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Royal London Sterling Extra Yield 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 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 September 2024	1,666.40

Asset allocation

	Fund (%)
Conventional credit bonds	93.40%
Conventional gilts	1.60%
Securitised	0.96%
Index linked credit bonds	0.13%
Other	3.91%

Fund analytics

	Fund
Fund launch date	11 April 2003
Base currency	GBP
Duration (years)	3.99
Yield to worst (%)	7.70
Number of holdings	250
Number of issuers	182

Performance to 30 September 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	3.16	8.88	14.72	4.79	5.23	6.45	7.79
Z Inc GBP	3.16	8.88	14.73	4.79	5.23	6.45	6.85

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 third quarter of 2024 amidst fairly benign markets, with spreads moving sideways and government yields falling.

Distributions in respect of the third quarter of 2024, payable at the end of November, are 1.88p, 1.71p, 1.75p and 1.74p, respectively for the A, B, Y and Z class income shares. These compare to amounts of 1.68p, 1.52p, 1.58p and 1.56p respectively distributed in respective of Q2 2024, and to 1.96p, 1.80p, 1.82p and 1.81p respectively distributed in respect of Q3 2023.

Performance at the start of the quarter was driven by the financial sectors of banking and insurance, especially the latter, with bonds of insurers Allianz, Aviva, Esure, M&G and Phoenix each up around 3% in July while banks including BNP, NatWest, Rabobank and Santander UK were up around 2%. This strength reflected both the financial sectors' sensitivity to the supportive market sentiment and their longer average duration than the fund, thus tending to benefit more from the decline in yields in the month.

This trend continued towards the end of the quarter - while generally relatively little price movement – performance was driven by the financial sectors of banking and insurance. Holdings in banks BNP, Lloyds, NatWest, Standard Chartered and UBS performed well in September, while holdings of insurance companies British Insurance, Esure, and Utmost notching up somewhat higher price improvements.

The investment in Doric Nimrod Air 2, the business leasing Boeing A380 aircraft to Emirates, performed well on news that agreement had been reached with Emirates for the sale of the aircraft at the end of what are now fairly short term leases. Amadeo Air, a similar business, also saw a price increase on the news.

The most significant detractor from performance in the period was the investment in Thames Water, where bonds fell by about 20% early in the quarter as markets reacted to adverse news flow, encompassing the regulator OFWAT's initial price determination for the sector for the prospective five-year period and credit rating agency downgraded Thames Water bonds to below investment grade.

Performance and activity

Top 10 holdings

	Weighting (%)
ELECTRICITE DE FRANCE SA 5.875000000	2.46
CO-OP GRP HLDS 7.500000000 2026-07-08	2.19
SANTANDER UK PLC 10.062500000	2.09
METROCENTRE FINANCE 8.750000000 2024-12-05	2.04
Santander UK 10.375% Pref Perp	2.03
CENTRICA PLC 6.500000000 2055-05-21	1.90
M&G PLC 6.340000000 2063-12-19	1.83
PHOENIX GRP HLD PLC 5.750000000	1.70
UNITED KINGDOM GILT 5.000000000 2025-03-07	1.60
ELECTRICITE DE FRANCE SA 7.375000000	1.58
Total	**19.42**

Fund activity

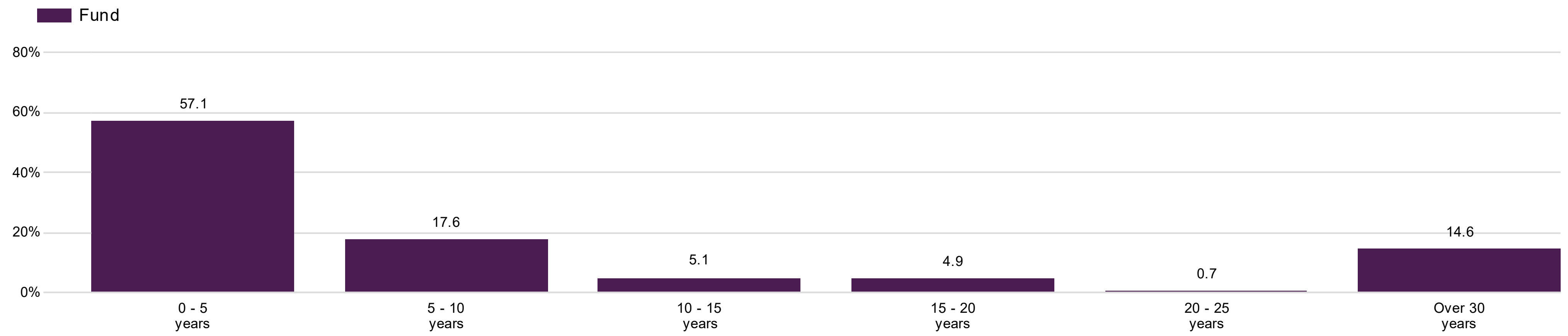
The fund participated in the flow of new issues in the quarter, but we saw reduced activity early in the period, reflecting the summer holiday period. In July, the fund participated in three new issues; BioCirc, the Danish renewable energy business offering four-year unrated floating rate euro-denominated bonds at an initial yield of 9.7%; Lime Petroleum, the North Sea Norwegian sector energy business offering three-year unrated floating rate Norwegian krone denominated bonds at an initial yield of 14%; and Stonegate Pub Company, the largest UK pub operator who issued five-year B rated euro-denominated floating rate bonds at a margin of 6.6% over three-month money market rates – this last new issue was part of a refinancing of the business elements of which were the pending early repayments at attractive pricing of shorter dated bonds in the business and of a tranche of senior secured and structured bonds, both held within the fund.

In August, activity included US dollar bonds of Dresdner Bank, euro denominated hybrid bonds – where the issuer has the option to extend repayment beyond the 2029 first call date but at increasing cost – of pharmaceutical company Merck, and unrated bonds of shipping group Ocean Yield.

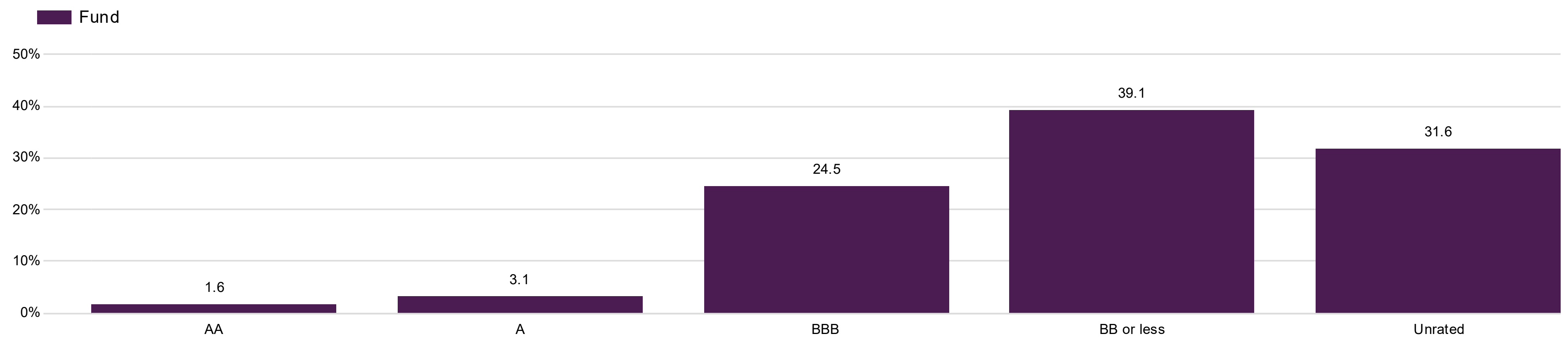
Towards the end of the quarter, we participated in new issues US dollar denominated bonds of banks HSBC and ING, and sterling denominated bonds of Nationwide Building Society, together with unrated bonds of shipping businesses Golar LNG and MPC Container Ships, and of Swedish technology group EcoDataCenter. Also in the month, a number of companies tendered or repaid bonds held in the fund, whilst concurrently issuing new bonds – these included utility EDF, insurer Just Group, and specialist recruitment business NES Fircroft. The fund benefited from an uplift from market price to repayment price and attractive pricing on the new bonds. Sales in the quarter included Royal Bank of Canada US dollar denominated AT1 bonds, crystallising a 4% capital profit from issue in April, and further reducing the holding of shares in DOF, after their sharp rise in price. A relatively small holding of secured property bonds of Intu Debenture was sold, crystallising a capital gain from purchase and at a level well above the latest valuation of the underlying assets, while 2025 dated bonds of energy company Genel were sold back to the company in a tender process at a level above par and their prevailing market price. We also sold bonds of vehicle manufacturer VW, while leisure company Unique Pub Finance elected to repay a tranche of their outstanding debt at a premium to the prevailing market price and banking group Barclays exercised their option to repay at the first call date on an AT1 issue.

Fund breakdown

Maturity profile

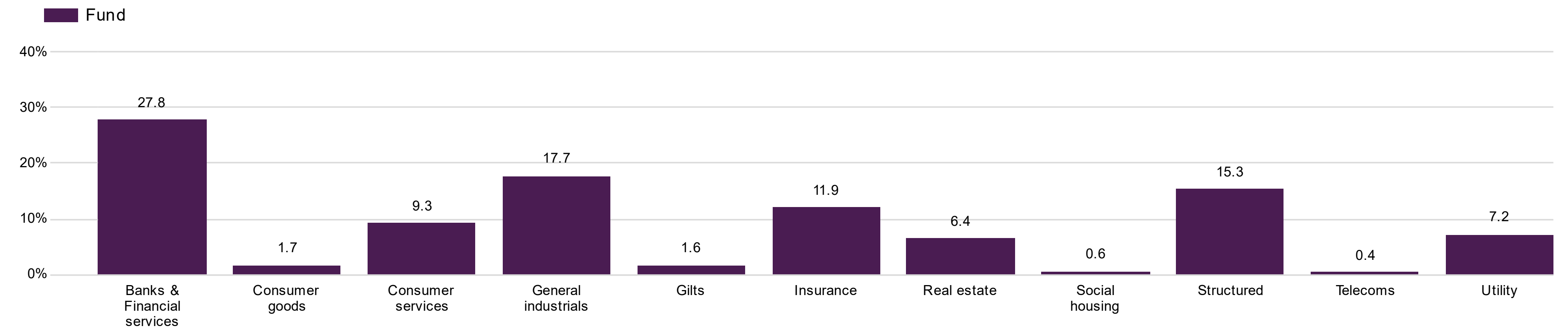


Credit ratings

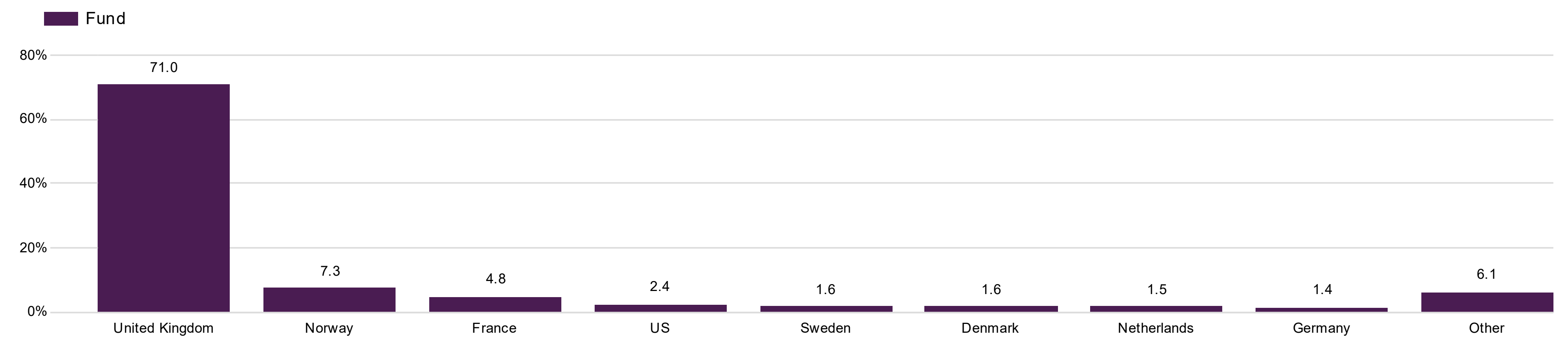


Fund breakdown

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	10	27
Number of engagements	15	73

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	**3**
Climate - Transition Risk	3
Governance	**4**
Remuneration	4
Social & Financial Inclusion	**7**
Just transition	6
Social & Financial inclusion	1
Technology, Innovation & Society	**2**
Cybersecurity	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.

NatWest - Just transition

Purpose:

We engaged with NatWest as part of a collaborative engagement with banks to integrate just transition principles into their climate transition plans. The aim was to address any questions regarding our recently published investor expectations on just transition and the banking sector. We aimed to encourage the bank to align its strategies accordingly.

Outcome:

NatWest initially expressed concerns about being evaluated solely on financial returns, which it felt constrained its incentives for ESG activities. However, the bank recognised the value of aligning with our just transition investor expectations for the sector. It found these guidelines beneficial in setting ambitious goals and taking subsequent actions. NatWest discussed the establishment of a new energy transition fund with a different risk appetite and committed to a social housing fund. The company acknowledged the importance of integrating just transition principles into its plans to enhance credibility and was receptive to our feedback on improving its communication around the issue.

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.

Volkswagen – Cyber security

Purpose:

Following our engagement with Volkswagen in March 2024, we aimed to assess its responses to our queries and public disclosures using our cybersecurity scoring methodology. This evaluation was intended to identify areas for improvement and encourage better practices.

Outcome:

We assessed Volkswagen's cybersecurity practices and based on this evaluation, we sent a follow-up email to Volkswagen with several key recommendations. We encouraged timely disclosures of significant cybersecurity incidents to enhance transparency and investor confidence. We suggested incorporating cyber considerations into inorganic growth strategies, adopting a digital-centric approach. We requested detailed information on vulnerability and penetration testing processes. Additionally, we recommended collaboration with peers and government bodies to enhance cyber standards and risk management. We advised evaluating cybersecurity in board effectiveness reviews and integrating cybersecurity KPIs into executive compensation to demonstrate a proactive approach to managing cyber risks. We will continue to monitor the company's disclosure for improvements in cyber security reporting.

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 then the well-publicised first debate, which appeared to favour Trump over President Biden, but then swung back as Kamala Harris emerged as a credible candidate and performed strongly in the second 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. The Fed see diminished upside risks to inflation and increased downside risks to employment and eased policy accordingly. 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.” As of their September meeting, the median forecast of participants showed another 50bps of cuts over the rest of 2024, then a further 100bps easing over 2025. Inflation data released over the quarter was relatively reassuring, while Q2 GDP was strong and forward-looking indicators were consistent with a continued robust pace of growth in Q3 by the end of the quarter. These mixed data signals contributed to ongoing volatility in US treasury markets.

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. Lagarde's comments at the time didn't give much away in terms of the likely pace of future cuts (beyond that they expect to be lowering rates further). Euro area CPI moved lower but there was little change in core or services inflation, which remains stubbornly above target levels. French politics were a focus for the early part of the quarter with a hung parliament the end result from the July election. Following these election results Michel Barnier – who previously negotiated with the UK over the terms of Brexit - was selected as PM in September and delayed a target to bring the deficit back within EU rules until 2029.

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 bond 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

Market commentary

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.

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 further increase uncertainty.

We believe current valuation levels for corporate bonds are attractive and continue to compensate investors for the risk of downgrade and, despite the uncertainties highlighted above, the outlook for the corporate sector remains relatively benign. A characteristic of the fund is the scope to invest across a wide range of assets, encompassing investment grade, high yield 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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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 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

Credit risk is the potential for loss due to a borrower, debtor or debt issuer defaulting on agreed obligations to make interest or capital repayments. Credit ratings are independent assessments of the credit risk of a debtor or an individual debt security. Securities that have a lower credit rating have a higher 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 September 2024

Cumulative (%)

	3 Month	6 Month	1 Year	3 Years	5 Years
A Inc GBP (gross)	3.16	4.84	14.72	15.08	29.06
A Inc GBP (net)	2.94	4.40	13.76	12.22	23.81
Z Inc GBP (gross)	3.16	4.84	14.73	15.08	29.06
Z Inc GBP (net)	3.01	4.54	14.06	13.10	25.43

Annualised (%)

	3 Years (p.a.)	5 Years (p.a.)
A Inc GBP (gross)	4.79	5.23
A Inc GBP (net)	3.91	4.36
Z Inc GBP (gross)	4.79	5.23
Z Inc GBP (net)	4.18	4.63

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
A Inc GBP (gross)	14.72	9.58	(8.45)	14.85	(2.35)
A Inc GBP (net)	13.76	8.66	(9.22)	13.89	(3.12)
Z Inc GBP (gross)	14.73	9.57	(8.45)	14.85	(2.35)
Z Inc GBP (net)	14.06	8.93	(8.98)	14.18	(2.87)

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.

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.

Income yield

Income yield reflects the annualised income net of expenses of the Fund as a percentage (calculated in accordance with the relevant accounting standards). Yield to Worst and Income Yield are calculated as a percentage of the mid-price of the Fund as at the date shown and are month end snap shots of the portfolio on that day and do not include any preliminary charges. Investors may be subject to tax on distributions.

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 signed off NAV per share. The impact of fees or other charges including tax, where applicable, can be material on the performance of your investment. The impact of fees reduces the return.

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

The lowest potential yield that can be received on a bond without the issuer defaulting. The yield shown for the Fund is the average for its individual holdings, weighted by their current market value, net of relevant fund management costs and gross of tax.