ROYAL LONDON GLOBAL BOND OPPORTUNITIES FUND

Quarterly Report 30 September 2020

For professional clients only, not suitable for retail investors

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Executive summary

- The fund returned 3.19% over the third quarter, gross of tax and management fees of the Z share class.
- The fund's Z share income distribution for the third quarter, payable at the end of November, is 1.31p, above the 1.26p distributed in respect of the second quarter of 2020.
- Markets continued their recovery since March during the quarter, albeit at a reduced pace compared to the previous quarter. The riskier asset classes continued to outperform, with improving underlying economic data, better than-expected corporate earnings and progress towards vaccines and treatments for Covid-19 supporting the risk-seeking investor sentiment. The fund performed strongly in this environment and has now substantially recovered from the March sell-off. After having returned -14.47% in the first quarter, the fund is now -0.86% for the year to date.

Performance

	Fund (%)
Q3 2020	**3.19**
Year-to-date	-0.86
Rolling 12 months	0.74
3 years p.a	3.61
Since inception p.a. 08.12.2015	5.61

Past performance is not necessarily a reliable indicator of future performance. The value of investments and the income from them is not guaranteed and may go down as well as up and investors may not get back the amount originally invested.

All performance figures stated gross of fees and tax unless otherwise stated, subject to rounding.

Source: RLAM. Based on the Z Inc share class. Performance for the fund is calculated on a mid basis with income re-invested. The fund returns in the table above are gross of standard management fees.

Yields

	Fund
Gross redemption yield[1]	5.01%
Gross income yield[1]	5.44%

Source: RLAM and State Street. Based on the Z Inc share class.

[1]Net of standard management charges.

[2]Excluding cash

Reported yields reflect RLAM's current perception of market conventions around timing of bond cash flows. Heightened uncertainty due to the COVID 19 crisis may impact these timings for bonds with callable feature.

Fund data

	Fund
Duration[2]	3.4 years
No. of stocks	197
Fund size	£219.2m
Launch date	08.12.2015

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Fund strategy

- The fund aims to achieve a high level of income with the opportunity for capital growth, by seeking attractive investments across a broad spectrum of fixed income opportunities, encompassing investment grade, sub-investment grade and unrated bonds.
- The fund mitigates stock-specific risk by holding a diversified portfolio of investments, so that no individual allocation can in isolation have an undue impact on overall performance.
- The fund's assets are held in securities denominated across a range of G10 currencies, with currency exposures substantially hedged back to sterling.
- The average duration of the fund's portfolio is relatively short, at 3.4 years, and the sensitivity of the fund's performance to changes in government bond yields is consequently modest.

Market Background

Index	Total return (%)	Spread movement (basis points)
HY global non-financial corps ICE BofA ML global non-financial high yield index	4.12	-88
AT1 ICE BofA ML contingent capital index	4.02	-28
HY non-financial emerging markets ICE BofA ML emerging markets high yield ex. subordinated financial index	3.42	-64
HY global non-financial hybrid corps ICE BofA ML global hybrid non-financial high yield index	3.11	-14
IG global non-financial hybrid corps ICE BofA ML global hybrid non-financial corporate index	2.39	-23
Euro investment grade corporate bonds ICE BofA ML euro corporate and Pfandbriefe index	1.89	-29
Dollar investment grade corporate bonds ICE BofA ML US corporate index	1.69	-16
Sterling investment grade corporate bonds ICE BofA ML sterling corporate and collateralised index	1.44	-23

Source: Bloomberg.

- Risk assets continued to perform strongly over the quarter, with AT1 and high yield debt markedly outperforming investment grade issues. This strong performance from risk assets came despite a significant rise in daily new Covid-19 cases globally, prompting many governments to tighten social distancing measures. The key drivers behind the increased risk appetite were improvements in underlying economic data, stronger-than-expected corporate earnings and positive newsflow on the development of vaccines and treatments for Covid-19.
- It was the second busiest quarter for high yield issuance ever; the busiest having been the previous quarter. This reflected companies taking a proactive approach in managing their risks, conscious of the pressures they came under in March, with the replacement cost of capital being lower for almost all of them. The amount of issuance was almost double that seen in the third quarter of 2019, with the majority being BB or B rated and overwhelmingly coming from the US dollar market. The comparatively muted European issuance continued to reflect the fact that European companies were able to raise liquidity through public sector facilities, rather than relying on the primary market.
- Having rallied strongly in the second quarter, oil prices traded within a fairly narrow range during the third quarter, ending September close to the price at the end of June. Natural gas prices performed more strongly, rising from around $1.75 per million British Thermal Units (MMBtu) to approximately $2.5/MMBtu. Reflecting the backdrop of rising commodity prices over the second and third quarters, as well as factors like an increase in the quality of the sector due to fallen angels (credit downgrades from investment grade to high yield) the energy sector performed very strongly in July, though struggled in September; possibly reflecting an acknowledgement that the rally in oil prices had ended.

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Fund commentary

- A number of the fund's holdings within the financial sectors (banks and insurance) performed very strongly over the quarter. This reflected their sensitivity to the continued improvement in sentiment in corporate bonds, as well as their strong income generation. Among them, noteworthy contributions to returns came from the banks **Lloyds** and **Rabobank**, the insurance businesses of **M&G** and **MetLife**, and the specialist multinational investor **DDM Debt**. An exception to these generally strong performances within the financial sectors was the fund's holding of **Metro Bank** debt. Covid-19 has compromised the profitability of the challenger bank, as it has been forced to increase loan provisions for bad debts.
- Investments in shipping, typically secured and over-collateralised, with a first charge on assets, were generally strong following subdued recent performance – these included **Borealis Finance**, **Global Ship Lease** and **MPC Containerships**. Within the general industrials sector, there were mixed performances. While oil & gas companies like **Ithaca Energy** and **Tulip Oil** delivered strong returns against the backdrop of higher oil prices, bonds of oil production platform vessel operator **Floatel International**, offshore drilling contractor **Vantage Drilling** and multinational mining and metallurgy company **Eramet** were down over the quarter.
- While the share price of **Amadeo Air Four Plus**, the aircraft leasing business, was little changed over the quarter, ending September at 33p, the company repaid one third of holdings at a price of 46p. This reflected the sale proceeds of two aircraft to Etihad earlier in spring this year. The company also announced its intention to resume dividend distributions, which had been suspended in April. Repayment proceeds from **Mutual Securitisation** were also received during the quarter.
- Our activity in the primary markets was fairly limited in July and August, reflecting the quieter holiday period, influential even in the context of the travel situation in the pandemic. With respect to new issues, our purchases included B rated, secured, five-year bonds of **Stonegate**, refinancing part of the cost of its recent acquisition of Enterprise Inns in a deal worth nearly £1bn; five-year floating rate notes of **Teekay Shuttle Tankers**, financing modern, fuel-efficient vessels; and long-dated subordinated debt of Finnish insurance group **Sampo Oyj**. We were able to become more active in September, with investment in new issues of renewable energy provider **European Energy**, oil company **Genel Energy**, property business **Scentre Group**, insurer **Swiss Re** and Italian bank **UniCredit**. We also added a new tranche of bonds of data centre owner **Bulk Infrastructure**.

Investment outlook

- While Covid-19 has certainly not disappeared, countries appear to have learned to cope with it better. There is evidence that treatments for the virus have improved and vulnerable people are being more effectively shielded. As a consequence, the proportion of deaths from the virus compared to total cases has fallen. At the same time, government measures for combating the virus are now less draconian, as alternatives to blanket lockdowns like 'test and trace' and localised lockdowns have become viable.
- We expect that economic activity will gradually improve in 2021, particularly if a successful vaccine or treatment for the Covid-19 becomes widely available. There are, however, many threats to this expectation: the possibility of new waves of the virus, complications in the development and distribution of vaccines, subdued consumer confidence and business investment, corporate failures, and government and central bank policies. In Europe, there are also uncertainties surrounding new trading arrangements between the UK and EU.
- The economic damage wrought by Covid-19 and the measures to contain its spread have been substantial. While most sectors have bounced back strongly, the second-order impacts remain evident. There is, nevertheless, still a high level of policy support in most economies, and this is likely to be increased in the US via the CARES Act. We expect that economies will recover slowly from here, with higher levels of unemployment.
- Over the next two or three years, interest rates look set to remain at very low levels, with yield curves heavily managed by governments. Central banks appear increasingly comfortable running inflation above their historic target levels, given their desires to avoid painful economic recessions. As yet, there are few signs of higher inflation, but it remains a possibility that will need to be monitored.
- We continue to believe that portfolio diversification is important and a focus on bonds supported by stable income streams and structural enhancements should provide protection in times of market turbulence. While the economic impact of the virus will have a detrimental impact on corporate profitability, we consider that the current credit spread offers sufficient compensation for default and other risks (e.g. liquidity and rating migration).

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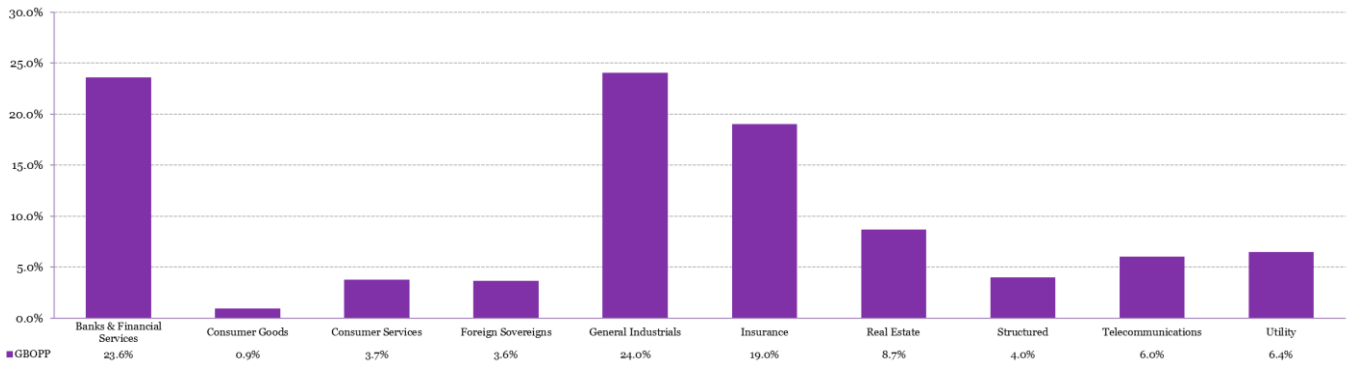
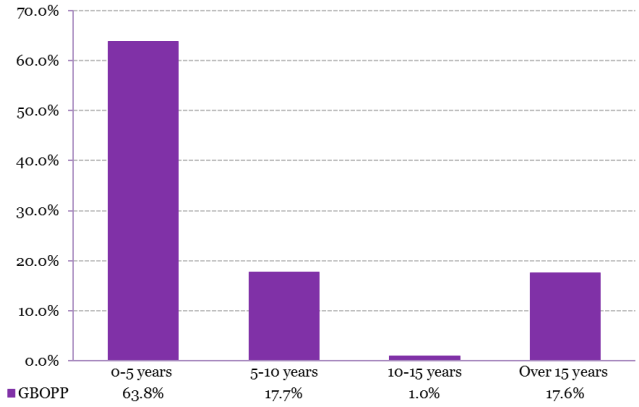
Sector breakdown



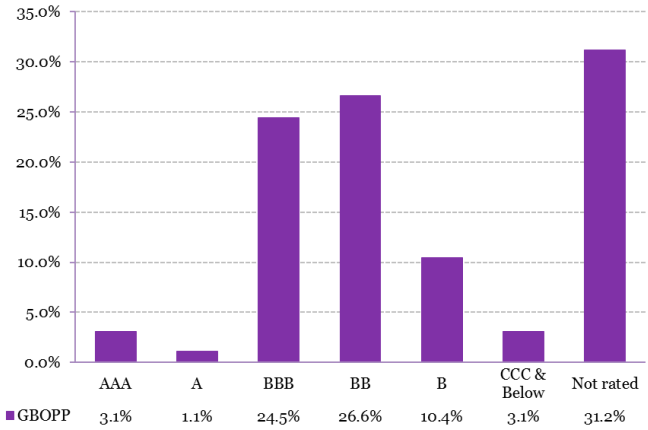
Source: RLAM. Figures include the impact of cash held.

Maturity profile



Source: RLAM. Figures include the impact of cash held.

Credit breakdown



Source: RLAM. Figures include the impact of cash held.

Ten largest bond holdings

	Weighting (%)
Lloyds Banking Group Plc 6.413% Perpetual	1.9
AXA SA 5.5% Perpetual	1.7
M&G Plc 3.875% 2049	1.5
Cooperatieve Rabobank U.A. 6.5% Perpetual	1.4
Aggregated Micro Power Infrastructure 8% 2036	1.4
Digiplex Norway Holding 2 AS FRN 2024	1.4
Heimstaden Perpetual	1.4
Lamon 6.75% 2044	1.3
ML 33 Holding A.S. 5.5% 2021	1.3
Storebrand Livsforsikring 6.875% 2043	1.3
Total	**14.6**

Source: RLAM. Figures include the impact of cash held, subject to rounding.

ROYAL LONDON
ASSET MANAGEMENT