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Royal London Sterling Extra Yield Bond Fund

Quarterly Investment Report

30 June 2024

Quarterly Report

The fund as at 30 June 2024

The purpose of this report is to provide an update on the Royal London Sterling Extra Yield 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

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"). 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
30 June 2024	1,637.65

Asset allocation

	Fund (%)
Conventional credit bonds	93.88%
Securitised	1.00%
Conventional gilts	0.71%
Index linked credit bonds	0.15%
Other	4.27%

Fund analytics

	Fund
Fund launch date	11 April 2003
Base currency	GBP
Duration (years)	3.98
Gross redemption yield (%)	7.42
Number of holdings	246
Number of issuers	181

Performance to 30 June 2024

Performance

	3 Month (%)	YTD (%)	1 Year (%)	3 Years (p.a.)	5 Years (p.a.)	10 Years (p.a.)	Since Inception (p.a.)
A Inc GBP	1.63	5.54	14.26	4.34	4.83	6.23	7.73
Z Inc GBP	1.63	5.55	14.26	4.34	4.84	6.23	6.71

Past performance is not a guide to future performance. Please refer to the Glossary for the basis of calculation and impact of fees. Source: Royal London Asset Management; Gross performance.

Performance based on RL Sterling Extra Yield Bond Fund (A Inc), since inception date of the share class is 11 April 2003 and RL Sterling Extra Yield Bond Fund (Z Inc), since inception date of the share class is 13 December 2013.

Performance commentary

The fund posted strong returns in the second quarter of 2024 in the midst of fairly benign markets, with spreads moving sideways and government yields rising.

Distributions in respect of second 2024, payable at the end of August, are 1.68p, 1.52p, 1.58p and 1.56p respectively for the A, B, Y and Z class income shares. These compare to amounts of 1.99p, 1.82p, 1.84p and 1.83p distributed in respective of Q1 2024, which were boosted by some stock specific matters including agribusiness REA Holdings paid the remaining preference dividends outstanding from their deferral during the Covid pandemic.

Driving performance, Santander UK perpetual bonds, one of the largest individual holdings in the fund, were up 6% in price partly in response to the news that insurer RSA were tendering for their preference shares at a level well above their prevailing market price, and highlighting the attractive yields and positive potential for such issues.

At the start of the period, the fund saw strong and resilient rate of income accrual, some positive individual holding performances in the structured sector, pubs businesses Mitchells & Butlers and Unique Pub, and in the energy sector, notably DOF Group and Enquest.

Unsurprisingly holdings in the financial sectors were notably buoyant in May, with holdings of banks BNP, NatWest, Royal Bank of Canada and Standard Chartered and of insurers Allianz, M&G and Pension Insurance all up around 2% in the month. Other areas of strong performance were French government owned utility EDF, also up some 2% in price May, Shamaran, the energy company which announced a partial early repayment triggering a 5% rise in price to the bonds par value.

Towards the end of the quarter, against a positive market background, most holdings in the fund increased in value. In particular, Sainsbury Bank bonds were up 2% on news that the banking business was to be sold to NatWest – the bonds which paid a coupon of 10.5% since issue in September 2022 rose to a price of to 112½ at end June, and up from 106½ at the start of 2024. Meanwhile insurer M&G tendered for a portion of its outstanding 'lower tier 2' bonds across a series of individual issues – a substantial part of the fund's holding of the 5.56% 2035/55 were repaid at a level 2.5% above their end May value. Away from financials, unrated secured bonds of property group Peel Holdings were up 3% in the month, while data centre business Bulk Infrastructure bonds were up 3% on news of additional equity finance being raised to grow the business.

Performance and activity

Top 10 holdings

	Weighting (%)
ELECTRICITE DE FRANCE SA 5.875000000	2.47
CO-OP GRP HLDS 7.500000000 2026-07-08	2.31
SANTANDER UK PLC 10.062500000	2.00
METROCENTRE FINANCE 8.750000000 2024-12-05	2.00
SANTANDER UK PLC	2.00
CENTRICA PLC 6.500000000 2055-05-21	1.87
M&G PLC 6.340000000 2063-12-19	1.80
PHOENIX GRP HLD PLC 5.750000000	1.65
ELECTRICITE DE FRANCE SA 6.000000000	1.56
HEATHROW FINANCE PLC 3.875000000 2027-03-01	1.53
Total	**19.19**

Fund activity

The fund participated in the flow of new issues in the quarter. Early in the quarter we identified a series of diverse new issue opportunities, including energy group OKEA and shipping business SFL, together with euro denominated bonds of Spanish fertiliser group Fertiberia. The fund also participated in the new issues of BBB rated bonds of motoring group AA, yielding 6.85% to 2031, and of Southern Water Services, yield 7.375% to 2041, and leisure business Center Parcs, 7.875% to 2029, together with unrated US dollar denominated bonds of energy services business Excellence Logging.

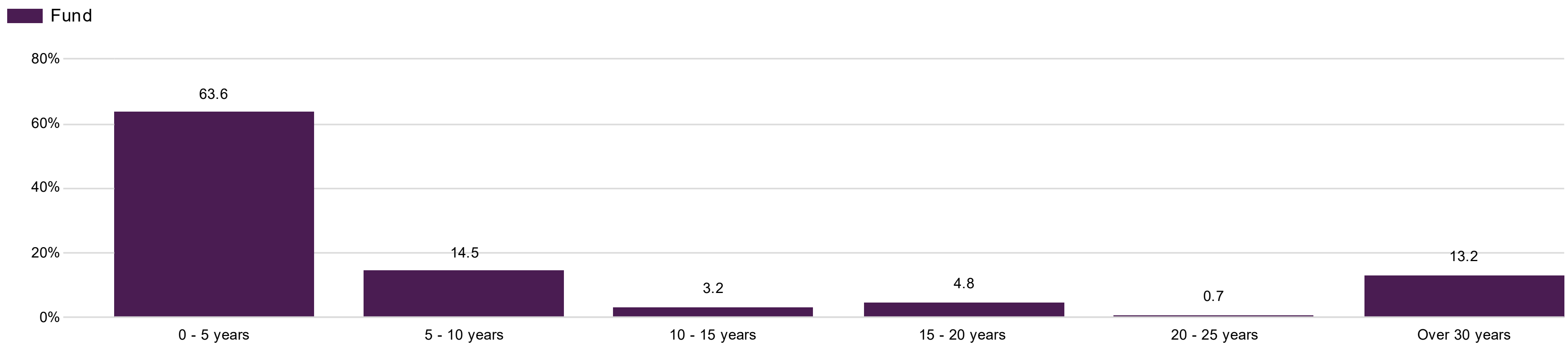
In financials, we participated in new issues from Coventry Building Society AT1 bonds offering an 8.75% coupon until first call date in 2029 – the issue a part of the balance sheet development ahead of the completion of the Co-op Bank acquisition, together with subordinated bonds of Barclays, yielding 8.5% to first call in 2030, and US dollar denominated bonds of Royal Bank of Canada.

We also added a new issue from Samose Energy – the southeast Asian energy business owning critical assets for the ongoing operation of offshore fields with these secured US dollar 2028 bonds offering income of 12.5%, while Danish gas company Bluenord, whose cash flow prospects are improving dramatically on the start of production from the Tyra field, issued 2029 US dollar bonds at a coupon of 9.5% while repaying their 2026 bonds whose terms restricted dividend payments, at a price of 110 after paying 9% income since issue in 2019.

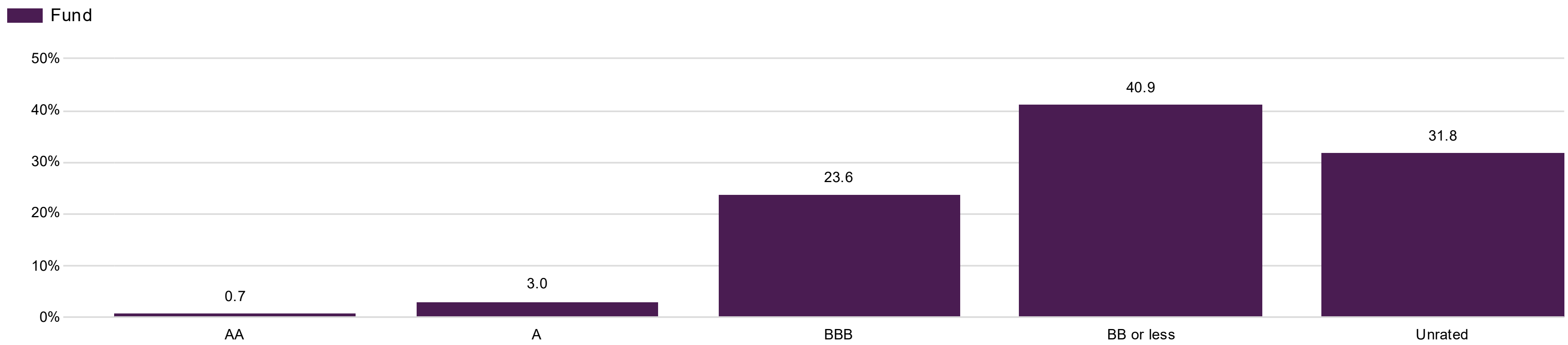
Sales in the quarter included crystallising capital profits on recent issues of Spanish banking group Caixabank and of French industrial business Eramet, and selling bonds of engineering group Rolls Royce, which had performed strongly after recent upgrade to BBB credit rating by S&P and Fitch. During the period, both UK utility business Centrica and Norwegian energy business DNO announced tenders for their existing short-dated bonds at a premium to their recent market price, while offering new attractively priced bonds. In each case the fund benefited from the uplift from prevailing market price to the tender level, preferential allocation on the new bonds which were attractively priced and traded up, and an uplift in income generation on coupon increase from old to new bonds – 5.25% to 6.5% and 7.875% to 9.25% respectively for these issuers.

Fund breakdown

Maturity profile

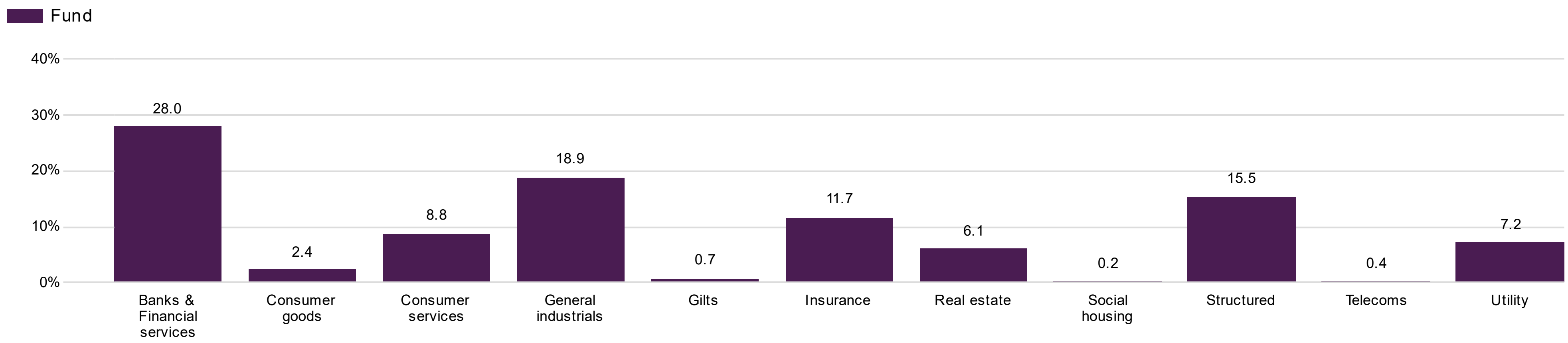


Credit ratings

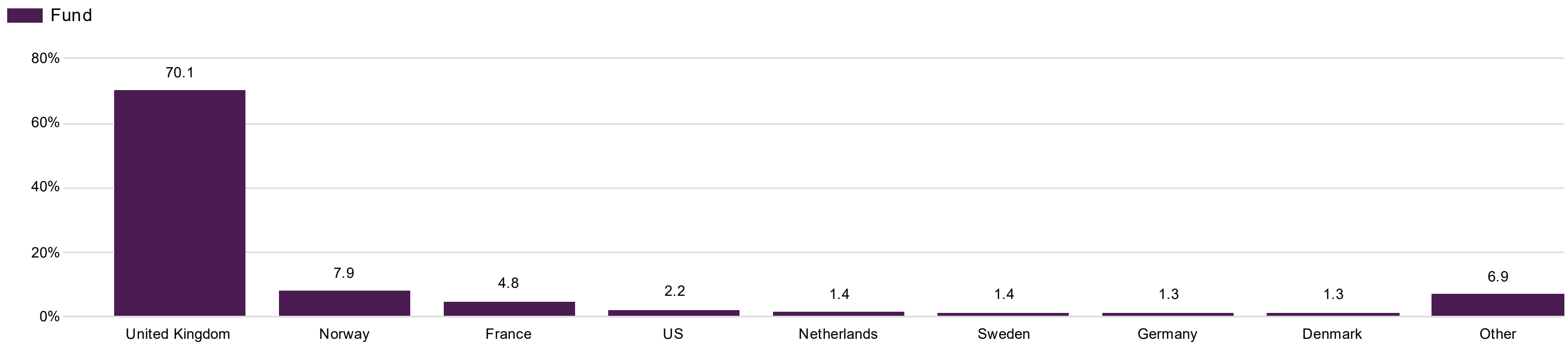


Fund breakdown

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	8	22
Number of engagements	12	56

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	6
Climate - Transition Risk	5
Climate - Physical Risk	1
Environment	1
Governance	2
Corporate Governance	1
Remuneration	1
Social & Financial Inclusion	2
Just transition	2
Technology, Innovation & Society	2
Technology & Society	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

BNP Paribas SA – Net zero

Purpose:

We, as part of a collaborative investor group coordinated by ShareAction, asked a question at BNP Paribas' AGM regarding its financing of oil and gas companies.

Outcome:

The CEO of BNP Paribas has expressed confidence in the bank's decision to cease involvement in oil and gas bond transactions since mid-February 2023. This move is indicative of the bank's disinterest in participating in oil and gas bonds and is seen as a positive step. BNP Paribas utilises International Energy Agency scenarios as a guide and seeks to reflect its insights in its policies. During our meeting, the CEO reaffirmed the bank's commitments, including its 10-90 goal, which aims for 90% of its energy sector financing to be low carbon, with the remainder for fossil fuels, contingent on suitable opportunities for financing. We will continue to monitor BNP's disclosures and assess the company's progress.

Heathrow Funding Ltd – Net zero

Purpose:

We engaged with Heathrow's representatives to review the company's sustainability disclosures. We wanted to provide constructive feedback and recommended enhancements to its current practices, focusing on environmental and social governance aspects to better align with industry standards and stakeholder expectations.

Outcome:

During our meeting we emphasised the significance of a 'just transition' and urged the company to develop a comprehensive plan that incorporates this concept into its overall approach. Additionally, we requested greater transparency regarding the decarbonisation strategies for mitigating Scope 1, 2, and 3 emissions. Specifically, we highlighted the importance of focusing on positive lobbying efforts, forging strategic partnerships and biodiversity. We will continue to monitor the company's disclosures and engage further if necessary.

Fund Engagement

Engagement outcomes

NatWest Group Plc – Just transition

Purpose:

At the 2024 Annual General Meeting, in partnership with Border to Coast and Friend Provident Foundation, we posed a question regarding the company's commitment to integrating the principles of a just transition within its climate transition plan.

Outcome:

The Chair responded that NatWest is determined to be a leading bank on sustainability in general and just transition specifically. The Chair believes that the bank understands the need for a just transition and continues to consider how it can integrate it into its climate plan and sustainability regularly. The bank's current climate transition approach has been informed by best practice guidance, and it uses partnerships to put into practice some of the principles of a just transition. We appreciated the Chair's response to our question, yet the answer did not provide any commitments beyond what we have discussed with the company in private meetings. We have recently published investor expectations for banks on just transition and we will look to use this to continue our engagement with the bank.

Vodafone – Ethical AI

Purpose:

We have reached out to Vodafone on behalf of the Investor Group as part of the World Benchmarking Alliance's Ethical AI collaborative engagement. Our aim is to schedule a meeting with the company to gain a deeper understanding of its ethical AI practices and to discuss opportunities for enhancing these practices.

Outcome:

Vodafone has provided a written response outlining its AI governance structure, highlighting the AI Governance Board's role in strategy and policy oversight, chaired by the Chief Commercial Officer and comprising senior executives such as the CEO of Vodafone Business and the Chief Technology Officer. The AI framework emphasises a responsible approach to AI, with a focus on ethical principles and risk management across the AI lifecycle. The company is proactive in human rights due diligence and is enhancing risk assessments to address AI risks effectively with a particular focus on establishing robust controls during the design phase. We continue to seek a detailed dialogue on its ethical AI practices.

Market commentary

Market overview

Markets have once again been dominated by interest rates during the quarter, despite little or no movement in this area. 2024 started with expectations that central banks would cut early and cut often. However, as the year has progressed, those expectations have changed. Inflation has generally not come down quite as fast as hoped, with services inflation proving sticky, particularly in the UK, while growth has generally not been as weak as feared – particularly in the US. Interest rates were cut just once across the Federal Reserve, European Central Bank and Bank of England, with the ECB cutting rates in June. Most central bank forecasters now only expect one or two cuts from each of these banks over the course of 2024 as a whole.

Ahead of the US Presidential elections in November, snap parliamentary elections were called in the UK and France, providing reminders that voter dissatisfaction with the seeming consensus on economic policy and ongoing lack of consensus on longer-term issues such as climate change create an uncertain backdrop for businesses and consumers alike.

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 the relatively strong core CPI inflation seen over January to April. The May data (released in June) was more reassuring both from a CPI and core PCE perspective. As of their June meeting, the median forecast of participants changed from showing 75 basis points of rate cuts for 2024 to only 25bps of cuts.

The ECB lowered rates by 25bps in June, following good inflation progress and previous hints from ECB speakers. Further rate moves after June are less certain and depend on data. Euro area CPI went up from 2.4% to 2.6% year-on-year in May, which was unexpected, and services inflation rose above 4.0%. The European elections saw incumbent parties suffer a loss of support and prompted President Macron to call an early parliamentary election. This uncertainty saw French government bonds weaken in relation to German government debt.

Data released in the UK in the second quarter confirmed that the country bounced out of technical recession in the Q1 and painted a picture of continued positive economic growth. First quarter GDP rose 0.7% quarter-on-quarter in real terms after falling 0.3% in the fourth quarter. Meanwhile inflation also dropped back to the Bank of England's 2% target. The rate of change in the CPI basket fell from 3.4% year-on-year in February to 2.0% in May, helped by lower electricity and gas bills. The Bank of England kept rates at 5.25%, even though headline inflation dropped. This reflected concern about services inflation and pay growth, both of which remain elevated. The calling of UK general election, which has resulted in a change of government, had minor impact on sterling asset prices, reflecting a view that there would be little shift in economic policy.

Government yields generally rose over the quarter, particularly following poor US inflation data released in April with yields largely range-bound through May and June. In the US, 10-year treasury yields rose from 4.21% to 4.40%, while German 10-year bunds similarly saw yields rise from 2.30% to 2.50%. Benchmark 10-year gilt yields rose from 3.94% to 4.18%.

The sterling investment grade credit market (iBoxx non-gilt index) returned -0.13% 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) widening marginally from 1.02% to 1.03% (iBoxx). Given the modest rise in yields, sectors with a greater proportion of long-dated bonds performed less well, including utilities and social housing. Of the major sectors, supranationals and banks produced positive returns, while insurance lagged.

Outlook

Last quarter we highlighted that we expected yields to remain sensitive to economic data, and unless there was a significant deterioration in underlying trends, we expected this to lead to range-bound yields. This is the scenario that unfolded over the quarter, with markets seeming to mark time until central banks – notably the Federal Reserve – start to cut rates.

Headline inflation is now significantly lower in the US, euro zone and UK compared to 2023. Base effects account for a material part of these falls. Beyond the headline figures, the likes of services inflation and wage growth remain higher than most central bankers would prefer. That said, we do expect to see more movement from central banks in the second half of the year, even if the quantum of those moves is less than many were forecasting earlier in the year.

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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This is a financial promotion and is not investment advice.

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Issued in July 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 30 June 2024

Cumulative (%)

	3 Month	6 Month	1 Year	3 Years	5 Years
A Inc GBP (gross)	1.63	5.54	14.26	13.61	26.66
A Inc GBP (net)	1.42	5.10	13.30	10.79	21.53
Z Inc GBP (gross)	1.63	5.55	14.26	13.61	26.66
Z Inc GBP (net)	1.48	5.25	13.60	11.65	23.12

Annualised (%)

3 Years (p.a.)	5 Years (p.a.)
4.34	4.83
3.47	3.97
4.34	4.84
3.74	4.24

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
A Inc GBP (gross)	14.26	2.55	(3.03)	16.01	(3.90)
A Inc GBP (net)	13.30	1.69	(3.84)	15.04	(4.64)
Z Inc GBP (gross)	14.26	2.55	(3.04)	16.01	(3.90)
Z Inc GBP (net)	13.60	1.95	(3.60)	15.34	(4.39)

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 30 June 2024. All figures are mid-price to mid-price in GBP.

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.