Sustainable stocks in the spotlight

February 2024

Views from the desk

We support the change to a more sustainable society by investing in companies based on what they do and how they do it. This positive contribution can be through the products and services they provide and operationally through ESG leadership i.e. how a company looks after its operational assets, the environment, its stakeholders and the role it plays within its industry.

We look for well-managed sustainable companies that are leaders in their fields with durable competitive advantages and which we believe can deliver more resilient growth, lower operational volatility, and better bond holder protection as a result of strong management of sustainability risks.

Our sustainable stocks in the spotlight showcases holdings across the Royal London Asset Management Sustainable fund range that we deem to be making a positive contribution towards a cleaner, healthier, safer and more inclusive society. In this first edition, we look at recent additions to our portfolios – a new bond issue from Sage Homes, as well as the addition of Agco to our equity portfolios.

FIXED INCOME

Sage Homes

Social housing

Security held	Sage AR Funding class A floating-rate notes with expected maturity 2025
Headquarters	UK
Sector	Structured
Theme	Social housing
Portfolios held	RL Sustainable World Trust RL Sustainable Growth Fund RL Sustainable Diversified Trust RL Sustainable Managed Growth Trust RL Sustainable Managed Income Trust

Company overview

Sage Homes is a provider of affordable housing across the UK, focusing on and the provision of social and affordable homes. The Sustainable funds' exposure is to Sage AR Funding, a commercial mortgage backed security (CMBS) transaction ultimately secured on portfolio of 1,712 housing units owned by Sage Homes.

Investment thesis

Social housing is a sector with unquestionable social credentials which benefits from strong credit quality and a rigorous regulatory regime that supports lender confidence. Despite these attractive features, however, as housing associations are facing a more challenging environment because of increasing cost pressures, it remains incumbent on us as long-term supporters of the sector to look beyond sector-wide social credentials and consider the qualities of each association. Our focus is on increasing investments to issuers with strong ESG credentials, including current performance on decarbonisation and tenant satisfaction.

One example of the active approach we take for the sector is provided by the holdings in Sage AR Funding across our Sustainable credit funds. The bonds are ultimately secured on a portfolio of 1,712 social and affordable housing units across the UK. These are modern high-quality properties, generally built between 2019 and 2021, with attractive characteristics from a sustainability perspective – a large proportion of properties has an energy performance certificate (EPC) rating of B or above, setting Sage apart from other housing associations' portfolios. The properties themselves are managed by Places for People Homes (PfP) – a large and regulated housing association that is also held in our Sustainable range.

As well as the robust cash flow credentials of the assets. the bonds benefit from direct security over the underlying properties and are rated AAA, supported by a loan-to-value of under 30%. Furthermore, due to this being a lower profile area of the sterling credit market, we were able to buy the bonds at a yield premium of around 1% over similar maturity but lower rated and unsecured investment grade bonds.

EQUITY

Agco

Industry 4.0

Security held	Agco Corporation shares
Headquarters	US
Sector	Industrials
Theme	Industry 4.0
Portfolios held	RL Sustainable Global Equity Fund RL Sustainable World Trust RL Sustainable Growth Fund RL Sustainable Diversified Trust RL Sustainable Managed Growth Trust

Company overview

Agco is a leader in the design, manufacture and distribution of agricultural machinery such as tractors, combines and sprayers and precision agricultural technology. It has a collection of brands which includes Challenger, Fendt, Massey Ferguson and Valtra.

The case for agriculture

Food production is of course socially positive and crucial. We must produce more food in the decades ahead to support growing populations, however this becomes harder to do in the face of climate change, labour shortages, degradation of arable land, increasing environmental regulation and rising costs of critical inputs like seed, fuel and fertiliser.

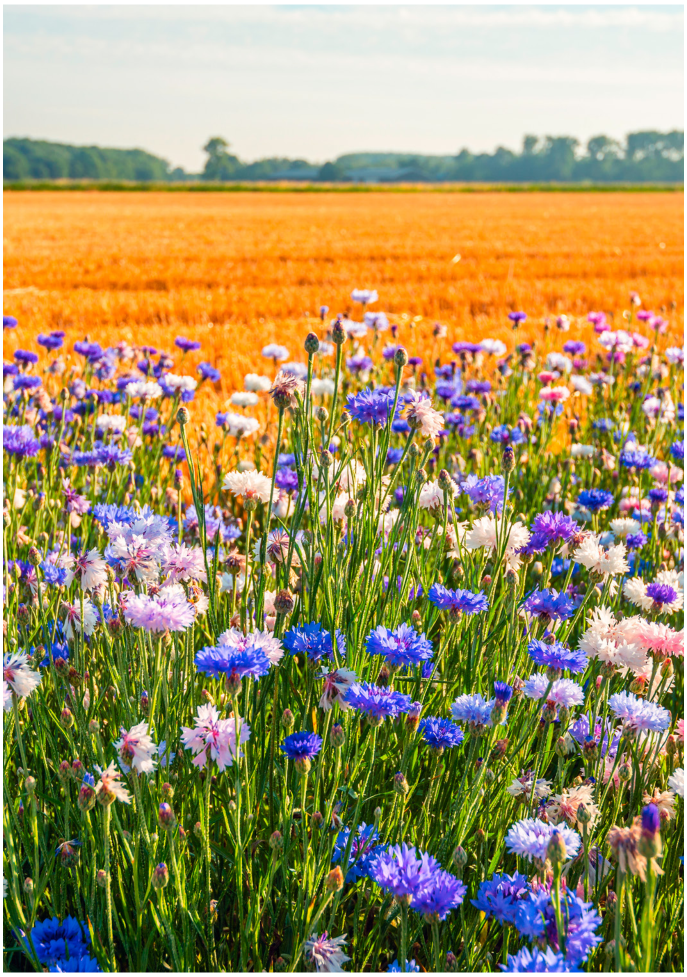
Farmers must therefore operate more efficiently, and makers of agricultural equipment can help. Higher crop yields, resulting in higher profits, because crops have been produced more sustainably are a win/win situation.

Investment thesis

Agco is the largest pure play agricultural equipment company in the world, with a focus on farmers and several strategic initiatives in place which should improve the prospects of the company. Its two main competitors, Deere and CNH, which are considerably larger, also sell equipment to other less attractive end markets, such as construction and forestry, and do not have such compelling growth stories. It is held across the Sustainable Funds.

We rate Agco's sustainability highly as it is a company where the improvement in its product portfolio and own operations is likely to have an especially material financial impact.

Product innovation is driven by feedback from farmers. One example is the Massey Ferguson 9S Series tractor. Farmers said that what they liked about previous iterations was the reliability, manoeuvrability, fuel consumption and grip, but that what they would like to be improved was the lack of horsepower, air conditioning system and the lack of hydraulic and cooling capabilities. Massey Ferguson addressed these concerns, as well as improving turning radius, increasing oil flow at low engine speed to reduce fuel consumption by 30% and introducing a continuous tyre inflation system which reduces soil compaction and maximises tractor efficiency. Better reliability of equipment avoids disruption to farmers' operations, as well as reducing the warranty cost to Agco.



Another innovation on the precision farming side is the Precision Planting SymphonyNozzle, which enables better control of rate and pressure of spraying which results in much less product being used/wasted. Improving spraying accuracy and reducing chemical costs, also means that less is lost to drift or ends up in waterways. The nozzle is easy to install and simple to service.

These are products with obvious benefits to the farmer. When making purchasing decisions, farmers want to know what something is worth to them in terms of increased yield or reduced operating cost, as well as the payback period of the product. Boosting the value proposition for farmers means that Agco can maintain attractive margins on their products.

On the operational side, manufacturing heavy industrial equipment like tractors is very resource intensive, which is to say that it is expensive and has a large environmental footprint. Reducing cost and growing profitability are helping the company's financial and sustainable credentials.

In 2022, Agco reduced the emissions intensity of its manufacturing operations by 31% compared to its 2020 baseline. At Massey Ferguson's plant in France (recently visited by the team), operational improvement initiatives are very clear to see, with the whole production process facing scrutiny to see how things could be done in a better way.

The company's energy efficiency projects include LED lighting systems retrofit, HVAC (heating, ventilation, air conditioning) system improvements, reduction of baseload energy use and replacement of inefficient equipment. The company's safety incident rate has been improving year on year and it has a goal to be best in the industry on this important metric by 2025. Not only is this the right thing to do, it helps further improve the workplace culture that is so crucial to Agco's ongoing success.

Investment risks

Concentration risk: The price of Funds that invest in a reduced number of holdings, sectors, or geographical areas may be more heavily affected by events that influence the stockmarket and therefore more volatile.

Exchange rate risk: Changes in currency exchange rates may affect the value of your investment.

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.

Emerging markets risk: Investing in emerging markets may provide the potential for greater rewards but carries greater risk due to the possibility of high volatility, low liquidity, currency fluctuations, the adverse effect of social, political and economic instability, weak supervisory structures and accounting standards.

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.

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.

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.

Efficient Portfolio Management (EPM) techniques: 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.

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. Inflation risk: Where the income yield is lower than the rate of inflation, the real value of your investment will reduce over time.

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.

Responsible Investment Style Risk: The Fund can only invest in holdings that demonstrate compliance with certain sustainable indicators or ESG characteristics. This reduces the number securities in which the Fund can invest and there may as a result be occasions where it forgoes more strongly performing investment opportunities, potentially underperforming non-sustainable funds.

Contact us

For more information about our range of products and services, please contact us.

Royal London Asset Management
80 Fenchurch Street,
London, EC3M 4BY

For advisers and wealth managers
bdsupport@rlam.co.uk
020 3272 5950

For institutional client queries
institutional@rlam.co.uk
020 7506 6500

www.rlam.com

We are happy to provide this document in Braille, large print and audio.

Issued in February 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.

Ref: PDF RLAM PD 0173

ROYAL LONDON
ASSET MANAGEMENT

120977 01 2024