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RLPPC Enhanced Buy & Maintain Cash Flows 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 RLPPC Enhanced Buy & Maintain Cash Flows 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

To achieve a yield of +1.30% in excess of gilts. The Fund is not managed in reference to any benchmark index.

Reference index: There is no benchmark for this fund.

Fund value

	Total £m
30 September 2024	163.00

Asset allocation

	Fund (%)
Conventional credit bonds	97.23%
Securitised	2.60%
Conventional foreign sovereign	0.12%
Conventional gilts	0.05%

Fund analytics

	Fund
Fund launch date	21 April 2002
Base currency	GBP
Duration (years)	6.21
Gross redemption yield (%)	5.77
Credit spread (%)	1.26
Number of holdings	362
Number of issuers	258

Performance and activity

Performance

	Fund (%)
Quarter	2.36
YTD	2.85
1 Year	11.02
3 Years (p.a.)	(2.49)
Since inception (p.a.)	(1.78)

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 RLPPC Enhanced Buy and Maintain Cash Flows Fund S Inc. Source: Royal London Asset Management; Gross performance; Since inception date of the share class is 2 April 2021.

Performance commentary

The third quarter was positive for fixed income investors, with strong absolute returns from sterling credit markets. Taking the iBoxx Sterling Non-Gilt index as a reference for the sterling credit market, the portfolio performed broadly in line. The portfolio has a duration position that is longer than the wider market as part of its objective, and this was a modest positive for returns relative to the market, offset by curve effects.

The combination of stock and sector positioning was a small positive – within the insurance sector, our exposure to selected long-dated bonds was beneficial. Selected tenders such as Just Group contributed to performance, with the company buying back bonds at above market levels. Our holding in EDF also benefitted from this, after the company called its 6% hybrid bonds, issuing a new green sterling-denominated hybrid bond with a coupon of 7.375%. Exposure to real estate and social housing also supported returns.

Stock selection was helpful when looking at performance against the reference index. This was focused in the structured sector – representing a substantial part of the overall portfolio – with strong performance from student loan provider ICSL and shopping centre Meadowhall.

Against this, our exposure to water was negative. This was largely due to ongoing volatility in 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 rating agencies downgrading Thames bonds earlier in the quarter. While there are undoubtedly issues in the sector, we do believe that a resolution will be found. We continue to review the holdings we have in the sector and believe that the market more than discounts most negative outcomes for the sector. Nonetheless, patience is likely to be necessary before the final resolution is clear. While this underperformance is disappointing, it does highlight the benefit of diversification in our approach, given that the overall effect of our exposure to the structured sector has been positive this year. Outside of exposure to water, our structured sector holdings again performed well and remain a key element of our sterling credit exposure. Structured bonds play a significant part in our approach, helping with the strategy of creating highly diversified portfolios with a focus on security and above-market yields, whilst preventing individual bonds from derailing overall performance.

Performance and activity

Top 10 holdings

	Weighting (%)
CLYDESDALE BANK PLC 4.625000000 2026-06-08	1.56
LLOYDS BANK PLC 6.000000000 2029-02-08	1.21
HIGH SPEED RAIL FIN 1 4.375000000 2038-11-01	1.04
THFC FUNDING NO 3 PLC 5.200000000 2043-10-11	0.95
AVIVA PLC 6.875000000 2058-05-20	0.91
PRS FINANCE PLC 1.750000000 2026-11-24	0.87
EQUITY RELEASE FUND NO 3 5.050000000 2033-04-26	0.78
HSBC BANK PLC 6.250000000 2041-01-30	0.72
ANNES GATE PROPERTY PLC 5.661000000 2031-06-30	0.71
GROSVENOR UK FINANCE PLC 6.500000000 2026-09-29	0.70
Total	**9.45**

Fund activity

Financials remain the focus of activity across both new issue and secondary markets. In the insurance sector, we added a new issue from US insurer MassMutual. These bonds rank alongside policyholders, offering strong downside protection and were attractively priced. We 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.

Covered bonds from favoured issuers are an attractive addition to the fund, given their dual recourse nature. Issuance remains light, but we did buy a new issue five-year covered bond from TSB.

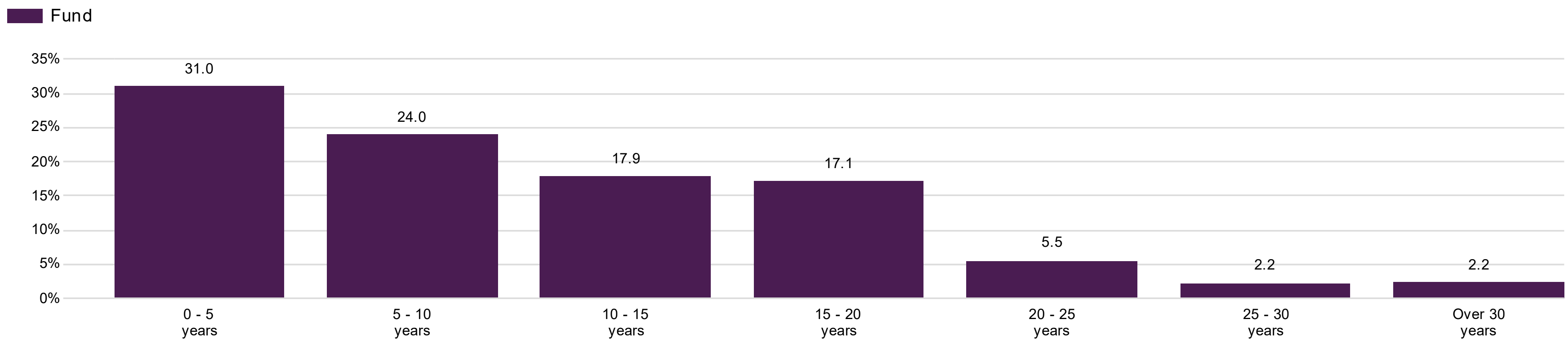
The water sector has been under pressure, but we believe that the market has overreacted to the company-specific difficulties at Thames, with spreads across the sector being affected regardless of quality of balance sheet or business model. We added South West Water and Welsh Water during the period. We believe that South West Water is a high quality company with a strong balance sheet. The bonds came to market at an attractive yield above equivalent and have performed well since purchase. Dŵr Cymru, or Welsh Water, is a mutually owned business with the lowest leverage in the sector, and its 2044 bonds came to market with an attractive above market yield.

While areas such as financials and structured bonds remain the largest in our portfolios, we look for opportunities in other areas to aid overall portfolio diversification. The real estate sector has struggled in recent years, but has recently started to close the valuation gap with European assets while also benefiting from expectations of falling interest rates. During the quarter we added a new issue from Great Portland Estates – prime West End London properties with a low loan-to-value and strong environmental credentials. In the transport sector, we added East Japan Railway, attractive long-dated bonds supporting critical infrastructure.

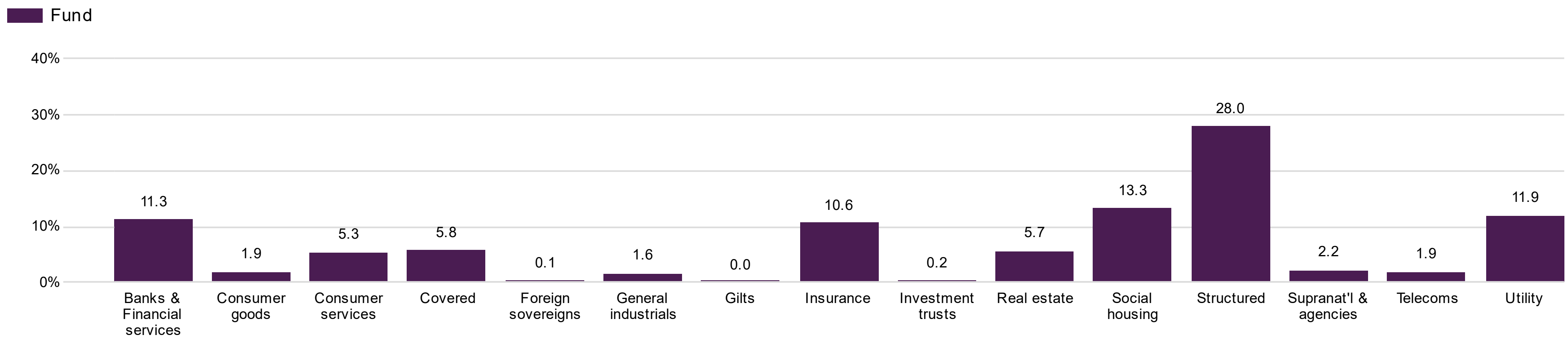
ROYAL LONDON ASSET MANAGEMENT

Fund breakdown

Maturity profile

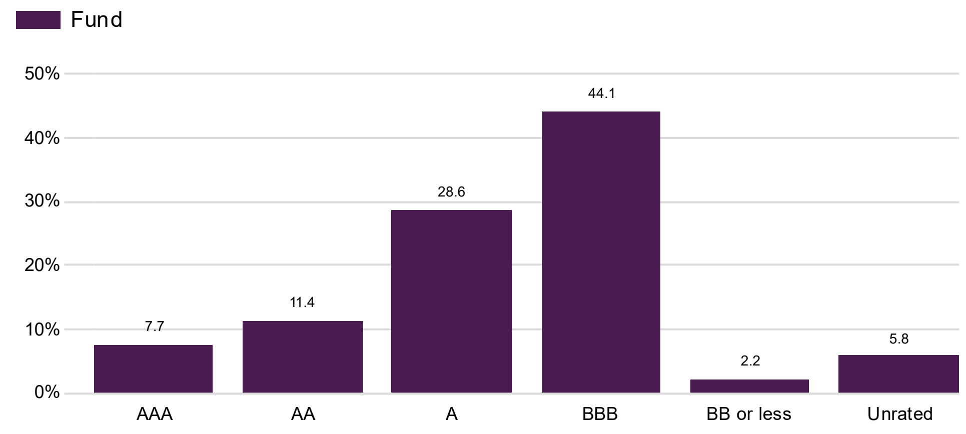


Sector breakdown



Credit ratings

Credit ratings



Downgrades

The table below details directly held credit bonds downgraded to sub-investment grade by at least one agency during the quarter.

Asset description	Current Rating	Previous Rating
THAMES WATER UTIL FIN 5.125000000 2037-09-28	CCC+	BBB-
THAMES WATER UTIL FIN 7.738000000 2058-04-09	CCC+	BBB-
THAMES WATER UTIL FIN 7.750000000 2044-04-30	CCC+	BBB-

Upgrades

The table below details directly held credit bonds upgraded from sub-investment grade by at least one agency during the quarter.

Asset description	Current Rating	Previous Rating
No upgrades this quarter		

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 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 Kamela 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.

UK data released in Q3 were consistent with the UK economy growing modestly, while headline inflation has been running close to the 2% target. Later in the period there was a worrying fall in consumer confidence in September, which may have reflected some concern over what the October Budget might bring after the new government flagged that ‘painful’ decisions may be required. The BoE cut rates 25bps, 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). Given the modest fall in yields, sectors such as social housing performed due to the greater proportion of long-dated bonds, while real estate also did well due to the sensitivity of the real estate market to interest rates. Of the major sectors, supranationals slightly lagged the market, while banks and insurance outperformed.

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 November 5. Meanwhile, events in the Middle East that have the potential to materially impact oil supply and pricing 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 credit spread premium over the market level in our buy & maintain strategy. We mitigate the risks 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 that spread premium in a risk-controlled manner, 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

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The portfolio has no index as a comparison.

Risks and Warnings

Fixed interest security 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.Key determinants include economic growth prospects, inflation, the government's fiscal position, short-term interest rates and international market comparisons. The returns from bonds are fixed as at the time of purchase. Therefore the fixed coupon payable and the final redemption proceeds are known at the outset. This means that if a bond is held until its redemption date, the total return that could be expected is unaltered from its purchase date, subject to counterparty default (see 'Credit risk' below). However, over the life of a bond, the yield priced by the market (as opposed to actual fixed coupons payable) at any given time will depend on the market environment at that time. Therefore, a bond sold before its redemption date is likely to have a different price to its purchase price and a profit or loss may be incurred.

Credit risk

The value of a fixed interest security will fall in the event of the default or reduced credit rating of the issuer. Generally, the higher the rate of interest, the higher the perceived credit risk of the issuer. This fund may invest a percentage of it's assets in sub-investment grade bonds. Such bonds have characteristics which may result in higher probability of default than investment grade bonds and therefore higher risk.

Overseas markets risk

Funds investing in overseas securities are exposed to, and can hold, currencies other than Sterling. As a result, overseas investments may be affected by the rise and fall in exchange rates.

Derivatives risk for efficient portfolio management

Derivatives may be used by this Fund for the purpose of efficient portfolio management. This restricts the use of derivatives to the reduction of risk and the reduction of cost. Such transactions must be economically appropriate and the exposure fully covered.

Derivatives risk for investment purposes

This fund may undertake transactions in derivatives and forward transactions (both on exchange and over the counter (OTC)). These may include interest rate swaps and interest rate futures for the purposes of meeting the investment objective, protecting the risk to capital, duration and credit management, as well as for hedging. While the discerning use of derivatives can be beneficial, derivatives also involve specific risks. These risks relate specifically to market risk, management risk, credit risk, liquidity risk, the risk of mispricing or improper valuation of derivatives and the risk that derivatives may not correlate perfectly with underlying assets, interest rates and indices. The use of derivative instruments may from time to time alter the economic exposure of the fund causing it to deviate significantly from the performance of the market as a whole. The use of these derivatives will be within the parameters allowed for linked funds by the Financial Conduct Authority and Prudential Regulation Authority.

Performance to 30 September 2024

Cumulative (%)

	3 Month	6 Month	1 Year	3 Years	Since Inception
Fund (gross)	2.36	2.31	11.02	(7.29)	(6.11)
Fund (net)	2.36	2.31	11.02	(7.29)	(6.11)

Annualised (%)

3 Years (p.a.)	Since Inception (p.a.)
(2.49)	(1.78)
(2.49)	(1.78)

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)	11.02	6.95	(21.92)	-	-
Fund (net)	11.02	6.95	(21.92)	-	-

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 RLPPC Enhanced Buy and Maintain Cash Flows Fund S Inc; Since inception date 2 April 2021.

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.

Credit spread

Credit spread is the difference in yield between two debt securities of the same maturity but different credit quality.

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.

Rating changes - downgrades

Directly held credit bonds downgraded from investment grade to sub-investment grade based on the RLAM composite rating during the quarter.

Rating changes - upgrades

Directly held credit bonds upgraded from sub-investment grade to investment grade based on the RLAM composite rating during the quarter.

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.