Royal London UK Smaller Companies Fund

Quarterly Investment Report

30 June 2024

Quarterly Report

The fund as at 30 June 2024

The purpose of this report is to provide an update on the Royal London UK Smaller Companies 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.

Contents

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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 smaller companies listed on the London Stock Exchange. The Fund's performance target is to outperform. after the deduction of charges, the FTSE Small Cap ex-IT (investment trusts) 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 Smaller Companies sector is considered an appropriate benchmark for performance comparison.

Benchmark: FTSE Small Cap ex-IT (investment trusts) Total Return GBP Index

Fund value

	Total £m
30 June 2024	337.35

Fund analytics

	Fund
Fund launch date	20 July 2007
Base currency	GBP
Number of holdings	67

Performance and activity

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Quarter	7.23	9.28	(2.05)
YTD	5.16	8.19	(3.03)
1 Year	13.61	18.54	(4.93)
3 Years (p.a.)	(7.63)	0.28	(7.91)
5 Years (p.a.)	3.36	7.87	(4.51)
10 Years (p.a.)	6.46	6.64	(0.18)
Since inception (p.a.)	8.60	9.88	(1.28)

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 Smaller Companies (M Acc). Source: Royal London Asset Management; Net performance; Since inception date of the share class is 1 May 2012.

Performance commentary

UK equities rallied through the second quarter of 2024, spurred on by stronger economic data, falling inflation, and a flurry of takeover approaches for public companies. Smaller companies outperformed their larger peers, in a 'risk-on' market which saw more cyclical companies and those with more financially geared balance sheets, outperform. The fund performed in line with the peer group median and underperformed the benchmark index.

Alpha FMC, AJ Bell, Johnson Service Group and GB Group were amongst the strongest positive contributors. Alpha FMC was the subject of a takeover approach by Bridgepoint private equity, at a 51% premium to the undisturbed share price. AJ Bell reported strong interim results, supported by improved asset flows onto savings platforms – both via financial advisors and directly from retail investors – as well as rising markets. Despite investing into improving their technology stack and customer services teams, they demonstrated positive operating leverage as rising revenues outstripped cost investment. Johnson Service Group results confirmed strong sales growth within their hotel, restaurant & catering division. Management also indicated their confidence in operating margins expanding back to pre-Covid levels earlier than expected, a result of pricing power, operational efficiencies, and lower energy costs. GB Group delivered solid full year results under their new CEO, with end markets demonstrating sustained improvement in demand following a challenging two years. New product launches and new customer wins through this period point to good operational execution despite tough markets, leaving them well placed to benefit from the emerging recovery, while their balance sheet has also de-geared.

YouGov and Auction Technology Group (ATG), were detractors to performance. YouGov's trading update revealed weaker than expected revenues due to soft corporate spending and, more worryingly, increased competition for their Data Products. Venture capital backed, loss making competitors have been undercutting YouGov on price which led to some customer churn and reduced new customer wins. Competitor products are based on outsourced panels and lack the granularity, history, and quality of YouGov's data from their proprietary panel. Competitor propositions will nevertheless be suitable for some customers, and YouGov need to adapt to demonstrate their product quality to the rest of the market. Management expect product enhancements, a more targeted sales approach, and a review of the cost base to return the business to profit growth next year. ATG declined as the company lowered guidance for organic growth for the full year. This was predominantly a reflection of softer demand on their Industrial & Commercial sites, as used equipment prices normalise post Covid; while disappointing this should prove temporary. Encouragingly, 'value added services' (namely their payment and shipping capabilities) continue to be well received by auctioneers.

Performance and activity

Top 10 holdings

	Weighting (%)
BOKU, Inc.	2.77
GlobalData Plc	2.69
XPS Pensions Group Plc	2.67
Porvair plc	2.52
Hollywood Bowl Group Plc	2.51
AJ Bell Plc	2.37
Chemring Group PLC	2.36
Alfa Financial Software Holdings Plc	2.35
Wilmington plc	2.32
Cranswick plc	2.23
Total	**24.79**

Fund activity

The fund participated in the IPO of Raspberry Pi and added to a number of existing holdings including Young & Co, DiscoverIE, Marshalls, and Moonpig. These were funded in part by the disposal of Videndum and Fuller, Smith & Turner.

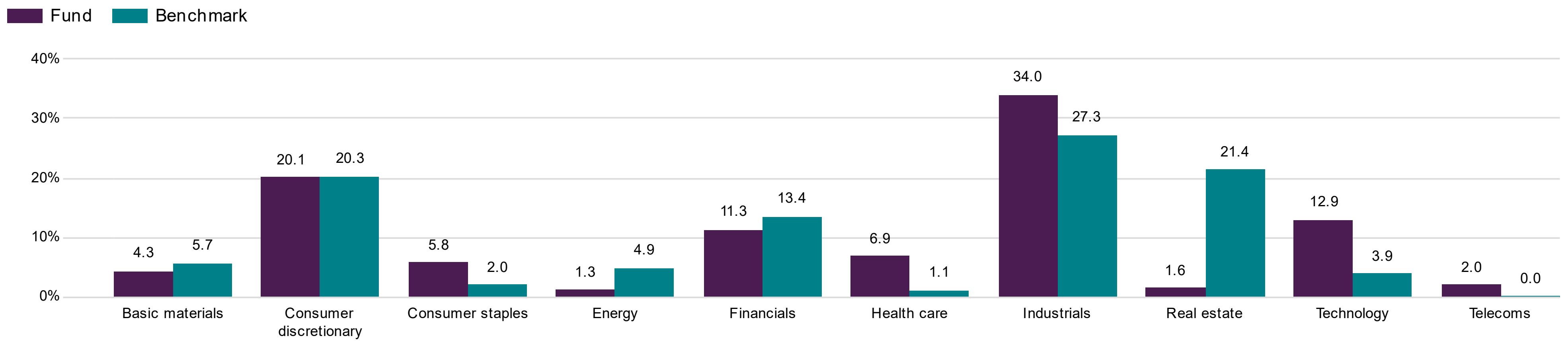
Raspberry Pi is a developer of low cost, high quality single board computers. The company is run by a founder-led management team who have an impressive track record and retain a meaningful shareholding. Raspberry Pi is well established in the enthusiast & education market, but they generate a greater proportion of revenues from the industrial & embedded end market, and we expect this to remain the main driver of growth. Engineers have been designing in Raspberry Pi's products to power edge computing applications and to enable industrial connectivity – together providing substantial long-term growth tailwinds to this market. Raspberry Pi has been taking share in this market thanks to their excellent brand, known for highly cost effective and reliable products, which crucially benefit from both company-developed and user-developed software applications.

The position in Fuller, Smith & Turner was disposed of following improved results, with the company benefiting from the much-delayed post-Covid recovery in central London traffic as sales have finally recovered to pre-pandemic levels on a nominal basis. The share price mirrored the recovery in sales, as did the valuation multiple. However, sales have been driven by substantial price inflation rather than improving volumes, and margins remain below previous levels – pointing to disappointing operational performance and an elevated central cost base. By contrast, peer Young & Co has delivered substantially better operational performance over the medium term under the current management team, but the valuation has reduced following their acquisition of City Pubs group last year (which was held in the fund) and the shares now trade at a discount to Fullers, despite a track record of better like-for-like sales, higher margins and returns on capital. We have increased our position in Youngs.

The position in Videndum was sold due to concerns over end markets, which have not yet demonstrated substantial recovery following the end of writers strikes, and the risk of further pressure on their balance sheet.

Fund breakdown

Sector weights



Market commentary

Market review

UK equities rallied through the second quarter of 2024, spurred on by encouraging economic data as UK GDP growth sequentially improved even as the rate of inflation slowed. Small cap companies outperformed their larger peers amid a flurry of takeover approaches, in a 'risk-on' market which saw more cyclical companies and those with more financially geared balance sheets, outperform. The FTSE All Share returned 4.5% while the FTSE 250 ex IT and the FTSE Smaller Companies ex IT returned 2.9% and 9.2% respectively.

Politics dominated the headlines through May and June, with elections called in both the UK and France. Within the UK, financial markets had been anticipating a change of administration for some time and an election is arguably a clearing event, removing the overhang of political uncertainty. In the UK, both major parties pledged fiscal stability as part of their campaigns, and the lack of significant moves amongst equity sectors or in bond markets through the campaign was telling.

The M&A spree continued with 21 takeover approaches (with a deal value >£100m) for UK public companies in the quarter, including Hargreaves Lansdown, Darktrace, Tyman, John Wood Group, Britvic, and Keywords Studios. In 2024 so far, 9% (by value) of the FTSE250, and 6% (by value) of the FTSE AIM All Share has announced a takeover approach. The fund's holding in Alpha FMC was subject to initial approaches from multiple private equity buyers, with Bridgepoint making an all-cash offer at a 51% premium to the undisturbed share price.

The rate of inflation fell throughout the quarter, with UK CPI hitting the Bank of England's target of 2% in June. This put UK inflation lower than that of the US and eurozone and paves the way for cuts to the Bank of England's interest rates after the summer.

Equity outflows have taken a substantial toll on the UK stock market over the last five years, and somewhat unbelievably investors continued to withdraw their money through the second quarter despite the attractive valuations, an improving economic backdrop and sustained bid approaches by private equity who evidently see the attractions of these companies. An estimated £4.7bn was withdrawn from UK equity funds in the period (DB Numis research). It will be interesting to see whether the new government implements any of the Mansion House reforms proposed last year, aimed at improving the UK capital markets.

Outlook

Forward looking economic data remains positive, with UK PMI surveys pointing to improving demand through the rest of the year. While there remain pockets of inflation – most notably in wages following the almost 10% increase in the National Living Wage in April – the headwinds to profit margins which have been facing companies over the last two years (inventory destocking, energy prices and raw material or component shortages) have generally faded. We think that corporates should find it much simpler to manage their cost bases through the coming year, while higher corporation tax rates in the UK have now annualised and interest rates are expected to fall. In aggregate, this should enable a return to more predictable profit growth for companies, subject to an ongoing recovery in corporate and consumer confidence. Political stability – assuming no shocks in the first budget of an incoming government – should additionally provide corporates with the confidence to invest into hiring or expanding capacity. We continue to expect an improving economic backdrop through 2024 and into 2025.

We consider that small and mid-cap equities offer good value in absolute terms, relative to history and relative to international equity indices. Our portfolio companies remain well capitalised, and many have net cash balance sheets which could be deployed on acquisitions or organic investment to enhance earnings growth. The number of small and mid-cap companies announcing share buybacks, reflecting their balance sheet strength as well as their view of equity market valuations, continues to increase.

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.

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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.

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.

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.

Smaller companies risk

The Fund invests in smaller companies, the prices for which can be less liquid and be more volatile than those of larger companies and therefore may have a greater impact on the value of the Fund.

Performance to 30 June 2024

Cumulative (%)

	3 Month	6 Month	1 Year	3 Years	5 Years
Fund (gross)	7.43	5.56	14.48	(19.38)	22.59
Fund (net)	7.23	5.16	13.61	(21.21)	17.98

Annualised (%)

3 Years (p.a.)	5 Years (p.a.)
(6.92)	4.15
(7.63)	3.36

Year on year performance (%)

	30/06/2023 - 30/06/2024	30/06/2022 - 30/06/2023	30/06/2021 - 30/06/2022	30/06/2020 - 30/06/2021	30/06/2019 - 30/06/2020
Fund (gross)	14.48	(6.03)	(25.06)	50.57	0.99
Fund (net)	13.61	(6.75)	(25.63)	49.42	0.22

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 June 2024. All figures are mid-price to mid-price in GBP for the Royal London UK Smaller Companies (M Acc).

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.