ROYAL LONDON FIXED INCOME

Fund Manager Commentary – February 2021

For professional clients only, not suitable for retail investors

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ECONOMIC DEVELOPMENTS

Economic developments

- While Covid-19 case numbers generally declined across the UK, US and Europe over the month as restrictions and vaccination programmes took effect, Europe is showing signs that the virus is rising again, threatening the easing of lockdowns. Falls in case numbers are also showing signs of stalling in the US.
- The UK government outlined a route out of lockdown with an end to most restrictions by mid-June. UK retail sales fell 8.8% in January, suggesting that the hit from the current lockdown is less than in April 2020, but worse than November. The proportion of online sales jumped to a record 35.2%. The PMI composite rose to 49.8, significantly above consensus, but still indicating flat activity on the month.
- In the US, President Biden's $1.9tn fiscal stimulus bill passed through the House, although is expected to be watered down to gain Senate approval. Direct cheques from the December stimulus package boosted consumer spending, with retail sales up +5.3% (consensus: +1.1%). Spending did not keep pace with income growth, however, so the personal savings rate jumped to 20.5%. February flash composite PMI was broadly steady at 58.8, indicating continued robust output growth. Consumer confidence rose to 91.3.
- In Europe, the composite PMI improved, but only to 48.1, with the services PMI hitting a three-month low. Consumer confidence improved slightly but remains soft. The ECB expressed concern about higher bond yields with President Lagarde stating that preserving favourable financing conditions is the compass for asset purchases. Mario Draghi was appointed as Italian prime minister, removing the immediate risk of early elections.

RLAM CREDIT FUND PERFORMANCE

Fund performance

	1 month (%)	Rolling 12 months (%)
RL Corporate Bond Fund Z Inc	**-2.31**	**2.71**
IA Sterling Corporate Bond Sector	-2.70	1.87
iBoxx Sterling Non-Gilts All Maturities Index	-3.08	1.07
RL Ethical Bond Fund Z Inc	**-2.49**	**2.15**
IA Sterling Strategic Bond Sector	-0.64	3.54
iBoxx Sterling Non-Gilts All Maturities Index	-3.08	1.07
RL Global Bond Opportunities Fund Z Inc	**0.36**	**3.49**
RL Investment Grade Short Dated Credit Fund Z Inc	**-0.43**	**2.17**
IA Sterling Corporate Bond Sector	-2.70	1.87
ICE BofA ML 1-5 year Sterling Non-Gilt All Stocks Index	-0.49	1.86
RL Short Duration Credit Fund Z Inc	**-0.22**	**2.80**
IA Sterling Strategic Bond Sector	-0.64	3.54
ICE BofA ML 1-5 year Sterling Non-Gilt All Stocks Index	-0.49	1.86
RL Sterling Credit Fund Z Inc	**-3.51**	**1.31**
IA Sterling Corporate Bond Sector	-2.70	1.87
iBoxx Sterling Non-Gilts All Maturities Index	-3.08	1.07
RL Sterling Extra Yield Bond Fund A Inc	**0.10**	**1.03**
RL Sterling Extra Yield Bond Fund B Inc	**0.06**	**0.53**
RL Sterling Extra Yield Bond Fund Y Inc	**0.13**	**1.47**
RL Sterling Extra Yield Bond Fund Z Inc	**0.12**	**1.30**
IA Sterling Corporate Bond Sector	-2.70	1.87
IA Sterling High Yield Sector	0.62	5.58
IA Sterling Strategic Bond Sector	-0.64	3.54

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.

Source: RLAM and FE, correct as of 28 February 2021. Returns quoted are net of fees.

[1]Please note that the benchmark pricing is end-of-day, and entails no currency conversion.

CREDIT MARKET REVIEW

Market highlights

Sterling investment grade credit

- With accommodative monetary policy and fiscal stimulus, positive inflation base effects and ongoing friction in global supply chains, global reflation was reflected in notably higher bond yields across the board in February. The benchmark 10-year gilt yield increased from 0.33% to 0.82%. Sterling investment grade corporate debt returned -3.08%, outperforming UK government bonds (-5.66%). The average sterling investment grade credit spread (the average extra yield available from a corporate bond compared with government debt of equal maturity) tightened 7 basis points from 0.98% to 0.91%.
- Total returns were negative for all sterling credit sectors. Covered bonds outperformed the broad market, along with the wider banks and insurance sectors. Otherwise, supranational bonds outperformed as sentiment turned more cautious. The healthcare, utilities and real estate sectors delivered notably negative returns. While sub-investment grade bonds delivered positive returns, there was no particular shape to the returns from different ratings as AAA and BBB rated bonds outperformed their AA and A rated peers. However, shorter-dated issues clearly outperformed longer-dated bonds.
- Credit issuance was lower in the sterling and euro markets in February compared to January. Issuance in the euro market was similar to February 2020, but net issuance was notably lower. Sterling credit issuance was only around half of the level a year ago. In both markets, issuance came more from the financial sectors.

ROYAL LONDON CORPORATE BOND FUND

Portfolio commentary

- Net of fees, the fund delivered a return of -2.31% in February (Z class, Income), outperforming the iBoxx Sterling Non-Gilts All Maturities Index, which returned -3.08%, and the -2.70% average return for its peer group (IA Sterling Corporate Bond). It has also outperformed the index and peer group on a rolling 12-month basis (+2.71% vs. +1.07% and +1.87%, respectively).
- Total returns were negative for nearly all sterling credit sectors. The outperformance of covered bonds and the financials sectors, particularly subordinated banks and insurance, was positive for performance as the portfolio is overweight here. Against this, the significant underweight in supranational bonds detracted from relative returns as this sector outperformed. Otherwise, the strong outperformance of sub-investment grade bonds was positive for returns.
- Overweight exposure to insurance, a substantial underweight in supranational bonds, and a bias towards secured issues (such as social housing) are the most noticeable features of sector positioning.
- We participated in eight new issues during the month. In financials, we bought a shorter-dated senior issue from **First Abu Dhabi Bank** and an AT1 perpetual bond of **BNP Paribas**, and a floating rate covered bond from **Nationwide Building Society**. We also participated in two structured issues – an issue by **Telereal** that is secured against BT telephone exchanges, in which we participated in both the 10- and 12-year tranches; and an unrated short-dated bond issued by **Chartered Opus** that is backed by government-sponsored Coronavirus Business Interruption Loan Scheme (CBILS) loans. Otherwise, we participated in new issues by **Whitbread**, which has sold the Costa chain and now mainly comprises Premier Inns and its German hotels business, which it is planning to expand; **Orsted**, the Danish leader in constructing and operating offshore wind farms; and a tap of a 2055 bond issued by **Cardiff University**.
- Secondary market activity primarily focused on managing liquidity. Notable trades included buying attractive legacy short call bonds in the banks sector (**HSBC** and **Natwest Markets**), while taking profits in **Skipton Building Society** and **Nationwide**. Following strong performance from the insurance sector, we sold holdings of two long-dated bonds of **Legal & General**, buying attractively priced **Scottish Widows** bonds. We also sold bonds of pubs and restaurants chain **Mitchells & Butler**, which were trading at a good level for junior debt following the government's roadmap out of lockdown. We also sold bonds of **Imperial Tobacco Group** after good performance, feeling that the spread is no longer attractive given the ESG risks. We also took profits in the **Whitbread** and **BNP Paribas** new issues.
- No bonds were called away or tendered from the portfolio.

Investment outlook

- Despite the risk of viral mutations, the success of the UK vaccination programme promises a return to more normal social and economic conditions by June and the government has outlined its route map out of lockdown through the second quarter. While the Budget delivered further support, higher unemployment seems likely in the longer term and the economy is likely to be compromised over the medium term by higher taxes given the surge in government debt. Despite the sharp rise in bond yields, interest rates look set to remain at low levels over the next two or three years, with yield curves heavily managed by central banks.
- 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 continue to have a detrimental impact on corporate profitability, we consider that the current credit spread still offers sufficient compensation for default and other risks (e.g. liquidity and rating migration). We expect investment grade credit bonds will outperform UK government securities over the next three years, although the magnitude of this outperformance is expected to be lower than our previous projections.

Key views within the fund

- The fund is diversified, with over 300 holdings, in order to improve overall portfolio liquidity and to reduce the effect on overall fund performance of any deterioration in the creditworthiness of an individual holding.

ROYAL LONDON CORPORATE BOND FUND

- A significant underweight in supranational bonds, as we expect corporate bonds to outperform over the medium term.
- Duration marginally below benchmark.
- An overweight position in subordinated financial debt, where we believe yields are attractive.
- The fund remains orientated towards secured bonds in the asset-rich investment trust, property and social housing sectors, and towards structured bonds, which benefit from a claim on assets and cashflows.
- Environmental, social and governance (ESG) risk factors are fully integrated in the management of the portfolio. The WACI (weighted average carbon intensity) of the portfolio is below that of the index.

Shalin Shah
Senior Fund Manager

Jonathan Platt
Head of Fixed Income

ROYAL LONDON ETHICAL BOND FUND

Portfolio commentary

- Net of fees, the fund (Z class, Income) delivered a return of -2.49% in February. This compares to the -3.08% return of the iBoxx Sterling Non-Gilts All Maturities Index and the average returns recorded for the Investment Association (IA) Sterling Strategic Bond sector and the IA Sterling Corporate Bond sector of -0.64% and -2.70%, respectively. The fund is a constituent of the former sector because its weighting in investment grade sterling corporate bonds has frequently been less than 80%, predominantly as a result of the holdings of unrated secured debt; however, in the context of its investment grade benchmark, the fund's performance relative to the more homogenous Sterling Corporate Bond sector is also relevant.
- Total returns were negative for nearly all sterling credit sectors. The outperformance of covered bonds and the financials sectors, particularly subordinated banks and insurance, was positive for performance as the portfolio is overweight here. Against this, the significant underweight in supranational bonds detracted from relative returns as this sector outperformed. Otherwise, the strong outperformance of sub-investment grade bonds was positive for returns.
- Overweight exposure to subordinated financial debt, a substantial underweight in supranational bonds and a bias towards secured and structured issues remained the most noticeable features of sector positioning.
- We participated in eight new issues during the month. In financials, we bought a shorter-dated senior issue from **Deutsche Bank** and a floating rate covered bond from **Nationwide Building Society**. We also participated in two structured issues – an issue by **Telereal** that is secured against BT telephone exchanges, in which we participated in both the 10- and 12-year tranches; and an unrated short-dated bond issued by **Chartered Opus** that is backed by government-sponsored Coronavirus Business Interruption Loan Scheme (CBILS) loans. Otherwise, we participated in new issues by **Whitbread**, which has sold the Costa chain and now mainly comprises Premier Inns and its German hotels business, which it is planning to expand; **Orsted**, the Danish leader in constructing and operating offshore wind farms; and **Asda**, which raised £2.75bn to fund the leveraged buyout of the supermarket chain by the Issa brothers and private equity firm TDR Capital. Lastly, we participated in a tap of a long-dated issue by **Blend Funding**, the social housing aggregator.
- Secondary market activity focused on managing liquidity. Notable trades included buying subordinated bonds of **HSBC**, short-dated bonds of **Investec** and **Intermediate Capital Group**, and relatively higher yielding insurance bonds of **Rothesay Life**. Against these purchases, we took profits in AT1 perpetual bonds of **Nationwide**. We added to our overweight allocation to structured bonds, buying long-dated issues of **Freshwater Finance** and **Income Contingent Student Loans**. We also added to our social housing exposure through **Libra Longhurst**, **Places for People Homes** and **Housing Finance Corporation**, and switching to longer-dated bonds of **Notting Hill Housing Trust** as yield curves steepened. We sold our holding of **Fiserv**, which provides payments and technology solutions to the financial services sector, and took profits in the **Whitbread** and **Asda** new issues.

Investment outlook

- Despite the risk of viral mutations, the success of the UK vaccination programme promises a return to more normal social and economic conditions by June and the government has outlined its route map out of lockdown through the second quarter. While the Budget delivered further support, higher unemployment seems likely and the economy is likely to be compromised over the medium term by higher taxes given the surge in government debt. Despite the sharp rise in bond yields, interest rates look set to remain at low levels over the next two or three years, with yield curves heavily managed by central banks.
- The level of yields of UK government securities will continue to be a significant influence on the performance of investment grade credit bonds. We expect investment grade credit bonds will outperform UK government securities over the medium term. While Covid-19 will have a detrimental impact on corporate profitability, we consider that the current credit spread still offers attractive compensation for default and other risks (e.g. liquidity and rating migration).
- We continue to believe that portfolio diversification is important and a focus on bonds supported by stable income streams and structural enhancements should support the performance of the fund.

Key views within the fund

- The fund is diversified in order to improve portfolio liquidity and to reduce the effect on overall performance of any deterioration in the creditworthiness of an individual holding.
- The fund has a significant underweight position in supranational bonds, as we expect corporate bonds to outperform over the medium term.

ROYAL LONDON ETHICAL BOND FUND

- Duration moderately below the benchmark. We believe the level of gilt yields will be challenging over the longer term.
- The fund has an overweight position in subordinated financial debt, where we believe yields are attractive.
- The fund remains orientated towards secured bonds in the asset-rich investment trust, property and social housing sectors, and towards structured bonds, which benefit from a claim on assets and cashflows.

ALPHA MANAGER 2020
Eric Holt
CITYWIRE +

Eric Holt
Senior Fund Manager

ROYAL LONDON GLOBAL BOND OPPORTUNITIES FUND

Executive summary

- The fund's Z class recorded a return, net of fee, of 0.40% in February. Returns across the credit universe generally flat or slightly negative, driven more by weakness in government bond yields than credit spread movements. Fund performance was aided by short duration positioning as well as its exposure to the energy sector, which performed well.

Market highlights

Index	Total return (%)	Spread movement (basis points)
AT1 **ICE BofA ML contingent capital index**	0.37	-25
HY global non-financial corps **ICE BofA ML global non-financial high yield index**	0.56	-22
HY global non-financial hybrid corps **ICE BofA ML global hybrid non-financial high yield index**	0.57	-26
HY non-financial emerging markets **ICE BofA ML emerging markets high yield ex. subordinated financial index**	-0.12	-5
IG global non-financial hybrid corps **ICE BofA ML global hybrid non-financial corporate index**	-0.22	-8
Dollar investment grade corporate bonds **ICE BofA ML US corporate index**	-1.99	-7
Sterling investment grade corporate bonds **ICE BofA ML sterling corporate and collateralised index**	-3.19	-7
Euro investment grade corporate bonds **ICE BofA ML euro corporate and Pfandbriefe index**	-0.78	-5

Source: Bloomberg

- While Covid-19 case numbers generally declined across the UK, US and Europe over the month as restrictions and vaccination programmes took effect, Europe is showing signs that the virus is rising again, threatening the easing of lockdowns. Falls in case numbers are also showing signs of stalling in the US.
- In the US, President Biden's $1.9tn fiscal stimulus bill passed through the House, although is expected to be watered down to gain Senate approval. Direct cheques from the December stimulus package boosted consumer spending, with retail sales rising faster than expected. In Europe, the ECB expressed concern about higher bond yields with President Lagarde stating that preserving favourable financing conditions is the compass for asset purchases. Mario Draghi was appointed as Italian prime minister, removing the immediate risk of early elections.
- Credit issuance was lower in the euro investment grade markets in February compared to January. Issuance in the euro market was similar to February 2020, but net issuance was notably lower, coming more from the financial sectors. Issuance in the high yield market was relatively buoyant in February and while this was somewhat lower than January, remained higher than the same month in 2020. The majority of issuance continued to be BB or B rated, with a slight bias towards the latter. Issuance came overwhelmingly from the US market, with European high yield issuance materially lower, albeit this has stabilised after falling dramatically in 2020.
- With accommodative monetary policy and fiscal stimulus, positive inflation base effects and ongoing friction in global supply chains, global reflation was reflected in notably higher bond yields across the board in February. In high yield markets, returns were mixed across market index sectors. Energy, the largest in the high yield universe, produced positive returns over the month, as did leisure, transport and real estate, while other major sectors such as healthcare, media and telecoms all saw negative returns. Generally speaking, lower rated debt outperformed, with CCC rated bonds outperforming B rated debt, which in turn outperformed BB rated debt. In local currency terms, there was little difference in returns between the US, Europe and UK, all of which produced modest positive returns, while emerging market high yield was broadly flat.

Portfolio commentary

- In a month where market performance was driven as much as underlying government bond weakness than credit spread movements, the fund's relatively short duration positioning was helpful. The fund's weighted average duration is just 3.4

ROYAL LONDON GLOBAL BOND OPPORTUNITIES FUND

years. In terms of credit exposure, our diversified approach across credit asset classes was helpful, with high yield performing well relative to investment grade. Finally our credit sector exposure was also positive. Our exposure to energy - related companies again performed well, including offshore drilling contractor **Vantage Drilling,** as did our holding in French mining company **Eramet**, and our structured bond holdings in UK pub operator **Mitchells & Butler**.

- Activity in the month was relatively light. The fund participated in a new issue of euro-denominated bonds from Swedish residential real estate company **Heimstaden**, as well as a new senior unsecured green bond from **Aker Horizons** as part of its fund raising for the acquisition of Mainstream Renewable Power. Existing bonds of UK North Sea oil business **Siccar Point** were tendered back to the company and proceeds largely reinvested in a new issue, maintaining coupon rate at 9% and taking 5 points of capital differential to extend maturity from 2023 to 2026. We also took profits on a recent US dollar new issue from **BNP** after strong performance.

Investment outlook

- Global economies may be jeopardised by recent lockdown measures and rising unemployment seems likely. While the positive developments regarding a vaccine rollout may allow societies to return to more normal conditions next year, economies are likely to be compromised over the medium term given the surge in government debt. Interest rates look set to remain at very low levels over the next two or three years, with yield curves heavily managed by central banks.
- 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).

Rachid Semaoune
Senior Fund Manager

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Senior Fund Manager

ROYAL LONDON INVESTMENT GRADE SHORT DATED CREDIT FUND

Portfolio commentary

- The fund recorded a net return of -0.43% (Z class, Income) in February, against the -0.49% gross return of the ICE BofA Merrill Lynch 1-5 Year Sterling Non-Gilt Index and the -2.70% average return of the wider all-maturities sector (IA Sterling Corporate Bond). It has also outperformed the index and wider peer group on a rolling 12-month basis (+2.17% vs. +1.86% and +1.87%, respectively).
- Total returns were negative for all sterling investment grade credit sectors. The outperformance of covered bonds and the financials sectors, particularly subordinated banks and insurance, was positive for performance as the portfolio is overweight here. Against this, the significant underweight in supranational bonds detracted from relative returns as this sector outperformed. The strong returns from the portfolio's lower-rated bonds (BBB) were also beneficial.
- The minimal weighting in supranational bonds, overweight holding of financial debt and bias towards secured and structured issues remained the fund's most notable sector characteristics.
- We participated in four new issues during the month. In financials, we bought a shorter-dated senior issue from **First Abu Dhabi Bank** and a floating rate covered bond from **Nationwide Building Society**. We also participated in a structured issue by **Telereal** that is secured against BT telephone exchanges, in which we participated in both the 10- and 12-year tranches. Otherwise, we participated in a new issue by **Whitbread**, which has sold the Costa chain and now mainly comprises Premier Inns and its German hotels business, which it is planning to expand.
- Secondary market activity primarily focused on managing liquidity. Notable trades included buying attractive short-dated senior bonds of **TP ICAP**, **GE Capital**, **Santander** and **Commerzbank**, and subordinated bonds of **HSBC, Investec** and **TSB**. We also bought relatively higher yielding insurance bonds of **Rothesay Life** and **Phoenix Group**, and switched between issues of **Legal & General** to enhance terms. Against this, we sold senior bonds of **Dexia** and **MetLife**, and covered bonds of **National Australia Bank**. We bought structured bonds of **Integrated Accommodation Services** and **Center Parcs**, and switched between structured bond issues of pubs and restaurants chain **Mitchells & Butlers**. We increased our social housing exposure, adding to **Places for People Homes**. Otherwise, we bought utilities bonds of **SSE** and **SPD Finance** to diversify away from the fund's financials exposure.
- Bonds of **Darrowby No 4** were called away from the portfolio.

Investment outlook

- Despite the risk of viral mutations, the success of the UK vaccination programme promises a return to more normal social and economic conditions by June and the government has outlined its route map out of lockdown through the second quarter. While the Budget delivered further support, higher unemployment seems likely in the longer term and the economy is likely to be compromised over the medium term by higher taxes given the surge in government debt. Despite the sharp rise in bond yields, interest rates look set to remain at low levels over the next two or three years, with yield curves heavily managed by central banks.
- 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 continue to have a detrimental impact on corporate profitability, we consider that the current credit spread still offers sufficient compensation for default and other risks (e.g. liquidity and rating migration). We expect investment grade credit bonds will outperform UK government securities over the next three years, although the magnitude of this outperformance is expected to be lower than our previous projections.

Key views within the fund

- The fund is diversified, with almost 300 holdings, in order to improve general portfolio liquidity and to reduce the effect on overall performance of any deterioration in the creditworthiness of an individual holding.
- It has a minimal weighting in supranational bonds, as we expect corporate debt to outperform over the medium term.

ROYAL LONDON INVESTMENT GRADE SHORT DATED CREDIT FUND

- Duration is in line with that of the benchmark.
- It has an overweight position in subordinated financial debt, where we believe yields are attractive.
- The fund remains orientated towards structured debt, which benefits from a claim on assets and cashflows; secured issues in the asset-rich property and social housing sectors; and covered bonds (i.e. senior bank debt benefiting from a first claim on a specified over-collateralised pool of assets).

Paola Binns
Head of Sterling Credit

ROYAL LONDON SHORT DURATION CREDIT FUND

Portfolio commentary

- Net of fees, the fund delivered a return of -0.22% in February (Z class, Income), outperforming the ICE BofA Merrill Lynch 1-5 Year Sterling Non-Gilt All Stocks Index, which returned -0.49%, and the -0.64% average return for its peer group (IA Sterling Strategic Bond sector).
- Total returns were negative for nearly all sterling credit sectors. The outperformance of the subordinated banks and insurance sectors was positive for performance as the portfolio is overweight here. Against this, the significant underweight in supranational bonds detracted from relative returns as this sector outperformed, as did the underweight in covered bonds. Otherwise, the strong outperformance of sub-investment grade bonds was positive for returns.
- Overweight exposure to subordinated financial debt, a substantial underweight in supranational bonds and a bias towards secured and structured issues remained the most noticeable features of sector positioning.
- We participated in eight new issues during the month. In financials, we purchased a floating rate covered bond from **Nationwide Building Society**. We also participated in three structured issues – an issue by **Telereal** that is secured against BT telephone exchanges, in which we participated in both the 10- and 12-year tranches; a AAA rated commercial mortgage-backed securities (CMBS) issue from **Taurus** (2021-UK1X) secured against logistical warehousing; and an unrated short-dated bond issued by **Chartered Opus** that is backed by government-sponsored Coronavirus Business Interruption Loan Scheme (CBILS) loans. Otherwise, we participated in new issues by **Whitbread**, which has sold the Costa chain and now mainly comprises Premier Inns and its German hotels business, which it is planning to expand; **Orsted**, the Danish leader in constructing and operating offshore wind farms; **Asda**, which raised £2.75bn to fund the leveraged buyout of the supermarket chain by the Issa brothers and private equity firm TDR Capital; and UK oil E&P company **Siccar Point Energy** (funded from selling an existing holding in this issuer).
- Secondary market activity primarily focused on managing liquidity. Notable trades included buying attractive legacy short call banks bonds of **Standard Chartered** and **Natwest Markets**. We also bought relatively higher yielding insurance bonds of **Legal & General**, **Rothesay Life** and **Phoenix Group**, and **TP ICAP** in the banks sector. Against this, we sold bonds of **HSBC**, **Barclays** and **Coventry Building Society**. We increased our holdings of structured bonds, adding to **Yorkshire Water** and **Income Contingent Student Loans**, which has an attractive yield and risk profile for a AA rated bond. Otherwise, we took profits in the **Asda** new issue.

Investment outlook

- Despite the risk of viral mutations, the success of the UK vaccination programme promises a return to more normal social and economic conditions by June and the government has outlined its route map out of lockdown through the second quarter. While the Budget delivered further support, higher unemployment seems likely in the longer term and the economy is likely to be compromised over the medium term by higher taxes given the surge in government debt. Despite the sharp rise in bond yields, interest rates look set to remain at low levels over the next two or three years, with yield curves heavily managed by central banks.
- 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 continue to have a detrimental impact on corporate profitability, we consider that the current credit spread still offers sufficient compensation for default and other risks (e.g. liquidity and rating migration). We expect investment grade credit bonds will outperform UK government securities over the next three years, although the magnitude of this outperformance is expected to be lower than our previous projections.

Key views within the fund

- The fund is diversified, with more than 300 holdings, in order to improve overall portfolio liquidity and to reduce the effect on overall performance of any deterioration in the creditworthiness of an individual exposure.
- The fund has a significant underweight in supranational bonds, as we expect corporate debt to outperform over the medium term.

ROYAL LONDON SHORT DURATION CREDIT FUND

- Fund duration slightly longer than the benchmark, as central banks maintain dovish policy stances.
- The fund has an overweight position in subordinated financial debt, where we believe yields are attractive.
- The fund remains orientated towards secured bonds in the asset-rich investment trust, property and social housing sectors, and towards structured issues, which benefit from a claim on assets and cashflows.

Paola Binns
Head of Sterling Credit

ROYAL LONDON STERLING CREDIT FUND

Portfolio commentary

- Net of fees, the fund delivered a return of -3.51% in February (Z class, Income), underperforming the iBoxx Sterling Non-Gilts All Maturities Index, which returned -3.08%, and the -2.70% average return for its peer group (IA Sterling Corporate Bond).
- Total returns were negative for nearly all sterling credit sectors. The outperformance of the financials sectors, particularly subordinated banks and insurance, was positive for performance as the portfolio is overweight here. Against this, the significant underweight in supranational bonds detracted from relative returns as this sector outperformed, as did the underweight in covered bonds. Otherwise, the strong outperformance of sub-investment grade bonds was positive for returns.
- Overweight exposure to subordinated financial debt, a substantial underweight in supranational bonds and a bias towards secured and structured issues remained the most noticeable features of sector positioning.
- We participated in 11 new issues during the month. In financials, we bought shorter-dated senior issues from **Deutsche Bank** and **First Abu Dhabi Bank**, and an AT1 perpetual bond of **BNP Paribas**. We also participated in two structured issues – an issue by **Telereal** that is secured against BT telephone exchanges, in which we participated in both the 10- and 12-year tranches; and an unrated short-dated bond issued by **Chartered Opus** that is backed by government-sponsored Coronavirus Business Interruption Loan Scheme (CBILS) loans. Otherwise, we participated in new issues by **Whitbread**, which has sold the Costa chain and now mainly comprises Premier Inns and its German hotels business, which it is planning to expand; **Orsted**, the Danish leader in constructing and operating offshore wind farms; **Asda**, which raised £2.75bn to fund the leveraged buyout of the supermarket chain by the Issa brothers and private equity firm TDR Capital; and UK oil E&P company **Siccar Point Energy** (funded from selling an existing holding in this issuer). Lastly, we participated in taps of two long-dated issues by **Cardiff University** and **Blend Funding**, the social housing aggregator.
- Secondary market activity primarily focused on managing liquidity. Notable trades included buying attractive legacy short call bonds of **HSBC**, and adding to our social housing exposure through **Libra Longhurst** and switching to longer-dated bonds of **Notting Hill Housing Trust** as yield curves steepened. We reduced our overall financials exposure, including selling bonds of **GE Capital**, **Skipton Building Society**, **New York Life** and **Aviva**. Otherwise, we also sold bonds of pubs and restaurants chain **Mitchells & Butler**, which were trading at a good level for junior debt following the government's roadmap out of lockdown; and sold our holding of **Fiserv**, which provides payments and technology solutions to the financial services sector. We also sold bonds of **BAT International** after good performance and because of the greater ESG risk profile. Finally, we took profits in the **Whitbread**, **Asda** and **BNP Paribas** new issues.
- No bonds were tendered or called away from the portfolio.

Investment outlook

- Despite the risk of viral mutations, the success of the UK vaccination programme promises a return to more normal social and economic conditions by June and the government has outlined its route map out of lockdown through the second quarter. While the Budget delivered further support, higher unemployment seems likely in the longer term and the economy is likely to be compromised over the medium term by higher taxes given the surge in government debt. Despite the sharp rise in bond yields, interest rates look set to remain at low levels over the next two or three years, with yield curves heavily managed by central banks.
- 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 continue to have a detrimental impact on corporate profitability, we consider that the current credit spread still offers sufficient compensation for default and other risks (e.g. liquidity and rating migration). We expect investment grade credit bonds will outperform UK government securities over the next three years, although the magnitude of this outperformance is expected to be lower than our previous projections.

Key views within the fund

- The fund is diversified, with around 400 holdings, in order to improve overall portfolio liquidity and to reduce the effect on overall performance of any deterioration in the creditworthiness of an individual holding.

ROYAL LONDON STERLING CREDIT FUND

- A significant underweight in supranational bonds, as we expect corporate bonds to outperform over the medium term.
- Duration moderately below the benchmark. We believe the level of gilt yields will be challenging over the longer term.
- An overweight position in subordinated financial debt, where we believe yields are attractive.
- The fund remains orientated towards secured bonds in the asset-rich investment trust, property and social housing sectors, and structured bonds, which benefit from a claim on assets and cashflows.

Paola Binns
Head of Sterling Credit

ROYAL LONDON STERLING EXTRA YIELD BOND FUND

Portfolio commentary

- The A, B, Y and Z class shares recorded returns of 0.10%, 0.06%, 0.13% and 0.12% respectively in February. After the strong start to the year in January, these bring 2021 year-to-date returns to 1.13%, 1.06%, 1.21% and 1.18% respectively.
- In January there was a modest reversal of 2020's sharp move down in gilt yields – in February this reversal was extended, largely eliminating the 8.84% index return from gilts in 2020. Down 5.82% in February, the worst single monthly performance since 1986, the year-to-date index return for gilts for 2021 was -7.48% by end February. The backdrop was a global rise in government bond yields, influenced by the magnitude of incoming President Biden's stimulus package in the US, a rise in commodity prices with the potential for a tick-up in inflation, and the efficacy and rate of Covid-19 vaccination, especially in the UK. From levels of -0.03% and 0.75% at end 2020, the yields on 5- and 30-year gilts had moved to 0.39% and 1.37% by the end of February – down 2% and 15% in price respectively – with the level of short-term price volatility starkly disproportionate to yield.
- The move in gilt yields was a significant influence on sterling investment grade corporate bonds, which posted a -2.97% index return in February, giving a 2021 year-to-date return of -3.86%. The average yield differential between sterling investment grade corporate bonds and gilts fell from 0.94% to 0.86% in the month, having started the year at 0.96%. Longer-dated bonds were most affected by the rise in gilt yields, while lower-rated BBB bonds held up relatively well, reflecting their greater sensitivity to the narrowing in average yield differentials over gilts. Sub-investment grade bonds were generally immune from the rise in government bond yields, reflecting the attraction of their higher yield and income in an environment where short-term interest rates seem likely to remain low – the European and global high yield indices posted returns of 0.59% and 0.44% in February, bringing 2021 year-to-date index returns to 1.01% and 0.63% respectively.
- In contrast to most months, there was a significant degree of divergence of performance for individual holdings in February. The tightening of average yield differentials over gilts provided only a relatively small degree of protection for longer-dated corporate bonds; financial holdings of banks **Barclays** and **Lloyds** and of insurers **Aviva**, **M&G** and **Scottish Widows** were all down around 4% over the month. Similarly, longer-dated secured and structured bonds of **ICSL** (senior bonds backed by student loans), **Longstone** (backed by operational properties of Sainsbury), **Peel** (secured on commercial property), **Progress Healthcare** (PFI bonds issued for the upgrade of Peterborough hospital) and **Tesco Property** (backed by the company's operational properties) were all down around 3%. In contrast the increase in commodity prices supported the prices of **EB Holdings**, **Eramet** and **Metalcorp**, each up about 5% in the month. The very sharp recovery in shipping rates buoyed the prices of secured bonds of **MPC Containerships** and **Songa Container** by about 3%, the latter having sold in February for $43m a vessel that had been bought for $23m in September 2017 and for which the proceeds are substantially held as part of the pool of security for the £130m bond issue. The rise in the price of oil, with Brent up nearly 20% from $56 to $66 a barrel in February, supported the prices of investment in the energy sector. Bonds of **OKEA** and **Tullow Oil** were up 3% and 6% respectively in the month, while **Vantage Drilling** bonds were up over 20%, albeit from a fairly subdued level, on news of the final determination in the company's favour of the settlement of a legal dispute over payment for a cancelled contract. Finally, bonds of pub businesses **Mitchells & Butlers** and **Spirit** were sharply better, up about 10%, on encouraging news on the rate of vaccination in the UK and the corresponding improvement in their business prospects after the extraordinarily challenging conditions in 2020.
- There was a diverse flow of new issue opportunities in February, including Canadian energy business **Petrotal**, euro-denominated 'hybrid' green bonds of renewable energy business **Orsted**, offshore services provider **Modex**, secured structured bonds of **Telereal** (backed by operational properties and lease obligations of BT), and structured bonds of **Opus** (backed by secured loans issued under the UK government's CBILS (Coronavirus Business Interruption Loan Scheme) that are substantially guaranteed against capital loss). In addition, new issues from hotel and restaurant group **Whitbread** and from **Bellis Acquisition** (the vehicle for the purchase of ASDA from US owner Walmart) were purchased at issue and sold again within the month to crystallise short-term capital gains. Existing bonds of UK North Sea oil business **Siccar Point** were tendered back to the company and proceeds largely reinvested in a new issue, maintaining coupon rate at 9% and taking five points of capital differential to extend maturity from 2023 to 2026. Market purchases included bonds of **Premier Oil**, where the company is presently subject to acquisition by Chrysaor, secured bonds of **GLH Hotels** and of pubs group **Spirit**. Sales were focussed on lower-yielding shorter-dated bonds, including insurers **Axa**, **Legal & General**, **Phoenix** and **Rothesay Life**, financials **Investec Bank** and **TP Icap**, and hybrid bonds of utility **SSE**. Holdings of smaller-issue unrated bonds of communications infrastructure group **Digiplex** and shipping group **Stolt Neilson** were reduced, crystallising capital gains. Activity in short-dated gilts reflected efficient liquidity management in the fund during the month.

Investment outlook

- Despite the risk of viral mutations, the success of the UK vaccination programme promises a return to more normal social and economic conditions by June and the government has outlined its route map out of lockdown through the second quarter. While the Budget delivered further support, higher unemployment seems likely in the longer term and the economy

ROYAL LONDON STERLING EXTRA YIELD BOND FUND

is likely to be compromised over the medium term by higher taxes given the surge in government debt. Despite the sharp rise in bond yields, interest rates look set to remain at very low levels over the next two or three years, with yield curves heavily managed by central banks.

- 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 continue to have a detrimental impact on corporate profitability, we consider that the current credit spread still offers sufficient compensation for default and other risks (e.g. liquidity and rating migration). We expect investment grade credit bonds will outperform UK government securities over the next three years, although the magnitude of this outperformance is expected to be lower than our previous projections.

Key views within the fund

- The fund's objective is to achieve a high level of income 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 investment can in isolation have an undue impact on overall performance. In addition, where possible within the yield objective of the fund, investments are focused on bonds where risk is mitigated by structure or a claim on assets or cashflows.

Rachid Semaoune
Senior Fund Manager

ALPHA MANAGER 2020
Eric Holt
CITYWIRE +

Eric Holt
Senior Fund Manager

RLAM GOVERNMENT BOND FUND PERFORMANCE

Fund performance

	1 month (%)	Rolling 12 months (%)
RL Global Index Linked Bond Fund Z Inc	**-3.55**	**0.71**
IA Global Bonds Sector	-1.79	1.09
Barclays World Government Inflation-Linked Bond Index (hedged)	-2.69	1.42
RL Index Linked Bond Fund M Inc	**-5.40**	**-4.93**
IA UK Index Linked Gilts Sector	-5.34	-5.01
FTSE Actuaries UK Index-Linked All Stocks Index	-5.08	-3.59
RL Short Duration Gilt Fund Z Inc	**-0.59**	**0.07**
IA UK Gilts Sector	-5.96	-4.66
FTSE Actuaries UK Conventional Gilts up to 5 Years Index	-0.74	0.10
RL Short Duration Global Index Linked Bond Fund Z Inc	**-1.26**	**2.62**
IA Global Bonds Sector	-1.79	1.09
RL Short Duration Global Index Linked Composite Benchmark[1 2]	-0.82	2.36
RL UK Government Bond Fund Z Inc	**-5.68**	**-3.83**
IA UK Gilts Sector	-5.96	-4.66
FTSE Actuaries UK Conventional Gilts All Stocks Index	-5.66	-4.22

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.

Source: RLAM and FE, correct as of 28 February 2021. Returns quoted are net of fees.

[1]Please note that the benchmark is priced end-of-day.

[2]The composite benchmark consists of: 30% Barclays UK Government Inflation Linked Bond 1-10 year index, 70% Barclays World Government Inflation Linked Bond (ex UK) 1-10 year index (GBP hedged).

GOVERNMENT BOND MARKET REVIEW

Market highlights

- Yields rose sharply across all leading bond markets in February as the global reflation trade gained momentum. There was some divergence in performance, however, with yields rising more significantly in the UK and Canada. The UK continued to make good progress with its vaccination programme and the government outlined its roadmap for an end to most lockdown measures by mid-year. The Bank of England's Monetary Policy Committee ruled out negative interest rates for at least six months, by which time the economy should be growing sharply again once lockdown ends. In the US, President Biden's $1.9tn fiscal stimulus bill passed through the House, although it was expected to be watered down to gain Senate approval. Direct cheques from the December stimulus package boosted consumer spending, with retail sales up +5.3% (consensus: +1.1%). Spending did not keep pace with income growth, however, so the personal savings rate jumped to 20.5%. In Europe, disappointing progress with vaccinations and renewed increases in Covid-19 cases cast doubt over the state of the region's economic recovery. The composite PMI improved, but only to 48.1, with the services PMI hitting a three-month low. Consumer confidence improved slightly but remains soft. Mario Draghi was appointed as Italian prime minister, removing the immediate risk of early elections and resulting in strong relative performance from Italian government bonds.

Gilts

- The yield on 10-year UK government bonds increased by 49 basis points (bps) to 0.82% with longer-dated gilts (>15 years) notably underperforming shorter-dated issues (<5 years). Overall, gilts returned -5.66%, lagging sterling investment grade corporate debt (which returned -3.08%). The average sterling investment grade credit spread (the average extra yield available from a corporate bond compared with government debt of equal maturity) narrowed by 7bps to 0.91%.
- Gilts underperformed European government bond markets during the month as the UK made good progress with its vaccination programme and the government set out a roadmap out of lockdown by June. In contrast, the EU's programme seems less well coordinated and has struggled to source vaccine supplies.
- The yield curve steepened over the month as yields sold off at longer maturities, while the shortest-dated gilts remained relatively pinned where they were. The 10-year area of the curve bore the brunt of the selloff.

Index-linked gilts

- Index-linked UK government bonds returned -5.08%, underperforming conventional gilts (-5.66%). Returns were positive for short-dated issues (<5 years), but negative for longer-dated issues. The yield on five-year index-linked gilts rose 26bps to -2.75%, while 10- and 30-year yields increased 43bps and 32bps to -2.46% and -1.84%, respectively.
- The 10-year breakeven (implied) inflation rate increased 28bps to 3.38%. There continue to be inflationary pressures in global supply chains from pandemic-related disruption. Headline inflation will also get a boost from positive energy price base effects as Brent crude oil rose another 18.3%% to nearly $64 a barrel.

Overseas

- While yields rose, European markets were relatively strong over the month against global markets. Disappointing progress with vaccinations and renewed increases in Covid-19 cases cast doubt over the state of the region's economic recovery. The composite PMI improved, but only to 48.1, with the services PMI hitting a three-month low. The ECB expressed concern about higher bond yields with President Lagarde stating that preserving favourable financing conditions is the compass for asset purchases.
- The US was relatively stronger than in January, although the 10-year treasury yield rose 34bps to 1.40%. While President Biden's $1.9tn fiscal stimulus bill passed through the House, it was expected to be watered down to gain Senate approval. The February flash composite PMI was broadly steady at 58.8, indicating robust output growth. The market is now pricing in the stimulus package and significant GDP growth.
- US real yields increased again during the month, after hitting record lows last August, and inflation expectations (as measured by breakevens) continued to rise. The 10-year US real yield increased to -0.75% (+29bps) and the 10-year breakeven rate rose 5bps to 2.15%.

ROYAL LONDON GLOBAL INDEX LINKED BOND FUND

Portfolio commentary

- Net of fees, the fund delivered a return of -3.55% in February (M Class, Income), underperforming its benchmark (Barclays World Govt Inflation Linked Bonds - £ Hedged), which returned -2.69%. However, the performance of the fund and the index are calculated at different times of day, which affects the comparison. On a like-for-like basis, the fund underperformed by 39 basis points, returning -3.08%, although this may still have been affected by timing differences as US bonds rose sharply into the month-end close.
- Absolute returns were negative as real yields rose sharply across all leading bond markets with the global reflation story gathering pace as vaccine rollouts beat all expectations.
- Cross-market positions added value as the UK marginally underperformed, and we were overweight global markets against the UK.
- Yield curve strategies detracted from performance, in particular through an underweight position in the longest-dated bonds relative to the 30-year sector that impacted performance as the curve flattened on further pension fund demand. In addition, while cross-market positions added value, an underweight at the short end of the US curve relative to the longer end of the market detracted as the real curve steepened.
- Duration was tactically traded around 0.1 years short to 0.25 years long, given the volatility in bond markets and very sharp moves in yields. Duration made a small positive contribution.
- Breakevens made a limited contribution to performance. The portfolio started the month holding gilts on a breakeven basis as it became evident that LDI demand was picking up. The position was closed prior to the 2051 syndication. Towards the end of the month, with breakevens reaching post-RPI reform highs, we sold 30-year index linked bonds into gilts.

Investment outlook

- Bonds have fallen sharply on a stronger growth outlook, with expectations of the first interest rate increases being brought forward. We believe the sell-off is overdone as there are still many hurdles to overcome as countries end lockdowns and government support schemes are reduced. The US treasury market is now pricing in the new administration's fiscal stimulus and a strong recovery in GDP growth in 2021 and 2022, reflecting a marked shift over recent months.
- We used the rise in yields to move to a modest long position as strong demand from LDI is expected towards the end of the quarter. On the curve, we favour being overweight the 30-year sector, which should benefit from demand around the index extension as the 2026 issue drops out.
- On a cross market basis, given RPI reform, long-dated global bonds still offer value with real yields in excess of 200 basis points higher than the UK and we envisage increasing these positions further.
- Breakeven rates remain elevated and valuations have been pushed to extreme levels due to the positive growth outlook. We are minded to increase the overweight position in gilts as we continue to believe breakeven rates are overvalued, particularly in the context of strong performance by sterling.
- Otherwise, we are mindful of the strategy review that is currently being undertaken by the ECB. We expect it to take a similar approach to that adopted last year by the Federal Reserve, with increased flexibility around inflation. ECB president Christine Lagarde has openly discussed average inflation targeting.

Key views within the fund

- Bonds have fallen sharply on a stronger growth outlook, with expectations of the first interest rate increases being brought forward. We believe the sell-off is overdone as there are still many hurdles to overcome as countries end lockdowns and government support schemes are reduced. The US treasury market is now pricing in the new administration's fiscal stimulus and a strong recovery in GDP growth in 2021 and 2022, reflecting a marked shift over recent months.
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ROYAL LONDON GLOBAL INDEX LINKED BOND FUND

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Paul Rayner
Head of Alpha Strategies

Gareth Hill
Fund Manager

ROYAL LONDON INDEX LINKED BOND FUND

Portfolio commentary

- Net of fees, the fund delivered a return of -5.40% in February (M Class, Inc), underperforming the FTSE Actuaries UK Index Linked All index, which returned -5.08%. However, the performance of the fund and the index are calculated at different times of day, which affects the comparison. On a like-for-like basis, the fund returned -5.19%, underperformance of just 11 basis points.
- Absolute returns were negative as real yields rose sharply across all leading bond markets with the global reflation story gathering pace as vaccine rollouts beat all expectations.
- Cross-market positions added value as the UK marginally underperformed, and we were overweight global markets against the UK.
- The yield curve marginally detracted from performance, in particular through an underweight position in the longest-dated bonds relative to the 30-year sector that impacted performance as the curve flattened on further pension fund demand.
- Duration was tactically traded around -0.1 to 0.25 years long, given the volatility in bond markets and very sharp moves in yields. Duration made a small positive contribution.
- Breakevens made a limited contribution to performance. The portfolio started the month holding gilts on a breakeven basis as it became evident that LDI demand was picking up. The position was closed prior to the 2051 syndication. Towards the end of the month, with breakevens reaching post-RPI reform highs, we sold 30-year index linked bonds into gilts.

Investment outlook

- Bonds have fallen sharply on a stronger growth outlook, with expectations of the first interest rate increases being brought forward. We believe the sell-off is overdone as there are still many hurdles to overcome as countries end lockdowns and government support schemes are reduced.
- We used the rise in yields to move to a modest long position as strong demand from LDI is expected towards the end of the quarter. On the curve, we favour being overweight the 30-year sector, which should benefit from demand around the index extension as the 2026 issue drops out.
- On a cross market basis, given RPI reform, long-dated global bonds still offer value with real yields in excess of 200 basis points higher than the UK and we envisage increasing these positions further.
- Breakeven rates remain elevated and valuations have been pushed to extreme levels due to the positive growth outlook. We are minded to increase the overweight position in gilts as we continue to believe breakeven rates are overvalued, particularly in the context of strong performance by sterling.
- Otherwise, we are mindful of the strategy review that is currently being undertaken by the ECB. We expect it to take a similar approach to that adopted last year by the Federal Reserve, with increased flexibility around inflation. ECB president Christine Lagarde has openly discussed average inflation targeting.

Key views within the fund

- Activity remained fairly tactical over the month, given the volatility in bond markets and very sharp moves in yields.
- Duration was gradually increased as yields rose during the month, starting at 0.1 years long and moving to 0.25 years long when yields hit the highs of the year. As markets recovered into the end of the month, bonds were sold and the portfolio ended the month around 0.1 years long.
- The principal activity on the curve was buying the 30-year sector, which had cheapened prior to the 2051 syndication. This position was primarily funded through the sales of sub 10-year bonds on the curve.

ROYAL LONDON INDEX LINKED BOND FUND

- On a cross market basis, European bonds (including Spain, Italy and Germany) were sold early in the month after strong performance prior to the UK syndication. We bought Italy back when the Italian government extended the curve, issuing the first 30-year index linked bond. This position was sold profitably before the month end. Towards the end of the month, with spreads widening back above 200 basis points, the fund bought US, Australian and Canadian bonds.
- The portfolio started the month holding gilts on a breakeven basis as it became evident that LDI demand was picking up. The position was closed prior to the 2051 syndication. Towards the end of the month, with breakevens reaching post-RPI reform highs, we sold 30-year index linked bonds into gilts.

Paul Rayner
Head of Alpha Strategies

Ben Nicholl
Fund Manager

ROYAL LONDON SHORT DURATION GLOBAL INDEX LINKED BOND FUND

Portfolio commentary

- Net of fees, the fund delivered a reported return of -1.26% in February (M Class, Income), underperforming its composite benchmark, which returned -0.82%. However, the performance of the fund and the index are calculated at different times of day, which affects the comparison. On a like-for-like basis, the fund underperformed by 29 basis points, returning -1.11%, although this may still have been affected by timing effects as US bonds rose sharply into the month-end close.
- Absolute returns were negative as real yields rose sharply across all leading bond markets, with the global reflation story gathering pace as vaccine rollouts beat all expectations.
- Cross-market positions added value as the UK marginally underperformed and we were overweight global markets against the UK.
- Yield curve strategies detracted from performance, in particular through an underweight position in short-dated TIPS relative to the 10-year sector as the curve steepened.
- Duration was tactically traded around 0.1 years long to 0.25 years long, given the volatility in bond markets and very sharp moves in yields. Duration made a small positive contribution.
- Breakevens made a limited contribution to performance. The portfolio started the month holding gilts on a breakeven basis as it became evident that LDI demand was picking up. The position was closed prior to the 2051 syndication. Towards the end of the month, with breakevens reaching post-RPI reform highs, we sold 10-year index linked bonds into gilts.

Investment outlook

- Bonds have fallen sharply on a stronger growth outlook, with expectations of the first interest rate increases being brought forward. We believe the sell-off is overdone as there are still many hurdles to overcome as countries end lockdowns and government support schemes are reduced. The US treasury market is now pricing in the new administration's fiscal stimulus and a strong recovery in GDP growth in 2021 and 2022, reflecting a marked shift over recent months.
- We used the rise in yields to move to a modest long position as strong demand from LDI is expected towards the end of the quarter. On the curve, we favour being overweight the longer end of the benchmark given the steepness of curves, particularly in the UK and US.
- On a cross-market basis, we remain underweight UK, but after the recent underperformance these positions have been scaled back. We still believe UK to be fundamentally expensive and, on any widening of spreads, would look to reduce UK exposure.
- Breakeven rates remain elevated and valuations have been pushed to extreme levels due to the positive growth outlook. We are minded to increase the overweight position in gilts as we continue to believe breakeven rates are overvalued, particularly in the context of strong performance by sterling.
- Otherwise, we are mindful of the strategy review that is currently being undertaken by the ECB. We expect it to take a similar approach to that adopted last year by the Federal Reserve, with increased flexibility around inflation. ECB president Christine Lagarde has openly discussed average inflation targeting.

Key views within the fund

- Activity remained fairly tactical over the month, given the volatility in bond markets and very sharp moves in yields.
- Duration was gradually increased as yields rose during the month. Having started the month relatively flat, duration was added as yields rose prior to the long-dated UK syndication, ending the month 0.2 years long.

ROYAL LONDON SHORT DURATION GLOBAL INDEX LINKED BOND FUND

- On a cross-market basis, European bonds (including Spain, Italy and Germany) were sold early in the month after strong performance prior to the UK syndication. Towards the end of the month, with spreads widening back above 200 basis points, the fund bought Australian bonds.
- The portfolio started the month holding gilts on a breakeven basis as it became evident that LDI demand was picking up. The position was closed prior to the 2051 syndication. Towards the end of the month, with breakevens reaching post-RPI reform highs, we sold 10-year index linked bonds into gilts.

Paul Rayner
Head of Alpha Strategies

Gareth Hill
Fund Manager

ROYAL LONDON SHORT DURATION GILT FUND

Portfolio commentary

- Yields rose sharply across all leading bond markets in February as the global economic recovery and reflation thematic gained momentum. There was some divergence in performance, however, with yields rising more significantly in the UK versus other developed markets, notably Europe. The UK continued to make good progress with its vaccination programme and the government outlined its roadmap for an end to most lockdown measures by mid-year. The Bank of England's Monetary Policy Committee (MPC) all but ruled out negative interest rates for at least six months, by which time the economy is expected to be growing sharply again once lockdown ends. In the US, President Biden's $1.9tn fiscal stimulus bill passed through the House of Representatives, although it was expected to be watered down to gain Senate approval.
- We started the month with duration 0.35 years short relative to the benchmark. This was beneficial for performance in a rising yield environment. In addition to this, the fund ran a large 2/5 steepener (i.e. underweight 5-year and overweight 2-year maturity bonds) through the month, which also made a positive contribution to performance. We reduced curve exposure into month end, buying 5- and 10-year maturity bonds, which also brought duration to neutral.
- The fund was also heavily overweight the lowest coupon bonds in each maturity bucket. The lowest coupon bonds were issued last year at a yield premium to surrounding bonds. With many of these bonds approaching the end of their issuance cycle, they have started to outperform.
- We sold the holding of 10-year Spain against 5-year gilts after the MPC meeting and held no cross-market positions over the rest of the month.
- Late last year the fund bought T-bills, as they offered a better yield than very short-dated (<12m) gilts. While T-bills have risen a little in yield, very short-dated gilts have risen by more so this has been beneficial to the fund. Overall the fund has around 6% in T-bills.
- The fund's highly rated sterling credit exposure, which we hold primarily as a means of enhancing the portfolios yield continues to be run close to its maximum limit of 5%. These positions are predominantly AAA rated, secured, floating rate notes and should provide the fund with some additional protection in a rising yield environment.

Investment outlook

- We expect global government bond yields to rise but only very gradually from current levels, with expectations for rate hikes building in nearly all bond markets outside Europe. The US treasury market in particular is now pricing in the new administration's fiscal stimulus and a strong recovery in GDP growth in 2021 and 2022. In the short term, economic growth may be kept in check by uncertainty around new strains of Covid-19 and the ongoing success of the vaccination programmes, but ongoing global fiscal and monetary policy should see economic activity recover sharply over the medium term.
- We continue to look for opportunities to take both tactical and strategic positions in overseas government bonds, where appropriate to the fund's risk and return objectives.
- We now believe that nominal bond markets are more reflective of longer-term fundamentals. However, uncertainty remains high and markets are volatile, so these effects could be sustained for some time. As such, we look to keep overall duration relatively neutral, but add value through trading markets tactically in the short term.

Key views within the fund

- The portfolio currently has a neutral duration position relative to its benchmark. We expect a gradual increase in UK government bond yields as the year progresses.
- The fund has no overseas exposure at month end, although we continue to look for opportunities to take such positions on a relative basis.

ROYAL LONDON SHORT DURATION GILT FUND

- The portfolio has an allocation to high-quality corporate bonds, which we expect to outperform gilts in a low-yielding environment.
- The portfolio may look to tactically trade index-linked gilts to take advantage of mispricing opportunities. The fund held no exposure to UK inflation over the month.

CITYWIRE +

Craig Inches
Head of Rates and Cash

CITYWIRE +

Ben Nicholl
Fund Manager

Rayner Spencer Mills RATED FUND

SQUARE MILE A

ROYAL LONDON UK GOVERNMENT BOND FUND

Portfolio commentary

- Yields rose sharply across all leading bond markets in February as the global economic recovery and reflation thematic gained momentum. There was some divergence in performance, however, with yields rising more significantly in the UK versus other developed markets, notably Europe. The UK continued to make good progress with its vaccination programme and the government outlined its roadmap for an end to most lockdown measures by mid-year. The Bank of England's Monetary Policy Committee (MPC) all but ruled out negative interest rates for at least six months, by which time the economy is expected to be growing sharply again once lockdown ends. In the US, President Biden's $1.9tn fiscal stimulus bill passed through the House of Representatives, although it was expected to be watered down to gain Senate approval.
- Gilt yields were higher on the month across the curve and the curve slightly steepened, with 10-year maturity bonds bearing the brunt of the selloff. At the start of February, the fund's duration was 0.2 years shorter than the FTSE Actuaries UK Conventional Gilts All Stocks Index. As yields rose the fund reduced the relative short position, to end the month around 0.15 years long. With regard to yield curve positioning, the fund had a steepening bias in the 3s/10s part of the curve and was neutral in the longer end (i.e. 10s/30s), so the steepening of the curve (particularly in the 2s/10s area) was also positive for performance.
- Cross-market trading was also positive for performance. Having started February with a long position in Spanish government bonds against gilts, we sold this position back into UK following the MPC meeting. During the month, we sold Italian government nominal bonds and later bought Italian government index-linked bonds. While yields rose, this position was still positive for performance as it outperformed nominal gilts. At the end of the month, we bought Australian government nominal bonds at a yield of 278 basis points. We continued to hold a long-running position against Japanese index linked bonds which was positive for performance as index linked bonds outperformed nominal bonds globally.
- The fund had no UK inflation exposure during the month.
- The fund's modest highly-rated sterling credit exposure, which we hold primarily as a means of enhancing yield in the fund, marginally added to returns as credit spreads (the average extra yield available from corporate bonds compared with government debt of equal maturity) tightened further.

Investment outlook

- We expect global government bond yields to rise but only very gradually from current levels, with expectations for rate hikes building in nearly all bond markets outside Europe. The US treasury market in particular is now pricing in the new administration's fiscal stimulus and a strong recovery in GDP growth in 2021 and 2022. In the short term, economic growth may be kept in check by uncertainty around new strains of Covid-19 and the ongoing success of the vaccination programmes, but ongoing global fiscal and monetary policy should see economic activity recover sharply over the medium term.
- We continue to look for opportunities to take both tactical and strategic positions in overseas government bonds, where appropriate to the fund's risk and return objectives.
- We now believe that nominal bond markets are more reflective of longer-term fundamentals. However, uncertainty remains high and markets are volatile, so these effects could be sustained for some time. As such, we look to keep overall duration relatively neutral, but add value through trading markets tactically in the short term.

Key views within the fund

- The portfolio's duration is marginally longer than the benchmark, including the impact of cash holdings on duration.
- The fund holds a steepening bias with an overweight in less than 5-year maturity bonds
- The fund has a small overseas exposure, and we continue to look for opportunities to take such positions on a relative basis.

ROYAL LONDON UK GOVERNMENT BOND FUND

- The portfolio has allocations to high-quality corporate bonds, which we expect to outperform gilts in a low-yielding environment.
- The portfolio may look to tactically trade index-linked gilts to take advantage of mispricing opportunities, but had no exposure to UK inflation at the end of the month.

Craig Inches
Head of Rates and Cash

Ben Nicholl
Fund Manager

RLAM GLOBAL HIGH YIELD FUND PERFORMANCE

Fund performance

	1 month (%)	Rolling 12 months (%)
RL Global High Yield Bond Fund M Inc	**0.38**	**8.15**
RL Global High Yield Bond Fund Z Inc	**0.39**	**8.49**
IA Sterling High Yield Sector	0.62	5.58
ICE BofA ML BB-B Global Non-Financial High Yield Constrained Index	0.20	6.49
RL Short Duration Global High Yield Bond Fund A Inc	**0.16**	**0.54**
RL Short Duration Global High Yield Bond Fund M Inc	**0.20**	**0.94**
RL Short Duration Global High Yield Bond Fund Z Inc	**0.21**	**1.06**
IA Sterling High Yield Sector	0.62	5.58
Sterling Overnight Index Average Rate (SONIA)[1]	0.00	0.18

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.

Source: RLAM and FE, correct as of 28 February 2021. Returns quoted are net of fees.

[1] Benchmark: SONIA. Please note that this changed from 3-month LIBOR, effective 15 December 2020, and is reflected in the returns shown above.

ROYAL LONDON GLOBAL HIGH YIELD BOND FUND

Portfolio commentary

- The fund's Z class returned 0.39%, net of fee, in February, compared with 0.20% for the ICE BofA Merrill Lynch BB-B Global Non-Financial High Yield Constrained Index (100% GBP hedged).
- Index performance during the month was influenced by a positive income return of 0.42%, while the price return was -0.21%.
- The yield-to-worst* on the benchmark ended February at 3.95%. The fund yield stood at 4.73% at month end, excluding the impact of cash, and its duration was longer than that of the index.
- The global high yield market produced a small positive return in February. Spreads were modestly tighter over the month, while the positive impact from the carry on high yield bonds offset the impact of increased government bond yields over the month.
- While Covid-19 case numbers generally declined across the UK, US and Europe over the month as restrictions and vaccination programmes took effect, Europe is showing signs that the virus is rising again, threatening the easing of lockdowns. Falls in case numbers are also showing signs of stalling in the US.
- In the US, President Biden's $1.9tn fiscal stimulus bill passed through the House, although is expected to be watered down to gain Senate approval. Direct cheques from the December stimulus package boosted consumer spending, with retail sales rising faster than expected. In Europe, the ECB expressed concern about higher bond yields with President Lagarde stating that preserving favourable financing conditions is the compass for asset purchases. Mario Draghi was appointed as Italian prime minister, removing the immediate risk of early elections.
- With accommodative monetary policy and fiscal stimulus, positive inflation base effects and ongoing friction in global supply chains, global reflation was reflected in notably higher bond yields across the board in February. In high yield markets, returns were mixed across market index sectors. Energy, the largest in the high yield universe, produced positive returns over the month, as did leisure, transport and real estate, while other major sectors such as healthcare, media and telecoms all saw negative returns. Generally speaking, lower rated debt outperformed, with CCC rated bonds outperforming B rated debt, which in turn outperformed BB rated debt. In local currency terms, there was little difference in returns between the US, Europe and UK, all of which produced modest positive returns, while emerging market high yield was broadly flat.
- The US default rate, continuing a trend in recent months, remained broadly unchanged, with the energy and telecommunications sectors still the primary sources. High yield defaults are higher than was the case before the Covid outbreak, but have been stable since summer 2020.
- Issuance in the high yield market was relatively buoyant in February and while this was somewhat lower than January, remained higher than the same month in 2020. The majority of issuance continued to be BB or B rated, with a slight bias towards the latter. Issuance came overwhelmingly from the US market, with European high yield issuance materially lower, albeit this has stabilised after falling dramatically in 2020.
- The biggest contributor to the fund's performance was the oil and gas exploration company **Tullow Oil**. The largest detraction from relative performance came from the US sports media company **Diamond Sports Group**.
- **Yield-to-worst refers to the redemption date that produces the lowest return.*

Investment outlook

- There is a high level of uncertainty around the global economic growth outlook and the corresponding monetary and fiscal policy responses to be taken. As a result, we expect ongoing volatility, with corporate default rates experienced in the market to be lower than current market expectations.
- We continue to believe that global high yield bonds are attractive on a spread basis and that they overcompensate for default risk, while their level of income generation is also appealing on a relative basis.

Key views within the fund

- The fund's objective is to achieve a combination of capital growth and income. The fund seeks to achieve its investment objective by outperforming its benchmark, the BofA Merrill Lynch BB-B Global Non-Financial High Yield Constrained index, 100% hedged to sterling, by 1% per annum over rolling three-year periods.

ROYAL LONDON GLOBAL HIGH YIELD BOND FUND

- The fund seeks to mitigate stock-specific risk by holding a diversified portfolio of investments, so that no individual investment can, in isolation, have an excessive adverse impact on overall fund performance. Currency risk associated with holdings of bonds is hedged through the use of forward currency transactions.
- We expect bouts of market volatility due to market expectations surrounding US Federal Reserve monetary policy. As such, we believe bonds with near-term catalysts, which mitigate market risk, are an important attribute underpinning investment performance over the medium term.

Azhar Hussain
Head of Global Credit

Stephen Tapley
Global Credit Fund Manager

ROYAL LONDON SHORT DURATION GLOBAL HIGH YIELD BOND FUND

Portfolio commentary

- The fund's Z class returned 0.20%, net of fee, in February, compared with 0.00% for SONIA.
- The global high yield market produced a small positive return in February. Spreads were modestly tighter over the month, while the positive impact from the carry on high yield bonds offset the impact of increased government bond yields over the month.
- While Covid-19 case numbers generally declined across the UK, US and Europe over the month as restrictions and vaccination programmes took effect, Europe is showing signs that the virus is rising again, threatening the easing of lockdowns. Falls in case numbers are also showing signs of stalling in the US.
- In the US, President Biden's $1.9tn fiscal stimulus bill passed through the House, although is expected to be watered down to gain Senate approval. Direct cheques from the December stimulus package boosted consumer spending, with retail sales rising faster than expected. In Europe, the ECB expressed concern about higher bond yields with President Lagarde stating that preserving favourable financing conditions is the compass for asset purchases. Mario Draghi was appointed as Italian prime minister, removing the immediate risk of early elections.
- With accommodative monetary policy and fiscal stimulus, positive inflation base effects and ongoing friction in global supply chains, global reflation was reflected in notably higher bond yields across the board in February. In high yield markets, returns were mixed across market index sectors. Energy, the largest in the high yield universe, produced positive returns over the month, as did leisure, transport and real estate, while other major sectors such as healthcare, media and telecoms all saw negative returns. Generally speaking, lower rated debt outperformed, with CCC rated bonds outperforming B rated debt, which in turn outperformed BB rated debt. In local currency terms, there was little difference in returns between the US, Europe and UK, all of which produced modest positive returns, while emerging market high yield was broadly flat.
- Issuance in the high yield market was relatively buoyant in February and while this was somewhat lower than January, remained higher than the same month in 2020. The majority of issuance continued to be BB or B rated, with a slight bias towards the latter. Issuance came overwhelmingly from the US market, with European high yield issuance materially lower, albeit this has stabilised after falling dramatically in 2020.
- The US default rate, continuing a trend in recent months, remained broadly unchanged, with the energy and telecommunications sectors still the primary sources. High yield defaults are higher than was the case before the Covid outbreak, but have been stable since summer 2020.
- The biggest relative contributor to the fund's performance was the satellite operator **Intelsat**. There were no material detractors from performance, with business decision data provider Dun & Bradstreet a small negative for the fund.
- At month-end, the expected yield on the fund was 3.12% (3.17% on an FX-adjusted basis), with an expected maturity of 0.96 years.

Investment outlook

- There is a high level of uncertainty around the global economic growth outlook and the corresponding monetary and fiscal policy responses to be taken. As a result, we expect ongoing volatility, with corporate default rates experienced in the market to be lower than current market expectations.
- We continue to believe that global high yield bonds are attractive on a spread basis and that they overcompensate for default risk, while their level of income generation is also appealing on a relative basis.

Key views within the fund

- The fund's objective is to provide income. The manager seeks to achieve this by outperforming the benchmark, SONIA, by 2% per annum over rolling three-year periods.
- The fund is diversified in order to improve overall portfolio liquidity and to reduce the effect on overall fund performance of any deterioration in the creditworthiness of an individual holding.

ROYAL LONDON SHORT DURATION GLOBAL HIGH YIELD BOND FUND

- We expect bouts of market volatility due to changing market expectations surrounding monetary policy worldwide. As such, we believe companies with strong liquidity characteristics are an important element in underpinning investment performance over the medium term.

Azhar Hussain
Head of Global Credit

Stephen Tapley
Global Credit Fund Manager

ROYAL LONDON
ASSET MANAGEMENT