Royal London Global Bond Opportunities Fund

Quarterly Report 31 March 2022

Executive summary

- The fund returned -2.73% for the first quarter, gross of tax and management fees (Z class, Income).
- The fund's Z share income distribution for the first quarter, payable at the end of May, is 1.30p, compared to the 1.24p distributed in respect of the fourth quarter of 2021.
- 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 (%)
Q1 2022	**-2.73**
Year-to-date	-2.73
Rolling 12 months	2.34
3 years p.a.	4.52
5 years p.a.	4.94
Since inception p.a. 08.12.2015	5.67

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	5.31%
Gross income yield	5.43%

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]	4.0 years
No. of stocks	188
Fund size	£197.2m
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 investment grade, sub-investment grade and unrated bonds.
- 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 4.0 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	-8.7	+172
HY global non-financial corps ICE BofA ML global non-financial high yield index	-4.5	+84
AT1 ICE BofA ML contingent capital index	-5.4	+100
HY global non-financial hybrid corps ICE BofA ML global hybrid non-financial high yield index	-6.7	+79
Sterling investment grade corporate bonds ICE BofA ML sterling corporate and collateralised index	-5.8	+36
IG global non-financial hybrid corps ICE BofA ML global hybrid non-financial corporate index	-5.2	+79
Dollar investment grade corporate bonds ICE BofA ML US corporate index	-5.2	+32
Euro investment grade corporate bonds ICE BofA ML euro corporate and Pfandbriefe index	-3.9	+48

Source: Bloomberg.

- The combined impact of geopolitical events and the changing outlook for growth and inflation made the first quarter particularly challenging for credit investors. In all three months markets ended with higher yields, with the first two months of the year delivering a 'double whammy' of higher government yields and wider credit spreads. The benchmark 10-year treasury yield increased sharply over the quarter from 1.51% to 2.34%, having reached a highpoint of 2.47% in late March. As a result, US treasuries delivered a quarterly return of -4.90%. Meanwhile, the high yield spread widened by c. 125 basis points (bps). Broad benchmarks delivered notably negative returns, making this one of the most difficult quarters for some years.
- High yield markets started the year in rude health with an ultra-low default rate and a spread of c. +350bps. However, with the publication in early January of the minutes of its December FOMC meeting, it became clear that the Federal Reserve (Fed) was prepared to increase interest rates significantly faster and further than expected just a few months before. The Bank of England also signalled that it is tightening monetary policy sharply, raising interest rates twice more and reversing its quantitative easing programme, while the European Central Bank accelerated the end of its net asset purchases programme.
- High yield investors initially saw inflation as an interest rates story that would mainly play out through government bond markets and, without the Russian invasion of Ukraine, this might have remained the case. In January, government bond yields rose and spreads widened, although the dispersion of returns was fairly tight. The story was similar in February: government bond yields continued to rise (although they narrowed following the invasion of Ukraine and the sanctions imposed on Russia by many governments) and spreads widened further, mainly following

the invasion. The main impact of the conflict was felt in March – intra month, spreads widened to +470bps (making the quarterly shift +125bps) before rebounding to end the month at 391bps (+40bps from the start of the year), while government bond yields rose another 58bps.

- After a strong first two weeks in January, the adverse market conditions caused new issuance to more-or-less dry up in the first quarter. As funds built up cash reserves through the receipt of coupons, some managers sought value in the secondary market as the quarter came to a close simply to manage cash levels. While the uncertainty may continue to impact primary activity, investment grade new issuance resumed from mid-March and high yield issuance is expected to follow suit in the second quarter, particularly as there is still significant leveraged buy-out (LBO) activity in the pipelines.

Fund commentary

- While the fund delivered negative absolute returns in the quarter, reflecting the very weak performance of government bond markets and wider credit spreads, it performed particularly well relative to the relevant benchmarks for the different areas in which it is able to invest. 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 government bonds and 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.
- New issuance was limited by the volatile market conditions. However, activity was reasonably strong in the first few weeks of the year and we bought a number of new issues, including Austrian **AT&S** and senior bonds from **ICAP.** These bonds have historically been a little more volatile than those issued by conventional banks, but we believe this is more than reflected in the yield. Also, ICAP tends to see higher revenues when markets are more volatile and therefore further diversified our financials exposure. We also added a floating rate new issue from **Fibo**, the Scandinavian construction materials business, whose Norwegian krone five-year bonds offered income of 6% above short-term rates. When conditions stabilised towards the end of the quarter, we bought euro-denominated perpetual bonds of **Volkswagen** and senior banks issues from **Standard Chartered** and **Danske Bank**.
- In the secondary market, we made several switches. We sold US utility **Southern Co**, using the proceeds to add to hybrid bonds from **EDF** after the latter was marked down on a credit rating change. We continued to add to this position through the quarter. We also made a switch in subordinated bonds from **Legal & General** – selling 2052 bonds into 2047 equivalents, helping bring down portfolio duration but with almost no change in the credit spread gained. Lastly, we switched between issues from telecoms operator **Softbank** given the risk that the hybrids may not be called. We took profits on **Anglian Water** structured bonds that had outperformed following an upgrade from high yield to investment grade. We also sold several subordinated financials called, including **NatWest** and **Barclays**. We reinvested proceeds across a number of areas, including adding to existing positions in **Virgin Media** and **Jaguar**. We also added a new position in healthcare analytics provider **Iqvia**. Later in the quarter, we sold subordinated financials issues of **Investec**, **ING** and **Zurich** raising liquidity to take advantage of attractive pricing following the market volatility. We added to our existing position in **Heathrow Finance** structured bonds and bought legacy tier 1 insurance debt of **Achmea** with a 2025 call. Otherwise, we sold bonds of **Tulip Oil** that the company was buying back at an attractive price – these bonds had performed well despite the challenging market conditions. We also sold our holding of **Hawaiian Brands Intellectual Property**, given the company's high carbon intensity and the modest spread on the bonds.
- The fund remains well diversified, with low sensitivity to interest rates, and an attractive underlying yield that should support income generation.

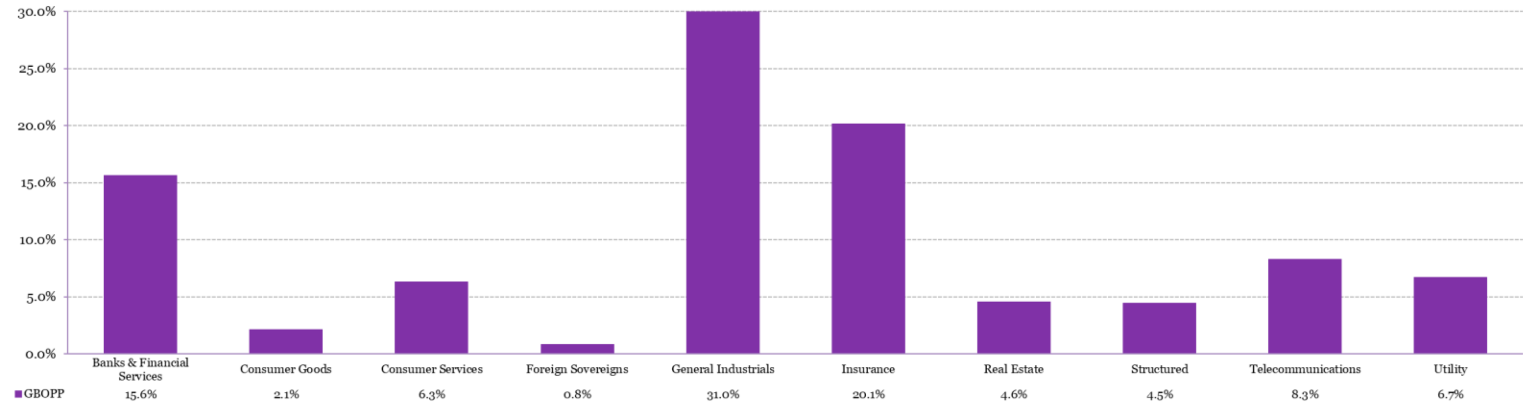
Investment outlook

- There is considerable uncertainty about the year ahead. The war in Ukraine has given central banks a real dilemma: tighten policy to address inflation or give some slack on further policy moves until the growth consequences become more evident? The US yield curve (between 2- and 10-year maturity bonds) inverted during March, which many view as recession signal, which is possible given that US investors are positioned for eight further rate hikes this year, taking the Fed Funds target rate above 2.5% (from 0.50% at present). As planned, the Fed also ended its quantitative easing programme at the end of March. In the UK the picture is only marginally different: five further hikes and a rate of 2%. There has also been a significant shift in the eurozone, with tightening now expected in the second half of the year. Although we expect a slowdown in medium term, we believe that market pricing may be too aggressive at present. However, we must highlight the uncertainty of any market forecasts at present, given the unpredictability of the situation in Ukraine.
- Some see the longer-term risk of recession as the key driver for credit markets over the rest of 2022. However, at a macroeconomic level, the US economy is better insulated from rising commodity prices (it is a net energy exporter), highlighting the potential for a diversion in monetary

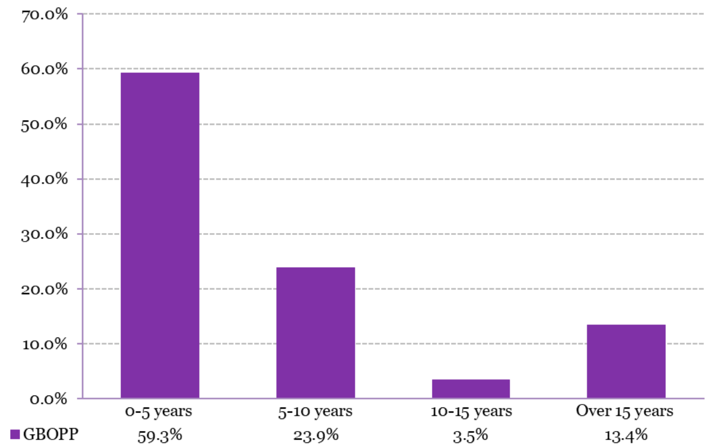
policy between central banks. Meanwhile, credit spreads on euro and sterling investment grade credit indices have widened sharply and now offer even better compensation for the risk of default: it is still expected that credit will outperform government debt over the medium term. The biggest driver of 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 to come.

- Crucially, as shown by its performance in the first 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 protect it from some of the volatility that may impact government bond markets.

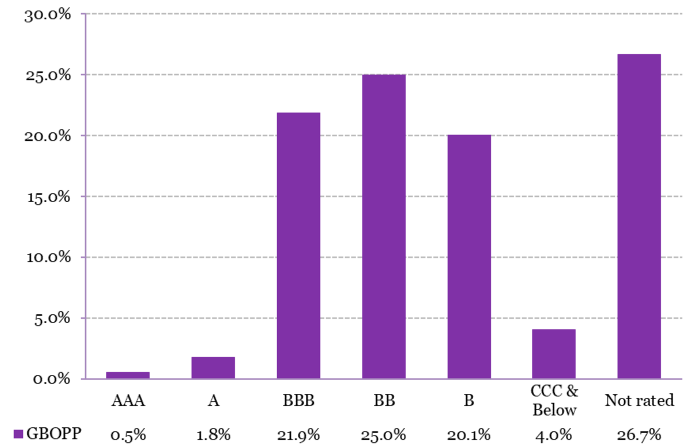
Sector breakdown



Maturity profile



Credit breakdown



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

Ten Largest Holdings

	Weighting (%)
Rabobank 6.5% Perpetual	1.8
M&G Plc 3.875% 2049	1.6
Electricité de France 5.375% Perpetual	1.6
Aggregated Micro Power Infrastructure 8% 2036	1.6
QBE Insurance Group Ltd 6.75%2044	1.4
M&G Plc 6.5% 2048	1.4
Swiss Re 4.625% Perpetual	1.4
Virgin Media Secured Finance Plc 5.5% 2029	1.4
Energy Transfer 6.75% Perpetual	1.4
Santander UK plc 10.375% Perpetual	1.3
Total	**14.8**

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

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