ROYAL LONDON

ASSET MANAGEMENT

ROYAL LONDON FIXED INCOME

Fund Manager Commentary – August 2018

For professional clients only, not suitable for retail investors

CONTENTS

ECONOMIC DEVELOPMENTS

Economic developments

The Bank of England raised its key interest rate to 0.75%, judging that the UK economy has a very limited degree of slack; the increase was only the second since 2007. Economic growth accelerated to 0.4% (quarterly pace) as construction rebounded. Sterling ended August near its level at the start of the month; after weakening initially amid concern about a ‘no deal’ Brexit, the currency rallied sharply in late August on indications that the EU might offer the UK an unprecedented partnership.

The tone of US activity data became more mixed, partly reflecting a slowing housing market, potentially a sign that Federal Reserve (Fed) rate hikes which began in 2015 are having an effect. Growth in nonfarm payrolls and industrial production weakened, and orders for durable goods fell. Markets anticipated another Fed rate rise in September, as remarks by Chairman Jerome Powell indicated that further measured increases are likely. The dollar strengthened.

Eurozone economic figures continued to indicate solid but unspectacular expansion and subdued inflation. Quarterly growth was revised up to 0.4%, helped by strength in the German and Dutch economies. However, monthly declines in German factory orders and industrial production suggested that the quarter ended on a weak note. ‘Core’ consumer price inflation remained relatively low at 1.1% (annual rate). The euro weakened against the dollar and strengthened against sterling for a fourth month.

RLAM CREDIT FUND PERFORMANCE

Fund performance

	1 month (%)	Rolling 12 months (%)
RL Corporate Bond Fund Z Inc	**0.46**	**0.55**
IA Sterling Corporate Bond Sector	0.31	-0.70
iBoxx Sterling Non-Gilts All Maturities Index	0.44	-0.80
RL Duration Hedged Credit Z Acc	**0.16**	**2.94**
IA Unclassified Sector	0.21	4.11
3 Month LIBOR	0.07	0.58
RL Ethical Bond Fund Z Inc	**0.38**	**0.74**
IA Sterling Strategic Bond Sector	0.08	-0.35
iBoxx Sterling Non-Gilts All Maturities Index	0.44	-0.80
RL European Corporate Bond Fund Z Inc	**0.81**	**-2.28**
IA Global Bonds Sector	0.24	-2.08
Merrill Lynch Euro Corporate and Pfandbrief Index[1]	0.41	-2.83
RL Global Bond Opportunities Fund Z Inc	**0.33**	**3.27**
RL Investment Grade Short Dated Credit Fund Z Inc	**0.17**	**0.62**
IA Sterling Corporate Bond Sector	0.31	-0.70
ICE BofA ML 1-5 year Sterling Non-Gilt All Stocks Index	0.16	0.11
RL Short Duration Credit Fund Z Inc	**0.20**	**1.59**
IA Sterling Strategic Bond Sector	0.08	-0.35
ICE BofA ML 1-5 year Sterling Non-Gilt All Stocks Index	0.16	0.11
RL Sterling Credit Fund Z Inc	**0.38**	**0.42**
IA Sterling Corporate Bond Sector	0.31	-0.70
iBoxx Sterling Non-Gilts All Maturities Index	0.44	-0.80
RL Sterling Extra Yield Bond Fund A Inc	**0.40**	**5.35**
RL Sterling Extra Yield Bond Fund B Inc	**0.35**	**4.83**
RL Sterling Extra Yield Bond Fund Y Inc	**0.43**	**5.81**
RL Sterling Extra Yield Bond Fund Z Inc	**0.42**	**5.62**
IA Sterling Corporate Bond Sector	0.31	-0.70
IA Sterling High Yield Sector	0.34	1.60
IA Sterling Strategic Bond Sector	0.08	-0.35

Past performance is not necessarily a reliable indicator of future performance. The value of investments and the income from them is not guaranteed and may go down as well as up and investors may not get back the amount originally invested.

Source: RLAM and FE, correct as of 31 August 2018. Returns quoted are net of fees.

[1]Please note that the benchmark pricing is end-of-day, and entails no currency conversion.

CREDIT MARKET REVIEW

Market highlights

Sterling Investment Grade Credit

- The benchmark 10-year gilt yield fell modestly during August; the asset class (all maturities) returned 0.16% and underperformed sterling investment grade corporate bonds, which returned 0.44%, for a third month. The average credit spread (the yield premium over gilt yields) was broadly unchanged at 1.20%.
- Absolute returns were positive for most sterling credit sectors. Secured and structured debt outperformed the broad market, along with telecommunications, utilities and most consumer sectors. Returns from supranational issues and covered bonds were modestly behind the wider credit market, while financials (banks and insurance) underperformed, paced by insurance. In terms of credit rating, AAA rated debt lagged behind lower rated bonds. By maturity, longer dated issues outperformed medium and shorter dated debt.
- Sterling investment grade credit issuance fell by two-thirds from July to 2018's lowest monthly total, and was down compared with a year earlier. Equivalent euro issuance rose moderately on the month and was up by more than half on the prior year. Industrials were the main sterling issuers, and financials led in the euro market.

European Investment Grade Credit

- The average credit spread (the extra yield from a corporate bond compared with government debt) widened by 8bps. The broad market (Merrill Lynch Euro Corporate and Pfandbrief Index) returned 0.05%.
- Total returns were positive for most euro credit sectors. Financial issues generally underperformed the wider euro credit market, led by peripheral financials; corporate 'hybrid' debt also lagged behind. Returns from industrials were in line with the broad market, while covered bonds and supranationals outperformed. By credit rating, BBB rated bonds lagged behind higher rated issues. By maturity, longer dated debt outperformed medium dated and shorter dated bonds.
- Euro investment grade credit issuance rose moderately on the month and was up by more than half on the prior year. Equivalent sterling investment issuance fell by two-thirds from July to 2018's lowest monthly total, and was down on a year earlier. Financials were the main euro issuers, and industrials led in the sterling market.
- Yields on benchmark 10-year government bonds fell moderately in most eurozone markets in August; the yield on 10-year German bunds declined by 12bps. Italy and Greece were the worst performers as yields rose sharply. Equivalent yields recorded a small rise in Japan and modest falls in the UK and the US.

ROYAL LONDON CORPORATE BOND FUND

Portfolio commentary

- The fund recorded a net return of 0.46% in August, compared to the 0.31% average return recorded for its sector (IA Sterling Corporate Bond).
- The fund's relative outperformance primarily reflects the substantial overweight holding of secured and structured bonds, which outperformed the wider sterling credit market. The above benchmark exposure to subordinated financial (banks and insurance) debt, which lagged behind the broad market, detracted from returns. The prominent underweight allocation to supranational issues, which underperformed moderately, had a small positive impact. The fund's duration position, relative to the benchmark, did not have a material effect.
- Underweight exposure to supranational bonds and a bias towards secured and structured debt, along with the overweight holding of subordinated financial debt, remain the most notable aspects of the fund's sector profile.
- In new issue activity, the fund bought perpetual subordinated US dollar bonds of financials **Barclays** and **BNP Paribas**, carrying respective coupons of 7.75% and 7%; the latter holding was subsequently expanded in the secondary market. Elsewhere, purchases included new 3-year senior debt of German carmaker **Volkswagen** priced at a spread of 113 basis points (bps) over yields on gilts, subsequently sold to manage cash, and a 12-year senior issue from utility **South Eastern Power Networks** at 160bps over gilts. The fund also bought secured debt of Liverpool-based social housing association **Riverside Group**, originally priced at 135bps over gilts as a 30-year issue in 2014.
- In the secondary market, the allocation to social housing association **Housing & Care 21** was sold to realise a profit, while holdings of **Yorkshire Building Society** and utility **Eastern Power Networks** were sold to manage liquidity. In financials, the fund initiated positions in bonds of German insurer **Allianz** that become callable in September and in specialist asset manager **Intermediate Capital Group**. The fund also expanded its holding of **Metro Bank** after a selloff and increased allocations including **RSA Insurance Group**, **Rabobank Nederland** and **Goldman Sachs Group**. In sell-off consumer sectors, exposures were established to food company **Mondelez International** and New Zealand dairy producer **Fonterra Co-operative**.

Investment outlook

- While the UK government published a White Paper in July giving more details on proposed relations with the EU after Brexit, we believe that uncertainty about the country's departure from the bloc will constrain business investment. Against this background, we expect interest rates to remain at low levels.
- We continue to believe that portfolio diversification is important and a focus on bonds supported by stable income streams and structural enhancements should provide protection in times of market turbulence.
- We consider that the current credit spread is adequate compensation for default and other risks (e.g. liquidity and rating migration). We expect investment grade credit bonds will modestly outperform UK government securities over the next three years.

Key views within the fund

- The fund is diversified, with over 300 holdings, in order to improve overall portfolio liquidity and to reduce the effect on overall fund performance of any deterioration in the creditworthiness of an individual holding.
- A significant underweight in supranational bonds, as we expect corporate bonds to outperform over the medium term.
- Duration broadly in line with that of the benchmark.
- An overweight position in subordinated financial debt, where we believe yields are attractive.
- The fund remains orientated towards secured bonds in the asset-rich investment trust, property and social housing sectors and structured bonds, which benefit from a claim on assets and cashflows.

Jonathan Platt
Head of Fixed Income

Shalin Shah
Senior Fund Manager

ROYAL LONDON DURATION HEDGED CREDIT FUND

Portfolio commentary

- The fund recorded a net return of 0.16% in August, while the average credit spread was broadly unchanged.
- Longer dated swap spreads fell (i.e. became more negative) during the month; this detracted from performance.
- In the wider market, the average credit spread was little changed at 1.20% on the Merrill Lynch Non Gilt Index. The fund's credit spread was also broadly unchanged.
- Fund performance was supported by the prominent allocation to secured and structured debt, which outperformed the wider sterling credit market. The significant holding of financial (banks and insurance) bonds, which lagged behind the broad market, was disadvantageous. The minimal exposure to supranationals and covered bonds, which underperformed modestly, had a small positive effect on returns. As UK government debt performed generally in line with corporate bonds, the relatively high allocation to gilts, reflecting credit bond sales undertaken in prior months, did not have a significant impact. Income generation has continued to benefit performance; there have been no defaults among bonds held in the fund.
- The preference for secured and structured bonds remained the most distinctive feature of sector positioning, along with a notable allocation to financials. Exposure to gilts rose modestly to 14.5% by the end of August.
- The fund took part in two new issues, including CMBS deal **Taurus 2018-2**, a securitisation of a loan backed by office buildings in Devonshire Square in London's financial district that was priced at an attractive spread over 3-month LIBOR. Elsewhere, the fund bought 12-year senior bonds of utility **South Eastern Power Networks** priced at 160 basis points (bps) over gilt yields.
- In the secondary market, activity was centred primarily on investing cashflows. The fund increased exposures to financials **RSA Insurance Group** and **Investec**; utilities **Cadent** and **Enel**; and structured debt of pub companies **Mitchells & Butlers** and **Spirit**. Within consumer sectors, positions were established in retailer **John Lewis** and food company **Mondelēz International**. In social housing, the fund sold holdings of **Optivo** and **BPHA**, while expanding the allocation to **Sunderland**. The exposure to **Metro Bank** was increased following underperformance.

Investment outlook

- While the UK government published a White Paper in July giving more details on proposed relations with the EU after Brexit, we believe that uncertainty about the country's departure from the bloc will constrain business investment. Against this background, we expect interest rates to remain at low levels.
- We continue to believe that portfolio diversification is important and a focus on bonds supported by stable income streams and structural enhancements should provide protection in times of market turbulence.
- We consider that the current credit spread overcompensates for default and other risks (e.g. liquidity and rating migration). We expect investment grade credit bonds will modestly outperform UK government securities over the next three years.

Key views within the fund

- The fund is diversified, with over 300 holdings, to improve overall portfolio liquidity and reduce the effect on overall performance of any deterioration in the creditworthiness of an individual holding.
- Minimal exposure to supranational debt, as we expect corporate bonds to outperform over the medium term.
- An exposure to credit risk with minimal exposure to duration (interest rate sensitivity), managed by purchasing interest rate swaps.
- A bias towards subordinated financial debt, where we believe yields remain attractive, despite the recent compression.
- An orientation towards secured bonds in the asset-rich investment trust, property and social housing sectors; structured bonds, which benefit from a claim on assets and cashflows; and the covered bond sector (i.e. senior bank debt benefiting from a first claim on a specified over-collateralised pool of assets).

Shalin Shah
Senior Fund Manager

ROYAL LONDON ETHICAL BOND FUND

Portfolio commentary

- The fund's Z class share recorded a return of 0.38% in August, net of fee. This compares to average returns recorded for the Investment Association (IA) Sterling Strategic Bond sector and the IA Sterling Corporate Bond sector of 0.08% and 0.31%, respectively. The fund is a constituent of the former sector because its weighting in investment grade sterling corporate bonds is less than 80%, predominantly as a result of the holdings of unrated secured bonds; however, in the context of its investment grade all-maturities benchmark, the fund's performance relative to the more homogeneous Sterling Corporate Bond sector is also relevant. On a year-to-date basis, the fund has returned -0.22%, compared with an average return of -1.05% for both IA sectors.
- The fund's relative outperformance in August primarily reflects the substantial overweight holding of secured and structured bonds, which outperformed the wider sterling credit market. The above benchmark exposure to subordinated financial debt, which lagged behind the broad market, detracted from returns. The prominent underweight allocation to supranational issues, which underperformed moderately, had a small positive impact, as did the fund's modest short duration stance relative to the benchmark.
- The overweight holding of financial (banks and insurance) bonds, the bias towards secured and structured debt and the underweight exposure to supranational issues remained the fund's most notable sector characteristics.
- In new issue activity, the fund took part in CMBS deal **Taurus 2018-2**, a securitisation of a loan backed by office buildings in Devonshire Square in London's financial district that was priced at an attractive spread over 3-month LIBOR. Elsewhere, the fund bought new 3-year senior debt of German carmaker **Volkswagen** priced at 113bps over yields on gilts and 12-year senior bonds of utility **South Eastern Power Networks** at 160bps over gilts.
- Activity in the secondary market consisted mainly of investing cashflows. The fund expanded allocations including UK train leasing companies **Great Rolling Stock** and **Eversholt Funding**; financials **QBE Insurance** and **Barclays**; and structured debt of **Trafford Centre**, backed by revenues from the Manchester shopping centre. In financials, an exposure to specialist asset manager **Intermediate Capital Group** was established, and in consumer sectors, the fund increased holdings of retailer **John Lewis**, school operator **Alpha Plus Group** and media company **Daily Mail and General Trust**.

Investment outlook

- While the UK government published a White Paper in July giving more details on proposed relations with the EU after Brexit, we believe that uncertainty about the country's departure from the bloc will constrain business investment. Against this background, we expect interest rates to remain at low levels.
- We continue to believe that portfolio diversification is important and a focus on bonds supported by stable income streams and structural enhancements should provide protection in times of market turbulence.
- We consider that the current credit spread is adequate compensation for default and other risks (e.g. liquidity and rating migration). We expect investment grade credit bonds will outperform UK government securities over the next three years.

Key views within the fund

- The fund is diversified, with over 300 holdings, in order to improve portfolio liquidity and to reduce the effect on overall performance of any deterioration in the creditworthiness of an individual holding.
- The fund has a significant underweight position in supranational bonds, as we expect corporate bonds to outperform over the medium term.

ROYAL LONDON ETHICAL BOND FUND

Key views within the fund continued

- Duration within the fund is moderately shorter than that of the benchmark.
- The fund has an overweight position in subordinated financial debt, where we believe yields are attractive.
- The fund remains orientated towards secured bonds in the asset-rich investment trust, property and social housing sectors, and towards structured bonds, which benefit from a claim on assets and cashflows.

FE ALPHA MANAGER 2018
ERIC HOLT

citywire AA

Eric Holt
Head of Credit

ROYAL LONDON EUROPEAN CORPORATE BOND FUND

Portfolio commentary

- The fund recorded a net return of 0.81% in August, compared to the 0.41% gross return of the Merrill Lynch Euro Corporate and Pfandbrief Index.
- The fund has overweight exposures to financial (banks and insurance) bonds and corporate 'hybrid' debt, which generally underperformed the broad euro credit market; the focus on short call dates and maturities within these holdings supported performance. As supranational issues outperformed, the fund's shift to a modest above benchmark holding had a small positive effect. Low exposure to peripheral financials, which lagged behind, was beneficial. As government debt outperformed corporate bonds, the fund's small holding of German bunds was advantageous.
- The duration of the fund is kept shorter than that of the benchmark index. This had a small negative impact on performance.
- The fund took part in one new issue as electric utility **Elia System Operator** sold perpetual 'hybrid' bonds carrying a 2.75% coupon, refinancing a loan used to increase ownership of its German unit.
- Away from new issues, bonds of energy companies **OMV** and **Total** were sold at a profit, while the allocation to insurer **La Mondiale SAM** was reduced after the market rallied. The fund sold holdings of **NatWest Markets** and **Lloyds Bank** to lower exposure to UK banks, and reduced a position in US pharmaceutical company **AbbVie** to manage exposure to the sector. Portfolio risk was managed by selling allocations to **Jyske Bank** and real estate investment company **Icade**, while cashflows were invested in bonds of supranationals including German state-owned development bank **KfW Group**. The fund initiated a position in **SRLEV** on speculation that the Dutch insurer may be acquired by a company with a higher credit rating as its ultimate owner, Anbang Insurance Group, sells assets after being taken over by China's government.

Investment outlook

- The European Central Bank (ECB) will reduce its asset purchases to €15 billion a month as of October and will wind-up the programme after December. As a result, we expect government bond yields to rise over the next 18 months and credit spreads to continue to widen during the second half of 2018.
- The fund is underweight BBB rated securities, as current spreads do not compensate for credit risk following compression caused by the ECB's purchase programme. Exposure to A rated issues remains overweight.
- The fund will continue to maintain a preference for subordinated financials and corporate 'hybrids', with a strong preference for short maturities, as we expect these two asset classes to outperform the broader market in a rising yield environment, despite the weak performance in the first half of 2018. Similarly, we expect covered bonds and supranationals to underperform in a rising yield environment and after the end of the ECB's asset purchase programme. The fund remains underweight consumer sectors, as current valuations do not compensate for credit and M&A risk.

Key views within the fund

- The fund is diversified, with over 200 holdings, in order to increase liquidity and reduce the effect of any deterioration in creditworthiness of an individual holding on overall performance.
- The fund's duration is kept shorter than that of the benchmark.
- By sector, the fund is underweight consumer-related, industrial and covered bonds, and overweight subordinated financials and corporate 'hybrid' debt.
- By credit rating, the fund is underweight BBB rated securities and overweight A rated and high yield issues.

CITYWIRE A

Rachid Semaoune
Senior Fund Manager

ROYAL LONDON GLOBAL OPPORTUNITIES BOND FUND

Executive summary

- The fund recorded a net return of 0.33% in August. The focus on short call dates and maturities within the significant holding of financial (banks and insurance) bonds helped the fund to outperform most varieties of corporate debt in a month when credit spreads widened.
- Distributions payable at the end of August were 1.52p.

Market highlights

Index	Total return (%)	Spread movement (basis points)
Dollar investment grade corporate bonds **ICE BofA ML US corporate index**	0.54	5
Sterling investment grade corporate bonds **ICE BofA ML sterling corporate and collateralised index**	0.50	-1
HY global non-financial corps **ICE BofA ML global non-financial high yield index**	0.20	14
Euro investment grade corporate bonds **ICE BofA ML euro corporate and Pfandbriefe index**	0.05	8
AT1 **ICE BofA ML contingent capital index**	-0.53	32
IG global non-financial hybrid corps **ICE BofA ML global hybrid non-financial corporate index**	-0.65	20
HY global non-financial hybrid corps **ICE BofA ML global hybrid non-financial high yield index**	-0.89	27
HY non-financial emerging markets **ICE BofA ML emerging markets high yield ex. subordinated financial index**	-2.03	85

Source: Bloomberg.

- Returns were negative for most types of non-investment grade corporate debt in an environment of widening credit spreads. Emerging markets issues were the worst performers amid heightened volatility across the asset class, as the Turkish and Argentine currencies slumped and Argentina's central bank raised its benchmark interest rate to 60%.
- Sterling structured debt of **Telereal Securitisation**, backed by cashflows of telecommunications company BT Group, was prominently supportive for performance, along with euro bonds of Swedish oil refiner **Corral Petroleum Holdings**. The allocations to US dollar subordinated issues of financials **Lloyds** and **Barclays** detracted from returns.

Portfolio commentary

- The fund participated in two new issues, buying perpetual subordinated US dollar debt of financial **Barclays** carrying a 7.75% coupon (funded by reducing the allocation to equivalent bonds of **UBS**). Elsewhere, perpetual 'hybrid' bonds of **Elia System Operator** with a 2.75% coupon were purchased, as the electric utility refinanced a loan used to increase ownership of its German unit.
- Away from new issues, the holding of telecommunications company **TDC** was reduced to realise a profit. Other fund activity in the secondary market was focussed on investing cashflows; within financials, short-dated bonds of **Swiss Reinsurance** and **AG Insurance** were among purchases. Elsewhere, the fund increased allocations including oil companies **Okea** and **Siccar Point Energy**; pub operator **Enterprise Inns**; and secured bonds of transportation company **Havilafjord**. A position was initiated in **SRLEV** on speculation that the Dutch insurer may be acquired by a company with a higher credit rating as its ultimate owner, Anbang Insurance Group, sells assets after being taken over by China's government.
- The holding of energy company **General Exploration Partners** was called away from the portfolio.
- The fund maintains a 2.5% hedge through the iTraxx Europe CDS (Credit Default Swap) Crossover index.

ROYAL LONDON GLOBAL OPPORTUNITIES BOND FUND

Investment outlook

- We expect global growth to remain close to its recent rates, but below its pre-financial-crisis average. The eurozone will be supported by loose monetary policy through the end of 2018, and we expect US growth to follow its recent upward trend. In the UK, we anticipate that inflation will fall back towards its 2% target during 2018, with GDP growth supported by a modest improvement in consumption.
- We expect global government bond yields to rise gradually over the next 12 months, as world growth remains positive. We expect the Fed to raise interest rates four times in 2018.
- We believe that present pricing of corporate bonds is still attractive over the medium term, while their level of income generation is also appealing with the prospect of short-term interest rates staying low. We believe credit valuations are underpinned by strong company balance sheets and extended central bank liquidity, which is pushing investors to broaden their search for yield.

CITYWIRE A

Rachid Semaoune
Senior Fund Manager

FE ALPHA MANAGER 2018 ERIC HOLT

citywire AA

Eric Holt
Head of Credit

ROYAL LONDON INVESTMENT GRADE SHORT DATED CREDIT FUND

Portfolio commentary

- The fund recorded a net return of 0.17% in August, compared to the 0.16% gross return of the ICE BofA Merrill Lynch 1–5 Year Sterling Non-Gilt Index and the 0.31% average return of its sector (IA Sterling Corporate Bond).
- Fund performance benefited from the substantial above benchmark holding of secured and structured bonds, which outperformed the broad sterling credit market. The overweight allocation to subordinated financial debt, which lagged behind the wider market, was disadvantageous. The above benchmark exposure to covered bonds and underweight holding of supranational issues, which both underperformed modestly, had small negative and positive effects, respectively. The fund's moderate short duration stance relative to the benchmark did not have a significant impact.
- Underweight exposure to supranational bonds, an overweight holding of financial (banks and insurance) debt and a bias towards secured and structured issues remained the fund's most notable sector characteristics.
- In new issue activity, the fund participated in **National Australia Bank**'s reopening of a senior issue maturing in 2022 that was originally priced at a spread of 80 basis points (bps) to gilt yields in 2017. Elsewhere, the fund bought new 3-year senior debt of **Volkswagen** at 113bps over gilts; this was viewed as inexpensive compared with the German carmaker's existing bonds.
- Activity in the secondary market centred on investing cashflows. The fund added to allocations including UK train leasing companies **Great Rolling Stock** and **Eversholt Funding**; **Telereal Securitisation**, secured against cashflows of telecommunications company BT Group; and structured debt of **Trafford Centre**, backed by revenues from the Manchester shopping centre. In financials, **BNP Paribas** and **Munich Re** were among holdings that were increased, along with covered bonds of **Deutsche Hypothekenbank** and **Co-operative Bank**; a position was initiated in **RSA Insurance Group**. Elsewhere, the fund expanded exposures to utility **Western Power Distribution Holding** and structured debt of pub company **Marstons**, and established an allocation to oil and gas company **BP**.

Investment outlook

- While the UK government published a White Paper in July giving more details on proposed relations with the EU after Brexit, we believe that uncertainty about the country's departure from the bloc will constrain business investment. Against this background, we expect interest rates to remain at low levels.
- We continue to believe that portfolio diversification is important and a focus on bonds supported by stable income streams and structural enhancements should provide protection in times of market turbulence.
- We consider that the current credit spread is adequate compensation for default and other risks (e.g. liquidity and rating migration). We expect investment grade credit bonds will modestly outperform UK government securities over the next three years.

Key views within the fund

- The fund is diversified, with over 300 holdings, in order to improve overall portfolio liquidity and to reduce the effect on overall performance of any deterioration in the creditworthiness of an individual holding.
- A significant underweight in supranational bonds, as we expect corporate bonds to outperform over the medium term.
- Duration moderately shorter than that of the benchmark.
- An overweight position in subordinated financial debt, where we believe yields are attractive.
- The fund remains orientated towards structured bonds, which benefit from a claim on assets and cashflows; secured bonds in the asset-rich property and social housing sectors; and the covered bond sector (i.e. senior bank debt benefiting from a first claim on a specified over-collateralised pool of assets).

Richard Nelson
Senior Fund Manager

CITYWIRE AAA

Paola Binns
Senior Fund Manager

ELITE PROVIDER
rated for bonds by FundCalibre.com

ROYAL LONDON SHORT DURATION CREDIT FUND

Portfolio commentary

- The fund recorded a net return of 0.20% in August, versus the 0.16% gross return of the ICE BofA Merrill Lynch 1-5 Year Sterling Non-Gilt Index and the 0.08% average return of the IA Sterling Strategic Bond sector.
- The fund's relative outperformance versus the benchmark mainly reflects the substantial overweight holding of secured and structured bonds, which outperformed the wider sterling credit market. The above benchmark exposure to subordinated financial debt, which lagged behind the broad market, detracted from returns. The prominent underweight allocation to supranational issues, which underperformed moderately, had a small positive impact, as did the modest short duration stance relative to the benchmark.
- Overweight exposure to financial (banks and insurance) bonds, a bias towards secured and structured issues and significant underweight exposure to supranational debt remained the most notable aspects of sector positioning. While exposure to consumer services rose by 1.0%, the holding remained relatively modest.
- The fund participated in a single new issue, purchasing 3-year senior bonds of **Volkswagen** priced at a spread of 113 basis points (bps) over gilt yields. This was viewed as inexpensive compared with the German carmaker's existing debt.
- Activity in the secondary market centred on investing cashflows. The fund added to allocations including **Great Rolling Stock** and **Eversholt Funding**, which raise money for UK train leasing companies; real estate company **ML 33**, secured against offices of Norwegian energy company Equinor, formerly known as Statoil; and structured debt of **Telereal Securitisation**, backed by cashflows of telecommunications company BT Group. Within financials, the fund expanded exposures to **BNP Paribas**, **Credit Suisse**, **Society of Lloyds** and covered bonds of **Co-operative Bank**. Elsewhere, oil and gas company **Aker BP**, pub operator **Enterprise Inns** and utility **Western Power Distribution Holding** were among exposures that were increased.

Investment outlook

- While the UK government published a White Paper in July giving more details on proposed relations with the EU after Brexit, we believe that uncertainty about the country's departure from the bloc will constrain business investment. Against this background, we expect interest rates to remain at low levels.
- We continue to believe that portfolio diversification is important and a focus on bonds supported by stable income streams and structural enhancements should provide protection in times of market turbulence.
- We consider that the current credit spread is adequate compensation for default and other risks (e.g. liquidity and rating migration). We expect investment grade credit bonds will modestly outperform UK government securities over the next three years.

Key views within the fund

- The fund is diversified, with more than 250 holdings, in order to improve overall portfolio liquidity and to reduce the effect on overall performance of any deterioration in the creditworthiness of an individual holding.
- The fund has a significant underweight in supranational bonds, as we expect corporate bonds to outperform over the medium term.
- Fund duration is modestly short relative to that of the benchmark.
- The fund has an overweight position in subordinated financial debt, where we believe yields are attractive.
- The fund remains orientated towards secured bonds in the asset-rich investment trust, property and social housings sectors, and structured bonds, which benefit from a claim on assets and cashflows.

CITYWIRE AAA

Paola Binns
Senior Fund Manager

Rayner Spencer Mills RATED FUND

ROYAL LONDON STERLING CREDIT FUND

Portfolio commentary

- The fund recorded a net return of 0.38% in August, versus the 0.31% average return for its sector (IA Sterling Corporate Bond).
- The fund's relative outperformance reflects the substantial overweight holding of secured and structured bonds, which outperformed the wider sterling credit market. The above benchmark exposure to subordinated financial debt, which lagged behind the broad market, detracted from returns. The prominent underweight allocation to supranational issues, which underperformed moderately, had a small positive impact, as did the modest short duration stance relative to the benchmark.
- Overweight exposure to financial (banks and insurance) debt, a substantial underweight in supranational bonds and a bias towards secured and structured issues remained the most noticeable features of sector positioning.
- In new issue activity, the fund bought perpetual subordinated US dollar bonds of financials **Barclays** and **BNP Paribas**, carrying respective coupons of 7.75% and 7%; the latter holding was subsequently sold to realise a profit. Elsewhere, purchases included new 3-year senior debt of **Volkswagen** priced at a spread of 113 basis points (bps) over yields on gilts, viewed as inexpensive compared with the German car manufacturer's existing bonds, and a 12-year senior issue from utility **South Eastern Power Networks** at 160bps over gilts.
- Secondary market activity consisted mainly of investing cashflows, with financials a significant source of purchases. The fund added to holdings of **QBE Insurance**, **Goldman Sachs Group**, **Leeds Building Society** and **HSBC Bank**, among others. Away from financials, allocations that were increased included **Great Rolling Stock**, which raises money for the largest UK train leasing company, and utility **Innogy**. The fund initiated positions in food producer **Mondeléz International** and structured debt of **Gatwick Funding**, which raises money for Gatwick Airport, while reducing a holding of telecommunications company **Orange** to manage cash. Exposure to specific credits was managed by reducing the holding of utility **Centrica** and partially switching an allocation to **HSBC Holdings** into **Goldman Sachs Group**.

Investment outlook

- While the UK government published a White Paper in July giving more details on proposed relations with the EU after Brexit, we believe that uncertainty about the country's departure from the bloc will constrain business investment. Against this background, we expect interest rates to remain at low levels.
- We continue to believe that portfolio diversification is important and a focus on bonds supported by stable income streams and structural enhancements should provide protection in times of market turbulence.
- We consider that the current credit spread is adequate compensation for default and other risks (e.g. liquidity and rating migration). We expect investment grade credit bonds will modestly outperform UK government securities over the next three years.

Key views within the fund

- The fund is diversified, with more than 300 holdings, in order to improve overall portfolio liquidity and to reduce the effect on overall performance of any deterioration in the creditworthiness of an individual holding.
- A significant underweight in supranational bonds, as we expect corporate bonds to outperform over the medium term.
- Duration moderately shorter than that of the benchmark.
- An overweight position in subordinated financial debt, where we believe yields are attractive.
- The fund remains orientated towards secured bonds in the asset-rich investment trust, property and social housing sectors, and structured bonds, which benefit from a claim on assets and cashflows.

Paola Binns
Senior Fund Manager

ROYAL LONDON STERLING EXTRA YIELD BOND FUND

Portfolio commentary

- In August, the fund posted returns of 0.40%, 0.35%, 0.43% and 0.42% for the A, B, Y and Z class shares, respectively. These bring 2018 year to date returns to 2.99%, 2.64%, 3.27% and 3.16% for these share classes, respectively.
- UK government bond yields were slightly lower over the course of the month, with the asset class delivering a return of 0.15%. Sterling corporate bonds did a little better, posting an index return of 0.45% – albeit the financial sectors of banking and insurance lagged a little, extending a feature which has been quite marked in 2018. European high yield bonds and global high yield bonds posted respective index returns of -0.20% and -0.07%. 2018 year to date returns for these four asset classes are now 0.14%, -0.71%, -0.35% and 0.30%, respectively.
- The return achieved by the fund in August broadly corresponded to its level of income generation, with correspondingly little change in the average market prices. Some financials – including banks **Barclays**, **Lloyds** and **UBS**, together with insurers **Generali**, **Legal & General** and **Scottish Widows** – were down in price, but in most cases with this significantly mitigated by strong income generation. There were two exceptions, both insurers, to this general trend of weakness in financials; holdings in both **Prudential** and **Standard Life Aberdeen** bonds rose about 1% in price in the month, following earlier strong performance. Prudential, which is unbundling its UK businesses from its overseas operations, climbed on the assessment that the amount of long-dated sterling bonds in issuance would not be well suited to either part of the demerged business, and thus a repurchase offer might be forthcoming. In the wake of Standard Life's sale of its insurance activities to Phoenix Group, the Standard Life Aberdeen bonds related to that part of the business have now been asset collateralised to reflect the onus for bond payment servicing, which still resides with Standard Life Aberdeen.
- Other individual robust performances in August included **Telereal**, backed by operating assets and lease obligations of UK telecoms incumbent BT; **OKEA**, the North Sea oil business benefitting from the very 'bond-friendly' Norwegian tax regime for the sector; aircraft leasing business **Amedeo Air Four Plus**, shares of which have good visibility and consistency in quarterly income distribution; and structured bonds of **Road Management Services**, the PFI deal for road improvement.
- Activity in the month included increasing holdings of **Co-op Group** 6.2% 2026 bonds, BB rated and now the fund's third-largest individual holding, offering a 4.4% yield; secured bonds of **EI Group**, formerly Enterprise Inns; purchasing at issue US dollar denominated bonds of **Barclays Bank**, offering a yield of 7.7% until their first call date in 2023; and adding to the recent issue of bonds of UK 'challenger' bank **Metro Bank**, offering a yield above 6% to their call date in 2023, with the issuer having the option to defer redemption until 2028, albeit at significant cost. Sales in the month included reducing the holdings in **Delamare Finance**, backed by operating assets and lease obligations of retailer Tesco, establishing a 12% capital gain from purchase price in 2016 and surrendering a yield of just 3.3% to their 2024 average life and in North Sea oil company **Aker BP**, whose US dollar bonds had delivered a near 10% return in that currency since issue in June 2017 and yielded just 2% over US treasuries, despite their BB credit rating (the balance of the holding was sold in early September). We also sold Australian insurer **QBE**, BBB rated but yielding just 3.7% to their call date in 2022 – the sale crystallised an attractive profit from purchase cost, and the fund's position was fully sold. Meanwhile, **Shamaran**, the Middle East oil company, having issued new bonds to refinance the business, repaid its 11.5% 2018 bonds a little ahead of their November maturity date at a predetermined modest premium to their par value. Having invested at issue in 2013, the fund's holding was more than doubled in early 2016, at a time of general market weakness and sharply falling oil prices, at a distressed price below 40. Finally, liquidity in the fund was managed by investment in short-dated gilts, on occasions when no immediate attractive opportunity for longer term investment was evident.

Investment outlook

- While the UK government published a White Paper in July giving more details on proposed relations with the EU after Brexit, we believe that uncertainty about the country's departure from the bloc will constrain business investment. Against this background, we expect interest rates to remain at low levels.
- We continue to believe that portfolio diversification is important and a focus on bonds supported by stable income streams and structural enhancements should provide protection in times of market turbulence.
- We consider that the current credit spread is adequate compensation for default and other risks (e.g. liquidity and rating migration). We expect investment grade credit bonds will modestly outperform UK government securities over the next three years.

ROYAL LONDON STERLING EXTRA YIELD BOND FUND

Key views within the fund

- The fund's objective is to achieve a high level of income by seeking attractive investments across a broad spectrum of fixed income opportunities, encompassing investment grade, sub-investment grade and unrated bonds.
- The fund mitigates stock-specific risk by holding a diversified portfolio of investments, so that no individual investment can in isolation have an undue impact on overall performance. In addition, where possible within the yield objective of the fund, investments are focused on bonds where risk is mitigated by structure or a claim on assets or cashflows.

Eric Holt
Head of Credit

RLAM GOVERNMENT BOND FUND PERFORMANCE

Fund performance

	1 month (%)	Rolling 12 months (%)
RL Absolute Return Government Bond Fund Z Acc	**-0.15**	**0.01**
IA Targeted Absolute Return Sector	-0.53	-0.40
IA Targeted Absolute Return Sector: Fixed Income Only	-0.42	-1.02
SONIA (Sterling Overnight Index Average Rate)	0.06	0.44
RL Global Index Linked Bond Fund Z Inc	**-0.08**	**-0.20**
IA Global Bonds Sector	0.24	-2.08
Barclays World Government Inflation-Linked Bond Index (hedged)	-0.11	-0.18
RL Index Linked Bond Fund M Inc	**-0.49**	**-1.57**
IA UK Index Linked Gilts Sector	-0.59	-2.27
FTSE Actuaries UK Index-Linked All Stocks Index	-0.65	-1.69
RL International Government Bond Fund M Inc	**0.09**	**-1.19**
IA Global Bonds Sector	0.24	-2.08
JP Morgan Traded World ex-UK Gov't Bond Index (hedged)	0.93	-2.68
RL Short Duration Gilt Fund Z Inc	**0.00**	**-0.60**
IA UK Gilts Sector	0.08	-0.46
FTSE Actuaries UK Conventional Gilts up to 5 Years Index	0.11	-0.71
RL Short Duration Global Index Linked Bond Fund Z Inc	**0.19**	**-0.37**
IA Global Bonds Sector	0.24	-2.08
RL Short Duration Global Index Linked Composite Benchmark[1] [2]	0.20	-0.21
RL UK Government Bond Fund Z Inc	**0.12**	**-0.72**
IA UK Gilts Sector	0.08	-0.46
FTSE Actuaries UK Conventional Gilts All Stocks Index	0.16	-0.45

Past performance is not necessarily a reliable indicator of future performance. The value of investments and the income from them is not guaranteed and may go down as well as up and investors may not get back the amount originally invested.

Source: RLAM and FE, correct as of 31 August 2018. Returns quoted are net of fees.

[1]Please note that the benchmark is priced end-of-day.

[2]The composite benchmark consists of: 30% Barclays UK Government Inflation Linked Bond 1-10 year index, 70% Barclays World Government Inflation Linked Bond (ex UK) 1-10 year index (GBP hedged).

GOVERNMENT BOND MARKET REVIEW

Market highlights

Gilts

- UK gilts (all maturities) returned 0.16% in August (in sterling terms) and underperformed investment grade sterling credit, which returned 0.45%. Longer dated gilts (15 years+) lagged behind shorter dated issues (1-5 years), returning 0.07% and 0.11%, respectively. The benchmark 10-year gilt yield rose 10 basis points (bps) to 1.43% by the close of the month, and the average investment grade sterling credit spread (the yield premium over gilt yields) was stable at 1.20%.
- Relative to other developed economies, gilts were among the poorer performing conventional sovereigns (in sterling terms). Among sovereign 1 year+ issues, Canada, the US and Germany performed best, while peripheral eurozone and Japan produced negative returns.
- In terms of yields, the strong performance from the US meant that the gap between the UK 10-year gilt and the equivalent US Treasury bond narrowed somewhat from the 30-year wides seen in July, shrinking from 163bps to 143bps. Demand from pension funds and insurers continues to keep the UK yield curve inverted, with 30-year bonds yielding more than their 50-year equivalent..
- The major news in the month was the rate rise from the Bank of England (BoE). This had largely been reflected in moves seen in July, and therefore prompted little reaction from conventional or index-linked gilts. We expect returns from gilts to remain range-bound in the short-term, despite some volatility, and that the BoE will announce no further rate rises this year and before hiking once in 2019.

UK

- Index-linked UK gilts (all maturities) returned -0.65%, underperforming conventional counterparts. In a reversal of July, longer dated (15 year+) index-linked bonds were the weakest, returning -1.07%, compared with 0.24% for shorter dated (1-5 year) debt. The yield on 30-year index-linked gilts ended the month broadly unchanged at -1.52%, while yields on 10-year and 5-year issues fell back slightly to -1.76% and -2.09%, respectively.
- UK 10-year breakeven (implied) inflation rates held to a narrow range in August, ending the month unchanged at 3.05% after touching highs of 3.09%.

Overseas

- The main theme of the month was a modest risk-off move. This was prompted by a number of factors. Emerging market concerns over Turkey and Argentina were one element, as were renewed concerns over Italy, where discussions around increased budget deficit levels caused yields to spike sharply higher. Towards the end of the month, Italian yields had surpassed the levels seen around the election in May, reaching their highest since 2014.
- Given this backdrop, it was little surprise that yields fell in safe haven markets, with Canada, Germany, Sweden and the US all seeing 10-year yields fall by around 10bps. Peripheral markets were the worst performing, with Spanish and Italian government bonds returning -0.62% and -3.18% for the month.
- Global index-linked sovereign bonds recorded a small negative return in August. 10-year US Treasury Inflation Protected Securities modestly outperformed equivalent UK index-linked gilts; the yield spread between the two narrowed by 2bps to 235bps. The yield on benchmark 10-year conventional US Treasury bonds stood at 2.86% at the end of August, while the equivalent TIPS yield was at 0.77% and 10-year breakeven (implied) inflation rates were at 2.09%.

ROYAL LONDON ABSOLUTE RETURN GOVERNMENT BOND FUND

Portfolio commentary

- The fund underperformed the cash benchmark by around 18bps in August, with year-to-date returns 17bps behind the benchmark. Curve positioning was the key detractor, with duration and inflation positions also dragging on performance, offsetting the impact of the positive contribution from cross-market positions.
- Government bond market moves were centred on emerging market risk (Turkey and Argentina), the Bank of England rate hike early in the month and concerns over Italian budget and the potential impact on deficit.
- In yield curves, we were positioned for a flatter curve in the UK, and steepening in the US. With curves steeper in the UK and flatter in the US, this stance was negative for performance. In addition, our short duration stance was also negative as the flight to safety seen over the month pushed core market yields lower, with curves steepening in the eurozone and UK.
- In cross market positions, our US vs Canada and Germany vs France positions both performed well.
- With markets generally more muted during the summer, activity was also somewhat lower, focusing on taking profits on a number of positions while using recent moves to add to risk selectively. We took profits on our US / Canada and Germany / France cross market positions, also trimming US / UK and Germany / UK real yield positions. With Italian 10-year yields reaching their highest levels since 2014, we added a modest Italy vs Germany bias.
- We used the strength in Germany and the US to add to our duration short, while adding to UK bonds after the rate hike. In terms of curve positions, we added to our flattening bias in the UK and Japan, selling 10-year bonds to buy equivalents of 30 years or more. Finally on inflation, we cut our exposure to the UK, reducing this in Germany and the US after strong performance.

Investment outlook

- In overseas government bonds, we believe the global economy will to continue to grow over the near term, and that core government bond yields will rise over 2018 as monetary policy support is gradually withdrawn. In terms of political risks, the ongoing Brexit negotiations may result in intermittent jolts.
- We still believe that inflation in Japan is priced too cheaply, and we will run long breakeven positions. Against this, though, we believe that UK inflation has now peaked; with the rise in sterling, we would expect UK breakeven rates to come under pressure at the 10-year point of the curve. With no long linker supply before September, we would expect longer dated UK inflation to reverse part of the fall seen this year and support long-dated index-linked bonds on the UK curve.
- With the prospect of a rate rise growing in the UK and low yield valuations, the duration short in the fund is expressed in the 10-year sector of the UK.
- With little UK conventional long supply over the third quarter, we are long cash gilts and index-linked bonds relative to swaps.

Key views within the fund

- The fund is short duration, predominantly in the UK and France, by around one year. The fund is short UK and European inflation relative to the US, particularly as we believe UK inflation has peaked whilst US CPI is expected to stay above 2.5% this year.

ROYAL LONDON ABSOLUTE RETURN GOVERNMENT BOND FUND

Key views within the fund continued

- We are underweight UK forwards (the UK curve looks too flat with too little inflation, term and political risk premium priced in). European curves look too steep, with rates due to rise next year.
- The fund is underweight UK real yields in the 10-year space relative to the US, with spreads in excess of 250bps.
- We have curve steepeners in Canada and the US, offset by curve flatteners in Europe and the UK.
- The fund is overweight the US relative to the UK and Europe.
- We believe UK swaps are expensive and are running long cash positions in gilts and index-linked bonds relative to interest rate swaps and inflation swaps.

Paul Rayner
Head of Alpha Strategies

ROYAL LONDON GLOBAL INDEX LINKED BOND FUND

Portfolio commentary

- Duration positioning was a small positive for the fund over the month. We started the month -0.2 years short duration, using market weakness to trim the scale of the position, before reinstating some of this later in the month to end August unchanged at -0.2 years short.
- In curve positioning, there was some steepening in the curve – driven by demand at the short end on investor concerns around a no-deal Brexit, while the long end struggled due to subdued demand from pension fund buyers. We continue to believe that the short end is overpriced relative to longer maturities, and therefore used the move as an opportunity to add modestly to our curve flattening position.
- Cross-market, our underweight in the UK was the main positive, notably against our US positioning. The exposure moved in our favour early in the month and we took profits. We added Italian index-linked government bonds during the month, first to take our positioning to neutral, after the bonds had performed poorly, but then moving overweight later on as we felt that the continued weakness had gone too far, and this also contributed to performance. We took profits on our German position after strong performance against the UK. Our Japanese positioning was a small negative after a sell-off in breakevens. However, we continue to believe that Japanese bonds offer good value and therefore used the weakness to add to our position.
- Global inflation-linked sovereigns returned -0.04% (Barclays World Government Inflation Linked Bond Index), outperforming UK index-linked gilts, which returned -0.65% (FTSE Actuaries, all maturities). Among 10-year inflation linked issues, Germany and the US outperformed the UK.

Investment outlook

- We expect real yields to continue to rise, led by shorter dated maturities. We anticipate no further rate rises by the Bank of England (BoE) in 2018 and two further hikes by the US Federal Reserve. This view will be dependent on the outcome of Brexit negotiations and economic indicators. We will continue to trade tactically to take advantage of intra-day volatility, which remains high.
- A noticeable trend over the past year has shown UK ultra-long dated bonds falling out of favour, and we expect this to continue as pension fund demand appears to be shifting towards the 30-year sector. After the recent strong performance of ultra-long bonds, this position has been neutralised.
- We believe global inflation-linked bonds offer better value than UK equivalents, and will be looking for both strategic and tactical opportunities for cross-market trades versus the UK in 2018, which we expect to arise from central bank comments, political events, and supply activity.
- We believe that UK breakeven rates now fully price in the future rise in inflation and we expect them to fall, particularly in shorter dated maturities.

Key views within the fund

- The fund's duration is shorter than the benchmark. We expect inflation to fall later in the year, and we would expect this to put pressure on the 10-year sector.
- There is an abundance of supply due in the third quarter, but predominantly in conventional gilts. The increase in net supply, combined with the expected base rate rise by the Bank of England, should lead to higher yields. Volatility is providing ample opportunities to add value by tactically trading within ranges of inflation-linked bonds.
- The fund remains long US inflation-linked bonds, with real yields 250bps higher than the UK as at the end of August, and overweight in Japan.

Paul Rayner
Head of Alpha Strategies

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Craig Inches
Head of Rates and Cash

ROYAL LONDON INDEX LINKED BOND FUND

Portfolio commentary

- Duration positioning was a small positive for the fund over the month. We started the month -0.2 years short duration, using market weakness to trim the scale of the position, before reinstating some of this later in the month to end August unchanged at -0.2 years short.
- In curve positioning, there was some steepening in the curve – driven by demand at the short end on investor concerns around a no-deal Brexit, while the long end struggled due to subdued demand from pension fund buyers. We continue to believe that the short end is overpriced relative to longer maturities, and therefore used the move as an opportunity to add modestly to our curve flattening position.
- Cross-market, our position in US 10-year linkers versus the UK was positive for performance. The exposure moved in our favour early in the month and we took profits, which proved helpful as some of the move unwound in the second half, and we were able to put some of the position back on. We also bought German index-linked bonds as the long end of this market weakened following the European Central Bank's guidance on the ending of QE, selling these before the end of the month following strong performance.
- Our cross-market positioning was the main positive for performance in August. Our position in US 10-year Treasury Inflation Protected Securities (TIPS) helped performance in July, and this was again helpful in August. Given the reduction in yield differentials between the two seen in recent months, we further trimmed our exposure to the US. We also sold our position in German index-linked bonds after these also outperformed the UK

Investment outlook

- We expect real yields to continue to rise, led by shorter dated maturities. We anticipate no further rate rises by the Bank of England (BoE) in 2018 and two further hikes by the US Federal Reserve. This view will be dependent on the outcome of Brexit negotiations and economic indicators. We will continue to trade tactically to take advantage of intra-day volatility, which remains high.
- A noticeable trend over the past year has shown UK ultra-long dated bonds falling out of favour, and we expect this to continue as pension fund demand appears to be shifting towards the 30-year sector. After the recent strong performance of ultra-long bonds, this position has been neutralised.
- We believe global inflation-linked bonds offer better value than UK equivalents, and will be looking for both strategic and tactical opportunities for cross-market trades versus the UK in 2018, which we expect to arise from central bank comments, political events, and supply activity.
- We believe that UK breakeven rates now fully price in the future rise in inflation and we expect them to fall, particularly in shorter dated maturities.

Key views within the fund

- The fund's duration is shorter than the benchmark. We expect inflation to fall later in the year, and we would expect this to put pressure on the 10-year sector.
- There is an abundance of supply due in the third quarter, but predominantly in conventional gilts. The increase in net supply, combined with the expected base rate rise by the Bank of England, should lead to higher yields. Volatility is providing ample opportunities to add value by tactically trading within ranges of inflation-linked bonds.
- The fund remains long US inflation-linked bonds, with real yields 250bps higher than the UK as at the end of August.
- With the next long-dated index-linked issuance not due until September, and most gilt issuance over the summer focused on 10-year bonds, we expect the real curve to flatten.
- The fund ended August long 25-year+ maturities relative to the benchmark and underweight in the 15-year sector.

Paul Rayner
Head of Alpha Strategies

Craig Inches
Head of Rates and Cash

ROYAL LONDON INTERNATIONAL GOVERNMENT BOND FUND

Portfolio commentary

- Portfolio duration ended August at -0.4 years short versus the benchmark, having begun the month -0.35 years short. Overall yield moves were generally fairly modest during the month, and fund activity remained quieter than usual. We took profits on curve-flattening trades in Germany and France, and sold Dutch bonds against Germany to capitalise on outperformance.
- The fund's overall short duration positioning had a small negative effect on performance, as yields on benchmark 10-year government bonds in core markets generally fell slightly, while yields in peripheral eurozone markets were higher.
- In terms of yield curve positioning, we took profits on our Japanese steepener position after the long end of the curve underperformed. Given the scale of the move, we switched to a small flattener position, as we believe that this may reverse somewhat in the coming weeks.
- In cross-market trades, we sold Belgian 35s against French 36s. This was a position we instigated in the Spring following strong outperformance by France took relative yields to attractive levels. With the position having performed well, we took profits. With peripheral bonds performing poorly on concerns over the Italian budget, we took advantage of higher yields to add to our position in Spain, moving to overweight.

Investment outlook

- We expect global government bond yield to continue to rise, led by shorter dated maturities. We anticipate no further rate rises by the Bank of England (BoE) in 2018 and two further hikes by the US Federal Reserve. This view will be dependent on the outcome of Brexit negotiations and economic indicators.
- We continue to take both tactical and strategic positions in the portfolio, where appropriate to the fund's risk and return objectives. We consider the majority of developed market government bonds to be expensive. Yields should rise over the next 18 months.
- Events in the eurozone, where the situation remains unpredictable, will continue to affect market sentiment. The European Central Bank's quantitative easing programme remains in place until the end of the year, making current yields on eurozone government bonds unattractive. Political risks within the region persist, and volatility is likely to present trading opportunities. We will continue to trade tactically to take advantage of intra-day volatility.

Key views within the fund

- The fund has a short duration position, as we believe global government bond yields remain expensive. This position continues to be actively managed and will evolve as market volatility permits.
- The majority of the fund's overall short duration position is in European government bonds; within this, the underweights are concentrated in semi-core Europe (France) and Italy, offset by an overweight position in Spain. The fund has a small positive exposure to the US and Japan.
- The fund is positioned for higher yields at the shorter end of across the curve in the majority of markets (the exception being the US), with a preference to be underweight 5-year to 15-year maturity bonds, and tilted towards neutral or overweight exposures to longer dated bonds.

Paul Rayner
Head of Alpha Strategies

Gareth Hill
Fund Manager

ROYAL LONDON SHORT DURATION GILT FUND

Portfolio commentary

- Portfolio duration ended August virtually unchanged at -0.45 years short versus the benchmark, having begun the month at -0.5%. We retained our 2s-5s steepening bias. Duration and yield curve positioning had little impact on performance over the month. Activity was relatively muted over the period. We reduced duration marginally ahead of the rate increase in early August.
- The fund has no exposure to overseas markets.
- The fund's modest exposure to highly rated sterling corporate bonds was a small help for performance over the month. There was little change in spreads, but the higher carry these bonds provide was supportive.

Investment outlook

- We expect global government bond yields to rise gradually from current levels. We anticipate no further rate rises by the Bank of England (BoE) in 2018 and two additional hikes by the US Federal Reserve.
- We continue to take look for tactical and strategic positions in overseas government bonds, where appropriate to the fund's risk and return objectives.
- We continue to believe that both gilt and index-linked real yields do not reflect longer term fundamentals, and as such, we will maintain a strategic short duration position relative to the benchmark.

Key views within the fund

- The portfolio's duration is -0.45 years shorter than the benchmark. We expect a gradual rise in UK government bond yields, with 5-year yields rising towards 1.3% by the end of 2018.
- The fund is positioned for higher yields and steeper curves at the very front end.
- The portfolio has allocations to high quality corporate bonds, which we expect to outperform gilts in a low-yielding environment.
- The fund has no exposure to overseas markets.
- The portfolio may look to trade index-linked gilts to take advantage of mispricing opportunities, but currently has no exposure.

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Craig Inches
Head of Rates and Cash

Ben Nicholl
Assistant Fund Manager

ROYAL LONDON SHORT DURATION GLOBAL INDEX LINKED BOND FUND

Portfolio commentary

- Duration positioning was a small positive for the fund over the month. We started the month -0.2 years short duration, using market weakness to trim the scale of the position, before reinstating some of this later in the month to end August unchanged at -0.2 years short.
- In curve positioning, there was some steepening in the curve – driven by demand at the short end on investor concerns around a no-deal Brexit, while the long end struggled due to subdued demand from pension fund buyers. This had little impact on performance over the month.
- Cross-market, our underweight in the UK was the main positive, notably against our US positioning. The exposure moved in our favour early in the month and we took profits. We added Italian index-linked government bonds during the month, first to take our positioning to neutral, after the bonds had performed poorly, but then moving overweight later on as we felt that the continued weakness had gone too far, and this also contributed to performance.
- Global inflation-linked sovereigns returned -0.04% (Barclays World Government Inflation Linked Bond Index), outperforming UK index-linked gilts, which returned -0.65% (FTSE Actuaries, all maturities). Among 10-year inflation-linked issues, Germany and the US outperformed the UK.

Investment outlook

- We expect real yields to continue to rise, led by shorter dated maturities. We anticipate no further rate rises by the Bank of England (BoE) in 2018 and two further hikes by the US Federal Reserve. This view will be dependent on the outcome of Brexit negotiations and economic indicators. We will continue to trade tactically to take advantage of intra-day volatility, which remains high.
- We believe global inflation-linked bonds offer better value than UK equivalents, and will be looking for both strategic and tactical opportunities for cross-market trades versus the UK in 2018, which we expect to arise from central bank comments, political events, and supply activity.
- We believe that UK breakeven rates now fully price in the future rise in inflation and we expect them to fall, particularly in shorter dated maturities.

Key views within the fund

- The fund's duration is shorter than the benchmark. We expect inflation to fall later in the year, and we would expect this to put pressure on the 10-year sector.
- There is an abundance of supply due in the third quarter, but mainly in conventional gilts. The increase in net supply, combined with the expected base rate rise, should lead to higher yields. Volatility is providing ample opportunities to add value by tactically trading within ranges of inflation-linked bonds.
- The fund remains long US and Italian inflation-linked bonds, and is currently underweight 0 to 5-year and slightly overweight 5-year to 10-year maturities.

Paul Rayner
Head of Alpha Strategies

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Craig Inches
Head of Rates and Cash

ROYAL LONDON UK GOVERNMENT BOND FUND

Portfolio commentary

- Portfolio duration ended August at -0.5 years short versus the benchmark, having begun the month at -0.6. The fund's overall duration positioning did not move significantly over the month. Early in the period we reduced the scale of the short stance, then reinstated this after the rate hike as the market rallied. In overall terms, the fund's short duration position was a small negative for performance. Curve positioning was also a small negative as we held a flattening bias. However, we continue to feel that short end yields look relatively unattractive and retain the position. Our positioning in 20-year gilts was positive as these performed well, and we took advantage of this to take profits, reinvesting in the 30-year area as this had lagged.
- Looking at cross-market and inflation exposure, we started the month with an overweight in US Treasuries and Treasury Inflation Protected Securities (TIPS). The US outperformed the UK over the month, this position was beneficial for fund performance on the month and we have now sold the position. The fund also retains a modest exposure to 30 year breakevens, but this had a negligible effect on performance.
- The fund's modest exposure to highly rated sterling corporate bonds was a small help for performance over the month. There was little change in spreads, but the higher carry these bonds provide was supportive.

Investment outlook

- We expect global government bond yields to rise gradually from current levels. We anticipate no further rate rises by the Bank of England (BoE) in 2018 and two further hikes by the US Federal Reserve.
- We continue to look for opportunities to take both tactical and strategic positions in overseas government bonds, where appropriate to the fund's risk and return objectives.
- We continue to believe both gilt and index-linked real yields do not reflect longer term fundamentals, and as such, we will maintain a strategic short duration position relative to the benchmark and hold overseas bonds to mitigate capital losses.

Key views within the fund

- The portfolio's duration is -0.5 years shorter than the benchmark. We expect a gradual rise in UK government bond yields, with 10-year yields rising towards 1.8% by the end of 2018.
- The fund is positioned for higher yields across the curve, with a preference to be underweight 5-year maturity bonds versus longs.
- The fund currently has no overseas exposure, but will look for opportunities to do so on a relative basis. We expect UK yields to underperform their global peers as the BoE moves rates away from emergency levels, helped by continued improvement in economic fundamentals, and Brexit pessimism recedes.
- The portfolio has allocations to longer dated, high quality corporate bonds, which we expect to outperform gilts in a low-yielding environment.
- The portfolio continues to tactically trade index-linked gilts to take advantage of mispricing opportunities.

Craig Inches
Head of Rates and Cash

Paul Rayner
Head of Alpha Strategies

RLAM GLOBAL HIGH YIELD FUND PERFORMANCE

Fund performance

	1 month (%)	Rolling 12 months (%)
RL Global High Yield Bond Fund A Inc	**0.58**	**0.33**
RL Global High Yield Bond Fund M Inc	**0.61**	**0.71**
RL Global High Yield Bond Fund Z Inc	**0.63**	**0.97**
IA Sterling High Yield Sector	0.34	1.60
ICE BofA ML BB-B Global Non-Financial High Yield Constrained Index	0.13	0.49
RL Short Duration Global High Yield Bond Fund A Inc	**0.33**	**1.14**
RL Short Duration Global High Yield Bond Fund M Inc	**0.37**	**1.54**
RL Short Duration Global High Yield Bond Fund Z Inc	**0.38**	**1.64**
IA Sterling High Yield Sector	0.34	1.60
3 month LIBOR	0.07	0.58

Past performance is not necessarily a reliable indicator of future performance. The value of investments and the income from them is not guaranteed and may go down as well as up and investors may not get back the amount originally invested.

Source: RLAM and FE, correct as of 31 August 2018. Returns quoted are net of fees.

GLOBAL HIGH YIELD MARKET REVIEW

Market highlights

The global high yield benchmark returned 0.13% in August. By rating, B rated bonds outperformed higher rated and lower rated issues, returning 0.20%; that compares with respective returns of 0.15% and 0.09% for debt rated CCC and lower and for BB rated bonds. In terms of maturity, medium dated issues lagged behind shorter dated and longer dated debt.

Global high yield new issuance in August came to about the equivalent of $15 billion, rising modestly from the prior month; however, that was down substantially from a year earlier. The US accounted for the majority of activity. Over 2018's first eight months, new issuance fell by more than a third from the previous year.

The global high yield rolling 12-month default rate was 1.75%, similar to the prior month. Regionally, default rates were 2.57% in the US, 0.89% in Europe and 0.99% in emerging markets. The global default rate is noticeably lower compared with the year-earlier level of 2.67%, and the most marked decline took place in emerging markets. Significant defaults in the market in August included Dandong Port Group, which missed principal and interest payments on debt. The company operates a port in northeast China that is a key conduit for trade with North Korea; activity has slowed after China restricted exports to North Korea in line with United Nations sanctions. Dandong was not held in the fund. No defaults were experienced in the fund's holdings.

All figures are based on ICE BofA Merrill Lynch data

ROYAL LONDON GLOBAL HIGH YIELD BOND FUND

Portfolio commentary

- The fund outperformed the benchmark in August on a gross basis, returning 0.63% versus the benchmark return of 0.13%.
- The global high yield market produced a moderate positive return in August. The high level of carry associated with the asset class was somewhat offset by emerging market concerns, mainly in relation to Turkey and Argentina. New issuance remained subdued and at a level significantly below the previous year.
- Broadly speaking, US economic data missed expectations during the month, after a prolonged period of positive surprises. For the second month in a row, European data missed by a lower margin than recently witnessed. Overall yields in the market were broadly unchanged, as wider credit spreads were offset by lower underlying yields on government bonds.
- Index performance in August was influenced by positive income return of 0.48%, while the price and hedging returns were negative at -0.26% and -0.09%, respectively.
- The yield on the fund's benchmark index ended August at 5.7%, compared with 5.6% at the beginning of the period. The fund yield stood at 5.4% at month end, and its duration was shorter than that of the index.

Investment outlook

- We continue to believe that global high yield bonds are attractive on a spread basis and that they overcompensate for default risk, while their level of income generation is also appealing on a relative basis.
- The current growth and rate environment provides a moderate default climate with ongoing refinancing opportunities.

Key views within the fund

- The fund's objective is to achieve a combination of capital growth and income. The fund seeks to achieve its investment objective by outperforming its benchmark, the BofA Merrill Lynch BB-B Global Non-Financial High Yield Constrained index, 100% hedged to sterling, by 1% per annum over rolling three year periods.
- The fund seeks to mitigate stock specific risk by holding a diversified portfolio of investments, so that no individual investment can, in isolation, have an excessive adverse impact on overall fund performance. Currency risk associated with holdings of bonds is hedged through the use of forward currency transactions.
- We expect bouts of market volatility due to market expectations surrounding the tightening of monetary policy by the Fed. As such, we believe bonds with near-term catalysts, which mitigate market risk, are an important attribute underpinning investment performance over the medium term.

Azhar Hussain
Head of Global High Yield

Stephen Tapley
Global High Yield Fund Manager

ROYAL LONDON SHORT DURATION GLOBAL HIGH YIELD BOND FUND

Portfolio commentary

- The fund outperformed the benchmark on a gross basis in August, returning 0.38% versus the benchmark return of 0.07%.
- The global high yield market produced a moderate positive return in August. The high level of carry associated with the asset class was somewhat offset by emerging market concerns, mainly in relation to Turkey and Argentina. New issuance remained subdued and at a level significantly below the previous year.
- Broadly speaking, US economic data missed expectations during the month, after a prolonged period of positive surprises. For the second month in a row, European data missed by a lower margin than recently witnessed. Overall yields in the market were broadly unchanged, as wider credit spreads were offset by lower underlying yields on government bonds.
- At month-end, the yield on the fund was 4.1%, with an expected maturity of 0.8 years.

Investment outlook

- We continue to believe that global high yield bonds are attractive on a spread basis and that they overcompensate for default risk, while their level of income generation is also appealing on a relative basis.
- The current growth and rate environment provides a moderate default climate with ongoing refinancing opportunities.

Key views within the fund

- The fund is diversified, with over 300 holdings, in order to improve overall portfolio liquidity and to reduce the effect on overall fund performance of any deterioration in the creditworthiness of an individual holding.

Azhar Hussain
Head of Global High Yield

Stephen Tapley
Global High Yield Fund Manager

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