ASSET MANAGEMENT

ROYAL LONDON UK GOVERNMENT BOND FUND

Quarterly Report 30 June 2019

For professional clients only, not suitable for investors

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ROYAL LONDON UK GOVERNMENT BOND FUND

Asset split

	Fund (%)	Benchmark[1] (%)
Conventional credit bonds[2]	7.5	0.0
Index linked credit bonds	0.0	0.0
Sterling conventional gilts	88.2	100.0
Sterling index linked gilts	0.0	0.0
Foreign conventional sovereign	1.4	0.0
Foreign index linked sovereign	3.0	0.0
Derivatives	0.0	0.0
Other	0.0	0.0

Fund data

	Fund	Benchmark[1]
Duration[3]	11.3 years	11.5 years
Gross redemption yield[4]	1.06%	1.02%
No. of stocks	43	46
Fund size	£885.0m	-

Source: RLAM, based on the Z share class. Launch date: 30.01.1990.

[1]Benchmark: FTSE® Actuaries All Stock Gilts Index.

[2]Conventional credit bond allocation includes exposure to non-sterling credit bonds and CDs, where applicable.

[3]excluding cash

[4]The gross redemption yield is calculated on a weighted average basis

Performance

	Fund (%)	Benchmark[1] (%)	Relative (%)
Q2 2019	**1.63**	**1.31**	**0.32**
Year-to-date	5.16	4.74	0.42
Rolling 12 months	5.18	4.90	0.28
3 years p.a.	2.43	1.96	0.47
5 years p.a.	5.43	5.54	-0.11
10 years p.a.	5.43	5.25	0.17
Since inception p.a. 30.04.2010	5.45	5.14	0.31

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.

All performance figures stated gross of fees and tax unless otherwise stated.

Source: RLAM, based on the Z share class.

[1]Benchmark: FTSE® Actuaries All Stock Gilts Index.

On 1 May 2012, the Royal London UK Government Bond Fund (Class B) was renamed the Royal London UK Government Bond Fund (Class Z). The Z share class was launched on 30 April 2010. All performance after this date is for the Z share class. All performance for periods prior to 30 April 2010 is for the Royal London UK Government Bond Fund (Class A).Therefore the performance shown in this table is a merged return which includes the historical 'A' share return for the periods to 30 April 2010, before the Z share existed. If you were invested in the fund prior to this, your investment was in the A shares. If you require separate performance solely for the Z shares since 30 April 2010, please contact your Client Account Manager.

Performance for the Royal London UK Government Bond Fund is based on pricing at noon, while index performance is based on pricing at close of business, preventing direct performance comparison. The significance of this timing discrepancy is likely to be greater for shorter measurement periods.

As of 6 April 2017, the UK Government announced that funds paying interest distributions will be required to pay those distributions gross of tax.

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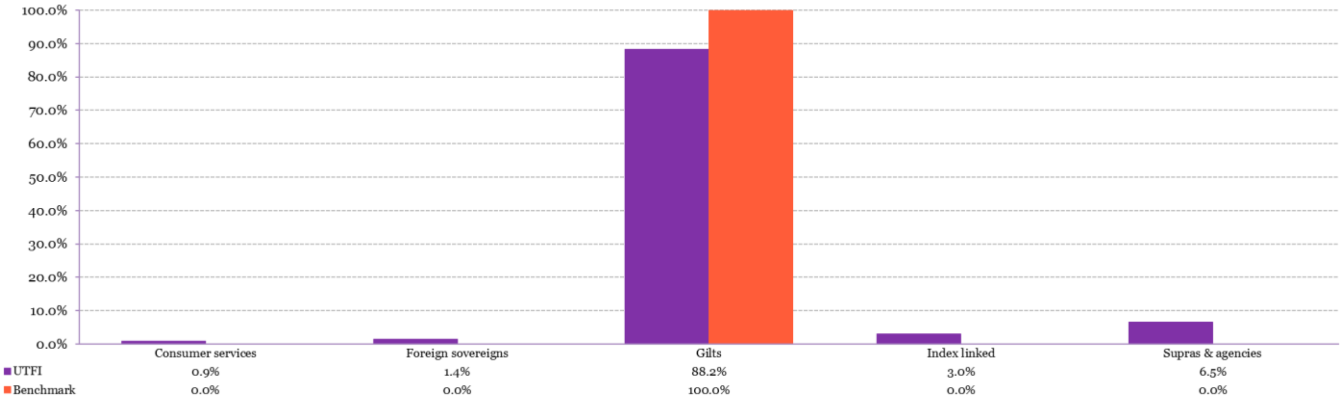
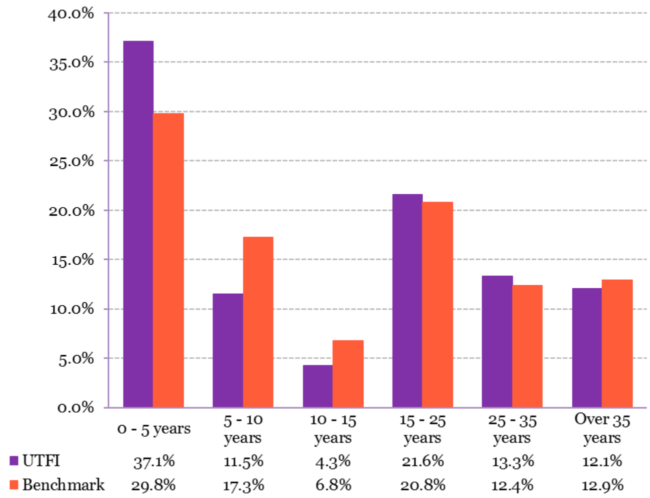
Sector breakdown

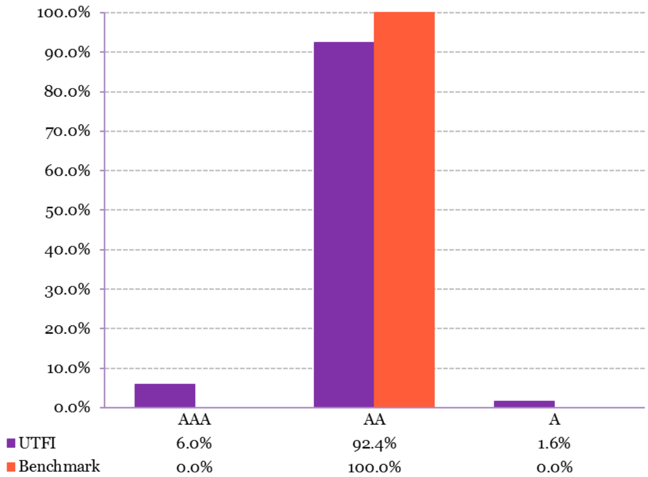


Source: RLAM. Figures in relation to your portfolio exclude the impact of cash held, although they do include the impact of CDs if held within your portfolio

Maturity profile



Credit breakdown



Ten Largest Holdings

	Weighting (%)
UK Treasury 1.75% 2019	20.6
UK Treasury 1.5% 2047	8.2
UK Treasury 4.75% 2020	5.6
UK Treasury 4.5% 2042	5.4
UK Treasury 2.25% 2023	5.4
UK Treasury 1.75% 2037	5.3
UK Treasury 0.75% 2023	3.8
UK Treasury 4.25% 2036	3.0
UK Treasury 4.5% 2034	2.9
UK Treasury 1.75% 2057	2.9
Total	**63.1**

Source: RLAM. Figures in the table above exclude derivatives where held, subject to rounding.

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Portfolio review

	What we thought	What we did	What happened	Effect on portfolio
Asset allocation	Highly-rated sterling credit bonds offered attractive yields relative to conventional gilts.	The fund retained its exposure to highly-rated sterling credit over the quarter, with an emphasis on AA rated supranationals.	Investment grade sterling credit bonds outperformed UK government bonds over the quarter.	Off-benchmark exposure to sterling credit bonds benefitted relative performance due to their higher 'carry' and credit spreads narrowing.
Duration	We expected a gradual increase in UK government bond yields.	We held a short duration stance throughout the quarter, looking for opportunities to increase or decrease the position tactically on market volatility.	The yield on the 10-year gilt fell by 17 basis points to 0.83%, extending last quarter's fall.	Strategically, the short duration position was negative for performance, but this effect was somewhat offset by gains from tactical positions as we took advantage of market extremes.
Yield curve	We believed that the short end of the curve looked expensive relative to Bank of England base rates, and that maturities beyond 30-years were expensive due to yield curve inversion.	We were underweight up to five-year gilts, and maintained a steepening bias between 30-year gilts and ultra-long dated issues.	Gilt yields fell relatively little at the short and long ends of the curve, with the curve inversion beyond 30-year maturities largely unchanged.	Curve positioning had a positive effect on performance, mitigating some of the impact of the fall in yields across the curve.

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Fund activity

- The fund actively traded its duration positioning within a range of -0.3 years to -0.7 years short versus the benchmark, ending the quarter around -0.5 years short (including the impact of cash holdings on duration). The fund's long held strategic short duration position was negative for performance, although the effect was somewhat offset by gains from tactical trading as we took advantage of market volatility.
- The fund held a bias towards short duration positioning throughout the quarter, based on our view that gilt yields are too low. Our economist's view remains that the next move in Bank of England (BoE) base rates will be up, although our forecast hike has been pushed back a year into the second half of 2020. This view is conditional upon the UK leaving the European Union with a deal. We would expect gilt yields to rise in such an environment. Yields fell in the second quarter, however, as UK and global economic data continued to deteriorate and trade tensions escalated. As part of a global rally in government bonds, the 10-year gilt yield ended the quarter at just 0.83%, having been 1.00% at the end of March.
- The fund's curve positioning provided some protection against the fall in yields as we were short in the weakest performing areas of the curve. We were short at the front end of the curve, due to the relatively limited capacity for short-dated yields to fall further given how close they were to BoE base rates. We also held a steepening bias at the long end of the curve, being overweight 30-year maturities and underweight ultra-long (50-year maturity) gilts.
- Trading in overseas markets was positive for performance over the quarter, as the fund tactically traded supply events. We closed our position in US TIPS and bought and sold German, French and Japanese government bonds. We also bought 10-year Spanish government bonds on an outright basis, taking some profits before switching them into the 30-year Spanish government bond. We moved into the longer-dated issue correctly anticipating that curves would flatten in Europe and that there would be a grab for high yielding assets.
- The fund held no UK inflation exposure over the quarter.
- The fund's modest exposure to highly rated sterling corporate bonds had a positive effect on returns over the quarter, reflecting their higher carry and credit spreads modestly tightening overall. There were no additions to or sales from the portfolio during the quarter.

Key views within the portfolio

- The portfolio's duration is -0.5 years shorter than the benchmark. We expect a gradual increase in UK government bond yields as the year progresses.
- The fund is positioned for higher yields, particularly at the shorter end of the curve. In longer maturity bonds the fund has a preference to be overweight 30 year maturity bonds versus 40 and 50-year maturities, where the yield curve is inverted.
- The fund has a small overseas exposure, and we continue to look for opportunities to take such positions on a relative basis. With the Royal London view that a 'no deal' Brexit will be avoided, we would 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, although held no inflation positions at the end of the quarter.

IMPORTANT INFORMATION

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