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# Royal London Global High Yield Bond Funds

Fund Manager Commentary

**31 August 2024**

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The purpose of this report is to provide an update on the Royal London Fixed Income Funds. The report has been produced by Royal London Asset Management. The report starts with a performance summary followed by Fund Manager commentary for each of the Funds. All data within this report is at the report date unless otherwise stated.

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# Performance

	1 month (%)	Rolling 12 months (%)
<b>RL Global High Yield Bond Fund M Inc</b>	<b>1.32</b>	<b>10.39</b>
<b>RL Global High Yield Bond Fund Z Inc</b>	<b>1.32</b>	<b>10.61</b>
ICE BofA ML BB-B Global Non-Financial High Yield Constrained Index	1.42	12.11
IA Sterling High Yield Sector	1.32	11.93
<b>RL Short Duration Global High Yield Bond Fund A Inc</b>	<b>0.77</b>	<b>7.57</b>
<b>RL Short Duration Global High Yield Bond Fund M Inc</b>	<b>0.80</b>	<b>7.99</b>
<b>RL Short Duration Global High Yield Bond Fund Z Inc</b>	<b>0.82</b>	<b>8.12</b>
Sterling Overnight Index Average Rate (SONIA) <sup>1</sup>	0.41	5.19
IA Sterling High Yield Sector	1.32	11.93

**Past performance is not a guide to future performance. The value of investments and the income from them is not guaranteed and may go down as well as up and investors may not get back the amount originally invested.**

Source: RLAM and Morningstar, as at 31 August 2024. Returns quoted are net of fees. Please note that with effect from 1 February 2024 RLAM are using peer group comparisons provided by Morningstar. Prior to this peer comparisons were provided by Lipper so there may be some differences compared to the data provided historically. All IA sector performance shown is for the median.

# Royal London Global High Yield Bond Fund

## Portfolio commentary

The fund returned 1.38% (gross of fees) in August versus the benchmark, the ICE BofA Merrill Lynch BB-B Global Non-Financial High Yield Constrained Index (100% GBP hedged), return of 1.42%. Net of fees (Z Inc) the fund returned 1.32%. Against the fund's objective, outperforming its benchmark by 1% per annum over rolling three-year periods, it is behind of the benchmark, gross of fees (0.27% versus 0.82%).

For the fourth consecutive month the global high yield market produced a positive return. In August, the market produced a GBP-hedged monthly return of 1.42% with the primary contributor during the month being the government yield curve which fell 20bps. The government yield curve has now fallen 86bps over the last four months. Global High Yield spreads (BB-B index) tightened 6bps during the month. The high yield market is now yielding 6.41% (YTW) with a duration of 3.5 years.

Following the move in the government yield curve, the fund sold the majority of its investment grade assets as their prices had rallied. The fund replaced these holdings with high yield assets. As a result, the fund's FX-adjusted yield stood at 7.50% at the end of August - an increase of 0.23% on the month - with a duration of 3.4 years.

Although August is typically a quieter month for new issuances with many people on holiday, the Global High Yield market saw \$20.7bn of new issuance, the highest August total since 2021. This brings the year-to-date figure to \$321.2bn (+\$143.7bn as compared with this period in 2023).

The US high yield default rate inched lower for the fourth consecutive month in August, falling to 1.7% from 1.8% in July. The rate posted in August rate is now the lowest mark since February 2023. The US high yield default rate has now been sitting in a range between 1.7% and 2.6% since February 2023. For comparison, during the GFC the default rate was seen over 20% and it was over 7% during the Covid pandemic. The global high yield rate was steady at 2.2% from July and is lower than the 2.9% seen in August last year.

These default levels would be entirely normal in an historic context, but the nature of the economic backdrop and strong company balance sheets means we expect default rates to grind higher, instead of sharply spiking.

In the fund, our strongest contributors versus the benchmark was our holdings in basic industry, media and telecommunications, while our real estate and utility bonds were a drag for performance versus the benchmark. The fund's total returns were broad based, with financial services and utilities the relative outperformers. By rating, our overweight position in B rated bonds contributed strongly during the month while our BB holdings were behind the benchmark. While outside the benchmark, both our BBB & Above and CCC & Below holdings contributed positively. By region, all areas saw a positive total performance, with our US holdings the relative outperformer.

For the market, all regions produced positive and comparable returns during the month. With respect to sectors, all sectors produced positive returns real estate being a relative outperformer.

**\*Yield-to-worst refers to the redemption date that produces the lowest return**



**Azhar Hussain**

Head of Global Credit



**Stephen Tapley**

Senior Fund Manager

# Royal London Global High Yield Bond Fund continued

## Investment outlook

High yield fundamentals are well supported and that has resulted in a very moderate default climate up to now. Current US high yield default rates are very low, sitting below 2%, with global defaults below 3%. While companies are relatively comfortable with the position that credit spreads are not going to be too volatile, and they have a good handle on the strength of their balance sheets, we can see a scenario where current tight spreads tighten further – with not many new issues and yields remaining high.

As spreads tighten, there becomes a perception that the high yield market is risky for investors, but we feel this does not tell the full story. The fundamentals in the market are considerably better than previously with the quality of names improving. We believe that the combination of attractive valuations, robust fundamentals, and the fact that macro headwinds have abated with the US monetary tightening cycle coming to an end, provides a constructive environment for 2024 and 2025.

In our view, the way through markets is to focus on those risks that you can control and know what you own. We will keep spread duration low and focus on the quality of issuers' financials, rather than relying on third-party ratings: at a sectoral level, cashflows are the key factor, meaning we need to know about on- and off-balance sheet leverage. We prefer not to wait for defaults as the recovery process can take time: however, should they occur, the key is to have an adequate solvency cushion.

We still believe 2024 should play out similarly to 2023: maturity wall concerns being overplayed; companies holding high liquidity; private debt markets eating the bottom cohort of public markets; public markets remaining open, with solid issuance levels. As long as public markets stay open, any maturity wall concerns will be swept away. And, as long as private markets are taking away the weakest parts of public markets, we believe defaults should stay low.

## Key views within the fund

The fund's objective is to achieve a combination of capital growth and income. The fund seeks to achieve its investment objective by outperforming its benchmark, the BofA Merrill Lynch BB-B Global Non-Financial High Yield Constrained index, 100% hedged to sterling, by 1% per annum over rolling three-year periods.

The fund seeks to mitigate stock-specific risk by holding a diversified portfolio of investments, so that no individual investment can, in isolation, have an excessive adverse impact on overall fund performance. Currency risk associated with holdings of bonds is hedged through the use of forward currency transactions.

We expect market volatility to continue due to market expectations surrounding Federal Reserve monetary policy. As such, we believe bonds with near-term catalysts, which mitigate market risk, are an important attribute underpinning investment performance over the medium term.

# Royal London Short Duration Global High Yield Bond Fund

## Portfolio commentary

The monthly return was 0.86%, gross of fees, in August, while the benchmark returned 0.41%. Net of fees (Z Inc), the fund returned 0.82%.

For the fourth consecutive month the global high yield market produced a positive return. In August, the market produced a GBP-hedged monthly return of 1.42% with the primary contributor during the month being the government yield curve which fell 20bps. The government yield curve has now fallen 86bps over the last four months. Global High Yield spreads (BB-B index) tightened 6bps during the month. The high yield market is now yielding 6.41% (YTW) with a duration of 3.5 years.

The fund's GBP-expected FX-adjusted yield decreased by 17bps to 6.74% with an expected duration of 1.1 years.

Although August is typically a quieter month for new issuances with many people on holiday, the Global High Yield market saw \$20.7bn of new issuance, the highest August total since 2021. This brings the year-to-date figure to \$321.2bn (+\$143.7bn as compared with this period in 2023).

The US high yield default rate inched lower for the fourth consecutive month in August, falling to 1.7% from 1.8% in July. The rate posted in August is now the lowest mark since February 2023. The US high yield default rate has now been sitting in a range between 1.7% and 2.6% since February 2023. For comparison, during the GFC the default rate was seen over 20% and it was over 7% during the Covid pandemic. The global high yield rate was steady at 2.2% from July and is lower than the 2.9% seen in August last year.

These default levels would be entirely normal in an historic context, but the nature of the economic backdrop and strong company balance sheets means we expect default rates to grind higher, instead of sharply spiking.

For the market, all regions produced positive and comparable returns during the month. With respect to sectors, all sectors produced positive returns real estate being a relative outperformer.

Decomposing the funds' assets: all regions produced positive returns with the Rest of the World assets outperforming on a relative basis. By rating, BB and single B assets produced similar positive returns. During the month all sectors also produced positive returns with no significant relative out/underperformers. Asset composition by region and rating were both broadly unchanged on the month.

Asset composition by region and rating were both broadly unchanged on the month.

During August the fund lost its holding in Constellium as the bond was redeemed by the company. The fund also sold its position in Rolls-Royce post its ratings upgrade to investment grade. New positions were added in Burger King, Edgewell Personal Care, Organon & Co and Univision. Cash was also spent on adding to existing holdings.

Overall, the cash level was 1.6% at end of the month.

Fund NAV was £1.25bn (+£13m on the month).

**\*Yield-to-worst refers to the redemption date that produces the lowest return**



**Azhar Hussain**

Head of Global Credit



**Stephen Tapley**

Senior Fund Manager

# Royal London Short Duration Global High Yield Bond Fund continued

## Investment outlook

High yield fundamentals are well supported and that has resulted in a very moderate default climate up to now. Current US high yield default rates are very low at around 2-3%, with global defaults not much higher, and we expect this to track to 3%-5% over the course of next year. We expect that most high yield issuers will wait for interest rates to recede from their relatively high levels before returning to the tap markets. They are relatively comfortable with the position that credit spreads are not going to be too volatile, and they have a good handle on the strength of their balance sheets.

Companies are becoming less focused on the US Federal Reserve as they adapt to the 'higher for longer' environment. With monetary policy lags appearing longer than they used to be there is some recognition by central banks that policy tightening needs time to work and that the impacts of policy tightening are still feeding through. This is causing spreads to tighten as investors are now convinced the fallout won't be coming until late 2024 or early 2025.

In our view, the way through difficult markets is to focus on those risks that you can control and know what you own. We will keep spread duration low and focus on the quality of issuers' financials, rather than relying on third-party ratings: at a sectoral level, cashflows are the key factor, meaning we need to know about on- and off-balance sheet leverage. We prefer not to wait for defaults as the recovery process can take time: however, should they occur, the key is to have an adequate solvency cushion.

We still believe 2024 should play out similarly to 2023: maturity wall concerns being overplayed; companies holding high liquidity; private debt markets eating the bottom cohort of public markets; public markets remaining open, with solid issuance levels. As long as public markets stay open, any maturity wall concerns will be swept away. And, as long as private markets are taking away the weakest parts of public markets, we believe defaults should stay low.

With yields at current levels and appealing potential returns, we will be paid sufficiently for maintaining a lower-risk position for at least another quarter until there is more clarity about the outlook. In keeping with the core focus of the strategy, we will keep duration low and focus on the quality of issuers' financials, rather than relying on third-party ratings. At a sectoral level, cashflows are the key factor and we continue to favour companies with contracted revenues. With regards to geography, our global outlook provides diversification away from country-specific risks.

## Key views within the fund

The fund's objective is to provide income. The manager seeks to achieve this by outperforming the benchmark, SONIA, by 2% per annum over rolling three-year periods.

The fund is diversified in order to improve overall portfolio liquidity and to reduce the effect on overall fund performance of any deterioration in the creditworthiness of an individual holding.

We expect market volatility to continue due to market expectations surrounding Federal Reserve monetary policy. As such, we believe bonds with near-term catalysts, which mitigate market risk, are an important attribute underpinning investment performance over the medium term. There seems little chance of a near-term resolution of the conflict in Ukraine – this also has significant implications for the global economy, particularly if ongoing higher energy prices and supply chain disruption exacerbate a global economic slowdown.

# Disclaimers

## Important information

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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 Market Act 2000.

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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](http://www.rlam.com).

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# Risk 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.

## 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.

## 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.

## 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.

## 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.

## Derivative risk

The 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.

## 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.

## 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.

## Sub-investment grade investment risk

Lower rated investment grade securities may have large uncertainties or major risk exposures to adverse conditions. The market value of securities in lower rated investment grade categories is more volatile than that of higher quality securities, and the markets in which these securities are traded are less liquid than those in which higher rated securities are traded.

## Unrated bond risk

Non-rated bonds may have the characteristics of either investment or sub-investment grade bonds. Market activity in unrated securities and instruments may be low for a considerable period of time and this may impact on liquidity.

# Performance to 31 August 2024

## Cumulative (%)

		3 Month	6 Month	1 Year	3 Years	5 Years
RL Global High Yield Bond Fund M Inc	Gross	3.74	4.62	11.29	0.82	14.63
RL Global High Yield Bond Fund M Inc	Net	3.55	4.21	10.39	-1.64	10.05
RL Global High Yield Bond Fund Z Inc	Gross	3.74	4.61	11.25	0.81	14.69
RL Global High Yield Bond Fund Z Inc	Net	3.60	4.31	10.61	-0.92	11.47
RL Short Duration Global High Yield Bond Fund A Inc	Gross	2.57	4.02	8.64	11.64	16.18
RL Short Duration Global High Yield Bond Fund A Inc	Net	2.31	3.51	7.57	8.37	10.63
RL Short Duration Global High Yield Bond Fund M Inc	Gross	2.56	4.02	8.63	11.63	16.16
RL Short Duration Global High Yield Bond Fund M Inc	Net	2.41	3.71	7.99	9.67	12.85
RL Short Duration Global High Yield Bond Fund Z Inc	Gross	2.57	4.03	8.64	11.64	16.18
RL Short Duration Global High Yield Bond Fund Z Inc	Net	2.45	3.78	8.12	10.04	13.48

## Annualised (%)

	3 Years (p.a)	5 Years (p.a)
	0.27	2.77
	-0.55	1.93
	0.27	2.78
	-0.31	2.19
	3.74	3.04
	2.71	2.04
	3.73	3.04
	3.12	2.44
	3.73	3.04
	3.24	2.56

## Year on year performance (%)

		30/06/2023 – 30/06/2024	30/06/2022 – 30/06/2023	30/06/2021 – 30/06/2022	30/06/2020 – 30/06/2021	30/06/2019 – 30/06/2020
RL Global High Yield Bond Fund M Inc	Gross	9.95	5.71	-15.11	15.15	-0.56
RL Global High Yield Bond Fund M Inc	Net	9.05	4.83	-15.82	14.20	-1.32
RL Global High Yield Bond Fund Z Inc	Gross	9.92	5.71	-15.11	15.23	-0.56
RL Global High Yield Bond Fund Z Inc	Net	9.29	5.10	-15.60	14.57	-1.07
RL Short Duration Global High Yield Bond Fund A Inc	Gross	7.92	8.91	-6.13	5.86	-1.67
RL Short Duration Global High Yield Bond Fund A Inc	Net	6.85	7.83	-7.06	4.82	-2.57
RL Short Duration Global High Yield Bond Fund M Inc	Gross	7.92	8.91	-6.13	5.87	-1.68
RL Short Duration Global High Yield Bond Fund M Inc	Net	7.28	8.27	-6.69	5.25	-2.19
RL Short Duration Global High Yield Bond Fund Z Inc	Gross	7.93	8.91	-6.13	5.86	-1.67
RL Short Duration Global High Yield Bond Fund Z Inc	Net	7.41	8.38	-6.58	5.35	-2.08

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 August 2024. All figures are mid-price to mid-price in GBP unless otherwise stated.