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Royal London Global High Yield Fund

Quarterly Investment Report

31 December 2023

Quarterly Report

The fund as at 31 December 2023

The purpose of this report is to provide an update on the Royal London Global High Yield Fund. The report has been produced by Royal London Asset Management. The report starts with a summary dashboard showing key information about the fund. A glossary is located at the end of the report covering the description of some of the more technical terms used with the report. All data within this report is at the report date unless otherwise stated.

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The fund

Fund performance objective and benchmark

The investment objective of the fund is to provide a combination of investment growth and income. The fund seeks to achieve its investment objective by outperforming its benchmark, the BoAML BB-B Global Non-Financial High Yield Constrained Index (the “Benchmark”) by 1% per annum over rolling three year periods.

Benchmark: ICE BofA ML BB-B Global Non-Financial High Yield Constrained Index

Fund value

	Total £m
31 December 2023	2,816.84

Fund analytics

	Fund
Fund launch date	15 February 2013
Base currency	GBP
Duration to worst (years)	4.22
FX adjusted yield (%)	7.25

Past performance is not a guide to future performance.
Please refer to the glossary for a description of the yield used.

Performance and activity

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Quarter	6.64	6.47	0.17
1 Year	11.47	11.25	0.22
3 Years (p.a.)	-0.07	-0.21	0.14
5 Years (p.a.)	3.57	3.20	0.37
10 Years (p.a.)	3.68	3.36	0.32
Since inception (p.a.)	4.02	3.55	0.47

Past performance is not a guide to future performance.

Please refer to the Glossary for the basis of calculation and impact of fees. Performance and since inception date based on Royal London Global High Yield Fund (Z Inc). Source Royal London Asset Management; Gross performance; Since inception date for the share class is 15 February 2013.

Performance commentary

The fund reported a strong return in the fourth quarter, performing broadly in line with the benchmark – while slightly ahead on a gross basis. It was a similar story over the year, with double digit returns for 2023.

The final couple months of 2023 saw very strong returns with a stunning magnitude of reversal in yields with spreads and rates substantially tighter. November ended up being the best month in 38 years for investment grade bonds, while it was simply the best month since last summer for the high yield market.

The fund's outperformance in the quarter was driven by idiosyncratic stock factors and our tendency to favour single B-rated bonds over BB. In particular, our holdings in media, services and telecommunications contributed to our outperformance versus the benchmark. Going forward, we will maintain a preference for B-rated bonds but are wary of sliding too far down the credit rating scale while yields remain high.

The performance of the fund gives us confidence going into next year but sluggish growth, in both the US and Europe, tight lending standards, and rates uncertainty could put pressure on spreads broadly. However, we still see the default cycle being extended into 2025, leading us to believe spreads will fall in a range of 340 to 450 for next year. We are confident in finding insulation to protect ourselves from the structurally weakest parts of the market.

Performance and activity

Top 10 holdings

	Weighting (%)
Live Nation Entertainment Inc 4.75% 15/10/2027	1.36
APX Group Inc 6.75% 15/02/2027	1.24
Transdigm Inc 5.5% 15/11/2027	1.22
Carnival Corp 7.625% 01/03/2026	1.00
SCIH Salt Holdings Inc 4.875% 01/05/2028	0.99
Wesco Distribution Inc 7.25% 15/06/2028	0.98
Telenet Finance Luxembourg 5.5% 01/03/2028	0.98
Teva Pharmaceuticals Ne 3.15% 01/10/2026	0.98
Amc Networks Inc 4.75% 01/08/2025	0.96
Rolls-Royce Plc 5.75% 15/10/2027	0.95
Total	10.66

Fund activity

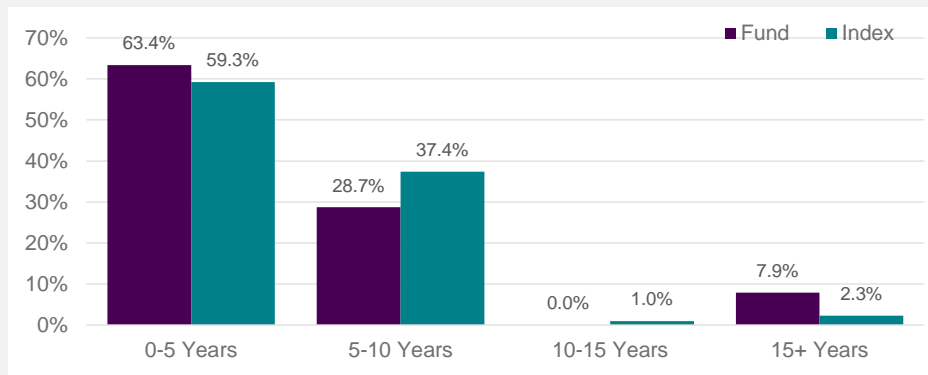
With the main uncertainty next year coming from rates, we are high on short duration bonds and carry – income matters in this yield environment. We continue to feel carry offered in high yield bonds will be our friend. The high yields seen in 2023 offer a buffer to absorb spread and default losses to keep total returns high in 2024.

We feel we are getting rewarded for our current yield and do not feel the need to take on incremental risk with the current carry being offered in the high yield market. Our focus will remain on targeting solid names with good financials that have levers to pull in any potential economic fallout.

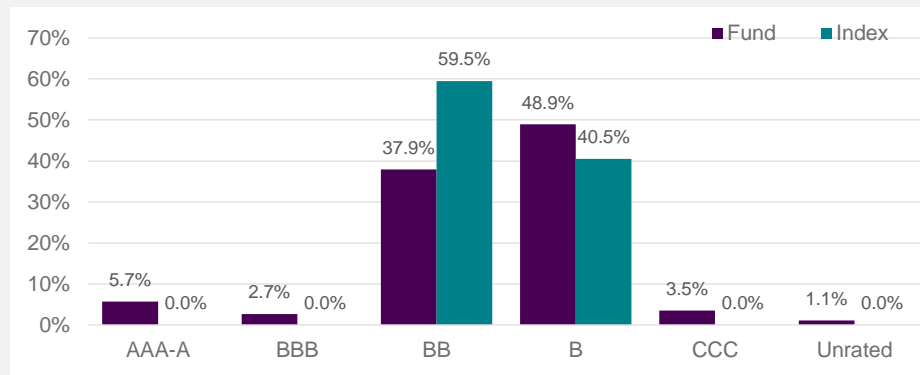
We think the tailwind risks of a much harsher recession than the shallow one currently predicted is hard to foresee as the credit market will be reacting to the recession, unlike its role in 2008 where it was a leading indicator as the root of the crisis. While we are comfortable with what we feel is a benign economic environment, we do accept there is increased idiosyncratic risk now than there was 12 months ago.

Asset allocation

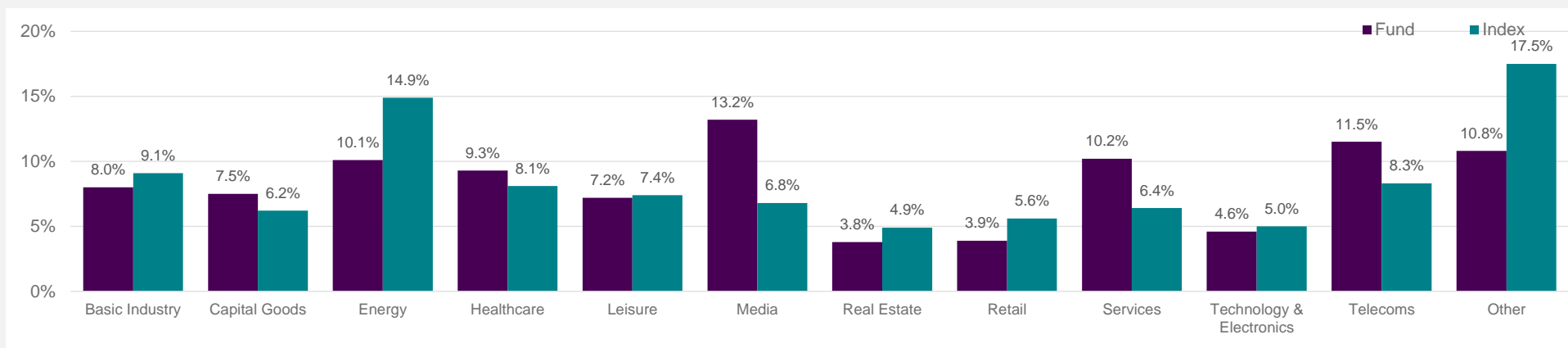
Maturity profile



Credit ratings



Sector allocation



Market commentary

Market overview

Economic attention over the quarter has been on inflation. At the start of the quarter investors focussed on the persistence of large price increases and central bank messaging on rates being held higher for longer. Yet, as headline inflation fell, sentiment swung dramatically towards the end of the quarter, pushing markets to price in interest rate cuts in 2024. The Federal Reserve (Fed), European Central Bank (ECB) and Bank of England (BoE) all left rates unchanged over the quarter, maintaining official rates at multi-year highs. The Fed has now held rates unchanged at its last three meetings. There has however been a significant shift in messaging, with the US central bank now indicating that it expects to cut rates by 0.75% in 2024. The ECB has similarly kept rates steady at its two most recent meetings, but central bankers in the eurozone said that no rate cuts have yet been discussed.

The Fed kept rates on hold at 5.25-5.50% over the quarter against a still resilient labour market backdrop, but with inflation continuing to cool. As of their December meeting, the median forecast of participants had 75bp of rate cuts in it for 2024 with a further 100bp of cuts pencilled in for 2025. Over the quarter, CPI inflation fell from 3.7% year-on-year in August, to 3.1% in November. That is still above June 2023 levels, but core continued a more consistent drift lower over the period. The core PCE measure of inflation fell over the quarter and month-on-month was only 0.1% in November. Third quarter GDP recorded a strong 4.9% quarter-on-quarter annualised growth. More timely economic activity indicators were mixed over the fourth quarter. The House passed a spending package that pushed the effective next government spending deal/shutdown deadline into early 2024.

Over the fourth quarter, the ECB kept rates on hold. Going into the December meeting, various ECB speakers had already broached the topic of rate cuts, effectively opening the door for cuts in the second half of 2024 while pushing back on the chance of a near term cut. President Lagarde said that they did not discuss rate cuts in December and that “between hike and cut there is a whole plateau – a whole beach – of hold.” Euro area CPI fell to only 2.4% year-on-year in November from 5.2% in August. Core CPI fell sharply over the same period too to 3.6%. The euro area economy (GDP) shrank by 0.1% quarter-on-quarter in the third quarter after recording only 0.1% GDP growth in both the first quarter and the second quarter. Germany’s constitutional court put hurdles in the way of additional German government spending, ruling against the transfer of borrowing authorised during Covid to the Climate Fund (that decision was taken in 2021), in the name of protecting Germany’s constitutional debt brake.

The Bank of England left interest rates unchanged over the period. The Monetary Policy Committee continued to be split – at the December meeting three of the nine members were still voting for a rate hike. UK inflation has fallen significantly, with the annual inflation rate falling to 3.9% in November, its lowest level in over two years. However, this remains well above the BoE 2% target, with core and wage inflation significantly higher than the headline rate.

Global government bond yields started the quarter continuing to rise – a trend that started in mid-2020, reflecting market views that rising inflation would necessitate higher interest rates. With inflation starting to come down, expectations of rate cuts in 2024 meant that bond yields fell in November and December, ending the quarter lower than they started, and ending 2023 at roughly the same levels as they started. In the US, 10-year treasury yields fell from 4.57% to 3.88%, falling back from 15-year highs to reverse virtually all of the rise seen in the prior quarter, and ending the year only modestly higher despite rising for most of 2023. German 10-year bunds similarly saw material falls in the fourth quarter, falling from 2.84% to 2.01%, while the benchmark 10-year gilt yield fell from 4.44% to 3.54% (all local currency terms).

Global corporate bond markets saw a strong rally into year-end but this could limit performance from spreads in 2024. December continued in a similar vein to November with spreads and rates continuing their declines leading to another month of healthy returns – allowing 2023 to report double digit returns. Over the fourth quarter, the ICE BofAML US Corporate Index returned 7.91%, while in the euro zone and UK, the ICE BofAML Euro Corporate & Pfandbrief Index and iBoxx Sterling Non-Gilt indices returned 5.49% and 7.35% respectively.

In the high yield market, the ICE BofAML (BB-B) Global Non-Financial High Yield Index (sterling hedged) benchmark returned 6.47% in the quarter as spreads hit 400bps. At the end of the period, the index’s yield-to-worst stood at 7.05%, having fallen from 8.20% at the start of the year. In the broader-based high yield index, which includes CCC rated bonds, spreads tightened to 400bps, with a yield-to-worst of 7.7%. Over the course of 2023, high yield new issuance has totalled \$175bn up from \$106bn in 2022.

Market commentary

Outlook

Our focus will remain on the Fed. With inflation expected to fall back towards the long-term target, the levels that the Fed is happy with and when it then begins to lower rates will be the key factor for the upcoming year. The resiliency of the economy has led to the narrative that interest rates will now stay 'higher-for-longer'. With monetary policy lags appearing longer than they used to be there is some recognition by central banks that policy tightening needs time to work and that the impacts of policy tightening are still feeding through. This is causing spreads to tighten as investors are now convinced the fallout won't be coming until late 2024 or early 2025.

Current default rates are very low at around 2-3% and while we expect this to track to 3%-5% over the course of next year. These levels would be entirely normal in an historic context, but the nature of the economic backdrop and strong company balance sheets means we expect default rates to grinding higher over this period, instead of sharply spiking. Even if default rates creep higher than our target range we don't see this as particularly worrying as it won't change the fundamentals of the high yield market and will only come about from Fed monetary policy, which has been priced into corporate valuations, instead of, as of yet, unknown increased economic hardship.

With this in mind, we believe 2024 should play out similarly to 2023: maturity wall concerns being overplayed; companies holding high liquidity; private debt markets eating the bottom cohort of public markets; public markets remaining open, with solid issuance levels. As long as public markets stay open, any maturity wall concerns will be swept away. And, as long as private markets are taking away the weakest parts of public markets, defaults should stay low.

In our view, the way through difficult markets is to focus on those risks that you can control and know what you own. We will keep spread duration low and focus on the quality of issuers' financials, rather than relying on third-party ratings: at a sectoral level, cashflows are the key factor, meaning we need to know about on- and off-balance sheet leverage. We prefer not to wait for defaults as the recovery process can take time: however, should they occur, the key is to have an adequate solvency cushion.

Further information

Find out more

Royal London Asset Management's Outlook 2024 document and podcasts are both available on our website. In this year's Outlook document, our fund managers assess the challenges and opportunities in their respective asset classes for 2024. With an environment of falling inflation and modest recession, the benefits or risk for equities or credit is not so clear cut and knowing your companies is key. We analyse the areas of concern and potential growth within this environment.

In our Outlook 2024 podcast, Piers Hillier, CIO, looks ahead to 2024 and discusses the issues he believes will be prominent over the next 12 months, and where the key investment risks and opportunities may lie.

Articles, videos and webinars explaining our investment thinking can be found in the Our Views section of www.rlam.com, including regular updates from our Fixed Income, Global Equity, Sustainable and Multi Asset teams.

Disclaimers

Important information

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A subsidiary of The Royal London Mutual Insurance Society Limited.

The Fund is a sub-fund of Royal London Asset Management Funds plc, an open-ended investment company with variable capital (ICVC), with segregated liability between sub-funds.

Incorporated with limited liability under the laws of Ireland and authorised by the Central Bank of Ireland as a UCITS Fund. It is a recognised scheme under the Financial Services and Markets Act 2000,

The Management Company is FundRock Management Company SA, Registered office: 33 rue de Gasperich L-5826 Hesperange, Luxembourg and is authorised and regulated by the Commission de Surveillance du Secteur Financier (CSSF).

The Investment Manager is Royal London Asset Management Limited.

For more information on the Fund or the risks of investing, please refer to the Prospectus or Key Investor Information Document (KIID), available via the relevant Fund Information page on www.rlam.com.

Most of the protection provided by the UK regulatory system, and the compensation under the Financial Services Compensation Scheme, will not be available.

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Risk and Warnings

Investment Risk

The value of investments and any income from them may go down as well as up and is not guaranteed. Investors may not get back the amount invested.

Credit Risk

Should the issuer of a fixed income security become unable to make income or capital payments, or their rating is downgraded, the value of that investment will fall. Fixed income securities that have a lower credit rating can pay a higher level of income and have an increased risk of default.

Efficient Portfolio Management (EPM) Techniques

The Fund may engage in EPM techniques including holdings of derivative instruments. Whilst intended to reduce risk, the use of these instruments may expose the Fund to increased price volatility.

Exchange Rate Risk

Changes in currency exchange rates may affect the value of your investment.

Interest Rate Risk

Fixed interest securities are particularly affected by trends in interest rates and inflation. If interest rates go up, the value of capital may fall, and vice versa. Inflation will also decrease the real value of capital. Unlike the income from a single fixed interest security, the level of income (yield) from a fund is not fixed and may go up and down. Bond yields (and as a consequence bond prices) are determined by market perception as to the appropriate level of yields given the economic background.

Liquidity Risk

In difficult market conditions the value of certain fund investments may be difficult to value and harder to sell, or sell at a fair price, resulting in unpredictable falls in the value of your holding.

Emerging Markets Risk

Investing in Emerging Markets may provide the potential for greater rewards but carries greater risk due to the possibility of high volatility, low liquidity, currency fluctuations, the adverse effect of social, political and economic instability, weak supervisory structures and accounting standards.

Counterparty Risk

The insolvency of any institutions providing services such as safekeeping of assets or acting as counterparty to derivatives or other instruments, may expose the Fund to financial loss.

Performance to 31 December 2023

Cumulative (%)

	3 Month	6 Month	1 Year	3 Years	5 years
Funds (gross)	6.64	7.50	11.47	(0.22)	19.20
Fund (net)	6.48	7.19	10.83	(1.94)	15.91

Annualised (%)

3 Years (p.a.)	5 years (p.a.)
(0.07)	3.57
(0.65)	2.99

Year on year performance (%)

	31/12/2022 – 31/12/2023	31/12/2021 – 31/12/2022	31/12/2020 – 31/12/2021	31/12/2019 – 31/12/2020	31/12/2018 – 31/12/2019
Funds (gross)	11.47	(14.13)	4.24	6.42	12.25
Fund (net)	10.83	(14.63)	3.63	5.83	11.69

Past performance is not a guide to future performance. The impact of fees or other charges including tax, where applicable, can be material on the performance of your investment.

Source: RLAM as at 31 December 2023. All figures are mid-price to mid-price in GBP for the Royal London Global High Yield Bond Fund (Z Inc).

Glossary

Asset split

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

Credit ratings

Credit ratings are based on RLAM composite ratings which uses a hierarchy of S&P, Moody's and the Fitch rating.

Duration

Measure of sensitivity of a Fixed Income instrument to changes in interest rates, indicating the potential impact of interest rate fluctuations on the value of the investment.

FX adjusted yield

FX adjusted yield is the gross rate of return to the expected maturity adjusted for hedging and excludes the impact of cash.

Fund analytics

All figures exclude cash. Credit bonds include non-sterling bonds and CDs where held within the fund or benchmark.

This is applicable to the following sections: fund Asset Allocation, Duration, Yield curve, Sector breakdown, Financial holdings, Credit ratings.

Fund size

Total value of the fund as of the last business day of the calendar month. The valuations are based on signed off prices and are on a mid-price basis.

Performance

Performance is calculated using the signed off NAV per share. The impact of fees or other charged include tax, where applicable, can be material on the performance of your investment. The impact of fees reduce the return.

Sector allocation

The global funds sector classifications are based on ICE BofA sector level 3 classifications..

Top 10 holdings

Top 10 assets held by market value, excluding derivatives and cash.

Yield to worst

Yield to worst is a measure of the lowest possible yield that can be received on a bond that fully operates within the terms of its contract without defaulting.