



# Royal London Short Term Money Market Fund

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Quarterly Report 31 December 2021



## Fund data

	Fund
Gross redemption yield <sup>1</sup>	0.18%
No. of issuers	39
Fund size	£3,413.5m
Weighted average maturity	0.1 years
Weighted average life	0.2 years

Source: RLAM, based on the Y Inc share class. Launch date: 22.07.1999.<sup>1</sup>The gross redemption yield is calculated on a weighted average basis. <sup>2</sup>The underlying yield aligns closely with the gross redemption yield of the fund taking in account expenses. Please see glossary for more detail. Reported yields reflect RLAM's current perception of market conventions around timing of bond cash flows. Heightened uncertainty due to the COVID 19 crisis may impact these timings for bonds with callable feature.

## Performance

	Fund (%)	Benchmark <sup>1</sup> (%)	Relative <sup>2</sup> (%)
<b>Q4 2021</b>	<b>0.03</b>	<b>0.02</b>	<b>0.01</b>
Year-to-date	0.08	0.06	0.02
Rolling 12 months	0.08	0.06	0.02
3 years p.a.	0.42	0.31	0.11
5 year p.a.	0.43	0.31	0.13
10 year p.a.	0.44	0.34	0.10
Since inception p.a. 22.07.1999	1.20	0.95	0.25

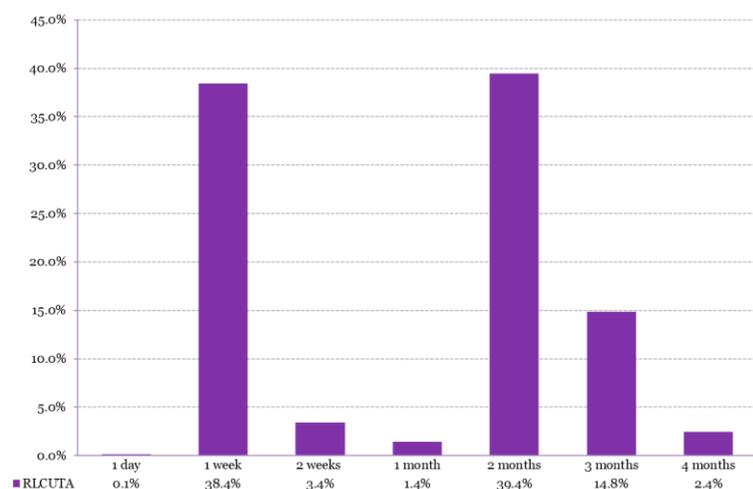
**Past performance is not necessarily a reliable indicator of future performance. The value of investments and the income from them is not guaranteed and may go down as well as up and investors may not get back the amount originally invested.** All performance figures stated gross of fees and tax unless otherwise stated. Source: RLAM, based on the Y Inc share class.<sup>1</sup>Benchmark: SONIA. Please note that this changed from 3-month LIBOR, effective March 20 2019, and is reflected in the returns shown above. As of 6 April 2017, the UK Government announced that funds paying interest distributions will be required to pay those distributions gross of tax. Following the implementation of the Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on Money Market Funds ("MMFs"), the fund is subject to the following risks: The fund is not a guaranteed investment. An investment in the fund is different from an investment in deposits. The principal invested in the fund is capable of fluctuation in value. The fund does not rely on external support for guaranteeing the liquidity of the fund or stabilising the NAV per unit or share. Any risk of loss of the principal is to be borne by the investor.

## Top ten issuers

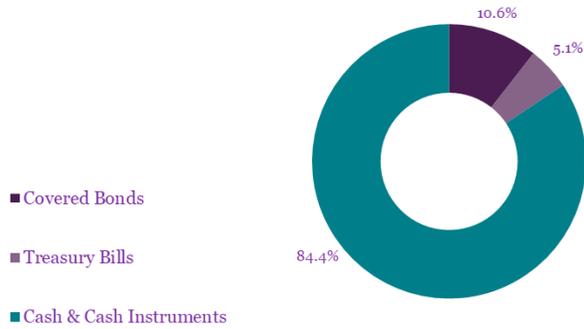
	Weighting (%)
Sumitomo Mitsui Banking Corp	9.3
Landesbank Hessen Thuringen	8.9
Nationwide Building Society	7.9
First Abu Dhabi Bank	5.6
UK Government	5.1
Toronto Dominion Bank	3.3
ABN Amro	3.2
Credit Industriel et Commercial	3.2
Natixis	3.1
Credit Agricole CIB	3.1
<b>Total</b>	<b>52.7</b>

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

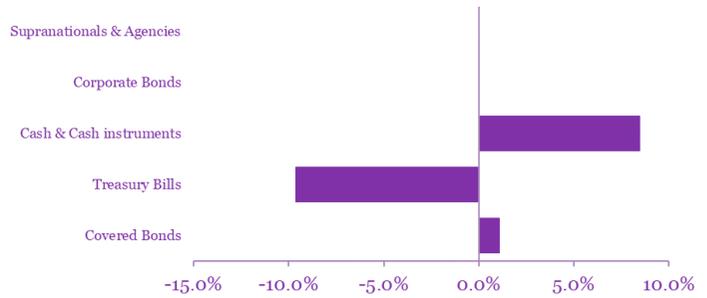
## Duration profile



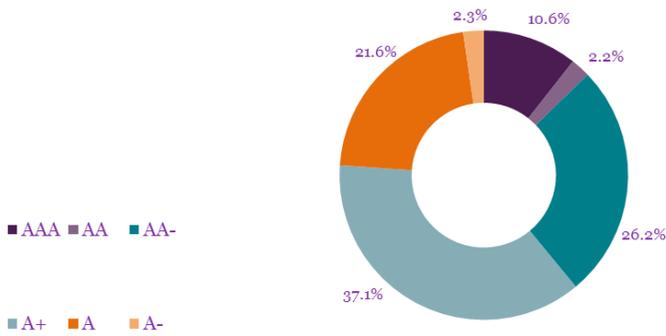
### Asset allocation profile Q4 2021



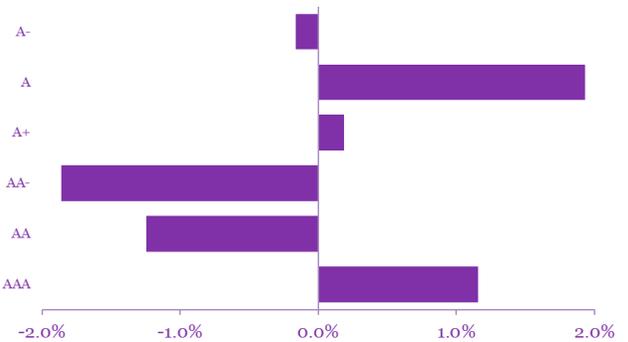
### Change since last quarter



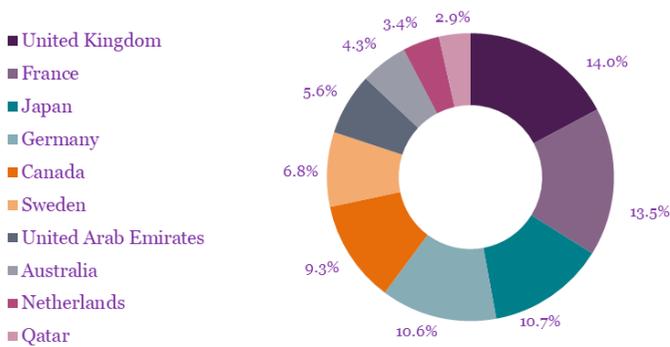
### Credit rating profile Q4 2021



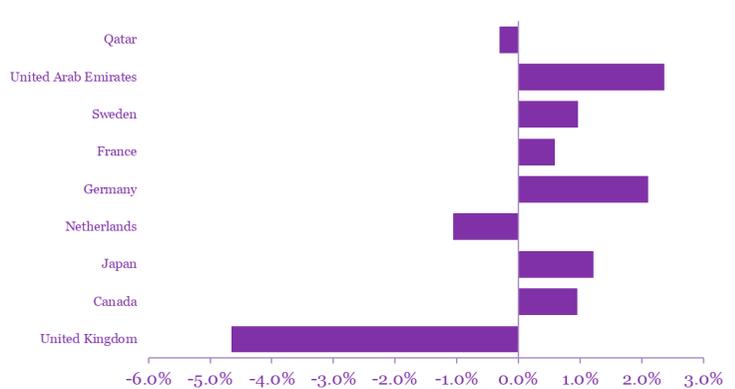
### Change since last quarter



### Top ten geographic allocation (ex gilts) Q4 2021



### Change since last quarter





## Market overview

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- Government bond and money markets were mixed in the fourth quarter, a period notable for its volatility. Markets grappled with the emergence of a new variant of Covid-19, Omicron, and experienced a surge in case numbers that led to increased restrictions on mobility across a number of countries. The quarter also saw very definite hawkish tilt from a number of central banks under pressure from persistently high global inflation data.
- In the US, messaging from the Federal Reserve (Fed) saw the removal of the term “transitory” from its inflation commentary. Fed Chair Powell gave very clear messaging regarding the likely future path of monetary policy, including a likely increase in the pace of the tapering (an increase in pace of quantitative easing (QE)), which in turn brought forward expectations of the first rate hike in the US.
- In Europe, the European Central Bank (ECB) met in December and announced what was perceived as a hawkish set of measures. It announced that the end of the Pandemic Emergency Purchase Programme (PEPP) in March 2022 will be accompanied by a doubling of its Asset Purchase Programme (APP) to €40 billion a month for the second quarter, reducing to €30bn and €20bn in the third and fourth quarters.
- In the UK, investors took meeting minutes from the September Monetary Policy Committee (MPC) meeting, and hawkish comments from Bank of England (BoE) Governor Bailey, as a signal that the base rates would rise in November. Having priced a November rate rise with near 100% certainty, markets were shocked by the MPC’s decision to leave rates unchanged by 7-2 – this, alongside concerns around the Omicron variant, led yields lower. December saw the highest CPI (inflation) print since the early 90s of 5.1%, leaving the MPC with little choice but to raise base rates to 0.25%, prompting a rise in yields.
- In UK bond markets, the benchmark 10-year gilt yield fell from 1.02% to 0.97%, leading gilts to return 2.42% on an all-maturities basis (FTSE Actuaries). The apparent stability of the gilts market is misleading, however: having risen to 1.20% in late October, the 10-year gilt yield rallied to just 0.70% on 13 December (before the Bank of England raised the UK base rate), then ending the year at 0.97%. Credit market returns were more pedestrian than gilts for the fourth quarter – sterling investment grade credit returned 0.34%, as the average sterling investment grade credit spread (the average extra yield available from a corporate bond compared with government debt of equal maturity) widened from 0.87% to 0.98%. Sterling investment grade credit returned -3.09% for the year as a whole, outperforming gilts, with the credit spread tightening by one basis point to 0.98%.
- UK money markets therefore unsurprisingly saw yields rise as well. After some 20 months trading at or just over 0.05%, SONIA jumped to 0.19%, while three-month Libor rose from 0.08% at the start of the quarter to end 2021 at 0.48%. Similarly, the longer 12-month Libor cash rate jumped from 0.37% to 0.81%. Two-year gilts, often seen as a proxy for market expectations of BoE rates, rose from 0.41% at the end of September to end the year at 0.68%.

## Performance and activity

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- Our cash funds are standalone vehicles. However, we know that many clients use a combination of these as part of a cash laddering strategy – using short maturity funds for more immediate liquidity needs and using other strategies for cash needs beyond six months or so. The return profiles of these funds will differ, but all are underpinned by a common philosophy and process. We focus on creating diversified portfolios that with high credit quality in the underlying banks. These portfolios also screen out tobacco, fossil fuel and armaments, but also factoring in ESG considerations when considering the banks that make up the majority of the portfolios. In this way we believe we create portfolios that meet client needs.
- Funds with a much greater focus on near-term liquidity such as the Short Term Money Market Fund are invested almost entirely in classic money market instruments such as treasury bills and short dated certificates of deposit, occasionally adding very short-dated, highly rated covered bonds to add incremental yield and diversification.
- Money market exposure was generally a modest positive over the quarter. Although rising yields are a headwind for money market funds (as these yields often rise faster than a portfolio can rotate into those higher yielding securities), the fact that this happened towards the end of the period was helpful.
- For most of the quarter, we focused on short-dated paper and were able to pick up a small premium over SONIA without taking undue interest rate risk. As we moved into December, we typically slow purchases in CDs, reflecting our strategy of avoiding having too much maturing paper in this month when banks are generally looking to shrink balance sheets. The majority of our activity focused on three-month maturities, including names such as **Natixis**, **Danske Bank**, **National Australia Bank** and **Santander**. We also added a short-dated covered bonds



in the secondary market when available. Purchases included Toronto Dominion Bank and Santander – both providing a small premium over SONIA, but also mitigating interest rate risk due to their floating rate structure.

## Outlook

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- The Office for Budget Responsibility forecasts CPI inflation to be around 4% through 2022 and markets are pricing two-year RPI at greater than 5%, significantly above the BoE CPI inflation target. And with wages rising, as well as a potentially tight labour market, investors are still searching for evidence to decipher whether current inflationary pressures are indeed transitory or not. As such the outlook for the gilt market remains uncertain, and we expect markets to continue hanging on every word from Bank of England commentators searching for signals regarding further interest rate rises.
- The market is 80% priced for a rate hike in February, taking the interest rate in the UK to 0.5%. With consumer price inflation above 5% (and still expected to peak higher), it would seem natural for the MPC to increase rates again. In total, the SONIA curve now suggests that there will be four rate increases in 2022. Rates have not been higher than 0.75% since 2009, and four rate increases suggests sticky inflation and /or an MPC resolutely focused on normalising rates. On balance, we think that the risk to that market forecast is on the downside, which is one reason we have been comfortable to buy one-year paper that effectively has those four rates reflected in the yield.
- A background of rising rates would be a difficult one for all cash and very short duration bond funds. Naturally with interest rates now having risen a little, and expectations of further increases already in prices, positioning around duration becomes more dynamic, rather than simply sitting as short as possible. Our strategy is to remain cautious, in keeping with the risk profile of our funds, ensuring that we continue to deliver on the security and liquidity expectations of the funds, looking for opportunities to mitigate the impact of rising yields on overall returns, while also taking advantage of market pricing in excessive rates to achieve additional yield.
- For exposure outside of these areas, our approach has always placed an emphasis on security and credit quality, both in the nature of assets we buy (such as covered bonds) but also in the way we assess credit quality, with our preference for bonds with security or covenants that we feel offer a degree of protection to investors. A high proportion of the assets in our funds are exempt from bail-in, and we will continue to favour such assets given these provide our clients with greater security.

## Find out more

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- A record number of current and prospective clients and consultants joined us online for the 2021 RLAM Investment Series (our annual client conference) between 1 and 5 November 2021. Fund managers and other in-house specialists addressed the macroeconomic environment and prospects for different asset classes, and the issues that they consider in managing their funds. There were also sessions on responsible and sustainable investing, addressing the latest developments in these fast-changing areas and considering their possible evolution. All the sessions are available to watch on demand – please visit the [RLAM Digital Insight Hub](#)
- You can find more of our thoughts on the opportunities and risks in the year ahead in our [RLAM Outlook 2022](#) document, and regular updates on our investment thinking in the *Our Views* section of [www.rlam.co.uk](http://www.rlam.co.uk)



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