An investor's guide to sustainable investing

Introduction

At Royal London Asset Management, responsible investment is a major part of our history and a vital part of our future.

As part of a mutual group, responsible investment is a natural fit and key element in delivering our Group purpose - Protecting today, investing in tomorrow. Together we are mutually responsible. Benefiting from the stability of being part of the UK's largest life, pensions and investment mutual we can take a longer-term view, ensuring we are well placed to invest responsibly and champion positive, enduring change.

Our Sustainable Investment team look at sustainable factors for investments we hold or are thinking of buying, that are helping to solve the world's social and environmental challenges, and through active engagement to encourage continual improvement. We believe this improves standards, reduces risk and ultimately produces better outcomes for our investors.

Please remember that the value of investments and any income from them may go down as well as up and is not guaranteed. Investors may not get back the amount invested.

What is sustainable investing?

There is a lot of confusing terminology around sustainable investing, with this often used interchangeably with terms such as 'ethical' or 'socially responsible' investing.

The UK's financial services regulator, the FCA, are in the process of evolving regulation for Sustainability Disclosure Requirement (SDR) and investment labels which they believe will help provide further clarity. This will continue to develop throughout 2023. However, although official terminology is still unclear, we continue to follow the idea of sustainable investment that we have used since we launched our first fund in this area in the early 1990s. At Royal London Asset Management our Sustainable Investment team believe this means:

- Companies that provide a positive contribution to society through their products and services, or that demonstrate leading sustainable practices in the way they operate to create a cleaner, healthier, safer and more inclusive world.
- Companies that are 'best in class' on environmental, social or governance (ESG) factors – for instance lowest carbon emission/most efficient energy producers. And by extension, we avoid companies that we feel are the worst in those areas.
- Excluding companies in certain sectors that we feel cannot meet our sustainable criteria - for example armaments or tobacco.

One way to look at sustainable investing is to look at other ways that you can invest and how much these incorporate responsible investment ideas.

There is obviously the 'traditional' way of investing, which paid no attention to sustainable factors at all – focusing solely on the financial side of things. We believe that this is now an impractical way to invest – as we have all seen in recent years that companies' share prices can be impacted by these, for instance with poor environmental behaviour causing consumers stop using certain companies.

A 'responsible investment' approach may focus on screening out against certain companies, so they would be ineligible as fund holdings. For example, a fund may screen out mining or fossil fuel companies on their environmental impact, or a bank on its corporate governance standards.

Sustainable investing takes this a step further by adding in a positive element. It is about seeking the **good**, not just avoiding the **bad**.

However, some aspects of sustainable investing mean companies may have exposure to activities that we would usually screen out, such as an energy company. For instance, where an energy company is a leader in moving away from carbon-intensive power generation, then we may consider them for our funds. However, all companies that we invest in will meet our over-riding principle of 'do no significant harm'.

The common factor between these three approaches is that they all target a 'market' rate of return. In other words, they are all based on the idea that adding in these considerations should not be detrimental to your return.

One final approach is often termed 'impact investing'. Some investors are happy to see lower returns if there is a greater positive impact on society. This can perhaps be described as philanthropy or charity, where perhaps even no return is expected.

Sustainable vs ethical investing?

For most investors, the most common confusion is between ethical and sustainable investing, which are sometimes used interchangeably. We see clear differences between them. Ethical and socially responsible funds have been around a long time. These are usually quite simple to understand, as these will have specific lists or definitions of companies that they will not invest in.

Please remember that the value of investments and any income from them may go down as well as up and is not guaranteed. Investors may not get back the amount invested.

Should the issuer of a fixed income security become unable to make income or capital payments, or their rating is downgraded, the value of that investment will fall. Fixed income securities that have a lower credit rating can pay a higher level of income and have an increased risk of default.

What's in my investment?

While there are many different types of investments, the most popular are equities and bonds. Typically, equities would be expected to provide better returns, but carry greater risk than bonds. When looking at bonds, those issued by governments are often seen as safer, and therefore tend to have lower returns than corporate bonds, which are issued by companies. Many investors build portfolios that include both equities and bonds to provide the desired mix of potential risk and return.

Bonds – sometimes referred to as **fixed income** – are investments issued as debt by corporations and public bodies to raise finance. Bonds pay out a previously agreed payment (or coupon) until a maturity date when the initial investment (or principal) is re-paid. Government bonds, such as those issued by the US or UK governments, are typically seen as lower risk investments and therefore pay relatively low coupons. Corporate bonds, issued by the likes of Barclays, Tesco or Anglian Water, tend to pay higher coupons but have a greater risk.

Equities – often called **shares** – are a way that allows many people to own a single company. Shareholders are effectively owners of the company, with those owning more shares owning a larger slice of the company. They are eligible for dividends, entitled to vote at annual general meetings, and participate in the growth of a company.

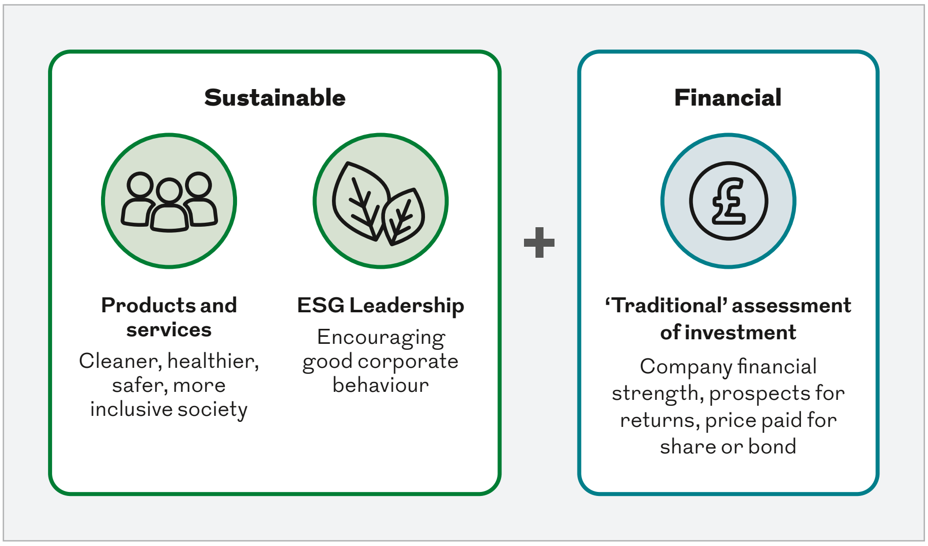
Our approach to sustainable investing

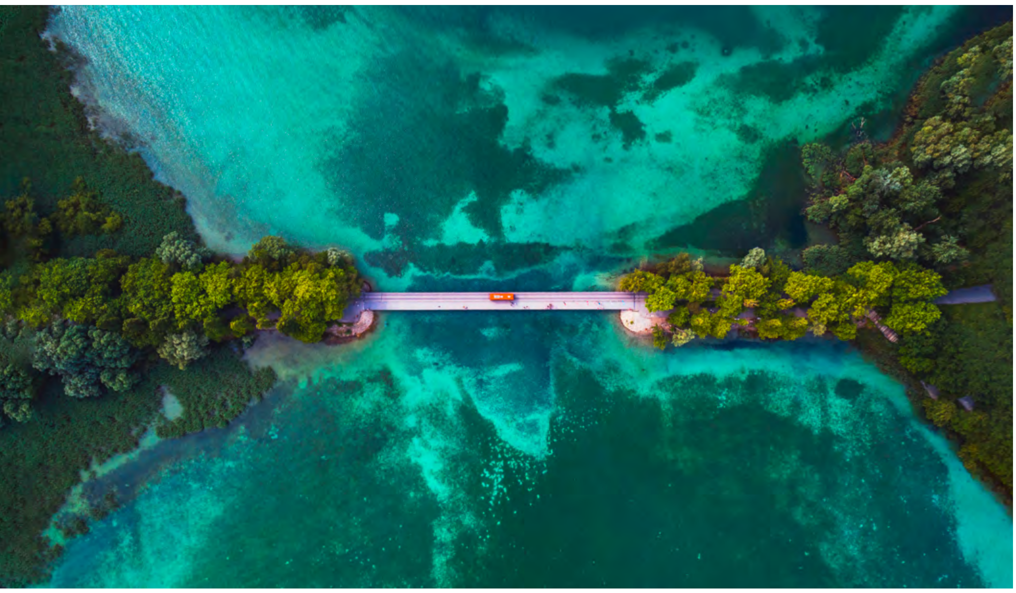
We believe that sustainable investing can easily be understood by considering it alongside other types of investment, and how much, if at all, these consider two factors: first, targeting an attractive overall return and second, building in consideration of sustainable factors.

In our view, sustainable investing means investing in companies whose products and services are helping to solve the world's social and environmental challenges, and through active engagement to encourage continual improvement.

The focus on investing in companies with sustainable factors means we will not invest in sectors such as armaments and tobacco, and will also not invest in companies that we believe manage ESG risks poorly.

Alongside these considerations, we believe it is vital to ensure that all investments made make sense from a financial point of view as well.





Experience matters

As sustainable investing has increased in popularity, so the number of sustainable funds on the market has also increased. However, while others may be new to this area, Royal London Asset Management has significant experience, with our Head of Sustainable Investment, Mike Fox, managing sustainable funds since 2003. Mike leads a team which is an integral part of our wider equities and fixed income capabilities and draws on expertise across the business.

Mike and his team work particularly closely with our Responsible Investment team. This team help analyse sustainable factors for potential investments, but also look out for the interests of holders of our funds. They do this by voting at company meetings, and engaging with companies we invest in to encourage best practice across areas such as cyber security, executive pay and succession planning. We do this because we think that well-run companies have the potential to make the best long-term investments. For a comprehensive look at our activities in 2022, click here.

Oversight is important

If you run a sustainable fund, you can find external research to make decisions about which companies are 'sustainable'. However, we think it is better to do this ourselves, but want a check on what we do.

We therefore set up an independent external advisory committee to support the Sustainable Investment team and advise on current and potential investments.

This committee comprises four specialists with complementary expertise from the academic, corporate, client and investment worlds relevant to sustainable investing. It is also independent of Royal London Asset Management as a whole. The committee is there as an extra check to challenge us, help to ensure we act in the spirit of our sustainable funds – as well as to share its knowledge and experience.

Our current sustainable themes

- Circular Economy & Environmental Efficiency
- Cleaner and safer transport
- Community funding
- Digital world
- Energy transition
- ESG Leadership
- Financial inclusion and resilience
- Hygiene and wellbeing
- Industry 4.0
- Knowledge and learning
- Next generation medicine
- Social & Environmental infrastructure
- Social housing

Source: Royal London Asset Management sustainable themes.

When looking at our portfolios, certain themes emerge. It is important to remember that themes come out of stock selection rather than the other way around. Each stock or bond in our sustainable funds has to meet our sustainable and financial criteria – we will not buy because a stock or bond represents a theme. We think it is important to have the flexibility to evolve as society evolves, ensuring that at all times we are investing in the most relevant themes and those most likely to deliver strong investment returns.

Our current themes

Circular Economy & Environmental Efficiency

If economic growth in the 20th century was driven by extraction, production, consumption and disposal, the more circular economy of the 21st century will emphasise the re-use, recycling, remanufacturing and subsequent consumption of our planet's scarce natural resources. From improving recycled inputs to cutting energy requirements, this theme is about doing more while using less.

Cleaner and safer transport

While transport facilitates trade, exchange, travel and globalisation, it remains one of the major sources of pollution through the use of the combustion engines and causes many deaths and injuries. Electric and autonomous vehicles offer the opportunity to move transport into a cleaner, safer future.

Community funding

Focusing on banks and building societies that fund and support individuals and small businesses.

Digital world

The exponential growth of data and computing power is allowing data to be used to make better decisions in areas such as healthcare diagnosis and energy usage. Cloud computing also plays a key role in decarbonising the economy by moving computing to more energy-efficient data centres.

Energy transition

The way we have extracted energy from the sun recently is through fossil fuels. Renewable energy, such as solar and wind, offers the opportunity to extract energy directly from the sun in a cleaner, more sustainable manner.

ESG Leadership

Companies could demonstrate a net benefit through their exceptional ESG practices. This extends beyond their direct operations to their interactions with their supply chains, customers and wider stakeholder base.

Financial inclusion & resilience

The future of finance, from next generation payment platforms to ensuring a better future, is driven by a desire to empower consumers. These businesses will also extend access to financial services to the surprisingly high portion of the world who are unable to access the basic financial structures taken for granted in the more affluent regions of the developed world.

Hygiene & wellbeing

While fending off everyday bacteria and regular exercise might seem more mundane than the latest medical advances, small steps can have a big impact. Companies in this theme provide the ingredients and finished products to improve our health and wellbeing, year in, year out.

Industry 4.0

Bringing together the physical and digital worlds to enhance the efficiency of a range of existing industries.

Knowledge and learning Infrastructure

Bringing together the physical and digital worlds to enhance the efficiency of a range of existing industries.

Next generation medicine

The new advancements in healthcare helping to enhance the standards. This looks at the ability to extract more accurate and timely health information from our bodies, and the ability to obtain our individual genetic profile.

Social & Environmental infrastructure

The economy of the future will require renewed investment in not just digital but also physical infrastructure. From cleaner, more biodiverse water systems to advanced and net-zero ready logistics facilities this theme will be the backbone of the future economy.

Social housing

The provision of housing for those on low or no income mainly though housing associations.

Why sustainable at Royal London Asset Management?

Experienced – the team has been running sustainable funds since 2003

Trusted – our track record on longevity, reputation and prudent management of risk, makes us well placed to become the trusted partner of investors seeking strong long-term returns

Durable – a process that has been through multiple market cycles

Flexible – a range of funds for different risk and return appetites

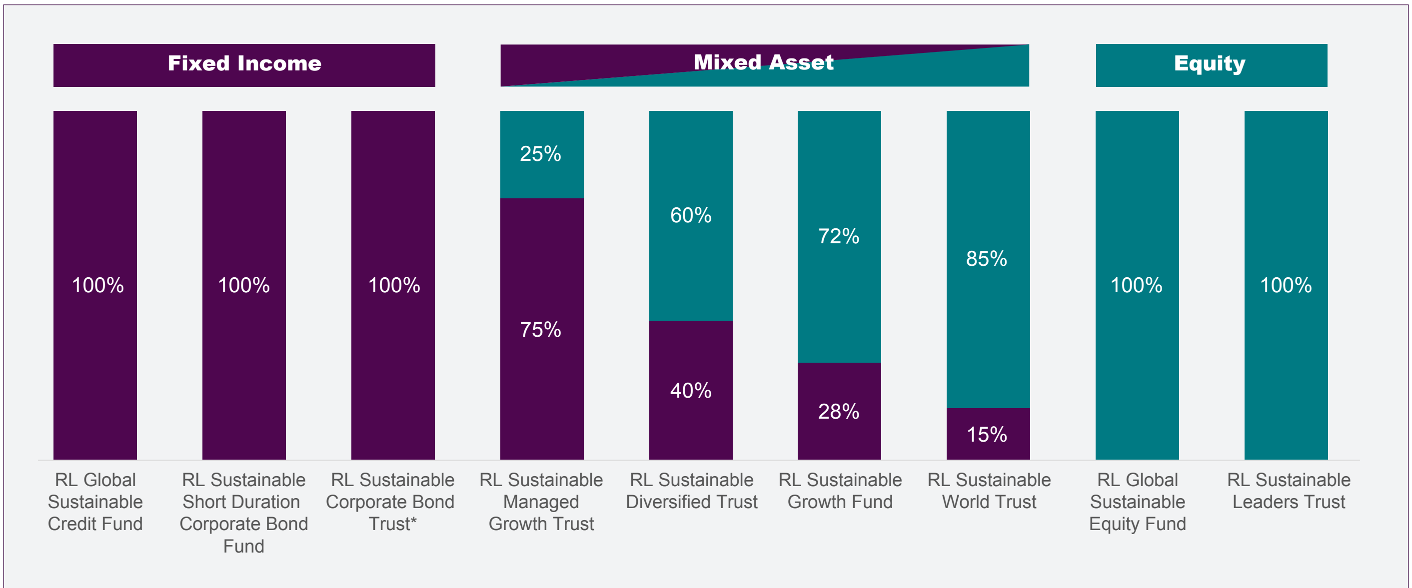
Oversight – an independent advisory team to make sure we keep to the 'spirit' of sustainable investing

Our sustainable range

We know that different people are comfortable with different levels of risk and have different objectives. Our sustainable fund range reflects this, with different combinations of UK and global shares and bonds.

Our funds are mapped against potential risk and returns and profiled by independent, professional risk rating agencies accordingly. Your adviser will help you understand the differences between them, to find the appropriate fund, or funds, that are suitable for you, given your own respective risk tolerance and investment time horizon.

The investment strategy will result in certain industries being excluded as a result of our ethical and sustainable investment policy. As a consequence, there may be increased risk due to reduced diversification opportunities.



For illustrative purposes – reflects approximate percentage asset allocation, weightings may vary.

At Royal London Asset Management we recommend that you discuss any financial decisions with a financial adviser, particularly if you are unsure whether an investment is suitable.

*Fund name changed from Royal London Sustainable Managed Income Trust on 27 March 2024.

Investment risks

Concentration risk: The price of Funds that invest in a reduced number of holdings, sectors, or geographical areas may be more heavily affected by events that influence the stockmarket and therefore more volatile.

Exchange rate risk: Changes in currency exchange rates may affect the value of your investment.

Liquidity risk: In difficult market conditions the value of certain fund investments may be difficult to value and harder to sell, or sell at a fair price, resulting in unpredictable falls in the value of your holding.

Emerging markets risk: Investing in emerging markets may provide the potential for greater rewards but carries greater risk due to the possibility of high volatility, low liquidity, currency fluctuations, the adverse effect of social, political and economic instability, weak supervisory structures and accounting standards.

Derivative risk: Derivatives are highly sensitive to changes in the value of the underlying asset which can increase both fund losses and gains. The impact to the fund can be greater where they are used in an extensive or complex manner, where the Fund could lose significantly more than the amount invested in derivatives.

Credit risk: Should the issuer of a fixed income security become unable to make income or capital payments, or their rating is downgraded, the value of that investment will fall. Fixed income securities that have a lower credit rating can pay a higher level of income and have an increased risk of default.

Interest rate risk: Fixed interest securities are particularly affected by trends in interest rates and inflation. If interest rates go up, the value of capital may fall, and vice versa. Inflation will also decrease the real value of capital.

Efficient Portfolio Management (EPM) techniques: The fund may engage in EPM techniques including holdings of derivative instruments. Whilst intended to reduce risk, the use of these instruments may expose the Fund to increased price volatility.

Counterparty risk: The insolvency of any institutions providing services such as safekeeping of assets or acting as counterparty to derivatives or other instruments, may expose the Fund to financial loss.

Inflation risk: Where the income yield is lower than the rate of inflation, the real value of your investment will reduce over time.

Investment risk: The value of investments and any income from them may go down as well as up and is not guaranteed. Investors may not get back the amount invested.

Responsible Investment Style Risk: The Fund can only invest in holdings that demonstrate compliance with certain sustainable indicators or ESG characteristics. This reduces the number securities in which the Fund can invest and there may as a result be occasions where it forgoes more strongly performing investment opportunities, potentially underperforming non-sustainable funds.

This document is a financial promotion and is not investment advice. Telephone calls may be recorded. For further information please see the Privacy policy at www.rlam.com.

Royal London Sustainable Corporate Bond Trust, Royal London Sustainable Managed Growth Trust, Royal London Sustainable Diversified Trust, Royal London Sustainable World Trust and Royal London Sustainable Leaders Trust are held within RLUM Limited Unit Trusts, which is an authorised unit trust scheme. The Manager is RLUM Limited, authorised and regulated by the Financial Conduct Authority, with firm reference number 144032.

The Royal London Sustainable Growth Fund and Royal London Global Sustainable Equity Fund are sub-funds of Royal London Equity Funds ICVC, an open-ended investment company with variable capital with segregated liability between sub-funds, incorporated in England and Wales under registered number IC000807. The Authorised Corporate Director (ACD) is Royal London Unit Trust Managers Limited, authorised and regulated by the Financial Conduct Authority, with firm reference number 144037.

The Royal London Global Sustainable Credit Fund is a sub-fund of Royal London Asset Management Funds plc, an open-ended investment company with variable capital and segregated liability between sub-funds. Incorporated with limited liability under the laws of Ireland and authorised by the Central Bank of Ireland as a UCITS Fund. It is a recognised scheme under section 264 of the Financial Services and Markets Act 2000. The Investment Manager is Royal London Asset Management Limited. Most of the protections provided by the UK regulatory system, and the compensation under the Financial Services Compensation Scheme, will not be available.

The Royal London Sustainable Short Duration Corporate Bond Fund is a sub-fund of Royal London Bond Funds II ICVC, an open-ended investment company with variable capital with segregated liability between sub-funds, incorporated in England and Wales under registered number IC001128. The Authorised Corporate Director (ACD) is Royal London Unit Trust Managers Limited, authorised and regulated by the Financial Conduct Authority, with firm reference number 144037.

For more information on the trusts or funds, or the risks of investing, please refer to the Prospectus or Key Investor Information Document (KIID), available via the relevant Fund Information page on www.rlam.com.

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Contact

To find out more about our sustainable fund range please speak to your financial adviser.

We are happy to provide this document in Braille, large print and audio.

Please contact us or speak to your financial adviser.

www.rlam.co.uk/contact-us

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