10 August

Royal London Market update

Lorna Blyth provides an update on the impact of recent market events on the Governed Range.

Lockdowns continued to ease across the globe as many countries begin to return to some sense of normality. We've seen regional lockdowns in areas like the North East of England and Aberdeen in Scotland, as well as Melbourne in Australia, however these are designed to reduce the likelihood of more National lockdowns in the future. Global Equity markets were relatively flat in July although they did remain volatile as we saw regions in both the UK, US and Europe show spikes in COVID cases. With both economic and virus risk still a very real threat, heightened volatility is expected to continue in the coming months. Year to date returns across the portfolios are ranging from -1.7% to -7.4% in the GPs while GRIPs range from 0.9% to -3%. All performance numbers quoted are net of a 1% charge and you can find returns for all the portfolios over the short and long term in the link at the end of this update. All the portfolios continue to be well diversified across a range of asset classes. Our durational bonds have continued their strong performance over the last year and year to date, all outperforming their respective benchmarks, except for short corporate bonds which has marginally underperformed. We continue to believe in the medium- and long-term value of global high yield bonds and closely monitor the assumptions backing these decisions.

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Please note that this is a fast-moving environment and markets and impacts on portfolios are changing. Opinions contained in this document represent views of our fund managers at time of writing.

Market view from Piers Hillier, CIO, RLAM

Over the past month equity markets have continued to grind higher, while credit spreads have narrowed, and government bond yields have declined. This rare combination is the product of numerous market drivers, among them: positive developments around a Covid-19 vaccine, sharply rising new cases and deaths, continued massive stimulus from governments and central banks, weakening economic data and rising tensions between the US and China. The exception to the positive market news this month was the UK stockmarket, which moved slightly lower, as second quarter earnings in the banking sector provided an early indication of the impact of Covid-19 on the credit quality of their loan portfolios, and the housebuilders indicated that demand had softened after the initial bounce post lockdown.

Our global equities team recently calculated that the nominal market-implied discount rate for developed markets has fallen yet again, by 0.2% to 4.1%. The rate has fallen steadily over the past decade, with the decline accelerating during the Covid-19 pandemic. It determines how much future cashflows ought to be discounted in calculating share prices, so when it falls equities ought to become more attractive. It also explains much of the outperformance of 'growth' stocks over 'value' stocks during the past decade, given that 'growth' stocks are more sensitive to declines in the discount rate.

Our investment teams have also been looking at the second quarter US corporate earnings season. The results have so far been very strong, nearly all coming in line or beating market expectations. Of course, to some extent that simply reflects how low expectations have been given the terrible economic data; second quarter US economic growth was the worst ever recorded at -32.9%. Reassuringly, the better-than-expected earnings results did not solely come from unsustainable cost cutting, but often from revenues having proven more resilient than expected.

In fixed income, the focus for many is on downgrades and defaults. How bad will these get? Our view is that there will be more downgrades in investment grade credit, including into sub-investment grade, and higher default rates in high yield markets. We continue to favour bonds offering security, even if the Bank of England's corporate bond purchases have largely ignored these.

As holders of secured bonds, we are in discussions with several issuers: for obvious reasons we cannot give details, but our overarching approach in these conversations has been to balance the need to be a responsible investor at a time of heightened economic uncertainty with our desire to guard our clients' interests.

Responsible Investment

An update on engagement on cyber security during the coronavirus crisis
Technology has brought many benefits to society, such as mobile telephony, virtual office, e-commerce, and remote diagnostics. With many of us working remotely during lock-down, we have been the beneficiaries of this sophisticated technology. But as technology advances, there are unprecedented systemic security threats that can undermine the trust and growth of the digital economy.

In 2019, we identified cybersecurity as a priority for engagement. This was based on the World Economic Forum's assessment of global risks, the EU Cybersecurity Act and the US Securities and Exchange Commission (SEC) identification of the issue as a growing threat to society, investors and capital markets. The risk was compounded by a lack of public disclosure by companies describing how they were addressing the issue.

During the first half of this year, we engaged with 25 companies in higher risk sectors as determined by the EU Cybersecurity Act and academic input. Our engagement conclusion was that, due to concerns about information sensitivity, companies tend not to disclose cybersecurity measures undertaken publicly even though their practices may be advanced. While some companies have identified cybersecurity as a key corporate risk, few can demonstrate that they have a cyber-resilient culture, underpinned by training and systems stress-testing.

We undertook the bulk of this engagement during the coronavirus lock-down, which provided interesting context to our discussions with companies since many people and companies have reported a surge in cyber security threats during the pandemic. Our engagement has benefitted from direct conversations with companies (using virtual technology, nonetheless!) to discover better information on their management practices which will better inform our investment decisions. We have published a report here, detailing our findings, which we hope our clients will find insightful and informative.

UK Commercial Property

The UK commercial property market has recently shown some signs of improved sentiment. The MSCI UK Monthly Index, which measures investment performance of 43 UK portfolios valued at £38.2bn, has seen month-on-month improvements since March, with total returns in June only marginally negative at -0.23%. We are expecting to see a further improvement in the July data when this gets released next week, however confidence remains fragile and economic indicators point towards a fragmented occupier market.

The retail sector continues to face strong headwinds; consumer confidence is low and as the furlough scheme unwinds at the end of October, job security is likely to fall further, which could diminish retail spending. Retail sales values in June showed a surprise return to growth of +1.5%. Volume growth outstripped value growth in June though which suggests that retailers are discounting heavily to stimulate sales. More store closures have been announced including Pizza Express (67 outlets), Oak Furnitureland (27 showrooms), Burger King (50 – 100 outlets), Pret a Manger (30 stores) and TUI (166 high street stores). Greggs has cut its expansion plans. Having originally announced it wanted to open 100 stores by the end of the year, it has now stated that is will open 60 new shops but close 50 existing stores. Retail vacancy rates rose slightly in the second quarter of the year from 12.2% to 12.4%. According to the MSCI Monthly Index, retail rental values fell on average by 3% over the quarter. This is the sharpest quarterly decline on record, highlighting the current weakness in occupier demand for physical space.

In contrast, the logistics sector remains relatively buoyant. Colliers reported that take-up for H1 2020 was 17.7 million square feet, which was 20% ahead of the same period last year. Given the challenges tenants have been facing, this is a remarkable figure.

In the office sector, take-up levels in Central London were 66% below average as the lockdown caused the market to halt, but there are now signs of recovery as restrictions ease. There have been mixed headlines as some lettings have been put on hold, particularly expansionary moves, but expiry driven activity continues. Availability has increased. CBRE report London vacancy at 5.3% up from 4.4% in Q1 and above long term average of 5.1%, the result of a rise in second-hand space. There is still demand for best-in-class though, with 50% of space under construction either let, or under offer.

Data from Savills indicates that Q2 2020 was the weakest quarter on record for investment activity in the UK commercial property market. They estimate that investment volumes in the first half of 2020 were 43% below the five-year average. We expect to see investment levels rebound in H2 as buyers seek to take advantage of opportunities and London's pricing relative to other European office markets, especially when accounting for its higher liquidity. Demand for warehouse and logistics investments continues to be strong with pricing for prime assets still trading at pre-lockdown levels. The next few months will serve as an interesting barometer to gauge how quickly confidence returns.

Performance year to date

Governed Portfolios

Portfolio Name	Percentage Growth 31.12.19 07.08.20 % Chg	Percentage Growth 07.08.19 07.08.20 % Chg
Governed Portfolio 1	**-5.27**	**-2.59**
Composite Benchmark	-4.22	-2.11
Difference	-1.05	-0.48
Governed Portfolio 2	**-3.77**	**-1.80**
Composite Benchmark	-2.99	-1.54
Difference	-0.78	-0.26
Governed Portfolio 3	**-1.71**	**-1.08**
Composite Benchmark	-0.89	-0.80
Difference	-0.82	-0.28
Governed Portfolio 4	**-7.05**	**-3.33**
Composite Benchmark	-6.34	-3.23
Difference	-0.71	-0.10
Governed Portfolio 5	**-5.74**	**-2.74**
Composite Benchmark	-4.81	-2.43
Difference	-0.93	-0.31
Governed Portfolio 6	**-3.73**	**-2.15**
Composite Benchmark	-2.84	-1.86
Difference	-0.89	-0.29
Governed Portfolio 7	**-7.42**	**-3.14**
Composite Benchmark	-7.78	-3.89
Difference	0.36	0.75
Governed Portfolio 8	**-7.34**	**-3.44**
Composite Benchmark	-6.61	-3.32
Difference	-0.73	-0.12
Governed Portfolio 9	**-4.61**	**-2.26**
Composite Benchmark	-3.90	-2.09
Difference	-0.71	-0.17

Governed Retirement Income Portfolios

Portfolio Name	Percentage Growth 31.12.19 07.08.20 % Chg	Percentage Growth 07.08.19 07.08.20 % Chg
Governed Retirement Income Portfolio 1	**0.92**	**0.18**
Composite Benchmark	1.78	0.70
Difference	-0.86	-0.52
Governed Retirement Income Portfolio 2	**-0.87**	**-0.52**
Composite Benchmark	0.10	0.02
Difference	-0.97	-0.54
Governed Retirement Income Portfolio 3	**-2.66**	**-1.20**
Composite Benchmark	-1.47	-0.50
Difference	-1.19	-0.70
Governed Retirement Income Portfolio 4	**-4.74**	**-2.21**
Composite Benchmark	-3.21	-1.31
Difference	-1.53	-0.90
Governed Retirement Income Portfolio 5	**-6.00**	**-2.71**
Composite Benchmark	-4.44	-1.79
Difference	-1.56	-0.92

Underlying Funds

Portfolio Name	Percentage Growth 31.12.19 07.08.20 % Chg	Percentage Growth 07.08.19 07.08.20 % Chg
RLP Absolute Return Government Bond-Pen	**0.53**	**2.14**
Benchmark	**-0.44**	**-0.55**
Difference	0.97	2.69
RLP Commodity-Pen	**-12.88**	**-14.67**
Benchmark	**-11.81**	**-13.61**
Difference	-1.07	-1.06
RLP Deposit-Pen	**-0.28**	**-0.39**
Benchmark	**-0.44**	**-0.56**
Difference	0.16	0.17
RLP Global High Yield Bond-Pen	**-0.94**	**2.84**
Benchmark	**-1.36**	**1.87**
Difference	0.42	0.97
RLP Global Managed-Pen	**-7.76**	**-2.45**
Benchmark	**-8.50**	**-3.33**
Difference	0.74	0.88
RLP Long (15yr) Corporate Bond-Pen	**9.23**	**7.77**
Benchmark	**9.24**	**8.22**
Difference	-0.01	-0.45
RLP Long (15yr) Gilt-Pen	**11.72**	**6.38**
Benchmark	**10.25**	**6.59**
Difference	1.47	-0.21
RLP Long (15yr) Index Linked-Pen	**8.85**	**1.57**
Benchmark	**7.35**	**0.90**
Difference	1.50	0.67
RLP Medium (10yr) Corporate Bond-Pen	**6.29**	**5.57**
Benchmark	**5.79**	**5.07**
Difference	0.50	0.50
RLP Medium (10yr) Gilt-Pen	**7.52**	**4.25**
Benchmark	**6.55**	**3.73**
Difference	0.97	0.52
RLP Medium (10yr) Index Linked-Pen	**5.00**	**-0.10**
Benchmark	**3.92**	**-0.65**
Difference	1.08	0.55
RLP Short (5yr) Corporate Bond-Pen	**2.29**	**2.45**
Benchmark	**2.57**	**2.25**
Difference	-0.28	0.20
RLP Short (5yr) Gilt-Pen	**3.33**	**1.76**
Benchmark	**2.93**	**1.34**
Difference	0.40	0.42
RLP Short (5yr) Index Linked-Pen	**1.68**	**-2.33**
Benchmark	**1.33**	**-2.27**
Difference	0.35	-0.06
RLP Property-Pen	**-4.21**	**-4.04**
Benchmark	**-4.72**	**-5.97**
Difference	0.51	1.93
RLP Sterling Extra Yield Bond-Pen	**-5.42**	**-3.65**
Benchmark	**1.67**	**2.78**
Difference	-7.09	-6.43
RLP Short Duration Global High Yield-Pen	**-1.89**	**-0.78**
Benchmark	**-0.33**	**-0.42**
Difference	-1.56	-0.36

Longer term performance

Please see **our latest performance**.

Past performance is not a reliable indicator of future results. 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.