# ROYAL LONDON SHORT TERM MONEY MARKET FUND

## Quarterly Report 30 June 2021

For professional clients only, not suitable for retail investors

# CONTENTS

**ROYAL LONDON SHORT TERM MONEY MARKET FUND** **3**

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## Fund data

| | Fund |
|---|---|
| Gross redemption yield[1] | 0.06% |
| No. of issuers | 46 |
| Fund size | £3,159.8m |
| 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.[1]The gross redemption yield is calculated on a weighted average basis. [2]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[1] (%) | Relative (%) |
|---|---|---|---|
| **Q2 2021** | **0.02** | **0.01** | **0.01** |
| Year-to-date | 0.03 | 0.02 | 0.00 |
| Rolling 12 months | 0.12 | 0.05 | 0.07 |
| 3 years p.a. | 0.53 | 0.39 | 0.14 |
| 5 year p.a. | 0.47 | 0.32 | 0.16 |
| 10 years p.a. | 0.47 | 0.37 | 0.11 |
| Since inception p.a. 22.07.1999 | 1.24 | 0.99 | 0.26 |

***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.*

*[1]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.*

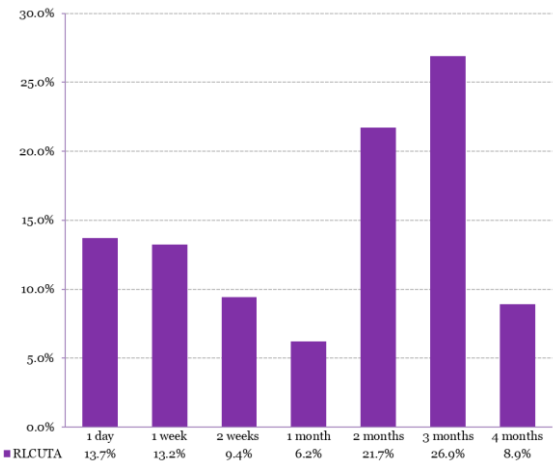
*Following the implementation of the Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on Money Market Funds ("MMFs"), the fund is subject to the following risks: The fund is not a guaranteed investment. An investment in the fund is different from an investment in 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 (%) |
|---|---|
| UK Government | 17.7 |
| Nationwide Building Society | 5.5 |
| KBC Bank | 4.0 |
| Royal Bank of Canada | 3.4 |
| BNP Paribas | 3.2 |
| Canadian Imperial Bank of Commerce | 3.2 |
| Nordea Bank AB | 3.2 |
| Sumitomo Mitsui Banking Corp | 3.0 |
| Banque Fédérative du Crédit Mutuel | 2.9 |
| First Abu Dhabi Bank | 2.5 |
| Total | 48.6 |

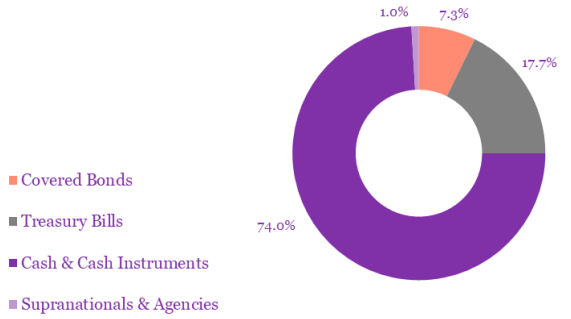
*Source: RLAM. Figures in the table above exclude derivatives where held, subject to rounding.*

## Duration profile

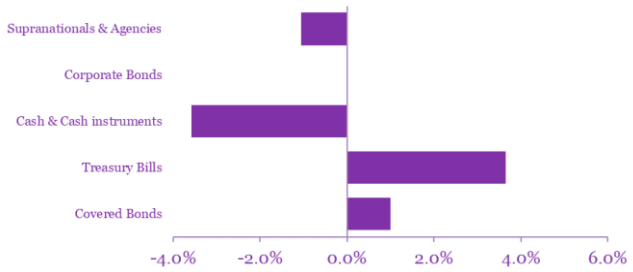


# ROYAL LONDON SHORT TERM MONEY MARKET FUND

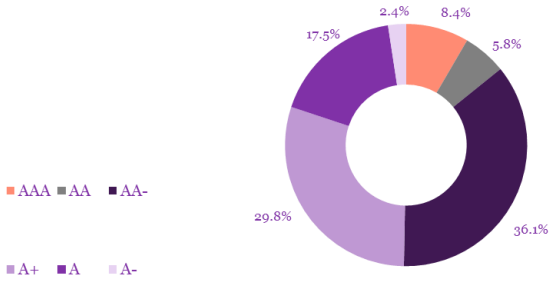
## Asset allocation profile Q2 2021



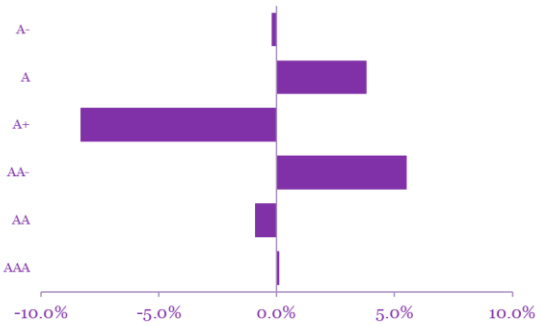

## Change since last quarter



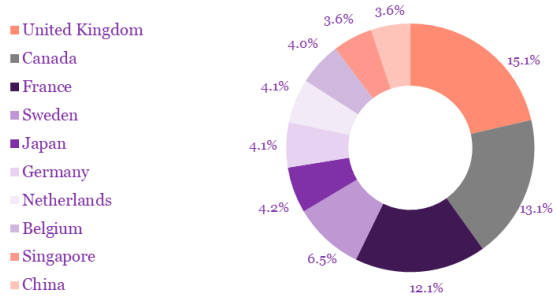

## Credit rating profile Q2 2021



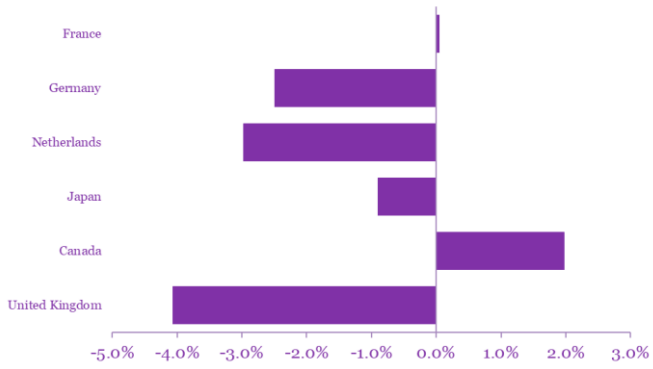

## Change since last quarter




## Top ten geographic allocation (ex gilts) Q2 2021




## Change since last quarter




*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.*

# ROYAL LONDON SHORT TERM MONEY MARKET FUND

## Market overview

- The quarter began with further progress being made in reducing the spread of Covid-19, with the number of new cases falling and vaccine rollout programmes accelerating in most parts of the world, particularly in the US and Europe. However, as lockdown restrictions started to ease, a sharp rise in deaths in India and fears over new viral strains, particularly the 'Delta' variant, became a significant cause for concern.
- In the US, the Biden administration followed up the $1.9tn economic relief bill of the first quarter with proposals for a $579bn infrastructure package promising investment in roads, water, clean transportation, and the electric grid. While the spending package, to be funded through stronger tax collection enforcement rather than formal tax increases, appeared to have bipartisan backing, it remained to be seen whether it would gain enough support to pass the 60-vote threshold required in the Senate.
- Inflation discussions were increasingly prevalent, with opinion divided as to whether rising prices were an indicator of nothing more than 'transitory' inflation, particularly given the lack of higher wage inflation, or a sign of more deep-rooted issues. US Federal Reserve (Fed) Chair Jerome Powell was keen to reiterate that price pressures were indeed transitory, but cautioned that effects on inflation "have been larger than we expected and they may turn out to be more persistent than we expected". However, central banks appeared firmly committed to maintaining accommodative monetary policies.
- In the UK, after a first quarter focused on rising inflation expectations and a corresponding increase in government bond yields, the benchmark 10-year gilt yield fell from 0.85% to 0.72% over the quarter, leading gilts to return 1.70% on an all maturities basis (FTSE Actuaries). In credit markets, investment grade credit spreads tightened slightly over the quarter, as the market returned 1.71%. The average sterling investment grade credit spread (the average extra yield available from a corporate bond compared with government debt of equal maturity) tightened from 0.96% to 0.91%.
- After modest increases in the first quarter, short-dated cash rates slipped back slightly in the second quarter, reflecting the relatively relaxed view about inflation and hence prospect of near-term interest rate rises. Three-month Libor slipped back from 0.09% to 0.08%, but still remains higher than the 0.03% levels seen at the start of 2021. Longer cash rate such as 12-month edged higher to 0.18%. Overnight rates were unchanged, with SONIA remaining at 0.05%, reflecting the reality that interest rate rises are still some way off.
- Cash rates also remained under pressure due to demand and supply factors. Central bank funding programmes have provided a wall of cheap money, meaning demand for short-term cash, particularly overnight cash, is limited, particularly at year end and half year end. At the margin, retail customers have also had higher balances given reduced opportunities to spend, further increasing cash on bank balance sheets and reducing appetite for more, which is helping suppress any upward pressure on rates.

## Performance and activity

- 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.
- Cash markets have been pricing in little or no rate hike activity until well beyond 2021. At the end of the second quarter, the market is suggesting a first rate hike in September 2022, and rates to reach just 0.75% by 2024.
- Given the fund's focus on near-term liquidity, it is invested almost entirely in classic money market instruments such as treasury bills and short dated certificates of deposit. With longer money market rates so low, and the desired fund risk profile, there is little incentive to extend duration. We have therefore tended to focus on paper with maturities of around three months. We retain an emphasis on names that we feel are high quality, and to ensure that we maintain a well-diversified portfolio. adding diversification through names such as **Skandinaviska Enskilda Banken**, **Landesbank Hessen-Thueringen** (LHT) and **Bank of Nova Scotia**. In addition, we have used availability of very short-dated covered bonds opportunistically. Given the high credit quality of these bonds, we are comfortable adding these where we can do without adding excessively to duration. During the quarter we were able to add covered from **Canadian Imperial Bank of Commerce** and **National Bank of Canada** – both paying an attractive premium to SONIA, but at around six months from maturity, less attractive for conventional credit portfolios.

# ROYAL LONDON SHORT TERM MONEY MARKET FUND

## Outlook

- Inflation will be a major focus in the second half of the year. It is not in doubt that inflation will increase: it is more around the nature of that inflation. Markets will be trying to determine how much of this increase is 'transitory' – simply being a reflection of the re-opening of the economy and the removal of what are deflationary restrictions – and how much is 'permanent'. For example, supply issues are undoubtedly a factor in price increases in some areas. For UK inflation, deconstructing how much is due to Covid restrictions, how much due to 'growing pains' as the UK / EU trading relationship adjusts and how much is due to traditional inflationary factors such as higher commodity prices. In our view, the main measure we will be looking at is wages: even here the picture is being distorted, as many workers remain on furlough, so we do not have a true picture of the UK's current employment situation. But if we start to see wage growth accelerate, then it would suggest this is more than just a short-term technical factor.
- Government and central bank interventions in economies continued to be supportive; this has caused government debt levels to escalate, the impact of which has been neutralised by central bank buying. Government yields remain too low in the medium term as investors will need to adjust to a situation of higher government debt and less QE. The clearing level will ultimately be higher than present yields. In the near term, if the third wave of infections is not as bad as feared (particularly if the link between infections and hospitalisations, and then on to deaths has been broken), then rate hike forecasts may be brought forward and we could see some steepening of money market curves.
- The outlook for performance is mixed. We continue to look for opportunities to beat SONIA, but with yields in traditional money market instruments so low, this is becoming harder to do if we wish to keep to our existing risk parameters. For shorter dated strategies, we would need to extend duration significantly to outperform SONIA by a relatively small amount, with the risk that any re-alignment of interest rate expectations would severely impact returns. For our Cash Plus and Enhanced Cash Plus funds, we can add credit risk, but with short-dated credit spreads also very low, we would again need to materially increase risk for a relatively small return enhancement. Our approach across our portfolios therefore remains unchanged. We continue to follow our investment process and risk management approach, and will take advantage of opportunities to enhance yield where we can do so in a measured way.
- For money market exposure in our funds, we will manage these to achieve what we feel is the best combination of yield and liquidity, accepting that the former will be depressed. 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. This approach mitigated the initial impact of the crisis on our funds, and although there are encouraging signs of a 'post-lockdown' world, we believe that this remains the most appropriate way to manage these funds.

ROYAL LONDON
ASSET MANAGEMENT

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