

# Fixed Income update

Leicestershire County Council Pension Fund  
18 November 2022

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This is a marketing communication.



*Beyond  
borders™*

# Client valuation

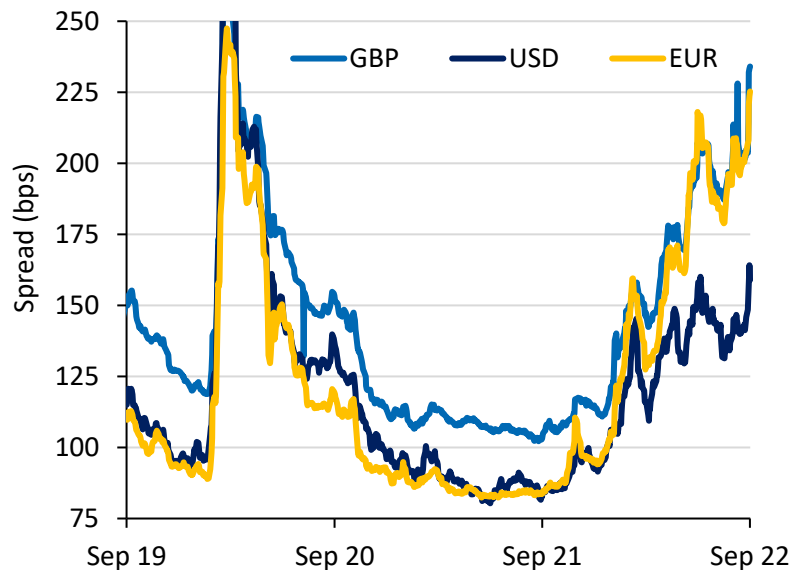
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- Index-Linked mandate
  - Mid Value as at 31 October 2022: £177.0m
- Global Short Dated Climate Transition Fund
  - Initial investment: £25m on 26 March 2021
  - Top up: £60m on 28 March 2022
  - Value as at 31 October 2022: £82.3m

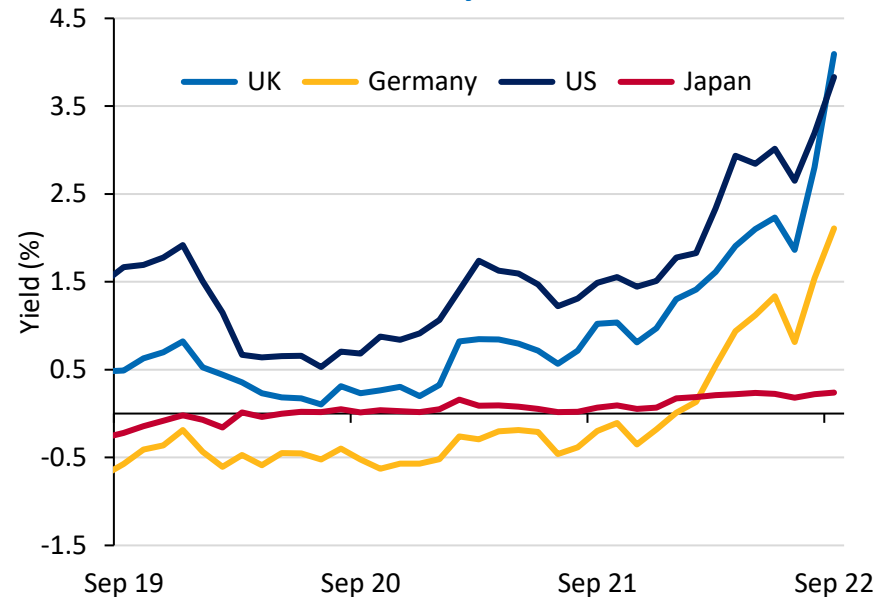
# Market review – 2022 so far

- A volatile year for bond markets, with September being one of the most tumultuous periods in recent times
- Global inflation remained stubbornly high, fueling uncertainty over when interest rates will peak
- G7 government bond markets remained volatile, with heightened political uncertainty and higher entrenched inflation exacerbating the weakness in the UK market
- The negative macroeconomic backdrop led to material weakness in global credit spreads

## Global Investment Grade spreads



## Core Government Bonds - 10yr Yields



Sources: LHC Barclays Live as at 30 September 2022. RHS Bloomberg as at 30 September 2022

# Index Linked Bond portfolio

	Returns						
	Q3 2022	2022 YTD	Financial YTD	1 year	3 years p.a.	5 years p.a.	Since inception p.a.
<b>Fund</b>	-8.91	-29.13	-25.02	-25.75	-9.05	-2.04	4.47
<b>Benchmark</b>	-9.33	-29.34	-25.23	-25.85	-9.23	-2.14	4.67
<b>Relative</b>	0.46	0.30	0.28	0.14	0.19	0.10	-0.19

- The Index-Linked bond portfolio is actively managed and holds 32 UK government index-linked bonds
- Whilst it outperformed its benchmark, the fund and the market have suffered negative returns over 2022 to date

Source: Aegon Asset Management as at 30 September 2022. price to price, gross returns. Any differences are due to rounding. Returns are gross. \*Inception:

# UK Index Linked bond prices have been in freefall

## Index Linked Bond price – 2068 maturity



## Why? UK market dynamics

1. The Bank of England has moved base rates from 0.25% to 2.25% between January to October 2022
2. High inflation, more than expected, has made fixed income less attractive as the market prices more interest rate rises
3. Global bonds have been falling in price due to the expensive starting point, high inflation, low unemployment rates and the expectation that central banks will keep raising interest rates until inflation falls

## Why? Index-linked bond dynamics

1. I-L bonds have very long maturity dates – the average duration is 17 years.
2. For 1% increase in interest rates the fund value will fall 17%
3. The market expects inflation NOT to keep rising from today's levels e.g. 5y RPI inflation is 4% vs 12.6% for September 2022
4. I-L bonds were hit very hard by the market fallout post September's budget and the pension fund selling that followed

# Global Short Dated Climate Transition Fund

- The fund invests in short-dated investment grade corporate bonds with up to four years to maturity
- It aims to outperform the GBP overnight cash rate by +1.25% per annum over rolling three-year periods
- It is a globally diversified portfolio holding 128 bonds from 100 in 19 countries

	Q3 2022	2022 Year to date	Inception to end 2021*	Inception to 30 September 2022 (Annualised)*
<b>Aegon Global Short Dated Climate Transition Fund</b>	-1.78%	-5.17%	0.31%	-3.13%
<b>Cash</b>	0.39%	0.71%	0.05%	0.48%

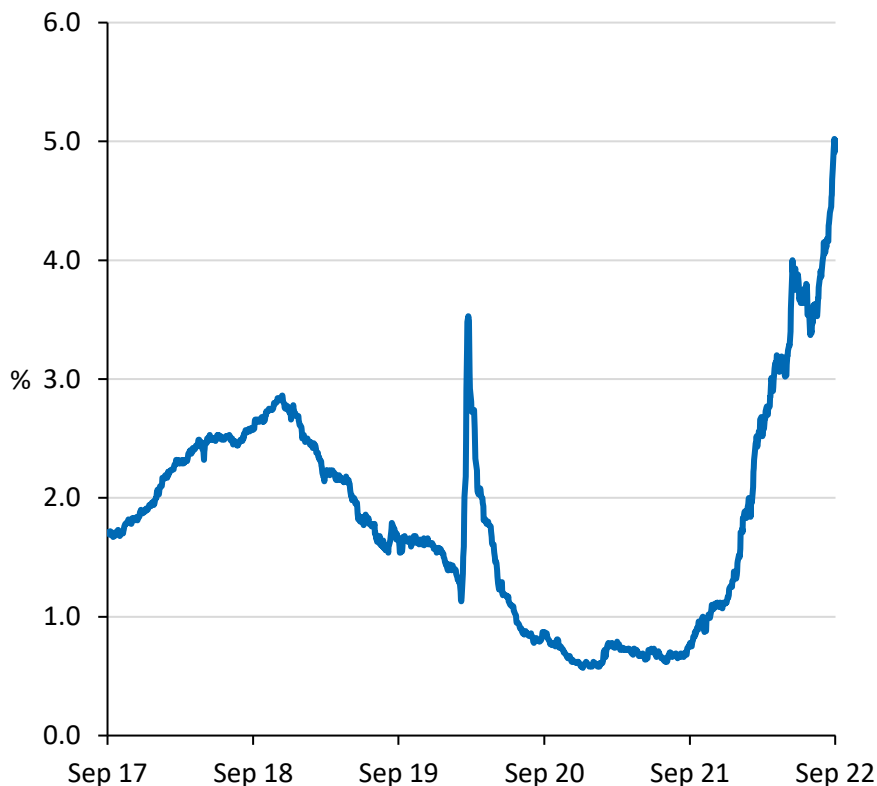
Source: Aegon Asset Management as at 30 September 2022. price to price, gross returns.

Aegon Short Dated Investment Grade Bond S (Acc) GBP shares vs Cash. Cash is represented by Sonia Compounded Index Total Return GBP  
Any differences are due to rounding. Returns are gross. \*Inception: 4 March 2021.

# Global Short Dated Climate Transition Fund review

## Global short-dated yields at multi-year highs

BofAML Global Large Cap Corporate 1-5 year index yield

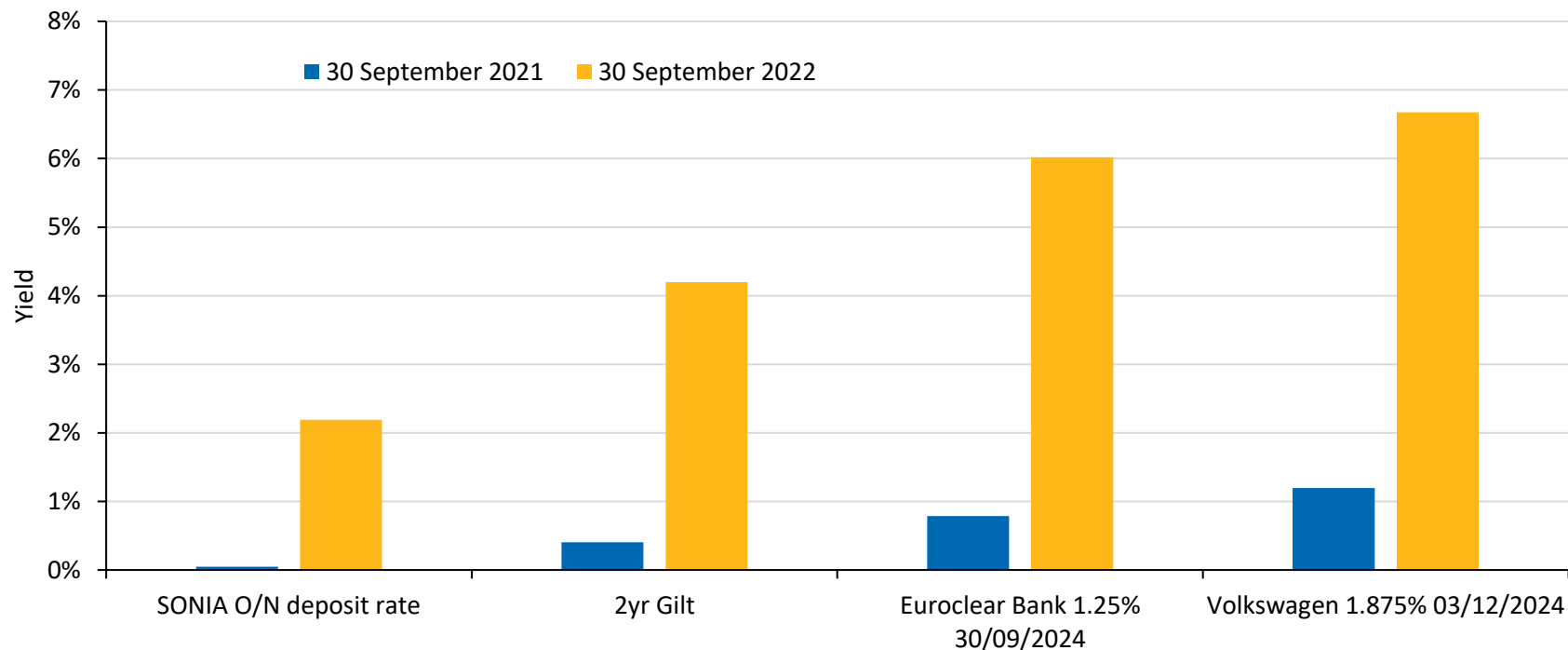


- Despite a consistently positive track record, short dated investment grade has not been immune to the sell off in bond markets in 2022
- The negative total returns of the fund have been driven by a marked increase in gilt yields coupled with an increase in credit spreads, particularly in the UK in Q3 2022
- Short dated funds have less interest sensitivity (or duration) than broader fixed income markets. We have actively managed this sensitivity to help limit drawdown
- The fund's global remit and its material exposure to non-£ assets (c70%) helped protect it from the worst of the turmoil in the UK
- The yield on Investment grade credit is at multi-year highs and very attractively priced for the fundamental credit risks

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# Attractive yield opportunities

## Attractive yield for low duration



<b>Duration</b>	N/A	1.9 years	1.9 years	2.0 years
<b>Credit rating</b>	N/A	AA	AA	BBB+

Source: Bloomberg as at 30 September 2022



# Market outlook

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- The market expects base rates to increase to 4.75%. We think this is too high for the following reasons:
  1. The mortgage market (6% - 2y fixed), is already reflecting the move higher and causing a slowdown
  2. High inflation and the cost of living crisis is already destructing demand which will get worse
  3. We expect a reversal or slow down in fiscal policy from the new government which will reduce demand
  4. The BoE own forecasts will show a slowdown and lower inflation over the medium term, they will not need to be overly restrictive
- As we move into the final quarter of 2022, we are constructive on the outlook for the investment grade credit market, primarily based on valuations being cheap on a long-term basis

# Multi faceted responsible investment approach

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**We are a leader in responsible investment with 30 years experience and a dedicated team of 20 responsible investment professionals**

**The Aegon Global Short Dated Climate Transition Fund has strong ESG characteristics and focuses on climate transition related opportunities and risks**

- **Climate transition focus:**
  - The fund directs investments to companies with a robust and credible plan towards net-zero
  - We have climate guidelines and milestones in place as a pathway towards net zero alignment
  - As a result of our ESG and climate approach, the fund aims to deliver a lower carbon footprint than the broad short dated corporate bond market
- **Best in class ESG approach:**
  - We filter ideas by applying our proprietary ESG framework which assigns an ESG category of 1-5 for each company in our research universe, with 1 being highest category with lowest ESG risks
  - We bias the portfolio to investments with higher ESG categories 1 to 3
- **Watchlist criteria to manage sustainable risks and impacts**
  - Avoiding controversial areas such as cluster munitions
- **Active engagement**
  - We believe in active stewardship and engagement and conducted 596 engagements worldwide in 2021

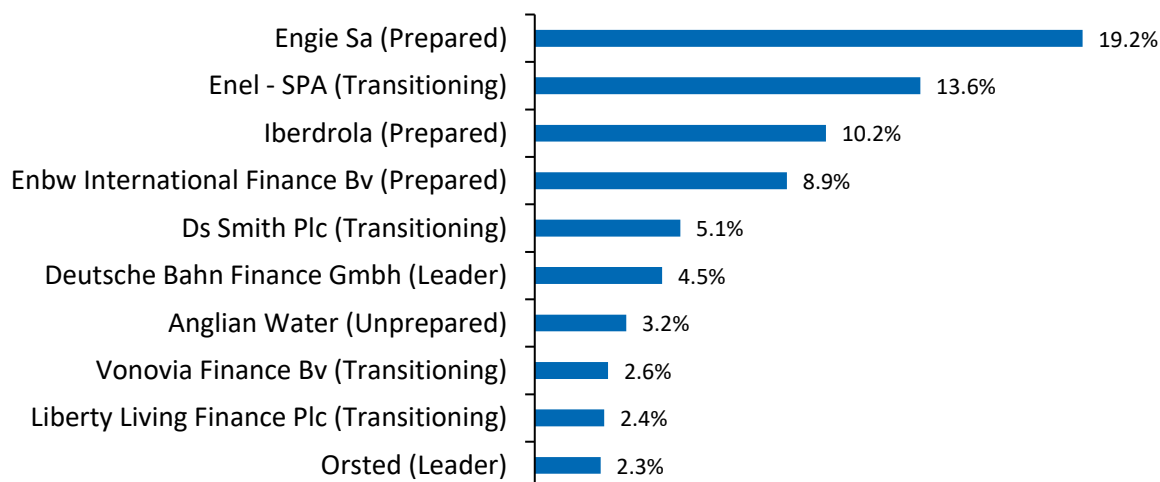
# Low carbon footprint

## Aegon Global Short Dated Climate Transition Fund

### Transparent carbon footprint reporting

Metric	Unit	Portfolio	Portfolio coverage	Universe	Index coverage	Portfolio carbon reduction vs index %
Weighted average carbon intensity	tCO2e / GBP million revenue	62	90%	157	94%	60% lower

### Weighted average carbon intensity by issuer (Top 10)



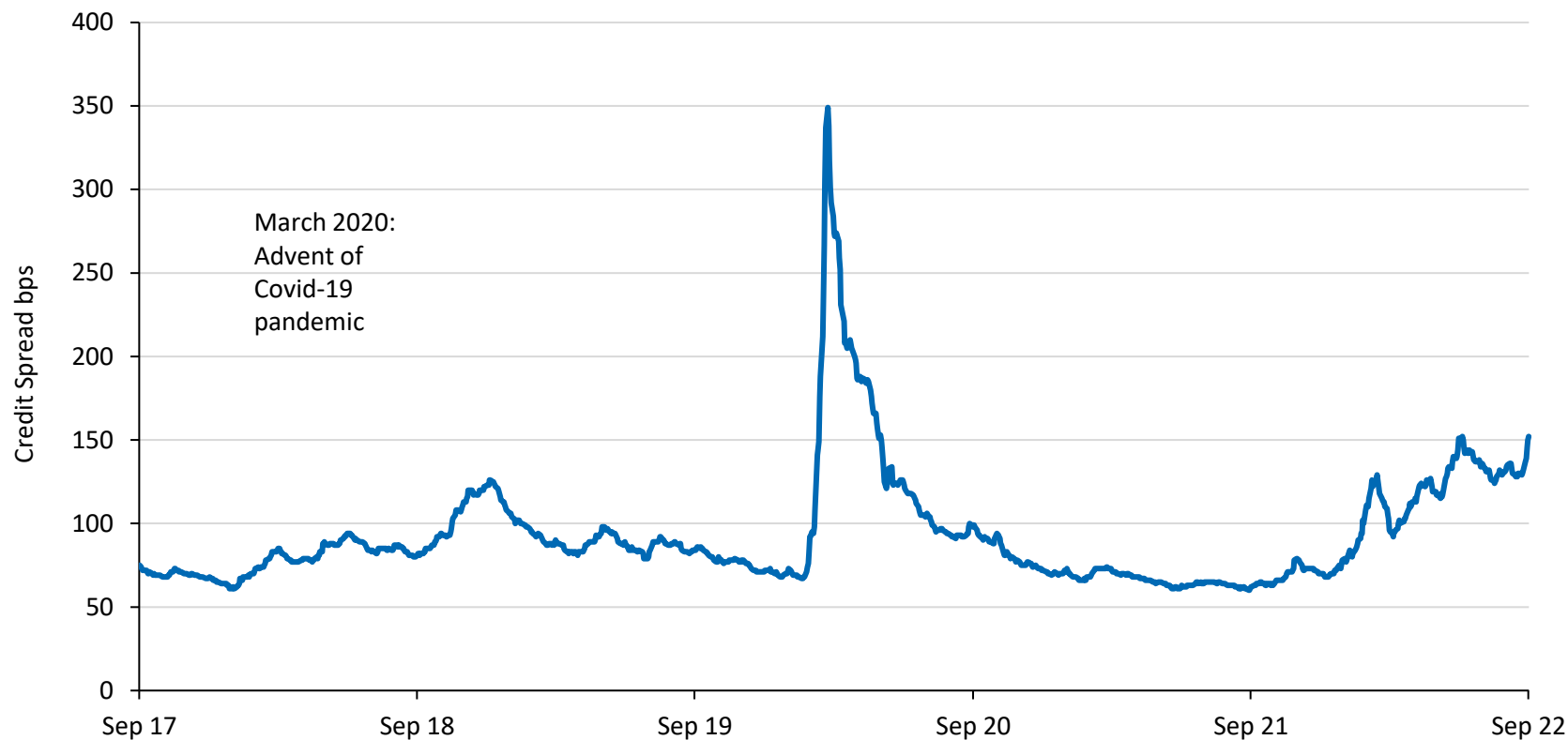
Source: Aegon Asset Management, 30 June 2022. Weighted Average Carbon Intensity (WACI) metric to measure carbon reduction. WACI is the portfolio weighted sum of the carbon intensity (in tCO2e per GBP million revenue) by issuer and recommended metric by Task Force for Climate-related Financial Disclosures (TCFD). Aegon AM sources carbon emissions data from external ESG data providers: Sustainalytics and MSCI. Combined they have comprehensive coverage of the proposed investment universe and portfolio (>90%) which can be further enhanced by internal mapping where appropriate. Certain information © 2021 MSCI ESG Research LLC. Reproduced by permission.

# Appendix

# Outlook for short dated corporate bonds

## Credit spreads at multi-year highs

BofAML Global Large Cap Corporate 1-5 year index spread

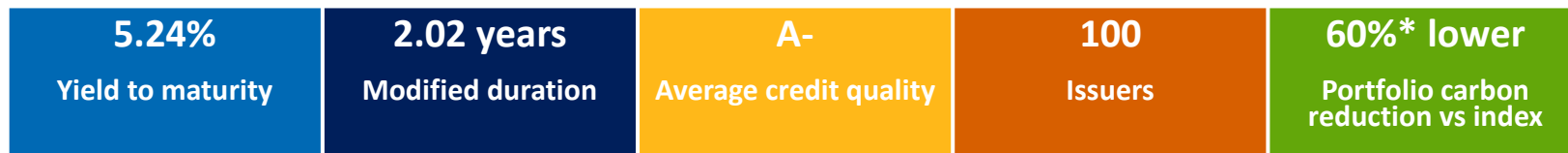


Source: Barclays Live as at 30 September 2022

# Aegon Global Short Dated Climate Transition Fund

<b>Co-managers</b>	Iain Buckle and Rory Sandilands
<b>Fund size</b>	£494m
<b>Objective</b>	<ul style="list-style-type: none"><li>• Targeting cash +1.25% per annum over rolling three years (gross of fees)</li><li>• ≥30% lower weighted average carbon intensity vs broader universe</li></ul>
<b>Portfolio characteristics</b>	<ul style="list-style-type: none"><li>• Diversified global portfolio that minimises exposure to default and downgrade risk</li><li>• Global exposure hedged back to £ - no active currency risk</li><li>• Portfolio guidelines to support net-zero climate transition</li><li>• Best in class ESG approach</li><li>• EU SFDR Article 8</li></ul>
<b>Investment remit</b>	<ul style="list-style-type: none"><li>• Core of portfolio in investment grade corporate bonds with less than four years to expected maturity</li><li>• Capped duration exposure</li><li>• Capped exposure to non-investment grade bonds</li></ul>

## Key characteristics



As at 30 September 2022.

\* As at 30 June 2022

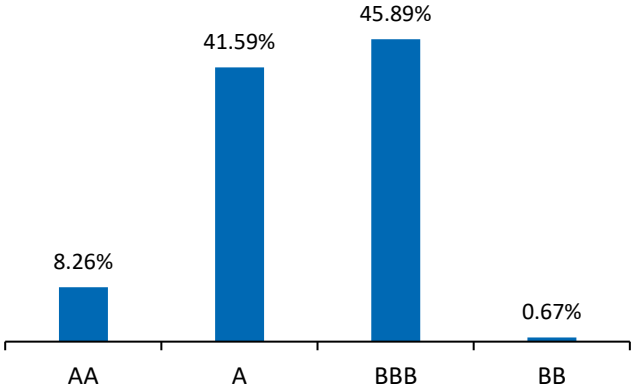
# Key portfolio characteristics

Past performance does not predict future returns. The information is for informational purposes and readers should not assume that investments in the securities identified and discussed were or will be profitable.

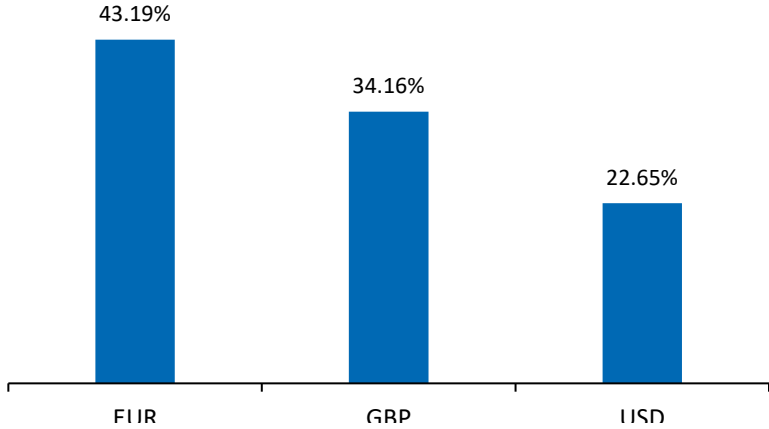
## Portfolio characteristics

Yield to maturity	5.24% (£ base currency); 2.60% (€)
Modified duration	2.02 years
Average credit quality	A-
Maximum issuer exposure	1.75%
Proportion in high-yield / non-rated/callable bonds	14.19%

## Breakdown by credit rating



## Breakdown by currency



Source: Aegon Asset Management as at 30 September 2022

# Key portfolio characteristics

Industry sector (iBoxx level 4)	% Weight
Banks	30.39%
Insurance	11.97%
Real Estate	9.65%
Automobiles & Parts	9.27%
Health Care	6.47%
Utilities	6.44%
Technology	4.91%
Travel & Leisure	4.26%
Industrial Goods & Services	3.93%
Financial Services	1.73%
MBS	1.66%
Whole Business Securitized	1.56%
Personal & Household Goods	1.11%
Media	0.70%
Retail	0.69%
Telecommunications	0.65%
Construction & Materials	0.53%
Covered	0.49%

Country sector	% Weight
US	27.80%
UK	24.64%
Germany	15.06%
France	6.94%
Italy	3.16%
Switzerland	2.84%
Luxembourg	2.67%
Spain	2.42%
Netherlands	1.82%
Sweden	1.61%
Belgium	1.54%
Japan	1.32%
Norway	1.07%
Australia	0.88%
Finland	0.73%
Hong Kong	0.69%
Ireland	0.53%
Denmark	0.43%
Bermuda	0.26%

Source: Aegon Asset Management as at 30 September 2022



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