Royal London Global Bond Opportunities Fund

Quarterly Report 30 June 2022

Executive summary

- The fund returned -6.09% for the second quarter, gross of tax and management fees (Z class, Income).
- The fund's Z share income distribution for the second quarter, payable at the end of August, is 1.25p, compared to the 1.30p distributed in respect of the first 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 (%)
Q2 2022	**-6.09**
Year-to-date	-8.66
Rolling 12 months	-6.57
3 years p.a.	1.50
5 years p.a.	3.05
Since inception p.a. 08.12.2015	4.44

Past performance is not necessarily a reliable indicator of 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 gross of fees and tax unless otherwise stated, subject to rounding.

Source: RLAM. Based on the Z Inc share class. Performance for the fund is calculated on a mid basis with income re-invested.

Yields

	Fund
Gross redemption yield	7.06%
Gross income yield	6.12%

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

[2]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.

Fund data

	Fund
Duration[2]	3.8 years
No. of stocks	190
Fund size	£180.6m
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 3.8 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	-10.4	+235
HY global non-financial corps ICE BofA ML global non-financial high yield index	-8.6	+135
AT1 ICE BofA ML contingent capital index	-9.9	+186
HY global non-financial hybrid corps ICE BofA ML global hybrid non-financial high yield index	-14.4	+148
Sterling investment grade corporate bonds ICE BofA ML sterling corporate and collateralised index	-10.8	+102
IG global non-financial hybrid corps ICE BofA ML global hybrid non-financial corporate index	-6.7	+42
Dollar investment grade corporate bonds ICE BofA ML US corporate index	-7.8	+56
Euro investment grade corporate bonds ICE BofA ML euro corporate and Pfandbriefe index	-7.1	+79

Source: Bloomberg.

- Inflation was the headline macroeconomic influence over the quarter, although this crystallised into fears of recession in June. Higher energy and commodity prices added to the supply chain-related increases seen as the global economy emerged from the Covid-induced shutdown of 2020 and 2021.
- Central banks responded to this rising inflation by tightening monetary policy and indicating that there is more to come. The Federal Reserve (Fed) led the way, increasing rates by 1.25% over the quarter – its clear commitment to do more has led markets to price in a further 2% of hikes in 2022. The European Central Bank was less aggressive – partly due to a more fragmented backdrop, with the gap between German and 'peripheral' bonds widening in recent months – but confirmed that it will end its bond buying programme in July and signalled that a 25 basis points (bps) hike in July and another 50bps in September are both possible. The Bank of England (BoE) has increased rates at every meeting since December 2021 and this continued through the quarter, with the fifth consecutive increase in June taking the UK base rate to 1.25%.
- Bond markets returns were hit hard in the quarter, as rising interest rates again drove government bond yields higher globally (prices move inversely to yields): the benchmark 10-year US treasury yield rose by 67bps to 3.01%. Longer-dated bonds performed worst in the period due to their greater sensitivity to interest rates (duration risk).
- Meanwhile, the high yield spread widened by another 182bps to 614bps, taking the yield on the broad high yield index (including CCC rated bonds) to 8.9% – the quarter saw three consecutive months of higher yields and wider spreads, although most of these shifts occurred in June.

This was the third worst month for the ICE BofAML (BB-B) Global Non-Financial High Yield Index since it launched in 1997, as the market started to discount a recession rather than a slowdown. The index delivered returns of -10.30%, making this one of the most difficult quarters for some years. The combined impact of the first and second quarters was particularly painful, with the market down over 15% since the start of the year. After a record year for new issues in 2021 with c. $500bn of high yield issuance, the adverse market conditions caused new issuance to remain minimal in the second quarter having more-or-less dried up in January.

- Currency moves were significant in the quarter, following the volatility of the first quarter. The sharp rise in US interest rate expectations meant that the dollar was the strongest global currency: it appreciated significantly against the Swiss franc, euro and sterling, and rose over 11% against the yen. These movements will impact global trade and overseas earnings over coming months, and dollar strength will also be a risk for any emerging markets countries and companies that have borrowed in dollars. The price of Brent crude oil rose by another 6.4% to nearly $112 a barrel, but copper futures fell 21.9% on fears of recession and renewed Covid restrictions in China earlier in the quarter.

Fund commentary

- While the fund delivered negative absolute returns in the quarter – reflecting wider credit spreads and the weakness in high yield markets as fears of recession (and therefore higher defaults) took hold – it performed particularly well relative to the relevant benchmarks for the different areas in which it is able to invest. This was driven by three key areas: the low duration of the fund, which reduces sensitivity to rising government bonds yields; its highly diversified nature across asset classes, regions and sectors; and the ongoing high carry helped to mitigate the negative impact of wider credit spreads. In sector terms, the exposure to sectors that will perform well in an inflationary environment (such as energy, mining and shipping) was positive. Conversely, the fund's exposure to corporate hybrids was detrimental to returns; however, this impact was mitigated by our preference for short call dates, reducing the negative impact on performance.
- Due to the ongoing volatility, 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 also weak in euros and sterling, with both materially lower than for the comparable quarter in 2021 and the first quarter of 2022. We bought new issues of **Bayport**, the microloans company operating in developing countries, which was refinancing the maturity of an existing bond held in the fund, and Scandinavian transport fuel provider **Greenbit**, orientated towards increasing provision of renewable products. We also participated in a new issue of dollar-denominated bonds of finance group **Julius Baer**; and bought subordinated perpetual bank debt of **Barclays** and **Virgin Money**, and subordinated bonds of **SEB**. **Lime Petroleum**, the Norwegian continental shelf oil and gas production company, announced a new issue of 2025 bonds as part of acquisition financing of a stake in the established Brage field – the new bonds repay in instalments over their three-year term reflecting its strong cash flow generation.
- In terms of notable secondary market activity, we added to our existing holdings of **Waldorf Production**, **Bluewater Holding**, **EdF** hybrids and **Legal & General** subordinated bonds. We bought new positions in **Achmea** subordinated debt, **Darling Ingredients** and **Tullow Oil**, following its merger with Capricorn Energy. We also switched between issues of **TopBuild** to reduce maturity, and between holdco and opco issues of Swedish real estate company **Heimstaden** to reduce default risk. Otherwise, we sold relatively expensive bonds of **Standard Chartered** and **Achmea**, and reduced our holding in **Getlink**, to maintain liquidity. We also sold bonds of **Teekay LNG Partners**, **Iqvia** and **Energias de Portugal**. Lastly, we sold structured bonds of **Opus Chartered** in a buyback on favourable terms.
- The fund remains well diversified, with low sensitivity to interest rates, and an attractive underlying yield that should support income generation.

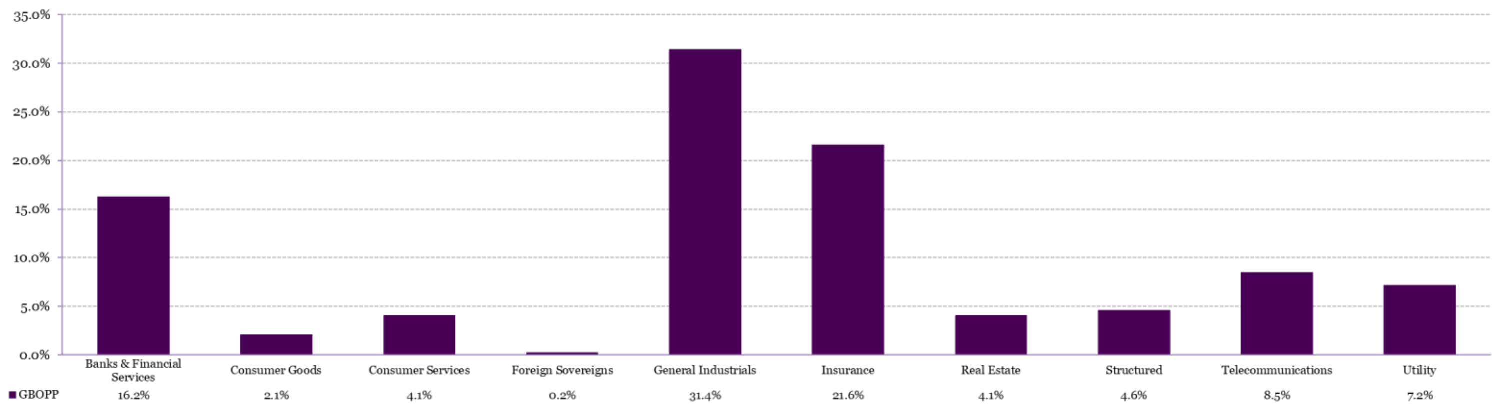
Investment outlook

- There is considerable uncertainty about the outlook for the rest of 2022 and into 2023. The Fed has raised rates again – with inflation rising at its fastest rate since 1981, the 0.75% increase in mid-June was the largest for nearly 30 years. Some investors fear that this could tip the US into a hard-landing recession. The picture is only marginally different in the UK: although the BoE increased rates sooner, it has signalled that it will take whatever steps are necessary to bring inflation under control. The strength of the dollar will make this more difficult, however, as dollar-priced imports (such as oil and gas) will become more expensive. At this point, hard data and forward-looking economic surveys are giving mixed messages about whether inflation will continue to dominate or if higher interest rates will lead to a recession.
- The longer-term risk of recession will be the key driver for credit markets over the rest of 2022. Spreads on investment grade credit indices have widened sharply and now offer even better compensation for the risk of default: we expect credit to outperform government debt over the medium term. The biggest driver of the high yield market is the default rate forecast and, given the unprecedented levels of liquidity in the global financial system since March 2020, we expect default rates to remain benign for some time. However, the high yield market is pricing in a severe recession – with spreads at over 640bps at the end of June, the implied five-year cumulative default rate was 33%. This compares

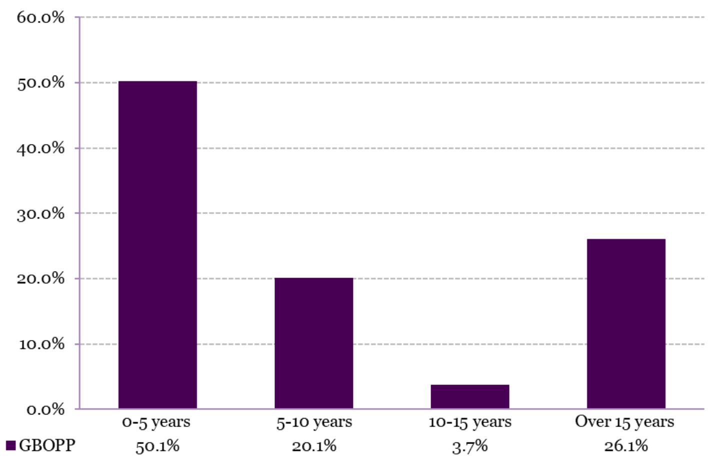
to cumulative default rates of 25% during the Global Financial Crisis and 30%+ in the 1990s and early 2000s. So, while defaults are currently at record lows, the high yield market is discounting a major recession and commensurate level of defaults. Yet this implied default rate takes no account of the much higher quality and more robust nature of the high yield market today, compared to previous cycles; nor of the current financial state of issuers as we head into the downturn. Following the bumper issuance of 2020 and 2021 (and the strength of the energy sector in 2021 and the first half of 2022), most issuers are in a stronger position than normal at this stage of a cycle and default and recovery expectations remain extremely benign.

- Crucially, as evidenced in the second quarter, 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.

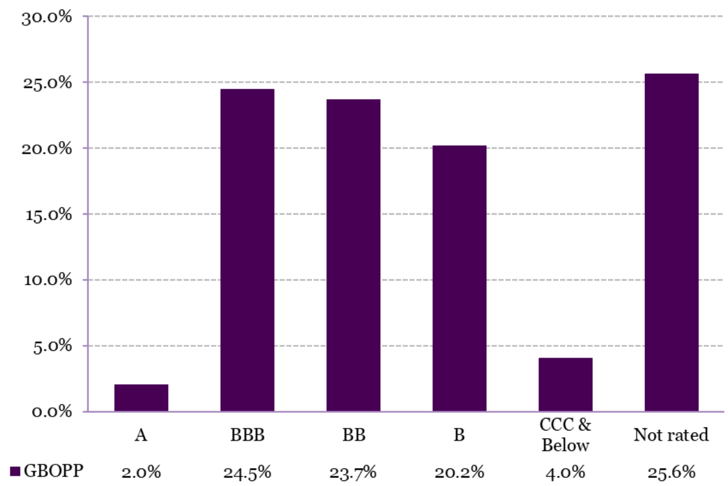
Sector breakdown



Maturity profile



Credit breakdown



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

Ten Largest Holdings

	Weighting (%)
Aggregated Micro Power Infrastructure 8% 2036	1.7
M&G Plc 3.875% 2049	1.6
Rabobank 6.5% Perpetual	1.6
QBE Insurance Group Ltd 6.75%2044	1.6
M&G Plc 6.5% 2048	1.5
Swiss Re 4.625% Perpetual	1.5
Electricité de France 5.375% Perpetual	1.5
Virgin Media Secured Finance Plc 5.5% 2029	1.5
DKT Finance APS 9.375% 2023	1.4
General Electric Co Float Perpetual	1.4
Total	**15.5**

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

IMPORTANT INFORMATION

For professional clients only, not suitable for retail investors. The views expressed are the author's own and do not constitute investment advice. This document is a financial promotion. It does not provide, and should not be relied on for, accounting, legal or tax advice, or investment recommendations. For more information on the fund or the risks of investing, please refer to the fund factsheet, Prospectus or Key Investor Information Document (KIID), available on www.rlam.com.
Past performance is not a reliable indicator of future results. 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.
Portfolio characteristics and holdings are subject to change without notice. This does not constitute an investment recommendation. For information purposes only, methodology available on request. Unless otherwise noted, the information in this document has been derived from sources believed to be accurate. Information derived from sources other than Royal London Asset Management is believed to be reliable; however, we do not independently verify or guarantee its accuracy or validity.

All confidential information relating to any Royal London Group company must be treated by you in the strictest confidence. It may only be used for the purposes of assessing the proposal to engage Royal London Asset Management Limited (RLAM). Confidential information should not be disclosed to any third party and should only be disclosed to those of your employees and professional advisers who are required to see such information for the purpose set out above. You should ensure that these persons are made aware of the confidential nature of such information and treat it accordingly. You agree to return and/ or destroy all confidential information on receipt of our written request to do so.
Telephone calls may be recorded. For further information please see the Legals notice at www.rlam.com.
The Fund is a sub-fund of Royal London Asset Management Funds plc, which is an umbrella fund with segregated liability between sub-funds. As a consequence, the holdings of one sub-fund are kept separate from the holdings of other sub-funds and your investment in the Fund cannot be used to pay the liabilities of any other sub-fund. Investors may exchange their shares in the Fund for shares in other sub-funds of Royal London Asset Management Funds plc.
Issued by Royal London Asset Management Limited, Firm Registration Number: 141665, registered in England and Wales number 2244297; Royal London Unit Trust Managers Limited, Firm Registration Number: 144037, registered in England and Wales number 2372439; RLUM Limited, Firm Registration Number: 144032, registered in England and Wales number 2369965. All of these companies are authorised and regulated by the Financial Conduct Authority. Royal London Asset Management Bond Funds Plc, an umbrella company with segregated liability between sub-funds, authorised and regulated by the Central Bank of Ireland, registered in Ireland number 364259. Registered office: 70 Sir John Rogerson's Quay, Dublin 2, Ireland.
All of these companies are subsidiaries of The Royal London Mutual Insurance Society Limited, registered in England and Wales number 99064. Registered Office: 55 Gracechurch Street, London, EC3V 0RL. The Royal London Mutual Insurance Society Limited is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. The Royal London Mutual Insurance Society Limited is on the Financial Services Register, registration number 117672. Registered in England and Wales number 99064. FQR RLAM EM 1320.