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Royal London Diversified Asset-Backed Securities Fund

Quarterly Investment Report

30 September 2024

Quarterly Report

The fund as at 30 September 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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ROYAL LONDON
ASSET MANAGEMENT

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
30 September 2024	302.08

Asset allocation

	Fund (%)
Conventional credit bonds	81.66%
Securitised	15.00%
Conventional gilts	2.13%
Index linked credit bonds	0.85%
Conventional foreign sovereign	0.17%
Other	0.20%

Fund analytics

	Fund
Fund launch date	24 September 2012
Base currency	GBP
Duration (years)	0.91
Yield to worst (%)	6.19
Number of holdings	313
Number of issuers	195

Performance and activity

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Quarter	1.27	1.25	0.03
YTD	5.80	3.83	1.97
1 Year	10.15	5.17	4.98
3 Years (p.a.)	5.68	3.27	2.41
5 Years (p.a.)	5.33	2.03	3.30
10 Years (p.a.)	3.94	1.30	2.64
Since inception (p.a.)	4.29	1.17	3.11

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 RL Diversified Asset-Backed Securities Fund (Z Acc). Source: Royal London Asset Management; Gross performance; Since inception date of the share class is 24 September 2012.

Performance commentary

Third quarter returns were driven by the portfolio's carry with a slight positive from duration positioning, while credit spreads were broadly neutral. The performance from our bonds in the banking, real estate and insurance sectors were particularly strong in the quarter.

Selected tenders such as Just Group and Aviva also contributed to our performance, with the companies buying back bonds at above market levels.

The major detractor to performance came from the water sector with bonds in Thames Water and Southern Water weaker over the quarter. This followed a harsher than expected draft outcome of the regulatory review by Ofwat, and resultant rating agency downgrades. We continuously review the holdings given clear uncertainties, and engage with issuers and Ofwat, the sector regulator, on a regular basis.

While there are evident issues that need addressing in the sector, we do believe that a resolution will be found and that the market more than discounts most negative outcomes. Nonetheless, patience is likely to be necessary before the final resolution is clear. While this specific underperformance is disappointing, the overall fund performance does highlight the benefit of diversification in our approach. In addition, we did take the opportunity to add further to the sector, where valuations appeared attractive and via new issuance.

Outside of exposure to water, our structured sector holdings again performed well and remain a key element of our portfolio. Secured bonds play a significant role in our approach, enhancing returns whilst dampening the impact of idiosyncratic risk. In addition, the creditor control effective protections afford us means that, on occasion, issuers will choose to pay up to remove these controls.

During the quarter, the UK pub company, Stonegate, took the decision to repurchase its Unique Pub securitisation at a material premium as part of a wider refinancing exercise. Unique was one of the largest holdings in the fund, reflecting its extremely low leverage, strong covenants and excess yield; precisely the reasons it was ripe for early redemption. We will continue to seek out and embed under-valued secured bonds into the fund, happy to earn the excess income or benefit from the capital gain of early redemption.

Performance and activity

Top 10 holdings

	Weighting (%)
UNITED KINGDOM GILT 3.500000000 2025-10-22	2.13
LEGAL & GENERAL GROUP 5.500000000 2064-06-27	1.26
BRITLD-BEARER BD 5.264000000 2035-09-24	1.21
HSBC BNK CAO FND STER 1 5.844000000	1.17
PETERBORO PROGRES HEALTH 5.580000000 2042-10-02	1.10
BARCLAYS BANK PLC 6.278000000	1.08
EURO 38X A 5.200000000 2029-07-22	0.98
PKMRP 2022-1X A 6.518870000 2045-07-25	0.97
TELEREAL SECURITISATION 5.839339000 2031-09-10	0.97
BROADGATE FINANCING PLC 4.999000000 2031-10-05	0.95
Total	**11.82**

Fund activity

Within the bank and insurance sectors, so-called ‘legacy bonds’ are those that no longer meet the current requirements of today’s regulatory environment, and as such can become inefficient for issuers to leave outstanding. As a result, we continue to expect to see old bonds called and new ones reissued. We hold a number of positions in these bonds, as the call price is typically above market levels – meaning we receive a higher price than prevailing for the existing bond, and often an attractive price and allocation to the new bond.

This has supported performance over the past few years and the most recent example this quarter was Aviva, who called their 2036 bonds at a premium to market pricing. We then added the new 2054 replacements, which came to market with an attractive yield premium. Continuing our exploitation of this market inefficiency, we added a US dollar legacy bond from HSBC.

We also added the new issue of subordinated bonds from Just Group, the insurer looking stronger with an improved balance sheet and solvency ratios. Their existing bonds were tendered at just 35bps over gilts with the new issue coming at just over 300bps over gilts.

As discussed, the water sector has been under pressure, but we believe that the market has overreacted to the company-specific difficulties at Thames, with spreads across the sector being affected regardless of quality of balance sheet or business model. We added South West Water and Welsh Water during the period.

We believe that both companies offered an attractive spread considering the strength of their balance sheets and the premium reflected negative sentiment within the sector. The bonds have performed well since purchase. Dŵr Cymru, or Welsh Water, is a mutually owned business with one of the strongest ratings in the sector, and its 2044 bonds came to market with an attractive above market yield.

We continue to see value in other regulated infrastructure assets offering attractive spreads. During the quarter, we added bonds in Gwynt y Môr OFTO, an offshore transmission operator that connects the windfarm to the National Grid. The bonds were very attractively priced and offer strong sustainability characteristics given the nature of the business as an enabler of the transition to a low carbon economy.

In the structured area, a key component of the portfolio, we continue to believe that the additional security and covenants are underpriced by the wider market. During the quarter, we 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

Performance and activity

Fund activity (continued)

Europe. We felt that these bonds were very attractively priced, being less favourably viewed by the market as they are not in typical bond indices.

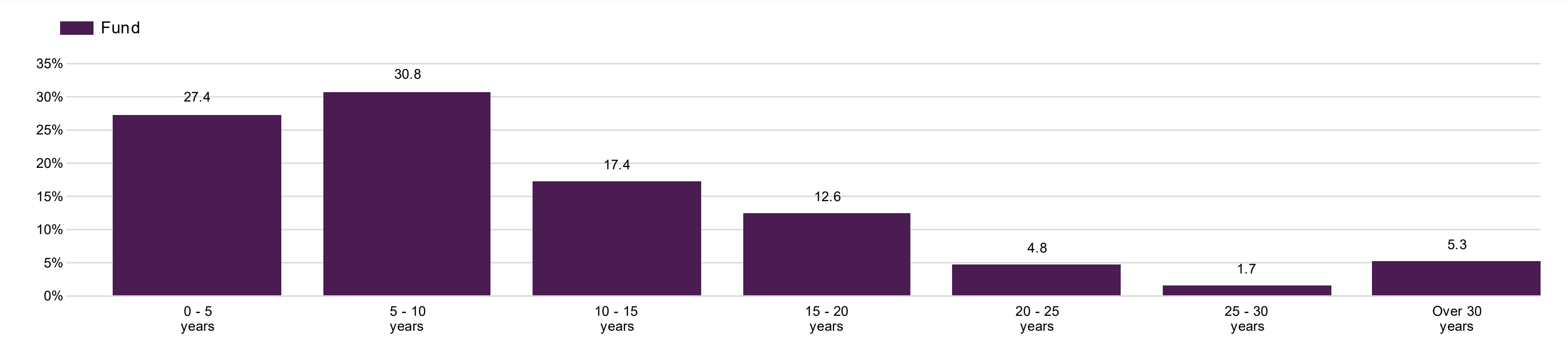
By contrast, more recent but junior issues, that do sit on the index, trade at tighter spread levels. We also added senior secured notes from student accommodation provider UPP – these 2040 bonds providing a much higher credit spread than the wider student accommodation market.

We remain selective in terms of adding securitisation positions, maintaining a clear focus on senior bonds and where we can receive additional return for less conventional collateral.

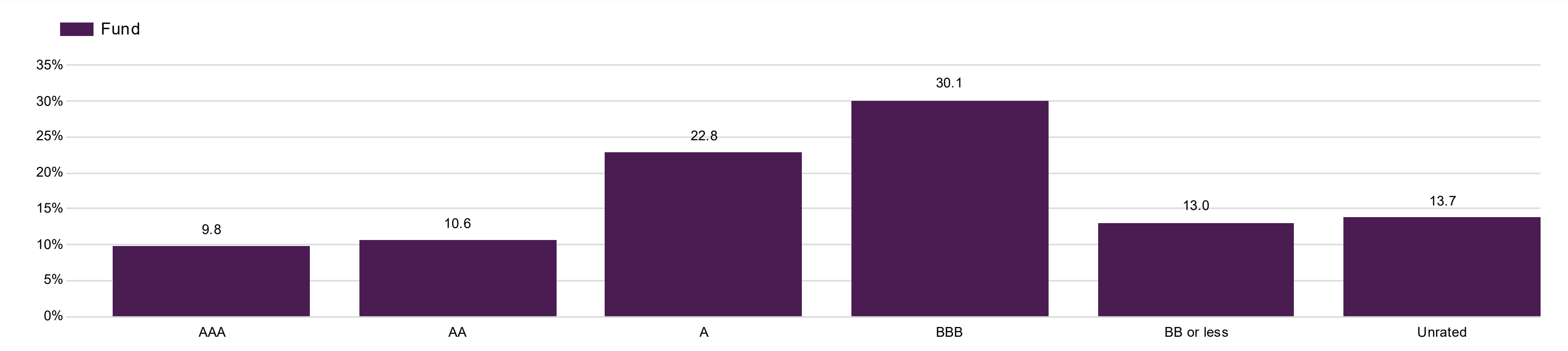
One example was our purchase of a senior CMBS position, Hera Financing 2024-1A, which is secured on flexible office space in London with around 4x coverage from the value of the pledged assets. Despite this low leverage and AAA rating we were able to buy the bonds at Sonia+1.9%.

Fund breakdown

Maturity profile

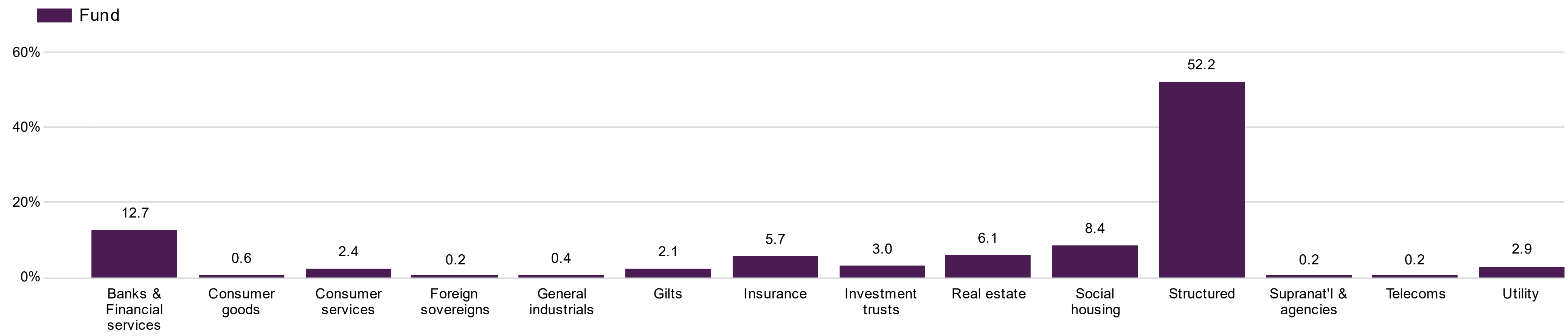


Credit ratings



Fund breakdown

Sector breakdown



Market commentary

Market overview

Markets continued to focus on central bank actions during the quarter, as both the Federal Reserve (Fed) and Bank of England (BoE) followed the European Central Bank (ECB) in making the first rate cuts this cycle. This follows the significant rises through 2022 and 2023 as part of efforts to reduce inflation. Along with a significant stimulus package in China, this policy shift generally helped fixed income markets to perform positively over the quarter as yields fell to reflect lower central bank interest rates. After initial weakness, equity markets started to rise once more, reflecting the hope that the policy easing would result in a soft landing for the economy with the US S&P 500 index hitting an all-time high. Despite guidance from central banks that further cuts will be measured, markets are still pricing in material rate cuts over the next year or so.

After elections in the UK and France grabbed headlines in the second quarter, attention moved firmly to the forthcoming US elections. Markets believe that a Trump presidency would see looser fiscal policy and higher tariffs and protectionism. Sentiment has swung on the fortunes of the early days of the race, first following the Trump assassination attempt and debate against President Biden, which appeared to favour Trump, but then swung back as Kamala Harris emerged as a credible candidate and performed strongly in her debate with the former president. Somewhat remarkably, markets have remained sanguine about rising geopolitical tensions in the Middle East.

As mentioned above, the Fed cut 50bps to 4.75%-5%. This was in contrast to most economist expectations, but in line with what the market had been increasingly pricing. Their forecasts and language indicated that they anticipate the change as the beginning of a series of cuts, returning rates “to a more neutral stance.” In the euro area, the ECB cut the deposit rate 25bps to 3.50% on the back of inflation data coming in “broadly as expected” and “still subdued” economic activity. UK data released in Q3 were consistent with the UK economy growing modestly, while headline inflation has been running close to the 2% target. The BoE cut rates 25bp, though with (only) a 5-4 vote, warning that they need to be careful not to cut too quickly – duly leaving rates unchanged in September.

Government yields generally fell over the quarter, reflecting the start of the rate cutting cycle. In the US, 10-year treasury yields fell from 4.40% to 3.79%, while German 10-year bunds similarly saw yields fall from 2.50% to 2.13%. Benchmark 10-year gilt yields dipped from 4.18% to 4.01%. These gilt yields had been as low as 3.75% in mid-September, many attributed the increase at the end of the quarter to concerns that the Budget might see a further increase in gilt issuance.

The sterling investment grade credit market (iBoxx non-gilt index) returned 2.28% 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) ending the period unchanged at 1.07% (iBoxx).

Outlook

As we enter the final months of 2024, market focus has moved from when central banks will first cut interest rates, to the scale and timetable of those cuts. As we saw at the start of 2024, markets have generally been overly aggressive in their expectations – at one point in September two-year and five-year treasury yields had dropped further below the Fed Funds rate than any point in many decades. While this has at times been supported by commentary from central bank members, we have generally been more cautious. Our caution reflects that while headline inflation may have come down, service and wage inflation are still generally at levels that are not normally consistent with significant rate cuts. After a decade that includes a world-wide pandemic, a European land war, and the election of a TV reality star as US president, perhaps there is no ‘normal’ to fall back on, but we are certainly more cautious about the rate outlook. In terms of bond yields, we have a general preference to be long duration, and are more cautious about the short end of the market if rate cut expectations are not met, but see the environment as one that requires considerable tactical agility rather than taking a strong strategic view on yields.

Geopolitics has played a greater role in markets over the past few years after a lengthy period where it was often seen as mere background noise. The forthcoming US Presidential election is too close to call as we head into October, but with meaningful differences between the two candidates, this will weigh on markets in the run-up to election day. Meanwhile, events in the Middle East have the potential to impact oil supply and further increase uncertainty.

We believe that sterling investment grade all-in yields (using iBoxx) at over 5% remain attractive, both in absolute terms but also relative to government bonds. Credit spreads continue to compensate investors for the risk of default and, despite the uncertainties highlighted above, the outlook for the corporate sector remains relatively benign.

We target – and achieve – a material yield premium over the market level in our sterling credit strategies. As ever, the risks inherent in our investment grade 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:

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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Issued in October 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 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.

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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 30 September 2024

Cumulative (%)

	3 Month	6 Month	1 Year	3 Years	5 Years
Fund (gross)	1.27	3.12	10.15	18.05	29.70
Fund (net)	1.17	2.90	9.68	16.55	26.76

Annualised (%)

	3 Years (p.a.)	5 Years (p.a.)
Fund (gross)	5.68	5.33
Fund (net)	5.23	4.85

Year on year performance (%)

	30/09/2023 - 30/09/2024	30/09/2022 - 30/09/2023	30/09/2021 - 30/09/2022	30/09/2020 - 30/09/2021	30/09/2019 - 30/09/2020
Fund (gross)	10.15	8.33	(1.07)	8.38	1.38
Fund (net)	9.68	7.87	(1.49)	7.88	0.81

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 September 2024. All figures are mid-price to mid-price in GBP for the RL Diversified Asset-Backed Securities Fund (Z Acc).

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.

Distribution yield

The distribution yield reflects the amounts that may be expected to be distributed over the next 12 months. It is calculated net of standard management charges. It reflects RLAM's current perception of market conventions around timing of bond cash flows.

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.