Royal London Fixed Income Funds

Fund Manager Commentary

October 2023

Contents

Economic Developments

- UK economic data released in October continued to paint a picture of slowing economic activity and a less tight labour market, while inflation remained high – albeit well below its peak. Year-on-year September CPI inflation remained at 6.7%, with core inflation a touch lower on the month at 6.1%Y. Pay growth came in a bit weaker than expected, though remains very strong year-on-year. Housing activity indicators generally remained subdued and mortgage approvals declined. September retail sales fell more than expected whilst consumer confidence fell significantly.
- The Federal Reserve signalled that higher bond yields and tighter financial conditions were effectively tightening monetary policy and therefore doing some of the work for them. September CPI came in a touch stronger than expected and so-called 'super-core' inflation picked up month-on-month on both CPI and PCE measures of inflation. Activity indicators were relatively robust with Q3 US GDP at 4.9% annualised, while September non-farm payrolls were also much stronger than expected.
- As expected, the **ECB** kept rates on hold at their October policy meeting. **ECB President Lagarde** repeated the message that rates will have to remain restrictive for a considerable period, and that it was too early to talk about rate cuts. October CPI came in lower than expected at 2.9% with the fall in core inflation less pronounced. Activity data released over the month were relatively weak again. Q3 GDP saw a small fall, a touch weaker than expected. The October composite PMI fell to 46.5 from 47.2, weaker than expected, driven by services and consistent with falling private sector activity. The European Commission's economic confidence survey-based measure of activity deteriorated a touch further.

Royal London Asset Management Credit Fund Performance

	1 month (%)	Rolling 12 Months (%)
RL Corporate Bond Fund Z Inc	**-0.65**	**5.77**
IA Sterling Corporate Bond Sector	0.08	3.82
iBoxx Sterling Non-Gilts All Maturities Index	-0.02	2.79
RL Ethical Bond Fund Z Inc	**0.05**	**4.57**
IA Sterling Strategic Bond Sector	-0.44	3.19
iBoxx Sterling Non-Gilts All Maturities Index	-0.02	2.79
RL Global Bond Opportunities Fund Z Inc	**-0.42**	**8.45**
IA Global Mixed Bond Sector	-1.07	7.34
RL Investment Grade Short Dated Credit Fund Z Inc	**0.51**	**5.64**
IA Sterling Corporate Bond Sector	0.08	3.82
ICE BofA ML 1-5 year Sterling Non-Gilt All Stocks Index	4.24	3.37
RL Short Duration Credit Fund Z Inc	**0.89**	**6.71**
IA Sterling Strategic Bond Sector	-0.44	3.19
ICE BofA ML 1-5 year Sterling Non-Gilt All Stocks Index	4.24	3.37
RL Sterling Credit Fund Z Inc	**-0.09**	**5.87**
IA Sterling Corporate Bond Sector	0.08	3.82
iBoxx Sterling Non-Gilts All Maturities Index	-0.02	2.79
RL Sterling Extra Yield Bond Fund A Inc	**-0.07**	**8.16**
RL Sterling Extra Yield Bond Fund B Inc	**-0.11**	**7.62**
RL Sterling Extra Yield Bond Fund Y Inc	**0.03**	**8.64**
RL Sterling Extra Yield Bond Fund Z Inc	**-0.04**	**8.45**
IA Sterling Corporate Bond Sector	0.08	3.82
IA Sterling High Yield Sector	-0.72	7.47
IA Sterling Strategic Bond Sector	-0.44	3.19

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.

Source: Royal London Asset Management and FE, as at 31 October 2023. Returns quoted are net of fees.

All IA sector performance shown is for the median.

Credit Market Review

Market highlights – sterling investment grade credit

- The sterling investment grade market (iBoxx) was broadly flat in October, posting a marginally negative return. The average investment grade credit spread (the average extra yield available from a corporate bond compared with government debt of equal maturity) rose from 1.34% to 1.41%.
- Supranationals was the best performing sector over the month, while the banking sector also posted a positive return. These effects were offset by negative returns in the insurance, social housing, and utility sectors. By maturity, shorter-dated bonds again saw the strong returns, comfortably outperforming longer-dated bonds which struggled against the backdrop of higher gilt yields.
- Sterling issuance slowed considerably in October, dropping by more than a half to £2.7bn from £5.6bn in September. Year-to-date investment grade sterling issuance is now at £55.9bn, up from £41.1bn issued over the same period last year.
- The benchmark 10-year gilt inched higher to 4.52% at the end of September from 4.45% at the start of the month but this masks gilt market volatility with an intra-month high of 4.33%. During the month, gilts returned -0.36% (FTSE Actuaries) on an all-maturities basis. In the US, 10-year yields increased from 4.56% to 4.93%, while in Germany yields fell slightly to 2.81% from 2.85%.
- Most government bond yields moved higher in October, although yields in Europe were more mixed., reflecting the bond-friendly combination of weak growth and falling headline inflation.

Royal London Corporate Bond Fund

Portfolio commentary

- The fund underperformed its benchmark, the iBoxx Sterling Non-Gilts All Maturities Index, in October. The fund posted a small negative return for the month but remains well ahead of the benchmark year-to-date.
- UK government bond yields moved slightly higher in October, while credit spreads widened marginally. The sterling credit market outperformed gilts over the month, with returns broadly flat, while gilts were negative.
- During the month, the fund's underweight in supranational holdings was the main detractor, although the overweight position in banks and insurance was unhelpful, with our stock selection in banks hurting while the insurance sector fell back after a period of strong performance. Conversely, our exposure to structured bonds and the utility sector was beneficial to performance.
- New issuance was again relatively muted over the month given higher funding costs for issuers. Financials continued to dominate primary market activity during the month, where we added senior bonds from **Barclays, and Tier 2 bonds from Credit Agricole**.
- 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 secured over the whole business, and finally a new 2040 issue from **Thames Water** which came at a significant premium to secondaries and peers**.**
- In the secondary market we added selectively to subordinated bank and insurance debt – where yields still remain elevated– buying **HSBC** at attractive levels. In addition, legacy insurance bonds remain attractive, and we added **Legal & General** and **Aviva** during the month. Outside of financials, we added senior bonds from **Fidelity National Information Services**.

Investment outlook

- We expect the downward trend in inflation to continue through the rest of 2023, as energy and food price increases moderate and sluggish GDP weakens the labour market. Nonetheless, UK interest rates are likely to remain high as the Bank of England continues to focus on bringing inflation under control.
- Although the economic data remain very mixed, we still believe that elevated rates will lead to a slowdown in the UK, impacting company earnings and leading to some increase in credit rating downgrades and default rates. We still favour sterling credit bonds over government debt as credit spreads remain at reasonably attractive levels. However, recent outperformance means that their relative attractiveness has reduced. 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.
- Our credit strategies generally have a material yield premium to the market, which we feel will support performance both in absolute terms and relative to the market. We retain a significant targeted exposure to BBB rated bonds and believe that compensation for default risk remains most attractive in this rating band.

Key views within the fund

- Well diversified, with over 300 holdings, in order to improve overall portfolio liquidity and to reduce the effect on overall fund performance of any deterioration in the creditworthiness of an individual holding.
- A significant underweight in supranational bonds, as we expect corporate bonds to outperform over the medium term.
- Duration slightly longer than the benchmark, which has been increased as yields have risen. Interest rate sensitivity is broadly neutral when factoring in a number of bonds which have theoretical duration but are not as interest rate sensitive.
- An overweight position in subordinated financial debt, where we believe yields are attractive.
- Orientated towards secured bonds in the asset-rich investment trust, property and social housing sectors, and towards structured bonds, which benefit from a claim on assets and cashflows.
- Environmental, social and governance (ESG) risk factors are fully integrated in the management of the portfolio. The WACI (weighted average carbon intensity) of the portfolio is below that of the index.

CITYWIRE AA

Shalin Shah
Senior Fund Manager

Matt Franklin
Fund Manager

Royal London Ethical Bond Fund

Portfolio commentary

- The fund slightly outperformed its benchmark, the iBoxx Sterling Non-Gilts All Maturities Index, in October. On a year-to-date basis, the fund has posted positive returns and remains well ahead of the benchmark.
- UK government bond yields moved slightly higher in October, while credit spreads widened marginally. The sterling credit market outperformed gilts over the month, with returns broadly flat, while gilts were negative.
- During the month, the fund's underweight in supranational holdings was a detractor, although the overweight position in banks and insurance was unhelpful, with our stock selection in banks hurting while the insurance sector fell back after a period of strong performance. Conversely, our exposure to structured bonds and the utility sector was beneficial to performance.
- New issuance was again relatively muted over the month but there were noteworthy new issues in the structured sector. 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 finally a new 2024 issue from **Thames Water**. The bonds are at the operating company level and came at a very attractive spread.
- In the secondary market we increased exposure to social housing provider **Haven Funding**.

Investment outlook

- We expect the downward trend in inflation to continue through the rest of 2023, with the base effects of sharp rises in electricity and gas prices seen last October begin to fall off, and sluggish GDP weakens the labour market. Nonetheless, UK interest rates are likely to remain high as the Bank of England continues to focus on bringing inflation under control.
- Although the economic data remain very mixed, we still believe that elevated rates will lead to a slowdown in the UK, impacting company earnings and leading to some increase in credit rating downgrades. We still favour sterling credit bonds over government debt as credit spreads remain at reasonably attractive levels. However, recent outperformance means that their relative attractiveness has reduced. 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.
- Our credit strategies generally have a material yield premium to the market, which we feel will support performance both in absolute terms and relative to the market. We retain a significant targeted exposure to BBB rated bonds and believe that compensation for default risk remains most attractive in this rating band.

Key views within the fund

- The fund is diversified in order to improve portfolio liquidity and to reduce the effect on overall performance of any deterioration in the creditworthiness of an individual holding.
- The fund has a significant underweight position in supranational bonds, as we expect corporate bonds to outperform over the medium term.
- Duration is broadly in line with the benchmark
- The fund has an overweight position in subordinated financial debt, where we believe yields are attractive.
- The fund remains orientated towards secured bonds in the asset-rich property and social housing sectors, and towards structured bonds, which benefit from a claim on assets and cashflows.

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Eric Holt
Senior Fund Manager

Paola Binns
Head of Sterling Credit

Royal London Global Bond Opportunities Fund

Market highlights

Index	Total return (%)	Spread at end of month (basis points)	Spread change over month (basis points)
HY global non-financial corps **ICE BofA ML global non-financial high yield index**	-1.06	485	39
AT1 **ICE BofA ML contingent capital index**	-0.02	446	5
Emerging market **ICE BofA ML**	-1.38	650	49
HY global non-financial hybrid corps **ICE BofA ML global hybrid non-financial high yield index**	-0.06	360	16
IG global non-financial hybrid corps **ICE BofA ML global hybrid non-financial corporate index**	0.10	277	8
Dollar investment grade corporate bonds **ICE BofA ML US corporate index**	-1.82	132	7
Sterling investment grade corporate bonds **ICE BofA ML sterling corporate and collateralised index**	-0.21	166	5
Euro investment grade corporate bonds **ICE BofA ML euro corporate and Pfandbriefe index**	0.42	154	7

Source: Bloomberg

- The Federal Reserve signalled that higher bond yields and tighter financial conditions were effectively tightening monetary policy and therefore doing some of the work for them. September CPI came in a touch stronger than expected and so-called ‘super-core’ inflation picked up month-on-month on both CPI and PCE measures of inflation. Activity indicators were relatively robust with Q3 US GDP at 4.9% annualised, while September non-farm payrolls were also much stronger than expected.
- As expected, the ECB kept rates on hold at their October policy meeting. ECB President Lagarde repeated the message that rates will have to remain restrictive for a considerable period, and that it was too early to talk about rate cuts. October CPI came in lower than expected at 2.9% with the fall in core inflation less pronounced. Activity data released over the month were relatively weak again. Q3 GDP saw a small fall, a touch weaker than expected. The October composite PMI fell to 46.5 from 47.2, weaker than expected, driven by services and consistent with falling private sector activity. The European Commission’s economic confidence survey-based measure of activity deteriorated a touch further.
- UK economic data released in October continued to paint a picture of slowing economic activity and a less tight labour market, while inflation remained high – albeit well below its peak. Year-on-year September CPI inflation remained at 6.7%, with core inflation a touch lower on the month at 6.1%Y. Pay growth came in a bit weaker than expected, though remains very strong year-on-year. Housing activity indicators generally remained subdued and mortgage approvals declined. September retail sales fell more than expected whilst consumer confidence fell significantly.
- Most government bond yields moved higher in October, although yields in Europe were more mixed., reflecting the bond-friendly combination of weak growth and falling headline inflation. In the US, 10-year yields increased from 4.56% to 4.93%, while in Germany yields fell slightly to 2.81% from 2.85% and in the UK 10-year yields inched higher from 4.45% to 4.52%.

- In credit markets, spreads were generally slightly wider, but rising yields in the US and UK led to small negative returns for investment grade markets, while eurozone investment grade markets saw modest positive returns.

Portfolio commentary

- The fund recorded a gross return of -0.38% (0.05% net, Z Acc share class) in October. The fund's low duration and wide diversification help mitigate the impact of higher yields and wider spreads in most markets.
- Fund activity in October included participating in new issues of utility **Thames Water**, BBB rated and offering 8.25% but for a 17-year term, and offshore energy services business **Borr Drilling**, secured, B rated, offering an 11.5% yield for their seven-year life and with company revenues underpinned by long-term contracts at major energy companies. In addition, we bought a new **Santander** senior bond at a very attractive credit spread premium, as well as a new euro hybrid deal from hotel chain **Accor**.
- In the secondary market, we added Norwegian energy business **Lime Petroleum**, while also looking for opportunities to add to subordinated financials where we felt markets were overly pessimistic, example including a rare upper tier two bond from French insurer **La Mondiale** and AT1 bonds from **BNP** and **Societe Generale**

Investment outlook

- We expect that inflation has peaked. This is driven by our view that energy prices will moderate and that weaker GDP growth will reduce the tightness of the labour market. Nonetheless, euro zone and UK interest rates are likely to rise a bit further as the ECB and BoE continue to focus on bringing inflation under control.
- Although the economic data remain very mixed, we still believe that higher rates will lead to a slowdown, impacting company earnings and leading to some increase in credit rating downgrades and default rates. Nevertheless, it is our view that with yields higher across the board, there are opportunities across the fixed income universe and credit spread levels mean that investors are being well paid to take credit over government bond risk. Against this background, we will maintain our focus on identifying companies with strong balance sheets and ensuring that portfolios are diversified across issuers and sectors.

CITYWIRE A

Eric Holt
Senior Fund Manager

CITYWIRE A

Rachid Semaoune
Senior Fund Manager

Royal London Investment Grade Short Dated Credit Fund

Portfolio commentary

- The fund slightly outperformed its benchmark, the ICE BofAML 1-5yr Sterling Non-Gilt All Stocks Index, in October. The fund posted a positive return for the month and remains ahead of the benchmark year-to-date.
- UK government bond yields moved slightly higher in October, while credit spreads widened marginally. The sterling credit market outperformed gilts over the month, with returns broadly flat, while gilts were negative.
- During the month, the fund's underweight in supranational holdings was the main detractor, although the overweight position in insurance was unhelpful, as the sector fell back after a period of strong performance. Conversely, our holdgins in consumer goods and structured was beneficial.
- New issuance was again relatively muted over the month. Financials continued to dominate primary market activity during the month, where we added senior bonds from **Barclays**.
- 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%.
- In the secondary market we added selectively to subordinated bank and insurance debt – where yields still remain elevated– buying **Virgin Money** at attractive levels. In addition, legacy insurance bonds remain attractive, and we added **Legal & General** and **Aviva** during the month.

Investment outlook

- We expect the downward trend in inflation to continue through the rest of 2023, as energy and food price increases moderate and sluggish GDP weakens the labour market. Nonetheless, UK interest rates are likely to remain high as the Bank of England continues to focus on bringing inflation under control.
- Although the economic data remain very mixed, we still believe that elevated rates will lead to a slowdown in the UK, impacting company earnings and leading to some increase in credit rating downgrades. We still favour sterling credit bonds over government debt as credit spreads remain at reasonably attractive levels. However, recent outperformance means that their relative attractiveness has reduced. 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.
- Our credit strategies generally have a material yield premium to the market, which we feel will support performance both in absolute terms and relative to the market. We retain a significant targeted exposure to BBB rated bonds and believe that compensation for default risk remains most attractive in this rating band.

Key views within the fund

- The fund is diversified, with almost 300 holdings, in order to improve general portfolio liquidity and to reduce the effect on overall performance of any deterioration in the creditworthiness of an individual holding.
- It has a minimal weighting in supranational bonds, as we expect corporate debt to outperform over the medium term.
- Fund duration was marginally longer than the benchmark at month end.
- It has an overweight position in subordinated financial debt, where we believe yields are attractive.
- The fund remains orientated towards structured debt, which benefits from a claim on assets and cashflows; secured issues in the asset-rich property and social housing sectors; and covered bonds (i.e. senior bank debt benefiting from a first claim on a specified over-collateralised pool of assets).

Paola Binns
Head of Sterling Credit

Royal London Short Duration Credit Fund

Portfolio commentary

- The fund outperformed its benchmark, the ICE BofAML 1-5yr Sterling Non-Gilt All Stocks Index, in October. The fund posted a positive return for the month and remains ahead of the benchmark year-to-date.
- UK government bond yields moved slightly higher in October, while credit spreads widened marginally. The sterling credit market outperformed gilts over the month, with returns broadly flat, while gilts were negative.
- During the month, the fund's underweight in supranational holdings was a detractor, although the overweight position in insurance was also unhelpful, as the sector fell back after a period of strong performance. Conversely, our exposure general industries and structured was beneficial.
- New issuance was again relatively muted over the month. Financials continued to dominate primary market activity during the month, where we added senior bonds from **Barclays**.
- 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%.
- In the secondary market we added selectively to subordinated bank and insurance debt – where yields still remain elevated– buying **Virgin Money** at attractive levels. In addition, legacy insurance bonds remain attractive, and we added **Legal & General** and **Aviva** during the month. Outside of financials, we increased exposure to social housing provider **Haven Funding**.

Investment outlook

- We expect the downward trend in inflation to continue through the rest of 2023, as energy and food price increases moderate and sluggish GDP weakens the labour market. Nonetheless, UK interest rates are likely to remain high as the Bank of England continues to focus on bringing inflation under control.
- Although the economic data remain very mixed, we still believe that elevated rates will lead to a slowdown in the UK, impacting company earnings and leading to some increase in credit rating downgrades. We still favour sterling credit bonds over government debt as credit spreads remain at reasonably attractive levels. However, recent outperformance means that their relative attractiveness has reduced. 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.
- Our credit strategies generally have a material yield premium to the market, which we feel will support performance both in absolute terms and relative to the market. We retain a significant targeted exposure to BBB rated bonds and believe that compensation for default risk remains most attractive in this rating band.

Key views within the fund

- The fund is diversified, with more than 300 holdings, in order to improve overall portfolio liquidity and to reduce the effect on overall performance of any deterioration in the creditworthiness of an individual exposure.
- The fund has a significant underweight in supranational bonds, as we expect corporate debt to outperform over the medium term.
- The fund's duration slightly below that of the benchmark at month end.
- The fund has an overweight position in subordinated financial debt, where we believe yields are attractive.
- The fund remains orientated towards secured bonds in the asset-rich investment trust, property and social housing sectors, and towards structured issues, which benefit from a claim on assets and cashflows

Paola Binns
Senior Fund Manager

Royal London Sterling Credit Fund

Portfolio commentary

- The fund slightly underperformed its benchmark, the iBoxx Sterling Non-Gilts All Maturities Index, in October. On a year-to-date basis, the fund has posted positive returns and remains well ahead of the benchmark.
- UK government bond yields moved slightly higher in October, while credit spreads widened marginally. The sterling credit market outperformed gilts over the month, with returns broadly flat, while gilts were negative.
- During the month, the fund's underweight in supranational holdings was the main detractor, although the overweight position in banks and insurance was unhelpful, with our stock selection in banks hurting while the insurance sector fell back after a period of strong performance. Conversely, our exposure to structured bonds and the utility sector was beneficial to performance.
- New issuance was again relatively muted over the month. Financials continued to dominate primary market activity during the month, where we added senior bonds from **Barclays,** and Tier 2 bonds from **Credit Agricole**.
- 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 finally a new 2024 issue from **Thames Water**. The bonds are at the operating company level and came at a very attractive spread.
- In the secondary market we added selectively to subordinated bank and insurance debt – where yields still remain elevated– buying **BNP** and **Societe Generale** at attractive levels. In addition, legacy insurance bonds remain attractive, and we added **Legal & General** and **Aviva** during the month. Outside of financials, we added senior bonds from **Fidelity National Information Services**.

Investment outlook

- We expect the downward trend in inflation to continue through the rest of 2023, as energy and food price increases moderate and sluggish GDP weakens the labour market. Nonetheless, UK interest rates are likely to remain high as the Bank of England continues to focus on bringing inflation under control.
- Although the economic data remain very mixed, we still believe that elevated rates will lead to a slowdown in the UK, impacting company earnings and leading to some increase in credit rating downgrades and default rates. We still favour sterling credit bonds over government debt as credit spreads remain at reasonably attractive levels. However, recent outperformance means that their relative attractiveness has reduced. 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.
- Our credit strategies generally have a material yield premium to the market, which we feel will support performance both in absolute terms and relative to the market. We retain a significant targeted exposure to BBB rated bonds and believe that compensation for default risk remains most attractive in this rating band.

Key views within the fund

- Well diversified, with around 350 holdings, in order to improve overall portfolio liquidity and to reduce the effect on overall performance of any deterioration in the creditworthiness of an individual holding.
- A significant underweight in supranational bonds, as we expect corporate bonds to outperform over the medium term.
- Fund duration was broadly in line with the benchmark at month end.
- Orientated towards subordinated financial debt, where we believe yields are attractive.
- The fund remains orientated towards secured bonds in the asset-rich investment trust, property and social housing sectors, and structured bonds, which benefit from a claim on assets and cashflows.

CITYWIRE AA

Paola Binns
Senior Fund Manager

Royal London Sterling Extra Yield Bond Fund

Portfolio commentary

- In October the fund posted returns of -0.07%, -0.11%, -0.03% and 0.04% for the A, B, Y and Z class shares respectively. These bring 2023 year-to-date returns for these share classes to 3.94%, 3.50%, 4.32% and 4.18% respectively.
- Against a backdrop where economic data flow was generally subdued, financial markets began to anticipate that the peak in short-term interest rates had peaked, albeit with little conviction of any early prospect of interest rate cuts. Thus yields on short-dated gilts edged lower in the month while yields on long-dated gilts rose. Over the month as a whole, gilts posted an index return of -0.41%. Sterling investment grade corporate bonds held up better than gilts, with index returns of -0.08% in October, reflecting both shorter average duration and higher yields than gilts. European sub-investment grade bonds and global high yield bonds posted index returns of -0.27% and -1.00% respectively in October – reflecting their sensitivity to the implications of subdued economic data. 2023 year-to-date index returns for these four asset classes – gilts, sterling investment grade corporate bonds, European sub-investment grade bonds and global high yield bonds – were -4.98%, 1.08%, 5.82% and 4.45% respectively.
- In a month where there was relatively little change in price in many holdings in the fund, there were nevertheless two features of note. First, longer dated bonds in the fund tended to react to the rise in yields of long-dated gilts; bonds of financials **Aviva**, **Barclays**, **Lloyds Bank** and **M&G** were down around 3% in price in the month, with long-dated bonds of French government owned utility **EDF** down 4%. Second, against a challenging background in recent months there were stock-specific positive developments in the property sector. **Canary Wharf** announced a £300 equity capital injection, alleviating concern on short-term liquidity ahead of a 2025 bond maturity and triggering a 3% uptick in price on the month. Meanwhile Manchester-based property group **Bruntwood** announced a £500 million equity injection into its joint venture **Bruntwood** SciTech, comprising cash from partners Greater Manchester Pension Fund and Legal & General and asset transfer from Bruntwood, triggering a 3% rise in the price of Bruntwood's 2025 bonds. Property company **Peel Holdings** 2026 bonds benefited from the decline in yields of short-dated bonds, posting a 2% return for the month.
- Fund activity in October included participating in new issues of roadside recovery business RAC, BBB rated and offering 8.25% for their five-year life, of utility **Thames Water**, also BBB rated and offering 8.25% but for a 17-year term, and offshore energy services business **Borr Drilling**, secured, B rated, offering an 11.5% yield for their seven-year life and with company revenues underpinned by long-term contracts at major energy companies. Market purchases included bonds of insurance business **Esure Group** and Norwegian energy business **Lime Petroleum**, while sales in the month included short-dated bonds of UK bank **Virgin Money** and of energy group **HKN**. Finally activity in the month in short-dated gilts reflected short-term cash management.

Key views within the fund

- The fund's objective is to achieve a high level of income 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 investment can in isolation have an undue impact on overall performance. In addition, where possible within the yield objective of the fund, investments are focused on bonds where risk is mitigated by structure or a claim on assets or cashflows.

CITYWIRE A

Rachid Semaoune
Senior Fund Manager

CITYWIRE A

Eric Holt
Senior Fund Manager

Royal London Asset Management Government Bond Fund Performance

	1 month (%)	Rolling 12 Months (%)
RL Global Index Linked Bond Fund Z Inc	**-0.43**	**-2.93**
Global Inflation Linked Bond Sector	-0.34	-2.78
Barclays World Government Inflation-Linked Bond Index (hedged)	-0.71	-3.14
RL Index Linked Bond Fund M Inc	**-0.69**	**-10.57**
IA UK Index Linked Gilts Sector	-1.08	-11.26
FTSE Actuaries UK Index-Linked All Stocks Index	-1.28	-9.92
RL Short Duration Gilt Fund Z Inc	**0.70**	**2.20**
IA UK Gilts Sector	-0.14	-5.93
FTSE Actuaries UK Conventional Gilts up to 5 Years Index	0.45	1.64
RL Short Duration Global Index Linked Bond Fund Z Inc	**0.19**	**1.37**
Global Inflation Linked Bond Sector	-2.78	7.25
RL Short Duration Global Index Linked Composite Benchmark[1]	1.53	4.63
RL UK Government Bond Fund Z Inc	**0.16**	**-5.03**
IA UK Gilts Sector	-0.14	-5.93
FTSE Actuaries UK Conventional Gilts All Stocks Index	-0.36	-5.76

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.

Source: Royal London Asset Management and FE, correct as of 31 October 2023. Returns quoted are net of fees. Please note the fund returns are based on mid-day pricing, and benchmark returns are priced at end of day.All IA sector performance shown is for the median.

[1] The composite benchmark consists of: 30% Bloomberg UK government Inflation Linked Bond 1-10 year index, 70% Bloomberg World Government Inflation Linked Bond (Ex UK) 1-10 year index (GBP Hedged).

Government Bond Market Review

Market highlights

- Most government bond yields moved higher in October, although yields in Europe were more mixed, reflecting the bond-friendly combination of weak growth and falling headline inflation.
- The benchmark 10-year gilt inched higher to 4.52% at the end of August from 4.45% at the start of the month but this masks gilt market volatility with an intra-month high of 4.73%. During the month, gilts returned -0.36% (FTSE Actuaries) on an all-maturities basis. In the US, 10-year yields increased from 4.56% to 4.93%, while in Germany yields fell slightly to 2.81% from 2.85%.
- UK economic data released in October continued to paint a picture of slowing economic activity and a less tight labour market, while inflation remained high – albeit well below its peak. Year-on-year September CPI inflation remained at 6.7%, with core inflation a touch lower on the month at 6.1%Y. Pay growth came in a bit weaker than expected, though remains very strong year-on-year. Housing activity indicators generally remained subdued and mortgage approvals declined. September retail sales fell more than expected whilst consumer confidence fell significantly.
- The Federal Reserve signalled that higher bond yields and tighter financial conditions were effectively tightening monetary policy and therefore doing some of the work for them. September CPI came in a touch stronger than expected and so-called 'super-core' inflation picked up month-on-month on both CPI and PCE measures of inflation. Activity indicators were relatively robust with Q3 US GDP at 4.9% annualised, while September non-farm payrolls were also much stronger than expected.
- As expected, the ECB kept rates on hold at their October policy meeting. ECB President Lagarde repeated the message that rates will have to remain restrictive for a considerable period, and that it was too early to talk about rate cuts. October CPI came in lower than expected at 2.9% with the fall in core inflation less pronounced. Activity data released over the month were relatively weak again. Q3 GDP saw a small fall, a touch weaker than expected. The October composite PMI fell to 46.5 from 47.2, weaker than expected, driven by services and consistent with falling private sector activity. The European Commission's economic confidence survey-based measure of activity deteriorated a touch further.

Royal London Global Index Linked Bond Fund

Portfolio commentary

- Net of fund management fees, the fund returned -0.39% in October (M Inc share class), against benchmark returns of -0.71%. It should be noted that returns can be distorted by the differing valuation points of the fund and index. On a like-for-like basis, the fund performed in line with the index over the month.
- Our duration position was the main negative impact over the month, as yields rose over the month. However, we mitigated the impact through tactical trading as volatility increased due to the ongoing crisis in the Middle East. We ended the month with a modest long duration position.
- Curve positioning was positive over the month, with our bias towards 20-year bonds over 10-year index linked gilts helpful. During the month we took profits on old style eight-month lagged 2030 index linked gilts after these outperformed 2029 and 2032 new style bonds. The rest of our curve activity focused on the 2033 supply, taking advantage of weakness in the 10-year area of the curve to move longer ahead of the auction, then switching 20- and 30-year bonds into the new supply after the curve flattened.
- Our cross-market positioning produced mixed results for performance during the month. Our largest position remains an overweight in Australia, which underperformed as stronger inflation data led the market to price in further rate hikes. However, we had trimmed exposure earlier in the month, adding to the US, and reversed this after Australian weakness. We also bought a new issue of 2039 Spanish index linked bond – the first since Covid – taking profits after strong performance, trimming longer dated French bonds to reduce overall exposure to Europe but adding US five-year TIPS as real yields hit 2.5%.
- We tactically traded breakevens around supply events – which added value. The fund added 12-year gilts early in the month ahead of the 2033 index linked auction, selling these back as breakevens weakened in the issue.

Investment outlook

- We expect the downward trend in inflation to continue through the rest of 2023, as energy and food price increases moderate and sluggish GDP weakens the labour market. Nonetheless, UK interest rates may rise further as the BoE continues to focus on bringing inflation under control.
- We believe that whilst inflation will fall sharply this year, it is likely to remain well above target in most economies by the end of the year, and particularly so in the UK. Shallow recessions are possible but are unlikely to be deep enough at this stage to ease the excessive tightness seen in labour markets. As a result, base rates will continue to remain at higher levels and are unlikely to be cut anytime soon.
- Supply will be an issue for the market over the next few years, with around £200bn per annum forecast over each of the next five years. Alongside quantitative tightening (where the BoE is selling its gilt holdings back into the market), this will represent a headwind for gilts and we see similar impacts affecting other government bond markets.
- Despite the impact of supply, with the peak of interest rates near and with real yields have risen considerably in recent months across most major government bond markets, we believe that yields are beginning to offer long-term value. At the margin, we are therefore looking for opportunities to add duration to portfolios, using market volatility or weakness as attractive entry points.

Key views within the fund

- The portfolio has a long duration position, with higher yields on index linked bonds after considerable time in negative territory.
- The fund is biased towards flatter curves.
- The fund is neutral in terms of UK vs global markets. Within global, we remain overweight in France with domestic buying expected to aid the latter, and underweight in peripheral European markets.
- The fund has no breakeven positions, but we anticipate buying gilts as longer dated break even rates remain elevated.

Paul Rayner
Head of Alpha Strategies

Gareth Hill
Fund Manager

Royal London Index Linked Bond Fund

Portfolio commentary

- Net of fund management fees, the fund returned -0.68% in October (M Acc share class), against returns of -1.28% for benchmark. It should be noted that returns can be distorted by the differing valuation points of the fund and index. On a like-for-like basis, the fund performed in line with the index.
- Our duration position was the main negative impact over the month, as yields rose over the month. However, we mitigated the impact through tactical trading as volatility increased due to the ongoing crisis in the Middle East. We ended the month with a modest long duration position.
- Curve positioning was positive over the month, with our bias towards 20-year bonds over 10-year index linked gilts helpful. During the month we took profits on old style eight-month lagged 2030 index linked gilts after these outperformed 2029 and 2032 new style bonds. The rest of our curve activity focused on the 2033 supply, taking advantage of weakness in the 10-year area of the curve to move longer ahead of the auction, then switching 20- and 30-year bonds into the new supply after the curve flattened.
- Our cross-market positioning produced mixed results for performance during the month. Our largest position remains an overweight in Australia, which underperformed as stronger inflation data led the market to price in further rate hikes. However, we had trimmed exposure earlier in the month, adding to the US, and reversed this after Australian weakness. We also bought a new issue of 2039 Spanish index linked bond – the first since Covid – taking profits after strong performance, also adding US five-year TIPS as real yields hit 2.5%.
- We tactically traded breakevens around supply events – which added value. The fund added 12-year gilts early in the month ahead of the 2033 index linked auction, selling these back as breakevens weakened in the issue.

Investment outlook

- We expect the downward trend in inflation to continue through the rest of 2023, as energy and food price increases moderate and sluggish GDP weakens the labour market. Nonetheless, UK interest rates may rise further as the BoE continues to focus on bringing inflation under control.
- We believe that whilst inflation will fall sharply this year, it is likely to remain well above target in most economies by the end of the year, and particularly so in the UK. Shallow recessions are possible but are unlikely to be deep enough at this stage to ease the excessive tightness seen in labour markets. As a result, base rates will continue to remain at higher levels and are unlikely to be cut anytime soon.
- Supply will be an issue for the market over the next few years, with around £200bn per annum forecast over each of the next five years. Alongside quantitative tightening (where the BoE is selling its gilt holdings back into the market), this will represent a headwind for gilts and we see similar impacts affecting other government bond markets.
- Despite the impact of supply, with the peak of interest rates near and with real yields have risen considerably in recent months across most major government bond markets, we believe that yields are beginning to offer long-term value. At the margin, we are therefore looking for opportunities to add duration to portfolios, using market volatility or weakness as attractive entry points.

Key views within the fund

- The portfolio has a long duration position, with higher yields on index linked bonds after considerable time in negative territory.
- The fund is still biased towards flatter UK curves.
- The fund holds limited cross market positions on a tactical basis, notably in Australia, France and the US, but continues to look for opportunities to add value.
- The fund has no strategic breakeven positions, but we have been buying gilts tactically as long breakevens remain at elevated levels.
- The exposure to highly rated sterling corporate bonds was maintained as we believe the attractive yields these offer more than compensate for the credit risk given our view that spreads discount a significant portion of bad news.

Paul Rayner
Head of Alpha Strategies

Ben Nicholl
Fund Manager

Royal London Short Duration Global Index Linked Bond Fund

Portfolio commentary

- Net of fund management fees, the fund returned 0.10% in October (M Inc share class), ahead of benchmark returns. It should be noted that returns can be distorted by the differing valuation points of the fund and index. On a like-for-like basis, the fund performed in line with the index over the month.
- Our duration position was the main negative impact over the month, as yields rose over the month. However, we mitigated the impact through tactical trading as volatility increased due to the ongoing crisis in the Middle East. We ended the month with a modest long duration position.
- Curve positioning was positive over the month, with our bias towards 20-year bonds over 10-year index linked gilts helpful. During the month we took profits on old style eight-month lagged 2030 index linked gilts after these outperformed 2029 and 2032 new style bonds. The rest of our curve activity focused on the 2033 supply, taking advantage of weakness in the 10-year area of the curve to move longer ahead of the auction.
- Our cross-market positioning produced mixed results for performance during the month. Our largest position remains an overweight in Australia, which underperformed as stronger inflation data led the market to price in further rate hikes. However, we had trimmed exposure earlier in the month, adding to the US, and reversed this after Australian weakness. We also bought a new issue of 2039 Spanish index linked bond – the first since Covid – taking profits after strong performance, although we reduced overall exposure to Europe through sales of 10-year German bonds, while adding US five-year TIPS as real yields hit 2.5%.
- We tactically traded breakevens around supply events – which added value. The fund added 12-year gilts early in the month ahead of the 2033 index linked auction, selling these back as breakevens weakened in the issue.

Investment outlook

- We expect the downward trend in inflation to continue through the rest of 2023, as energy and food price increases moderate and sluggish GDP weakens the labour market. Nonetheless, UK interest rates may rise further as the BoE continues to focus on bringing inflation under control.
- We believe that whilst inflation will fall sharply this year, it is likely to remain well above target in most economies by the end of the year, and particularly so in the UK. Shallow recessions are possible but are unlikely to be deep enough at this stage to ease the excessive tightness seen in labour markets. As a result, base rates will continue to remain at higher levels and are unlikely to be cut anytime soon.
- Supply will be an issue for the market over the next few years, with around £200bn per annum forecast over each of the next five years. Alongside quantitative tightening (where the BoE is selling its gilt holdings back into the market), this will represent a headwind for gilts and we see similar impacts affecting other government bond markets.
- Despite the impact of supply, with the peak of interest rates near and with real yields have risen considerably in recent months across most major government bond markets, we believe that yields are beginning to offer long-term value. At the margin, we are therefore looking for opportunities to add duration to portfolios, using market volatility or weakness as attractive entry points.

Key views within the fund

- The portfolio has a long duration position, with higher yields on index linked bonds after considerable time in negative territory.
- The fund is still biased towards flatter curves.
- The fund is neutral in terms of UK vs global markets. Within global, we remain overweight in France with domestic buying expected to aid the latter, and underweight in peripheral European markets.
- The fund has no breakeven positions but expects to use uncertainty in this are to take these on a tactical basis.

Paul Rayner
Head of Alpha Strategies

Ben Nicholl
Fund Manager

Royal London Short Duration Gilt Fund

Portfolio commentary

- The fund underperformed its benchmark in October. Year-to-date, the fund has outperformed its benchmark.
- Five-year gilt yields were largely unchanged on the month.
- As our long position is mainly concentrated in the 5-year part of the curve, which was unmoved, our strategic long position did not add much to performance. Whilst our strategic position did not add value, our tactical trading of the position contributed to performance. Markets were particularly volatile during October and provided plenty of opportunities for active investors to trade the market.
- The fund ended October 0.45yr long.
- Our relative-value positioning was the main contributor to performance. The large overweight position in certain 2025 bonds we hold saw a strong performance, as they were the best performing sub-5 year bond – with the surrounding 2026 bonds performing poorly.
- The main detractor from performance was our cross-market positioning.
- Our holding in Australian government bonds was detrimental to performance, as they underperformed gilts in the period. We did, however, take profit on a US position. We bought US Tips in the period, but then sold them later in the month.
- The fund does not hold any breakeven holdings.

Investment outlook

- We believe that whilst inflation will fall sharply this year, its likely to remain well above target in most economies by the end of the year, and particularly so in the UK. Shallow recessions are possible but are unlikely to be deep enough at this stage to ease the excessive tightness seen in labour markets. As we approach 2024, central banks are close to peak rates, and markets are preparing themselves for cuts, starting in H2 2024.
- In the UK, the market is now assuming base rates have peaked at 5.25% , with the first cut priced in for H2 2024, and falling to a terminal level of around 3.75%% by late 2026. At one point in early July the market was pricing peak rates closer to 6.5%. Government bond markets have moved a long way during the last few months, particularly in the UK where 5-year gilts have fallen significantly from their summer peak.
- Supply will be an issue for the market over the next few years, with around £200bn per annum forecast over each of the next five years. Alongside quantitative tightening (where the BoE is selling its gilt holdings back into the market), this will represent a headwind for gilts. However, when considering gilts in a global context, we believe the gilt market is somewhat priced for this.

Key views within the fund

- The portfolio's duration is long of the benchmark, including the impact of cash holdings on duration.
- The fund holds no cross-market exposure currently.
- The portfolio has allocations to high quality corporate bonds, which we expect to outperform gilts.

CITYWIRE A

Paul Rayner
Head of Alpha Strategies

MORNINGSTAR Bronze

CITYWIRE AA

Ben Nicholl
Fund Manager

Royal London UK Government Bond Fund

Portfolio commentary

- The fund underperformed its benchmark in October. Year-to-date, the fund has outperformed its benchmark.
- Gilt yields ended October broadly where they started the month, but this belies the volatility seen during the period. This stemmed largely from the nervousness around the US economic data, particularly the jobs data – which was much stronger than expected – and the upcoming strong supply.
- In this environment, the fund benefitted from its slight steepening bias in the 5-to-10 year portion of the curve.
- Our strategic long position marginally detracted from performance. The funds long duration position relative to the benchmark remains concentrated in 5-year maturity bonds.
- Despite the strategic long duration position not aiding performance, our decision to tactically trade around the position was beneficial during the month – which saw us add to our long duration position as the fund went +0.75y long relative to the benchmark.
- The main laggard to performance during the month was our cross-market position – namely our holding in Australian government bonds.
- We are overweight Aussie government bonds – sitting 0.3y long – which detracted from performance as they both rose in yield, but also underperformed gilts in the period. Despite this underperformance, we still view Australia as an attractive market to invest in at these yields levels, particularly in a global context, and took part in a syndication during October.
- In October we also sold German bunds back into gilts to free up space for the Australian syndication – which added to our performance, as gilts outperformed bunds post the trade.

Investment outlook

- We believe that whilst inflation will fall sharply this year, its likely to remain well above target in most economies by the end of the year, and particularly so in the UK. Shallow recessions are possible but are unlikely to be deep enough at this stage to ease the excessive tightness seen in labour markets. As we approach 2024, central banks are close to peak rates, and markets are preparing themselves for cuts, starting in H2 2024.
- In the UK, the market is now assuming base rates have -peaked at 5.25%, with the first cut priced in for H2 2024, and falling to a terminal level of around 3.75% by late-2026. At one point in early July the market was pricing peak rates closer to 6.5%. Government bond markets have moved a long way during the last few months, particularly in the UK where 5-year gilts have fallen significantly from their summer peak.
- Supply will be an issue for the market over the next few years, with around £200bn per annum forecast over each of the next five years. Alongside quantitative tightening (where the BoE is selling its gilt holdings back into the market), this will represent a headwind for gilts. However, when considering gilts in a global context, we believe the gilt market is somewhat priced for this.

Key views within the fund

- The portfolio’s duration is slightly long versus the index, including the impact of cash holdings on duration, although we continue to trade around this as market volatility provides opportunities to add value.
- The fund retains an exposure to steepening at the ultra-long end of the curve, being underweight 50-year maturity gilts versus 30-year maturity bonds.
- The fund has a small strategic allocation to Australia which is an outright long position.
- The portfolio has allocations to high quality corporate bonds which provide additional yield for the portfolio.
- The fund has no inflation exposure currently.

Paul Rayner
Head of Alpha Strategies

Ben Nicholl
Fund Manager

Royal London Asset Management Global High Yield Fund Performance

	1 month (%)	Rolling 12 Months (%)
RL Global High Yield Bond Fund M Inc	**-1.29**	**4.87**
RL Global High Yield Bond Fund Z Inc	**-1.26**	**5.14**
IA Sterling High Yield Sector	-0.72	7.47
ICE BofA ML BB-B Global Non-Financial High Yield Constrained Index	6.73	7.68
RL Short Duration Global High Yield Bond Fund A Inc	**-0.12**	**5.72**
RL Short Duration Global High Yield Bond Fund M Inc	**-0.09**	**6.14**
RL Short Duration Global High Yield Bond Fund Z Inc	**-0.08**	**6.26**
IA Sterling High Yield Sector	-0.72	7.47
Sterling Overnight Index Average Rate (SONIA)[1]	4.25	0.83

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.
Source: RLAM and FE, correct as of 31 October 2023. Returns quoted are net of fees.
All IA sector performance shown is for the median.

Royal London Global High Yield Bond Fund

Portfolio commentary

- The fund (Z class) returned -1.26%, net of fees, in October, which was behind the benchmark, the ICE BofA Merrill Lynch BB-B Global Non-Financial High Yield Constrained Index (100% GBP hedged), return of -0.85%. Against the fund's objective, outperforming its benchmark by 1% per annum over rolling thee-year periods, it is ahead of the benchmark, gross of fees (-0.36% versus -0.88%).
- The Global High Yield market had to contend with spreads widening and the government yield curve increasing during October. Global High Yield spreads (BB-B index) widened by 33bps in the month with the government yield curve increasing 14bps. This resulted in a negative monthly return of -0.85% for the wider high yield market. The high yield market is now yielding 8.71% (YTW) with a duration of 3.8 years.
- The fund's yield, FX-adjusted, stood at 9.22% (YTW) at the end of October, with a duration of 4.1 years.
- The month of October saw the smallest amount of high yield new issuance since July with $9.4bn issued, less than half the amount issued in September. Of the $9.4bn issued, there was a 47% BB versus 53% single B rated companies split. Year to date, high yield new issuance has totalled $142bn.
- The US high yield default rate inched higher to 2.6% from 2.5% in September. The default rate, while still low, is at a year-to-date high. For comparison, during the GFC the default rate was seen over 20% and it was over 7% during the pandemic. We had forecast a default rate of around 4% for 2023 and it seems we are likely to have been pessimistic in our calculation, we are currently tracking at a sub 3% global HY default rate for 2023.
- These default levels would be entirely normal in an historic context, but the nature of the economic backdrop and strong company balance sheets means we expect default rates to grinding higher over this period, instead of sharply spiking.
- In the fund, our underperformance versus the benchmark came from our basic industry and media holdings - which saw a negative performance steeper than the benchmark holdings negative return. This was partially offset by our real estate and transportation positions, which saw a nice outperformance versus the benchmark. By rating, our BB bonds outperformed the benchmark, while still negative returns, while our B rated holdings slightly underperformed. While outside the benchmark, our BBB & Above and CCC & Below bonds both saw negative total returns. Regionally, we saw negative returns across regions with the UK outperforming.
- For the market, all regions produced negative returns during the month - seeing similar negative returns relative to each other. With respect to sectors, only the automotive sector produced positive returns. Transportation, media and basic industry underperformed all sectors on a relative basis.

*YIELD-TO-WORST REFERS TO THE REDEMPTION DATE THAT PRODUCES THE LOWEST RETURN

Investment outlook

- In our view, the banking turmoil towards the end of the first quarter means a global recession is closer than anticipated at the start of the year. Banks will look to be more cautious with lending, leading to a broad credit contraction that we would expect to push the global economy into recession towards the end of this year or early 2024. Our focus will remain on the Fed. With inflation expected to fall back towards the long-term target, the levels that the Fed is happy with and when it then begins to lower rates will be the key factor for the upcoming year.
- In this higher rate environment, we are beginning to see a disconnect between yields and valuations. The longer yields stay higher, there will be a realisation that higher costs of capital are here to stay so valuations will need to be adjusted. This supports our move into investment grade names as some of the longer duration, high quality, low single A, high BBB, and longer duration debt offer good value with 5% plus yields. If the rates environment starts to turn you also get some yield compression which gives you some good convexity.
- It is also worth mentioning implied default rates take 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 our default and recovery expectations remain extremely benign. We are seeing yields at their highest rates in 10 years or more, so we feel comfortable handling the predicted rise in defaults to come as our cushion is more substantive.
- In our view, the way through difficult markets is to focus on those risks that you can control and know what you own. We will keep spread duration low and focus on the quality of issuers' financials, rather than relying on third-party ratings: at a sectoral level, cashflows are the key factor, meaning we need to know about on- and off-balance sheet leverage. We

prefer not to wait for defaults as the recovery process can take time: however, should they occur, the key is to have an adequate solvency cushion.

Key views within the fund

- The fund's objective is to achieve a combination of capital growth and income. The fund seeks to achieve its investment objective by outperforming its benchmark, the BofA Merrill Lynch BB-B Global Non-Financial High Yield Constrained index, 100% hedged to sterling, by 1% per annum over rolling three-year periods.
- The fund seeks to mitigate stock-specific risk by holding a diversified portfolio of investments, so that no individual investment can, in isolation, have an excessive adverse impact on overall fund performance. Currency risk associated with holdings of bonds is hedged through the use of forward currency transactions.
- We expect market volatility to continue due to market expectations surrounding Federal Reserve monetary policy. As such, we believe bonds with near-term catalysts, which mitigate market risk, are an important attribute underpinning investment performance over the medium term. There seems little chance of a near-term resolution of the conflict in Ukraine – this also has significant implications for the global economy, particularly if ongoing higher energy prices and supply chain disruption exacerbate a global economic slowdown.

Azhar Hussain
Head of Global Credit

Stephen Tapley
Global Credit Fund Manager

Royal London Short Duration Global High Yield Bond Fund

Portfolio commentary

- The monthly return was -0.04% (Z class) on a gross basis, a markedly stronger performance than the broad global high yield market.
- The Global High Yield market had to contend with spreads widening and the government yield curve increasing during October. Global High Yield spreads (BB-B index) widened by 33bps in the month with the government yield curve increasing 14bps. This resulted in a negative monthly return of -0.85% for the wider high yield market. The high yield market is now yielding 8.32% (YTW) with a duration of 3.8 years.
- The fund's expected FX-adjusted yield increased by 37bps to 8.32% with an expected duration of 1.5 years. All things being equal, an annual default rate of 13% (with 60% losses) would be required for an implied zero total return, at the current fund yield. This scenario is far in excess of both our own and market default expectations. It would equate to over a quarter of the fund defaulting over the next two years. It is worth recalling that the fund has never had any credit losses from defaults since inception.
- The month of October saw the smallest amount of high yield new issuance since July with $9.4bn issued, less than half the amount issued in September. Of the $9.4bn issued, there was a 47% BB versus 53% single B rated companies split. Year to date, high yield new issuance has totalled $142bn.
- The US high yield default rate inched higher to 2.6% from 2.5% in September. The default rate, while still low, is at a year-to-date high. For comparison, during the GFC the default rate was seen over 20% and it was over 7% during the pandemic. We had forecast a default rate of around 4% for 2023 and it seems we are likely to have been pessimistic in our calculation, we are currently tracking at a sub 3% global HY default rate for 2023.
- These default levels would be entirely normal in an historic context, but the nature of the economic backdrop and strong company balance sheets means we expect default rates to grinding higher over this period, instead of sharply spiking.
- For the market, all regions produced negative returns during the month - seeing similar negative returns relative to each other. With respect to sectors, only the automotive sector produced positive returns. Transportation, media and basic industry underperformed all sectors on a relative basis.
- Decomposing the funds' assets: US and RoW assets outperformed on a relative basis with European and UK assets producing negative returns. By rating, the fund's BB rated assets outperformed single B rated assets. By sector, automotive and utility sectors outperformed on a relative basis with the capital goods sector underperforming on a relative basis.
- Asset composition by region and rating were both broadly unchanged on the month.
- Pilgrim's Pride redeemed their 2027 maturity bond during October which illustrates how some companies are addressing their capital structure early in a prudent manner.
- Overall, the cash level was 0.0% at end of the month.
- Fund NAV was £1,1705m (-£45m on the month).

*FX ADJUSTED YIELD IS THE GROSS RATE OF RETURN TO THE EXPECTED MATURITY ADJUSTED FOR HEDGING AND INCLUDES THE IMPACT OF CASH.

Investment outlook

- In our view, the banking turmoil towards the end of the first quarter means a global recession is closer than anticipated at the start of the year. Banks will look to be more cautious with lending, leading to a broad credit contraction that we would expect to push the global economy into recession towards the end of this year or early 2024. Our focus will remain on the Fed. With inflation expected to fall back towards the long-term target, the levels that the Fed is happy with and when it then begins to lower rates will be the key factor for the upcoming year.
- It is also worth mentioning the 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 our default and recovery expectations remain extremely benign.

- The outlook for interest rates and economic growth remains unclear through the rest of 2023 and we will retain a defensive mindset until the prognosis for inflation is clearer.
- With yields at current levels and appealing potential returns, we will be paid sufficiently for maintaining a lower-risk position for at least another quarter until there is more clarity about the outlook. In keeping with the core focus of the strategy, we will keep duration low and focus on the quality of issuers' financials, rather than relying on third-party ratings. At a sectoral level, cashflows are the key factor and we continue to favour companies with contracted revenues. With regards to geography, our global outlook provides diversification away from country-specific risks.

Key views within the fund

- The fund's objective is to provide income. The manager seeks to achieve this by outperforming the benchmark, SONIA, by 2% per annum over rolling three-year periods.
- The fund is diversified in order to improve overall portfolio liquidity and to reduce the effect on overall fund performance of any deterioration in the creditworthiness of an individual holding.
- We expect market volatility to continue due to market expectations surrounding Federal Reserve monetary policy. As such, we believe bonds with near-term catalysts, which mitigate market risk, are an important attribute underpinning investment performance over the medium term. There seems little chance of a near-term resolution of the conflict in Ukraine – this also has significant implications for the global economy, particularly if ongoing higher energy prices and supply chain disruption exacerbate a global economic slowdown.

IMPORTANT INFORMATION