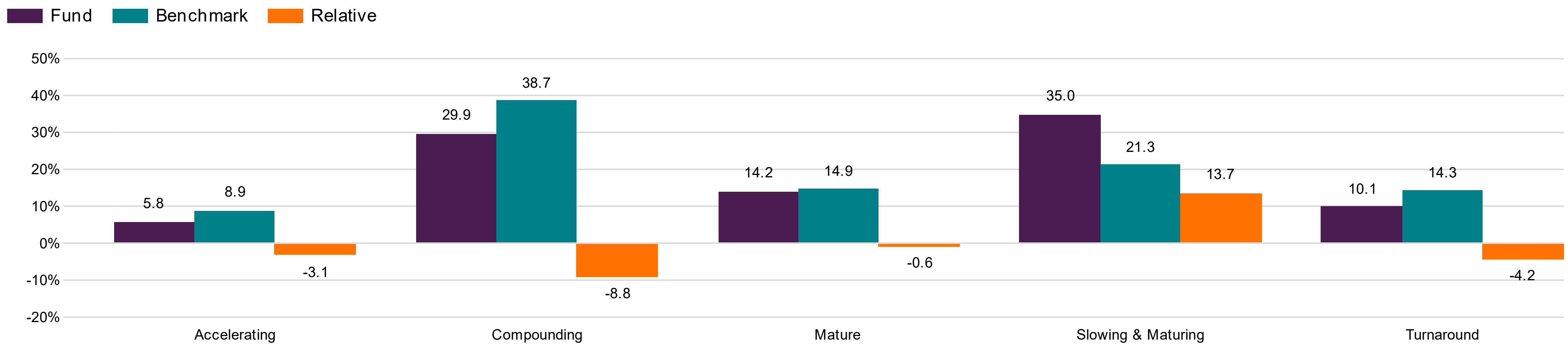
Positioning

Over the last quarter, late Life cycle stocks (Mature and Turnaround) outperformed the earlier stages of the Life Cycle (Accelerator and Compounding) due to rising long-term bond yields. As we frequently say, changes in discount rates are the key determinant of style leadership in the market, and in a quarter where the US 10-year government bond yield increased from around 3.8% to a yield of 4.8%, it was unsurprising to see growth underperform, given that growth stocks, whose valuations are made up of cashflows to be earnt far off into the future, are more sensitive to changes in the discount rate for determining what those cashflows are worth. The reason for this steepening of long-term government bond yields is less because of expectation of further rate rises to come, but more because of an unwind of the steep inversion in the yield curve, as markets started to price in greater chances of some form of soft landing. There are also simple technical reasons that the likes of JP Morgan CEO, Jamie Dimon, have been speaking openly out, namely that the US has significant need to issue new long-term bonds in the coming months, and with most US banks having made disastrous investments in long term government bonds in the last couple of years, the list of buyers is reduced at a time of historical high supply. Despite a general feeling in markets that the outlook for economies is less bad than people thought, the situation remains highly uncertain. Indeed, one could argue that the negative impact on markets from a strong economy could actually be worse than the negative impact of falling earnings from standard recession, given that economic strength likely leads to higher bond yields and thus higher discount rates. At the same time, we have yet to see the sharp increase in borrowing costs flow fully through into economies, indeed most corporates do not need to refinance until 2025+, so there is the possibility of significant economic hardship, as businesses and industries reliant on cheap debt get found out.

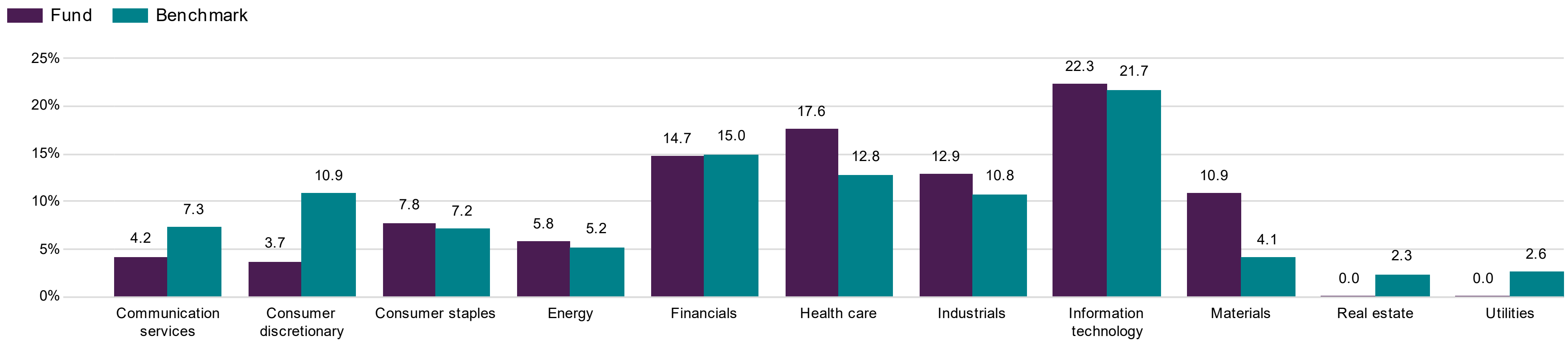
We are not envious of funds with concentrated views, whether they be stylistic or macro based, on what happens from here. There look to be multiple possible scenarios with relatively similar probabilities of happening, that could have vastly different impacts on not only the earnings of different types of stocks, but also the discount rates by which stocks are valued. We take comfort from our focus on strong long-term wealth creation and strong balance sheets, and the valuations of our late Life Cycle cyclicals, many of which are at historical trough levels of price to book. This, combined with our focus on balancing the portfolio by Life Cycle, sector and region, can hopefully enable continued generation of alpha in a range of different scenarios.

Fund breakdown

Holdings and weights

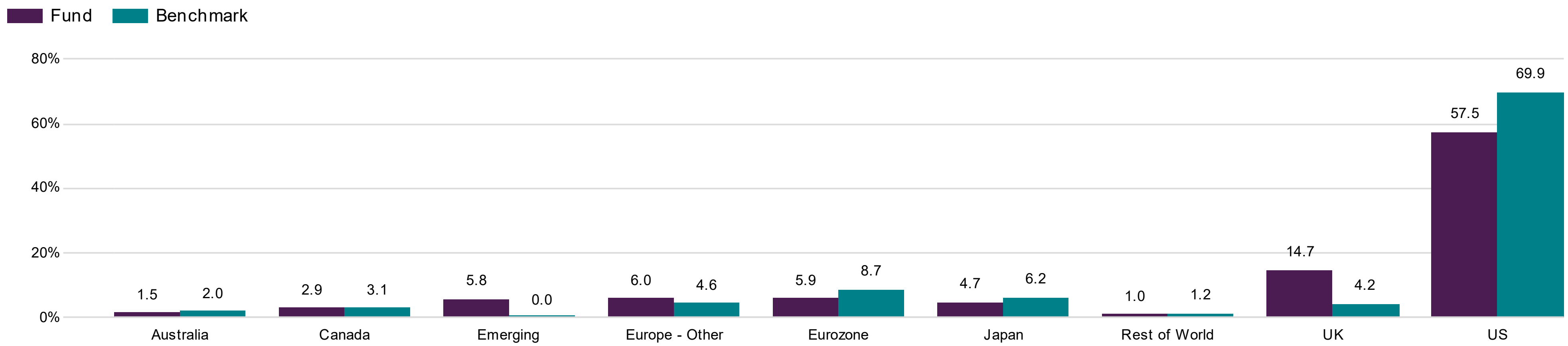


Sector weights



Fund breakdown

Regional weights



Market commentary

Equity markets made losses over the period under review on fears that policy will remain tighter for longer than expected, which saw equities drop to their lowest levels since early June. The quarter also saw a market rotation with the best performing sector being the fossil fuel-based energy sector, which had underperformed in prior quarters, and the information technology sector giving back some gains, having been the best performing sector year-to-date. For the third quarter, MSCI World and MSCI All Countries World Index (ACWI – which also includes 26 emerging markets) produced negative returns for the quarter in US dollar terms. Looking at national MSCI indices, the strongest market was Japan, while the weakest was Eastern Europe. In terms of style, the MSCI World Growth Index produced weaker returns versus the MSCI World Value Index.

The price of Brent crude oil soared by 24.7%, to $92.20 a barrel. Copper futures also declined a further 1.5% in dollar terms on the back of warning signs emerging of a weakening in global demand as China’s economic rebound stalls.

The US dollar appreciated by 3.1% against the yen, by 2.96% against the euro, and by 4% against sterling. On a translational basis, sterling’s strength against the dollar impacts sterling investors in overseas assets as it lowers the returns over the quarter. However, the weaker dollar will benefit any emerging markets countries and companies that have borrowed in dollars.

The third quarter was characterised by mixed data around the world, with central banks coming towards the end of their rate hiking path, but with cuts still seemingly a while away. The global economic picture is rosier now than it was at the start of the year, but global growth is spluttering again amid a disappointing bounce in China activity, slow-to-no growth in Europe and against a backdrop of restrictive monetary policy. The US still looks at risk of recession too, even if activity data to date has been fairly robust.

Inflation has fallen significantly and, although higher energy prices threaten a widespread revival in headline inflation, other factors – including a weak economic activity backdrop – should pull inflation lower still. With taming inflation still the priority for central banks, there is still a possibility of further rate hikes from the Federal Reserve (Fed), European Central Bank (ECB) and Bank of England (BoE), but peak rates look to be near, with real rates now well into positive territory.

Further Information

Please click on the links below for further information:

Stewardship and responsible investment at RLAM

Royal London voting and engagement

TCFD climate report

Find out more

Articles, videos and webinars explaining our investment thinking can be found in the Our Views section of www.rlam.com, including regular updates from our Fixed Income, Global Equity, Sustainable and Multi Asset teams. Notable publications in the third quarter include our annual Climate Report, as well as our annual Assessment of Value reports, available from the home page of www.rlam.com.

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Issued in October 2023 by Royal London Asset Management Limited, 80 Fenchurch Street, London EC3M 4BY. Authorised and regulated by the Financial Conduct Authority, firm reference number 141665. A subsidiary of The Royal London Mutual Insurance Society Limited.

The Fund is a sub-fund 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.

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Risks and Warnings

Investment Risk

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.

EPM Techniques

The Fund may engage in EPM techniques including holdings of derivative instruments. Whilst intended to reduce risk, the use of these instruments may expose the Fund to increased price volatility.

Exchange Rate Risk

Changes in currency exchange rates may affect the value of your investment.

Liquidity Risk

In difficult market conditions the value of certain fund investments may be difficult to value and harder to sell, or sell at a fair price, resulting in unpredictable falls in the value of your holding.

Emerging Markets Risk

Investing in Emerging Markets may provide the potential for greater rewards but carries greater risk due to the possibility of high volatility, low liquidity, currency fluctuations, the adverse effect of social, political and economic instability, weak supervisory structures and accounting standards.

Counterparty Risk

The insolvency of any institutions providing services such as safekeeping of assets or acting as counterparty to derivatives or other instruments, may expose the Fund to financial loss.

Charges from Capital Risk

Charges are taken from the capital of the Fund. Whilst this increases the yield, it also has the effect of reducing the potential for capital growth.

Performance to 30 September 2023

Cumulative (%)

	3 Month	6 Month	1 Year	3 Years	Since Inception
Fund (gross)	4.05	7.15	17.76	59.68	63.66
Fund (net)	3.86	6.77	16.92	56.27	59.48

Annualised (%)

3 Years (p.a.)	Since Inception (p.a.)
16.88	14.68
16.04	13.85

Year on year performance (%)

	30/09/2022 - 30/09/2023	30/09/2021 - 30/09/2022	30/09/2020 - 30/09/2021	30/09/2019 - 30/09/2020	30/09/2018 - 30/09/2019
Fund (gross)	17.76	4.27	30.05	-	-
Fund (net)	16.92	3.52	29.11	-	-

Past performance is not a guide to future performance. The impact of fees or other charges including tax, where applicable, can be material on the performance of your investment.
Source: RLAM as at 30 September 2023. All figures are mid-price to mid-price in GBP for the Royal London Global Equity Income Fund M Income; Since inception date 25 February 2020.

Glossary

Active share

Active share is a measure used to assess the degree of difference between the portfolio's holdings and its benchmark.

Fund value

Total value of the fund as of the last business day of the calendar month. The fund value is as at close of business and on a mid-price basis.

Number of holdings

Total number of unique holdings of the Fund excluding cash, currency and derivatives.

Performance

Performance is calculated using the daily end of day NAV per share produced by HSBC based on the mid price.

Sector weights

Breakdown of holdings by GICS (Global Industry Classification Standard) sector relative to the benchmark index.

Top 10 holdings

Top 10 assets held by market value, excluding derivatives and cash.

Tracking error

Tracking error measures how closely a portfolio follows its benchmark. It quantifies the standard deviation of the difference in return between the portfolio and benchmark.