The Church of Scotland Investors Trust

Constituted by Act of Parliament 1994

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Church of Scotland – Income Fund Factsheet
Q3 2024

Performance commentary

The third quarter was positive for fixed income investors, with strong absolute returns from sterling credit markets. The portfolio outperformed its benchmark index over the period, with the combination of stock and sector positioning positive. Within the banking sector, our exposure to subordinated bonds was again helpful while in insurance, our exposure to selected long-dated bonds was also beneficial. Selected tenders such as Just Group and Aviva, contributed to our outperformance, with the companies buying back bonds at above market levels. Our holding in EDF also benefitted from this, after the company called its 6% hybrid bonds, issuing a new green sterling-denominated bond with a coupon of 7.375%.

Against this, our exposure to structured bonds was a small negative. This was largely due to ongoing volatility in the water sector, with bonds in Thames Water and Southern Water weaker over the quarter. This followed a harsher than expected draft outcome of the regulatory review by Ofwat, and rating agencies downgrading Thames bonds earlier in the quarter. While there are undoubtedly issues in the sector, we do believe that a resolution will be found. While this underperformance is disappointing, it does highlight the benefit of diversification in our approach, given that the overall effect of our exposure to the structured sector has been positive this year. Outside of exposure to water, our structured sector holdings again performed well and remain a key element of our sterling credit exposure.

For the Global Bond Opportunities fund, we saw a positive return over the quarter, with strong returns from both investment grade and high yield exposure with hybrid bonds and contingent capital bonds (cocos) also helpful. The fund has a high degree of diversification, with material exposure to a range of assets including US dollar, euro and sterling investment grade bonds, high yield and unrated bonds. Within banks, the largest sector exposure in the fund, we have a significant exposure to AT1 bonds: these performed well during the period, with the likes of Rabobank and Barclays notable performers.

The Sterling Extra Yield fund posted strong returns in the third quarter of 2024 amidst fairly benign markets, with spreads moving sideways and government yields falling. Performance at the start of the quarter was driven by banking and insurance. This strength reflected both the financial sectors' sensitivity to the supportive market sentiment and their longer average duration. This trend continued towards the end of the quarter - while generally relatively little price movement – performance was driven by the financial sectors of banking and insurance. The investment in Doric Nimrod Air 2, the business leasing Boeing A380 aircraft to Emirates, performed well on news that agreement had been reached with Emirates for the sale of the aircraft at the end of what are now fairly short term leases. Amadeo Air, a similar business, also saw a price increase on the news.

RLAM Performance Summary:

	Church of Scotland (%)	Benchmark (%)	Relative (%)
Q3 2024	2.85	2.28	0.58
12 months	12.77	9.72	3.04
3 Years	0.83	-2.87	3.70
since migration (01/02/2012)	5.39	2.89	2.50

***Risk Warning**: - Investors should bear in mind that values fluctuate and, as past performance is no guarantee of future returns, investors may not get back the original amount invested. The Growth Fund and Income Fund units are only realisable on the monthly dealing dates. The distributions paid by the Deposit, Growth and Income Funds are all liable to fluctuation.*

Extracted from Royal London Asset Management's Investment Report for The Church of Scotland Investors Trust Income Fund as at 30 September 2024 and Savills Charities Property Fund @ cpfund.co.uk

Investment Outlook

At the start of this year we mentioned 'peak optimism' – the idea that markets were pricing in far more rate cuts than we felt were likely. This was swiftly followed by 'peak pessimism' – an expectation that rate cuts would be much slower and fewer than previously thought. In practice, at various points this year, markets have expected only a single rate cut in 2024, or as many as six. The volatility seen in government bond markets this year reflects these extremes and the changes from one to the other. We saw this again in the third quarter, with soft data in August / September pushing markets to once again price in many rate cuts.

This volatility provides opportunities for active managers. We have actively traded duration this year to benefit from these swings and expect to continue to do so. Duration has been pared back again towards the end of the quarter with excessive rate cuts priced into markets.

As well as changing market expectations, supply remains a factor in short-term movements, generating discounts prior to pricing. Over the past quarter, fears of increased supply auctions have offered good opportunities to add UK risk. The UK budget will be a key event at the end of October. UK bonds have underperformed on fears of a substantial increase in supply to favour Labours spending plans. We believe the cheapening has gone too far and will begin to increase UK positions.

We believe that sterling investment grade all-in yields (using iBoxx) at over 5% remain attractive, both in absolute terms but also relative to government bonds. Credit spreads continue to compensate investors for the risk of default and, despite the uncertainties highlighted above, the outlook for the corporate sector remains relatively benign.

We target – and achieve – a material yield premium over the market level in our sterling credit strategies. As ever, the risks inherent in our investment grade credit portfolios are mitigated 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, achieved with superior downside protections, will generate outperformance.

Savills Charities Property Fund Performance Summary