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RLPPC UK Corporate Bond Fund

Quarterly Investment Report

31 March 2024

Quarterly Report

The fund as at 31 March 2024

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

The Fund aims to achieve +0.50% in excess of the benchmark net of fees per annum, on a rolling three year basis. The UK Corporate Bond Fund (UCF) 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. The iBoxx Sterling non-Gilt all maturities index is considered an appropriate benchmark for performance comparison.

Benchmark: iBoxx Sterling Non-Gilt All Maturities Index

Fund value

	Total £m
31 March 2024	1,985.95

Asset allocation

	Fund (%)	Benchmark
Conventional credit bonds	97.27%	99.43%
Securitised	2.48%	-
Conventional foreign sovereign	0.13%	0.57%
Conventional gilts	0.12%	-

Fund analytics

	Fund	Benchmark
Fund launch date	31 May 2000	
Base currency	GBP	
Duration (years)	6.02	5.53
Gross redemption yield (%)	6.15	5.14
Number of holdings	417	1,259
Number of issuers	252	498

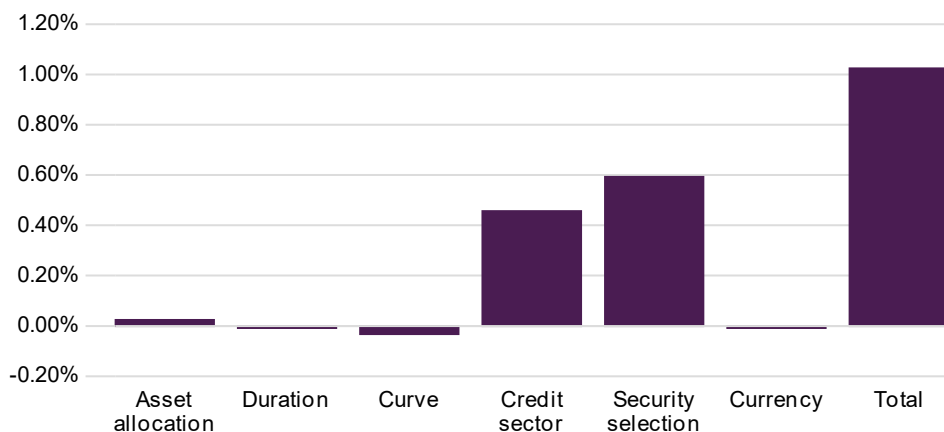
Performance and activity

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Quarter	1.16	0.06	1.10
1 Year	9.00	6.14	2.87
3 Years (p.a.)	(1.39)	(3.32)	1.93
5 Years (p.a.)	1.43	(0.39)	1.82
10 Years (p.a.)	3.91	2.48	1.43
Since inception (p.a.)	5.96	4.59	1.37

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 the combination of our sector allocation and stock positioning. At a sector level, our underweight position in supranationals and overweight in both insurance and structured were the main positives as supranationals continued to lag the wider market, having also underperformed in the second half of 2023. Stock selection in insurance and bank bonds also contributed strongly. These positive contributions from bank and insurance stocks were broad-based. Our bias towards subordinated bonds was helpful, as was our exposure to structured bonds, despite the negative impact of our holding in Thames Water.

Thames Water shareholders had previously announced an intention to inject £750m of equity into the utility by March 2025, with £500m of this anticipated by March 2024. In late March, and following discussions with OfWat, the necessary conditions for that initial injection had not been met. This has been negatively received by credit markets – as was the S&P downgrade to BBB- after the end of the quarter. We continue to believe that liquidity in the operating company remains satisfactory and that the business can continue to fund itself and serve its customers. Equally, until regulatory clarity is received, we expect newsflow to be negative. However, we believe that valuations remain attractive on a fundamental basis, given the strength of protection afforded via the regulated asset base and an expectation that a regulatory determination in June will allow the company to gain shareholder support and avoid a scenario in which taxpayer money is required to support the company. We believe that the risk in the business remains political in nature, as higher returns to incentivise the significant investment that is required to enhance the network will require price rises for consumers. Nationalisation or a change in the regulatory regime would create wider ramifications for the funding of UK infrastructure and impose significant liabilities on UK taxpayers.

Alongside the announcement by Thames Water, Thames Kemble (the holding company for Thames Water) announced that it will not be able to meet the maturity on its £190m April 2024 loan and at the start of April, formally announced a default on the £400m 4.625% 2026 bonds. Whilst significant risks have already been reflected in Holdco bond pricing, the news weighed further on this bond. Our bias remains in the safest part of the capital structure – operating company debt that is closest to the assets – position sizing has reflected the differing risks and holdings remain part of a very diversified portfolio of lending decisions.

Performance and activity

Fund activity

New issue activity remained a key focus over the quarter. A notable trend has been the reduction in the new issue premia (the additional yield required to sell new bonds) and at times, book building sizes have looked extraordinary – suggesting huge latent demand. This has led to some caution on our part – we still believe that credit spreads more than compensate credit investors for the risk of default, but are equally aware that demand in certain parts of the market can lead to less favourable pricing.

Financials continued to dominate primary market activity during the quarter. Here we added senior bonds from Metropolitan Life, these bonds ranking alongside policyholders in seniority, in addition we participated in the issues for Barclays senior bonds at around 200bps over equivalent gilts and UK mortgage specialist OSB at a yield of over 8.5%.

Exposure to structured bonds remains a cornerstone of our process and portfolios. Issuance has been somewhat low in recent months, but there were opportunities in the sector during the quarter. Examples included Land Securities and Gatwick Funding, the latter secured on cashflows from the airport. We also added a rare new issue from Telereal – secured on rentals paid on BT telephone exchanges.

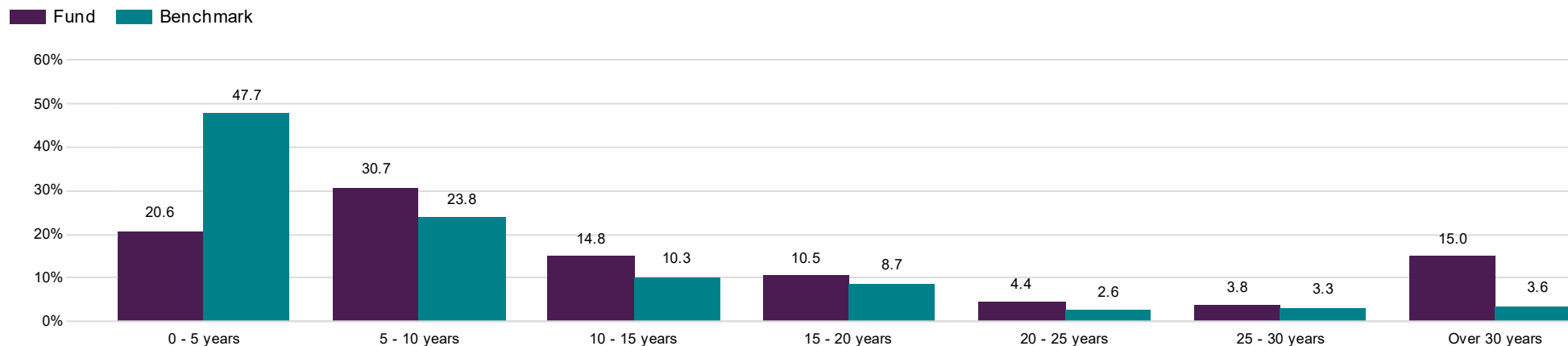
Demand from annuity buyers has supported longer-dated high quality bonds. In a number of areas, this has pushed spreads to levels that we feel were unattractive, and we took advantage of the higher demand for these bonds to take profits and recycle into more attractive areas. Our exposure to social housing was an example of this. Here we took profits on Housing & Care 21, after spreads had tightened to lower levels than the wider market, initially recycling proceeds into gilts to maintain duration, then reinvested into more attractive opportunities.

We remain cautious around utilities as valuations are generally not as appealing as other areas of the market. However, during the quarter, we felt that valuations in the gas sector, an area we had reduced in recent years, had improved significantly, with credit spreads materially wider than those in the regulated electricity sector. As a result, we were happy to purchase a new issue from the UK's largest gas distribution network Cadent. In the water sector, there has been limited contagion from Thames Water, and we believe it is unlikely that we see removal of support from regulated asset bases across the sector. We added new issues of operating company level bonds from Northumbrian Water and Southern Water, both at attractive yield premiums.

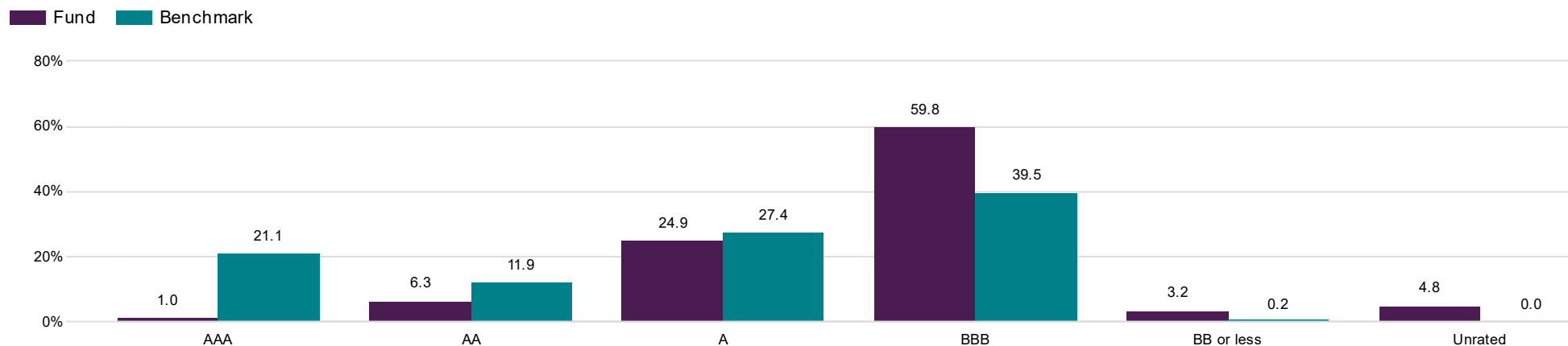
Finally, we added a new 2054 bond from Motability, who help disabled people and their families lease cars, scooters or wheelchairs. We also picked up a new 2036 euro-denominated issue from Dutch telecommunications company KPN. The company has strong ESG credentials, and the bonds came at an attractive yield premium to the market.

Fund breakdown

Maturity profile

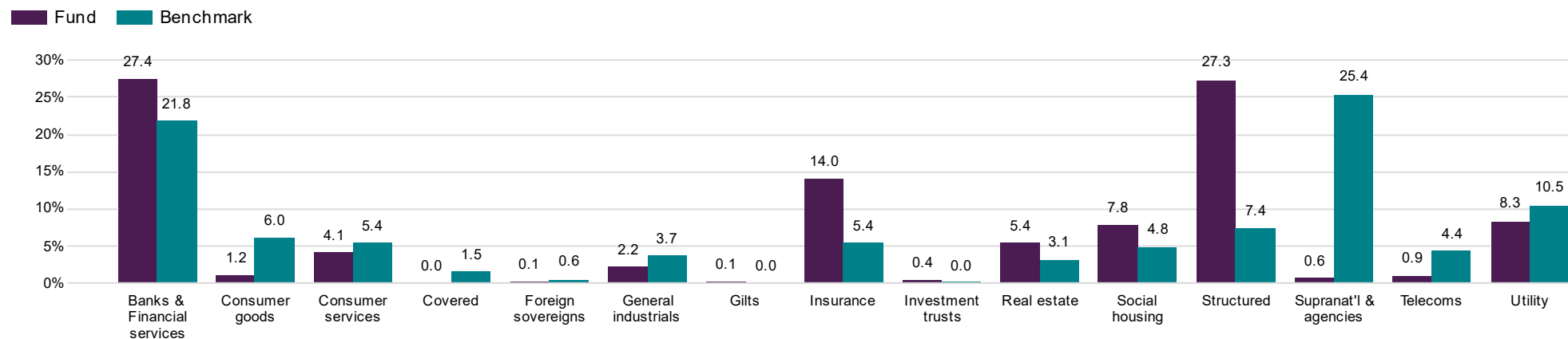


Credit ratings



Fund breakdown

Sector breakdown



Characteristics and climate

Climate metrics

	Fund	Benchmark	Difference (%)
Financed emissions (tCO ₂ e)	51,362	n/a	n/a
Financed emissions coverage	47.33%	n/a	n/a
Carbon footprint (tCO ₂ e/\$M invested)	20.80	35.65	(41.64)
Carbon footprint coverage	47.33%	47.77%	(0.92)
Weighted average carbon intensity (tCO ₂ e/\$M sales)	52.16	59.10	(11.73)
Weighted average carbon intensity coverage	98.14%	97.08%	1.09

All climate metrics presented above are for Scope 1-2 emissions. Unless specified in the objective, the data is for information only and should not be taken to mean they are being managed to/controlled.

Implied temperature rise

	Fund (%)	Benchmark (%)	Difference (%)
Implied temperature rise (ITR) coverage	47.33	47.77	(0.92)
% of portfolio below 2°C ITR	34.77	38.55	(9.83)
% of portfolio below 1.5°C ITR	17.62	17.25	2.15

SBTi net - zero

	Fund (%)	Benchmark (%)	Difference (%)
SBTi Net-Zero committed	10.35	16.02	(35.40)
SBTi Near-Term committed	8.88	6.44	37.79
SBTi Near-Term targets set	12.21	21.78	(43.92)

Fund Engagement

Engagement definition

Engagement is active dialogue with investee companies (or other entities). There are two types: engagement for information, which is dialogue as part of investment research or ongoing monitoring, without specific objectives for change, and engagement for change, which is purposeful dialogue to influence positive change, with defined objectives and demonstrable outcomes.

Engagements

Engagement activity	Fund 3 months	Fund 12 months
Number of entities engaged	14	53
Number of engagements	16	104

This is an estimate. Some engagements at the issuer level may not have been attributed to the specific bond held in the fund, resulting in a lower number of engagement activities.

Total engagements by theme and topic



Climate	5
Climate - Transition Risk	5
Governance	7
Remuneration	3
Strategy	2
Board	1
Corporate Governance	1
Health	1
Health - Community	1
Social & Financial Inclusion	5
Just transition	3
Labour & Human Rights	1
Social & Financial inclusion	1

Engagement focus

Firm-wide engagement activity is centred around six themes which we have identified in consultation with our clients. These are: climate change; biodiversity; health; governance and corporate culture; social and financial inclusion; innovation, technology and society. Portfolio level engagements are not thematic and are focussed on issues specific to managing the portfolio and meeting the investment objective.

Engagement data represents all engagements undertaken at both firm and portfolio level across Royal London Asset Management, and may not be limited to those undertaken solely for the purpose of managing the fund.

Fund Engagement

Engagement outcomes

BP Plc - Cyber Security

Purpose:

To evaluate the company against our established cyber investor expectations of best practice and identify areas where improvement is needed. We then communicate these findings to the company and encourage the adoption of stronger practices.

Outcome:

We engaged in a constructive dialogue with BP which allowed us to gain in depth insights into BP's cyber governance and practices, particularly in relation to our published cybersecurity investor expectations. We found an above average approach to managing suppliers, conducting cyber due diligence, and integrating cyber security measures through inorganic growth. As BP transitions from an International Oil Company (IOC) to an Integrated Energy Company (IEC), it faces unique cyber security challenges and opportunities. This transition involves expanding customer touchpoints, growing the renewables portfolio, and leveraging AI, all of which require a vigilant and adaptive cyber security framework.

HSBC Bank Plc - Just Transition

Purpose:

To review and provide feedback on the company's draft Net Zero Transition Plan.

Outcome:

HSBC's Net Zero Transition Plan, informed by GFANZ and TPT, sets a strategic vision for sector specific transitions and an actionable plan. In a feedback session with the Chief Sustainability Officer, the company highlighted its commitment to the real economy decarbonisation, especially in developing markets. The plan details a sectoral approach based on global financing needs, and HSBC's strategies to support decarbonisation and leverage financing opportunities. It also emphasises a fair and inclusive transition, with ongoing efforts to integrate just transition principles. We will continue to engage with the company, placing particular emphasis on the operationalisation of their commitment to a just transition.

Fund Engagement

Engagement outcomes

National Australia Bank - Just Transition

Purpose:

To foster transparency and accountability, we encourage the company to disclose its strategy for incorporating just transition considerations into its decarbonisation efforts. Furthermore, we sought clarity on the company's responsible lending practices within their microfinance operations.

Outcome:

National Australia Bank (NAB) is committed to a just transition and microfinance, recognising the interconnection between the two as microfinance plays a crucial role in supporting communities affected by the energy transition. The company is developing a just transition plan and contributing to the 'UNGC Think Lab on Just Transition' for business guidance. Its microfinance efforts are philanthropic, aligning with its place-based strategy for a just transition. Good Shepherd, the company's partner, conducts internal audits and quality processes. NAB advocates for responsible microfinance and is encouraged to promote these practices nationally.

South West Water - Water Utilities

Purpose:

To assess how South West Water's most recent water asset management plan for the period 2025 to 2030 aligns with our water sector expectations of best practice and identify areas where improvement is needed.

Outcome:

The meeting with South West Water concluded positively, with the company providing further insights into its proactive environmental initiatives and upstream thinking, aimed at addressing biodiversity concerns. The company is shifting towards integrating natural capital into its decision making. It has also piloted natural capital catchment plans and conducted detailed reviews of water challenges. In addition, South West Water is at the forefront of assessing antimicrobial resistance (AMR) risks and is collaborating with the University of Exeter to enhance its understanding in this domain. We will be reassessing the company based on its latest disclosure to our investor expectations and share areas of improvement with it.

Fund Engagement

Engagement outcomes

Vattenfall - Just Transition

Purpose:

To understand how the company is integrating just transition into its business decision making process. We aim to encourage the company to disclose plans to integrate social considerations into its decarbonisation strategy.

Outcome:

Vattenfall has identified key areas for a just transition, focusing on commitments to customers, employees, and communities. The company is open to using metrics and KPIs for employee reskilling but needs clearer communication on retraining and redeployment. Community engagement strategies differ by market, with early engagement in Sweden and proactive measures in the UK and Netherlands. Vattenfall shows commitment to just transition, but further clarity is needed on its systematic integration into business decisions. We will continue to monitor progress and engage with the company on this issue.

Market commentary

Market overview

A key theme to emerge during the quarter was indication of a more favourable global macro backdrop. Despite some mixed signals, the US economy remains resilient, while Europe and the UK show signs of gradually exiting their recessions. Activity in China also seems to be stabilising. At the same time, core central banks are still confident that the disinflation trend remains intact, despite some recent setbacks in inflation prints. Policymakers have often highlighted that they are in no rush to cut rates – with markets now generally pricing the start of the easing cycles to begin this summer. The Federal Reserve, European Central Bank and Bank of England all left interest rates unchanged over the quarter.

One major development over the quarter is that markets have recalibrated their pricing for expected central bank cuts over this year. At the end of last year, markets were pricing in an aggressive rate cutting cycle, but then swiftly move to temper those forecasts. This re-pricing contributed to negative returns for global government bond markets over the quarter. Despite the belief of many that it was the anticipation of a 'Fed-pivot' that contributed to the rally in equity markets in late 2023, equity markets proved to be immune to this bond market sell-off as global growth and business confidence showed signs of resilience and investors focused on the potential offered by AI.

Government yields rose in all the major markets. In the US, 10-year treasury yields rose from 3.88% to 4.21%, while German 10-year bunds similarly saw yields rise from 2.01% to 2.30%. Mirroring this backdrop of rising yields, UK government bonds produced a return of -1.62% (FTSE Actuaries) over the first quarter, with the benchmark 10-year gilt yield rising from 3.54% to 3.94%. The bulk of this move occurred in the first two weeks of January, before largely trading in a range between 4% and 4.2% for the rest of the quarter. The rising yield environment helped short-dated bonds to outperform their longer-dated equivalents.

In contrast to the losses in the government bond market, the sterling investment grade credit market (iBoxx non-gilt index) returned 0.06% over the quarter, with the effect of higher yields mitigated by tighter credit spreads and the higher carry in this area. The shorter duration of the credit market index also helped offset some of the government market headwind. 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 1.15% to 1.02% (iBoxx). Given the rise in yields, sectors with a greater proportion of long-dated bonds performed poorly, including utilities and social housing. Of the major sectors, supranationals was the worst performing sector, while in financials, the banks and insurance sectors performed well.

Issuance picked up in the first three months of the year compared to the fourth quarter of 2023, but overall supply in key areas such as financials was materially lower than the same period last year. This helped spreads tighten in bank and insurance sector.

Outlook

The rally in bond yields seen late last year, prompted by hopes that falling inflation would lead to relatively rapid and numerous interest rate cuts, was largely unwound in the first two weeks of 2024. This reflects the change in interest rate expectations and the sensitivity of markets to incoming economic data. Looking at market pricing, UK base rates are projected to be around 4.5% at the end of 2024, this is in contrast to the 12-month outlook, where markets were projecting rates below 4%. We expect yields to remain sensitive to economic data, and unless there is a significant deterioration in underlying trends, we expect this to lead to range bound-yields and the opportunity to add/trim duration as markets react to individual data points.

Headline inflation is expected to reach the 2% Bank of England target level in the next few months. However, we are mindful that underlying pressures in the labour market and parts of the services sector mean that headline inflation figures may be somewhat misleading. In addition, data since the start of the year suggests that the UK is growing again – albeit slowly. This trend can be seen in the US and euro zone as well. Overall, the global tone is that rate cuts are not going to come through as quickly as anticipated and that the neutral level may be a bit higher than previously thought.

With bond yields generally higher than they were at the start of the year, and interest rate cuts now closer, we believe that overall government bond yields look attractive. Credit spreads have come in further – and are now looking somewhat tight in longer-dated bonds – but continue to compensate credit investors for the risk of default. From a credit spread perspective we continue to find better value in shorter-dated credit bonds, but with absolute yields at attractive levels we prefer to be broadly neutral in overall duration positioning, with a bias to extend on further rises in yields.

We target – and achieve – a material yield premium over the market level in our sterling credit strategies. We mitigate the risks by maintaining highly diversified portfolios, with a bias towards bonds that offer greater security and downside protection. Our view remains that over the medium term our focus on delivering greater income than the benchmark will generate outperformance.

Further Information

Please click on the links below for further information:



Find out more

In an uncertain geopolitical and economic environment, we recognise the importance of keeping our clients updated on our current investment thinking.

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

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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 March 2024

Cumulative (%)

Annualised (%)

	3 Month	6 Month	1 Year	3 Years	5 Years	3 Years (p.a.)	5 Years (p.a.)
Fund (gross)	1.16	9.29	9.00	(4.11)	7.37	(1.39)	1.43
Fund (net)	1.08	9.11	8.64	(5.06)	5.64	(1.71)	1.10

Year on year performance (%)

	31/03/2023 - 31/03/2024	31/03/2022 - 31/03/2023	31/03/2021 - 31/03/2022	31/03/2020 - 31/03/2021	31/03/2019 - 31/03/2020
Fund (gross)	9.00	(9.63)	(2.67)	10.11	1.69
Fund (net)	8.64	(9.92)	(2.99)	9.75	1.39

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 March 2024. 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.

Carbon footprint

Exposure to high emitters in the portfolio, expressed in tCO₂e/\$M invested. Financed emissions are divided by the portfolio value, the same approach for listed companies and private issuers is applied in this metric.

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.

Financed emissions

The emissions from activities in the real economy that are financed through lending and investment portfolios, expressed in tCO₂e. Emissions are attributed to a portfolio based on the portion of the company's value the portfolio holds, and using different accounting values for public and private corporates. We provide financed emissions for scope 1 and 2 emissions.

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.

Implied temperature rise (ITR)

ITR aims to measure the global warming outcome from the emissions trajectory of a company, if the whole economy followed the same trajectory.

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.

SBTi

The Science-Based Targets initiative is a consortium of organisations that set up the definition and promotion of science-based target setting.

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.

Glossary

Weighted Average Carbon Intensity (WACI)

Portfolio's exposure to carbon-intensive companies, expressed in tCO₂e / \$M revenue. Scope 1 and scope 2 GHG emissions are divided by companies revenues, then multiplied based on portfolio weights (the current value of the investment relative to the current portfolio value). The WACI is calculated as a weighted average sum of the holdings with carbon intensity coverage.

In line with our bespoke and targeted approach to credit analysis, we have developed an in-house carbon data tool that addresses coverage and mapping issues with third party systems. The development of this tool has been a critical element of RLAM's ESG integration into our credit process, addressing coverage and mapping issues with third party systems. This enhanced coverage is reflected in the WACI figures provided in this report, with all other metrics instead being based on data from MSCI.