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# Royal London Diversified Asset-Backed Securities Fund

Quarterly Investment Report

31 December 2024



# Quarterly Report

## The fund as at 31 December 2024

The purpose of this report is to provide an update on the Royal London Diversified Asset-Backed Securities 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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# The fund

## Fund performance objective and benchmark

The Fund's investment objective is to achieve a positive absolute return in all market conditions over rolling 3-year periods, by predominantly investing in asset-backed securities and other sterling-denominated corporate bonds. The Fund's performance target is to outperform, before the deduction of charges, the Bank of England Sterling Overnight Interbank Average (SONIA) plus 2% per annum over rolling 3 year periods. The benchmark is considered suitable as it is consistent with how the Fund is managed in seeking to provide a "cash plus" performance outcome.

Benchmark: SONIA (Sterling Overnight Index Average)

## Fund value

	Total £m
31 December 2024	314.58

## Asset allocation

	Fund (%)
Conventional credit bonds	96.76
Conventional gilts	1.70
Index linked credit bonds	1.37
Conventional foreign sovereigns	0.16

## Fund analytics

	Fund
Fund launch date	24 September 2012
Base currency	GBP
Duration (years)	0.84
Gross redemption yield (%)	6.31
Number of holdings	312
Number of issuers	205

# Performance and activity

## Performance

	Fund (%)	Benchmark (%)	Relative (%)
Quarter	2.54	1.19	1.35
1 Year	8.49	5.07	3.42
3 Years (p.a.)	6.27	3.67	2.59
5 Years (p.a.)	5.36	2.24	3.12
10 Years (p.a.)	4.29	1.41	2.88
Since inception (p.a.)	4.41	1.25	3.16

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 Z Acc GBP. Source: Royal London Asset Management; Gross performance; Since inception date of the share class is 24 September 2012.

## Performance commentary

The fund recorded a strong return in the quarter, significantly outperforming its benchmark.

The fund's diversified nature was reflected in the diversity of performance drivers in the quarter and helped to effectively dampen risk despite volatile markets.

Overarching hedging of interest rate risk helped to protect returns even though yields rose significantly over the period. Although the fund's small long duration position marginally reduced overall performance this was more than offset by the fund's strong income generation.

Actively selected spread duration within secured bonds, including CMBS and ABS sub sectors, where spreads tightened also contributed. Certain bonds held within the banking, real estate and insurance sectors also performed strongly.

After some recent underperformance, bonds in the water sector benefited from significant spread tightening after Ofwat released their final regulatory determination in December, which saw an improvement in allowable returns compared to the draft release in the summer.

The greater return visibility for the sector should allow for further spread tightening over time. We also expect to see more issuance as the water firms look to fund a large increase in infrastructure spending over the next regulatory period.

The fund also benefited from an early redemption of its holdings in Annington Funding at a premium to market pricing.

Central to the fund's investment strategy is sourcing the best assets across both secured bonds and securitisations. Our relatively recent acquisition of a floating rate CMBS bond called Euro 38, which is secured on Aldgate Tower in London, at a price significantly below par proved well timed as the issuer announced an early redemption of the bond at par during the quarter.

Outside of secured bonds, our long-held exposure to subordinated bonds issued by the UK insurance company, Direct Line was also helpful, with their bonds benefiting from a re-rating following the announcement of the takeover by Aviva. Elsewhere in the financial sector, HSBC redeemed their legacy tier 1 USD denominated debt at a significant premium to markets, with the fund positioned to continue benefiting from continuing take outs of legacy instruments.

# Performance and activity

## Top 10 holdings

	Weighting (%)
UNITED KINGDOM OF GREAT BRITAIN AN 3.5 22 Oct 2025	1.61
DWR CYMRU (FINANCING) LTD. 4.377 31 Mar 2026	1.24
BARCLAYS BANK PLC 6.278 31 Dec 2079	1.22
LEGAL & GENERAL GROUP PLC 5.5 27 Jun 2064	1.22
HSBC BANK FUNDING STERLING LP 5.844 31 Dec 2079	1.21
BRITISH LAND CO PLC 5.264 24 Sep 2035	1.13
PROGRESS HEALTH 5.581 02 Oct 2042	1.07
PARKMORE POINT RMBS 2022-1 PLC 4.7 25 Jul 2045	0.93
TRAFFORD CENTRE FINANCE LTD A3 4.7 28 Jul 2038	0.90
TELEREAL SECURITISATION PLC 4.7 10 Dec 2033	0.90
<b>Total</b>	<b>11.41</b>

## Fund activity

The new issue market was relatively subdued during the fourth quarter, and indeed for 2024 as a whole, across both corporate bond and securitisation markets.

During the quarter, we did add to a new issue from gas distributor Northern Gas Networks, which forms an essential part of the UK's infrastructure, where around three-quarters of households still rely on mains gas for heating.

We also added a new issue from Italian gas utility giant Snam, which is a debut issuer in the UK and, as well as providing useful diversification for the fund, also paid us a premium against more established utility issuers.

Elsewhere within utilities space, we added to Southern Water debt, where spreads overcompensated for risk, particularly in low cash price 2037 debt whilst taking profit on earlier buys within Thames Water. We also added to South East Water at very attractive levels.

Within the secured space, we took part in a new floating rate note issue from UK Logistics – with the bonds secured against a total of 63 logistics properties spread throughout the UK and positioned in close proximity to urban centres.

These are AAA rated bonds that came at a spread of more than double the spread on the average A rated corporate bond, further demonstrating the portfolio advantage of looking beyond fixed rate bond indices for additional return opportunities.

We remain active in secondary markets, searching out compelling, and often idiosyncratic, investment opportunities. For instance, we were able to add bonds from Channel Link Enterprises in the secondary market. These are super senior long-dated, floating rate bonds secured on the company's assets, namely the concession to operate the Channel Tunnel. The bonds yield more than double the typical spread on corporate bond indices, which are largely unsecured in nature, despite the clear credit enhancements.

Similarly, we were able to source bonds from preferred issuers Telereal – secured on BT telephone exchanges – and Derby Healthcare, a highly rated bond secured on a PFI contract to operate and maintain a hospital, which also pay above market spreads despite strong fundamentals.

Our approach also involves effecting switches or trades that enhance returns, reduce risk, or a combination of the two. Examples during the fourth quarter included a switch from the more concentrated UK property company, Great Portland Estates, into Blackstone Property Partners Europe, a widely diversified real estate vehicle, adding 17bps of spread. It remains vital to this approach that we are close to the specifics of the bonds we buy.

# Performance and activity

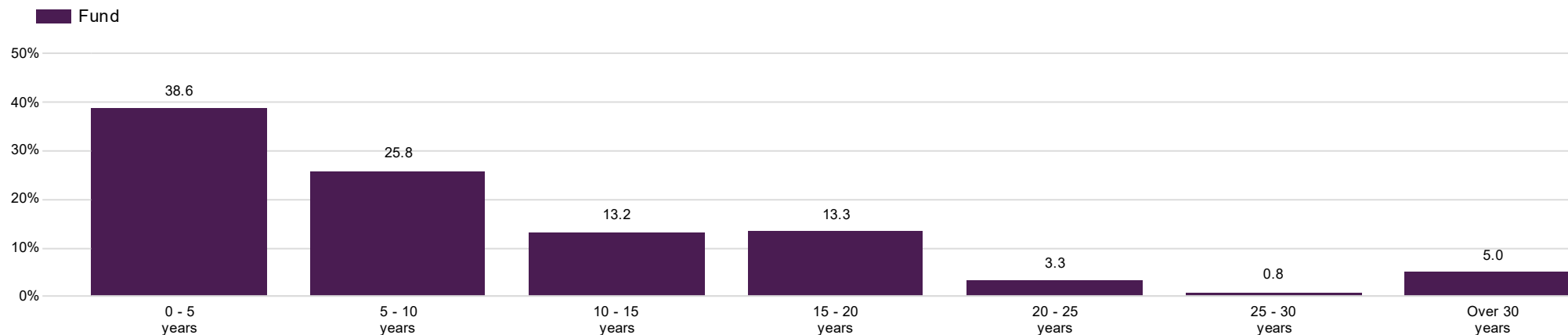
## Fund activity (continued)

As an illustration, we sold London & Quadrant's 2029 bonds into their 2032 bonds during the quarter, adding around 30bps of additional spread. This was achieved despite no change in fundamentals, as we had identified that the market was not pricing in a mandatory increase in the 2032 bond issue's coupon, following the housing association's failure to meet sustainable KPI requirements that only existed in this specific bond.

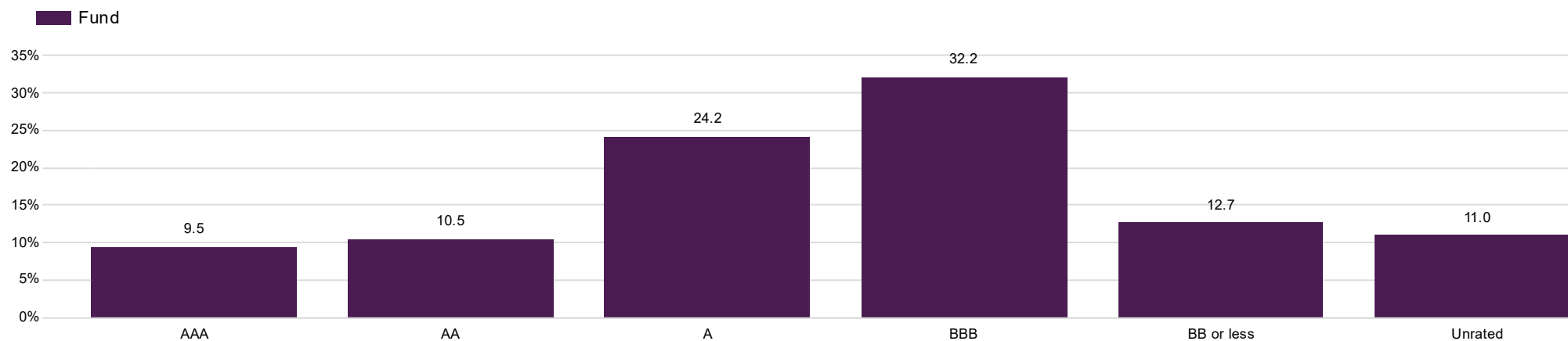
Within the legacy financial space, we added to Generali and HSBC debt during the quarter.

# Fund breakdown

## Maturity profile

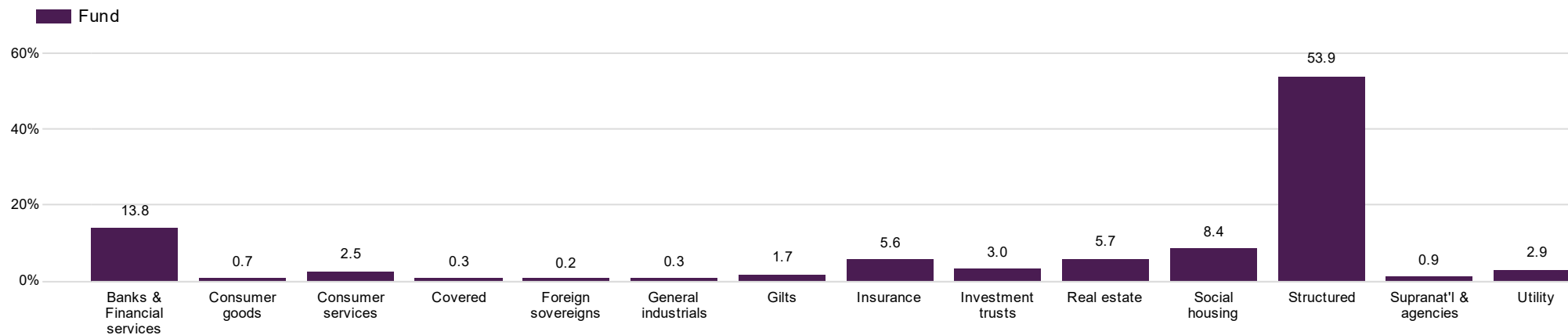


## Credit ratings



# Fund breakdown

## Sector 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	14	30
Number of engagements	17	67

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



<b>Biodiversity</b>	<b>1</b>
<b>Climate</b>	<b>9</b>
Climate - Transition Risk	8
Climate - Physical Risk	1
<b>Governance</b>	<b>4</b>
Corporate Governance	3
Remuneration	1
<b>Health</b>	<b>4</b>
Mental Health	4
<b>Social &amp; Financial Inclusion</b>	<b>4</b>
Just transition	2
Social & Financial inclusion	2

The numbers of engagements and themes/topics discussed may differ where a single engagement covers multiple themes/topics.

## Engagement focus

Firm-wide engagement activity is centred around six themes which we have identified in consultation with our clients. These are: climate change; nature and 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

### Barclays Plc - Just transition

#### Purpose:

We met with Barclays's, a UK multinational bank, Sustainability team as part of our collaborative engagement with banks on just transition, aiming to integrate this issue throughout its net zero plan and address questions regarding our recently published investor expectations.

#### Outcome:

The meeting with Barclays's Sustainability team was positive, providing valuable feedback on our investor expectations. Barclays acknowledged the importance of just transition integration and identified it as a key area in its human rights assessment. The company is incorporating just transition into products like greener home rewards and green mortgages. The bank's decarbonisation target for the mortgage sector aims to avoid restricting financing for those in need. Just transition is also part of its transition finance framework. Barclays is refining just transition in commercial lending and recognises its importance in North America, aligning with our guidelines. We will continue to monitor the bank's disclosures on just transition and will look to assess the bank against our investor expectations in the future.

### Electricite De France SA (EDF) – Net zero

#### Purpose:

We met with EDF's, a French multinational electric utility company, Head of ESG Performance team to discuss its latest results in the Climate Action 100+ (CA100+) benchmark and discuss our 2025 engagement priorities with the company.

#### Outcome:

EDF performed well in the CA100+ benchmark, showing improvements across several areas. The company is working on clarifying its Scope 3 emissions reduction trajectory, detailing short, medium, and long-term goals. EDF maintains a low carbon intensity in electricity and heat production, which is sometimes under-recognised in CA100+ assessments. Due to EU Taxonomy classification issues related to its UK nuclear assets, specific green CAPEX numbers have not been published, but we will be assessing for improved company disclosures next year. We will continue to engage with EDF to discuss its updated Scope 3 decarbonisation pathways.

# Fund Engagement

## Engagement outcomes

### Lloyds Banking Group Plc - Just transition

#### Purpose:

We met with Lloyds Banking Group, UK-based financial services group, as part of our collaborative engagement with banks on just transition, aiming for the bank to integrate this issue throughout its climate transition plan and demonstrate implementation at product, sector, and regional levels.

#### Outcome:

Lloyds Banking Group continues to view just transition as integral to the company's purpose and growth strategy. The positive call highlighted several innovative projects, supporting its alignment with just transition principles. Lloyds found our investor expectations helpful but noted that a sector lens might miss interdependencies, advocating for a system-based approach instead. The company provided examples of just transition integration across various systems, such as sustainable farming, greening the built environment, low carbon transport, and energy transition.

Lloyds has launched several innovative products aligned with just transition, including a £500mn social housing retrofit product. Lloyds have developed a roadmap with the Green Finance Institute and NatWest for property-linked finance for retrofit projects. The bank's regional approach to lending addresses challenges in across the UK, with initiatives like working with local authorities to tackle local issues, expected to create jobs and reduce regional inequalities. Combined with balance sheet lending for regional projects, Lloyds' approach appears relatively advanced.

# Market commentary

## Market overview

Markets were volatile during the fourth quarter – with the US elections and the potential for central bank rate cuts the main causes of uncertainty. With the election of Donald Trump as US President, and the Republicans having a majority in both the Senate and House of Representatives, markets moved to price in potentially higher US deficits.

Alongside political events, attention remained on the Federal Reserve, European Central Bank and Bank of England to see if expected rate cuts would materialise. However, with inflation remaining higher than central bankers would like, expectations for rate cuts in 2025 were revised down. This backdrop pushed government bond yields higher, leading to negative absolute returns for most investment grade credit markets despite credit spreads tightening and credit excess returns over government bonds being positive, while equities ended a strong 2024 with another positive quarter, with US stocks – notably the ‘magnificent seven’ – leading the way.

At its final meeting of 2024, and as expected, the Bank of England kept rates on hold at 4.75%. Meanwhile, according to the minutes, “a gradual approach to removing monetary policy restraint remains appropriate.” Away from economic data, the new Labour government presented its first budget. This was less obviously a budget for growth than one for public services repair with a substantial proposed increase in day-to-day fiscal spending and net investment. Public spending was increased substantially, but at the cost of a big increase in taxes. Since the Budget, business optimism has dropped, and firms are indicating a mix of responses to the rise in National Insurance contributions including hiring less and raising prices.

The Federal Reserve cut rates 50bps over the quarter to a 4.25% - 4.5% target range. They signalled fewer cuts for 2025 than previously indicated, indicating only 50bps cuts for 2025 (100bps previously). In November, Donald Trump was elected US President for the second time. A Trump presidency will likely bring a change in both policy making style and substance. It was a clean sweep for the Republicans, winning the White House, Senate and House of Representatives, increasing the prospects of Trump getting his fiscal policies through.

As widely expected, the European Central Bank’s final decision of the year saw another 25bps rate cut, taking the deposit rate to 3.00%.” The picture for activity outside Germany and France was somewhat better than for those two economies, with both France and Germany affected in recent months by political/policy uncertainty.

Government bond yields rose over the quarter, as central banks continued to struggle to bring inflation back to target levels and amid ongoing political volatility with elections across Europe and the US. In the US, 10-year treasury yields rose to 4.57% from 3.78%, while German 10-year

bunds similarly saw yields rise to 2.36% from 2.06%. Benchmark 10-year gilt yields increased to 4.57% from 4.01%.

The sterling investment grade credit market (iBoxx non-gilt index) returned -0.49% over the quarter, with the average sterling investment grade credit spread (the average extra yield available from non-gilt bonds compared with government debt of equal maturity) tightening over the period from 1.03% to 0.86% (iBoxx). The negative absolute return was broad based across the sterling investment grade credit market with the only sectors seeing positive returns being banks and real estate, with both markets benefitting from the potential of higher interest rates for longer. Consumer services and social housing were the relative laggards.

## Outlook

Perhaps the most unexpected aspect of UK fixed income markets in 2024 was the rise in gilt yields. Markets started the year expecting that falling inflation would lead to a number of rate cuts that would drag the entire UK curve lower. In the event, although we got two rate cuts, these really only impacted the short end – with longer yields pushed higher, first because inflation did not come down as expected and Trump presidency is widely seen as more inflationary, and second because issuance is going to be higher than expected. As a result, UK 30-year gilt yields are now at 25-year highs.

UK investment grade markets mostly mitigated the negative impact of higher underlying yields with higher carry and tightening credit spreads. As this point, with these back towards pre-GFC levels, it is reasonable to ask whether spreads have moved too far. In our view, given current expectations for the global and UK economies, we continue to believe that current spread levels more than compensate investors for default risk as evidenced by historic default rates in investment grade markets. However, the compression seen in credit markets over the last two years has shifted the relative attraction of higher beta exposure compared to lower risk government related exposure. We are conscious of the significant nature of moves and continue to be mindful of this within stock selection.

We believe that sterling investment grade all-in yields (using iBoxx) at over 5% remain attractive but the relative attraction between gilt and credit spread has changed, with a larger component of the yield being sought from government bond yields. We remain confident that we can further achieve an attractive yield premium in our portfolios, as we look to exploit market inefficiencies, with long-standing belief such as the undervaluing of security now augmented by newer inefficiencies such as the ‘mechanised’ approaches used by annuity providers that treat credit as a homogenous commodity area, buying in a relatively price insensitive manner. Experience suggests that this is not a good way to create long-term value for investors.

## Further Information

Please click on the links below for further information:



### 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](http://www.rlam.com), including regular updates from our Fixed Income, Global Equity, Sustainable and Multi Asset teams.

# Disclaimers

## Important information

For professional clients only, not suitable for retail clients.

This is a financial promotion and is not investment advice.

Telephone calls may be recorded. For further information please see the Privacy Policy at [www.rlam.com](http://www.rlam.com).

Issued in January 2025 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](http://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.

## 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.

## 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.

## Leverage risk

The Fund employs leverage with the aim of increasing the Fund's returns or yield, however it also increases costs and its risk to capital. In adverse market conditions the Fund's losses can be magnified significantly.

# Performance to 31 December 2024

## Cumulative (%)

## Annualised (%)

	3 Month	6 Month	1 Year	3 Years	5 Years	3 Years (p.a.)	5 Years (p.a.)
<b>Fund (gross)</b>	2.54	3.85	8.49	20.03	29.86	6.27	5.36
<b>Fund (net)</b>	2.43	3.62	8.03	18.50	26.96	5.82	4.88

## Year on year performance (%)

	31/12/2023 - 31/12/2024	31/12/2022 - 31/12/2023	31/12/2021 - 31/12/2022	31/12/2020 - 31/12/2021	31/12/2019 - 31/12/2020
<b>Fund (gross)</b>	8.49	10.57	0.05	6.08	1.99
<b>Fund (net)</b>	8.03	10.10	(0.37)	5.63	1.43

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 December 2024. All figures are mid-price to mid-price for the Royal London Diversified Asset-Backed Securities Fund Z Acc GBP share class.



# 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.

## Yield to worst

Yield to worst is a measure of the lowest possible yield that can be received on a bond that fully operates within the terms of its contract without defaulting.