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Investment allocation in a 'managing COVID' world

Presentation to the



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Your presenters



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Investment allocation in a 'managing COVID' world

Discussion points

1. Economic environment - Review and Outlook

- Growth, Inflation, Interest rates
- Policy actions

2. Looking ahead

- Implication on asset valuations and future returns
- RLAM current views

3. The challenges of being responsible

- Balancing sustainability vs returns

4. How should AFM members react?

Question:

What is your key concern over the next 12-18 months?

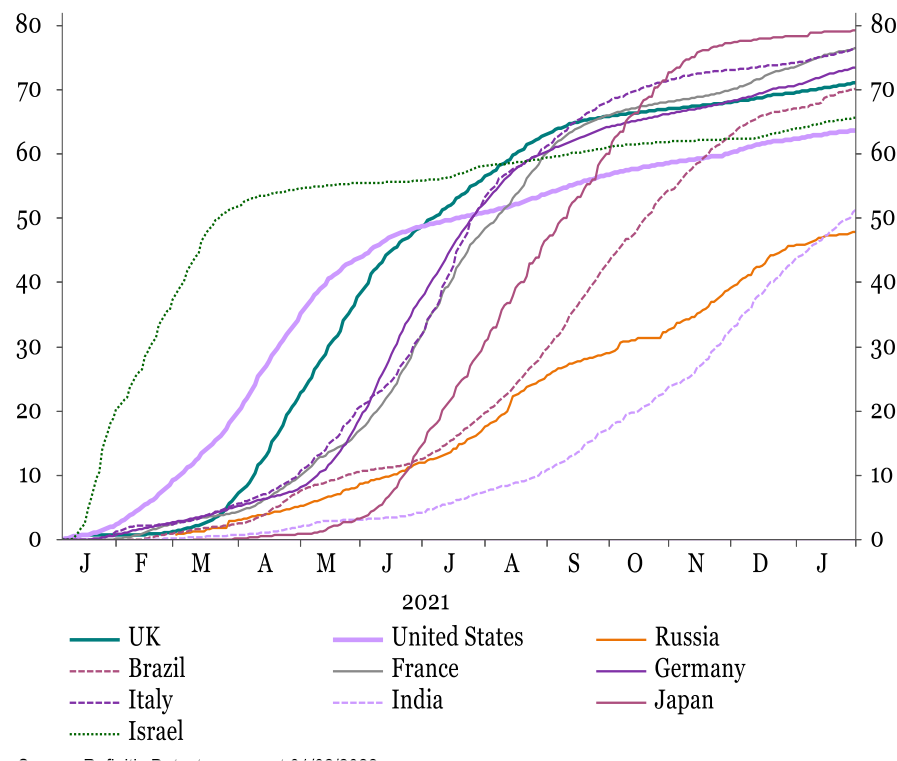
- Increased regulation
- Inflation
- Central banks raising interest rates and stopping QE
- Other

1. Economic review and outlook

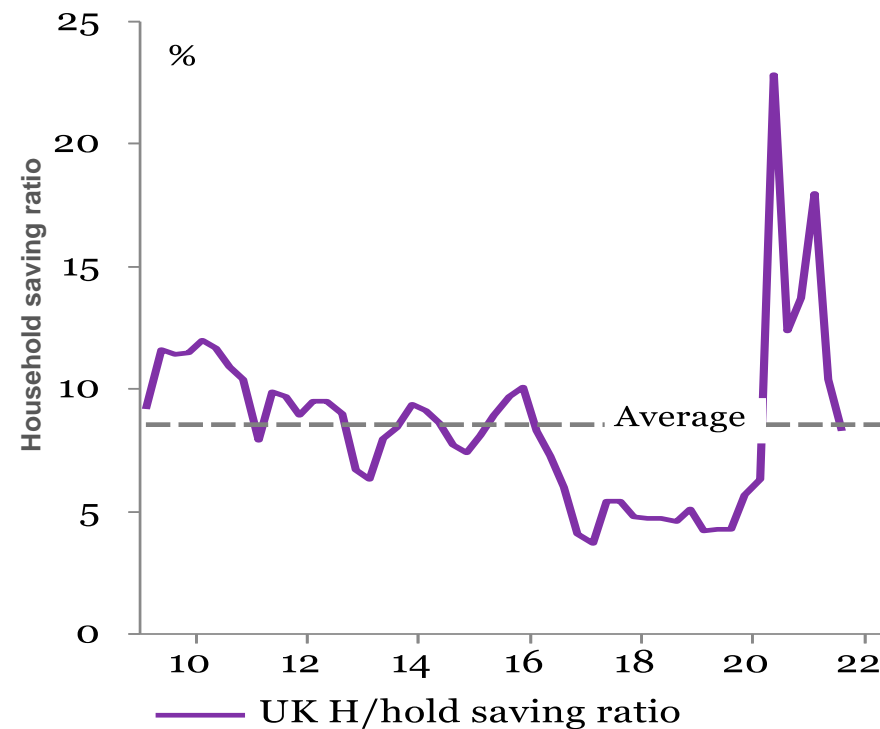
The UK Economy continues to recover from Covid

The world as we are

Strong vaccine rollout globally



UK: Household saving rate and deposits



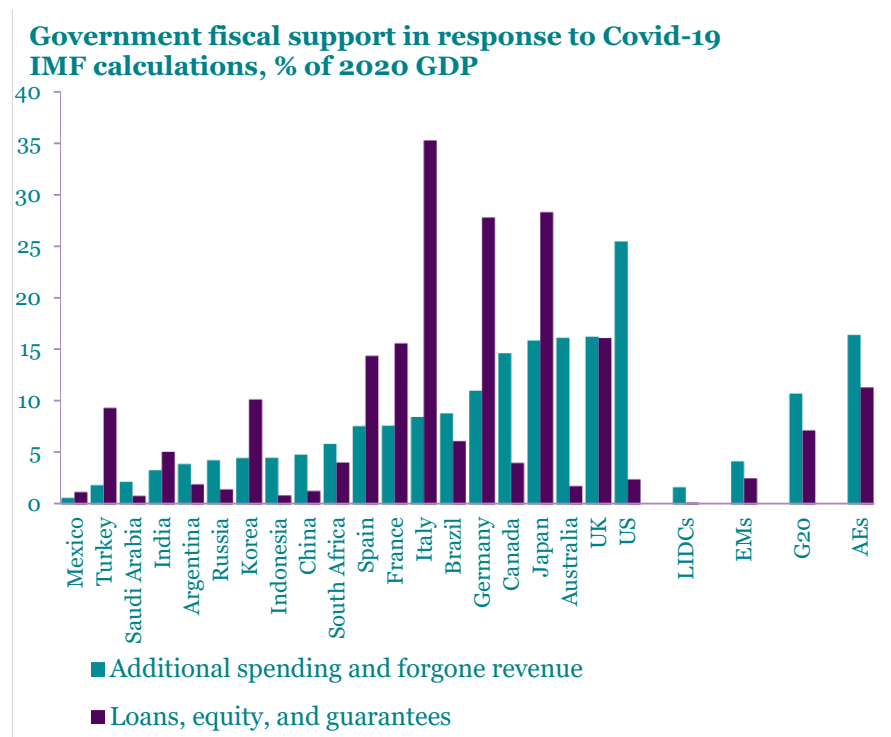
Source: Refinitiv Datastream as at 4 February 2022.

January 2022 snapshot

Key risks: Inflationary boom and bust

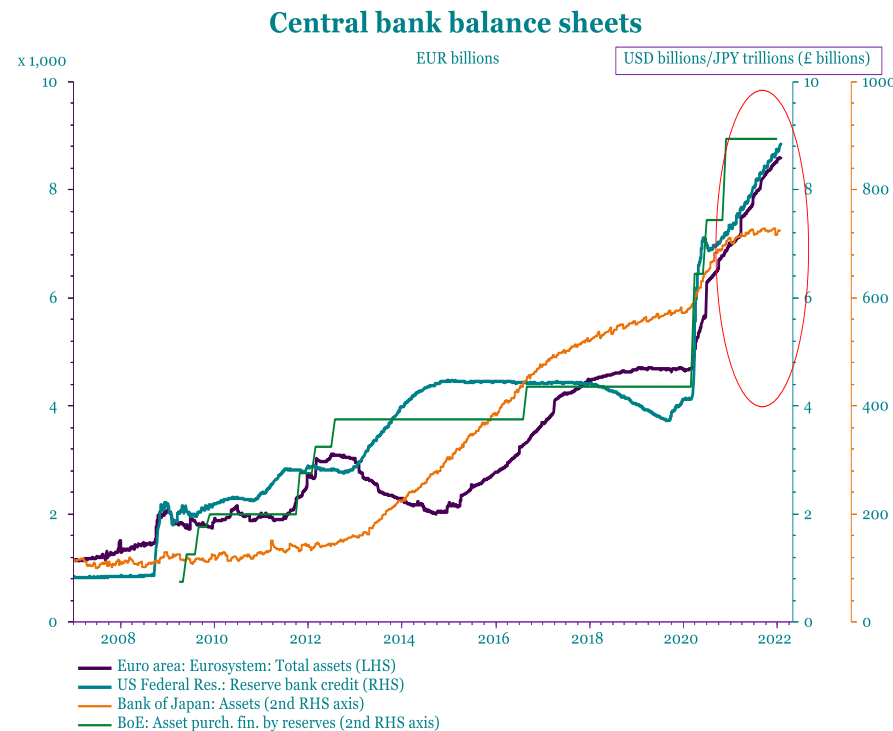
Fiscal and Monetary ease has been massive

Government fiscal support in response to Covid-19 IMF calculations, % of 2020 GDP



Source: IMF Fiscal Monitor April 2021.
The views expressed are the author's own and do not constitute investment advice.

Central bank balance sheets



Source: Refinitiv Datastream as at 4 February 2022.

Next shock more likely to be inflationary rather than deflationary

The world as we are

UK Overview – from the Bank of England

In a nutshell



The UK economy continues to recover



Higher energy and goods prices are pushing inflation above our 2% target



We expect inflation to rise to about 7% in the spring, but then fall back



We have increased interest rates to return inflation to our 2% target

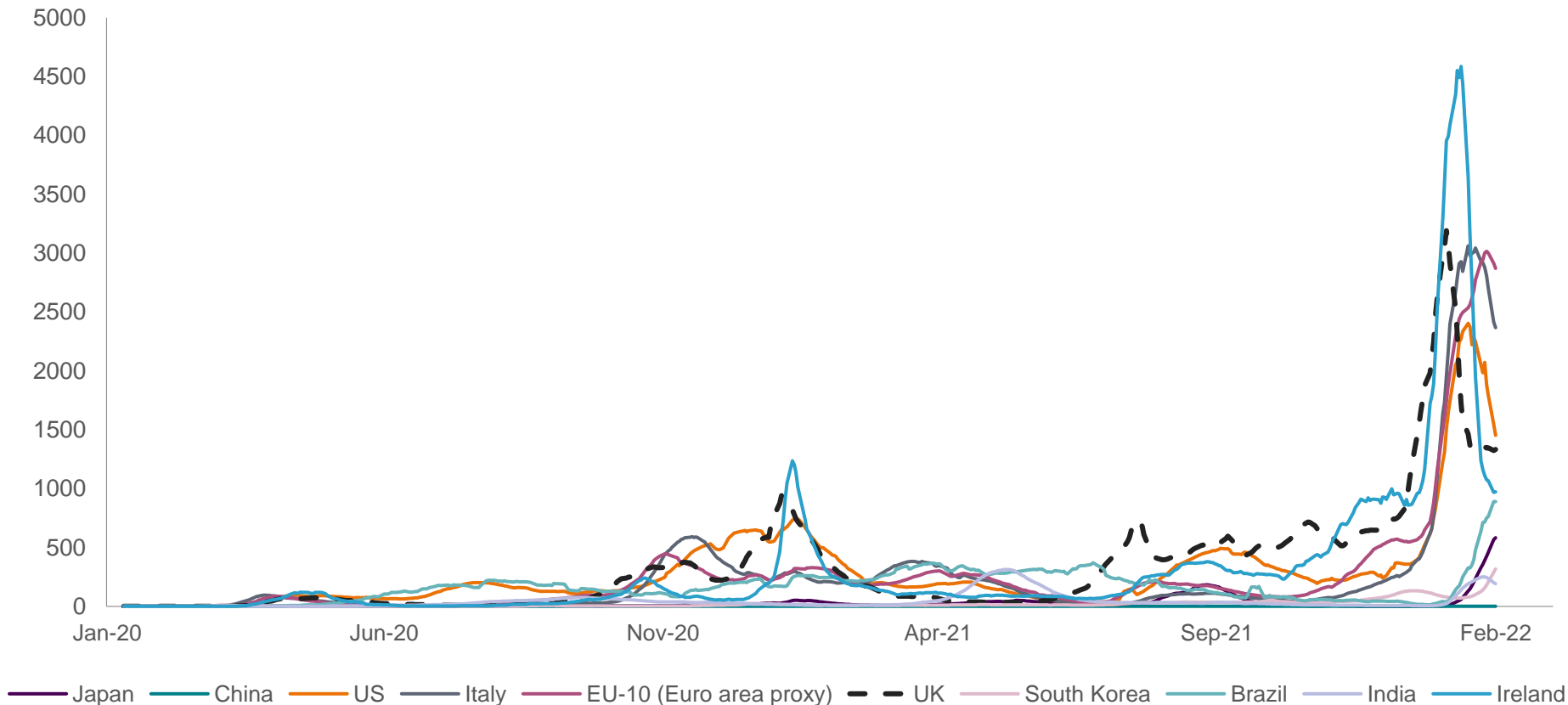
Source: 3 February 2022 Inflation Report.

February 2022 snapshot

Key risks: Deflationary Downside

Vaccine-resistant Covid Variants could keep growth subdued

Daily new cases, 7 day average, per million population



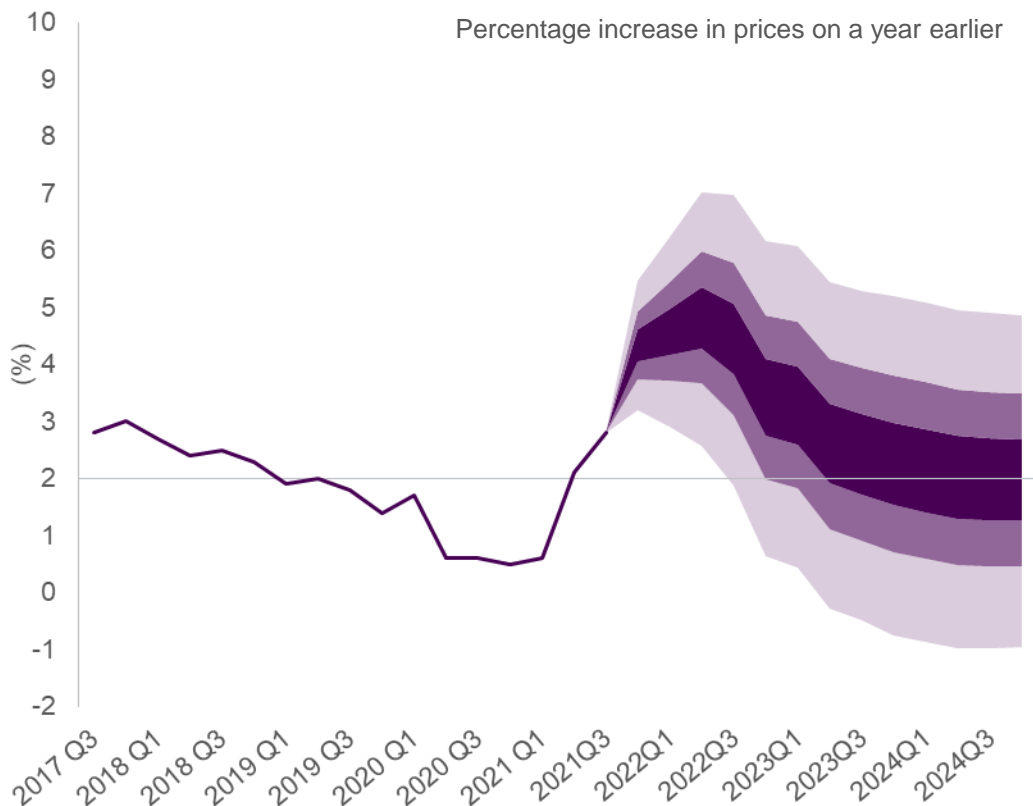
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Source: Datastream 04/02/2022.

BoE Inflation forecasts looking ahead - November

Projected path of Inflation - higher for longer?

Distribution of inflation over the next 3 years



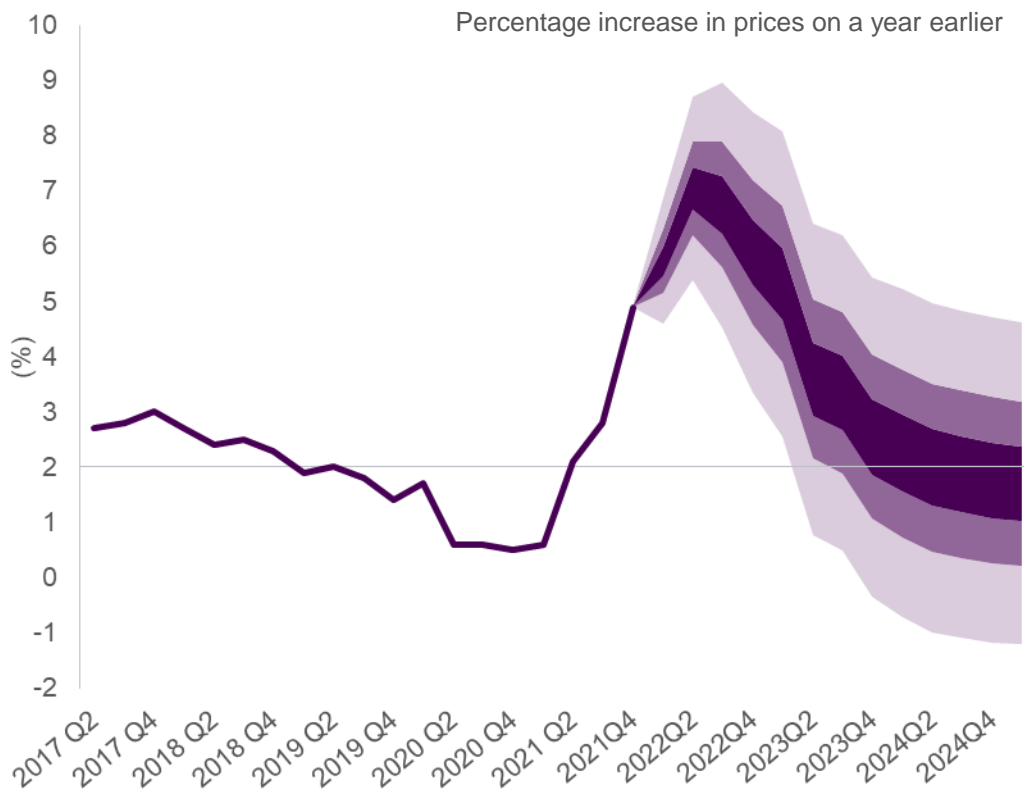
- Supply side problems following economies reopening will cause inflation to remain above target for a sustained period
- BoE projects, with 50% likelihood, inflation to be back within target within the next 3 years

Past performance is not a reliable indicator of future results. The views expressed are the author's own and do not constitute investment advice.
 Source: Bank of England, RLAM. February 2022.

BoE Inflation forecasts looking ahead - December

Projected path of Inflation - higher for longer?

Distribution of inflation over the next 3 years

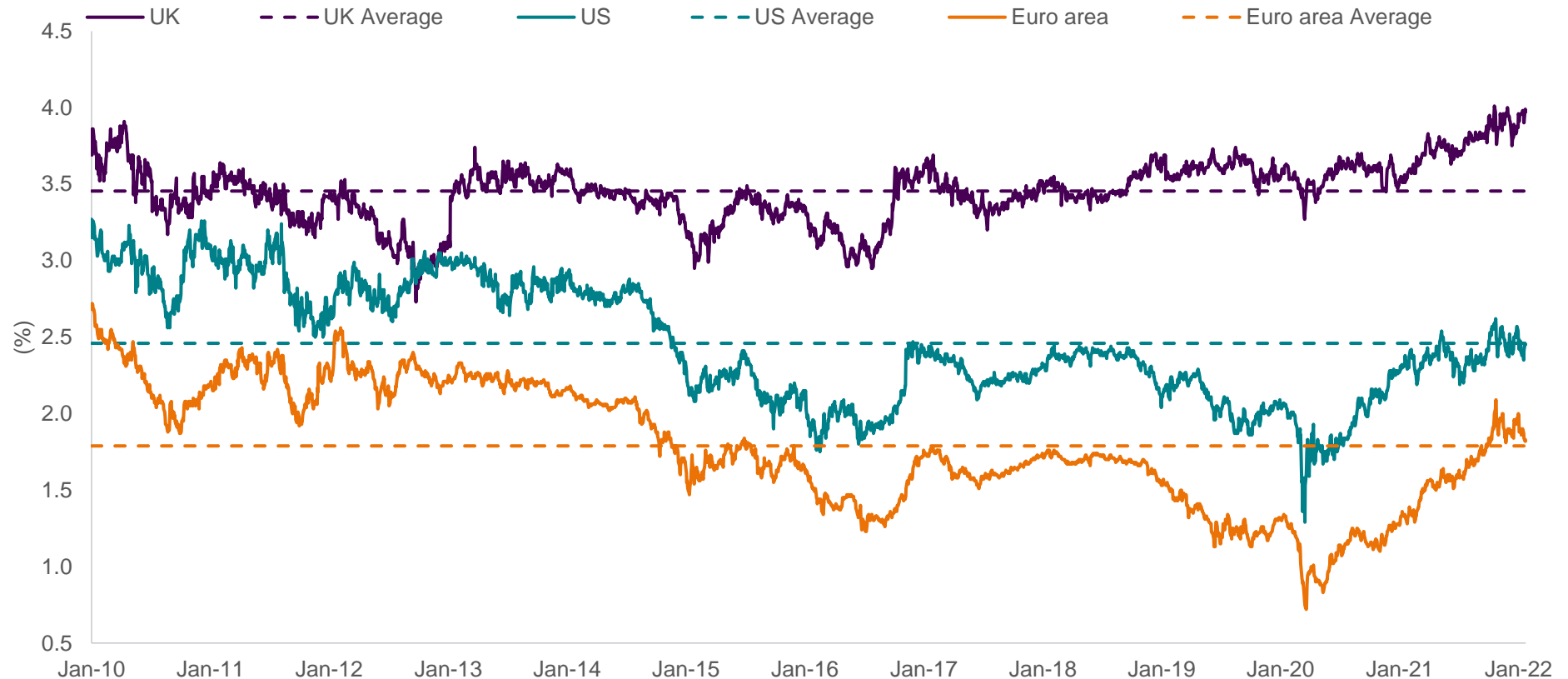


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 Source: Bank of England, RLAM. February 2022.

Covid policy response causing inflation Seen globally

Medium-term inflation expectations are around pre-crisis averages in the US and euro area



- a) Five-year inflation, five years ahead, derived from swaps. The instruments are linked to the UK RPI, US CPI and euro-area HICP measures of inflation respectively.
- b) UK RPI is due to be aligned with CPIH from February 2030, which will affect the pricing of this measure. Since 2000, CPIH inflation has averaged 85 basis points lower than RPI inflation.

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Source: Bloomberg Finance L.P. and Bank of England, February 2022.

Question:

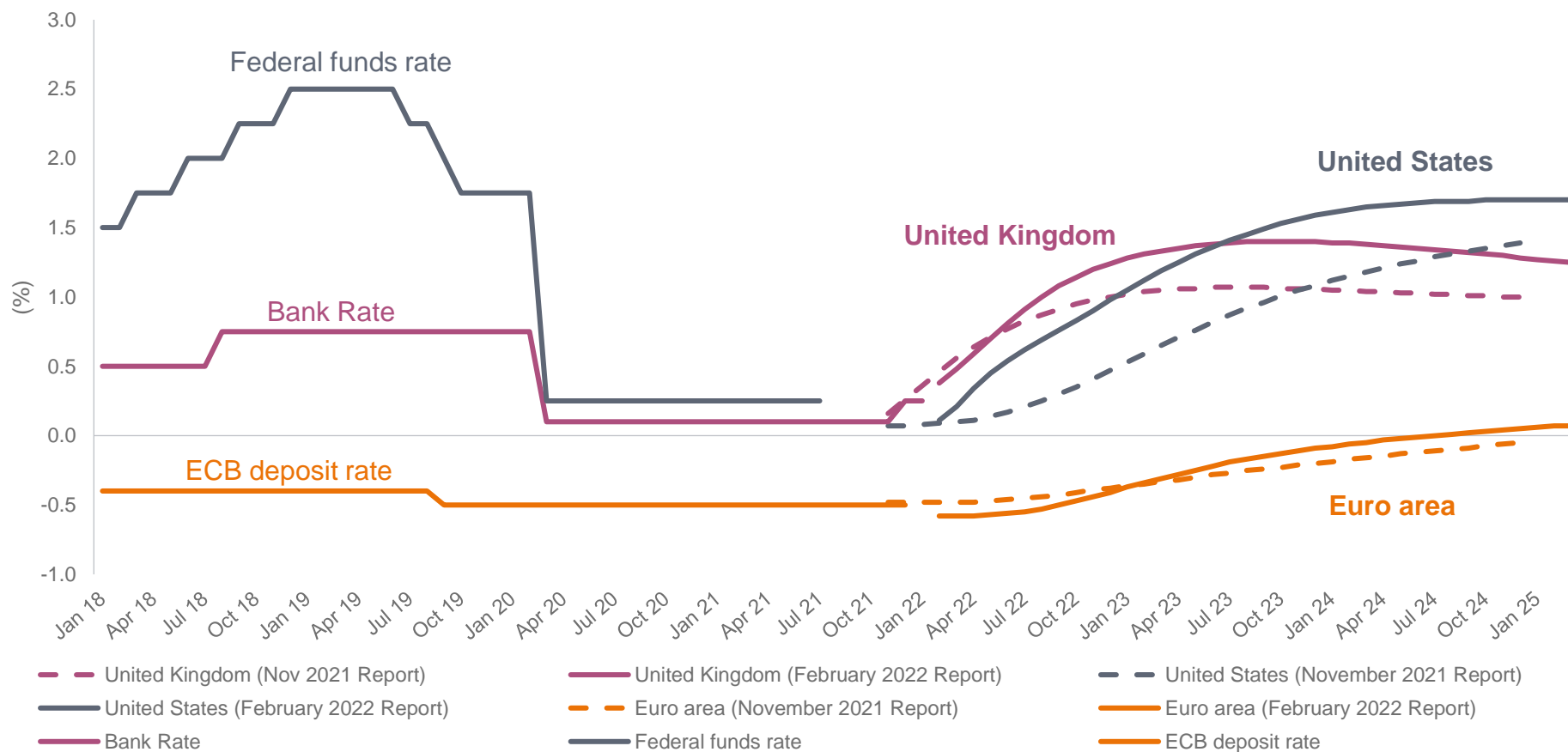
At the end of 2022 where do you expect CPI inflation to be?

- $<2\%$
- $2\%-3\%$
- $3\%-4\%$
- $>4\%$

Responding to the inflation shock

Interest rates – global perspective

Market participants expect policy rates to increase, particularly in the UK and US



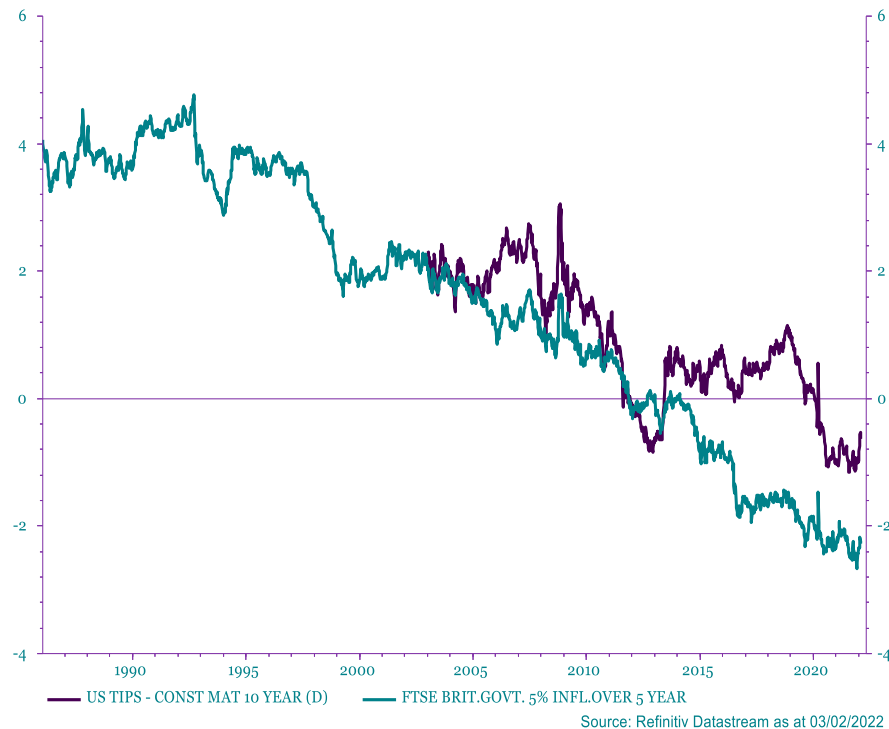
Source: Bloomberg Finance L.P. and Bank of England. February 2022

2. Looking ahead

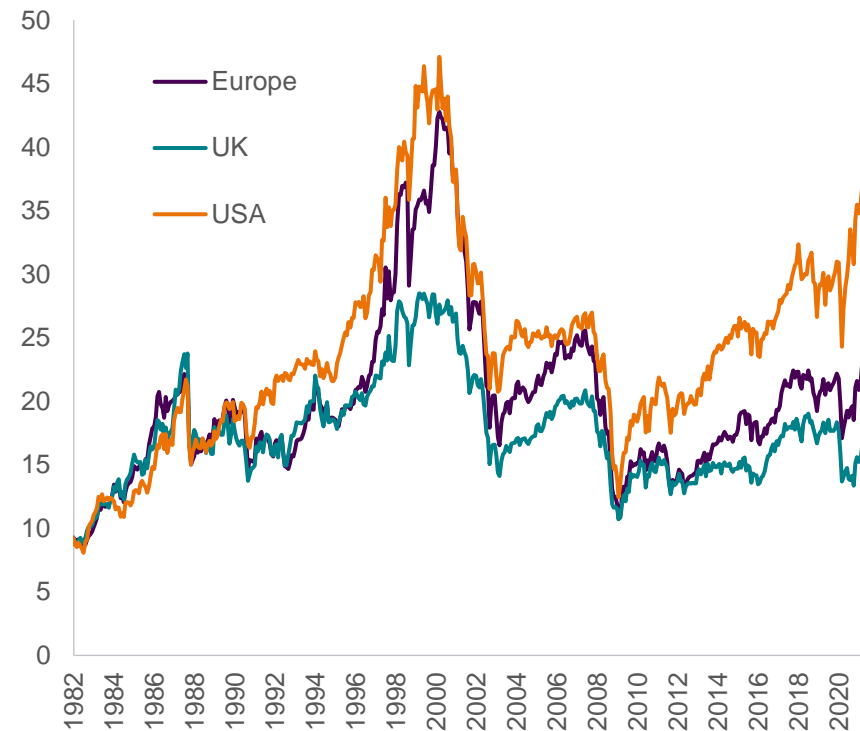
Covid policy response has driven equity and bond valuations to extremes

Real bond yields are negative and equity multiples are high

Real government bond yields are negative



Cyclically Adjusted PE ratios are high, especially in the US

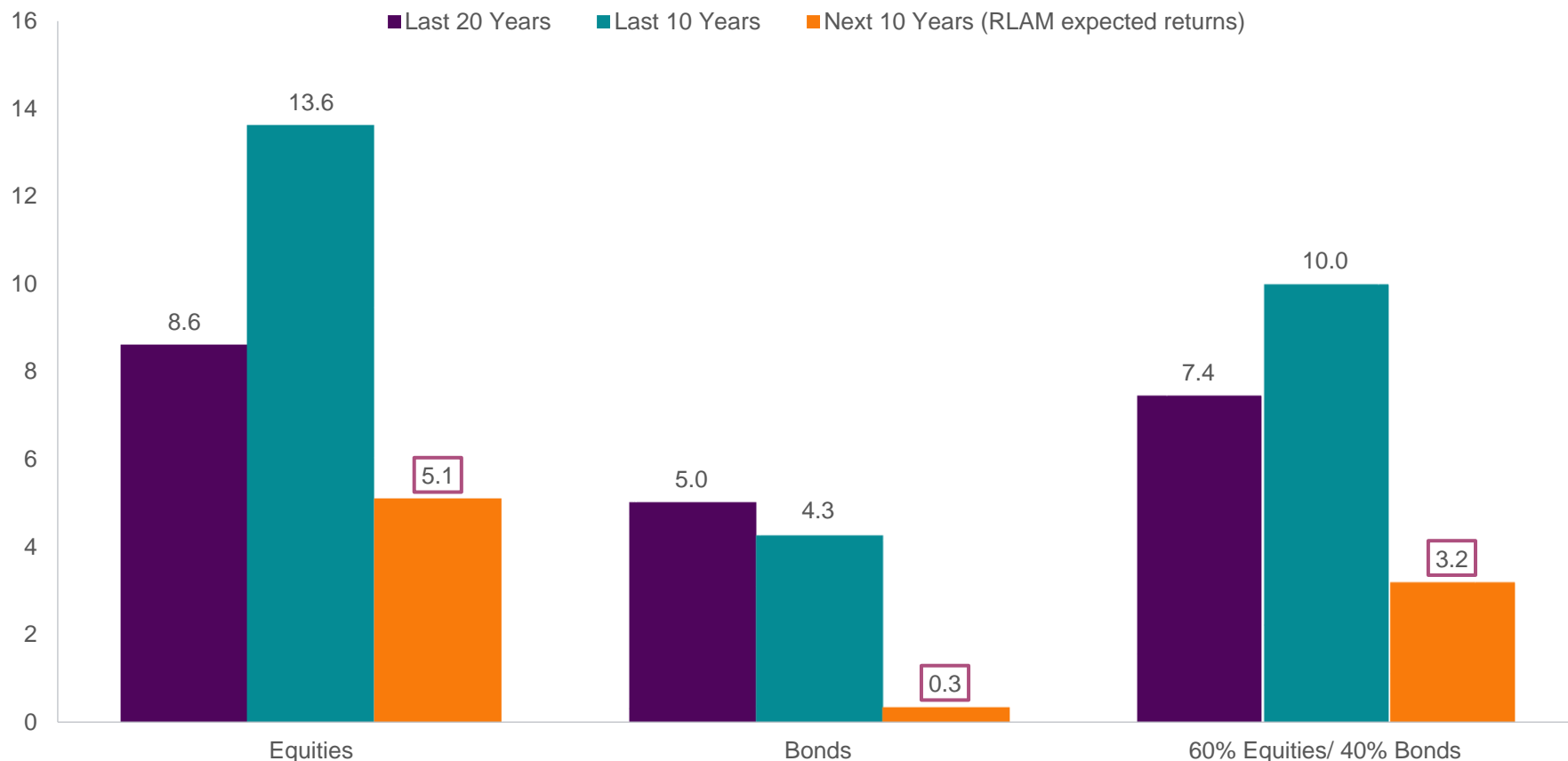


Past performance is not a reliable indicator of future results.

Source: Datastream, Barclays, RLAM.

Lower Expected Returns from Equities and Bonds in the next 10 years Due to expensive valuations and rising interest rates

Annualised Cumulative Returns (%)

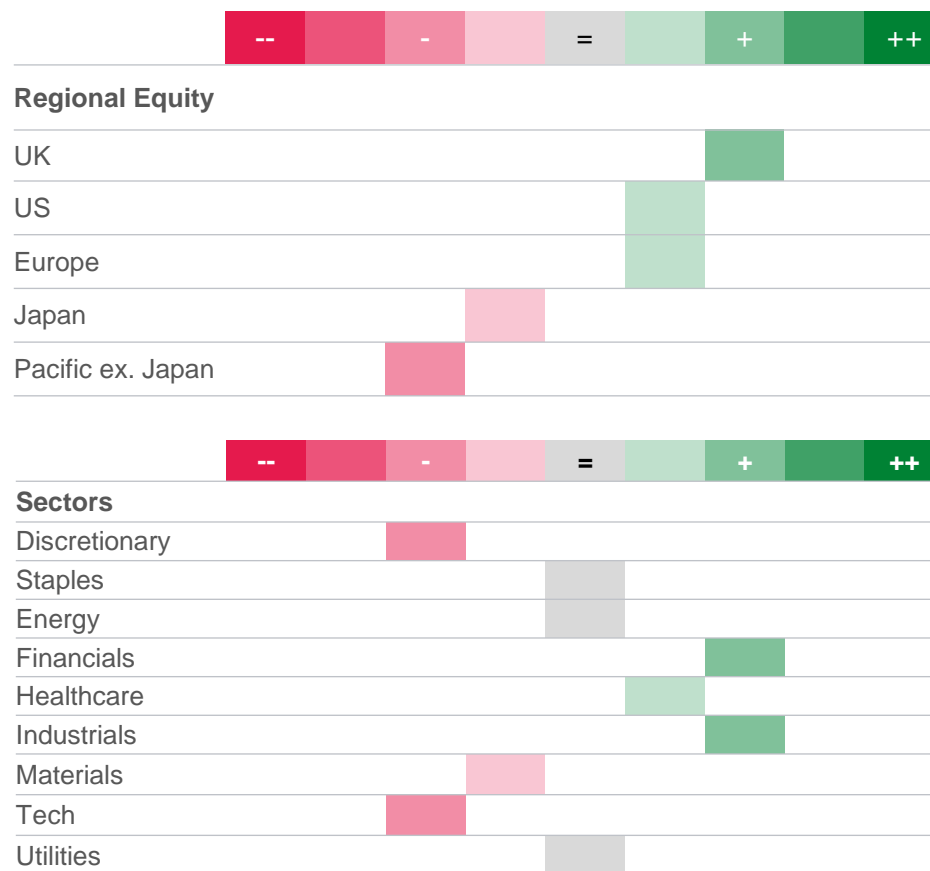
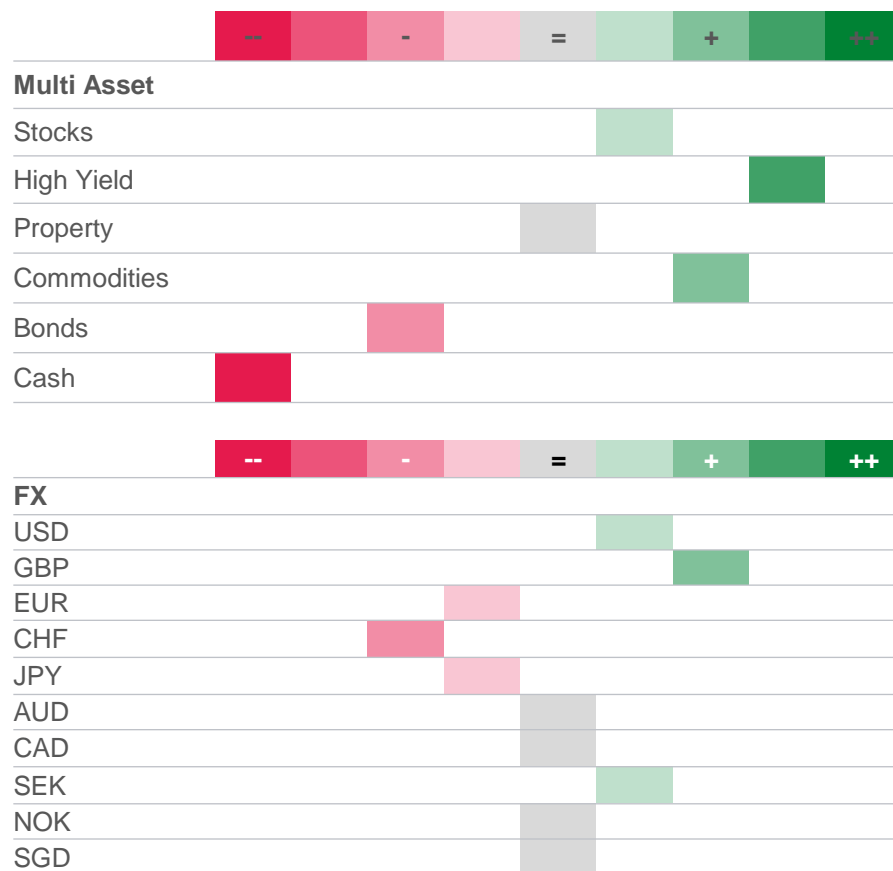


The views expressed are the author's own and do not constitute investment advice. Past performance is not a reliable indicator of future results.
 Source: Expected risk and return based on RLAM's capital market assumption as of August 2021. Gross of fees. Please note that this does not reflect the actual performance of the RL GMAP Fund range and should be used for information purposes only, not as a reliable indicator of future performance. MSCI All Country World Net Return Index in GBP and Bloomberg Sterling Aggregate Bonds Total Return Index are used to represent Equities and Bonds, respectively

RLAM market and asset class views

Current tactical positions

Underweight cash, bonds, EM and growth stocks



Weightings may vary according to tactical asset allocation and the Fund may invest outside of indicated asset classes as the manager sees fit. The views expressed are the author's own and do not constitute investment advice.

Source: RLAM. Tactical positions as of 12 January 2022.

Question:

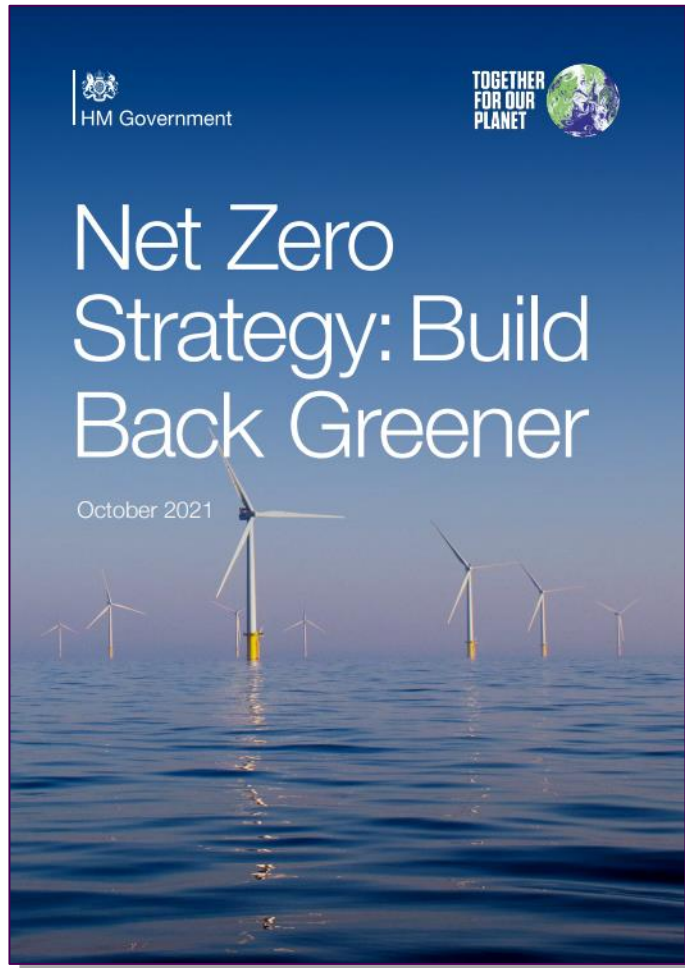
How are you intending to change your asset allocation over 2022?

- No change
- Retain same asset classes but change risk level
- Use new asset classes – listed only
- Use new asset classes – including private markets

3. The challenges of being responsible

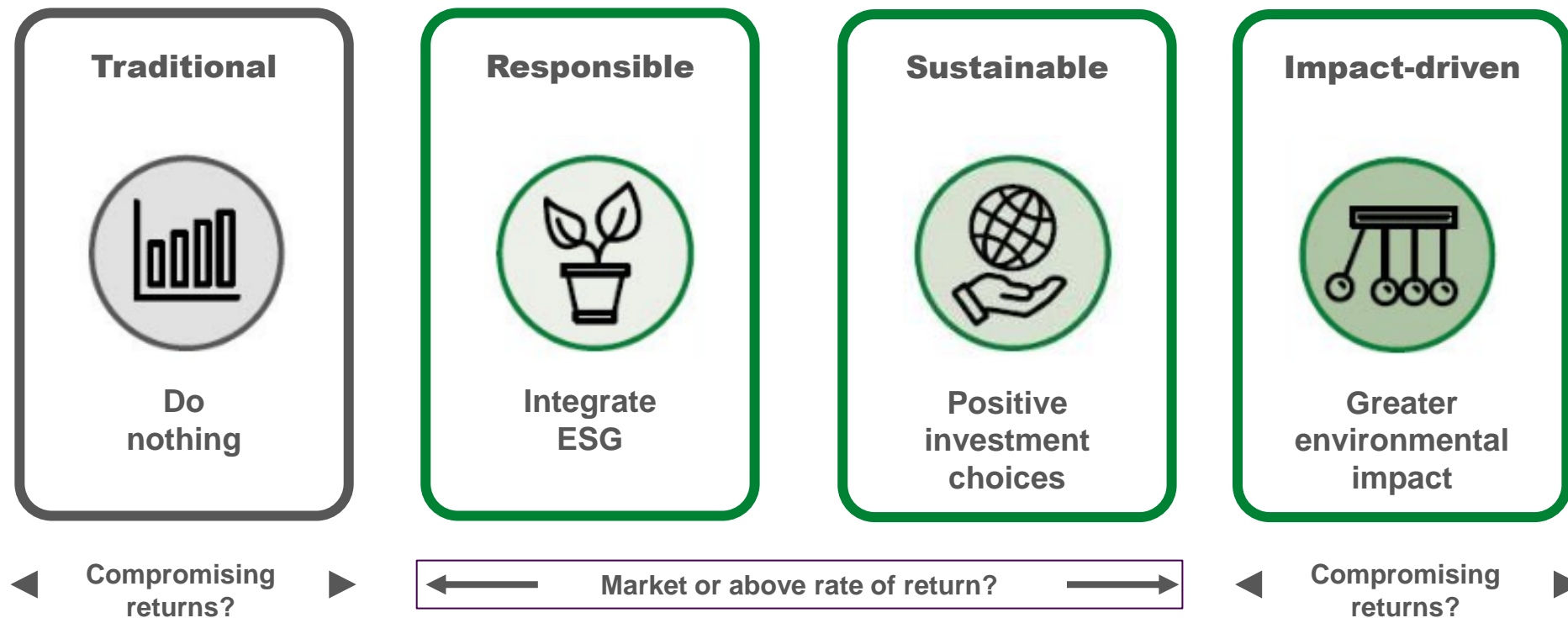
UK looking ahead

Post Brexit, post Covid build



The current position?

The 'Sustainability Spectrum'



Care needed around balancing sustainability vs returns

The future?

Responsible Investing – achieving the optimal balance

Responsible investing becoming ‘the norm’

- Challenge remains on:
 - How “green” to make the portfolio
 - Data
 - Bedding down of new SFDR regulation
 - New UK regulation still being drafted
 - Avoiding green washing



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Source: RLAM as at February 2022.

Question:

Where are you on your responsible investing journey?

- No actions taken
- Initial investigations underway
- Policy defined but not yet implemented
- Policy defined and implemented

Question:

Which best classifies your businesses?

- Sustainability/Responsible investing is more important than financial returns
- Sustainability/Responsible investing is of equal importance as financial returns
- Sustainability/Responsible investing is of importance but less so than financial returns

4. How could AFM members react?

How could AFM members react?

Four ideas...

1. Increased diversification

- Range of asset classes
- How should these be positioned looking forwards?

2. 'Return-aware' inflation hedging

- Duration of hedging instruments
- Global vs UK

3. More dynamism

- Managing downside risks
- Reacting to opportunities

4. Robust sustainability approach

- Meeting sustainability expectations...
- ...in return-aware manner

Patch-work quilt of asset class returns

But where do markets go from here this year?

1. Increased diversification

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
1	Gilts +15.6%	EM Stocks +12.8%	Global Stocks +21.2%	Property +19.5%	Property +13.9%	EM Stocks +35.4%	EM Stocks +21.1%	Property +7.5%	Global Stocks +22.6%	Global Stocks +14.3%	Commodities +28.3%
2	Property +8.1%	UK Stocks +12.3%	UK Stocks +20.8%	Gilts +13.9%	Global Stocks +4.4%	Commodities +33.3%	Global Stocks +14.0%	Cash +0.6%	UK Stocks +19.2%	EM Stocks +11.9%	Global Stocks +20.0%
3	Cash +0.6%	Global Stocks +12.1%	Multi Asset +15.1%	Global Stocks +12.2%	Multi Asset +2.9%	Global Stocks +30.3%	UK Stocks +13.1%	Gilts +0.6%	Multi Asset +16.9%	Gilts +8.3%	UK Stocks +18.3%
4	Multi Asset -2.4%	Multi Asset +10.6%	Property +11.0%	Multi Asset +9.5%	UK Stocks +1.0%	Multi Asset +20.1%	Multi Asset +12.2%	Global Stocks -3.1%	EM Stocks +15.9%	Multi Asset +2.9%	Multi Asset +17.7%
5	UK Stocks -3.5%	Gilts +2.7%	Cash +0.5%	EM Stocks +7.9%	Gilts +0.6%	UK Stocks +16.8%	Property +11.2%	Multi Asset -3.8%	Gilts +6.9%	Cash +0.3%	Property +15.4%
6	Global Stocks -6.9%	Property +2.3%	Gilts -3.9%	UK Stocks +1.2%	Cash +0.5%	Gilts +10.1%	Gilts +1.8%	Commodities -5.7%	Commodities +3.5%	Property -1.0%	EM Stocks +1.0%
7	Commodities -12.7%	Cash +0.6%	EM Stocks -5.3%	Cash +0.5%	EM Stocks -10.3%	Property +2.6%	Cash +0.3%	EM Stocks -7.6%	Property +2.1%	Commodities -6.1%	Cash +0.0%
8	EM Stocks -18.4%	Commodities -5.4%	Commodities -11.2%	Commodities -11.8%	Commodities -20.3%	Cash +0.4%	Commodities -7.1%	UK Stocks -9.5%	Cash +0.7%	UK Stocks -9.8%	Gilts -5.2%

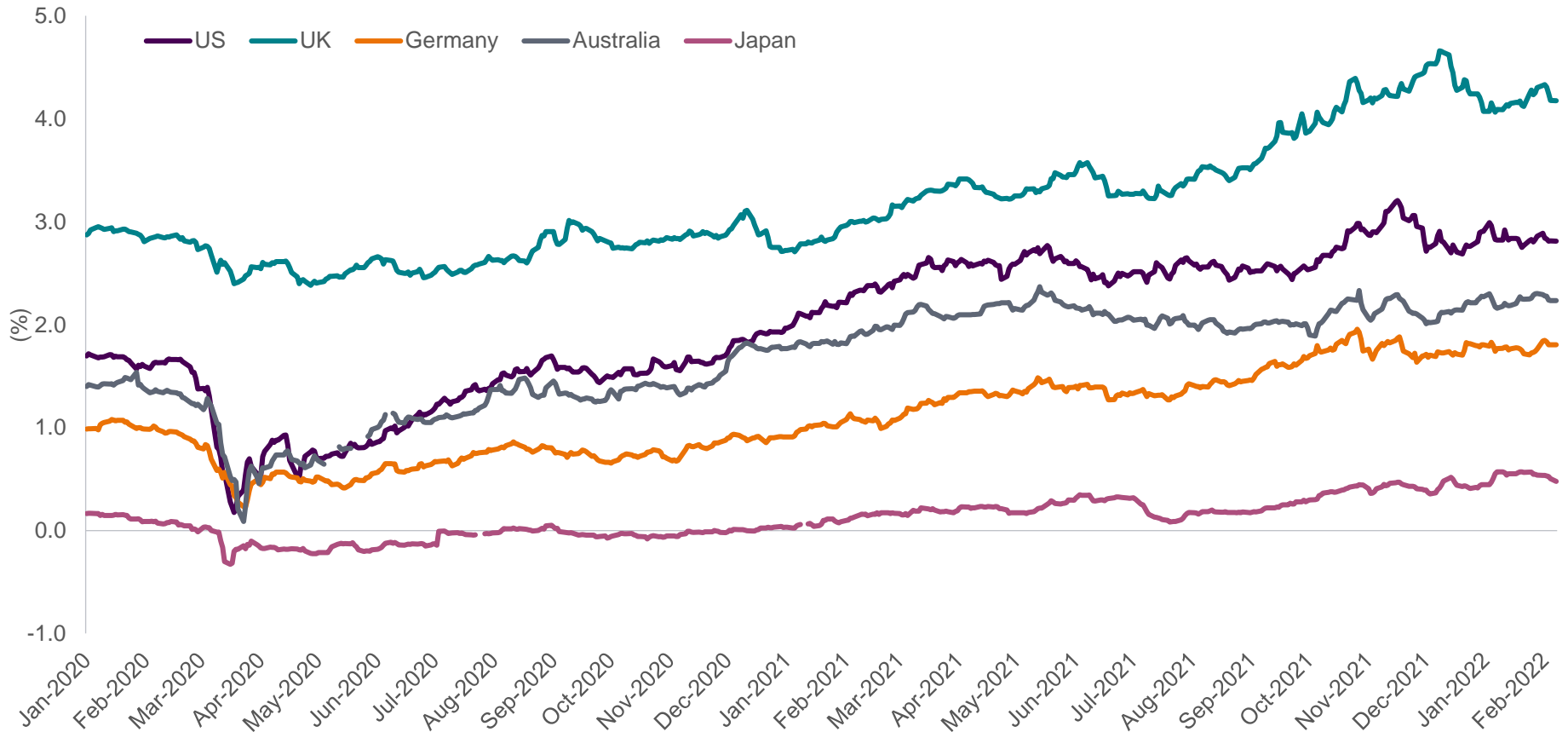
Past performance is not a reliable indicator of future results.

Source: RLAM, DataStream as at 1 January 2022; property as at November 2021. 'Multi Asset' returns are based on the benchmark weights of Royal London Global Multi Asset Portfolio (GMAP) Adventurous Fund / Governed Portfolio 4. Indices used are FTSE All Share, FTSE World, MSCI Emerging Markets ESG Leaders, MSCI/AREF UK All Balanced Quarterly Property Fund, Bloomberg Commodity Index, BoAML BB-B Global Non-Financial High Yield Constrained Index, iBoxx Sterling Non-Gilt Index, FTSE Actuaries UK Index Linked Gilts,, FTSE Actuaries UK Conventional Gilts Index, FTSE Actuaries UK Conventional Gilts up to 5 Years Index, SONIA. Total returns in sterling terms.

UK inflation expensive

Implied 10 year inflation globally

2. 'Return-aware' inflation hedging



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 7 February 2022.

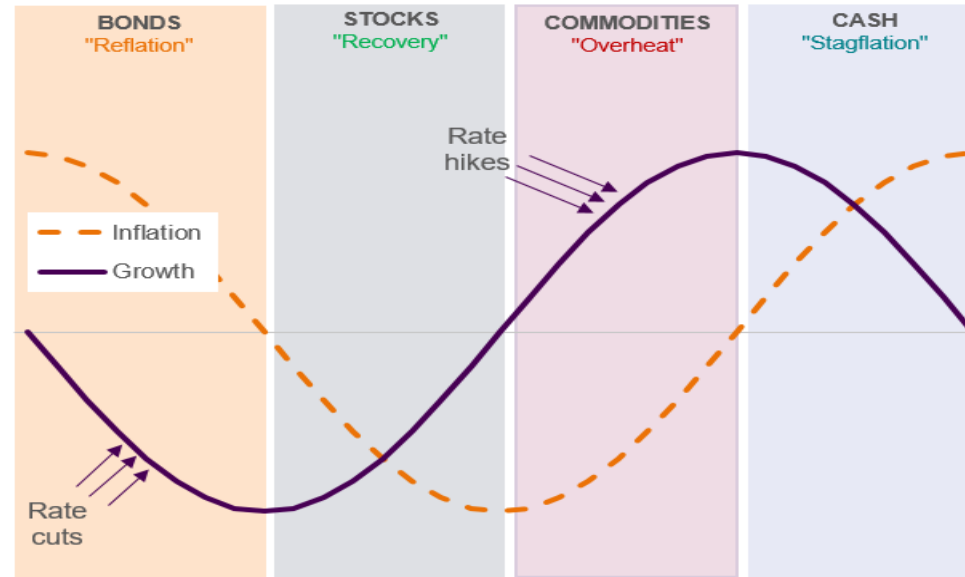
Gaining inflation exposures need to be balanced with interest rate exposures - working smarter, not harder

The Investment Clock model

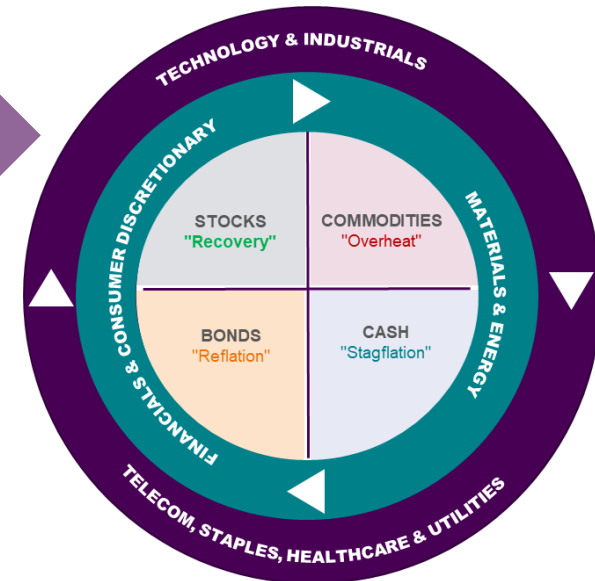
Links the business cycle to asset rotation

3. More dynamism

Business Cycle



Investment Clock



Historic Asset Class Returns through business cycles

	Growth	Inflation	Bonds	Stocks	Commodities	Cash
Reflation	↓	↓	9.5%	-3.3%	-27.4%	3.1%
Recovery	↑	↓	4.9%	20.9%	-10.0%	1.3%
Overheat	↑	↑	0.8%	6.8%	17.4%	0.4%
Stagflation	↓	↑	-0.7%	-13.6%	38.9%	-0.4%
	Average return		3.2%	6.4%	2.6%	1.0%

Source: RLAM for illustrative purposes only. Data based on an analysis of business cycles since April 1973.



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