



ASSET MANAGEMENT

**FUND MANAGER  
COMMENTARY**

**ROYAL LONDON  
EQUITIES**

**MAY 2017**

*For professional investors only, not suitable for retail investors*



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## RLAM EQUITY PERFORMANCE

	1 month (%)	Rolling 12 months (%)
<b>RL UK Equity Income M Inc</b>	<b>4.47</b>	<b>23.82</b>
IA UK Equity Income Sector	3.58	21.59
FTSE All Share Index	4.36	24.52
<b>RL UK Growth Fund M Acc</b>	<b>3.48</b>	<b>25.06</b>
IA UK All Companies Sector	3.58	21.59
FTSE All Share Index	4.36	24.52
<b>RL UK Mid Cap Growth Fund M Acc</b>	<b>3.26</b>	<b>18.66</b>
IA UK All Companies Sector	3.58	21.59
FTSE 250 Index	2.15	19.48
<b>RL UK Opportunities Fund M Acc</b>	<b>2.75</b>	<b>15.15</b>
IA UK All Companies Sector	3.58	21.59
FTSE All Share Index	4.36	24.52
<b>RL UK Smaller Companies Fund M Acc</b>	<b>4.29</b>	<b>22.61</b>
IA UK Smaller Companies Sector	3.54	27.56
FTSE Small Cap ex IT Index	1.78	23.99

Source: RLAM and FE. Returns quoted are net of fees. 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.



## ROYAL LONDON UK EQUITY INCOME FUND

### Portfolio Commentary

- During May, the Fund was ahead of both the All Share Index and competitor funds. The Fund's performance benefited from an unsolicited bid approach for **Berendsen**, at a large premium to the prevailing share price, from French competitor, Elis. The Fund also benefited from **Spirax Sarco**, whose announcement of an earnings enhancing acquisition was well-received. The largest detractor was **Close Brothers**, whose shares gave up the strong gains made in the previous month.
- During the month, the Fund took some profits in Berendsen following the bid approach, having added to the holding when the shares were at much lower levels in March. The Fund also sold the remainder of its **Booker holding**, and further reduced the position in **Atkins (WS)**. The Booker bid is likely to face intense scrutiny from the Competition and Markets Authority. The money raised from these sales was reinvested into a broad range of existing holdings, including **McCarthy & Stone** and **De La Rue**.
- By market cap, the breakdown of the Fund is 54.1% large cap, 38.9% mid-cap and 7.0% small cap/ AIM/ other.

### Investment Outlook

- The impending general election adds to political risk in the short term, although the stock market continues to assume that the conservatives will be re-elected with a working majority, despite a recent narrowing in opinion polls. Overall, the manager believes the UK is likely to experience an extended period of economic uncertainty over the Brexit negotiations. The consumer background is likely to remain challenging for the balance of 2017 and stock selection within the consumer space will remain very important. The Fund is underpinned by cautious economic growth assumptions, and its focus on strong market positions, cashflow-backed dividends and robust balance sheets should provide resilience in a whole range of possible economic outcomes.



**Martin Cholwill**  
SENIOR FUND MANAGER





## ROYAL LONDON UK GROWTH FUND

### Portfolio Commentary

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- During May, the Fund's performance was behind both the All Share index and competitor funds, ranking in the 60<sup>th</sup> percentile in its peer group for the month. Year-to-date, however, the Fund remains well ahead of its peers, ranking in the 29<sup>th</sup> percentile.
- The biggest headwind to relative performance during May came from some market 'heavyweights' which performed particularly well over the month, but which are either not held in the Fund, or are held at less than the benchmark's level. These included, **Vodafone**, **Reckitt Benckiser**, **Unilever** and **HSBC**. In terms of positive performance, the Fund benefited from its holding in **Berendsen**, who received an unsolicited bid approach from the French company **Elis**. The Fund also saw strong performance from its holdings in **Sage**, **Intermediate Capital** and **B&M Retail**, all of which released trading statements.
- During the month, the Fund reduced its holding in Berendsen into the sharp rise in the share price, following the bid for the company, and also reduced its holdings in **Booker** and **Atkins (WS)**, both of which are still in bid situations. Two new holdings were established in pharmaceutical company **Hikma** and insurer **Standard Life**.

### Investment Outlook

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- All eyes will be on this month's UK general election, particularly as recent polls suggest that the result may be closer than initially thought. The Fund is not positioned for any single macroeconomic scenario, and instead looks to invest in a range of companies that are in control of their own destinies, whatever the market conditions. The Fund aims to invest in businesses that have strong market positions, robust cashflows and un-stretched balance sheets, traits which should allow long-term dividend growth.



**Richard Marwood**  
SENIOR FUND MANAGER



## ROYAL LONDON UK MID CAP GROWTH FUND

### Portfolio Commentary

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- The FTSE250 underperformed the FTSE100 as sterling weakness benefited the larger multinational companies. Sterling has responded to moves in opinion polls, and its influence on UK equity market performance is growing. The more domestic-focused mid cap sectors probably need a decisive election outcome to revive their relative performance.
- The Fund outperformed, driven by good stock selection. **Sophos** was the main contributor, as the global cyber attack in May built on its preannouncement of strong billings growth of 20% in April, while the company's results provided further good news of margin expansion and a mid-term growth in free cashflow and billings. **Bodycote** experienced some profit-taking after a broker downgrade. There were two additions to the Fund: first, **Coats**, the industrial threads company, will be admitted to the FTSE 250 index at its June rebalancing, which could be a technical boost for the company's shares. The second addition was **Alfa Financial Software**, which develops asset finance software and provides a global software platform for automotive and equipment finance providers. **Restaurant Group** and **Spire Healthcare** were sold, while profits were taken in **Atkins (WS)** as the share price remained above the level of the bid.

### Investment Outlook

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- The recovery in the UK version of the 'reflation trade' that appeared to be underway a month ago now appears to have been something of a false dawn. Mounting uncertainty about the US policy outlook, uncertainty over the UK general election, and the dip of UK gilt yields back below 1%, have provided more obstacles for companies that should benefit from arising rate environment, and it is difficult to make the case for an imminent reversal of their recent underperformance.



**Derek Mitchell**  
SENIOR FUND MANAGER



## ROYAL LONDON UK OPPORTUNITIES FUND

### Portfolio Commentary

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- The FTSE250 underperformed the FTSE100 as sterling weakness benefited the larger multinational companies. Sterling has responded to moves in opinion polls, and its influence on UK equity market performance is growing. The more domestic-focused mid cap sectors probably need a decisive election outcome to revive their relative performance.
- The Fund underperformed its benchmark as several stocks disappointed. **Ashtead** has fallen 10% since its March high, as hopes for Trump infrastructure spending and tax cut have faded. However, upcoming numbers should reflect the positive trends in US rental industry growth. **BT** has struggled from increased regulatory oversight, as well as intensifying competition, along with a possible risk to its dividend from the accelerated capital expenditure required for its fibre rollout. **Synthomer** was the best performer, as its share price responded positively to the trading update at the end of April. There was one addition to the Fund: **Intermediate Capital Group** is a specialist asset manager investing in private debt, credit and equity. The Fund has sold of its position in **Booker** in order to avoid owning Tesco shares. The competition enquiry into the deal could last until the end of the year.

### Investment Outlook

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- The recovery in the UK version of the 'reflation trade' that appeared to be underway a month ago now appears to have been something of a false dawn. Mounting uncertainty about the US policy outlook, uncertainty over the UK general election, and the dip of UK gilt yields back below 1%, have provided more obstacles for companies that should benefit from a rising rate environment, and it is difficult to make the case for an imminent reversal of their recent underperformance.



**Derek Mitchell**  
SENIOR FUND MANAGER





## ROYAL LONDON UK SMALLER COMPANIES FUND

### Portfolio Commentary

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- The Fund performed very strongly both in absolute terms and relative to its benchmark index and comparative peer group. Outperformance was again driven by stock selection rather than sector allocation, as a number of portfolio holdings reported positive earnings updates. In particular, **Coats** and **GB Group** contributed positively to portfolio performance. The former released a trading update detailing an encouraging sales trajectory, especially in its performance materials division, and there was also speculation that the company would join the FTSE 250 index in June. GB Group made a strategically compelling and earnings-enhancing acquisition of PCA Predict, for which the Fund subscribed.
- The Fund sold its remaining holding in **Manx**, following the sale of shares by the executive management, and also sold **Galliford Try** (a mid-cap stock) after the end of merger negotiations with Bovis. The proceeds were in part used to add to the holdings in **Zegona Communications** (which was bid for by Euskatel), **GB Group** (as part of the fundraising to acquire PCA Predict) and **Medica** (which supplies teleradiology services to the NHS). The Fund also took part in the Initial Public Offering (IPO) of **PRS REIT**, a specialist Real Estate Investment Trust focusing on the development of the fast-growing private rented accommodation sector in the UK.

### Investment Outlook

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- Despite hitting new highs, small and mid-cap stocks underperformed their larger peers in the FTSE 100 as sterling came under renewed pressure, UK government bond yields declined and investors sought more defensive stock attributes. A decisive election outcome would be positive for sentiment towards UK mid and small-cap stocks. There is currently a low level of correlation between stocks, indicating a stock-pickers' market, and bottom-up earnings numbers have been and will continue to be a key driver of performance. The current level of analyst profit growth projections for 2017 remains undemanding and management tones have been positive.
- We continue to focus on investing in smaller companies with strong balance sheets, healthy cashflow and positive earnings optionality.



**Henry Lowson**  
SENIOR FUND MANAGER







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