For professional clients only, not suitable for retail clients.

Royal London Ethical Bond Fund

Quarterly Investment Report

31 December 2023

ROYAL LONDON
ASSET MANAGEMENT

Quarterly Report

The fund as at 31 December 2023

The purpose of this report is to provide an update on the Royal London Ethical Bond Fund. The report has been produced by Royal London Asset Management. The report starts with a summary dashboard showing key information about the fund. A glossary is located at the end of the report covering the description of some of the more technical terms used within the report. All data is as at the report date unless otherwise stated.

Contents

The fund

Fund performance objective and benchmark

The fund's investment objective is to achieve a total return over the medium term (considered to be a period of 3-5 years), by investing predominantly in sterling-denominated corporate bonds, which meet predetermined ethical criteria. The fund's performance target is to outperform, after the deduction of charges, the Markit iBoxx Sterling Non-Gilt Total Return All Maturities GBP Index over rolling 5-year periods. The Index is considered an appropriate benchmark for the fund's performance, as many of the fund's potential investments will be included in the Index. The fund is actively managed, meaning that the manager will use their expertise to select investments to meet the objective.

Benchmark: Markit iBoxx Sterling Non-Gilt All Maturities Index

Fund value

	Total £m
31 December 2023	1,275.45

Asset allocation

	Fund (%)	Benchmark
Conventional credit bonds	96.75%	99.38%
Securitised	3.05%	-
Index linked credit bonds	0.20%	-
Conventional foreign sovereign	-	0.62%

Fund analytics

	Fund	Benchmark
Fund launch date	31 January 2007	
Base currency	GBP	
Duration (years)	5.90	5.54
Gross redemption yield (%)	6.57	4.77
Number of holdings	344	1,264
Number of issuers	209	501

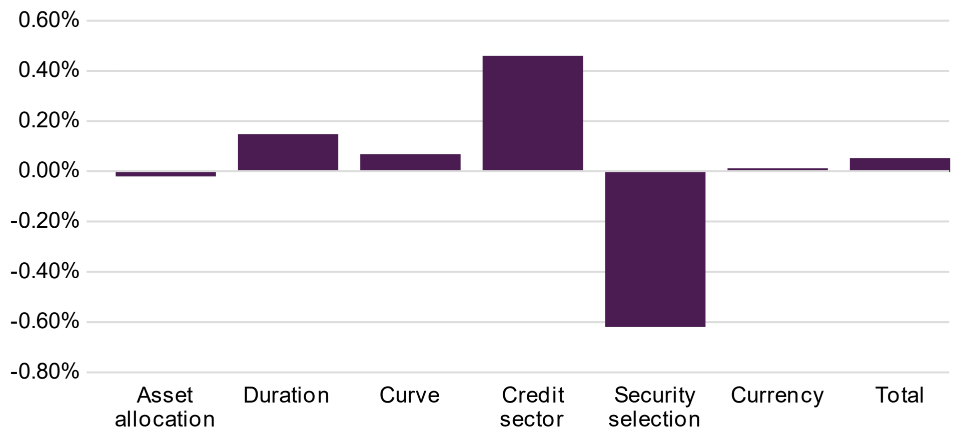
Performance and activity

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Quarter	7.56	7.35	0.20
1 Year	10.14	8.60	1.54
3 Years (p.a.)	(2.87)	(4.69)	1.81
5 Years (p.a.)	1.88	0.40	1.48
10 Years (p.a.)	3.84	2.71	1.13
Since inception (p.a.)	5.26	3.92	1.33

Past performance is not a guide to future performance. Please refer to the Glossary for the basis of calculation and impact of fees. Performance and since inception date based on RL Ethical Bond Fund (Z Inc). Source: Royal London Asset Management; Gross performance; Since inception date of the shareclass is 31 October 2009.

Attribution over the quarter



Performance commentary

The fund saw a positive return in the period and was broadly in line with the iBoxx Sterling Non-Gilt index benchmark. The main driver of positive performance was our sector positioning, notably our underweight position in supranationals, which continued to lag the wider market having done so in the third quarter. Duration and curve positioning were positive – we were slightly long going into the quarter and the fall in yields and strong performance from longer-dated bonds therefore helped.

Stock selection effects were negative: we saw negative selection effects in structured bonds, which generally have a lower sensitivity to wider market moves. In addition, our holding in Thames Water was a detractor from performance over the quarter. We maintained exposure to Thames Water as part of a diversified portfolio, based on the attractiveness of the overall blended yield across holdings in operating company and holding company debt. Whilst structurally junior holding company debt underperformed and was downgraded, our larger exposure to the operating company debt was beneficial for performance over the quarter. We continue to believe that the sector remains attractively valued – largely based on our view that spreads in the sector overcompensate when compared to other regulated infrastructure assets such as UK electricity distribution.

Last quarter we highlighted an issue with our holding in HDL, where the principal was not repaid on maturity at the end of July. We are pleased to confirm that the bond was redeemed in full in November. We believe this is a good outcome as not only did holders receive full repayment, but also accrued interest at the coupon rate since the end of July. In our view, this demonstrates the power of covenants and how these can protect investors' interests in this sort of scenario. Naturally we prefer to avoid any default, but as we expressed in our initial update we had confidence in our position. It should be noted that, over time, the investment in HDL has been materially beneficial – despite the default.

Performance and activity

Fund activity

Financials remain the largest part of the market with issuance in 2023 skewed similarly. We continued to find opportunities across the financial sector, adding subordinated bonds where we feel the risk/ reward profile is attractive, examples during the quarter including Aviva and defined benefit pension buy-in and buy-out specialist Pension Insurance Corporation. Finally we added an AT1 subordinated new issue from Close Brothers at a yield in excess of 11%. This market, having been very quiet since the Credit Suisse rescue, has been active with investors now confident that such debt will rank higher than equity holders in US dollar, euro and sterling markets.

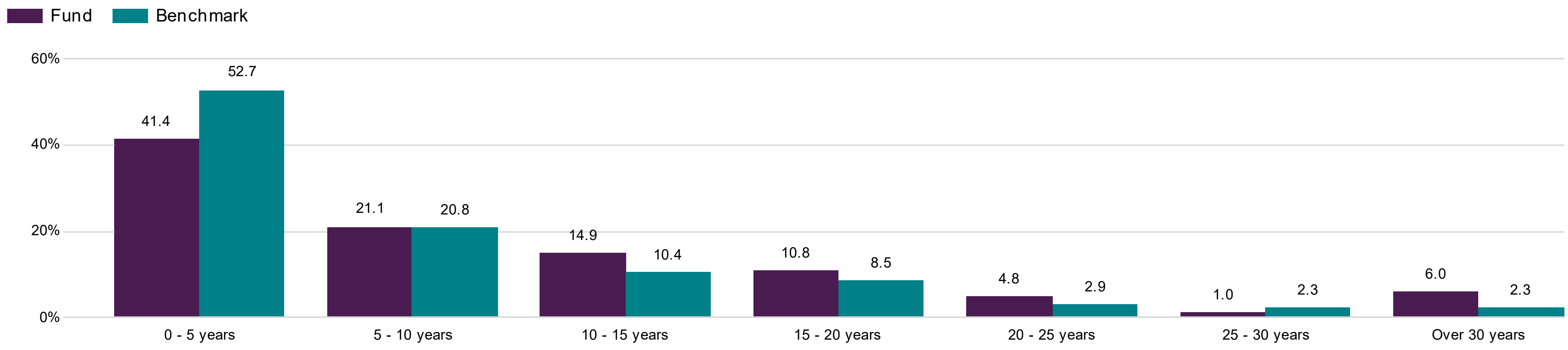
We are selective in our exposure to utilities – often feeling that we can find better value elsewhere. However, the sector's regulated nature is attractive, and its more long-dated maturity profile means that it sits well with our philosophy of being long-term lenders. Southern Water is a regulated utility and we bought a new issue of senior operating company bonds during the quarter. We felt these were attractively priced – the company trades wider than the sector due to perceived operational and financial issues, but in our view operating performance is starting to improve, supported by significant new equity injections over the last few years. We also added a new 2040 issue from Thames Water. The bonds are at the operating company level and came at a very attractive spread.

Social housing remains a key area for the fund. During the quarter a new issue of 2041 bonds from Places for People. The company owns and manages 240,000 properties across the UK and the bonds came at an attractive spread premium to the market.

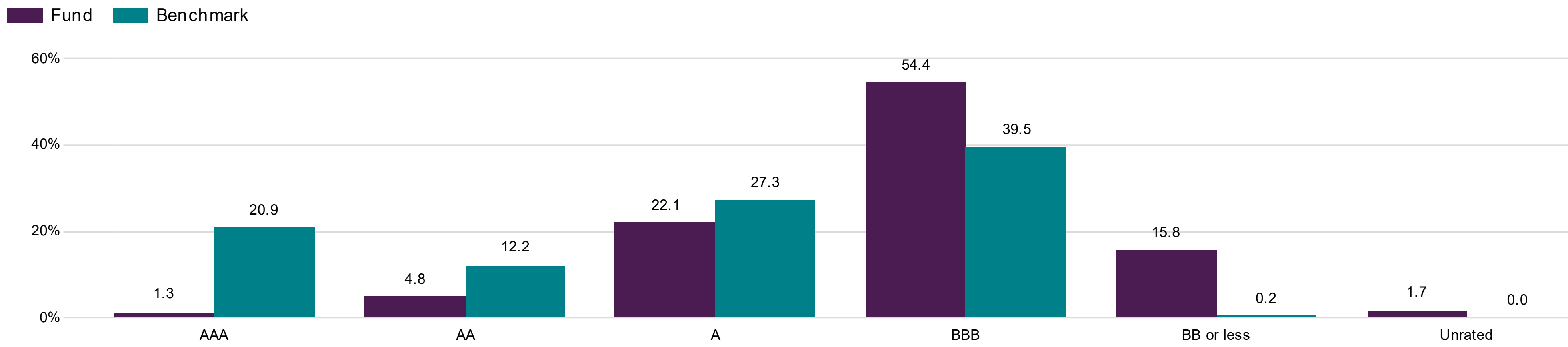
There were noteworthy new issues in the structured sector as well. We added a new issue of Stark Financing, a commercial mortgage-backed security secured against 103 UK property assets, predominantly 'last mile' warehouse assets. The floating rate A notes we bought are rated AAA and have an attractive loan-to-value, also paying an attractive premium to SONIA. We also added a five-year new issue from the RAC, these bonds yielding over 8% and benefiting from security over the business.

Fund breakdown

Maturity profile

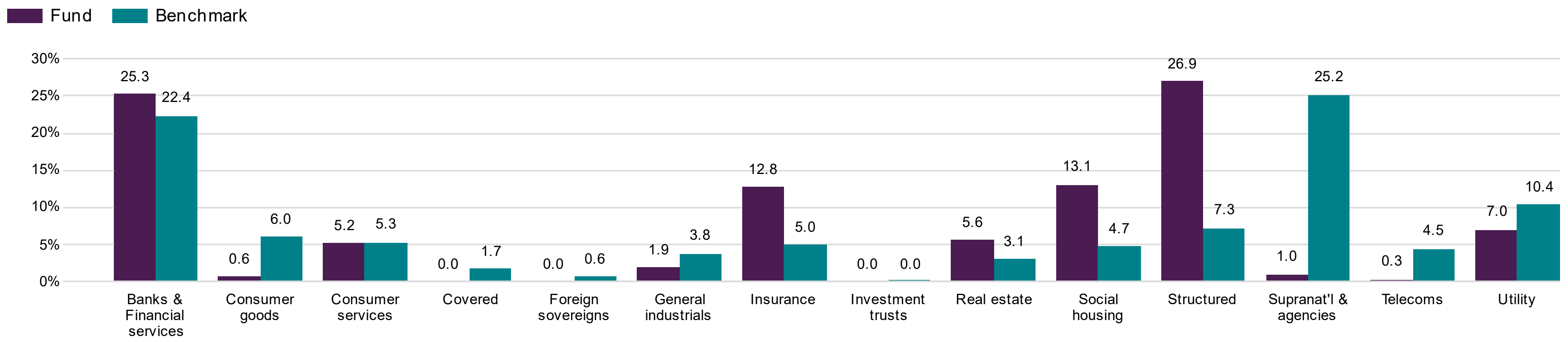


Credit ratings



Fund breakdown

Sector breakdown



Characteristics and climate

ESG characteristics rationale

The fund integrates the assessment of environmental, social, and governance (ESG) risks into the investment decision making process in order to help mitigate ESG risks and/or identify opportunities for investors. In addition to identifying and managing ESG risks, RLAM's Ethical Bond Fund applies an additional layer to its process - ethical bond screening. This process identifies bonds which meet predetermined ethical criteria, excluding from investment in the fund bonds which fall short of these requirements. Full details of the exclusions can be found at www.rlam.com

ESG characteristics

	Yes	No
ESG integration	✓	
Promotes environmental or social characteristics		✓
Sustainable fund objective		✓
Additional exclusions	✓	

Additional exclusions

Exclusion criteria that make sure a fund does not invest into a specific service or product. Royal London Asset Management has a controversial weapons exclusion across all investments.

Adult entertainment	✓
Alcohol	✓
Animal welfare	✓
Armaments	✓
Controversial weapons	✓
Fossil fuels	✓
Gambling	✓

High environmental impact	✓
Human rights issues	✓
Nuclear power	✓
Nuclear weapons	✓
Tobacco	✓

Climate metrics

	Fund	Benchmark	Difference (%)
Financed emissions (tCO2e)	47,127	n/a	n/a
Financed emissions coverage	39.49%	n/a	n/a
Carbon footprint (tCO2e/$M invested)	29.28	35.73	(18.06)
Carbon footprint coverage	39.49%	48.85%	(19.17)
Weighted average carbon intensity (tCO2e/$M sales)	61.59	58.05	6.10
Weighted average carbon intensity coverage	88.71%	94.93%	(6.56)

All climate metrics presented above are for Scope 1-2 emissions. Unless specified in the objective, the data is for information only and should not be taken to mean they are being managed to/controlled.

Implied temperature rise

	Fund (%)	Benchmark (%)	Difference (%)
Implied temperature rise (ITR) coverage	37.07	46.66	(20.56)
% of portfolio below 2°C ITR	47.00	46.56	0.94
% of portfolio below 1.5°C ITR	28.87	29.56	(2.36)

SBTi net - zero

	Fund (%)	Benchmark (%)	Difference (%)
SBTi Net-Zero committed	9.87	16.59	(40.49)
SBTi Near-Term committed	5.79	6.88	(15.90)
SBTi Near-Term targets set	9.39	22.08	(57.49)

Fund Engagement

Engagement definition

Engagement is active dialogue with investee companies (or other entities). There are two types: engagement for information, which is dialogue as part of investment research or ongoing monitoring, without specific objectives for change, and engagement for change, which is purposeful dialogue to influence positive change, with defined objectives and demonstrable outcomes.

Engagements

Engagement activity	Fund 3 months	Fund 12 months
Number of entities engaged	23	49
Number of engagements	32	97

This is an estimate. Some engagements at the issuer level may not have been attributed to the specific bond held in the fund, resulting in a lower number of engagement activities.

Total engagements by theme and topic

Climate	**6**
Climate - Transition Risk	6
Governance	**3**
Board	1
Corporate Governance	1
Remuneration	1
Health	**2**
Health - Community	2
Social & Financial Inclusion	**20**
Just transition	12
Social & Financial inclusion	7
Labour & Human Rights	1
Technology, Innovation & Society	**2**
Cybersecurity	2

Engagement focus

Firm-wide engagement activity is centred around six themes which we have identified in consultation with our clients. These are: climate change; biodiversity; health; governance and corporate culture; social and financial inclusion; innovation, technology and society. Portfolio level engagements are not thematic and are focussed on issues specific to managing the portfolio and meeting the investment objective.

Engagement data represents all engagements undertaken at both firm and portfolio level across Royal London Asset Management, and may not be limited to those undertaken solely for the purpose of managing the fund.

Fund Engagement

Engagement outcomes

Electricite de France

Purpose:

As part of the CA100+ collaborative engagement, we met with the company's Chief Sustainability Officer and her team to discuss engagement priorities. These included 1) improving EDF's scope 3 emissions targets and reduction levers, 2) improving scope 1 emissions including expanding its renewable and nuclear plans, 3) improving offsetting, residual emissions, just transition, and CAPEX disclosures.

Outcome:

EDF set new targets to reduce its scope 1 emissions from electricity generation by 60%, 70%, and 80% by 2025, 2030, and 2035, respectively, from a 2017 baseline. The company has already halved its scope 1 emissions between 2017 and 2022. EDF also clarified its Net Zero by 2050 target, confirming that it includes scope 3 emissions (almost 80% of its current emissions) and entails reducing emissions by at least 90%, with the remaining 10% abated through quality carbon removal projects after 2030.

National Grid Plc

Purpose:

Following the release of National Grid's Responsible Business Charter update, we engaged in a meeting with the Chief Sustainability Officer to offer feedback and suggest further enhancements to their climate transition plans.

Outcome:

National Grid was receptive to the majority of our feedback and sought additional guidance on their Just Transition plans. We positively acknowledged the company's improved emission reduction target and renewed emphasis on biodiversity. The company will be improving its lobbying disclosures and developing a Climate Transition Plan. However, it was unable to provide further clarity on forward looking expenditures and maintained that gas will continue to play a vital role in balancing the grid and, most notably, in their heating retail business in the US.

Standard Chartered

Purpose:

In a collaborative engagement on cybersecurity led by Royal London Asset Management, we engaged with Standard Chartered about its performance against our investor expectations. We used the opportunity to further understand its cybersecurity governance and risk management to assess whether it aligns with best practice.

Outcome:

Our conversation with Standard Chartered was positive and the company welcomed our feedback on how its practices and disclosures could be improved. Standard Chartered demonstrate best practice on the governance and risk management processes surrounding cybersecurity. We were satisfied that appropriate improvements have been made following a 2021 fine for failure to report breaches and encouraged related public disclosures. The security of the information perimeter is another area for improvement, and we gained comfort that the company was focused on this area.

Market commentary

Market overview

Economic attention over the quarter has been on inflation. At the start of the quarter investors focussed on the persistence of large price increases and central bank messaging on rates being held higher for longer. Yet, as headline inflation fell, sentiment swung dramatically towards the end of the quarter, pushing markets to price in interest rate cuts in 2024. The Federal Reserve (Fed), European Central Bank (ECB) and Bank of England (BoE) all left rates unchanged over the quarter, maintaining official rates at multi-year highs. The Fed has now held rates unchanged at its last three meetings. There has however been a significant shift in messaging, with the US central bank now indicating that it expects to cut rates by 0.75% in 2024. The ECB has similarly kept rates steady at its two most recent meetings, but central bankers in the eurozone said that no rate cuts have yet been discussed.

In tune with the other major central banks, and potentially marking the high point in the UK interest rate cycle, the Bank of England left interest rates unchanged over the period. The Monetary Policy Committee continued to be split – at the December meeting three of the nine members were still voting for a rate hike. UK inflation has fallen significantly, with the annual inflation rate falling to 3.9% in November. This is the lowest rate of increase in over two years. However, this remains well above the BoE 2% target, with core and wage inflation significantly higher than the headline rate.

Global government bond yields started the quarter continuing the rising trend that started in mid-2020. This reflected market views that rising inflation would necessitate even higher interest rates and the mantra of higher for longer. Yet, with inflation starting to come down, expectations of rate cuts in 2024 contributed to significant falls in bond yields fell in November and December. The fall in yields was such that yields along the length of the curve ended the quarter lower than they started, and closed 2023 at roughly the same levels as they started. UK government bonds produced strong returns due to falling yields, delivering an 8.1% return (FTSE Actuaries) over the fourth quarter with the benchmark 10-year gilt yield falling from 4.44% to 3.54%.

The sterling investment grade credit market (iBoxx non-gilt index) returned 7.35% over the quarter, helped by lower government bond yields and tighter credit spreads. This was lower than the return from gilts due to the shorter duration of the credit market index. The average sterling investment grade credit spread (the average extra yield available from non-gilt bonds compared with government debt of equal maturity) tightened from 1.38% to 1.15% (iBoxx). Given the fall in yields, sectors with a greater proportion of long-dated bonds performed well, including utilities and social housing. Supranationals was the worst performing sector, while in financials, banks lagged slightly but insurance bonds modestly outperformed the market.

Issuance was relatively low in the fourth quarter, reflecting usual seasonal patterns. For the year as a whole, sterling issuance was £63.9 billion, or £28 billion in net terms, compared with £51.5 billion and -£2.7 billion respectively in 2022.

Outlook

Inflation has come down significantly in 2023 but remains well above the Bank of England's target, and now does not have the 'easy' wins of base effects to push this lower. In our view, wage inflation is the key metric to watch: we believe that the Bank will find it hard to start cutting rates if wages continue to rise at 5-6% per annum. Although the economic data remain very mixed, we still believe that higher interest rates will contribute to a slowdown in the UK. This could well impact company earnings and lead to some increase in pressure on credit markets. However, consumer resilience has been greater than expected in both the UK and globally, which has helped support growth and prevent a recession. How this continues into 2024 could prove critical.

As we came into November 2023, we felt that the all-in yield on sterling investment grade credit was looking very attractive, having risen significantly since the start of the year. The falls in gilt yields since then have largely reversed those rises. Our sterling credit strategy focuses on three sources of return: gilt yields, market credit spreads, and the additional credit spread we generate over credit benchmarks. Whilst ten-year gilt yields of 3.5% are not as attractive as the 4.5% seen in October, we feel that the excess yield available on investment grade credit overcompensates for default risk. Further, the additional yield embedded in our credit strategies, over that available from credit benchmarks, gives us confidence in our ability to deliver long-term outperformance.

We expect supply to weigh on credit markets in the first quarter but believe that underlying fundamentals will limit spread widening. Our emphasis remains on building diversified portfolios, with a high relative exposure to asset backed and strongly covenanted bonds offering attractive yields. This strategy underpins the excess yield of the portfolio relative to its benchmark.

Although recent outperformance means that the relative attractiveness of sterling credit bonds has reduced, we still favour holding them compared to UK government debt as credit spreads remain at levels that more than compensate for the credit risk. Given the potential challenges in the outlook, we remain focused on identifying companies with strong balance sheets, favouring issues with security and downside protection, and ensuring that portfolios are diversified across issuers and sectors.

Further Information

Please click on the links below for further information:

Stewardship and responsible investment at RLAM

Royal London Sterling credit ESG analysis

TCFD climate report

Find out more

Royal London Asset Management's Outlook 2024 document and podcasts are both available on our website. In this year's Outlook document, our fund managers assess the challenges and opportunities in their respective asset classes for 2024. With an environment of falling inflation and modest recession, the benefits or risk for equities or credit is not so clear cut and knowing your companies is key. We analyse the areas of concern and potential growth within this environment.

In our Outlook 2024 podcast, Piers Hillier, CIO, looks ahead to 2024 and discusses the issues he believes will be prominent over the next 12 months, and where the key investment risks and opportunities may lie.

Articles, videos and webinars explaining our investment thinking can be found in the Our Views section of www.rlam.com, including regular updates from our Fixed Income, Global Equity, Sustainable and Multi Asset teams.

Disclaimers

Important information

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Issued in January 2024 by Royal London Asset Management Limited, 80 Fenchurch Street, London EC3M 4BY. Authorised and regulated by the Financial Conduct Authority, firm reference number 141665. A subsidiary of The Royal London Mutual Insurance Society Limited.

The 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 fund 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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The Index provided by IHS Markit is subject to disclaimer currently available here (and as updated by IHS Markit from time to time): https://ihsmarkit.com/Legal/disclaimers.html and/or in the prospectus for the Fund.

Risks and 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.

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.

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. Unlike the income from a single fixed interest security, the level of income (yield) from a fund is not fixed and may go up and down. Bond yields (and as a consequence bond prices) are determined by market perception as to the appropriate level of yields given the economic background.

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.

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.

Charges from Capital Risk

Charges are taken from the capital of the Fund. Whilst this increases the yield, it also has the effect of reducing the potential for capital growth.

Performance to 31 December 2023

Cumulative (%)

	3 Month	6 Month	1 Year	3 Years	5 Years
Fund (gross)	7.56	10.21	10.14	(8.37)	9.75
Fund (net)	7.45	9.98	9.70	(9.46)	7.63

Annualised (%)

	3 Years (p.a.)	5 Years (p.a.)
Fund (gross)	(2.87)	1.88
Fund (net)	(3.26)	1.48

Year on year performance (%)

	31/12/2022 - 31/12/2023	31/12/2021 - 31/12/2022	31/12/2020 - 31/12/2021	31/12/2019 - 31/12/2020	31/12/2018 - 31/12/2019
Fund (gross)	10.14	(16.75)	(0.07)	8.33	10.57
Fund (net)	9.70	(17.08)	(0.47)	7.89	10.18

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 2023. All figures are mid-price to mid-price in GBP for the RL Ethical Bond Fund (Z Inc).

Glossary

Asset allocation

Breakdown of the assets by asset classes. Based on RLAM asset classification scheme.

Attribution

Attribution is shown for the most recent quarter. Attribution figures are based on end of business returns for both the fund and the index whereas performance figures are based on midday returns for the fund and end of business for the index. Therefore the performance will not include market moves between midday when the fund is priced, and end of business when the index is calculated. This may result in a different figure being shown for the quarterly performance vs attribution data.

Carbon footprint

Exposure to high emitters in the portfolio, expressed in tCO2e/$M invested. Financed emissions (explained above) are divided by the portfolio value, the same approach for listed companies and private issuers is applied in this metric.

Credit ratings

Credit ratings are based on RLAM composite ratings which uses a hierarchy of S&P, Moody's and then the Fitch rating.

Duration

Measure of sensitivity of a Fixed Income instrument to changes in interest rates, indicating the potential impact of interest rate fluctuations on the value of the investment.

ESG Integration

The systematic and explicit inclusion of environmental, social and governance (ESG) factors into investment analysis and investment decisions.

Exclusions

Explicitly prohibits investing in a particular company, sector, business activity, country or region.

Financed emissions

The emissions from activities in the real economy that are financed through lending and investment portfolios, expressed in tCO2e. Emissions are attributed to a portfolio based on the portion of the company's value the portfolio holds, and using different accounting values for public and private corporates. We provide financed emissions for scope 1 and 2 emissions.

Fund Analytics

All figures exclude cash. Credit bonds include non-sterling bonds and CDs where held within the fund or benchmark.

This is applicable to the following sections: fund Asset Allocation, Duration, Yield curve, Sector breakdown, Financial holdings, Credit ratings.

Fund restrictions definitions

Adult Entertainment: Companies which own or produce adult entertainment services, or engage in the
distribution or sale of adult entertainment services.
Alcohol: Companies which have involvement in brewing, distillation or sale of alcoholic drinks.
Animal Welfare: Companies that conduct animal testing (other than for purposes of human or animal
health and/or where it is required by law or regulation).
Armaments: Companies who manufacture armaments or nuclear weapons or associated products.
Controversial Weapons: Weapons which have an indiscriminate and disproportional impact on
civilians or weapons that are illegal and prohibited by international conventions and treaties.
Fossil Fuels: Companies involved in the exploration, extraction or refining of oil, or gas, or coal, plus any
activity relating to thermal coal.
Gambling: Companies who promote irresponsible gambling which includes betting shops, casinos or
amusement arcades.
High Environmental Impact: Companies which have a high environmental impact, and which have
'no evidence' of appropriate environmental management systems.
Human Rights Risks: Companies with a strategic presence operating in countries of concern and which
have 'no evidence' of policies or systems to manage human rights risks.
Nuclear Power: Companies who generate energy from Nuclear Power.
Nuclear Weapons: Companies that manufacture, nuclear; or are involved in the production of
intended-use parts, whole weapons systems, or exclusive delivery platforms.
Tobacco: Companies which are growing, processing or selling tobacco products.

Glossary

Fund value

Total value of the fund as of the last business day of the calendar month. The fund value is as at close of business and on a mid-price basis.

Gross redemption yield

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.

Implied temperature rise (ITR)

ITR aims to measure the global warming outcome from the emissions trajectory of a company, if the whole economy followed the same trajectory.

Number of holdings

Total number of unique holdings of the Fund excluding cash, currency and derivatives.

Number of issuers

Number of unique issuers of all assets held by the Fund, excluding cash, currency and derivatives.

Performance

Performance is calculated using the daily end of day NAV per share produced by HSBC based on the mid price.

Promotes environmental or social factors

An ESG Fund promotes, among other characteristics, environmental or social characteristics, or a combination of those characteristics, provided that the companies in which the investments are made follow good governance practices.

SBTi

The Science-Based Targets initiative is a consortium of organisations that set up the definition and promotion of science-based target setting.

Sector breakdown

Breakdown of the fixed income assets, excluding derivatives and cash by RLAM's internal industry sector classification scheme. Figures are subject to rounding.

Sustainable fund objective

A product that has sustainable investment or a reduction in carbon emissions as its objective.

Weighted Average Carbon Intensity (WACI)

Portfolio's exposure to carbon-intensive companies, expressed in tCO_2e / \$M revenue. Scope 1 and scope 2 GHG emissions are divided by companies revenues, then multiplied based on portfolio weights (the current value of the investment relative to the current portfolio value). The WACI is calculated as a weighted average sum of the holdings with carbon intensity coverage.