The active management rebound

After an especially challenging first half of 2020 for active managers with smaller cap tilts and valuation disciplines, investors who stuck to their knitting have been rewarded strongly over the past 6-9 months. In this paper, we share the drivers of the recent rebound, the experience for different manager styles and our views for global equity active manager selection going forward. As economies reopen, Russell Investments' beliefs – strong stock picking from multiple differentiated skilled active managers, combined with a disciplined approach to valuation – are well-positioned to continue their recent, strong outcomes.

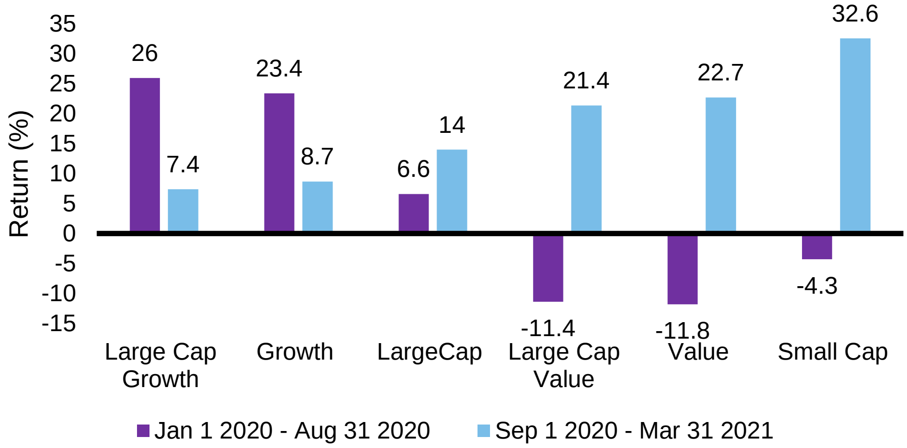
What happened in 2020?

2020 was a challenging year for active management, particularly for valuation driven investors. As the COVID-19 crisis escalated, the *stay-at-home* trade drove market concentration from already extreme to historic levels, as a narrow handful of the largest tech names rallied to all-time highs. The COVID-19 shock was highly unusual in that these same names led the market in the initial downswing led again in the sharp upturn. Given these headwinds, our global equity fund performance was challenging for most of 2020. However, starting in the late summer of 2020 things began to change. The rebound in performance shows how staying disciplined through volatile markets can be rewarded.

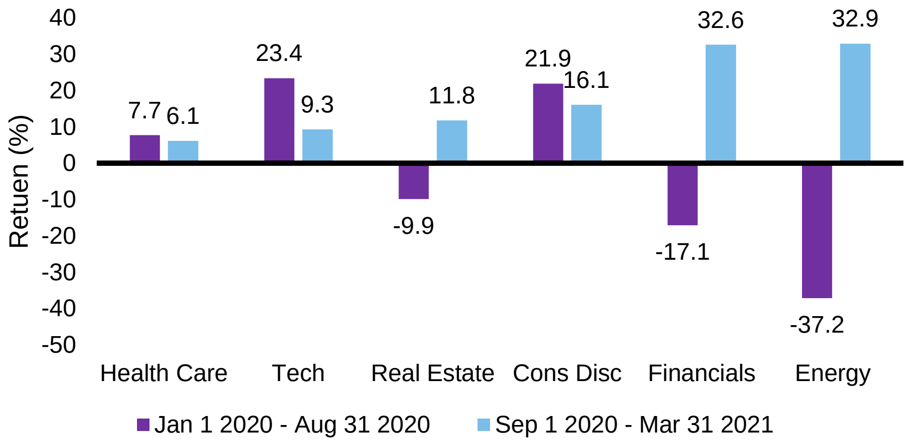
Markets turn fast

The initial signs of style rotation occurred in late Q3 2020, a pattern that gained traction after three consecutive vaccine *Monday's* in November. The swing in sentiment fueled some of the largest daily momentum reversals ever. The charts below show just how aggressively markets rotated.

Style Performance



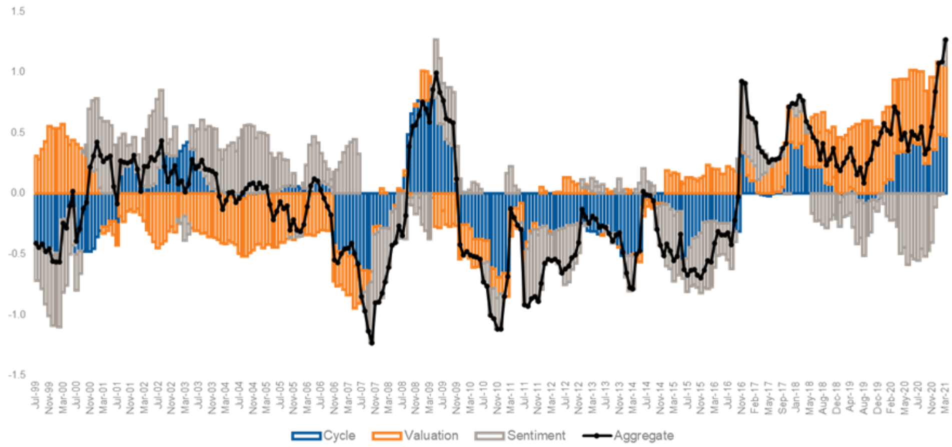
Sector Performance



Gross Total Return, net dividend withholding tax, in USD. MSCI indices. Source: MSCI and FactSet as of 31 March 2021.

We entered the new year with our proprietary **cycle** and **valuation** assessment/signals strongly supporting a tilt to value. The sentiment signal turned positive in early 2021. In our view, this rare combination of positive cycle, valuation and sentiment (CVS) represents a once in a generation opportunity for valuation conscious investors. The chart below shows the evolution of this aggregate CVS score for the value factor over time – out-stretching even the tech bubble as a supportive message for value stocks.

Contribution from Cycle, Valuation & Sentiment to Aggregate Signal for RFP Value Factor



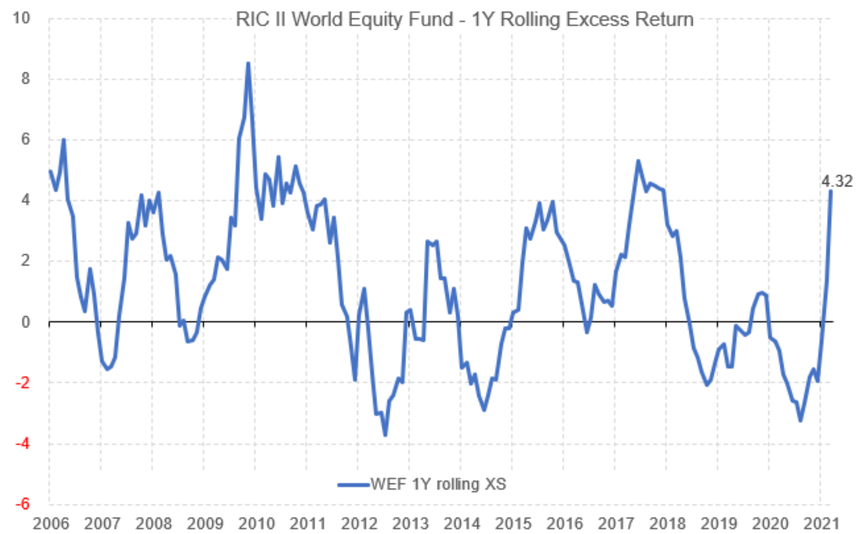
Source: Russell Investments, MSCI, FTSE, Refinitiv.

Fund performance trends: Discipline pays off

Russell Investments' multi-manager approach gives us the opportunity to remain well-diversified, with the stock-picking of our managers driving outcomes, while also leaning into these indicators when they offer extreme opportunities.

While 2020 was a challenging year, our multi-manager approach allowed the funds to stay in the game during a period where for some managers the outcomes were 10-20% behind the broad market. The turning point began around September and picked up steam in Q1, 2021. The exhibit below shows the rolling one-year excess returns for the RIC II World Equity Fund, illustrating the quick turnaround.

RIC II World Equity Fund – 1Y Rolling Excess Return



Source: Russell Investments, MSCI World NET Index in USD, to 31 March 2021. Performance is gross of fees.

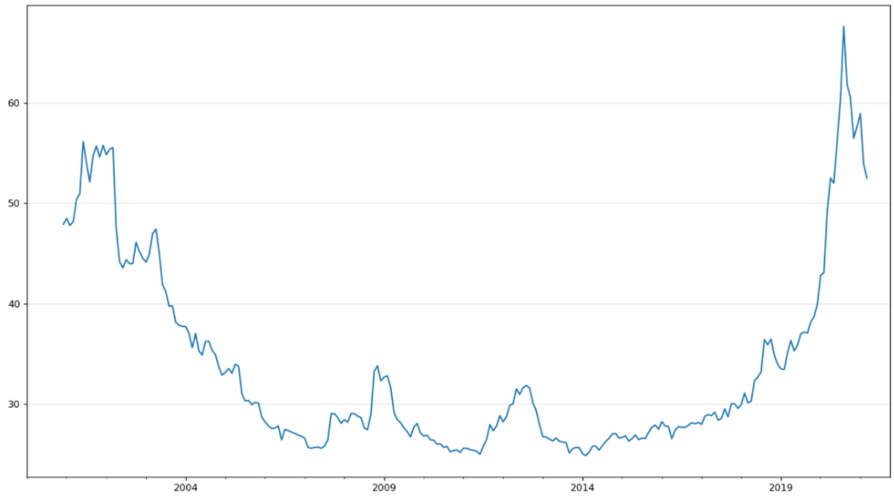
The value of your investments may fluctuate. Results achieved in the past do not offer any guarantee for the future.

	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011	2010	2009
World Equity Fund	14.0%	28.5%	-10.1%	26.8%	8.2%	1.9%	4.9%	27.6%	16.5%	-7.9%	16.0%	36.7%
Fund Benchmark **	15.9%	27.7%	-8.7%	22.5%	7.7%	-0.9%	5.2%	27.4%	16.2%	-6.0%	11.8%	30.0%
Excess Return	-1.9%	0.9%	-1.4%	4.3%	0.5%	2.8%	-0.3%	0.2%	0.3%	-1.9%	4.2%	6.7%
MSCI World Index (USD) – Net Returns	15.9%	27.7%	-8.7%	22.4%	7.5%	-0.9%	4.9%	26.7%	15.8%	-5.5%	11.8%	30.0
Excess Return	-1.9%	0.9%	-1.4%	4.4%	0.7%	2.8%	0.0%	0.9%	0.7%	-2.4%	4.2%	6.7%

** Russell Investments World Equity Fund is currently measured against the MSCI World Index (USD) - Net Returns. Prior to 31/12/2017 the benchmark was Russell Developed Large Cap Net, prior to 31/03/2011 it was the MSCI World Net, prior to 31/12/2008 it was the MSCI World Gross. Source: Confluence, 31 March 2021. Performance numbers are gross of fees in US Dollars. Past performance is not a guide to future performance. Any reference to returns linked to currencies may increase or decrease as a result of currency fluctuations. The Fund is actively managed with reference to the MSCI World Index (USD) - Net Returns. The Fund's performance will be measured against the Index which it seeks to outperform by 2% over the medium to long term.

Value managers experienced the most dramatic rotation, with Q1 excess returns against the broad market approaching 10% in some cases. Despite headwinds for growth names in 2021, our growth managers broadly outperformed their growth indices in Q1 after posting outstanding 2020 results. Part of this recent success has come from opportunities presented by the unwinding of extremely narrow market concentration in 2020, as seen below. As market concentration has declined, stock-picking has returned to favour, we expect this to continue going forward.

Market Concentration: Improving, but remains historically high



Herfindahl-Hirschman Index as of 31 March 2020. Source: Russell Investments, FactSet, MSCI.

Our 2021 outlook

As we move into Q2 2021 the active management environment is looking increasingly favourable. In addition to the significant CVS tailwinds mentioned above, many of the traditional indicators for active managers are flashing positive as well. Cross sectional stock volatility remains high and stock versus stock correlations are falling. Market concentration indicators remain historically untenable and should continue to fall (see market concentration exhibit above). Our growth managers have navigated this rotation well, hanging onto prior gains. Additionally, the more challenged performers of the last few years, value and quants, have turned a corner. These trends should accelerate as vaccines continue to be distributed and economies begin to reopen.

Remaining humble – risks to manage in 2021

While we believe our positioning is supported by the broad market outlook, there are scenarios that could be problematic. A sharp return of the *stay-at-home* trade due to virus variants coupled with a lack of vaccine efficacy remains a watchpoint. Risk complacency in the markets is concerning, i.e., the euphoria around meme stocks, Bitcoin and non-fungible tokens. An unexpected rise in geopolitical tensions causing a *flight* to *safety* is always a risk. However, our funds remain broadly diversified and much less volatile than single manager alternatives.

There is still time to hop on board

Markets move fast and the 2020/2021 period has seen some of the most dramatic rotations in history. Staying committed to our preferences for skilled stock picking, smaller cap exposures and valuation discipline, while mitigating risks has paid off. If history is any guide, these broader active management rotations can extend for long periods of time, especially when reverting from such extreme starting points. Our view is that there is still plenty of time for investors to benefit from the active management opportunities in a truly open architecture set of global and regional active managers.

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MCR-01017/15-06-2021 EMEA 2181