MULTI ASSET STRATEGIES FUND: NAVIGATING THE CORONA RECOVERY

The Royal London Multi Asset Strategies Fund (MAST) looks to capture upside in positive market trends while limiting downside during periods of market turbulence through diversification, active positioning and volatility management. Risk control measures led us to cut equity exposure significantly in March when the coronavirus crisis hit. Global stocks have since recovered most of their losses but volatility is still unusually high and the outlook remains very uncertain. As a result, the fund is making only a cautious and limited return to the asset class and returns since the lows have been modest compared to the UK and global stocks.

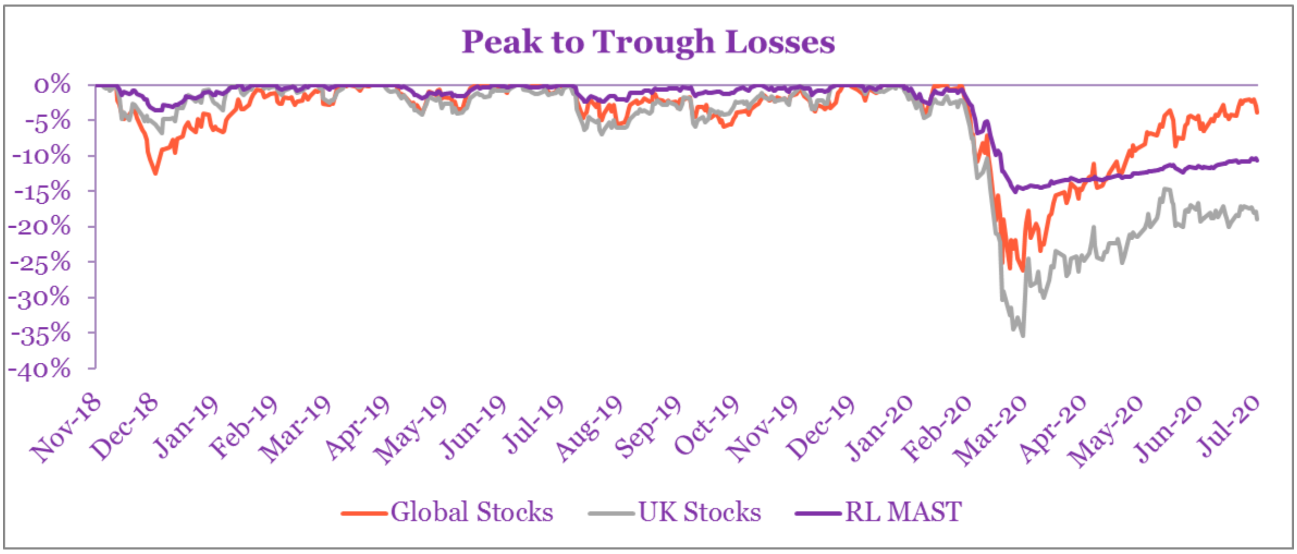
We are constructive on markets longer term and anticipate the virus could be suppressed within a year or two through a gradual build-up of immunity, better treatments and a possible vaccine. However, we see significant two-way risk over the short to medium term. In the scenario of a sustained and rapid re-opening in economies a drop in volatility and a positive shift in tactical positioning will potentially allow us to capture more of the upside. However, markets could easily suffer a relapse due to bad news on the virus or the premature removal of stimulus and MAST's disciplined approach to risk management can limit further losses in this scenario.

Risk control limited losses but reduced the rebound

The speed and severity of the economic shock meant risk management measures were not fully in force when the coronavirus crisis hit and the fund experienced a drop of around 15% from its 17 January high water mark. This compares to falls over the same period of 35% and 26% for UK and global equities, respectively. Since its inception, in November 2018, the fund has made a return of -3.5%.

Stock markets have rebounded on the back of policy stimulus and a partial resumption in economic activity and MAST is now down a cumulative 11% from its high water mark as compared to losses of 19% for UK equities and just 4% for global equities over this period (chart 1).

Chart 1: Peak to trough drawdown for MAST and Equities



Note: Decline from high water mark for RL Multi Asset Strategies Fund – M Acc share class (net of fees), MSCI World Net Total Return index in GBP terms and FTSE All Share Total Return index. From 23/11/2018, as of 27 July 2020. Source: Bloomberg.

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.

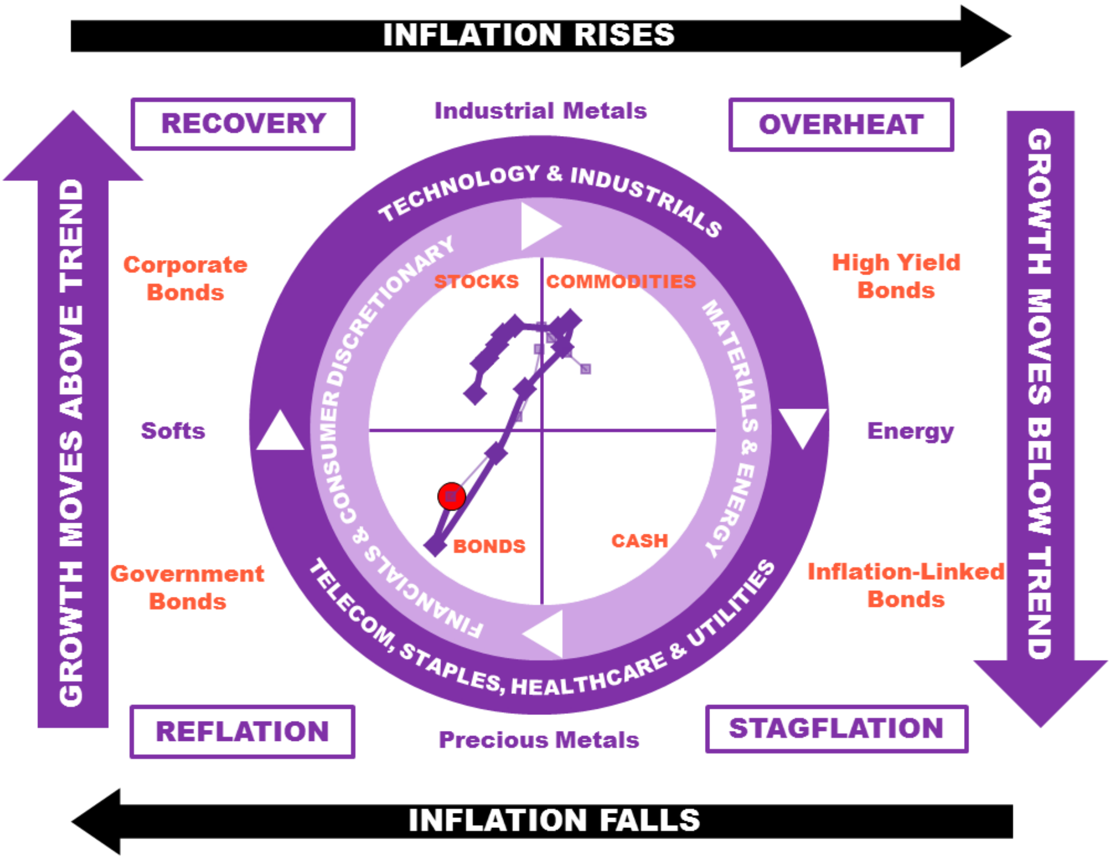
The relatively flat performance of MAST since the lows reflects the fact that a large proportion of the fund's downside risk control measures have remained in place given the choppy and uncertain nature of the rebound and equity exposure remains below its expected average.

Two scenarios: Recovery or Relapse?

The coronavirus crisis caused a synchronised sudden-stop in global economic activity. While this was the deepest economic decline on record it was probably also the shortest with economic activity coming back to life very rapidly in countries where social distancing measures have been eased. In this initial re-opening phase markets have behaved as if this were a V-shaped recovery but immunity levels remain very low and a return to normality will take a long time to play out. In the meantime, we see considerable two-way risk.

In the scenario of a rapid and continued economic re-opening we would expect stock markets to make significant further gains with the Investment Clock model that guides our asset allocation moving into equity-friendly Recovery (chart 2). In these circumstances a drop in volatility and a positive shift in our tactical positioning ought to return equity exposure to more normal levels, allowing us to potentially capture more upside in what could be a long and positive market trend.

Chart 2: Investment Clock with RLAM base case for the future trail

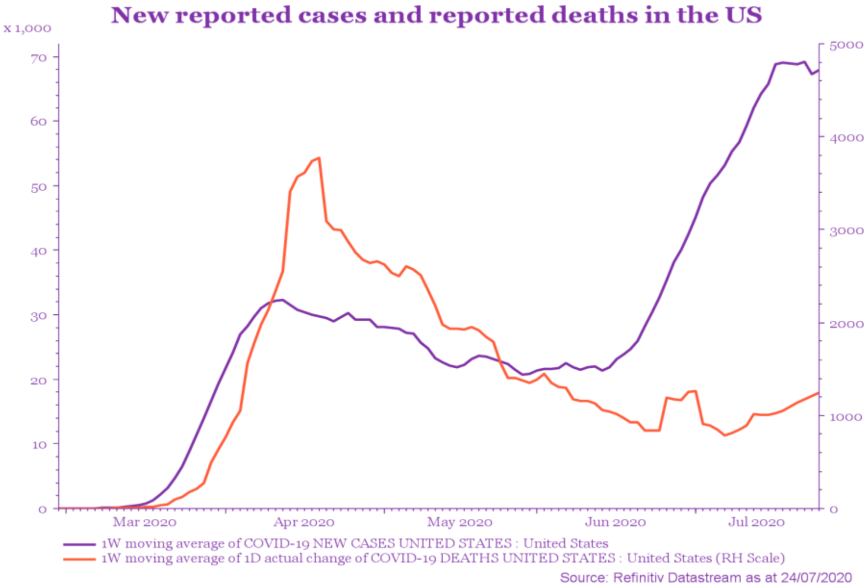


Source: RLAM. For illustrative purposes only. Trails shows readings based on global growth and inflation indicators. Red dot is the current reading. Faint trail represents a positive scenario for future readings taking the corona virus impact into account.

Portfolio characteristics and holdings are subject to change without notice. This does not constitute an investment recommendation. For information purposes only.

On the other hand markets could suffer a relapse if a second wave of infections, such as that already evident in the US (chart 3), triggers a renewed retrenchment in economic activity or if investors sense fiscal and monetary policy support will be removed prematurely as may be the case with the planned tapering of the UK furlough scheme this summer. MAST's disciplined approach to risk management can limit further losses in these circumstances.

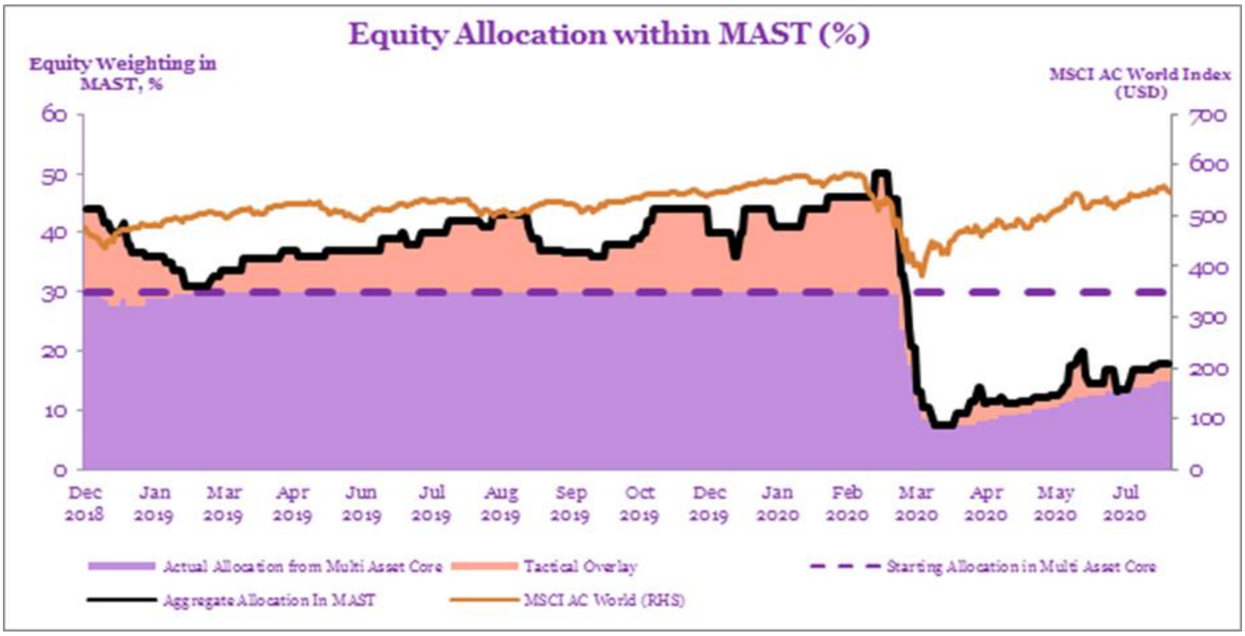
Chart 3: New US infections have risen sharply in recent weeks



A cautious and limited return to equity markets

Given the high degree of uncertainty, we have made only a limited and cautious return to the equity markets. We reduced exposure in the fund from a starting position of around 50% to a low of 7.5% in March. At the time of writing we have taken exposure back to 18% (chart 4).

Chart 4: Target equity exposure in MAST



Portfolio characteristics and holdings are subject to change without notice. This does not constitute an investment recommendation. For information purposes only.

Source: RLAM, MSCI AC World index USD data from Bloomberg. As at 24/07/2020.

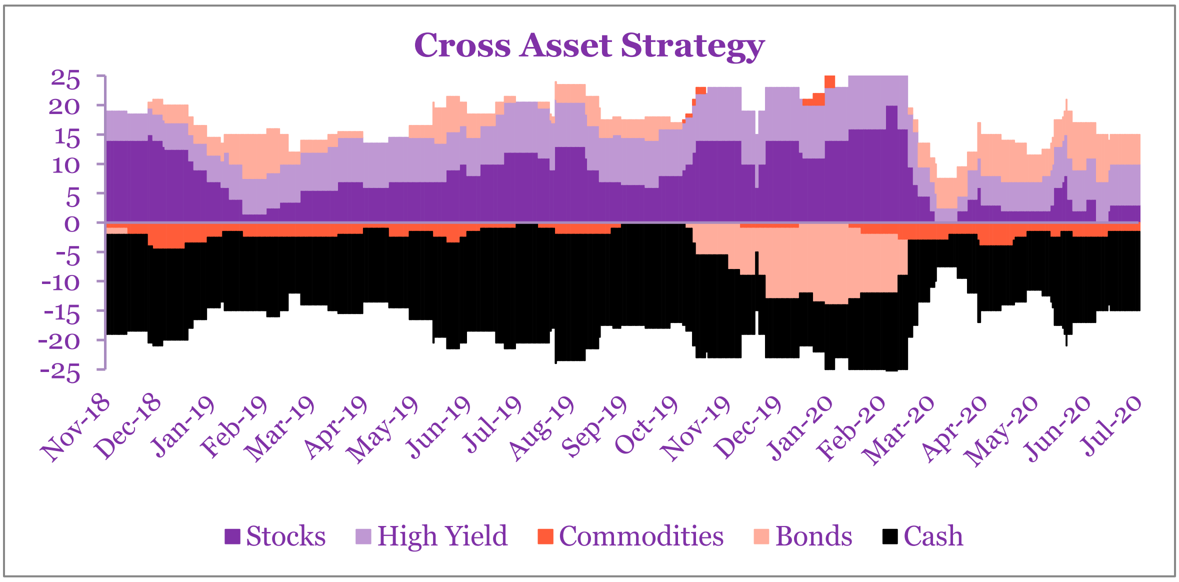
Most of the reduction in exposure in March reflected risk management in the core portfolio as volatility surged to levels last seen during the 2008 failure of Lehman Brothers. We cut weightings in this part of the fund from 30% to 7.5%. While volatility has dropped markedly since then, daily stock market swings of two percent or more remain common and this suggests continued market fragility. As a result, we have so far added back only 7.5% to core portfolio equity exposure. Meanwhile tactical equity positions, which were large at the start of the year, have been ranging between flat and a small positive.

Attuned to Tactical Opportunities

While we haven't committed aggressively to equities we don't lack conviction in our tactical asset allocation with the crisis throwing up a wide range of opportunities within and between the asset classes at our disposal.

- We are broadly neutral on equities within our cross asset strategy (chart 5) but we maintain a large tactical position in global high yield bonds as we expect the asset class to benefit from Federal Reserve support. The banks were too big to fail in 2008 but in 2020 it was the credit markets that were bailed out. We have only a low exposure to commodities given excess capacity and a poor outlook for demand.

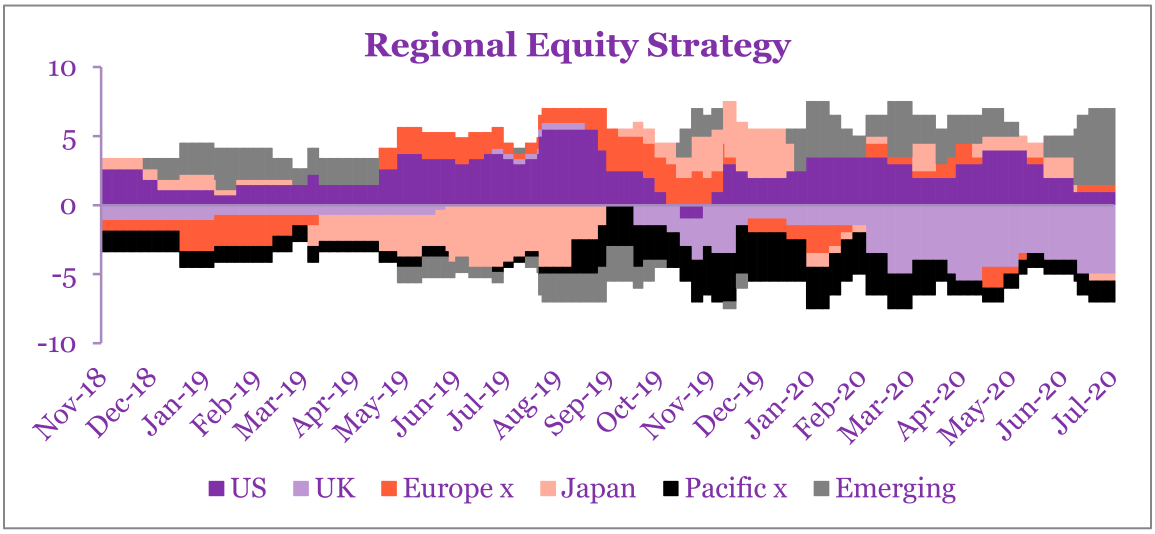
Chart 5: Tactical Positions – Cross Asset



Portfolio characteristics and holdings are subject to change without notice. This does not constitute an investment recommendation. For information purposes only. Source: RLAM as at 24/07/2020.

- In terms of region equity strategy (chart 6), our strongest conviction position has been to overweight the US and more recently the emerging markets while underweighting UK equities (chart 6). The US was defensive during the sell-off and a strong performer in the recovery while emerging market equities have been helped by dollar weakness and China's apparent success in suppressing the virus. The UK has been a very poor performer given its large exposure to resource sectors and on-going concerns around both the handling of the pandemic and trade deal negotiations with the EU.

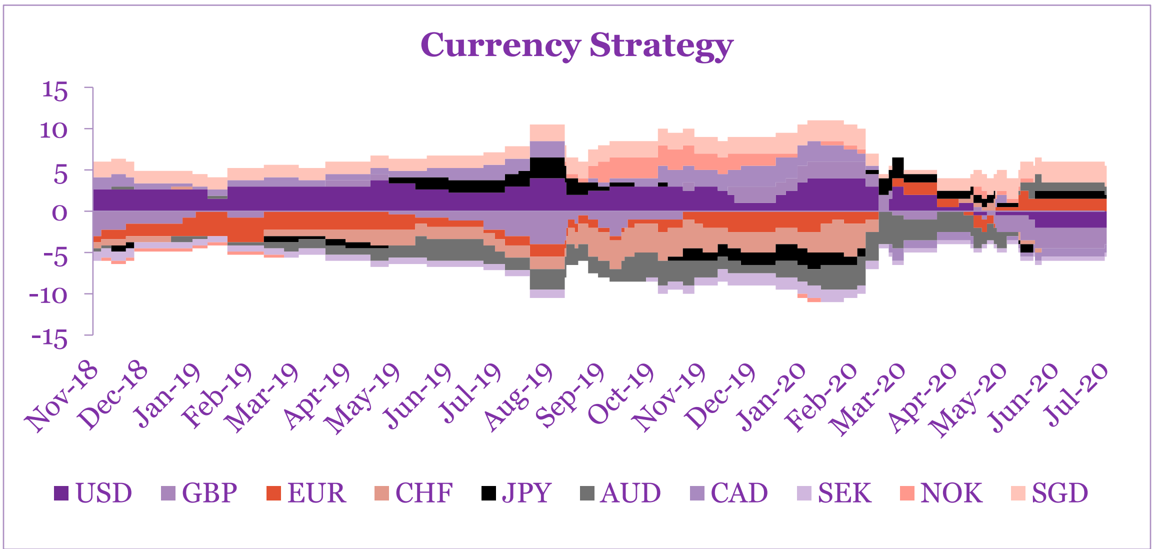
Chart 6: Tactical Positions – Regional Equity



Portfolio characteristics and holdings are subject to change without notice. This does not constitute an investment recommendation. For information purposes only. Source: RLAM as at 24/07/2020.

- We shrank currency positions as volatility rose (chart 7), initially remaining short the Australian dollar, given uncertainty surrounding global growth prospects, although it has done better as lockdowns have begun to ease. More recently we moved underweight sterling and the US dollar in favour of the euro which has strengthened on the back of improved Eurozone fiscal coordination.

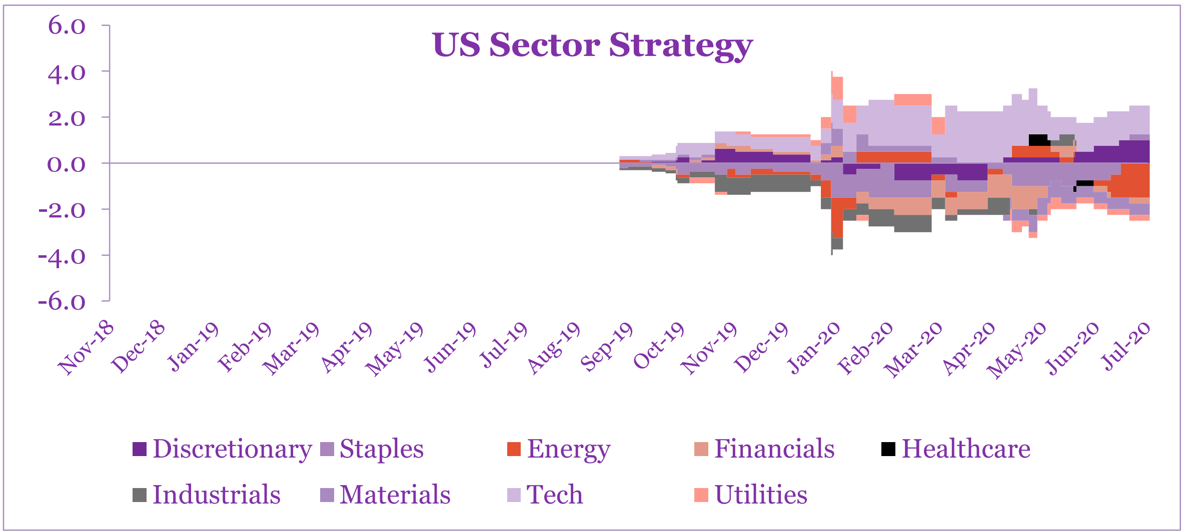
Chart 7: Tactical Positions – Foreign Exchange



Portfolio characteristics and holdings are subject to change without notice. This does not constitute an investment recommendation. For information purposes only. Source: RLAM as at 24/07/2020.

- We introduced a US sector strategy in late 2019 (chart 8) which has added value. During the crisis we were helped by our overweight position in technology relative to hard hit industrials, materials and financials. We remain positive on the US technology and consumer discretionary sectors, areas that don't need government help but are getting it anyway. We are currently most underweight the energy sector.

Chart 8: Tactical Positions – US Equity Sectors



Portfolio characteristics and holdings are subject to change without notice. This does not constitute an investment recommendation. For information purposes only. Source: RLAM as at 24/07/2020.

Outlook for returns

We are constructive on markets over the longer term as the virus is highly likely to be suppressed within a year or two through a gradual build-up of immunity, better treatments and a possible vaccine. Fiscal and monetary support has been massive as governments felt an obligation to offset the impact of lockdown measures. With virus risks lingering and unemployment high, we believe policy makers will be unlikely to remove stimulus prematurely and this should result in a strong recovery.

This outlook makes us confident that MAST should be able to deliver on its investment objective of aiming to generate excess returns over cash (SONIA) of 4% per annum gross of fees on a rolling five year basis. However, while our simulation showed MAST achieving this objective over 70% of such periods since the mid-1990s, it would have beaten cash by a lower margin in five year windows including the 2000-2003 bear market. It remains to be seen if the setback of 2020 will have a similar dampening effect on returns including this period.

Before launching the fund we engaged in extensive back testing to help us understand how the investment process would have weathered a wide range of historical market conditions. There are a number of comparable, albeit smaller shocks in which simulated returns for MAST showed a decline of roughly half that of equity markets (table 1). In each case, MAST would have moved back to a new high water mark within around a year. The current drawdown is larger than those in the simulation and could take a proportionately longer time to heal.

Table 1: MAST and equity market performance in sudden shocks

			Maximum Drawdown		
Max Drawdown (Peak To Trough Losses)	**Start**	**Return to High Water Mark**	**Global Equities**	**UK Equities**	**RL MAST**
Coronavirus	21/01/2020	?	-26%	-35%	-15%
Dot Com downturn/September 11 Attack in 2001	30/04/2001	30/11/2001	-28%	-26%	-10%
China Devaluation Panic	28/02/2015	31/12/2016	-16%	-19%	-9%
Russia crisis/collapse of LTCM in 1998	30/06/1998	31/12/1998	-24%	-24%	-8%
Bernanke Fed Hike in 2006	31/03/2006	30/06/2007	-12%	-10%	-8%

Source: RLAM. Simulated data is used prior to the inception date of 23rd November 2018. The simulation assumes fixed weight allocations to Multi Asset Core, with volatility management and constant risk budget for tactical asset allocation. The simulation for MAST is calculated using historical positions generated by RLAM's in-house tactical asset allocation models and signals from our volatility management process.

Net of estimated fees and transaction costs. Simulated data or historical data are not a guide to future performance. MSCI World Net Total Return index in GBP terms and FTSE All Share Total Return index (Source: Bloomberg).

Our investment process has weathered difficult markets in the past and we added significant value over the 2007-9 global financial crisis. We believe a disciplined and active approach to both risk control and tactical asset allocation will be crucial over the current period. The flexibility of MAST means it is well placed to respond as the situation evolves, avoiding concentration risk through diversification, de-risking quickly during a relapse and exploiting tactical opportunities as they arise.