Royal London Global Bond Opportunities Fund

Quarterly Report

31 December 2022

Executive summary

- The fund returned 3.64% for the fourth quarter, gross of tax and management fees (Z class, Income). For the 12-month period, the fund has returned -6.64%. This negative absolute performance was primarily driven by the widening of credit spreads.
- The Z share income distribution for the fourth quarter, payable at the end of February is 1.32p, compared to the 1.40p distributed in respect of the third quarter of 2022.
- We continue to believe that both global investment grade and high yield bonds are attractive on a spread basis and that they overcompensate for default risk, while their level of income generation is also appealing on a relative basis.

Performance

	Fund (%)
Q4 2022	**3.64**
Year-to-date	-6.64
Rolling 12 months	-6.64
3 years p.a.	1.18
5 years p.a.	2.71
Since inception p.a. 08.12.2015	4.44

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.

All performance figures stated in sterling, gross of fees and tax unless otherwise stated, subject to rounding. The impact of fees or other charges including tax, where applicable, can be material on the performance of your investment. The impact of fees reduces your return.

Source: RLAM. Based on the Z Inc share class.

Performance for the fund is calculated on a mid basis with income re-invested. Performance for other share classes available at www.rlam.com.

Yields

	Fund
Gross redemption yield	7.89%
Gross income yield	6.50%

Source: RLAM and State Street. Based on the Z Inc share class.

[1]Excluding cash

Reported yields reflect RLAM's current perception of market conventions around timing of bond cash flows. Heightened uncertainty due to the COVID 19 crisis may impact these timings for bonds with callable feature.
Gross redemption yield is the rate of discount at which a bond's future obligations of interest and capital payments equates to its current price. The gross redemption yield shown for the fund is the average for its individual holdings, weighted by their current value, net of relevant fund management costs and gross of tax.

Fund data

	Fund
Duration[1]	3.7 years
No. of stocks	181
Fund size	£172.7m
Launch date	08.12.2015

Fund strategy

- The fund aims to achieve a high level of income with the opportunity for capital growth, by seeking attractive investments across a broad spectrum of fixed income opportunities, encompassing sub-investment grade, unrated bonds and investment grade.
- The fund mitigates stock-specific risk by holding a diversified portfolio of investments, so that no individual allocation can in isolation have an undue impact on overall performance.
- The fund's assets are held in securities denominated across a range of G10 currencies, with currency exposures substantially hedged back to sterling.
- The average duration of the fund's portfolio is relatively short, at 3.7 years, and the sensitivity of the fund's performance to changes in government bond yields is consequently modest.

Market Background

Index	Total return (%)	Spread movement (basis points)
HY non-financial emerging markets ICE BofA ML emerging markets high yield ex. subordinated financial index	9.5	-251
HY global non-financial corps ICE BofA ML global non-financial high yield index	5.10	-99
AT1 ICE BofA ML contingent capital index	8.54	-68
HY global non-financial hybrid corps ICE BofA ML global hybrid non-financial high yield index	3.97	-65
Sterling investment grade corporate bonds ICE BofA ML sterling corporate and collateralised index	7.24	-44
IG global non-financial hybrid corps ICE BofA ML global hybrid non-financial corporate index	3.40	-45
Dollar investment grade corporate bonds ICE BofA ML US corporate index	3.53	-29
Euro investment grade corporate bonds ICE BofA ML euro corporate and Pfandbriefe index	1.24	-54

Source: Bloomberg.

- Central banks responded to the continued strength of inflation by further tightening monetary policy and reiterating that they will do whatever it takes to suppress rising prices. The US Federal Reserve (Fed), European Central Bank (ECB) and Bank of England (BoE) each raised rates by 1.25% in aggregate over the period. Since March, the Fed has raised rates seven times by 4.25% in total – its 0.75% increases in June, July, September and November were the biggest single increases for nearly 30 years. Investors expect further hikes in 2023 as the services sector of the US economy has remained notably strong.
- The ECB was slower to react, partly due to a more fragmented backdrop with a gap between Germany and 'peripheral' economies. However, it ended its bond buying programme in July and increased rates by 0.75% (its first hike for 11 years and a bigger increase than the 0.50% expected by economists). Further increases followed in September, October and December with a clear commitment to raise rates further in 2023. The BoE increased rates to 3.5% over the quarter, taking its tally to eight increases in 2022 and nine so far in this cycle.
- Despite these interest rate rises and volatility, however, risk assets outperformed in the fourth quarter as inflation appeared to be nearing its peak. Investors started to anticipate lower rates of inflation and the peak of the interest rate cycle early in 2023 as central banks pivot away from hawkish monetary policies to more nuanced strategies. In local currency terms (i.e., without the considerable impact of US dollar weakness over the quarter), nearly all major stock markets delivered positive returns for the quarter. Likewise, global credit markets delivered positive returns and tighter spreads across the board (see table, above).

- UK bond markets continued to be impacted by Kwasi Kwarteng's ill-fated 'mini-Budget' with the BoE forced to intervene in the gilt market. Although this calmed financial markets temporarily, the volatility continued for several weeks, only moderating when new policies were set out by new Chancellor Jeremy Hunt and then confirmed in the Autumn Statement in mid-November.
- As a result, the UK gilt market was the strongest major government bond market over the quarter, delivering a return of +1.7% as the benchmark 10-year gilt yield fell by 42 basis points (bps) from 4.09% to 3.61%. Shorter-dated gilts performed best; gilts with five years to maturity or less provided positive returns of 2.7%, whereas the 15 years or more to maturity segment returned -1.9%. Otherwise, most other significant markets delivered negative returns over the period as yields rose (prices move inversely to yields): the 10-year US treasury yield rose by 5bps to 3.87%; and the 10-year German bund yield rose by 46bps to 2.57%.
- Primary credit market activity recovered in the fourth quarter. Despite minimal activity in December, sterling issuance was £11.5bn over the quarter, primarily from the financial sectors. For the year as a whole, however, the total sterling issuance of £50.9bn was below the £62.5bn and £57.0bn for 2021 and 2020, respectively. Similar patterns were also seen in the euro investment grade market.
- After several challenging quarters, the fourth quarter was more positive for high yield bonds despite the weakness in underlying treasury bonds. The ICE BofAML (BB-B) Global Non-Financial High Yield Index benchmark returned 5.04% to sterling investors with the spread tightening to 440bps. The index ended the quarter with a still-generous 'all-in' yield of 8.1%, which has increased from 4.2% at the start of 2022. In the broader-based high yield index, which includes CCC rated bonds, spreads tightened to 520bps from 620bps. By our estimates this implies a 24% cumulative default rate over a five-year period. While there was some improvement in activity levels, new issuance remained relatively weak over the quarter.
- After falling back in the third quarter, the price of Brent crude oil fell by another 4.0%, to less than $86 a barrel – this is below the prevailing price at the time of the Russian invasion of Ukraine in late February. Natural gas prices fell over 50% in the quarter as the weather in Europe remained relatively warm. Meanwhile, copper futures recovered to rise by 3.5% in dollar terms despite the evident slowdown in China.
- Currencies continued to be volatile in the quarter, although in the opposite direction as the dollar weakened. The Fed's apparently softer approach to raising interest rates pushed it sharply lower and the dollar was the weakest major currency over the quarter: it depreciated by nearly 10% against the yen and euro, and by over 7% against sterling. The strength of sterling against the dollar was detrimental to the returns to sterling investors from global bonds.

Fund commentary

- The fund delivered strong positive returns for the fourth quarter, reflecting more stable returns from government bond markets and tighter credit spreads in many markets. While the low duration of the fund was a negative, this was offset by its highly diversified nature across asset classes, regions and sectors, and the ongoing high carry. In sector terms, the insurance (particularly subordinated insurance), structured and utilities sectors contributed positively to returns, outweighing the impact of general industrials (**Metalcorp** and **Aggregated Micro Power** were the largest negative contributors) and telecoms.
- Due to the ongoing volatility and higher yields, issuance in the high yield market was a fraction of the levels seen through much of 2021. New issuance came predominantly from the US, with minimal high yield issuance in euros. Investment grade credit issuance was better in euros and sterling, but still not at the levels seen in 2020 and 2021. However, there were still opportunities to participate, particularly in financials, which arguably find it easier than corporates to pass on higher debt costs to customers. We bought senior banks issues by **HSBC**, **NatWest** and **Crédit Suisse**, and subordinated banks issues from **Lloyds**, **BNP Paribas**, **Société Générale**, **Commerzbank**, **Permanent TSB** and **Investec**. We also participated in a subordinated insurance issue from **ASR Nederland**. In general industrials, we bought issues from **Enquest**, **Bluewater Holdings** and **Bouygues**. Otherwise, we bought utility issues from **ENEL** and **EdF**.
- In the banks sector, we added to the **NatWest** new issue in the secondary market and bought senior bank debt of **Intermediate Capital Group**. We also added to our position in subordinated insurance, buying bonds of **La Mondiale Sam**, **Ethias**, **ASR Nederland** and **Prudential Financial**. We sold some existing subordinated bonds against the new issues, including those of **Permanent TSB**, **Lloyds**, **Barclays** and **Credit Suisse**. We also exited a position in **Nordea** subordinated bonds following the significant recovery in the bonds from their lows. Outside the financials sectors, we added to our existing position in Lime Petroleum. We sold our position in **Nordic Capital Partners** in capital goods on concerns about refinancing risk; and tendered bonds of **Golar LNG** in a company buyback. We also took some profits in utility **Co-entreprise de Transport d'Electricité** (CTE), the holding company for RTE – the operator of the French electrical power transmission network. We bought the bonds in the third quarter and they had performed particularly well. Otherwise, to offset the new issuance purchases in general industrials, we exited our position in **Harbour Energy** on valuation grounds, reduced our exposure to **DOF Subsea** after it

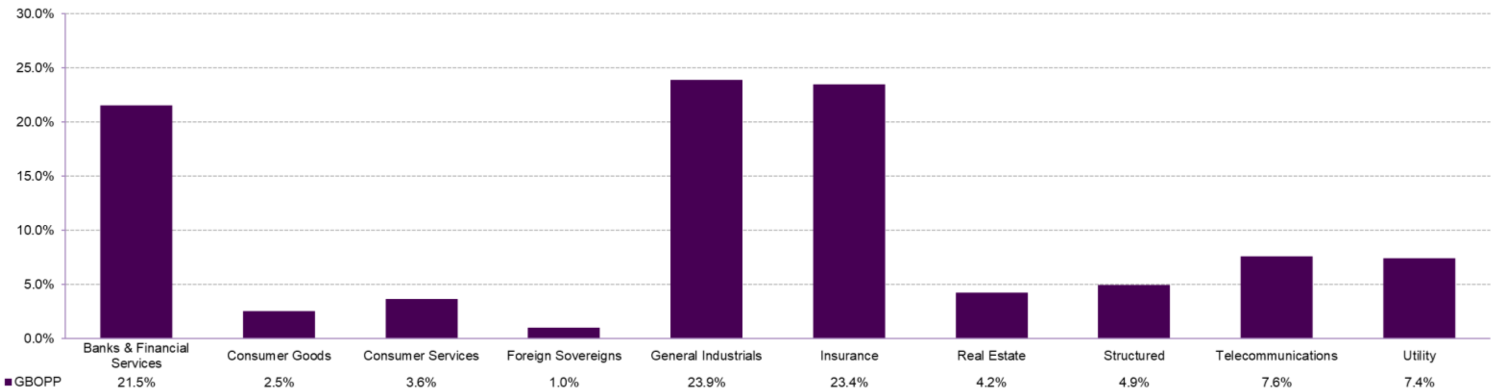
announced a restructuring, and sold hybrid bonds of **GE** and **AT&S** that had performed well. We also sold a number of non-financials bonds, including debt of **TUI Cruises**, **Fluvius**, **Subsea**, **Bouygues** and **Techem Blitz**.

- The fund remains well diversified, with low sensitivity to interest rates, and an attractive underlying yield that should support income generation. It remains our view that this attractive level of income and the fund's sectoral biases will deliver outperformance over the medium term.

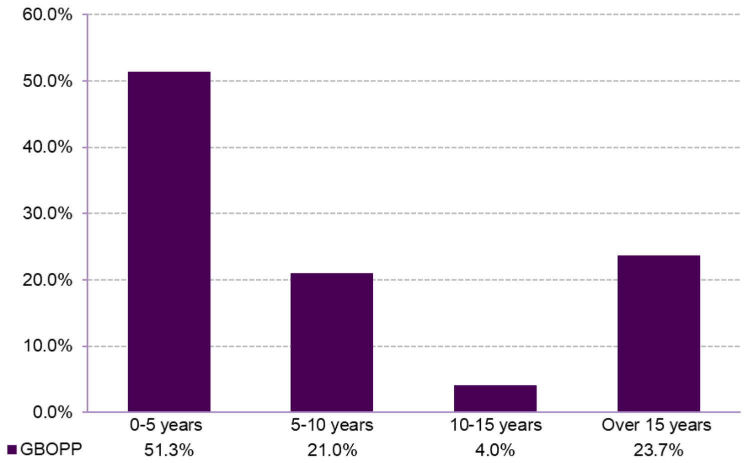
Investment outlook

- We expect inflation to peak in the coming months as the anniversary of the Russian invasion of Ukraine passes in late February – the impact of oil and gas price rises in 2022 will drop out through base effects, and weaker GDP growth will reduce tightness in labour markets. Nonetheless, interest rates have risen sharply and weaker GDP growth will impact the corporate sector, and we expect to see some increase in credit downgrades and default rates. We will maintain focus on identifying companies with strong balance sheets, favouring issues with security and downside protection, and ensuring that the fund remains well diversified across issuers and sectors.
- Despite this outlook, we believe that the widening in credit spreads this year has taken valuations to attractive levels, on both a relative basis compared to government bonds and in absolute terms. Credit spreads discount a significant portion of bad news, and investors are being paid well to take credit over government bond risk. The yields on gilts, sterling investment grade bonds, European sub-investment grade bonds and global sub-investment grade bonds have risen sharply this year. Investment grade credit is still close to its most compelling level for nearly 10 years, particularly if inflation starts to fall: furthermore, the fund delivers a yield premium to the market.
- In the broader-based global high yield index, which includes CCC rated bonds, spreads tightened to 520bps by year end. By our estimates this implies a 24% cumulative default rate over a five-year period, which compares to cumulative default rates of 25% during the Global Financial Crisis and 30%+ in the 1990s and early 2000s. So, while defaults are currently at record lows, the high yield market is discounting a significant recession and commensurate level of defaults. Yet this implied default rate takes no account of the much higher quality and more robust nature of the high yield market today, compared to 2008/9; nor of the current financial state of issuers as we head towards the downturn. Most issuers are in a stronger position than normal at this stage of a cycle and default and recovery expectations remain extremely benign.
- The fund's unconstrained approach across a broad spectrum of fixed income opportunities – encompassing investment grade, sub-investment grade and unrated bonds in a wide range of credit markets – means that risks are diversified, while providing considerable opportunities. Furthermore, the short duration of the fund should limit the impact of the volatility that may continue to impact government bond markets.

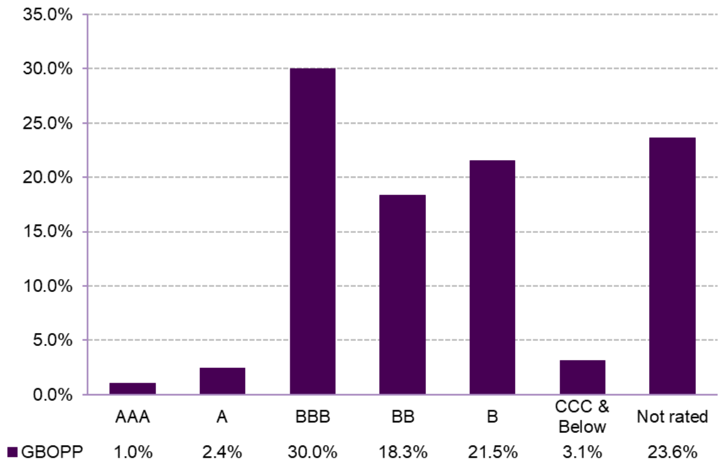
Sector breakdown



Maturity profile



Credit breakdown



Source: RLAM. Figures include the impact of cash held.

Ten Largest Holdings

	Weighting (%)
Lamon 6.75% 2044	2.1
M&G Plc 3.875% 2049	1.9
Rabobank 6.5% Perpetual	1.8
EDF 5.375% Perpetual	1.8
QBE Insurance Group Ltd 6.75%2044	1.7
Aggregated Micro Power Holdings 8% 2036	1.7
M&G Plc 6.5% 2048	1.6
Energy Transfer LP 6.75% Perpetual	1.5
Swiss Re 5.524% Perpetual	1.5
Legal & General 5.25 2047	1.3
Total	**16.9**

Source: RLAM. Figures in the table above exclude derivatives where held, subject to rounding.

Risk warnings

- **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.
- **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.
- **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.
- **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.
- **Exchange Rate Risk:** Changes in currency exchange rates may affect the value of your investment.
- **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.
- **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.
- **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.

Performance to 31 December 2022

	Cumulative (%)					Annualised (%)	
	3M	6M	1Y	3Y	5Y	3Y	5Y
Fund (gross)	3.64	2.21	-6.64	3.60	14.31	1.18	2.71
Fund (net)	3.50	1.94	-7.13	2.02	11.68	0.67	2.23

	Year on year performance (%)				
	Q4 2021 to Q4 2022	Q4 2020 to Q4 2021	Q4 2019 to Q4 2020	Q4 2018 to Q4 2019	Q4 2017 to Q4 2018
Fund (gross)	-6.64	7.08	3.63	9.29	0.96
Fund (net)	-7.13	6.52	3.13	8.86	0.56

Past performance is not a guide to future performance. The impact of fees or other charges including tax, where applicable, can be material on the performance of your investment.
Source: RLAM as at 31 December 2022. All figures are mid-price to mid-price in GBP for the Z Inc share class.

IMPORTANT INFORMATION

For professional clients only, not suitable for retail investors.

This 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.

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