ROYAL LONDON SHORT TERM MONEY MARKET FUND

Quarterly Report 31 March 2021

For professional clients only, not suitable for retail investors

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Fund data

	Fund
Gross redemption yield[1]	0.07%
No. of issuers	73
Fund size	£3,642.8m
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 (%)
Q1 2021	**0.01**	**0.01**	**0.00**
Year-to-date	0.01	0.01	0.00
Rolling 12 months	0.17	0.06	0.12
3 years p.a.	0.57	0.41	0.16
5 year p.a.	0.50	0.33	0.17
10 years p.a.	0.49	0.38	0.12
Since inception p.a. 22.07.1999	1.26	1.00	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.

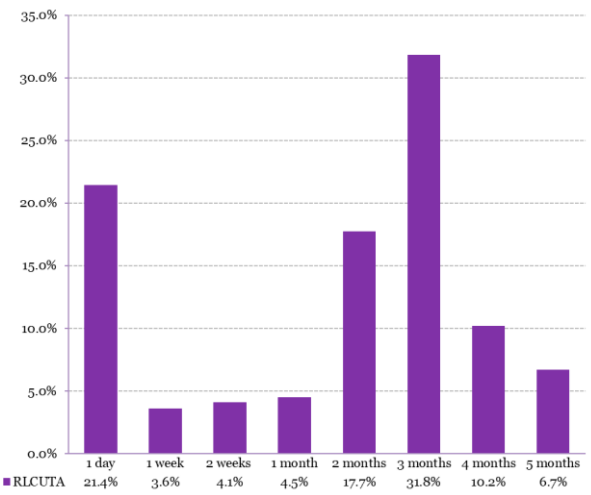
Following the implementation of the Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on Money Market Funds ("MMFs"), the fund is subject to the following risks: The fund is not a guaranteed investment. An investment in the fund is different from an investment in 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	14.7
Royal Bank of Canada	5.3
Rabobank	4.8
Nationwide Building Society	4.7
BNP Paribas	4.4
DZ Bank	4.4
Barclays Bank	4.1
Sumitomo Mitsui Banking Corp	3.5
Santander UK Plc	2.8
ANZ Banking Group	2.8
Total	**51.5**

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

Duration profile



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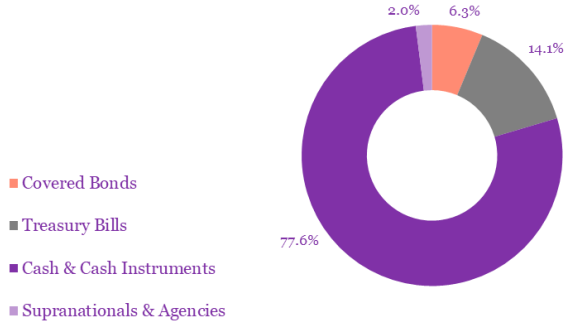
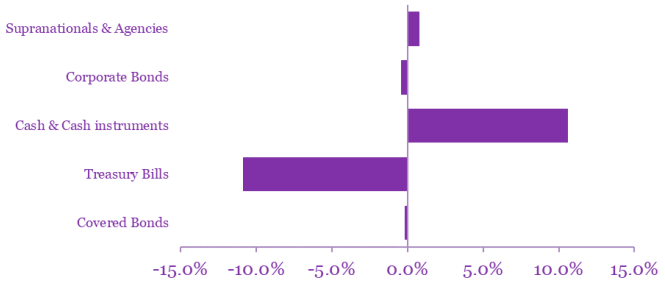
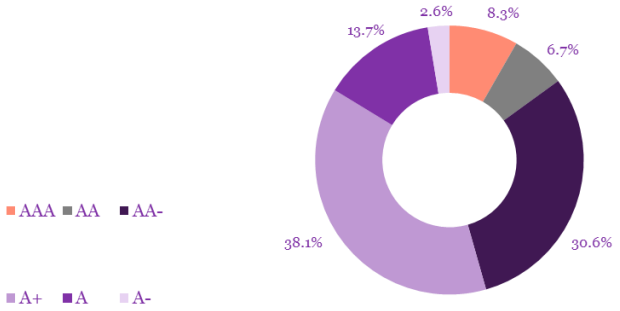
Asset allocation profile Q1 2021



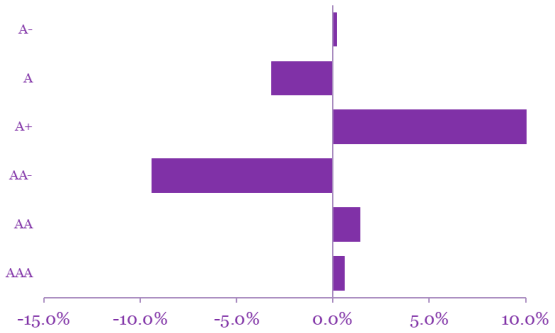
Change since last quarter



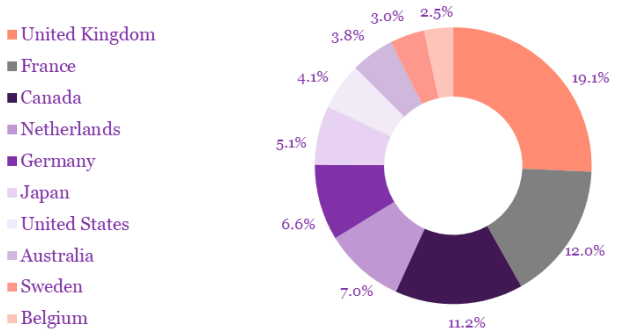
Credit rating profile Q1 2021



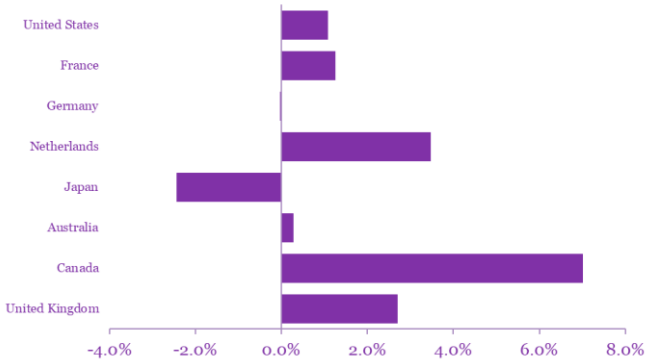
Change since last quarter



Top ten geographic allocation (ex gilts) Q1 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 year started with cautious optimism about vaccines that offered the prospect of the reopening of the global economy and a strong recovery from mid-year, tempered by concerns about new strains of Covid-19 and extended lockdown measures in the short term. This balance shifted over the quarter with vaccinations exceeding expectations in the UK and US, and the route map out of lockdown announced by the UK government. Meanwhile, the Democrats' victory in the Georgia Senate runoffs and President Biden's $1.9tn fiscal package shifted investors' expectations to a more pronounced recovery in the US, leading to higher and steeper bond yields in the US. In addition, there were concerns that higher inflation from ongoing frictions in global supply chains and positive base effects over the coming months could lead to central bank tightening sooner than previously anticipated.
- As a result of these shifting expectations, the benchmark 10-year gilt yield rose from 0.20% to 0.85% over the quarter, leading gilts to return -7.24% on an all maturities basis (FTSE Actuaries). This, however, only takes gilt yields back to the level at which they started 2020. In comparison, credit markets were a relative 'bystander' with investment grade credit spreads broadly unchanged over the quarter. 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 0.99% to 0.96%.
- Cash rates started to move a little higher over the quarter, reflecting the underlying improvement in optimism about the UK and global economy. Three-month Libor started the year at 0.03% and rose to 0.09%, while 12-month Libor rose from 0.08% to 0.16%. The increase suggested that the market had moved on from its expectation in later 2020 that the economy would need increased support using factors such as negative rates. Overnight rates were unchanged, with SONIA remaining at 0.05%, reflecting the reality that a less negative view on the economy still means rates will remain low for some time.
- Cash rates also remained under pressure due to demand and supply factors. Central bank support means banks have had less cause to come to money markets to fund short-term liquidity needs. As a result, there was excess cash looking for short-term homes, limiting the increases in very short-dated money market 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 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.
- Performance for the fund was driven by the nature of the investment objective and the subsequent portfolio mix. We always avoid holding too much short-term liquidity coming into year end as counterparty banks are usually looking to reduce short-term cash on their balance sheet. At the start of this year, we felt that the market was too pessimistic about the economy, which depressed rates on traditional money market instruments such as CDs, meaning we started 2021 with a bias towards overnight and very short-dated instruments. As market expectations changed, we were happy to add to higher quality names in three or six month maturity paper as these provide a better return.
- Funds with a much greater focus on near-term liquidity such as this one are invested solely in classic money market instruments such as treasury bills and short dated certificates of deposit. Rates for these instruments have still to rebound materially from the historic lows seen last year. This has affected absolute returns and we would expect this to remain the case for some months – market expectations are for three-month rates to be back above 0.10% at some point in the second quarter. While we would not rule this out, we feel it does rely on predominantly positive newsflow around vaccinations and the easing of restrictions.
- Activity during the quarter remained focused on t-bill auctions and rolling maturities of existing paper, extending average maturity of our purchases as yields edged higher. In addition to CDs, we looked for opportunistic purchases elsewhere, for example adding government guaranteed commercial paper from **KfW** to add liquidity and diversification to the portfolio. Covered bonds remained hard to source but we have been able to add very short-dated paper (typically six months maturity or less) occasionally in the secondary market for small yield pick-ups over similar maturity CDs, examples including **ANZ** and **National Bank of Canada** during the quarter.

Outlook

- 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. Real yields are just too low, especially in the UK and especially at longer maturities.

- The pandemic has heightened geopolitical tensions. Vaccine nationalism and success rates in vaccinations, differing economic recoveries, changing leadership in the US and the rise of China, the desire to protect perceived national interests - all have contributed to a more inward looking mindset. This may be bad for further globalization moves.
- Central bank support has been a major distortion for money markets in recent months. Whether through 'normal' QE or other programmes, returns on a huge range of instruments have been pushed lower. The modest increase in the first quarter has not really altered this – as an example, three month Libor has only returned to the levels seen in summer 2020. Investors in this area will be living with very low returns for some months yet.
- As fund managers, we could increase interest rate or credit risk to compensate for these lower rates. Although vaccination programmes are well-established in the UK and US, and likely to accelerate in the EU over the coming months, Covid-related news is still likely to ebb and flow, and we therefore feel that building portfolios dependent on positive news would be ill-advised.
- 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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