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RLPPC UK Long Corporate Bond 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 UK Long 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.

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ROYAL LONDON
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The fund

Fund performance objective and benchmark

The Fund aims to achieve +0.50% in excess of the benchmark net of fees per annum, on a rolling three year basis. The UK Long Corporate Bond Fund (LCF) invests predominantly in long-dated sterling credit bonds, including unrated bonds and sub-investment grade bonds. The fund may also invest in UK government bonds and non-sterling bonds. The Markit iBoxx GBP Non-Gilts Over 15 Years index is considered an appropriate benchmark for performance comparison.

Benchmark: Markit iBoxx Sterling Non-Gilt over 15 Years Index

Fund value

	Total £m
30 September 2024	204.90

Asset allocation

	Fund (%)	Benchmark
Conventional credit bonds	93.00%	98.80%
Conventional gilts	3.41%	-
Securitised	2.49%	-
Conventional foreign sovereign	1.10%	1.20%

Fund analytics

	Fund	Benchmark
Fund launch date	30 April 2003	
Base currency	GBP	
Duration (years)	12.89	12.98
Gross redemption yield (%)	5.96	5.60
Number of holdings	121	213
Number of issuers	99	145

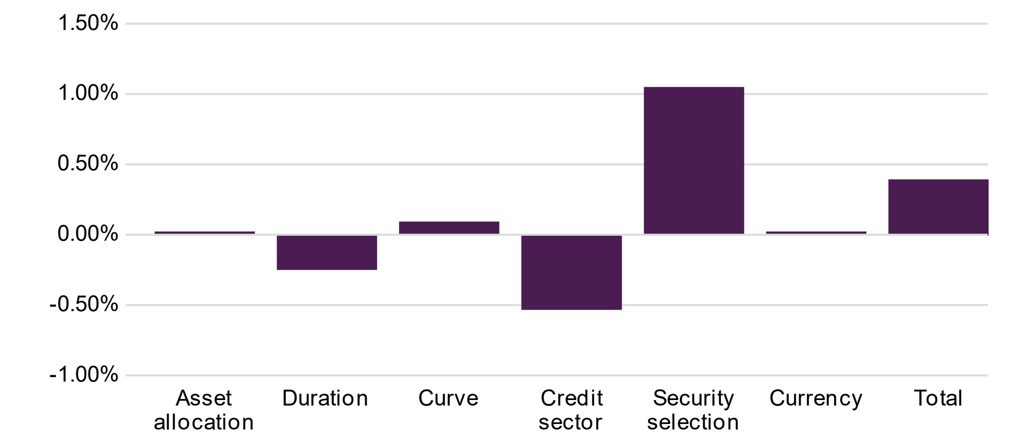
Performance and activity

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Quarter	1.99	1.62	0.37
YTD	(0.92)	(2.36)	1.44
1 Year	13.85	12.36	1.49
3 Years (p.a.)	(8.20)	(10.08)	1.87
5 Years (p.a.)	(3.84)	(5.56)	1.72
10 Years (p.a.)	2.45	1.32	1.14
Since inception (p.a.)	4.86	4.02	0.84

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 Long Corporate Bond Fund (Acc). Source: Royal London Asset Management; Net performance; Since inception date of the share class is 30 April 2003.

Attribution over the quarter



Performance commentary

The third quarter was positive for fixed income investors, with strong absolute returns from sterling credit markets. The portfolio outperformed its benchmark index over the period, with positive contributions from the combination of stock and sector positioning. Within the banking sector, our exposure to subordinated bonds was again helpful while in insurance, our exposure to selected long-dated bonds was also beneficial.

Against this, our exposure to structured bonds was a small negative. This was largely due to ongoing volatility in the water sector, with bonds in Thames 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 (%)
ELECTRICITE DE FRANCE SA 6.000000000 2114-01-23	3.75
UNITED KINGDOM GILT 0.500000000 2061-10-22	3.41
M&G PLC 6.340000000 2063-12-19	2.42
HSBC HOLDINGS PLC 6.000000000 2040-03-29	2.25
HEATHROW FUNDING LTD 4.625000000 2046-10-31	2.11
M&G PLC 6.250000000 2068-10-20	2.02
FIN FOR RESID SOC HOUS 8.369000000 2058-10-04	2.00
LEGAL & GENERAL GROUP 5.500000000 2064-06-27	1.91
GENFINANCE II PLC 6.064000000 2039-12-21	1.81
WELLCOME TRUST LTD/THE 2.517000000 2118-02-07	1.80
Total	**23.48**

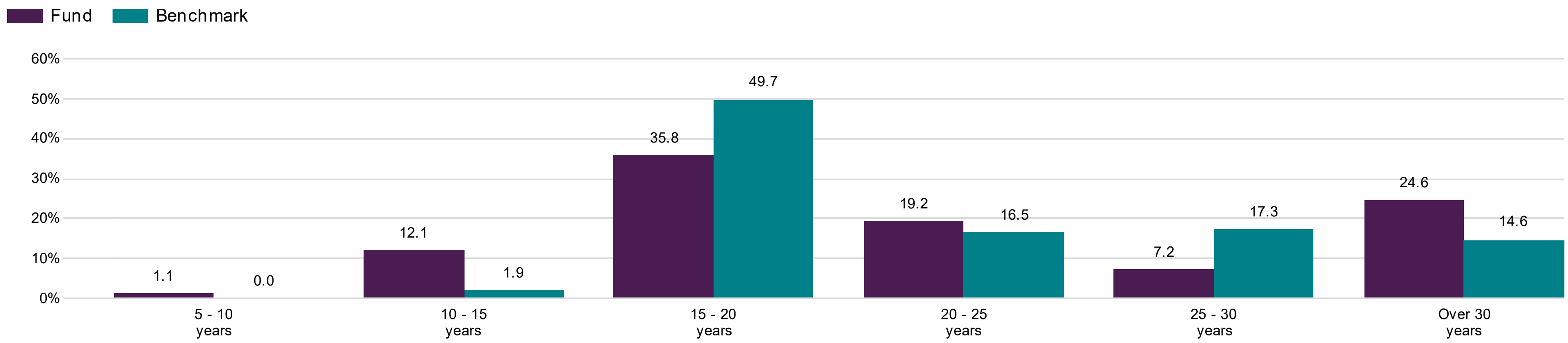
Fund activity

Financials remain the focus of activity across both new issue and secondary markets. 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.

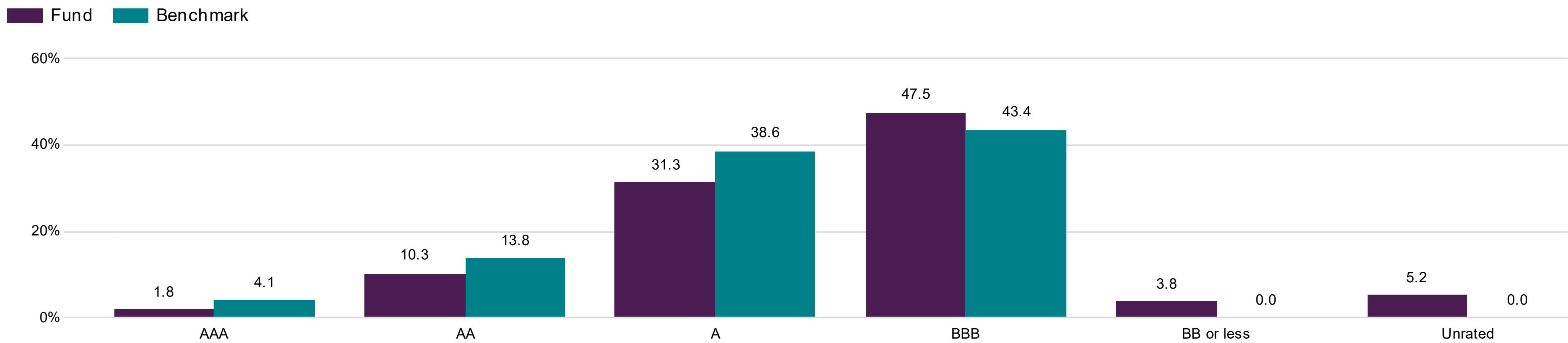
While areas such as financials and structured bonds remain the largest in our portfolios, we look for opportunities in other areas to aid overall portfolio diversification. In the real estate sector, we added a new issue from Realty Income, which invest in diversified commercial real estate, primarily in the US but also UK and mainland Europe. In the transport sector, we added East Japan Railway, attractive long-dated bonds supporting critical infrastructure.

Fund breakdown

Maturity profile

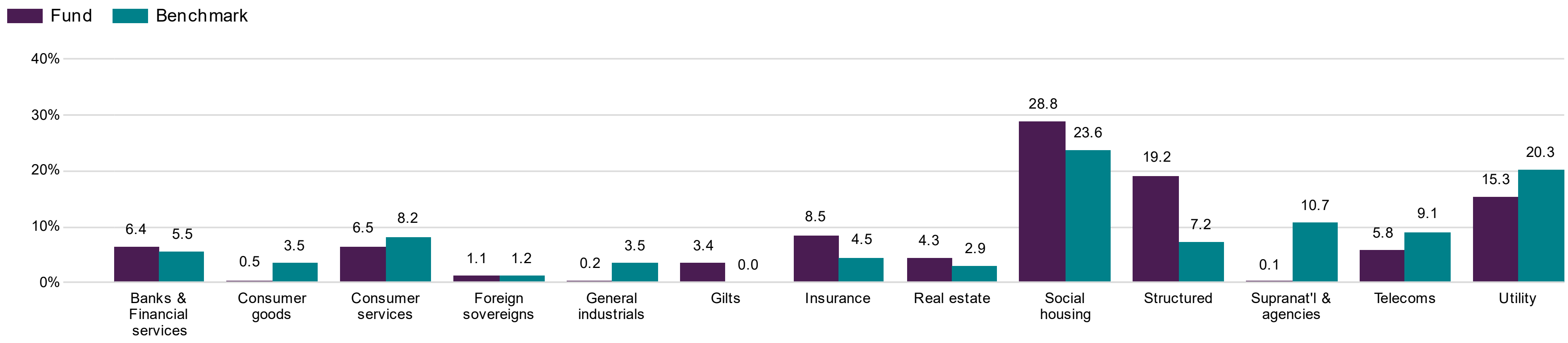


Credit ratings



Fund breakdown

Sector breakdown



Characteristics and climate

Climate metrics

	Fund	Benchmark	Difference (%)
Financed emissions (tCO2e)	13,548	n/a	n/a
Financed emissions coverage	36.47%	n/a	n/a
Carbon footprint (tCO2e/$M invested)	52.01	60.16	(13.55)
Carbon footprint coverage	36.47%	39.27%	(7.14)
Weighted average carbon intensity (tCO2e/$M sales)	60.72	88.89	(31.69)
Weighted average carbon intensity coverage	93.10%	94.49%	(1.47)

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	36.47	39.27	(7.14)
% of portfolio below 2°C ITR	35.32	47.09	(25.00)
% of portfolio below 1.5°C ITR	15.39	19.30	(20.25)

SBTi net - zero

	Fund (%)	Benchmark (%)	Difference (%)
SBTi Net-Zero committed	10.72	13.54	(20.76)
SBTi Near-Term committed	0.65	3.86	(83.22)
SBTi Near-Term targets set	19.14	23.40	(18.20)

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	12	31
Number of engagements	16	66

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	6
Climate	6
Climate - Physical Risk	3
Climate - Transition Risk	3
Governance	3
Corporate Governance	2
Remuneration	1
Health	5
Health - Community	5
Social & Financial Inclusion	6
Just transition	5
Labour & Human Rights	1
Technology, Innovation & Society	1
Technology & Society	1

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

HSBC Bank Plc - Just transition

Purpose:

Our engagement purpose was to encourage HSBC to disclose its plans for integrating social issues into its decarbonisation strategy, in line with the just transition considerations outlined in the Paris Agreement.

Outcome:

Since publishing its net zero report, the company has been strategically embedding just transition principles. It prioritised innovation in sustainability-related lending, aiming to extend services to a broader customer base, including smaller businesses. The company is exploring the development of sustainability-linked bonds and loans and assessing the necessity of just transition-linked products. In emerging markets, it continues to work on the Just Energy Transition Partnership project. The company is also increasing integration across its retail bank and asset management divisions. While it faces challenges in applying universal principles to both emerging and developed markets, it is committed to supporting just transition while meeting climate targets. The company is enhancing relationship managers' understanding of just transition and incorporating specific questions into climate transition plans for high-emitting sectors. Although further details on its plans are pending, the company has an ambitious work plan for the next five months and plans to include initial disclosures in existing reports, with potential for a standalone plan in the future.

United Utilities - Biodiversity

Purpose:

The engagement meeting aimed to understand United Utilities' strategies and commitments towards enhancing biodiversity, managing water quality, and addressing environmental challenges. The collaborative engagement sought insights into the company's plans and performance commitments in these areas.

Outcome:

United Utilities emphasised its focus on achieving net gains in biodiversity and has appointed a Biodiversity Strategy Manager to develop a comprehensive strategy. The company discussed plans to address wastewater overflows through hybrid solutions and sustainable drainage systems, highlighting the importance of urban biodiversity and connectivity. The company outlined its land strategy, aiming for a 10% biodiversity net gain and addressing targets for Sites of Special Scientific Interest (SSSIs). United Utilities is exploring technological solutions such as drones for baseline biodiversity assessments and monitoring. It is also collaborating with partners to drive landscape recovery and implement nature-based solutions, while also engaging with regulators to shape future policies. Its environmental strategy includes initiatives for carbon sequestration, peatland restoration, and woodland creation. The company is addressing pollution in Lake Windermere and is part of the UK water industry's research programme on antimicrobial resistance, working to enhance water management quality.

Fund Engagement

Engagement outcomes

Vodafone – Ethical AI

Purpose:

A meeting was organised to discuss Vodafone's approach to ethical AI, focusing on the history, current practices, and future strategies for AI deployment within the company as part of the World Benchmarking Alliance's (WBA) collaborative engagement.

Outcome:

Vodafone has established a comprehensive AI governance structure, ensuring AI is a recognised role within the organisation. A dedicated team manages AI compliance and ethics, embedding new EU data regulations. The governance board oversees AI projects from ideation to implementation, incorporating risk assessments. Vodafone aims to avoid 'shadow AI' (the use of generative AI without the control or knowledge of the business) by embedding AI into its technology architecture which adheres to GDPR and the EU Privacy Directive. The company focuses on responsible AI, complying with the EU AI Act, and participates in forums to stay ahead in AI governance. Ethical principles such as transparency, fairness, and DEI guide its AI development, supported by an AI assessment platform and role-based training for reskilling. We will evaluate the company's performance in comparison to its peers as part of the broader WBA collaborative engagement and identify potential areas for improvement.

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.

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.

ROYAL LONDON ASSET MANAGEMENT

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

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Risks and Warnings

General risks

The degree of investment risk depends on the fund you choose.
The prices of units can go down as well as up.
The return from your investment is not guaranteed; therefore, you may get back less or more than shown in the illustrations.
You may not get back the amount that you originally invested.
Past performance is not a guide to future return.
Inflation may, over time, reduce the value of your investments in real terms.
There may be a variation in performance between funds with similar objectives owing to the different assets selected.
Funds aiming for relatively high performance can incur greater risk than those adopting a more standard investment approach.
The use of derivatives in pursuit of a fund's objective may cause its risk profile to change and this may be material.

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.

Performance to 30 September 2024

Cumulative (%)

	3 Month	6 Month	1 Year	3 Years	5 Years
Fund (gross)	2.08	0.47	14.22	(21.92)	(16.46)
Fund (net)	1.99	0.31	13.85	(22.66)	(17.78)

Annualised (%)

3 Years (p.a.)	5 Years (p.a.)
(7.91)	(3.53)
(8.20)	(3.84)

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)	14.22	4.40	(34.52)	0.56	6.40
Fund (net)	13.85	4.07	(34.73)	0.23	6.07

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 Long Corporate Bond Fund (Acc).

Glossary

Asset allocation

Breakdown of the assets by asset classes. Based on RLAM asset classification scheme.

Attribution

Attribution is shown for the most recent quarter. Attribution figures are based on end of business returns for both the fund and the index whereas performance figures are based on midday returns for the fund and end of business for the index. Therefore the performance will not include market moves between midday when the fund is priced, and end of business when the index is calculated. This may result in a different figure being shown for the quarterly performance vs attribution data.

Carbon footprint

Exposure to high emitters in the portfolio, expressed in tCO2e/$M invested. Financed emissions are divided by the portfolio value, the same approach for listed companies and private issuers is applied in this metric.

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.

Financed emissions

The emissions from activities in the real economy that are financed through lending and investment portfolios, expressed in tCO2e. Emissions are attributed to a portfolio based on the portion of the company's value the portfolio holds, and using different accounting values for public and private corporates. We provide financed emissions for scope 1 and 2 emissions.

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.

Implied temperature rise (ITR)

ITR aims to measure the global warming outcome from the emissions trajectory of a company, if the whole economy followed the same trajectory.

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.

SBTi

The Science-Based Targets initiative is a consortium of organisations that set up the definition and promotion of science-based target setting.

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.

Glossary

Weighted Average Carbon Intensity (WACI)

Portfolio's exposure to carbon-intensive companies, expressed in tCO2e / $M revenue. Scope 1 and scope 2 GHG emissions are divided by companies revenues, then multiplied based on portfolio weights (the current value of the investment relative to the current portfolio value). The WACI is calculated as a weighted average sum of the holdings with carbon intensity coverage.

In line with our bespoke and targeted approach to credit analysis, we have developed an in-house carbon data tool that addresses coverage and mapping issues with third party systems. The development of this tool has been a critical element of RLAM's ESG integration into our credit process, addressing coverage and mapping issues with third party systems. This enhanced coverage is reflected in the WACI figures provided in this report, with all other metrics instead being based on data from MSCI.