



January Bond Bulletin

Jonathan Platt, Head of Fixed Interest

January saw global bond markets weaken on fears of higher inflation. In the UK, government bonds returned -1.9% whilst credit returned -0.5%, the relative outperformance of credit bonds reflecting the narrowing of spreads over the month. Index-linked bonds, which had outperformed in Q4 2010, underperformed conventional gilt and credit, giving a monthly return of -2.2%.

The main focus in January was on the UK GDP data for Q4 2010, which unexpectedly showed a decline of 0.5%. Whilst the adverse weather conditions were undoubtedly unhelpful, the data indicated a significant loss in momentum in the latter part of 2010. In our opinion, commentators calling for an early rate rise to quell inflation miss two important points. First, economic growth remains fragile and, secondly, the inflation problem is not domestically generated and any tightening of monetary policy would only work through a strengthening of the exchange rate – a development which would be unwelcome.

Within government funds, we generally increased duration through reducing exposure to near cash proxies and purchasing five year bonds. Activity in credit funds was relatively subdued although we participated in several new issues e.g. Experian, Credit Agricole, Societe Generale and a covered bond issue from Nationwide was purchased

Our economic view for 2011 remains unchanged: growth will be sluggish and inflation will not be a problem. The increase in duration during the month meant that government funds ended the month about 0.5 years above benchmark.

RLAM funds are generally positioned for an improvement in credit markets. We expect that the UK yield curve will flatten in 2011 and still prefer longer dated bonds.

Source: rlam as at 3 February 2011 unless otherwise stated.

This article is for professional customers only. The views expressed are the author's own and do not constitute investment advice.

rlam is a marketing brand including the following companies: Royal London Asset Management Limited registered in England & Wales number 2244297; Financial Services Authority (FSA) register number 141665. Royal London Pooled Pensions Company Limited registered in Scotland number SC048729; FSA register number 110456. Royal London Unit Trust Managers Limited registered in England & Wales number 2372439; FSA register number 144037. Royal London Cash Management Limited registered in England & Wales number 19632; FSA register number 121844. All of the above are authorised and regulated by the Financial Services Authority.

It also includes Royal London Asset Management Bond Funds Plc registered in Ireland number 364259 and regulated by the Central Bank of Ireland. All these companies are subsidiaries of The Royal London Mutual Insurance Society Limited registered in England and Wales number 0099064 (FSA registration number 117672). Head office: 55 Gracechurch Street, London EC3V 0RL.

Our reference: 046-PRO-02/2011-SS