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Royal London UK Mid Cap Growth Fund

Quarterly Investment Report

31 March 2024

ROYAL LONDON
ASSET MANAGEMENT

Quarterly Report

The fund as at 31 March 2024

The purpose of this report is to provide an update on the Royal London UK Mid Cap Growth 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 capital growth over the medium term (3-5 years), by investing at least 80% in the shares of UK medium-sized companies listed on the London Stock Exchange. The Fund's performance target is to outperform, after the deduction of charges, the FTSE 250 ex-IT (investment trust) Total Return GBP Index (the "Index") over rolling 5-year periods. The Index is considered an appropriate benchmark for the Fund's performance, as the Fund's potential investments will predominantly be included in the Index. In addition to the benchmark for the Fund's performance as noted above (the "Index"), the IA UK All Companies sector is considered an appropriate benchmark for performance comparison.

Benchmark: FTSE 250 ex-IT (investment trust) Total Return GBP Index

Fund value

	Total £m
31 March 2024	374.60

Fund analytics

	Fund
Fund launch date	1 June 2006
Base currency	GBP
Number of holdings	48

Performance and activity

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Quarter	0.68	1.90	(1.22)
1 Year	8.21	10.05	(1.84)
3 Years (p.a.)	(0.86)	0.43	(1.29)
5 Years (p.a.)	2.80	3.31	(0.51)
Since inception (p.a.)	5.08	4.58	0.50

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 UK Mid-Cap Growth (Z Acc). Source: Royal London Asset Management; Net performance; Since inception date of the shareclass is 6 May 2014.

Performance commentary

After a strong end to 2023, UK equities had a mixed first quarter of 2024 as investors moderated their expectations for interest rate cuts and economic data was a little softer than anticipated. Small and mid-cap markets underperformed. The fund underperformed the benchmark during the quarter, largely driven by stock selection.

Intermediate Capital, Bodycote and Beazley all announced positive results or trading during the period and were amongst the strongest contributors. Intermediate Capital Group issued Q3 results which revealed better-than-expected fundraising activity, led by two of its flagship strategies, Senior Debt Partners and Strategic Equity – bucking the trend of peers in the private equity market where some have struggled to raise new funds. In January Bodycote announced the acquisition of a US heat treatment business and kicked off a £60m share buyback programme, followed by strong results in March. Beazley delivered record full year results, with a combined ratio of 74% (this demonstrates an extremely successful underwriting result) and announced a $325m buyback alongside an increased dividend.

M&A activity was once again a feature of the small and mid cap market, with a number of companies bid for including Spirent Communications (held within the fund), Wincanton, Virgin Money, DS Smith, Accrol, and Mattioli Woods. Spirent was initially subject to an offer from Viavi (a US listed peer) which was subsequently trumped by Keysight (another US peer), with the latter offer at a c. 85% premium to Spirent's undisturbed share price.

Watches of Switzerland and Genus were significant detractors to performance. Watches of Switzerland downgraded profits guidance, following a deterioration in Christmas trading and particularly within lower tier luxury watches and jewellery. Sales in the UK declined year on year. By comparison demand was more robust in the US where they posted double-digit same store sales growth, reassuring of the supply and demand dynamics in their most important growth market. Profit margins compressed due to lower sales, but the business remains profitable and cash generative, with a significant net cash balance sheet to fund growth or shareholder returns. Genus also had to reduce earnings guidance due to weak demand in both bovine and porcine markets in a number of territories, but most acutely in China. The management team are taking action to fundamentally improve the economics of the business model in bovine, as well as removing some central costs to drive profitability. Within porcine, despite the weak trading results from China, they're nevertheless making progress winning large Chinese customers and transitioning more customers to predictable royalty contracts; this will be a better business when demand returns, echoing their world-class European and US operations.

Performance and activity

Top 10 holdings

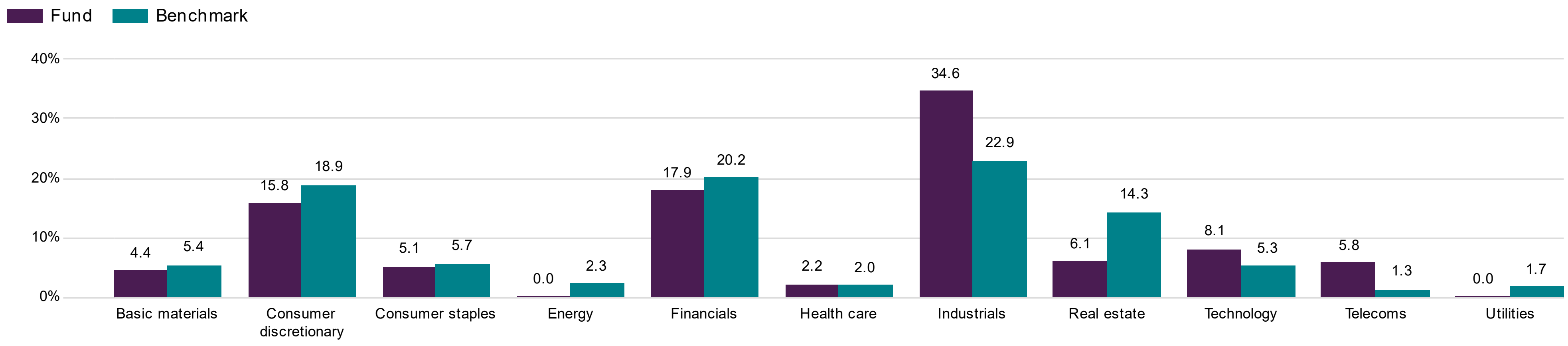
	Weighting (%)
Cranswick plc	3.28
Genuit Group PLC	3.14
Hill & Smith PLC	3.13
Rotork plc	3.12
Coats Group plc	2.96
Bodycote plc	2.93
Ascential Plc	2.92
Telecom Plus PLC	2.78
JTC Plc	2.78
Grainger plc	2.71
Total	**29.75**

Fund activity

The fund initiated a new position in homewares retailer Dunelm, funded by the disposal of B&M and Rathbones. Dunelm is the market leader in most of their homewares categories, having consistently taken share through their value proposition and “Good, Better, Best” range which allows them to address a very wide audience. The founding Adderley family still retain a significant minority stake, but under the current executive team the business has refined and improved their multi-channel offer and significantly grown their addressable market. The business generates significant free cashflow from its capital light operations, which more than covers their careful store expansion plan and ongoing online growth, as well as funding consistent excess returns to shareholders.

Fund breakdown

Sector weights



Market commentary

Market review

UK equities had a mixed first quarter of 2024 as it became clear that central bankers were not about to cut interest rates quite as early as hoped; various inflation data suggested that rates would have to stay elevated for a few more months, while in the UK economic indicators were generally soft. Small and mid-cap markets underperformed, with the FTSE All Share returning 3.5% while the FTSE 250 ex IT and the FTSE Smaller Companies ex IT respectively returned -1.1% and -2.0%.

The usual flurry of corporate January trading updates revealed winners and losers from the Christmas period – the larger grocers, food producers and consumer staples companies generally did better, while fashion retailers, online retailers and luxury goods companies had a tougher time – including a number of profit warnings. However this appears to be more of a change in consumer spending rather than wholesale reduction, as pubs, restaurants and travel operators all reported sustained demand.

The more detailed earnings season in March, where many businesses release their results for the prior calendar year, provided a clearer indication of how 2024 is shaping up. The message of course varied by sector, and there were a substantial number of weak updates – but for the most part, businesses were talking of no further deterioration in demand and some early signs that things were improving. One of the significant challenges to many corporates in 2023 was destocking, as earlier supply chain bottlenecks eased and customers ended up with excessive inventory to sell off, in turn reducing their orders for new product (magnifying falling demand whether for cosmetics, cars, trainers or industrial machines). Early indications suggest that this has mostly run its course, which should make demand more predictable through 2024.

Optimism for all things AI-related was the other significant trend within equity markets, albeit the impact was generally focused on large cap and international markets – the Nasdaq hit all-time highs in March following a series of eye-opening earnings statements from global tech companies including Nvidia.

Equity outflows have taken their toll on the UK stock market over the last four years, and this continued through the first quarter with an estimated outflow of -£4.6bn from mutual funds (Numis research). The government delivered its Budget for 2024, with one of the more relevant announcements being the launch of the British ISA. This will provide retail investors with an additional tax-free allowance should this be used to invest in UK equities or other UK investments, and while this alone is unlikely to be enough to reverse the flows described above, it should provide some support.

Outlook

Forward looking economic data suggests an improving trend through 2024. While the UK economy technically entered a mild recession at the end of 2023, consumers and corporates have generally coped reasonably well with the first rising interest rate cycle seen in over a decade. Banking sector balance sheets remain healthy, as do those of corporates. Input cost inflation – whether energy, freight or raw material related – has significantly declined over the past year and corporates should find it much simpler to manage their cost bases through the coming year. Whether central bank interest rates are cut earlier or later than August of this year (current market consensus), it seems very unlikely that they're increased. As such, corporate and consumer confidence, already on an improving trajectory since interest rate increases were paused last summer, should strengthen as the year goes on. Consequently, we expect gradually improving demand through the 2024.

We believe that small and mid-cap equities continue to offer good value, not only relative to history and international equity indices but also in absolute terms. Our portfolio companies remain well capitalised and most have net cash balance sheets which could be deployed on acquisitions or organic investment to enhance earnings growth. However, in an era where capital is no longer 'free', management teams must focus even more rigorously on the appropriate allocation of capital. Equity outflows have depressed many share prices and in cases where companies have strong balance sheets but depressed share prices, it may be hard to find a higher return for shareholders than simply buying back their own stock. In this way, companies may accrete their earnings per share growth significantly. We expect this to continue given the attractive valuations on offer.

Despite the market's obsession with forecasting short-term macroeconomic data over the recent past, our focus has always been on investing over the long term. We continue to seek out companies with the key fundamental SIMBA attributes (Scaleability, Innovation, strong Management teams, Barriers to entry and unique Assets) that will allow them to take market share and prosper throughout economic cycles. We continue to believe that it is these fundamental attributes that drive earnings and thus stock prices over the long term and we remain excited by the opportunities currently on offer for UK small and medium company investors.

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

In an uncertain geopolitical and economic environment, we recognise the importance of keeping our clients updated on our current investment thinking.

Articles, videos, podcasts and webinars giving the latest views of our investment experts 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.

Disclaimers

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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 risk

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.

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.

Performance to 31 March 2024

Cumulative (%)

	3 Month	6 Month	1 Year	3 Years	5 Years
Fund (gross)	0.83	11.27	8.88	(0.74)	18.42
Fund (net)	0.68	10.93	8.21	(2.56)	14.83

Annualised (%)

	3 Years (p.a.)	5 Years (p.a.)
Fund (gross)	(0.25)	3.44
Fund (net)	(0.86)	2.80

Year on year performance (%)

	31/03/2023 - 31/03/2024	31/03/2022 - 31/03/2023	31/03/2021 - 31/03/2022	31/03/2020 - 31/03/2021	31/03/2019 - 31/03/2020
Fund (gross)	8.88	(7.69)	(1.24)	42.64	(16.36)
Fund (net)	8.21	(8.26)	(1.85)	41.76	(16.87)

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 31 March 2024. All figures are mid-price to mid-price in GBP for the Royal London UK Mid-Cap Growth (Z Acc).

ROYAL LONDON ASSET MANAGEMENT

Glossary

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 FTSE ICB (Industry Classification Benchmark) sector relative to the benchmark index.

Top 10 holdings

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