Idiosyncratic returns – consistent alpha across different style cycles

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Royal London Asset Management (RLAM) has partnered with Fundrock distribution S.A, who will distribute RLAM's products and services in the EEA. This follows the United Kingdom's withdrawal from the European Union and ending of the subsequent transition period, as UK Financial Services firms, including RLAM, can no longer passport their business into the EEA.

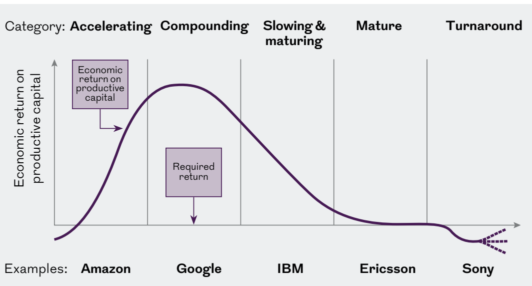
In 2017, RLAM launched two global equity strategies – Global Equity Select and Global Equity Diversified. The strategies have since produced four years of attractive absolute and relative returns, continuing an impressive track record from a strategy that was initially launched in 2002. Using a markedly differentiated stock selection approach, the strategies have delivered a consistent track record of performance across economic cycles and differing periods of style leadership.

Given the polarisation of Growth and Value style returns over the recent market cycle, it is a good opportunity to look back and understand the drivers behind performance. What we see is evidence of an approach that has idiosyncratic company insights driving outperformance, without depending on a favourable style environment.

A differentiated approach to peers

We believe that to deliver superior risk-adjusted returns you need to have a competitive edge in comparison to your peers. Our Economic Return Framework and Corporate Life Cycle Concept form the basis of our investment process and provide the team with a high-quality global set of data that can be used to identify companies which are both creating wealth for equity shareholders and fundamentally undervalued.

Figure 1: Corporate Life Cycle Concept



Source: RLAM for illustrative purposes only.

Proprietary informational and analytical advantages

Our Economic Return Framework covers more than 5000 stocks across the globe and has been built to standardise both balance sheet and cashflow data across regions, sectors, timelines and accounting practices. We believe that this provides us with an advantaged start point of economic value comparisons across our investible universe.

Our Corporate Life Cycle Concept (figure 1) uses this standardised real economic return data to categorise companies into five distinct phases, each representing a different stage of a corporate's life cycle. This allows us to better compare and evaluate companies within each stage, mindful of the knowledge that the key drivers of success in each are different.

Our Shareholder Wealth Creation test seeks to identify companies that are creating shareholder wealth with superior business models, management skill and capital allocation opportunities, recognising that the drivers of this wealth creation are Life Cycle specific. For example, a Compounding business creates wealth via maintaining high returns on productive capital and growing; however, a Turnaround business should actually look to shrink weak assets, as a route to improve its returns on capital.

Stock selection and portfolio construction

We perform fundamental and valuation analysis on companies with the strongest evidence of long-term wealth creation. Importantly, the path of analysis is again informed by proprietary Life Cycle stage considerations and with reference to industry structure and company-specific sources of competitive advantage. There is also an explicit focus on Life Cycle specific ESG (environmental, social and governance) analysis, further differentiating our work.

Through our process we identify three categories of companies with material ESG issues: clearly positive, challenging but attractive and clearly negative. Positive companies, like those who are part of the environmental solution in clean tech, can be great investments – the challenge can be buying at an attractive price. Clearly negative is a deal-breaker and we avoid these companies. Challenging but attractive companies need further investigation beyond a simple industry or sector-led approach.

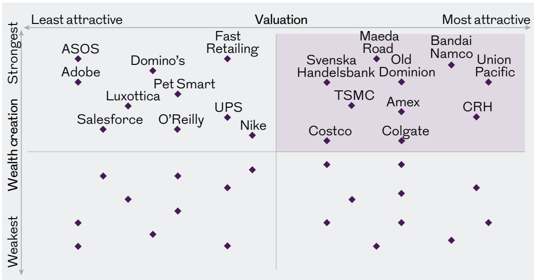
These analyses give us a pool of stocks that provides the source of potential investments for inclusion in our global equity strategies.

Ultimately we believe that this process leads to portfolios that are balanced across regions, sectors, styles and life cycle segments. Our approach provides investors with a differentiated return stream that has delivered across different style cycles.

Consistent alpha – seeing through the market cycles

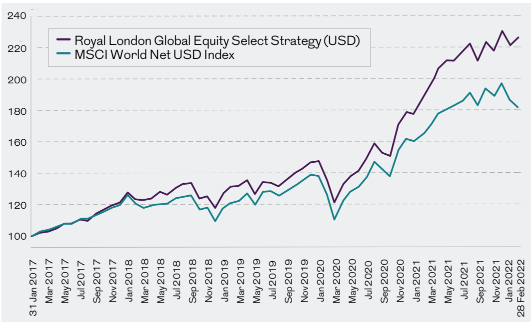
As we enter a new phase in the global economy, our global equity strategies are designed to have high levels of stock specific risk and limited aggregate style exposures. This means that should our idiosyncratic stock picking alpha be as successful as it has been in the last 19 years, the strategies have the potential to perform on a relative basis across multiple market and socio-economic scenarios.

Figure 2: Portfolio construction



Source: RLAM, for illustrative purposes only.

Figure 3: Global Equity Select performance



Past performance is not a reliable indicator of future results. Source: RLAM as at 28 February 2022. Performance of the RL Global Equity Select Strategy is based off gross end of day prices. 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.

Figure 4: Global equity strategies

	Global Equity Select	Global Equity Diversified	Global Sustainable Transitions
Benchmark	MSCI World Net Total Return Index	MSCI World Net Total Return Index	MSCI World ACWI Index
Performance target	To outperform the benchmark by 2.5% p.a. over rolling three year periods (net of fees)	To outperform the benchmark by 0.4%-0.8% p.a. over rolling three year periods (net of fees)	To outperform the benchmark by 2% over rolling three year periods (net of fees)
Typical number of holdings	25-45	175-225	35-50
Approach	Unconstrained, high active share	Diversified holdings, low tracking error	Material contribution to sustainable transition, high active share

Source: RLAM as at March 2022.

Investment Risks:

Past performance is not a guide to future performance. 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. The views expressed are those of the author at the date of publication unless otherwise indicated, which are subject to change, and is not investment advice.

For more information contact
info_frd@fundrock.com

ROYAL LONDON
ASSET MANAGEMENT