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Royal London Sterling Extra Yield Bond Fund (A Inc)

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 Sterling Extra Yield Bond Fund (A Inc). 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 investment objective of the fund is to achieve a high level of income. The fund seeks to achieve a gross redemption yield (GRY) of 1.25 times the gross redemption yield of the FTSE Actuaries British Government 15 Year index. The Benchmark is being used by the Fund for performance comparison purposes only and the Fund does not intend to track the Benchmark.

Fund value

	Total £m
31 March 2024	1,619.13

Asset allocation

	Fund (%)
Conventional credit bonds	94.85%
Other	4.38%
Securitised	0.62%
Index linked credit bonds	0.15%

Fund analytics

	Fund
Fund launch date	11 April 2003
Base currency	GBP
Duration (years)	3.84
Gross redemption yield (%)	7.34
Number of holdings	238
Number of issuers	174

Performance and activity

Performance

	Fund (%)
Quarter	3.85
1 Year	12.81
3 Years (p.a.)	5.05
5 Years (p.a.)	5.08
10 Years (p.a.)	6.39
Since inception (p.a.)	7.74

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 Sterling Extra Yield Bond Fund (A Inc). Source: Royal London Asset Management; Gross performance; Since inception date of the shareclass is 11 April 2003.

Performance commentary

The fund posted strong returns in the first quarter of 2024. After the extraordinarily strong performance in fixed interest markets in the final two months of 2023, triggered primarily by growing expectations that interest rates had peaked and would soon start a progressive decline, there was a significant reversal at start of 2024, however in March there was a partial recovery. While headline inflation benefitted from some past, mainly energy related, 'base effects' falling out of the annual rates, core inflation was more resilient, labour markets remained tight and the political and economic outlook remained challenging.

Distributions in respect of the first quarter, payable at the end of May, are 1.99p, 1.82p, 1.84p and 1.83p respectively for the A, B, Y and Z class income shares. These compare to amounts of 1.80p, 1.63p, 1.67p and 1.66p distributed in respective of the first quarter of 2023. While there can be a fair degree of volatility from quarter to quarter in fund distributions, investments in FRNs (floating rate notes), where income is referenced to a margin over short term rates and thus has increased over the course of the past year, and the higher yield levels recently prevailing for investment of fund flows, have both contributed to this uplift in income generation.

To start the period, the resilience of the fund against rising bond yields was very broadly based; as approximately two-thirds of the holdings rose in price in January, with robust income generation substantially mitigating the price decline of the remaining third of portfolio holdings. While some longer dated bonds, including utility EDF, student loan securitisation ICSL and structured bonds property business Trafford Centre Finance, were down in price due to the rise in government yields, the only stock specific setbacks were of Close Brothers bonds.

Towards the end of the quarter, against a benign market background, the vast majority of holdings in the fund posted positive returns. Financials generally performed well, with holdings of banks Barclays, BNP, Lloyds and Rabobank up in March while insurers Aviva, Bupa, M&G and Phoenix were also up. Other specific strong performances were secured bonds of property company Peel Holdings, retailer John Lewis, secured bonds of pub business Unique and energy group Tullow Oil.

Our holding in Thames Water was a detractor from performance over the quarter. We maintained exposure to Thames Water as part of a diversified portfolio. 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.

Performance and activity

Performance commentary (continued)

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.

Performance and activity

Top 10 holdings

	Weighting (%)
ELECTRICITE DE FRANCE SA 5.875000000	2.44
CENTRICA PLC 5.250000000 2075-04-10	2.29
CO-OP GRP HLDS 7.500000000 2026-07-08	2.28
METROCENTRE FINANCE 8.750000000 2024-12-05	2.07
SANTANDER UK PLC 10.062500000	1.92
M&G PLC 6.340000000 2063-12-19	1.91
SANTANDER UK PLC	1.91
HEATHROW FINANCE PLC 3.875000000 2027-03-01	1.70
PHOENIX GRP HLD PLC 5.750000000	1.69
ELECTRICITE DE FRANCE SA 6.000000000	1.55
Total	**19.76**

Fund activity

The fund participated in the flow of new issues in the quarter. At the start of the period, in the energy sector, we added Seacrest, onshore oil and production in Brazil, Talos, the large US energy business who repaid an existing bond held in the fund at a premium, and TWMA, the support services business in the energy sector.

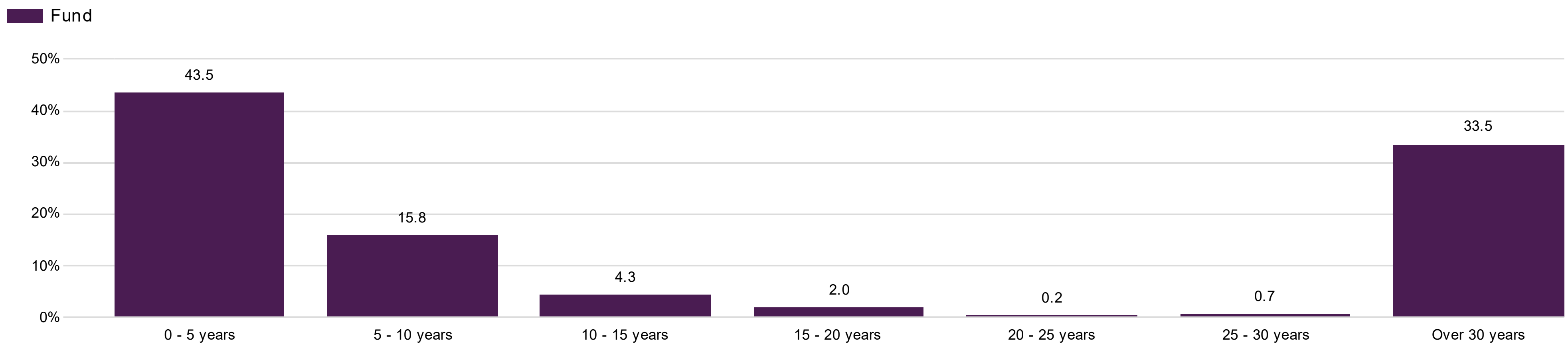
In financials we added new issues from Investec, together with BNP and ING and Standard Chartered, each US dollar denominated AT1 bonds with BB/BBB credit ratings and offering yields at or near 8%. We also participated in the new issues of investment grade bonds of Barclays Bank, of European insurer NN Group.

Outside of this, we participated in new issues from Altera Shuttle Tankers 9% bonds 2028, unrated but benefitting from long term contracts and business with major international energy companies, and Scatec, the European renewable energy business which issued Norwegian krone 2028 floating rate bonds at an initial yield of 9%. New issues also included UK water utility SWS Finance and structured bonds of Telereal, backed by operating properties and associated lease obligations of BT Group, B rated new issues of car manufacturer Aston Martin and transport logistics business SGL, and unrated bonds of energy services company Varel and shipping group Ocean Yield.

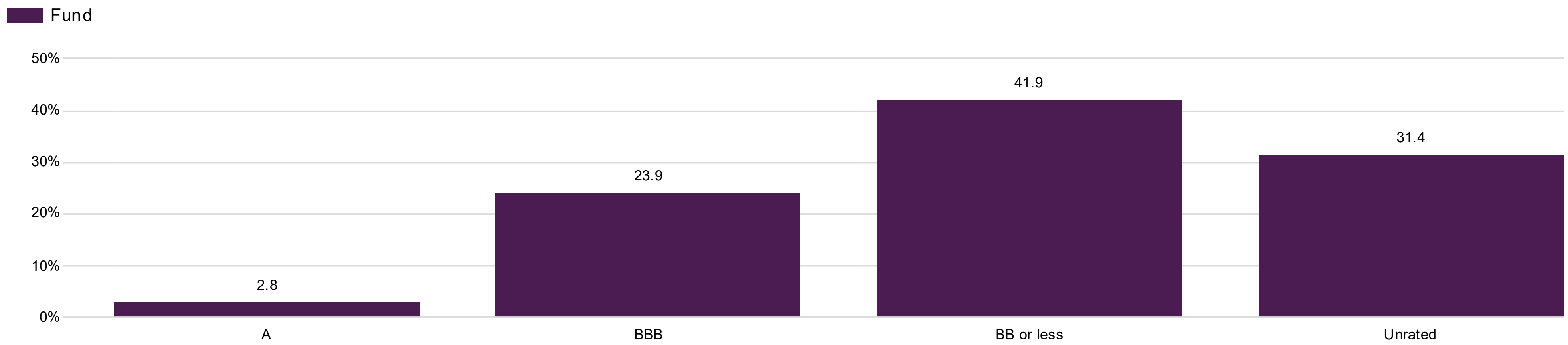
Sales in the period included short-dated bonds of airport operator Heathrow, bonds of Australian gas pipeline business APA Infrastructure, short-dated bonds of banking group Virgin Money, of troubled US healthcare business Medical Properties Trust and of DOF Group.

Fund breakdown

Maturity profile

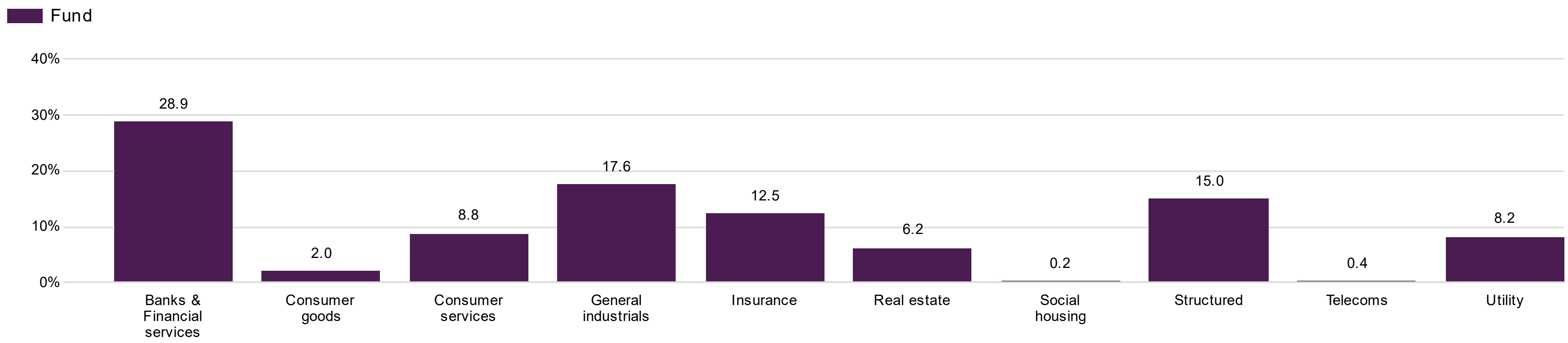


Credit ratings

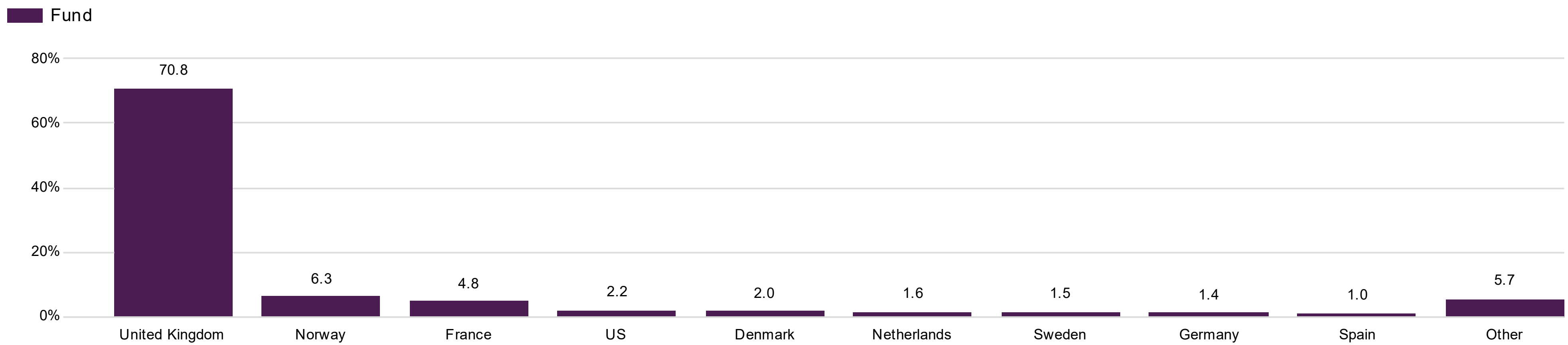


Fund breakdown

Sector breakdown



Geographical breakdown



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	7	24
Number of engagements	9	55

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	**5**
Remuneration	2
Strategy	2
Board	1
Social & Financial Inclusion	**3**
Just transition	2
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

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.

Vattenfall - Just Transition

Purpose:

To understand how the company is integrating just transition into its business decision making process. We aim to encourage the company to disclose plans to integrate social considerations into its decarbonisation strategy.

Outcome:

Vattenfall has identified key areas for a just transition, focusing on commitments to customers, employees, and communities. The company is open to using metrics and KPIs for employee reskilling but needs clearer communication on retraining and redeployment. Community engagement strategies differ by market, with early engagement in Sweden and proactive measures in the UK and Netherlands. Vattenfall shows commitment to just transition, but further clarity is needed on its systematic integration into business decisions. We will continue to monitor progress and engage with the company on this issue.

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 data. 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 the significant recalibration of the 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 moved 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.

The US Federal Reserve continued to keep rates on hold at 5.25-5.50% over the quarter against a still resilient labour market backdrop, and after a couple of stronger than expected inflation prints. As of their March meeting, the median forecast of participants still had 75bps of rate cuts in it for 2024 though with 75bps rather than 100bps of cuts pencilled in for 2025. Over the quarter, CPI inflation was broadly stable, at 3.2% year-on-year in February, from 3.1% in November (briefly 3.4% in December). However, core CPI inflation rose a stronger than expected 0.4% month-on-month in both January and February. The core PCE measure of inflation fell over the quarter in year-on-year terms, but came in above 0.2% month-on-month in both January and February. Fourth quarter GDP recorded a strong 3.4% quarter-on-quarter annualised, weaker than in the third quarter but still well above trend. More timely economic activity indicators were broadly consistent with reasonable growth in the first quarter. Real personal spending grew. Non-farm payroll gains were above 200K in January and February, but the unemployment rate jumped two-tenths in February.

Over the first quarter, the European Central Bank kept rates on hold. As of the March meeting, the staff inflation forecasts were more consistent with sustainably hitting the target and President Christine Lagarde continued to emphasise that they wanted more data, more evidence, before cutting rates. She said that they would know a "little more in April, but we will know a lot more in June." Various ECB speakers have signalled that they think a rate cut is likely/possible in June. Euro area CPI rose in December, but fell back to 2.6% by February. Core CPI fell gradually over the same period too to 3.1% year-on-year. The euro area economy (GDP) was flat in Q4 at 0.0% quarter-on-quarter. Business surveys, however, were consistent with the economy remaining in (mild) recessionary territory, even if the composite PMI improved over the quarter.

Global corporate bonds saw mixed effects during the quarter. In the US, euro zone and UK, the negative impact of rising underlying government bonds was offset by credit spread tightening and positive carry, to leave returns roughly flat (local terms). Lower down the rating scale, global high yield markets saw modest gains, while areas such as corporate hybrids and contingent capital bank bonds (cocos) all produced positive returns over the period.

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 an index 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 3.9% 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 gilt yields mitigated by tighter credit spreads and the higher income accrual. 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.

Data released in the first quarter confirmed that the UK experienced a technical recession in the second half of 2023 but painted a picture of stronger economic activity in the first quarter, with falling inflation and more signs of softening underlying domestic inflationary pressure. Fourth quarter GDP fell 0.3% quarter-on-quarter in real terms after falling 0.1% in the third quarter. Meanwhile, CPI inflation fell a bit further to 3.4% year-on-year in February from 3.9% for the November release. Core inflation fell to 4.5% year-on-year from 5.1% over the same period. By the end of the quarter (the January data release) regular pay growth figures were showing more sign of slowing, at 6.1% (3M/Y) for the 3-months to January (from 7.2% three-months earlier). Consistent with falling – but still above target – inflation, but with activity and labour market data fairly resilient, the Bank of England continued keep rates on hold at 5.25%. The Budget saw the

Market commentary

Chancellor present further tax cuts, adding net stimulus near term but with the projections for future years still implying sizeable real terms spending cuts for 'unprotected' government departments.

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.

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 previously anticipated and that the neutral level may be a bit higher than previously thought.

A characteristic of the fund is the scope to invest across a wide range of assets, encompassing investment grade, investment grade and unrated bonds, diversified by sector and across both Sterling and non-Sterling bonds. This, together with a process orientated towards mitigating risk by investment in bonds where structure or a claim on assets or on cash flows, and with a focus on income generation, has been the basis of the fund's strong performance over the longer term. While the state and challenges of economic and market conditions change over time, we believe the fund is well positioned to continue to deliver attractive returns to investors.

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 Asset Management Funds plc, an open-ended investment company with variable capital (ICVC), with segregated liability between sub-funds.

Incorporated with limited liability under the laws of Ireland and authorised by the Central Bank of Ireland as a UCITS Fund. It is a recognised scheme under the Financial Services and Markets Act 2000.

The Management Company is FundRock Management Company SA, Registered office: 33 rue de Gasperich, L - 5826 Hesperange, Luxembourg and is authorised and regulated by the Commission de Surveillance du Secteur Financier (CSSF).

The Investment Manager is Royal London Asset Management Limited.

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.

Most of the protections provided by the UK regulatory system, and the compensation under the Financial Services Compensation Scheme, will not be available.

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FTSE makes no claim, prediction, warranty or representation either as to the results to be obtained from the Fund or the suitability of the Index for the purpose to which it is being put by Royal London Asset Management.

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.

Exchange rate risk

Changes in currency exchange rates may affect the value of your investment.

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.

Derivative risk

Derivatives are highly sensitive to changes in the value of the underlying asset which can increase both Fund losses and gains. The impact to the Fund can be greater where they are used in an extensive or complex manner, where the Fund could lose significantly more than the amount invested in derivatives.

Performance to 31 March 2024

Cumulative (%)

	3 Month	6 Month	1 Year	3 Years	5 Years
Fund (gross)	3.85	9.42	12.81	15.95	28.15
Fund (net)	3.64	8.97	11.86	13.06	22.99

Annualised (%)

	3 Years (p.a.)	5 Years (p.a.)
Fund (gross)	5.05	5.08
Fund (net)	4.17	4.22

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)	12.81	(1.53)	4.38	23.23	(10.31)
Fund (net)	11.86	(2.36)	3.51	22.20	(10.98)

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 Sterling Extra Yield Bond Fund (A Inc).

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.

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.

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.