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RLPPC Enhanced Buy & Maintain Cash Flows Fund

Quarterly Investment Report

30 September 2023

ROYAL LONDON
ASSET MANAGEMENT

Quarterly Report

The fund as at 30 September 2023

The purpose of this report is to provide an update on the RLPPC Enhanced Buy & Maintain Cash Flows 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.

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ROYAL LONDON
ASSET MANAGEMENT

The fund

Fund performance objective and benchmark

The objective of the Fund is to provide excess income, relative to equivalent UK Government Bonds, over the life of the Fund.

Reference index: There is no benchmark for this fund.

Fund value

	Total £m
30 September 2023	161.82

Asset allocation

	Fund (%)
Conventional credit bonds	95.08%
Securitised	3.60%
Money market instruments	1.20%
Conventional foreign sovereign	0.12%

Fund analytics

	Fund
Fund launch date	1 April 2021
Base currency	GBP
Duration (years)	5.97
Gross redemption yield (%)	6.40
Credit spread (%)	2.05
Number of holdings	363
Number of issuers	258

Performance and activity

Performance

	Fund (%)
Quarter	1.77
YTD	1.58
1 Year	6.95
3 Years (p.a.)	-
5 Years (p.a.)	-
10 Years (p.a.)	-
Since inception (p.a.)	(6.49)

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 RLPPC Enhanced Buy and Maintain Cash Flows Fund S Inc. Source: Royal London Asset Management; Gross performance; Since inception date of the shareclass is 2 April 2021.

Performance commentary

The third quarter saw positive returns for the portfolio, with the negative impact of higher government bond yields more than offset by tighter credit spreads and the carry built into the portfolio. Looking at performance in the context of the wider sterling credit market, the portfolio return was slightly lower – primarily because as a buy & maintain strategy, the portfolio has a longer duration than a market index such as the iBoxx Sterling Non-gilt index. With yields edging higher and short-dated bonds performing best, this hurt returns relative to the market.

Sector positioning was broadly neutral. The banking and insurance sectors performed well, notably subordinated bank bonds, and the portfolio has a lower weighting than the market due to our preference for senior and secured debt, although this was offset by our low weighting in supranationals, which lagged the wider market. In stock terms, there were no major impacts on performance, although early repayment and calls continue to be supportive, for example with the redemption of 2024 bonds from Go-Ahead at a premium to market pricing.

Exposure to floating rate notes (FRNs), where interest payments are linked to cash rates, has increased in recent quarters. This helps dampen interest rate risk and has boosted income receipts. Our holding in student loan provider ICSL is an example of this, where income payments are linked to Sterling Overnight Interbank Average (SONIA) rate; income on these securities has risen significantly over the time, reflecting higher SONIA rates.

One negative impact on performance for the quarter was HDL. At the end of July, HDL Debenture Ltd – formerly Hemingway Properties PLC – as issuer of a bond secured on a pool of UK commercial property, confirmed that it was unable to pay the outstanding principal on the bond's maturity date (31st July 2023). The issuer did pay the bond's coupon on this date out of available resources, but the non-payment of principal constitutes an event of default under the bond documentation. This bond has security over a specific pool of ring-fenced assets and based on the latest property valuation dated June 2023, after netting off the available cash, bond principal is covered by property collateral by over 1.6x. The issuer is in ongoing discussions with a majority group of bondholders facilitated by The Investment Association with regards to the sale and/or refinancing of the underlying collateral in order to facilitate repayment of the bonds. Any terms for this would have to be acceptable to bondholders. Despite the excess level of asset cover and control that bondholders have over the situation to preserve our economic position, we have downgraded the internal rating on the bond to 'D' to reflect specifically the non-payment of principal at scheduled maturity rather than our expectation, at this time, of any economic loss. We will continue to monitor and manage this situation actively.

Performance and activity

Fund activity

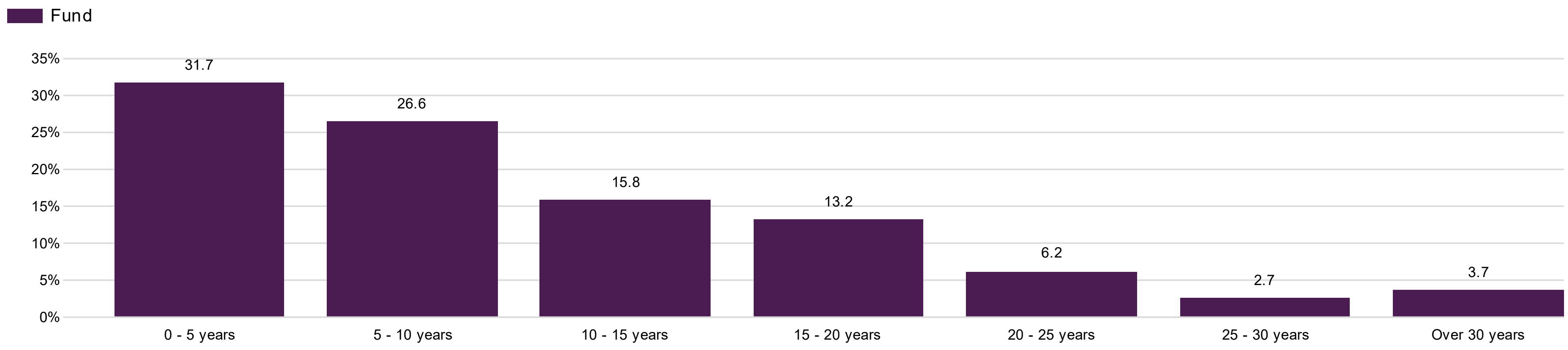
Primary activity was relatively low over the quarter. As well as the seasonal lull usually seen over the summer, rising overall yields means it is less attractive to raise debt capital. With a rising yield environment, many companies had brought capital raising forward to take advantage of low yields, and we would therefore expect issuance to remain somewhat lower in the next few quarters.

In the secured sector, we participated in a new issue from Last Mile Logistics – a commercial mortgage-backed security floating rate note backed by a portfolio of logistics assets across the UK with an attractive loan to value ratio and AAA rating. In the consumer area, we bought a new long-dated issue from disability vehicle provider Motability, adding to overall portfolio diversification.

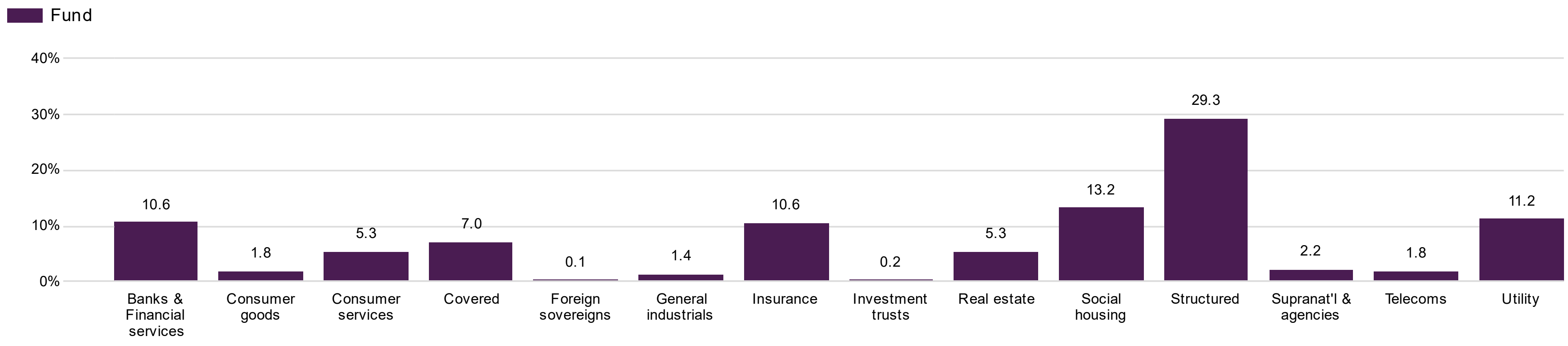
Market dynamics continue to provide opportunities to make switches where we can improve credit quality, yield or spread. During the quarter we sold social housing issuer Hexagon, adding Paragon in the same sector for an increase in credit spread, maintaining credit quality whilst add around 30bps in credit spread.

Fund breakdown

Maturity profile

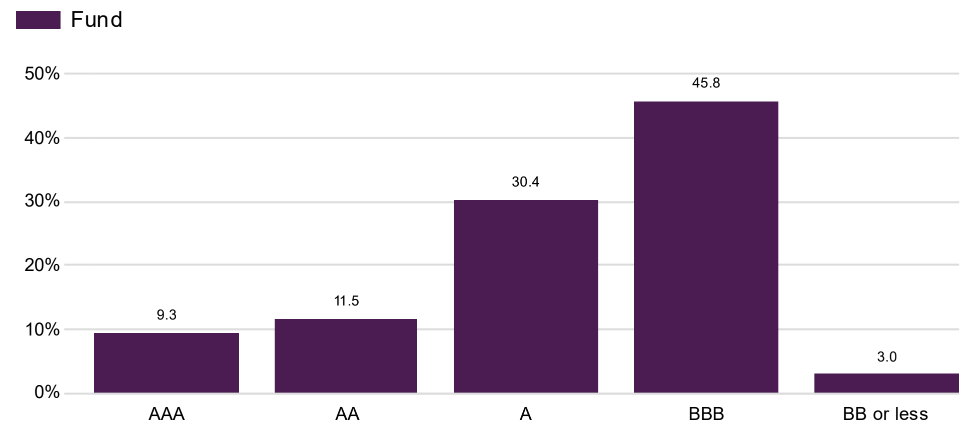


Sector breakdown



Credit ratings

Credit ratings



Downgrades

The table below details directly held credit bonds downgraded to sub-investment grade by at least one agency during the quarter.

Asset description	Current Rating	Previous Rating
No downgrades this quarter		

Upgrades

The table below details directly held credit bonds upgraded from sub-investment grade by at least one agency during the quarter.

Asset description	Current Rating	Previous Rating
No upgrades this quarter		

Market commentary

Market overview

The third quarter was characterised by mixed data around the world, with central banks coming towards the end of their rate hiking path, but with cuts still seemingly a while away. The global economic picture is rosier now than it was at the start of the year, but global growth is spluttering again amid a disappointing bounce in China activity, slow-to-no growth in Europe and against a backdrop of restrictive monetary policy. The US still looks at risk of recession too, even if activity data to date has been fairly robust.

Inflation has fallen significantly and, although higher energy prices threaten a widespread revival in headline inflation, other factors – including a weak economic activity backdrop – should pull inflation lower still. With taming inflation still the priority for central banks, there is still a possibility of further rate hikes from the Federal Reserve (Fed), European Central Bank (ECB) and Bank of England (BoE), but peak rates look to be near, with real rates now well into positive territory.

The outlook is still lacklustre in the UK. A technical recession is still assumed for the UK in the next 12 months, but a modest one. There are still risks from the housing sector and consumer spending has yet to respond fully to tighter monetary policy. GDP growth has been weak since late 2021 and PMI business surveys point to deterioration, falling into recessionary territory over the summer. Inflation should fall significantly at headline level, but domestically driven inflation continues to look strong, despite higher interest rates. The labour market is starting to look less tight and lead indicators of wage growth suggest some slowing ahead but so far, pay growth remains much too strong to be consistent with hitting a 2% inflation target.

Global government bond markets continued to see yields move higher – a trend that started in mid-2020, reflecting market views that rising inflation would necessitate higher interest rates and that the central banks and governments would ultimately have to withdraw the support measures put in place during the global financial crisis and then used further to help mitigate the economic impact of Covid. With the end of the rate rising cycle possibly in sight, but issuance expected to remain high, markets have become more volatile.

UK government bonds struggled, being impacted by the higher-than-expected inflation print. Gilts delivered a -0.63% return (FTSE Actuaries) over the third quarter with the benchmark 10-year gilt yield rising to 4.44% from 4.39% but pulled back from a 4.75% high seen in mid-August.

The sterling investment grade credit market (Non-Gilt) returned 2.26% over the quarter, as the negative impact of higher government bond yields was offset by tighter credit spreads and the greater proportion of short-dated bonds (which performed well relatively to longer-dated equivalents) in credit indices. 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 1.48% to 1.38% (iBoxx). Banks and insurance bonds performed strongly in the quarter while senior insurance debt also enjoyed an impressive quarter. No sector saw negative returns, but real estate was broadly flat, and healthcare and transportation lagged other sectors. By rating, there was no standout performer in investment grade, with all bands posting returns between 1.8% and 2.5%. High yield bonds, however, saw a strong quarter, seeing returns of 3.7%. In duration terms, shorter-dated maturities performed significantly better than longer-dated equivalents.

Primary credit activity picked up after a particularly slow July. Sterling issuance was £11.2bn over the quarter, which was slightly behind the £11.5bn seen over the same time last year and significantly below the £17.4bn issued in the second quarter.

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 rise further as the BoE continues 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 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.

The 'all-in yield' on sterling investment grade credit (government yield plus credit spread) remains attractive, particularly if inflation starts to fall as we expect. Our buy & maintain strategies generally have a significant targeted exposure to BBB rated bonds (albeit lower than the broad market indices), but we believe that compensation for default risk remains most attractive in this rating band.

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

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. Notable publications in the third quarter include our annual Climate Report, as well as our annual Assessment of Value reports, available from the home page of www.rlam.com.

Disclaimers

Important information

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The portfolio has no index as a comparison.

Risks and Warnings

Fixed interest security 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. Key determinants include economic growth prospects, inflation, the government's fiscal position, short-term interest rates and international market comparisons. The returns from bonds are fixed as at the time of purchase. Therefore the fixed coupon payable and the final redemption proceeds are known at the outset. This means that if a bond is held until its redemption date, the total return that could be expected is unaltered from its purchase date, subject to counterparty default (see 'Credit risk' below). However, over the life of a bond, the yield priced by the market (as opposed to actual fixed coupons payable) at any given time will depend on the market environment at that time. Therefore, a bond sold before its redemption date is likely to have a different price to its purchase price and a profit or loss may be incurred.

Credit risk

The value of a fixed interest security will fall in the event of the default or reduced credit rating of the issuer. Generally, the higher the rate of interest, the higher the perceived credit risk of the issuer. This fund may invest a percentage of it's assets in sub-investment grade bonds. Such bonds have characteristics which may result in higher probability of default than investment grade bonds and therefore higher risk.

Overseas markets risk

Funds investing in overseas securities are exposed to, and can hold, currencies other than Sterling. As a result, overseas investments may be affected by the rise and fall in exchange rates.

Derivatives risk for Efficient Portfolio Management:

Derivatives may be used by this Fund for the purpose of efficient portfolio management. This restricts the use of derivatives to the reduction of risk and the reduction of cost. Such transactions must be economically appropriate and the exposure fully covered.

Derivatives risk for investment purposes:

This fund may undertake transactions in derivatives and forward transactions (both on exchange and over the counter (OTC)). These may include interest rate swaps and interest rate futures for the purposes of meeting the investment objective, protecting the risk to capital, duration and credit management, as well as for hedging. While the discerning use of derivatives can be beneficial, derivatives also involve specific risks. These risks relate specifically to market risk, management risk, credit risk, liquidity risk, the risk of mispricing or improper valuation of derivatives and the risk that derivatives may not correlate perfectly with underlying assets, interest rates and indices. The use of derivative instruments may from time to time alter the economic exposure of the fund causing it to deviate significantly from the performance of the market as a whole. The use of these derivatives will be within the parameters allowed for linked funds by the Financial Conduct Authority and Prudential Regulation Authority.

Performance to 30 September 2023

Cumulative (%)

	3 Month	6 Month	1 Year	3 Years	Since Inception
Fund (gross)	1.77	(1.23)	6.95	-	(15.43)
Fund (net)	1.77	(1.23)	6.95	-	(15.43)

Annualised (%)

	3 Years (p.a.)	Since Inception (p.a.)
Fund (gross)	-	(6.49)
Fund (net)	-	(6.49)

Year on year performance (%)

	30/09/2022 - 30/09/2023	30/09/2021 - 30/09/2022	30/09/2020 - 30/09/2021	30/09/2019 - 30/09/2020	30/09/2018 - 30/09/2019
Fund (gross)	6.95	(21.92)	-	-	-
Fund (net)	6.95	(21.92)	-	-	-

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 30 September 2023. All figures are mid-price to mid-price in GBP for the RLPPC Enhanced Buy and Maintain Cash Flows Fund S Inc; Since inception date 2 April 2021.

Glossary

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

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

Credit spread
Credit spread is the difference in yield between two debt securities of the same maturity but different credit quality.

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.

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 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.

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.

Rating changes - downgrades
Directly held credit bonds downgraded from investment grade to sub-investment grade based on the RLAM composite rating during the quarter.

Rating changes - upgrades
Directly held credit bonds upgraded from sub-investment grade to investment grade based on the RLAM composite rating during the quarter.

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.