NAVIGATING THE CORONA CRISIS

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ROYAL LONDON ASSET MANAGEMENT

Multi asset views from RLAM

Royal London Asset Management manages £127.8 billion in life insurance, pensions and third party funds*. The multi asset team manages the Governed Range and well as Global Multi Asset Portfolios (GMAPs) and the Multi Asset Strategies Fund (MAST) available on platforms.

*As at 31/03/2020

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The coronavirus pandemic brought the ten year global economic expansion to an abrupt halt with the Dow Jones suffering its largest six week drop since the 1929 crash. Stocks recovered about half of their losses when policy makers stepped in with massive easing. The outlook from here depends on the uncertain path back to normality and active management will be critical. We cut equity exposure to a small overweight and have a strong preference for high yield bonds over commodities and property, asset classes lacking policy support.

Investment Clock Jumps to Reflation

At the start of the year inflation was low, policy was loose and a new global upswing was under way. Social distancing measures to slow the spread of the coronavirus outside of China plunged the world into a sudden and very deep recession. The Investment Clock moved decisively into Reflation, the phase of the business cycle characterised by economic weakness and deflationary pressure. We cut overweight positions in equities as the seriousness of the economic shock became apparent.

Shock, Panic, Policy Response

The crash in stocks reflected a collapse in earnings expectations. Our sentiment indicator hit a record panic reading (see chart), setting the scene for a sharp rebound. Stocks and high yield bonds recovered about half of their losses as policy makers responded in scale to support consumers, businesses and credit markets.

Navigating the Recovery

The outlook from here depends on the uncertain path back to normality and we are taking a flexible approach. We currently have a small overweight in equities and a strong preference for high yield bonds, which benefit from effective policy maker support, over commodities and property, which don't. We are overweight US equities versus the UK and technology versus financials at the sector level.

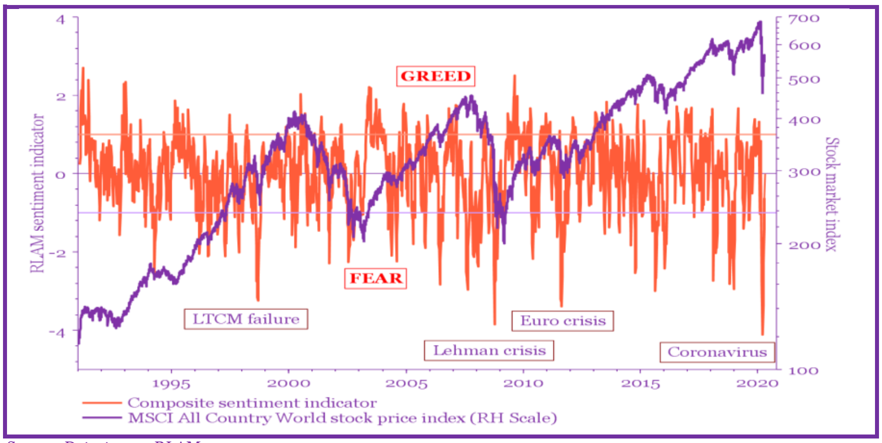
Downside risk mitigation in Multi Asset Funds

Our multi asset funds dropped in value more or less in line with their peer groups with lower risk funds suffering smaller losses, as expected. Diversification was beneficial in March with property holding up and government bonds rising. The Multi Asset Strategies Fund ('MAST') also suffered a drop but volatility capping came into force to limit further downside. The bounce back in stocks has been almost as intense as the decline and equity exposure remains low in this fund.

Markets usually stop panicking when policy makers start to. Stocks recovered about half of their losses after massive fiscal and monetary ease was announced.

With sentiment back to neutral the outlook from here depends on the uncertain path back to normality.

Chart 1: RLAM Investor Sentiment Indicator and Stock Prices



Source: Datastream, RLAM

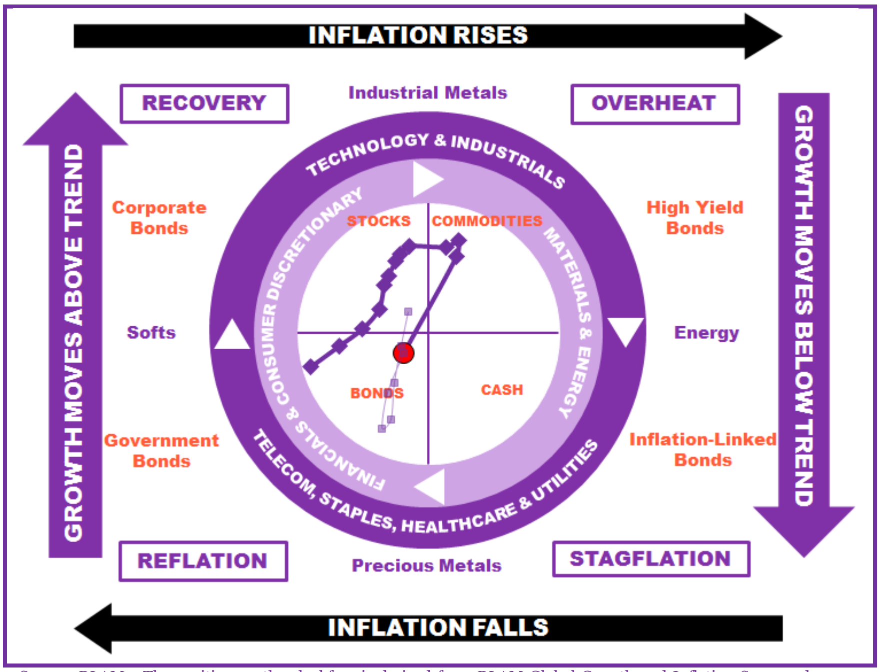
Please visit www.investmentclock.co.uk for our blog and information about our multi asset range. For product details, contact: multiassetsupport@rlam.co.uk

INVESTMENT CLOCK MOVES DECISIVELY INTO REFLATION

At the start of the year inflation was low, policy was loose and a new global upswing was under way. Social distancing measures to slow the spread of the coronavirus outside of China plunged the world into a sudden and very deep recession. The Investment Clock moved decisively into Reflation, the phase of the business cycle characterised by economic weakness and deflationary pressure.

We expect the Clock to move deeper into Reflation before eventually moving into disinflationary Recovery as economies re-open, but the path back to normality is highly uncertain.

Chart 2: The Investment Clock Moves Decisively into Reflation

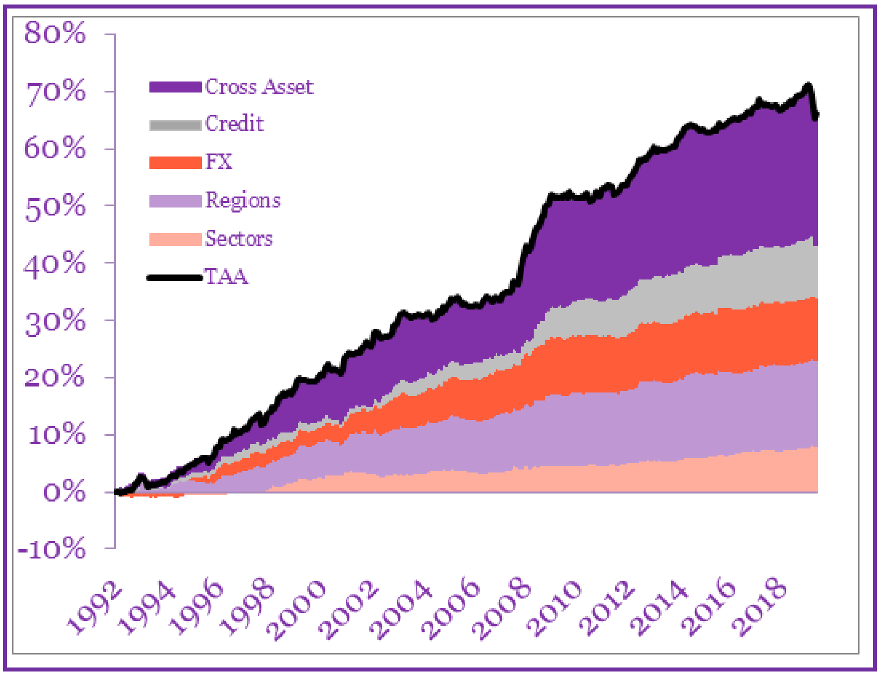


Source: RLAM. The position on the clockface is derived from RLAM Global Growth and Inflation Scorecards. The red dot is the current reading and the trail shows the previous 18 months and a base case future scenario.

We started the year positive on equities and high yield bonds. As a result, tactical asset allocation was a detractor in Q1, with two of our five core strategies delivering negative returns. We cut positions as the seriousness of the economic shock became apparent, moving ahead of our tactical models, which helped to reduce losses in the funds we manage.

Our model-based process has a good long-term track record and we have been through many crises together. Experience has shown that added value has typically been stronger during bear markets than bull markets. We believe a clear and logical approach to active management will be critical over the next few months with volatility high and new trends likely to emerge.

Chart 3: RLAM Cumulative Tactical Model Backtest



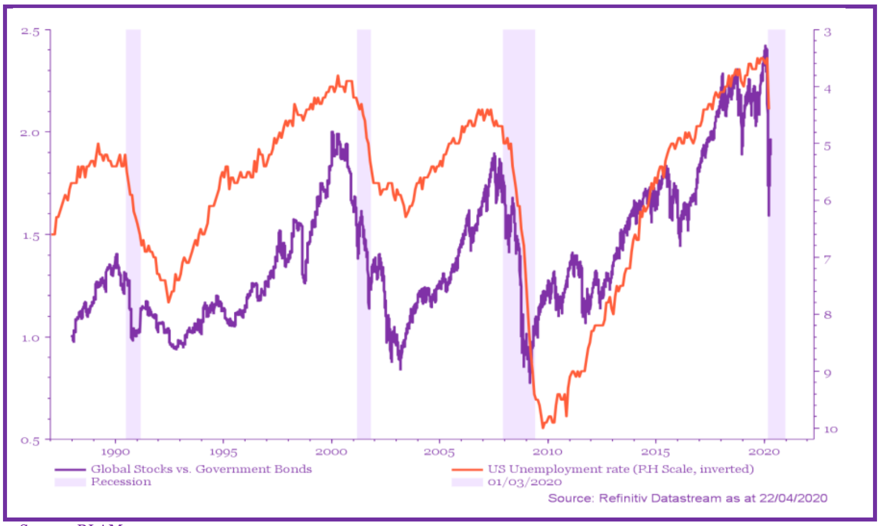
Source: RLAM. For illustrative purposes only. Simulated past performance is not a guide to future performance. The value of investments and the income from them is not guaranteed and may go down as well as up and investors may not get back the amount originally invested. Simulated Portfolio returns are calculated using historical positions based on in-house tactical asset allocation models between December 1992 and April 2020. Returns are quoted gross of fees and transaction costs. Such fees and costs would reduce the returns actually received.

SHOCK, PANIC, POLICY RESPONSE

The coronavirus crisis ended the longest US expansion since records began in 1857. Stocks usually underperform when unemployment is rising. Economists think the sudden stop in the US economy in 2020 could see unemployment rise from under 4% (the lowest level in fifty years) to around 20% (the highest since the Great Depression).

With the magnitude of this change in economic prospects in mind, it is perhaps no surprise that we have just experienced the largest six week drop in the Dow Jones index since the 1929 crash.

Chart 4: Stocks vs Bonds and US Unemployment (inverted)



Source: RLAM

Our investor sentiment indicator hit a record low in March, more than four standard deviations below average. Every week of March made it into the top ten most depressed weekly readings in 30 years of data.

With sentiment this depressed, a strong rebound was likely. This prevented us from moving underweight equities.

Chart 5: RLAM Composite Sentiment Indicator Top 10 Shocks

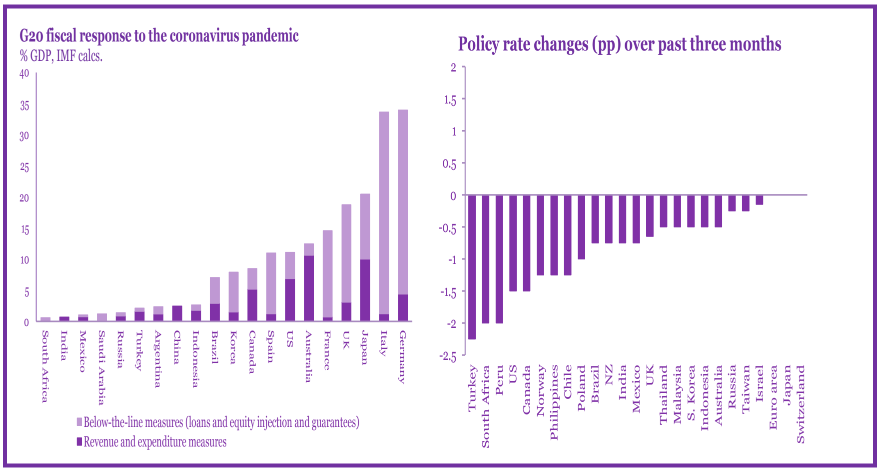
	Date	RLAM Composite Sentiment Indicator	Description
1	23/03/2020	-4.12	Coronavirus
2	16/03/2020	-4.04	Coronavirus
3	10/10/2008	-3.93	Lehman Failure
4	19/08/2011	-3.46	Euro Crisis
5	09/03/2020	-3.38	Coronavirus
6	12/08/2011	-3.36	Euro Crisis
7	30/03/2020	-3.33	Coronavirus
8	04/09/1998	-3.32	LTCM Failure
9	05/08/2011	-3.29	Euro Crisis
10	28/08/1998	-3.24	LTCM Failure

Source: RLAM. Composite sentiment indicator includes factors related to market volatility, retail investor bullishness and US director dealing in shares in their own companies.

Markets usually stop panicking when policy makers *start* to panic. The size of the fiscal and monetary policy support deployed to support consumers, businesses and credit markets is something the world has never seen outside of war time.

Stocks and high yield bonds rallied strongly to recover about half of their losses. It's a mixed picture, however. Commodities are making new lows and government bond yields haven't risen.

Chart 6: G20 policy response to the coronavirus pandemic



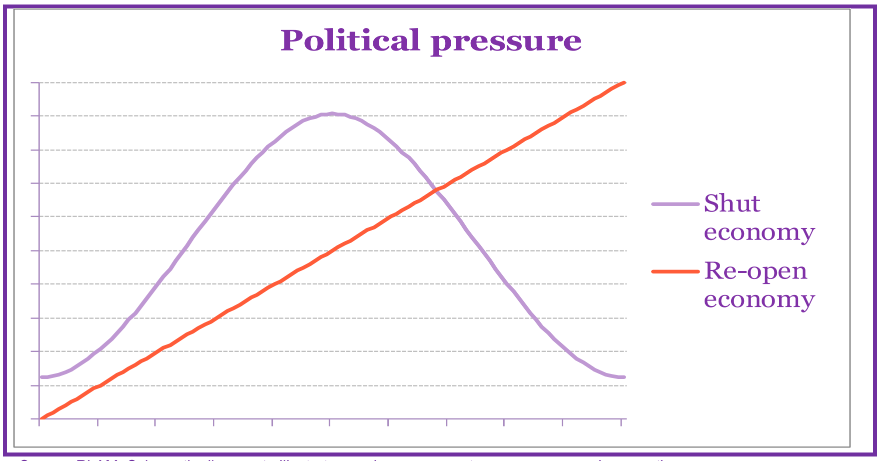
Source: RLAM, IMF, Bloomberg. Fiscal response is IMF estimate, data to 8th April 2020

NAVIGATING THE RECOVERY

The outlook for financial markets from here depends on the uncertain path back to normality and we are taking a flexible approach.

Stocks could recover further as a partial easing of lockdown conditions takes place with loose policy still in place. Political pressure to re-open economies is rising while the need to maintain a full lockdown is likely to drop as new hospital admissions decline. Most G20 countries are beginning to show signs that this process is under way.

Chart 7: Economies will start to re-open



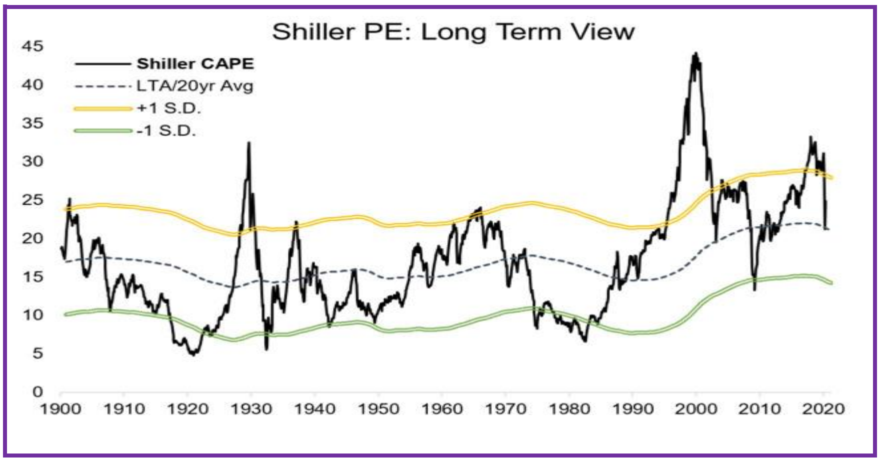
Source: RLAM. Schematic diagram to illustrate growing pressures to re-open economies over time.

We wouldn't rule out a re-test of the March lows, however. Equity valuations are not cheap. The Shiller PE multiple, which compares US equity prices to ten year average earnings, is back to its 20 year average and well above the level it reached during the 2008/9 recession.

Stocks could sell off again if there are unexpected delays in re-opening economies, if we see a second wave of infections or if the pace of recovery disappoints.

We currently have a small overweight in equities and we are ready to move in either direction as events unfold.

Chart 8: Long Term Valuation is not Cheap

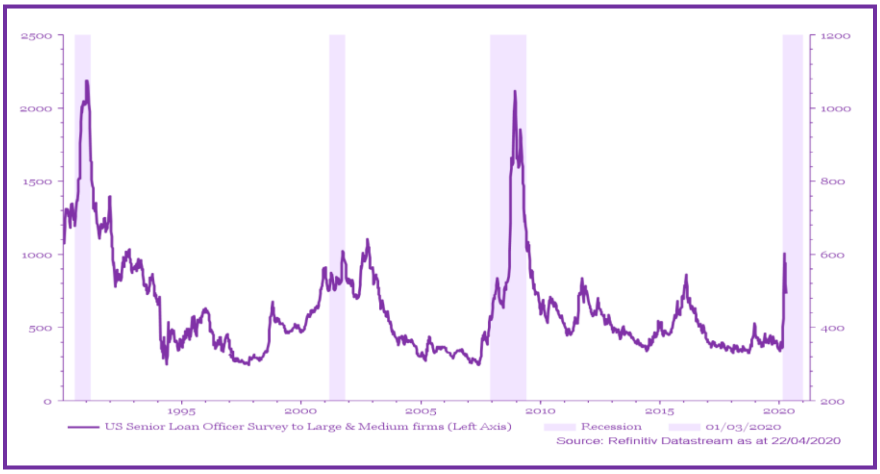


Source: Topdown Charts, Refinitive Datastream, Robert Shiller

We continue to see tactical opportunities in other asset classes. We have a strong preference for high yield bonds over commodities and property. Credit spreads widened considerably as corporate cashflow dried up but the Federal Reserve announced an enormous purchase programme to keep credit flowing and this should support the high yield market.

Meanwhile, commodities are making new lows despite OPEC+ production cuts and there is no effective policy support for UK commercial property, which is likely to see lower capital values as rents are deferred and occupancy drops.

Chart 9: High Yield Bond Spreads Have Widened



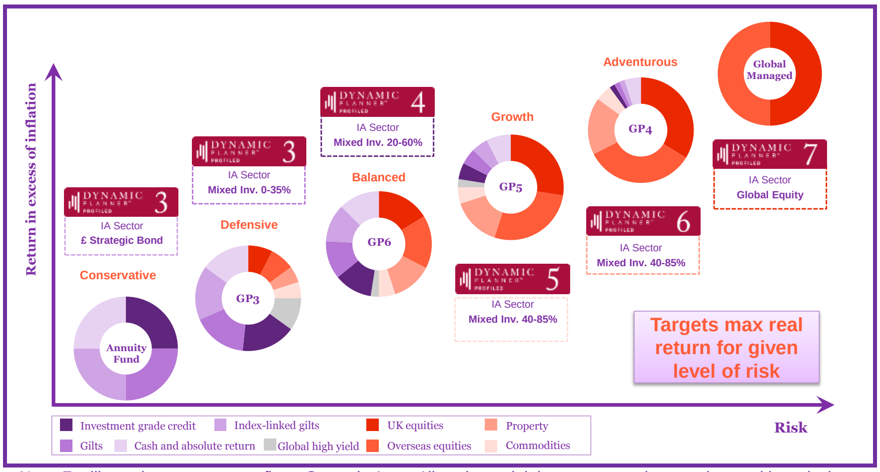
Source: RLAM

DOWNSIDE RISK MITIGATION IN MULTI ASSET FUNDS

Our multi asset funds dropped in value more or less in line with their respective peer groups with lower risk funds suffering smaller losses, as expected.

Diversification was beneficial in March with property holding up and government bonds posting strong returns. Overseas exposure was also helpful given the 12% slide in the pound against the dollar during the equity market sell-off.

Chart 10: Royal London multi asset funds – GMAPs and GPs

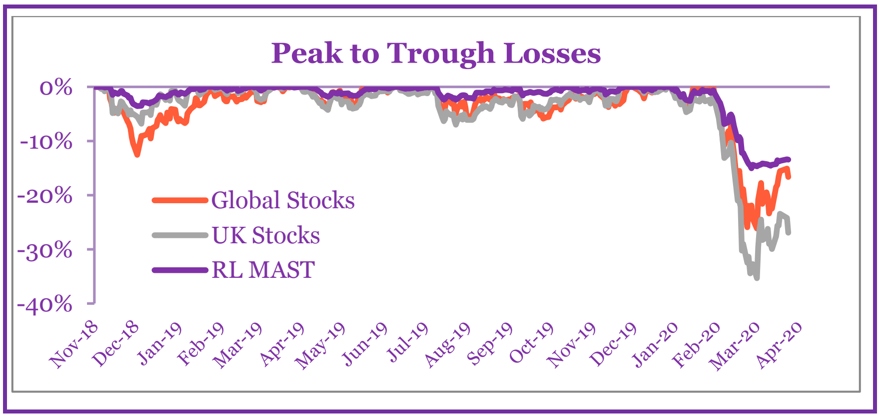


Note: For illustrative purposes – reflects Strategic Asset Allocation weightings, may vary in accordance with tactical asset allocation. Risk rating is established by Distribution Technology (DT) and is out of 10.

The Multi Asset Strategies Fund ('MAST') saw a peak to trough drawdown of 15%. This compares to a 26% drop in global equities and 35% for UK equities.

MAST aims to capture upside in positive market trends, while reducing equity exposure in periods of turbulence in order to limit downside risk and focus more of its risk budget on tactical strategies at these times.

Chart 11: MAST Drawdown from High Water Mark

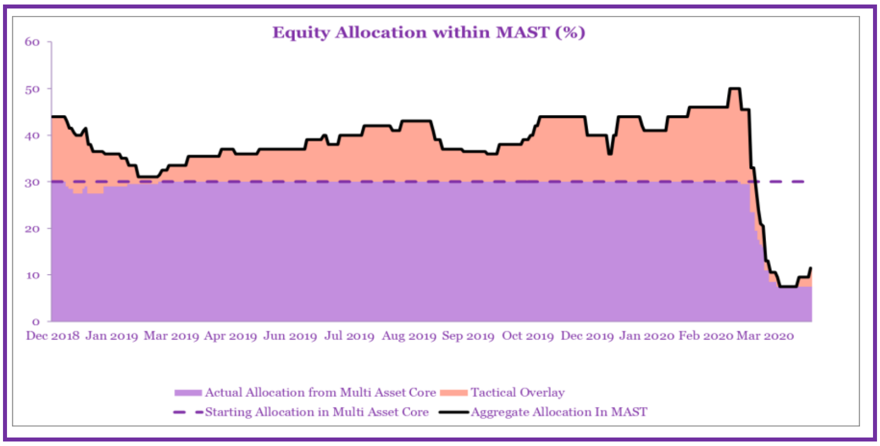


Source: RLAM. Decline from high water mark for RL Multi Asset Strategies Fund (net of fees), the MSCI World index in GBP terms and FTSE All Share index as of 16 April 2020.

Risk control measures came into force as volatility rose in March. We sold equities, taking exposure from 45% at the market high to less than 10%. The bounce back in stocks has been almost as intense as the decline and equity exposure remains low in this fund.

As a result, MAST is relatively insulated should a market re-test occur. The volatility capping process is very responsive to market conditions and we'd expect exposure to rise rapidly when uncertainty eventually recedes and a positive long-term trend reasserts itself.

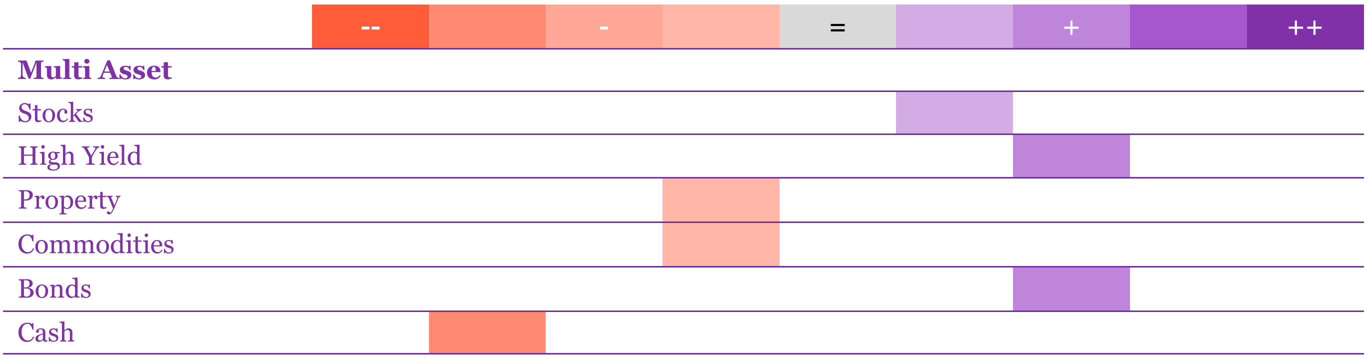
Chart 12: Target equity exposure in MAST

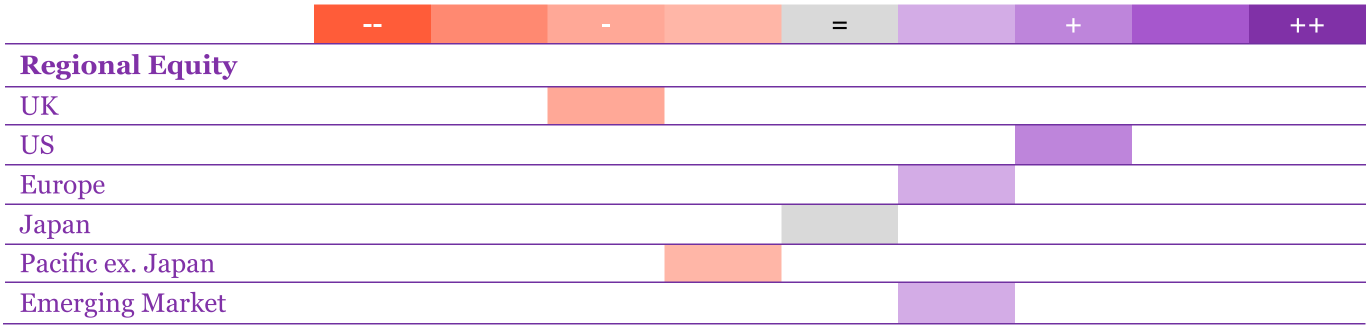


Source: RLAM

WHERE WE STAND: OVERWEIGHT STOCKS AND HIGH YIELD

The outlook depends on the uncertain path back to normality. We currently have a small overweight in equities but are ready to move in either direction and we are overweight government bonds as a hedge. We have a strong preference for high yield over commodities and property. We are overweight US equities with a large underweight in the UK and overweight US technology versus financials.





Source: RLAM, tactical positions as of April 2020. Weightings may vary and the Fund may invest outside of indicated asset classes as the manager sees fit. For illustrative purposes only.

Multi asset: small overweight in stocks, underweight commodities

- We cut equity exposure to a broadly neutral level during March as the pandemic hit and now have a modestly positive position and we are also overweight government bonds as a hedge against more prolonged economic weakness.
- We have a strong preference for high yield bonds versus commodities and property.

Equity regions and sectors: overweight US and tech; underweight UK and financials

- We have been overweight US equities for several years. The market's defensive and interest-rate sensitive nature mean it continues to outperform. We are underweight the UK, which suffers from an energy and resources-heavy sector breakdown.
- Our US sector strategy is overweight technology, which has been resilient during the slowdown. We are underweight financials, a sector which tends to underperform when yield curves flatten.
- Our active currency positions are small at present, with underweights in commodity-sensitive currencies.