

For professional clients only, not suitable for retail clients.



Royal London Sustainable Short Duration Corporate Bond 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 Sustainable Short Duration Corporate Bond 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.

Contents

The fund	3
Performance and activity	4
Fund breakdown	6
ESG	8
Market commentary	11
Further information	13
Disclaimers	14
Performance net and gross	16
Glossary	17

The fund

Fund performance objective and benchmark

The Fund's investment objective is to achieve a total return over the medium term, which should be considered as a period of 3-5 years, by predominantly investing in sterling-denominated corporate bonds, which will primarily be short-duration (5 years or less). Investments in the Fund will adhere to the Investment Manager's ethical and sustainable investment policy. The Fund's performance target is to outperform the ICE Bank of America Merrill Lynch Sterling Non-Gilt (1-5 Years) Total Return (GBP Unhedged) Index (the "Index"), after the deduction of charges, over rolling 5-year periods. The IA Sterling Corporate Bond sector is considered an appropriate benchmark for performance comparison.

Benchmark: ICE BofA 1-5 Year Sterling Non-Gilt Index

Fund value

	Total £m
31 December 2024	158.78

Asset allocation

	Fund (%)	Benchmark (%)
Conventional credit bonds	100.00	99.15
Conventional foreign sovereigns	-	0.85

Fund analytics

	Fund	Benchmark
Fund launch date	23 November 2022	
Base currency	GBP	
Duration (years)	2.99	2.64
Gross redemption yield (%)	6.18	5.10
Number of holdings	229	603
Number of issuers	149	302

Past performance is not a guide to future performance. Please refer to the glossary for a description of the yield used.

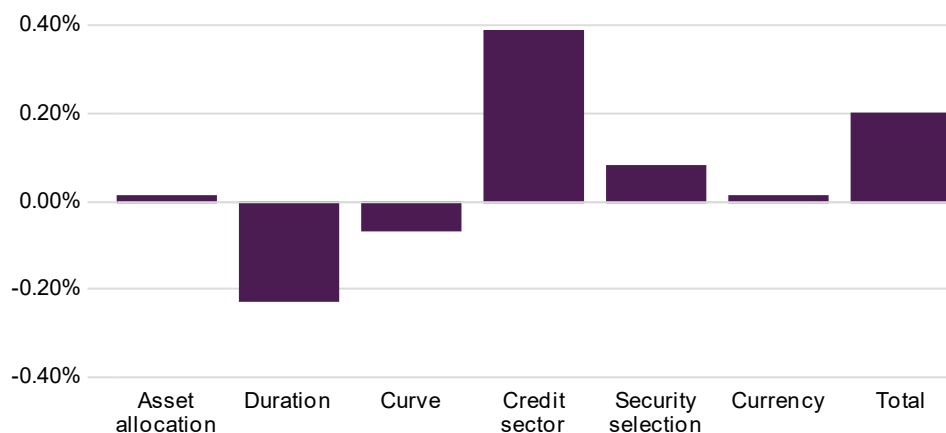
Performance and activity

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Quarter	0.79	0.55	0.24
1 Year	5.59	4.09	1.50
Since inception (p.a.)	6.75	4.99	1.76

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 23 November 2022.

Attribution over the quarter



Performance commentary

All issuers within our sustainable holdings offer a net benefit to society through either their products/services or their operations. As well as reducing risk, we seek out opportunities that are under-researched e.g., bonds that do not fall into mainstream indices or benchmarks and/or are unrated by ratings agencies. Importantly, the sustainable credit proposition provides access to critical sectors that most investors can't access via equity markets. Key themes in the funds include social housing, social & environmental infrastructure, community funding (regulated banks and building societies focused on SME and retail lending), financial inclusion & resilience (such as insurers offering products which protect individuals and businesses from unexpected events) and the energy transition. On sustainability grounds, we have no exposure to bonds of oil & gas companies or extractive industries. We are also underweight in the general industrial and consumer goods sectors, and to a lesser extent in consumer services.

The final quarter of 2024 was turbulent for fixed income investors amid a series of headwinds coming from rising government bond yields, ongoing political volatility – domestic and abroad – and differences in central bank policies. Credit spreads are at all-time tight levels, across markets, and gilt yields are at multi-decade highs. But we still believe all-in yield from credit is attractive and that the risk of downgrade or default is still well compensated at current spread levels.

Despite this, the fund was able to outperform over the quarter, driven by the diversification of the portfolio and ability to mitigate risk – where we have reduced exposure to subordinated debt in some instances. Much of the outperformance was generated by credit allocation. The overweight position in structured bonds, and underweight exposure to supranationals contributed positively. Looking at stock selection, our insurance bonds were standout performers, led by insurance perpetual bonds from Swiss RE and Esure.

The main detractor for performance was our duration positioning. The fund was long duration versus the benchmark and, as yields rose, we gave back some performance gained earlier in the year from the same positioning as yields had fallen. Gilt yields moved higher following the UK budget, where concern lingered around inflation pressures and focus then shifted to the pace of interest cuts from the Bank of England. Going forward, however, we are happy with the small long duration position, expecting gilt yields to fall over the medium term.

Performance and activity

Top 10 holdings

	Weighting (%)
LEGAL & GENERAL GROUP PLC 5.375 27 Oct 2045	2.01
INTERNATIONAL FINANCE FACILITY FOR 2.75 07 Jun 2025	1.77
SGSHR_21-1X 4.7 17 Nov 2051	1.55
BAZALGETTE FINANCE PLC 2.375 29 Nov 2027	1.36
HSBC BANK FUNDING STERLING LP 5.844 31 Dec 2079	1.35
LLOYDS BANKING GROUP PLC 6.625 02 Jun 2033	1.33
UNITE (USAF) II PLC 3.921 30 Jun 2025	1.24
NATWEST GROUP PLC 2.105 28 Nov 2031	1.21
PORTERBROOK RAIL FINANCE LIMITED 7.125 20 Oct 2026	1.19
HSBC HOLDINGS PLC 8.201 16 Nov 2034	1.18
Total	14.19

Fund activity

The water sector is part of the utilities sector that has been under greater scrutiny in recent years and in our regular reports and other updates. Late in the fourth quarter, the water regulator produced its final determination for the sector for the next five years. This was less restrictive than the draft determination, and in our view provides scope for spreads to normalise and issuance to pick up as the sector looks to fund a significant increase in capex. During the quarter, we added bonds from Yorkshire Water in the secondary market. Yorkshire is seen as a weaker issuer in the sector, but following the final determination, we feel it has a more favourable outlook than is priced into current spread levels.

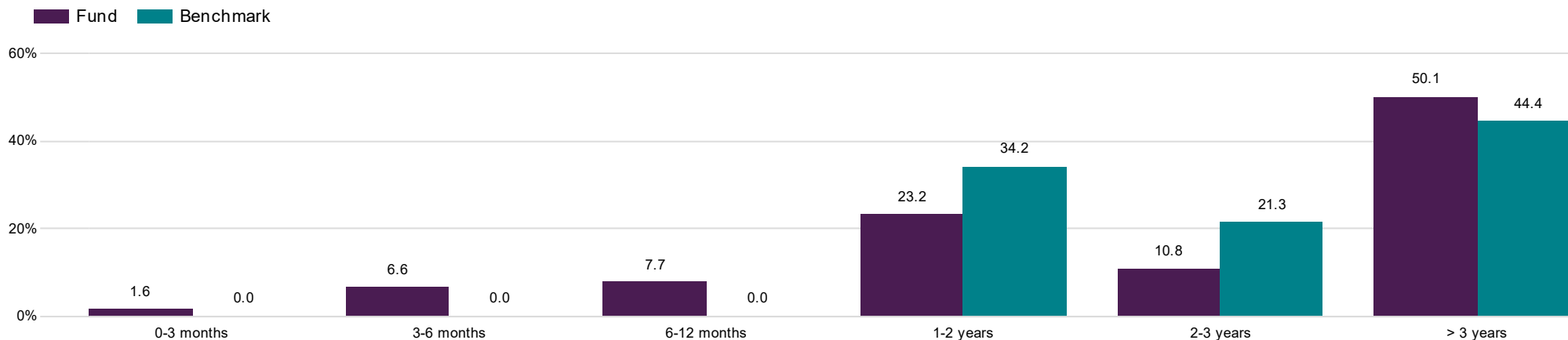
Structured bonds also remain a key component in our portfolios. During the quarter we took part in a new floating rate note issue from UK Logistics – with the bonds secured against a total of 63 logistics properties spread throughout the UK and positioned in a close proximity to urban centres, allow SMEs to reduce their direct emissions as well as transportation costs thanks to being closer to end customers. These are AAA rated bonds that came at a spread of more than double the spread on the average A rated corporate bond and show the value available in non-index issues.

We also added 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, which represents a key economic link between the UK and Europe. The bonds yield more than 2% over equivalent gilts. Although it may not be immediately apparent, the Channel Tunnel facilitates a reduction in emissions. Freight transported via rail through the tunnel is estimated to produce 12 times lower emissions compared to transport via ferry across the Channel. The bonds yield more than 2% over equivalent gilts, as well as benefiting from a senior position relative to other Channel Tunnel lending.

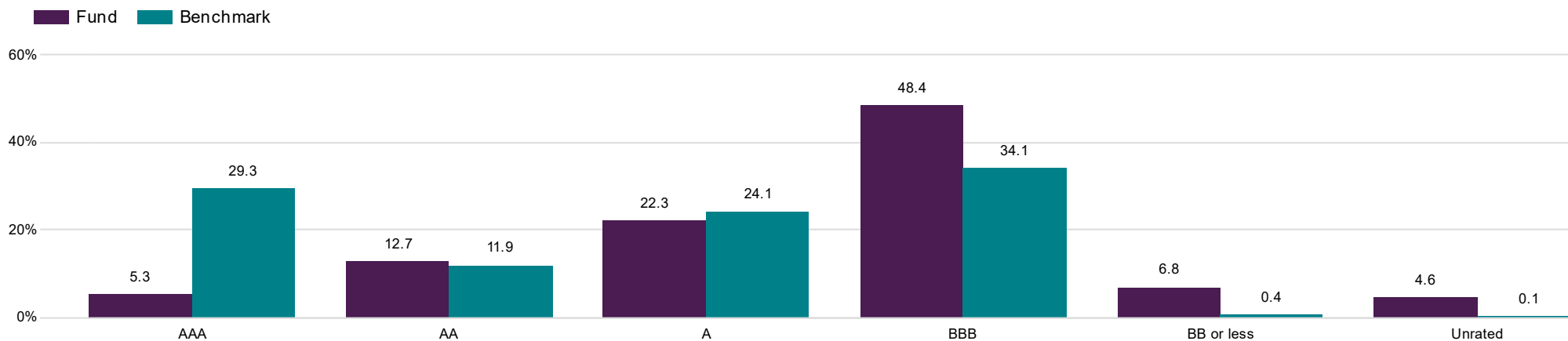
We also added to long-term favoured issuer Telereal, with bonds secured on BT exchange rentals, but where the credit spread on the secured bonds underpinned by cashflows from BT was higher than that on the unsecured bonds from BT itself.

Fund breakdown

Maturity profile

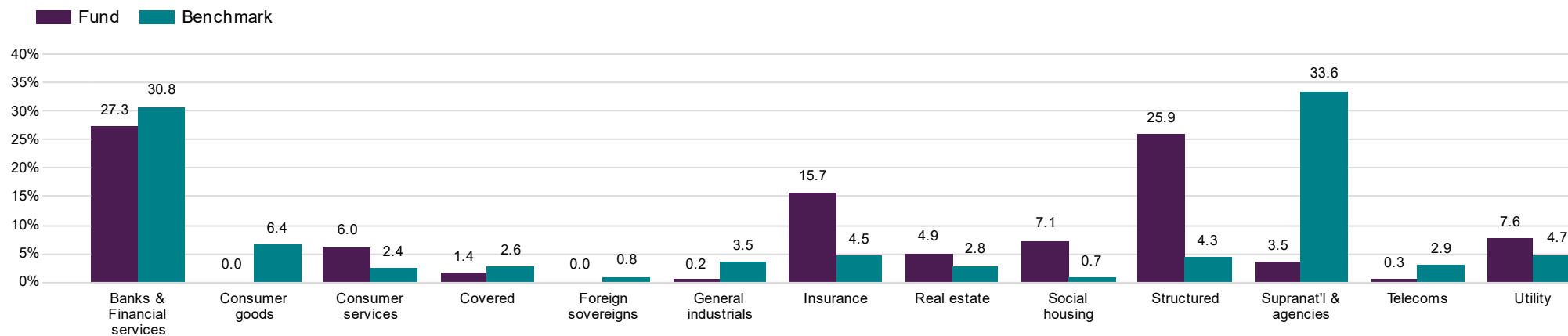


Credit ratings



Fund breakdown

Sector breakdown



Characteristics and climate

ESG characteristics rationale

The Fund focuses on the sustainability of the products and services of the companies it invests in, as well as their standards of environmental, social, governance ("ESG") management, alongside financial analysis. The investment approach is fundamentally based on positive screening; identifying companies that are making a positive contribution towards a cleaner, healthier, safer and more inclusive society, through assessing both what a company does and how it does it, and through active engagement to encourage continual improvement. The fund will not invest in companies that undertake business activities deemed to be detrimental to society. Further details of the Funds Sustainable Investment process can be found in the ethical and sustainable investment policy at www.rlam.com/uk/individual-investors/policies-and-regulatory/

ESG characteristics

Royal London Asset Management has a controversial weapons exclusion across all investments. Our full policy can be found on our website:

www.rlam.com/globalassets/media/literature/policies/controversial-weapons-policy.pdf

	Yes	No
ESG integration	✓	
Promotes environmental or social characteristics	✓	
Sustainable fund objective	✓	
Additional exclusions	✓	

Additional exclusions

Exclusion criteria that make sure a fund does not invest into a specific service or product. Royal London Asset Management has a controversial weapons exclusion across all investments.

Adult entertainment	✓	High environmental impact	✓
Alcohol	✓	Human rights issues	✓
Animal welfare	✓	Nuclear power	✓
Armaments	✓	Nuclear weapons	✓
Fossil fuels	✓	Tobacco	✓
Gambling	✓		

Climate metrics

	Fund	Benchmark	Difference (%)
Financed emissions (tCO2e)	1,680	n/a	n/a
Financed emissions coverage	53.81%	n/a	n/a
Carbon footprint (tCO2e/\$M invested)	8.61	13.15	(34.55)
Carbon footprint coverage	53.81%	81.83%	(34.24)
Weighted average carbon intensity (tCO2e/\$M sales)	29.35	38.38	(23.52)
Weighted average carbon intensity coverage	93.84%	95.40%	(1.63)

All climate metrics presented above are for Scope 1-2 emissions. Unless specified in the objective, the data is for information only and should not be taken to mean they are being managed to/controlled.

Implied temperature rise

	Fund (%)	Benchmark (%)	Difference (%)
Implied temperature rise (ITR) coverage	49.31	62.60	(21.23)
% of portfolio below 2°C ITR	36.17	35.14	2.92
% of portfolio below 1.5°C ITR	17.09	14.82	15.28

SBTi net - zero

	Fund (%)	Benchmark (%)	Difference (%)
SBTi Net-Zero committed	6.08	7.67	(20.70)
SBTi Near-Term committed	6.22	7.31	(14.87)
SBTi Near-Term targets set	6.87	10.31	(33.39)

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	10	27
Number of engagements	13	62

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



Biodiversity	2
Climate	3
Climate - Transition Risk	3
Governance	5
Corporate Governance	3
Remuneration	2
Health	3
Mental Health	3
Social & Financial Inclusion	2
Just transition	1
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; 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.

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

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.” November CPI inflation rose to 2.6% year-on-year as expected on ‘base effects’. Pay growth was stronger than expected. October GDP shrank month-on-month after falling in September, with this contraction (and subdued business surveys since) raising the risk of a mild GDP contraction in the fourth quarter. 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). Third quarter GDP (released over the quarter) rose at an above trend pace, supported by strong consumer spending growth. The US PMI composite meanwhile rose further and continued to signal a robust pace of US private sector output growth, although manufacturing business survey measures remain more subdued than services. 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. Business optimism on the PMI survey rose, hitting a two and a half year high in December, “reflecting growing optimism about business

conditions under the incoming Trump administration,” though manufacturers flagged concerns about tariffs (where Trump has promised increases) and inflation.

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 bank continues to note that domestic inflation remains high, “mostly” attributable to wages and prices in certain sectors, and acknowledge that they are “still adjusting to the past inflation surge with a substantial delay.” Third quarter GDP released over the quarter was stronger than expected. The PMI business survey composite, however, remained consistent with subdued private sector activity growth throughout the fourth quarter, ending the quarter below the 50 ‘no growth’ level. 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. France’s finance minister was replaced after Barnier’s budget failed to pass and Germany will now have early elections in the first quarter of 2025. CPI inflation rose on data released over the quarter, reaching 2.3% in November.

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.

Market commentary

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.

We target – and achieve – a material yield premium over the market level in our sustainable sterling credit strategies. As ever, the risks inherent in our credit portfolios are mitigated 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 greater income than the benchmark, achieved with superior downside protections, will generate outperformance.

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, 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.

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 II ICVC, an open-ended investment company with variable capital with segregated liability between sub-funds, incorporated in England and Wales under registered number IC001128.

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.

ICE indexes and data are the intellectual property of ICE Data Indices, LLC, its affiliates ("ICE Data") and/or its Third-Party Suppliers and has been licensed for use by Royal London Asset Management. ICE Data and its Third-Party Suppliers accept no liability in connection with its use. See <https://www.theice.com/market-data/disclaimer> for a full copy of the Disclaimer.

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.

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.

Charges from capital risk

Charges are taken from the capital of the Fund. Whilst this increases the yield, it also has the effect of reducing the potential for capital growth.

Responsible investment 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.

Performance to 31 December 2024

Cumulative (%)

Annualised (%)

	3 Month	6 Month	1 Year	3 Years	Since Inception	3 Years (p.a.)	Since Inception (p.a.)
Fund (gross)	0.79	3.33	5.59	-	14.75	-	6.75
Fund (net)	0.71	3.17	5.26	-	14.00	-	6.42

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
Fund (gross)	5.59	8.53	-	-	-
Fund (net)	5.26	8.19	-	-	-

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 Sustainable Short Duration Corporate Bond Fund Z Acc GBP share class. Since inception date 23 November 2022.

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.

Top 10 holdings

Top 10 assets held by market value, excluding derivatives and cash.