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RLPPC Enhanced Buy & Maintain Cash Flows 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 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

To achieve a yield of +1.30% in excess of gilts. The Fund is not managed in reference to any benchmark index.

Reference index: There is no benchmark for this fund.

Fund value

	Total £m
31 March 2024	164.93

Asset allocation

	Fund (%)
Conventional credit bonds	96.49%
Securitised	3.32%
Conventional foreign sovereign	0.12%
Conventional gilts	0.07%

Fund analytics

	Fund
Fund launch date	1 April 2021
Base currency	GBP
Duration (years)	6.44
Gross redemption yield (%)	5.81
Credit spread (%)	1.76
Number of holdings	358
Number of issuers	254

Performance and activity

Performance

	Fund (%)
Quarter	0.52
1 Year	7.17
3 Years (p.a.)	(2.82)
Since inception (p.a.)	(2.82)

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 1 April 2021.

Performance commentary

Although government bonds saw negative returns in the first quarter, the lower duration of credit markets, combined with tighter spreads and the impact of higher carry helped sterling corporate bonds post positive returns for the period. The portfolio also posted positive absolute returns for the quarter.

Taking the iBoxx Sterling Non-Gilt index as a reference for the sterling credit market, the portfolio outperformed over the quarter. The negative impact of the long duration position was offset by the combination of stock and sector positioning. Our underweight in supranationals was helpful as these continued to lag the wider market, having also underperformed in the second half of 2023, while our positioning in insurance bonds, which performed well, also helped performance. These offset the negative impact of a lower weighting in subordinated banks. These performed strongly over the quarter – although we remain comfortable with this bias given the objective of the portfolio.

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 Barclays senior bonds at 170bps over equivalent gilts and UK mortgage specialist OSB at a yield of over 8.5%. In the secondary market, we effected a switch in HSBC, selling 2033 bonds after strong performance, buying 2041 bonds for a pick-up in spread of around 60bps.

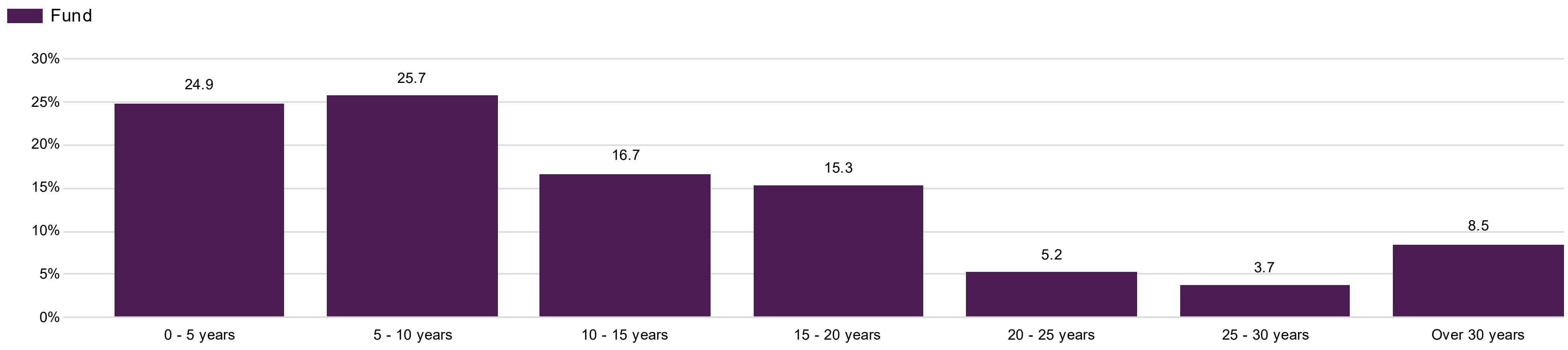
Exposure to structured bonds remains a cornerstone of our process and portfolios. Issuance has been somewhat low in recent months, but there were opportunities in the sector during the quarter. Examples included Land Securities and a rare new issue from Telereal – secured on BT telephone exchanges.

Demand from annuity buyers has supported longer-dated high quality bonds. In a number of areas, this has pushed spreads to levels that we feel were unattractive, and we took advantage of the higher demand for these bonds to take profits and recycle into more attractive areas. Our exposure to social housing was an example of this. Here we took profits on Blend, after spreads had tightened to materially lower levels than the wider market. These monies were initially recycled into gilts to maintain duration, but then reinvested into more attractive opportunities in both new issue and secondary market. This included a new issue from BPHA, who manage almost 20,000 homes across to Oxford to Cambridge corridor and we feel have strong EPC performance – indicating strong energy efficiency across their portfolio, at an above market average yield.

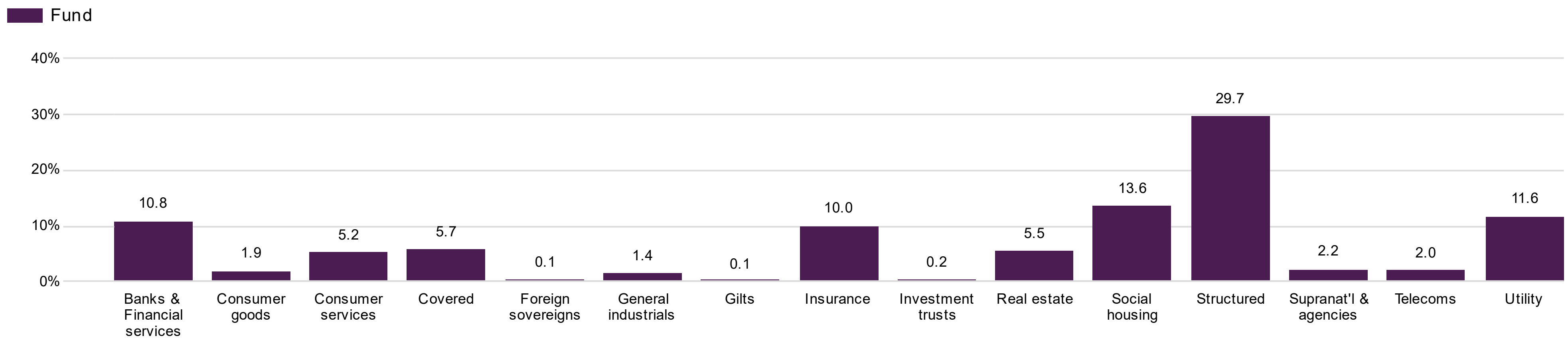
We remain cautious around utilities as valuations are generally not as appealing as other areas of the market. However, during the quarter, we felt that valuations in the gas sector, an area we had reduced in recent years, had improved significantly, with credit spreads materially wider than those in the regulated electricity sector. As a result, we were happy to purchase a new issue from the UK's largest gas distribution network Cadent. We added new issues of operating company level bonds from Northumbrian Water and Southern Water, both at attractive yield premiums.

Fund breakdown

Maturity profile

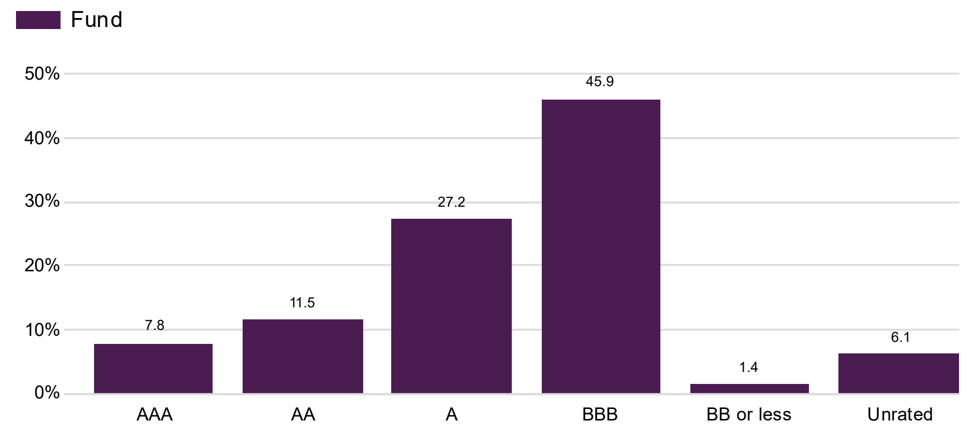


Sector breakdown



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

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.

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.

We target – and achieve – a material credit spread premium over the market level in our buy & maintain strategy. 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 that spread premium in a risk-controlled manner, 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

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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 31 March 2024

Cumulative (%)

	3 Month	6 Month	1 Year	3 Years	Since Inception
Fund (gross)	0.52	8.51	7.17	(8.23)	(8.23)
Fund (net)	0.52	8.51	7.17	(8.23)	(8.23)

Annualised (%)

3 Years (p.a.)	Since Inception (p.a.)
(2.82)	(2.82)
(2.82)	(2.82)

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)	7.17	(10.82)	(3.99)	-	-
Fund (net)	7.17	(10.82)	(3.99)	-	-

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 RLPPC Enhanced Buy and Maintain Cash Flows Fund S Inc;Since inception date 1 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.