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RLPPC UK Corporate Bond 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 RLPPC UK Corporate Bond Fund. The report has been produced by Royal London Asset Management. The report starts with a summary dashboard showing key information about the fund. A glossary is located at the end of the report covering the description of some of the more technical terms used within the report. All data is as at the report date unless otherwise stated.

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The fund

Fund performance objective and benchmark

To outperform its benchmark by 0.50% per annum net of fees (on a rolling three year basis). The RLPPC UK Corporate Bond Fund invests predominantly in sterling credit bonds, including unrated bonds and sub-investment grade bonds. The fund may also invest in UK government bonds and non-sterling bonds.

Benchmark: iBoxx Sterling Non-Gilt All Maturities Index

Fund value

	Total £m
31 December 2023	1,900.14

Asset allocation

	Fund (%)	Benchmark
Conventional credit bonds	97.41%	99.38%
Securitised	2.44%	-
Conventional foreign sovereign	0.15%	0.62%

Fund analytics

	Fund	Benchmark
Fund launch date	31 May 2000	
Base currency	GBP	
Duration (years)	6.09	5.54
Gross redemption yield (%)	6.01	4.77
Number of holdings	406	1,264
Number of issuers	252	501

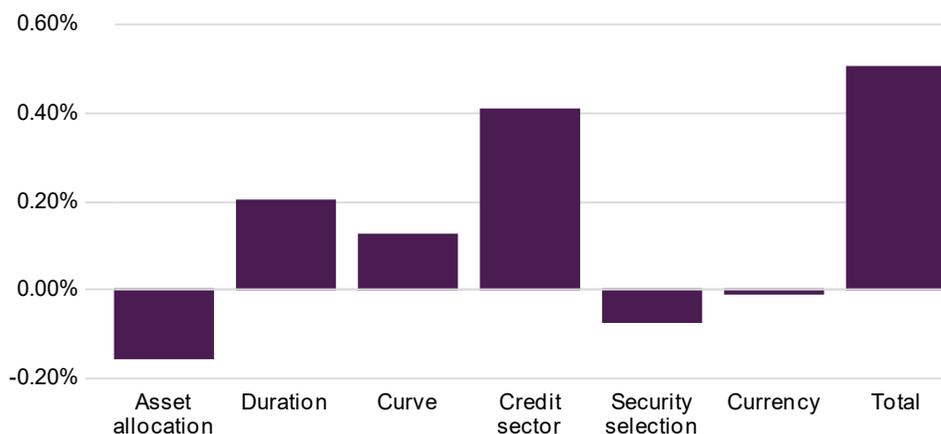
Performance and activity

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Quarter	8.04	7.35	0.69
1 Year	10.63	8.60	2.04
3 Years (p.a.)	(2.70)	(4.69)	1.99
5 Years (p.a.)	2.03	0.40	1.64
10 Years (p.a.)	4.11	2.71	1.40
Since inception (p.a.)	5.98	4.64	1.34

Past performance is not a guide to future performance. Please refer to the Glossary for the basis of calculation and impact of fees. Performance and since inception date based on RLPPC UK Corporate Bond Fund (Acc). Source: Royal London Asset Management; Gross performance; Since inception date of the shareclass is 31 May 2000.

Attribution over the quarter



Performance commentary

The fund saw a positive return in the period and was ahead of the iBoxx Sterling Non-Gilt index benchmark. The main driver of positive performance was our sector positioning, notably our underweight position in supranationals, which continued to lag the wider market having done so in the third quarter. Duration and curve positioning were positive – we were slightly long going into the quarter and the fall in yields and strong performance from longer-dated bonds therefore helped.

Stock selection effects were mixed: we saw positive selection in insurance bonds, notably longer dated subordinated bonds from Prudential and Legal & General, but negative selection effects in structured bonds, which generally have a lower sensitivity to wider market moves. In addition, our holding in Thames Water was also a detractor from performance over the quarter. We maintained exposure to Thames Water as part of a diversified portfolio, based on the attractiveness of the overall blended yield across holdings in operating company and holding company debt. Whilst structurally junior holding company debt underperformed and was downgraded, our larger exposure to the operating company debt was beneficial for performance over the quarter. We continue to believe that the sector remains attractively valued – largely based on our view that spreads in the sector overcompensate when compared to other regulated infrastructure assets such as UK electricity distribution.

Last quarter we highlighted an issue with our holding in HDL, where the principal was not repaid on maturity at the end of July. We are pleased to confirm that the bond was redeemed in full in November. We believe this is a good outcome as not only did holders receive full repayment, but also accrued interest at the coupon rate since the end of July. In our view, this demonstrates the power of covenants and how these can protect investors' interests in this sort of scenario. Naturally we prefer to avoid any default, but as we expressed in our initial update we had confidence in our position. It should be noted that, over time, the investment in HDL has been materially beneficial – despite the default.

Performance and activity

Fund activity

Financials remain the largest part of the market with issuance in 2023 skewed similarly. We continued to find opportunities across the financial sector, adding new senior issues from Barclays and Credit Agricole early in the period, We are also happy to add subordinated bonds where we feel the risk/ reward profile is attractive, examples during the quarter including Aviva and defined benefit pension buy-in and buy-out specialist Pension Insurance Corporation. Finally we added an AT1 subordinated new issue from Close Brothers at a yield in excess of 11%. This market, having been very quiet since the Credit Suisse rescue, has been active with investors now confident that such debt will rank higher than equity holders in US dollar, euro and sterling markets.

We are selective in our exposure to utilities – often feeling that we can find better value elsewhere. However, the sector's regulated nature is attractive, and its more long-dated maturity profile means that it sits well with our philosophy of being long-term lenders. Southern Water is a regulated utility and we bought a new issue of senior operating company bonds during the quarter. We felt these were attractively priced – the company trades wider than the sector due to perceived operational and financial issues, but in our view operating performance is starting to improve, supported by significant new equity injections over the last few years. We also added a new 2040 issue from Thames Water. The bonds are at the operating company level and came at a very attractive spread.

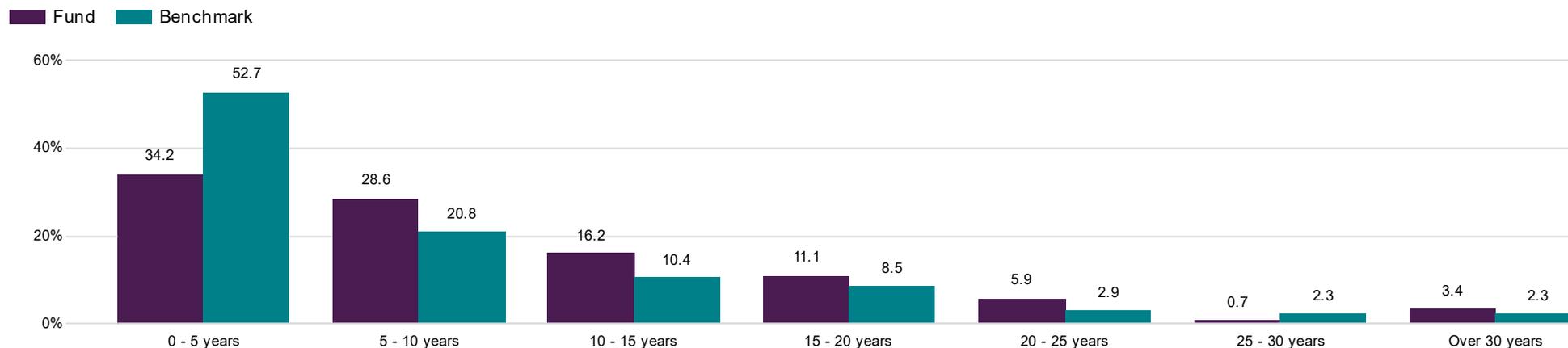
Social housing remains a key area for our sterling credit strategies. During the quarter a new issue of 2041 bonds from Places for People. The company owns and manages 240,000 properties across the UK and the bonds came at an attractive spread premium to the market.

There were noteworthy new issues in the structured sector as well. We added a new issue of Stark Financing, a commercial mortgage-backed security secured against 103 UK property assets, predominantly 'last mile' warehouse assets. The floating rate A notes we bought are rated AAA and have an attractive loan-to-value, also paying an attractive premium to SONIA. We also added a five-year new issue from the RAC, these bonds yielding over 8% and benefiting from security over the business.

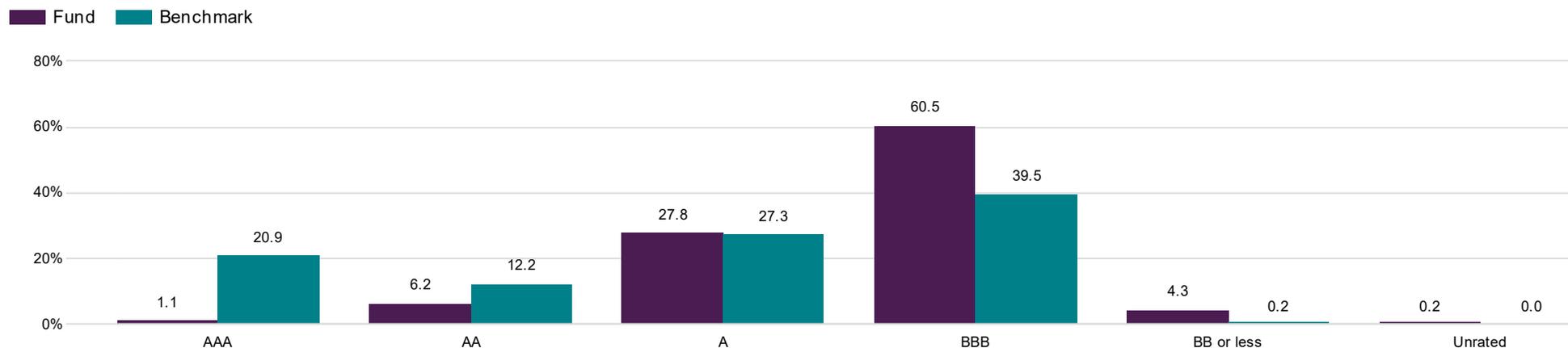
In the secondary market we added bonds from global financial solutions provider Fidelity National Information Services, while we also added a CMBS from Meadowhall Finance, secured on the Sheffield shopping centre with a low loan-to-value.

Fund breakdown

Maturity profile

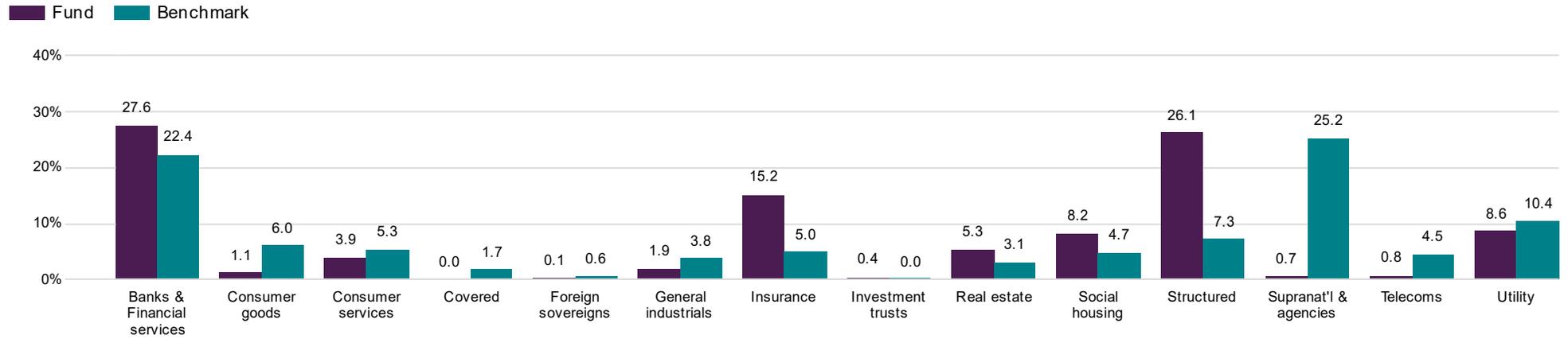


Credit ratings



Fund breakdown

Sector breakdown



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.

In tune with the other major central banks, and potentially marking the high point in the UK interest rate cycle, 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. This is the lowest rate of increase 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 the rising trend that started in mid-2020. This reflected market views that rising inflation would necessitate even higher interest rates and the mantra of higher for longer. Yet, with inflation starting to come down, expectations of rate cuts in 2024 contributed to significant falls in bond yields in November and December. The fall in yields was such that yields along the length of the curve ended the quarter lower than they started, and closed 2023 at roughly the same levels as they started. UK government bonds produced strong returns due to falling yields, delivering an 8.1% return (FTSE Actuaries) over the fourth quarter with the benchmark 10-year gilt yield falling from 4.44% to 3.54%.

The sterling investment grade credit market (iBoxx non-gilt index) returned 7.35% over the quarter, helped by lower government bond yields and tighter credit spreads. This was lower than the return from gilts due to the shorter duration of the credit market index. The average sterling investment grade credit spread (the average extra yield available from non-gilt bonds compared with government debt of equal maturity) tightened from 1.38% to 1.15% (iBoxx). Given the fall in yields, sectors with a greater proportion of long-dated bonds performed well, including utilities and social housing. Supranationals was the worst performing sector, while in financials, banks lagged slightly but insurance bonds modestly outperformed the market.

Issuance was relatively low in the fourth quarter, reflecting usual seasonal patterns. For the year as a whole, sterling issuance was £63.9 billion, or £28 billion in net terms, compared with £51.5 billion and -£2.7 billion respectively in 2022.

Outlook

Inflation has come down significantly in 2023 but remains well above the Bank of England's target, and now does not have the 'easy' wins of base effects to push this lower. In our view, wage inflation is the key metric to watch: we believe that the Bank will find it hard to start cutting rates if wages continue to rise at 5-6% per annum. Although the economic data remain very mixed, we still believe that higher interest rates will contribute to a slowdown in the UK. This could well impact company earnings and lead to some increase in pressure on credit markets. However, consumer resilience has been greater than expected in both the UK and globally, which has helped support growth and prevent a recession. How this continues into 2024 could prove critical.

As we came into November 2023, we felt that the all-in yield on sterling investment grade credit was looking very attractive, having risen significantly since the start of the year. The falls in gilt yields since then have largely reversed those rises. Our sterling credit strategy focuses on three sources of return: gilt yields, market credit spreads, and the additional credit spread we generate over credit benchmarks. Whilst ten-year gilt yields of 3.5% are not as attractive as the 4.5% seen in October, we feel that the excess yield available on investment grade credit overcompensates for default risk. Further, the additional yield embedded in our credit strategies, over that available from credit benchmarks, gives us confidence in our ability to deliver long-term outperformance.

We expect supply to weigh on credit markets in the first quarter but believe that underlying fundamentals will limit spread widening. Our emphasis remains on building diversified portfolios, with a high relative exposure to asset backed and strongly covenanted bonds offering attractive yields. This strategy underpins the excess yield of the portfolio relative to its benchmark.

Although recent outperformance means that the relative attractiveness of sterling credit bonds has reduced, we still favour holding them compared to UK government debt as credit spreads remain at levels that more than compensate for the credit risk. Given the potential challenges in the outlook, we remain focused on identifying companies with strong balance sheets, favouring issues with security and downside protection, and ensuring that portfolios are diversified across issuers and sectors.

Further Information

Please click on the links below for 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

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Risks and Warnings

General Risks

The degree of investment risk depends on the fund you choose.

The prices of units can go down as well as up.

The return from your investment is not guaranteed; therefore, you may get back less or more than shown in the illustrations.

You may not get back the amount that you originally invested.

Past performance is not a guide to future return.

Inflation may, over time, reduce the value of your investments in real terms.

There may be a variation in performance between funds with similar objectives owing to the different assets selected.

Funds aiming for relatively high performance can incur greater risk than those adopting a more standard investment approach.

The use of derivatives in pursuit of a fund's objective may cause its risk profile to change and this may be material.

Fixed interest security risk

Fixed interest securities are particularly affected by trends in interest rates and inflation. If interest rates go up, the value of capital may fall, and vice versa. Inflation will also decrease the real value of capital. Unlike the income from a single fixed interest security, the level of income (yield) from a fund is not fixed and may go up and down. Bond yields (and as a consequence bond prices) are determined by market perception as to the appropriate level of yields given the economic background. Key determinants include economic growth prospects, inflation, the government's fiscal position, short-term interest rates and international market comparisons. The returns from bonds are fixed as at the time of purchase. Therefore the fixed coupon payable and the final redemption proceeds are known at the outset. This means that if a bond is held until its redemption date, the total return that could be expected is unaltered from its purchase date, subject to counterparty default (see 'Credit risk' below). However, over the life of a bond, the yield priced by the market (as opposed to actual fixed coupons payable) at any given time will depend on the market environment at that time. Therefore, a bond sold before its redemption date is likely to have a different price to its purchase price and a profit or loss may be incurred.

Credit risk

The value of a fixed interest security will fall in the event of the default or reduced credit rating of the issuer. Generally, the higher the rate of interest, the higher the perceived credit risk of the issuer. This fund may invest a percentage of its assets in sub-investment grade bonds. Such bonds have characteristics which may result in higher probability of default than investment grade bonds and therefore higher risk.

Overseas markets risk

Funds investing in overseas securities are exposed to, and can hold, currencies other than Sterling. As a result, overseas investments may be affected by the rise and fall in exchange rates.

Derivatives risk for Efficient Portfolio Management:

Derivatives may be used by this Fund for the purpose of efficient portfolio management. This restricts the use of derivatives to the reduction of risk and the reduction of cost. Such transactions must be economically appropriate and the exposure fully covered.

Performance to 31 December 2023

Cumulative (%)

Annualised (%)

	3 Month	6 Month	1 Year	3 Years	5 Years	3 Years (p.a.)	5 Years (p.a.)
Fund (gross)	8.04	10.44	10.63	(7.88)	10.59	(2.70)	2.03
Fund (net)	7.95	10.26	10.27	(8.79)	8.82	(3.02)	1.70

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
Fund (gross)	10.63	(16.99)	0.30	8.71	10.44
Fund (net)	10.27	(17.26)	(0.03)	8.36	10.11

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 RLPPC UK Corporate Bond Fund (Acc).

Glossary

Asset allocation

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

Attribution

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

Credit ratings

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

Duration

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

Fund Analytics

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

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

Fund value

Total value of the fund as of the last business day of the calendar month. The fund value is as at close of business and on a mid-price basis.

Gross redemption yield

Gross redemption yield is the rate of discount at which a bond's future obligations of interest and capital payments equates to its current price. The gross redemption yield shown for the fund is the average for its individual holdings, weighted by their current value, net of relevant fund management costs and gross of tax.

Number of holdings

Total number of unique holdings of the Fund excluding cash, currency and derivatives.

Number of issuers

Number of unique issuers of all assets held by the Fund, excluding cash, currency and derivatives.

Performance

Performance is calculated using the daily end of day NAV per share produced by HSBC based on the mid price.

Sector breakdown

Breakdown of the fixed income assets, excluding derivatives and cash by RLAM's internal industry sector classification scheme. Figures are subject to rounding.