ROYAL LONDON INTERNATIONAL GOVERNMENT BOND FUND

Quarterly Report 30 June 2021

For professional clients only, not suitable for retail investors

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Asset split

	Fund (%)	Benchmark[1] (%)
Conventional credit bonds[2]	0.0	0.0
Index linked credit bonds	0.0	0.0
Sterling conventional gilts	3.9	0.0
Sterling index linked gilts	0.0	0.0
Foreign conventional sovereign	84.6	100.0
Foreign index linked sovereign	11.5	0.0
Derivatives	0.0	0.0
Other	0.0	0.0

Fund data

	Fund	Benchmark[1]
Duration[3]	7.5 years	7.8 years
Gross redemption yield[4]	0.46%	0.51%
No. of stocks	108	935
Fund size	£451.0m	-

Source: RLAM, based on the M share class. Launch date: 01.11.2011.

[1]Benchmark: JPMorgan Traded World ex-UK Government Bond Index (£ Hedged).

[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

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	**0.79**	**0.86**	**-0.07**
Year-to-date	-1.97	-2.19	0.22
Rolling 12 months	-1.12	-1.59	0.48
3 years p.a.	3.55	3.36	0.19
5 years p.a.	1.75	1.45	0.31
Since inception p.a. 01.11.2011	3.06	3.09	-0.02

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, subject to rounding.

Source: RLAM, based on the M share class.

[1]Benchmark: JPMorgan Traded World ex-UK Government Bond Index (£ Hedged).

Performance for the Royal London International 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 smaller for longer 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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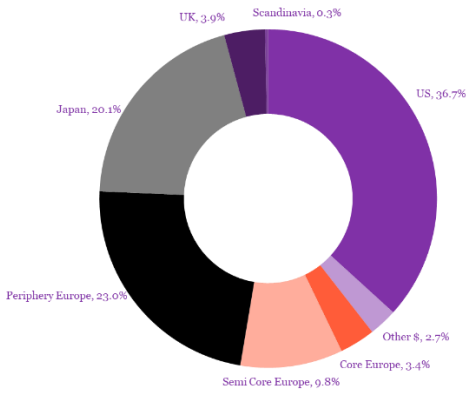
Ten largest holdings

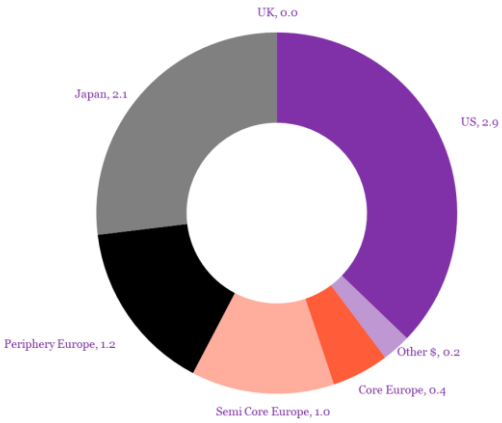
	Weighting (%)
BTP Italy 5.0% 2022	4.9
BTP Italy 4.75% 2021	3.9
UK Treasury 3.75% 2021	3.9
US Treasury 2.25% 2024	3.9
US Treasury 0.625% 2026	3.7
US Treasury 2.0% 2022	3.4
Japan (govt Of) 0.1%IL 2026	3.1
Japan (govt Of) 10yr Issue 0.8% 2022	3.0
Buoni Poliennali Del Tes 2.35% IL 2024	2.9
Japan (govt Of) 20yr Issue 0.4% 2039	2.6
Total	**35.4**

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

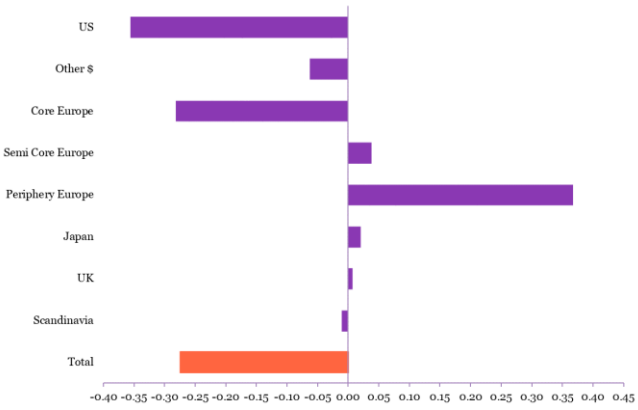
Geographic split by percentage



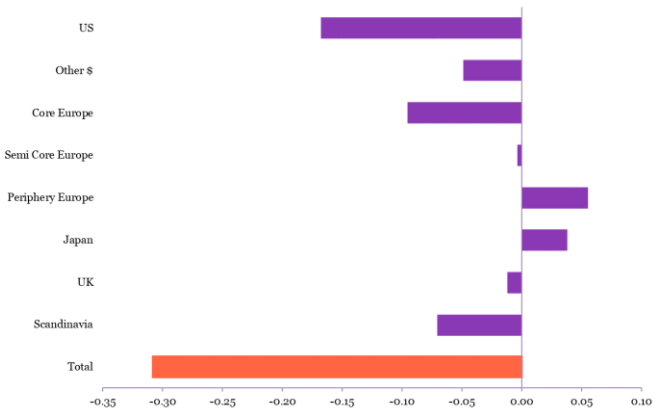
Geographic split by duration



Current position (by duration)



Change on the quarter by duration



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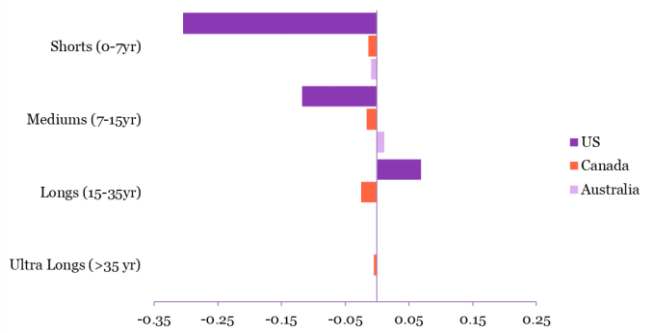
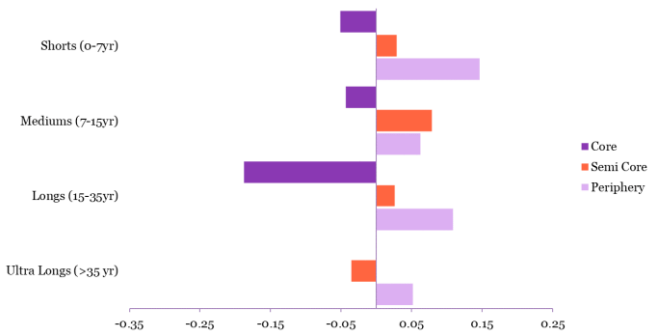
Yield Curve

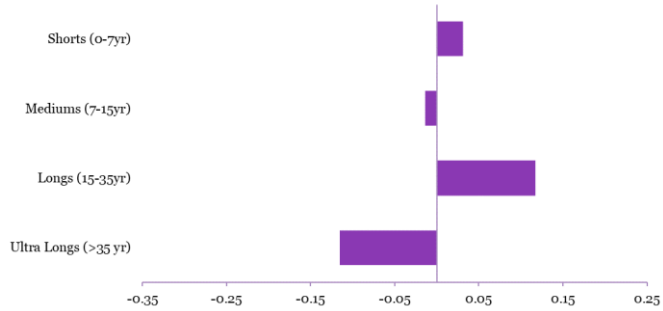
Dollar bloc



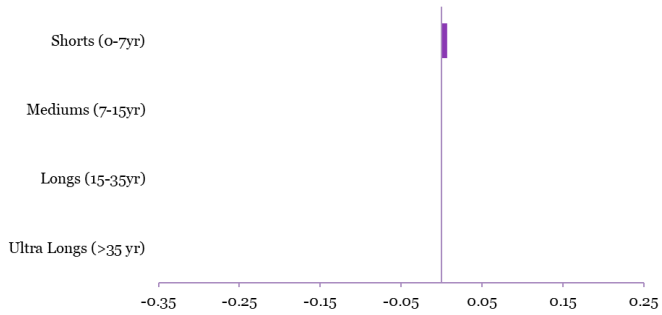
Euro bloc



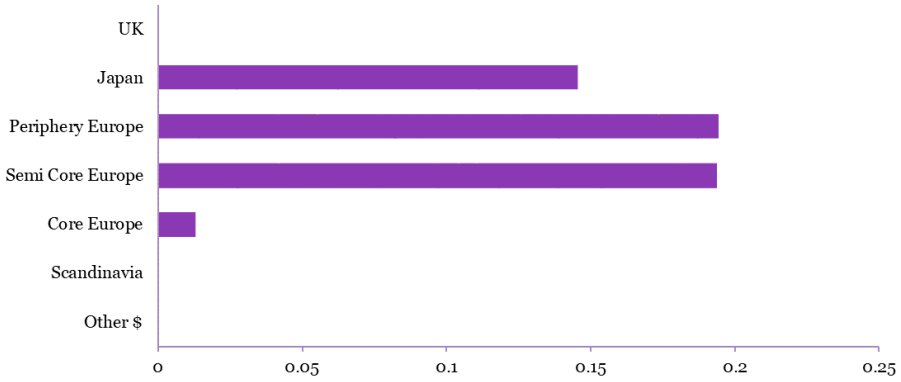
Japan



UK



Inflation breakeven



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Market overview

- Global government bond returns were mixed in the second quarter overall, however global yields fell through the latter half of the period as market enthusiasm began to temper on less positive Covid-19 newsflow. The US 10-year treasury yield fell by 27 basis points (bps) to 1.47%, leading global markets. The UK's 10-year gilt yields were relatively more stable but also fell, by 13bps, to 0.72%. European markets were weaker, although while yields broadly rose overall in the quarter, they predominantly rose in the first half of the period and fell from mid-May through until quarter-end. Germany's 10-year bund yield, for example, rose by 9bps to -0.21% for the quarter, rising from lows of -0.34% in the maiden week of the quarter to highs to highs of -0.10% in May. It has since fallen from mid-May to -0.21% at quarter-end. Bond yields in both core and periphery markets in Europe behaved in the same way, although the Greek 10-year government bond yield fell more significantly, falling overall during the quarter by 4bps to 0.83%.
- The second quarter saw investors re-engage with global economic data, and while data was broadly very strong and supported predictions of a sustained global economic recovery, a particularly strong US CPI print sent jitters through global markets on 12 May. As the US inflation measure hit 4.2%, the major global discussion point for the period turned to whether high inflation might be sustained rather than pass as transitory. Although the Federal Reserve reassured markets that inflation would indeed be transitory, and that they were not yet 'talking about talking about tapering', taper talk begun at the June Federal Open Market Committee (FOMC) meeting and forecasts showed a more hawkish stance. Median committee forecasts showed rates at 0.6% at the start of 2023 – much closer to current market prices – pricing in two 25bps rate rises during 2022. In comparison, March forecasts had predicted no rate rises over the same period.

  In Europe, the ECB followed a similar stance to the US on inflation and vied not to slow the pace of their asset purchasing programme as a response to strong data. Panetta, an economist and member of the ECB's executive board said; "only a sustained increase in inflationary pressure … could justify a reduction in our purchases." At the close of the quarter, any decision by the ECB to roll back support for markets had been delayed to a later date. The Bank of England (BoE) began to taper in May, slowing the pace of its quantitative easing programme – this had been broadly expected and was therefore already fully priced into gilt markets. At the end of the period, the BoE remained supportive of the UK economy. It was announced on 24 June that the Monetary Policy Committee (MPC) would leave interest rates unchanged at 0.1% and keep the total size of its bond-buying programme unchanged at £895bn, to be completed by the end of 2021.
- Breakevens ended the quarter largely unchanged as optimism around growth prospects waned, and the global reflation theme of the first quarter ran out of steam; 10-year breakeven in the US, UK fell by 9bps and 4bps respectively, while they rose by 1bp in Germany.

Portfolio commentary

- As the benchmark and the fund are priced at different times, the former taking a midday price rather than an end-of-day price, the fund appears to have slightly underperformed the benchmark over the quarter, by 7bps. However, this is not the case. When comparing on a like-for-like basis using end-of-day pricing, the fund outperformed the benchmark by 12bps for quarter.
- Cross-market strategies added to performance in the quarter, especially across European periphery markets. As monetary support in Europe continues via the Pandemic Emergency Purchase Programme (PEPP), ongoing bond purchases remain especially supportive of European periphery markets; prior to the pandemic the ECB's purchases of sovereign bonds, via the Asset Purchase Programme (APP), were restricted to investment grade sovereigns, but the PEPP has no such restrictions. The PEPP's key goal is to support weaker European economies through the pandemic, which leads to disproportionate support for periphery markets. We moved 0.1 years long Spain in the quarter, and also took part in a five-year Greek syndication, an off-benchmark market, both of which added to performance. Although typical seasonality trends would lend to holding higher yielding periphery bonds through the quiet summer period, upcoming policy events in Europe and the US, where monetary policy makers are likely discuss plans to taper monetary support, represent potential cliff edges for more sensitive periphery bonds. As such, we decided to trim exposure to periphery markets into the close of the period.
- Outside of periphery markets, we took part in the inaugural issuance of the EU's 'Next Generation EU' (NGEU) bonds, the fruition of an €800bn loan and grant programme agreed in April that runs through until 2026, which performed well. We also extended the France overweight, selling German and Belgian bonds into French market weakness that was linked to potential election risks in the country. We felt that markets were overly anxious regarding a Marine Le Pen Presidency, especially given that the election is still a distance off, and the performance of the National Rally in local elections to date has been underwhelming. Furthermore, Le Pen's stance on Europe seems to have softened since the last election, partly due to a tough Brexit process, but also because of strong support from Europe in France's recovery from Covid-19.
- The fund was neutral duration at the beginning of the quarter, as we have continued to avoid putting on large directional or structural duration positions, conscious that coronavirus newsflow and fiscal and monetary policy announcements might greatly impact market movements. However, as market enthusiasm tempered in the second quarter, we took profits on US

treasuries into market strength. This took us further underweight US versus the benchmark, and moved the fund from neutral to 0.3 years short duration at quarter-end. Nonetheless, having been broadly neutral for most of the period, the fund's duration positioning had little impact on performance for the period.

- Curve positioning added to performance in the quarter, as longer-dated US yields fell further than shorter-dated yields. This occurred after median Federal Open Market Committee (FOMC) forecasts in June showed a 0.6% rise in interest rates by the start of 2023, a year earlier than had been forecasted in previously by the FOMC in March – we maintained the flattening bias on the US curve into the end of the quarter. We also maintained a steepening bias on European curves, as we expect the ECB to tackle higher inflation by slowing its bond purchasing regime, not by rising interest rates. This will cause yields to rise in the market segments that bond purchasing programmes have supported to date.
- We added exposure to inflation throughout the quarter, especially in European markets where inflation looked particularly cheap. We bought five-year French and Italian inflation-linked bonds, as well as 10-year French inflation-linked bonds, which slightly detracted from performance in the period. We expect this performance to improve given that the bonds purchased all priced inflation at a level below the ECB's 2% target. We remain exposed to Japanese inflation.
- We adjusted duration tactically during periods of particular stress in the quarter. We traded, for example, in the lead up to US economic data releases, selling the US into France ahead of the US CPI print in June. This added to performance, as markets reacted negatively to higher than expected inflation data.

Outlook

- Given virus variants and regions vaccinating at very different paces, virus risks are not gone yet, so we expect the flow of global headlines to generate further volatility. However, we believe that market anxiety into quarter-end is slightly inflating prices, and although markets may become more squeezed on further nervousness, we have entered a slight strategic short to reflect this view. Nonetheless, we will continue to avoid any significant strategic duration positions in the fund due to the risks posed by market events and will continue to trade market volatility tactically to generate outperformance relative to the benchmark.
- An increase in Covid-19 cases at the end of the quarter could potentially slow the exit from states of lockdown. With a potentially curtailed tourist season coming up, it could be a tough summer period for Europe, bolstering the requirement for continued loose monetary policy. We remain broadly neutral in Europe and anticipate only a longer-term short, as larger portions of the bloc are vaccinated, and the economy opens more widely. We continue to favour peripheral markets due to the positive yields we can find in them in the context of an environment where yields are widely negative in core markets, although we have trimmed exposure prior to policy events which could spur volatility. The earlier than expected release of the ECB's strategic review towards the end of quarter, increasing their inflation target to 2% (from "close to, but below 2%"), was broadly in line with market expectation and focus has now shifted plans for the PEPP programme, which is due to expire in Q1 2022.
- While coronavirus concerns will remain critical through 2021, more traditional political risks will also come into play with the French and German elections on the horizon. We anticipate potential market uncertainty around these events, though these are unlikely to manifest until later in the year.
- As vaccine distribution picked up picked up and economic activity increased, central banks have continued to support global markets through loose monetary policy. With this in mind, breakevens surged at the end of 2020 and through the first quarter of 2021. While this surge plateaued in the second quarter, and we sold US breakevens into strength in the previous quarter, we continue to hold inflation in Europe. We will continue to do so while inflation-linked assets price inflation below the ECB's inflation target.

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ASSET MANAGEMENT