Royal London Sterling Extra Yield Bond

Fund Research Centre
Recommended

Why we recommend the fund

- This Recommended fund benefits from an established team and follows a long-standing and thorough credit process.
- The approach emphasises in-depth credit analysis with the team prepared to research and invest in smaller, less liquid and often esoteric issues.
- Fund manager, Eric Holt, is a credit analyst at heart and understands the often fine balance between quality and yield opportunity. Critically, he has a clear awareness of the risk of in investing in less liquid bonds.

Key characteristics and expected outcome

- When the fund was launched, Mr Holt wanted to offer a high yielding product that was valuation conscious. As such, the FTSE Actuaries British Government 15 Year Index was used as a yield aspiration, rather than a performance benchmark. In practice, the managers want to deliver an attractive level of income, with reference to the prevailing market environment.
- The managers' primary focus is on income and although they seek to diversify the different sources of income, the fund will be sensitive to market sentiment. This is an inevitable consequence of their value-orientated approach and their willingness to invest in less liquid and more esoteric corporate bond opportunities.
- Therefore, although the portfolio is attractive for income-seeking investors, they must have the tolerance and capacity for periods of capital volatility and, consequently, have a long-term investment horizon.

Risk commentary

The fund's KIID Synthetic Risk and Reward Indicator (SRRI) is 3. This is a regulatory measurement that is, where possible, calculated from the volatility of its weekly performance over a five-year period. A score of 3 means the fund's historic volatility is between 2% and 5%.

The score of 3 is unusual for this sector, where scores of 4 and 5 are more common. This is a function of market conditions, rather than a change in the investment approach. High yield bonds can experience periods of higher volatility which would impact this fund. The managers' issue-specific approach and exposures to smaller, less liquid and often esoteric bonds is also a differentiating feature that can set its risk/return profile apart from other funds in the peer group. Different share classes could have different SRRI scores.



Key Fund Facts

Inception Date:	11 April 2003
Manager(s) Since:	Eric Holt (Apr 03) Rachid Semaoune (Jan 19)
Fund Domicile:	Ireland
Base Currency:	£ Sterling
Fund Benchmark:	FTSE Gilts 15 Year
IA Sector:	£ Strategic Bond

Formal documentation, including the fund prospectus and the KIID, should be sought directly from the asset manager. A link to the asset manager's website can be found on the relevant fund page at fundresearchcentre.co.uk.

Fund Snapshot

A fixed income fund that invests across the credit spectrum with a focus upon income delivery. Proprietary credit analysis, combined with the manager's deep market experience, means that opportunities are often sought in structured/securitised bonds and unrated issues, where the fund can benefit from liquidity premium. Within its sector, the fund features in our 'Income Priority' category.

Investment Team

The fund is co-managed by Eric Holt and Rachid Semaoune. Messrs Holt and Semaoune are senior fund managers in the credit team at Royal London Asset Management (RLAM). Mr Holt has been involved with the fund since its launch. The fixed income division operates with a strong team ethos and, in running the fund, the managers enjoy the support of their colleagues in the credit team as well as the inputs of the broader RLAM fixed income and credit research teams.

Investment Philosophy

The managers' primary aim is to deliver an attractive income yield according to the prevailing environment, however not at the expense of volatility in the unit price. They seek to achieve this through detailed credit analysis, implemented in a way that is not constrained by benchmark positioning. The fund is well diversified across investment grade, sub-investment grade and non-rated bonds, with their investments always underpinned by the team's long-term assessment of value.

Investment Process

The managers believe that sterling credit markets offer investors long-established inefficiencies. The investment approach is built around the team's established credit process, with issuer analysis and credit selection being the primary drivers of positioning and performance. The team of portfolio managers and analysts undertake significant research to understand the long-term creditworthiness of each issuer, the likely outcome in a worst-case scenario and the degree to which investors are compensated for these risks. These factors are analysed by calculating an issuer's overall debt relative to earnings, understanding the likely volatility in earnings or other cashflows, and analysing the investor protection offered by the security and covenants related to individual bonds. In short, the team looks to make a value judgment, not just an assessment of the probability of default. They avoid over-reliance on credit ratings, instead identifying bonds where they believe they are sufficiently rewarded for the risk they are taking. For more esoteric bonds, which may be unrated or more complicated, they use a range of models, as well as using a wealth of external data to supplement their research.

The fund is constructed following a relative value assessment that considers the yield and spread of each issuer in the context of its leverage, credit rating and trend in creditworthiness. The managers are also mindful of the absolute value of the asset class.

Portfolio Construction and Risk Controls

The fund is well diversified in recognition of elevated level of risk at the issuer level, with the managers seeking to reduce single name credit risk. At least 75% of the fund must be invested in sterling-denominated securities. The fund may incorporate significant sector biases and will hold large exposures to unrated and securitised bonds, where the team has identified areas of value through the internal credit research.

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