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Royal London Investment Grade Short Dated Credit Fund

Quarterly Investment Report

31 March 2024

Quarterly Report

The fund as at 31 March 2024

The purpose of this report is to provide an update on the Royal London Investment Grade Short Dated Credit 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

ROYAL LONDON
ASSET MANAGEMENT

The fund

Fund performance objective and benchmark

The Fund's investment objective is to achieve a total return over the medium term (3-5 years) by investing at least 80% in investment-grade bonds. Of these, at least 70% will be short-dated (bonds that will reach maturity within five years). Prior to investment, the Fund's holdings are subject to predefined ethical criteria. The Fund's performance target is to outperform, after the deduction of charges, the ICE Bank of America 1-5 Year Sterling Non-Gilt Index (the "Index") by 0.25% over rolling 3-year periods. The Index is regarded as a good measure of the performance of short-dated sterling-denominated bonds, not including those issued by the UK government (gilts). The Index is considered an appropriate benchmark for the Fund's performance, as the Fund's potential investments will predominantly be included in the Index. In addition to the benchmark for the Fund's performance as noted above (the "Index"), the IA Sterling Corporate Bond sector is considered an appropriate benchmark for performance comparison.

Benchmark: ICE BoA ML 1-5 Year Sterling Non-Gilt Index

Fund value

	Total £m
31 March 2024	2,484.28

Asset allocation

	Fund (%)	Benchmark
Conventional credit bonds	98.96%	99.24%
Securitised	1.04%	-
Conventional foreign sovereign	-	0.76%

Fund analytics

	Fund	Benchmark
Fund launch date	7 December 2015	
Base currency	GBP	
Duration (years)	2.79	2.62
Gross redemption yield (%)	5.76	5.00
Number of holdings	315	612
Number of issuers	177	297

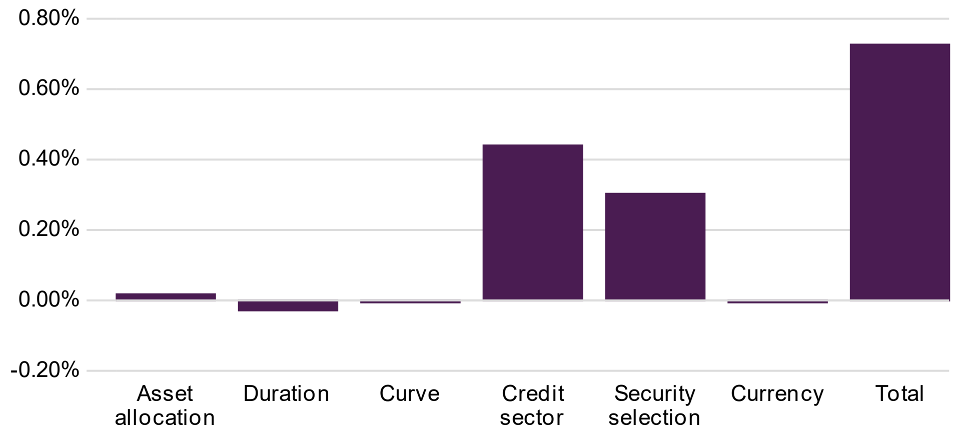
Performance and activity

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Quarter	1.27	0.59	0.68
1 Year	8.04	5.83	2.21
3 Years (p.a.)	0.68	(0.27)	0.95
5 Years (p.a.)	1.64	0.79	0.85
Since inception (p.a.)	1.96	1.36	0.60

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 Investment Grade Short Dated Credit Fund (Z Inc). Source: Royal London Asset Management; Gross performance; Since inception date of the shareclass is 7 December 2015.

Attribution over the quarter



Performance commentary

The fund saw a positive return in the period and was ahead of the benchmark. The main driver of positive performance was the combination of our sector allocation and stock positioning. At a sector level, our underweight position in supranationals and overweight in both insurance and structured were the main positives as supranationals continued to lag the wider market, having also underperformed in the second half of 2023. Stock selection in insurance and bank bonds also contributed strongly. These positive contributions from bank and insurance stocks were broad-based. Our bias towards subordinated bonds was helpful, as was our exposure to structured bonds, despite the negative impact of our holding in Thames Water.

Thames Water shareholders had previously announced an intention to inject £750m of equity into the utility by March 2025, with £500m of this anticipated by March 2024. In late March, and following discussions with OfWat, the necessary conditions for that initial injection had not been met. This has been negatively received by credit markets – as was the S&P downgrade to BBB- after the end of the quarter. We continue to believe that liquidity in the operating company remains satisfactory and that the business can continue to fund itself and serve its customers. Equally, until regulatory clarity is received, we expect newsflow to be negative. However, we believe that valuations remain attractive on a fundamental basis, given the strength of protection afforded via the regulated asset base and an expectation that a regulatory determination in June will allow the company to gain shareholder support and avoid a scenario in which taxpayer money is required to support the company. We believe that the risk in the business remains political in nature, as higher returns to incentivise the significant investment that is required to enhance the network will require price rises for consumers. Nationalisation or a change in the regulatory regime would create wider ramifications for the funding of UK infrastructure and impose significant liabilities on UK taxpayers.

We remain in the safest part of the capital structure – operating company debt that is closest to the assets and holdings remain part of a very diversified portfolio of lending decisions.

Performance and activity

Fund activity

New issue activity remained a key focus over the quarter. A notable trend has been the reduction in the new issue premia (the additional yield required to sell new bonds) and at times, book building sizes have looked extraordinary – suggesting huge latent demand. This has led to some caution on our part – we still believe that credit spreads more than compensate credit investors for the risk of default, but are equally aware that demand in certain parts of the market can lead to less favourable pricing.

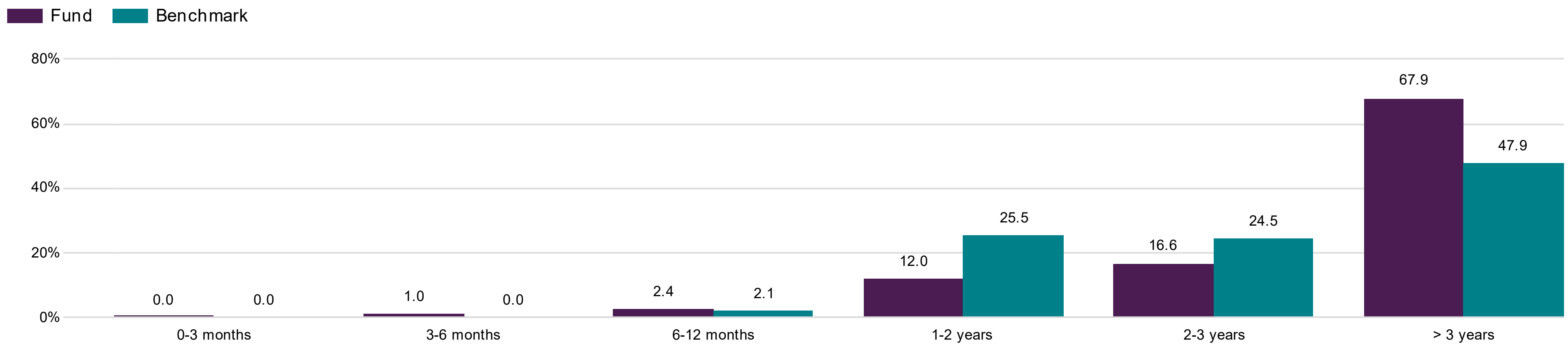
Financials continued to dominate primary market activity during the quarter. Here we added senior bonds from Metropolitan Life, these bonds ranking alongside policyholders in seniority, in addition we participated in the issue UK mortgage specialist OSB at a yield of over 8.5%.

Exposure to structured bonds remains a cornerstone of our process and portfolios. Issuance has been somewhat low in recent months, but there were opportunities in the sector during the quarter. Examples included Land Securities and a rare new issue from Telereal – secured on rentals paid on BT telephone exchanges.

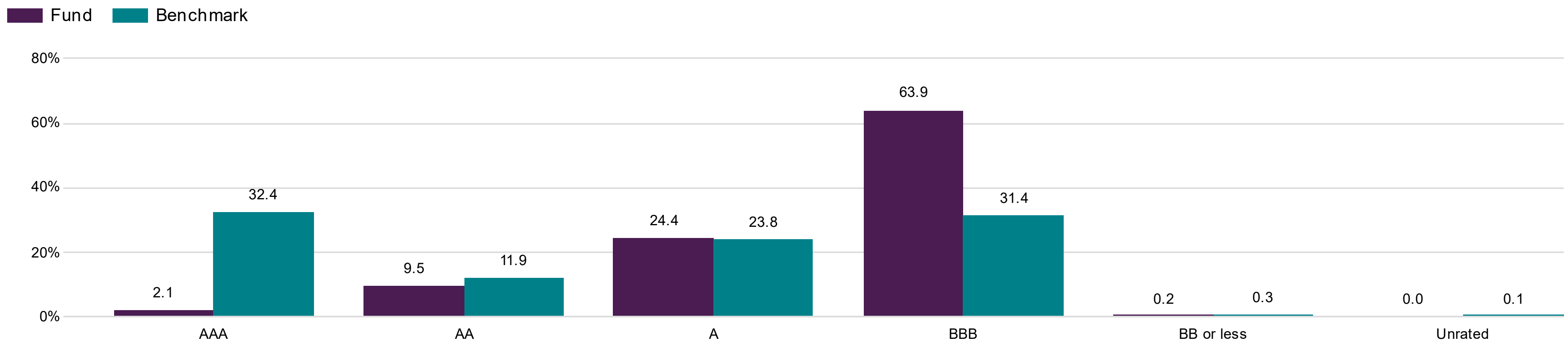
We remain cautious around utilities as valuations are generally not as appealing as other areas of the market. However, during the quarter, we felt that valuations in the gas sector, an area we had reduced in recent years, had improved significantly, with credit spreads materially wider than those in the regulated electricity sector. As a result, we were happy to add bonds from APT Pipelines in the secondary market.

Fund breakdown

Maturity profile

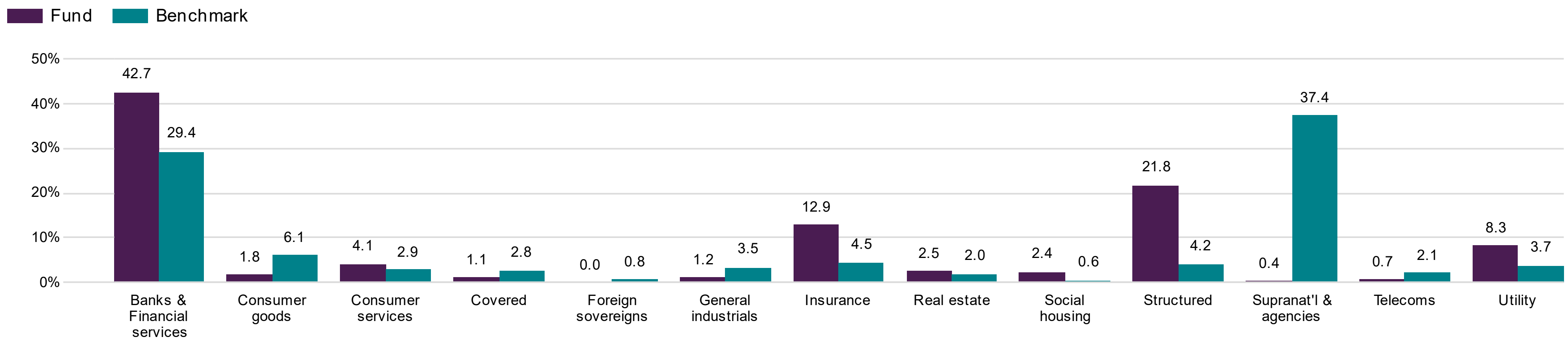


Credit ratings



Fund breakdown

Sector breakdown



Characteristics and climate

Climate metrics

	Fund	Benchmark	Difference (%)
Financed emissions (tCO2e)	52,696	n/a	n/a
Financed emissions coverage	55.06%	n/a	n/a
Carbon footprint (tCO2e/$M invested)	16.91	19.18	(11.82)
Carbon footprint coverage	55.06%	45.69%	20.49
Weighted average carbon intensity (tCO2e/$M sales)	48.91	30.59	59.87
Weighted average carbon intensity coverage	98.54%	97.10%	1.48

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	55.06	45.69	20.49
% of portfolio below 2°C ITR	38.42	34.16	12.46
% of portfolio below 1.5°C ITR	18.31	14.17	29.18

SBTi net - zero

	Fund (%)	Benchmark (%)	Difference (%)
SBTi Net-Zero committed	10.80	12.15	(11.05)
SBTi Near-Term committed	8.88	8.26	7.53
SBTi Near-Term targets set	12.59	14.89	(15.43)

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	8	40
Number of engagements	10	81

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	**2**
Climate - Transition Risk	2
Governance	**6**
Remuneration	3
Strategy	2
Board	1
Social & Financial Inclusion	**4**
Just transition	2
Labour & Human Rights	1
Social & Financial inclusion	1

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

BP Plc - Cyber Security

Purpose:

To evaluate the company against our established cyber investor expectations of best practice and identify areas where improvement is needed. We then communicate these findings to the company and encourage the adoption of stronger practices.

Outcome:

We engaged in a constructive dialogue with BP which allowed us to gain in depth insights into BP's cyber governance and practices, particularly in relation to our published cybersecurity investor expectations. We found an above average approach to managing suppliers, conducting cyber due diligence, and integrating cyber security measures through inorganic growth. As BP transitions from an International Oil Company (IOC) to an Integrated Energy Company (IEC), it faces unique cyber security challenges and opportunities. This transition involves expanding customer touchpoints, growing the renewables portfolio, and leveraging AI, all of which require a vigilant and adaptive cyber security framework.

HSBC Bank Plc - Just Transition

Purpose:

To review and provide feedback on the company's draft Net Zero Transition Plan.

Outcome:

HSBC's Net Zero Transition Plan, informed by GFANZ and TPT, sets a strategic vision for sector specific transitions and an actionable plan. In a feedback session with the Chief Sustainability Officer, the company highlighted its commitment to the real economy decarbonisation, especially in developing markets. The plan details a sectoral approach based on global financing needs, and HSBC's strategies to support decarbonisation and leverage financing opportunities. It also emphasises a fair and inclusive transition, with ongoing efforts to integrate just transition principles. We will continue to engage with the company, placing particular emphasis on the operationalisation of their commitment to a just transition.

Fund Engagement

Engagement outcomes

National Australia Bank - Just Transition

Purpose:

To foster transparency and accountability, we encourage the company to disclose its strategy for incorporating just transition considerations into its decarbonisation efforts. Furthermore, we sought clarity on the company's responsible lending practices within their microfinance operations.

Outcome:

National Australia Bank (NAB) is committed to a just transition and microfinance, recognising the interconnection between the two as microfinance plays a crucial role in supporting communities affected by the energy transition. The company is developing a just transition plan and contributing to the 'UNGC Think Lab on Just Transition' for business guidance. Its microfinance efforts are philanthropic, aligning with its place-based strategy for a just transition. Good Shepherd, the company's partner, conducts internal audits and quality processes. NAB advocates for responsible microfinance and is encouraged to promote these practices nationally.

Market commentary

Market overview

A key theme to emerge during the quarter was indication of a more favourable global macro backdrop. Despite some mixed signals, the US economy remains resilient, while Europe and the UK show signs of gradually exiting their recessions. Activity in China also seems to be stabilising. At the same time, core central banks are still confident that the disinflation trend remains intact, despite some recent setbacks in inflation prints. Policymakers have often highlighted that they are in no rush to cut rates – with markets now generally pricing the start of the easing cycles to begin this summer. The Federal Reserve, European Central Bank and Bank of England all left interest rates unchanged over the quarter.

One major development over the quarter is that markets have recalibrated their pricing for expected central bank cuts over this year. At the end of last year, markets were pricing in an aggressive rate cutting cycle, but then swiftly move to temper those forecasts. This re-pricing contributed to negative returns for global government bond markets over the quarter. Despite the belief of many that it was the anticipation of a 'Fed-pivot' that contributed to the rally in equity markets in late 2023, equity markets proved to be immune to this bond market sell-off as global growth and business confidence showed signs of resilience and investors focused on the potential offered by AI.

Government yields rose in all the major markets. In the US, 10-year treasury yields rose from 3.88% to 4.21%, while German 10-year bunds similarly saw yields rise from 2.01% to 2.30%. Mirroring this backdrop of rising yields, UK government bonds produced a return of -1.62% (FTSE Actuaries) over the first quarter, with the benchmark 10-year gilt yield rising from 3.54% to 3.94%. The bulk of this move occurred in the first two weeks of January, before largely trading in a range between 4% and 4.2% for the rest of the quarter. The rising yield environment helped short-dated bonds to outperform their longer-dated equivalents.

In contrast to the losses in the government bond market, the sterling investment grade credit market (iBoxx non-gilt index) returned 0.06% over the quarter, with the effect of higher yields mitigated by tighter credit spreads and the higher carry in this area. The shorter duration of the credit market index also helped offset some of the government market headwind. 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 1.15% to 1.02% (iBoxx). Given the rise in yields, sectors with a greater proportion of long-dated bonds performed poorly, including utilities and social housing. Of the major sectors, supranationals was the worst performing sector, while in financials, the banks and insurance sectors performed well.

Issuance picked up in the first three months of the year compared to the fourth quarter of 2024, but overall supply in key areas such as financials was materially lower than the same period last year. This helped spreads tighten in bank and insurance sector.

Outlook

The rally in bond yields seen late last year, prompted by hopes that falling inflation would lead to relatively rapid and numerous interest rate cuts, was largely unwound in the first two weeks of 2024. This reflects the change in interest rate expectations and the sensitivity of markets to incoming economic data. Looking at market pricing, UK base rates are projected to be around 4.5% at the end of 2024, this is in contrast to the 12-month outlook, where markets were projecting rates below 4%. We expect yields to remain sensitive to economic data, and unless there is a significant deterioration in underlying trends, we expect this to lead to range bound-yields and the opportunity to add/trim duration as markets react to individual data points.

Headline inflation is expected to reach the 2% Bank of England target level in the next few months. However, we are mindful that underlying pressures in the labour market and parts of the services sector mean that headline inflation figures may be somewhat misleading. In addition, data since the start of the year suggests that the UK is growing again – albeit slowly. This trend can be seen in the US and euro zone as well. Overall, the global tone is that rate cuts are not going to come through as quickly as anticipated and that the neutral level may be a bit higher than previously thought.

With bond yields generally higher than they were at the start of the year, and interest rate cuts now closer, we believe that overall government bond yields look attractive. Credit spreads have come in further – and are now looking somewhat tight in longer-dated bonds – but continue to compensate credit investors for the risk of default. From a credit spread perspective we continue to find better value in shorter-dated credit bonds, but with absolute yields at attractive levels we prefer to be broadly neutral in overall duration positioning, with a bias to extend on further rises in yields.

We target – and achieve – a material yield premium over the market level in our sterling credit strategies. We mitigate the risks by maintaining highly diversified portfolios, with a bias towards bonds that offer greater security and downside protection. Our view remains that over the medium term our focus on delivering greater income than the benchmark will generate outperformance.

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

In an uncertain geopolitical and economic environment, we recognise the importance of keeping our clients updated on our current investment thinking.

Articles, videos, podcasts and webinars giving the latest views of our investment experts 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 April 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 ICVC, an open-ended investment company with variable capital with segregated liability between sub-funds, incorporated in England and Wales under registered number IC000797.

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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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 risk

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.

Government and public securities risk

The Fund can invest more than 35% of net assets in different Transferable Securities and Money Market Instruments issued or guaranteed by any EEA State, its local authorities, a third country or public international bodies of which one or more EEA States are members.

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 March 2024

Cumulative (%) / Annualised (%)

	3 Month	6 Month	1 Year	3 Years	5 Years	3 Years (p.a.)	5 Years (p.a.)
Fund (gross)	1.27	6.30	8.04	2.04	8.47	0.68	1.64
Fund (net)	1.21	6.17	7.78	1.31	7.18	0.44	1.40

Year on year performance (%)

	31/03/2023 - 31/03/2024	31/03/2022 - 31/03/2023	31/03/2021 - 31/03/2022	31/03/2020 - 31/03/2021	31/03/2019 - 31/03/2020
Fund (gross)	8.04	(3.40)	(2.23)	6.02	0.26
Fund (net)	7.78	(3.63)	(2.46)	5.77	0.03

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 March 2024. All figures are mid-price to mid-price in GBP for the RL Investment Grade Short Dated Credit 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 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.

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 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.

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.

Glossary

Weighted Average Carbon Intensity (WACI)

Portfolio's exposure to carbon-intensive companies, expressed in tCO2e / $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.

In line with our bespoke and targeted approach to credit analysis, we have developed an in-house carbon data tool that addresses coverage and mapping issues with third party systems. The development of this tool has been a critical element of RLAM's ESG integration into our credit process, addressing coverage and mapping issues with third party systems. This enhanced coverage is reflected in the WACI figures provided in this report, with all other metrics instead being based on data from MSCI.