For professional clients only, not suitable for retail clients.

Royal London Absolute Return Government Bond Fund

Quarterly Investment Report

31 December 2023

Quarterly Report

The fund as at 31 December 2023

The purpose of this report is to provide an update on the Royal London Absolute Return Government Bond Fund. The report has been produced by Royal London Asset Management. The report starts with a summary dashboard showing key information about the fund. A glossary is located at the end of the report covering the description of some of the more technical terms used within the report. All data is as at the report date unless otherwise stated.

Contents

ROYAL LONDON
ASSET MANAGEMENT

The fund

Fund performance objective and benchmark

The investment objective of the fund is to target absolute positive capital growth.
The fund seeks to achieve its investment objective by outperforming its benchmark, the Sterling Overnight Index ("SONIA") on an annual basis by 2.5% over rolling three year periods and aims to provide positive performance over 12 month periods.

Benchmark: SONIA (Sterling Overnight Index Average)

Fund value

	Total £m
31 December 2023	1,300.75

Asset allocation

	Fund (%)
Conventional credit bonds	38.39%
Money market instruments	29.01%
Index linked foreign sovereign	17.76%
Conventional foreign sovereign	7.45%
Index linked gilts	4.35%
Conventional gilts	3.05%

Fund analytics

	Fund
Fund launch date	17 November 2014
Base currency	GBP

Performance and activity

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Quarter	2.45	1.28	1.16
1 Year	6.40	4.61	1.79
3 Years (p.a.)	3.37	2.00	1.37
5 Years (p.a.)	2.91	1.38	1.53
10 Years (p.a.)	-	-	-
Since inception (p.a.)	1.88	0.94	0.94

Past performance is not a guide to future performance. Please refer to the Glossary for the basis of calculation and impact of fees. Performance and since inception date based on RL Absolute Return Government Bond Fund (Z Acc). Source: Royal London Asset Management; Gross performance; Since inception date of the shareclass is 17 November 2014.

Performance commentary

The fund posted a strong return of 2.44% over the quarter versus 1.28% for the SONIA benchmark. Over the past year the fund has returned 6.39%, or 181bps ahead of benchmark. This has been in a 12-month period where we have seen extremely volatile markets, with bond yields initially rising as central banks continued to tighten monetary policy to combat the highest level of inflation in decades, then falling towards the end of the year as lower inflation saw the market call the peak in rates and price in multiple rate cuts in 2024.

The largest contributor to performance on the quarter was the holdings of highly rated FRNs and money market instruments which yielded well above 5%. These instruments benefitted as expectations of early and substantial rate cuts grew.

Our duration position was another significant positive over the quarter, with yields falling sharply. We have had a long bias for some time on the basis that yields had risen to very attractive levels. The fund began the quarter 1.5 years long with the largest overweight being 30-year Australia, which benefited performance as yields fell by 60 basis points in response to a positive fiscal position and a belief that the peak in short-term interest rates had been seen.

Duration was managed tactically over the quarter taking advantage of the volatility and numerous supply events adding value over the quarter. Exposure to Japan was one example of this, with fund going long Japan as yields hit 1% after a relaxation of yield curve controls but the re-entering a short position as yields rallied in the latter part of the year.

Inflation positions added value, particularly in Japan where breakeven rates rose over the quarter. Fund returns were also enhanced by running shorter dated yen assets hedged back into sterling. Short positions in both the UK and Europe also added value as inflation pricing moved lower in fear of weaker growth in 2024.

Curve positions – principally steepeners in US and flatteners in Australia – added value, particularly in the US as rate cuts were priced into the front end of the market.

Cross market positions were mixed but the strong performance of Italian bonds detracted from performance.

Performance and activity

Return Contribution

	Quarter	1 year	Target return (of live trades)
Inflation	30.00	54.77	28.00
Curve	43.00	138.60	40.00
Duration	18.00	73.58	50.00
Relative Value	(1.00)	19.51	0.00
Cross Market	5.00	7.29	10.00
FX Hedges	0.00	0.00	0.00
Cash	118.00	309.01	490.00
Total	**213.00**	**602.76**	**618.00**

Top Contributors

	Strategy	Q4 Contribution (bps)
CASH	CASH	118.00
Inflation	Japan	20.00
Duration	Australia	20.00
Curve	US/Australia box	19.00
Cross Market	UK/Europe	16.00

Bottom Contributors

	Strategy	Q4 Contribution (bps)
Cross Market	Europe short Italy	(21.00)
Duration	Europe	(8.00)
Curve	US	(5.00)
Curve	Japan	(1.00)

Performance and activity

Portfolio Exposure

Trades	Position size	Net duration exposure	Market beta	Target return (bps)
Inflation				
Long Japanese Breakeven	0.40	0.00	(0.30)	12.00
Short UK 10 and 20 year Rpi	0.70	0.00	0.20	10.00
Long US 5 year Breakeven	0.10	0.00	0.00	3.00
Long US 30 yearBreakeven	0.10	0.00	0.00	3.00
Curve				
US 5/30 Steepener	0.40	0.00	0.00	15.00
Aussie 3/30 flattener	0.30	0.00	0.00	10.00
Aussie 10/30 flattener	0.20	0.00	0.00	5.00
UK 30/50 Steepener	0.70	0.00	0.10	10.00
Cross Market				
Long Spain vs Italy 10y	0.10	0.00	0.00	5.00
Long UK vs Europe	0.10	-	0.05	5.00
Duration				
Short 10 year UK	0.40	(0.40)	(0.40)	10.00
Long Can Real Yield	0.10	0.10	0.10	5.00
Short 5 and 30 year Germany	0.30	(0.30)	(0.15)	10.00
Long 30 year Australia	0.40	0.40	0.20	10.00
Short 10 year Japan	0.10	(0.10)	-	5.00

Performance and activity

Portfolio Exposure

Trades	Position size	Net duration exposure	Market beta	Target return (bps)
Duration				
Short 10 year Italy	0.20	(0.20)	(0.06)	10.00
Cash				
Cash	0.20	0.20	-	490.00
Overall Net Duration Position	**4.80**	**(0.30)**	**(0.26)**	**618.00**

Performance and activity

Asset allocation – duration

	0 -2 yrs	2 -7 yrs	7 - 12 yrs	12 - 17 yrs	17 -22 yrs	22 -27 yrs	>27 yrs	Total
Australia	0.00	(0.31)	(0.21)	0.87	0.02	0.00	0.00	0.37
Canada	0.01	0.00	0.00	0.00	0.00	0.07	0.00	0.07
European Union	(0.00)	(0.13)	0.00	0.00	0.00	0.00	0.00	(0.13)
France	0.02	0.00	0.00	0.00	0.00	0.00	0.00	0.02
Germany	0.01	(0.16)	0.00	0.00	(0.12)	0.00	0.00	(0.26)
Italy	0.00	0.00	(0.28)	0.00	0.00	0.00	0.00	(0.28)
Japan	(0.00)	0.41	(0.56)	0.00	0.00	0.08	0.00	(0.07)
Norway	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02
Singapore	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Spain	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.07
Sweden	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.01
Switzerland	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
United Kingdom	0.00	0.13	(0.44)	0.00	0.57	(0.40)	(0.19)	(0.33)
United States	0.06	0.31	0.10	(0.50)	0.00	0.07	0.00	0.05
Total								(0.45)

Performance and activity

Asset allocation - inflation

	0 -2 yrs	2 -7 yrs	7 - 12 yrs	12 - 17 yrs	17 -22 yrs	22 -27 yrs	>27 yrs	Total
Australia	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Canada	0.00	0.00	0.00	0.00	0.00	0.07	0.00	0.07
Europe	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
France	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Germany	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Italy	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Japan	0.00	0.39	0.00	0.00	0.00	0.00	0.00	0.39
Norway	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Singapore	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Spain	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Sweden	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Switzerland	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
UK	0.04	0.18	(0.36)	0.00	(0.56)	0.00	0.00	(0.70)
US	0.00	0.10	0.00	0.00	0.07	0.00	0.00	0.17
Total								(0.07)

Performance and activity

Stand alone risk contribution

	Quarterly Vol (%)	Annual Vol (%)
Inflation	0.48	0.95
Curve	0.41	0.82
Duration	0.47	0.94
Relative Value	0.11	0.22
Cross Market	0.39	0.77
FX Hedges	0.18	0.37
Cash	0.16	0.33
Total stand alone vol	**2.20**	**4.40**
Diversification	1.59	3.18
Overall Volatility	**0.61**	**1.22**

Performance and activity

Fund activity

At the start of the quarter, we added to duration quarter though purchases of 30-year Australian bonds as yields reached 5.4% and UK longs traded back to levels seen in the LDI crisis of 2022. As yields fell sharply, we reduced duration from a peak of around 1.6 years to end the year 0.4 years short. Duration was sold across the globe, but also traded tactically around supply events.

Breakevens fell sharply over the quarter with both US and European breakevens falling to around 2%. With geopolitical risks increasing and labour markets remaining tight, we closed the short position in Europe, reduced the short in the UK and bought five-year US breakevens at around 2.05%

Curve steepening positions were increased in the US but as the 5-30 curve became volatile around data events, we traded this more tactically.

Market commentary

Market Overview

Economic attention over the quarter has been on inflation. At the start of the quarter investors focussed on the persistence of large price increases and central bank messaging on rates being held higher for longer. Yet, as headline inflation fell, sentiment swung dramatically towards the end of the quarter, pushing markets to price in interest rate cuts in 2024. The Federal Reserve (Fed), European Central Bank (ECB) and Bank of England (BoE) all left rates unchanged over the quarter, maintaining official rates at multi-year highs. The Fed has now held rates unchanged at its last three meetings. There has however been a significant shift in messaging, with the US central bank now indicating that it expects to cut rates by 0.75% in 2024. The ECB has similarly kept rates steady at its two most recent meetings, but central bankers in the eurozone said that no rate cuts have yet been discussed.

In tune with the other major central banks, and potentially marking the high point in the UK interest rate cycle, the Bank of England left interest rates unchanged over the period. The Monetary Policy Committee continued to be split – at the December meeting three of the nine members were still voting for a rate hike. UK inflation has fallen significantly, with the annual inflation rate falling to 3.9% in November. This is the lowest rate of increase in over two years. However, this remains well above the BoE 2% target, with core and wage inflation significantly higher than the headline rate.

Data released in the UK in the fourth quarter painted a picture of sluggish economic activity, with falling inflation and more signs of softening underlying domestic inflationary pressure. Third quarter GDP fell 0.1% quarter-on-quarter after 0.0% quarter-on-quarter in the second quarter. PMI business survey data signalled some improvement in private sector activity though, with the composite PMI indicator rising back above the 50 ‘no growth’ level. Inflation fell, and tended to surprise on the downside at headline level versus expectations.

Global government bond yields continued their upward path at the start of the quarter– a trend that began in mid-2020, reflecting market views that rising inflation would necessitate higher interest rates. With inflation starting to come down, expectations of rate cuts in 2024 meant that bond yields fell in November and December, ending the quarter lower than they started, and ending 2023 at roughly the same levels as they started. In the US, 10-year treasury yields fell from 4.57% to 3.88%, falling back from 15-year highs to reverse virtually all of the rise seen in the prior quarter, and ending the year only modestly higher despite rising for most of 2023. German 10-year bunds similarly saw material falls in the fourth quarter, falling from 2.84% to 2.01%.

The Fed kept rates on hold at 5.25-5.50% over the quarter against a still resilient labour market backdrop, but with inflation continuing to cool. As of the December meeting, the median forecast of voting regional bank governors had 75bp of cuts for 2024 with a further 100bp of cuts pencilled in for 2025. Over the quarter, CPI inflation fell from 3.7% year-on-year in August, to 3.1% in November. That is still above June 2023 levels, but core continued a more consistent drift lower over the period.

Over the fourth quarter, the ECB kept rates on hold. Going into the December meeting, various ECB speakers had already broached the topic of rate cuts, effectively opening the door for cuts in the second half of 2024 while pushing back on the chance of a near term cut.

UK index-linked markets performed strongly over the quarter, returning 8.72% (FTSE Actuaries All-maturities). Falling inflation and expectations of rate cuts in 2024 helped push real yields lower. Real yields on UK 10-year bonds fell from 0.60% to 0.17% with the 30-year dropping from 1.48% to 0.95% while yields on US 10-year index-linked bonds fell from 2.23% to 1.76%.

Outlook

We believe that inflation will continue to drift lower in 2024, although it is likely to remain above target in most economies by the end of the year, particularly so in the UK, which appears more at risk of inflation becoming more embedded and persistent, than other G10 economies. Shallow recessions are possible but are unlikely to be deep enough at this stage to ease the excessive tightness seen in labour markets. As we approach 2024, central banks are at peak rates, and markets are preparing themselves for cuts, starting in the first half of 2024.

In the US, the market is now assuming base rates have peaked at 5.25%, with the first cut priced in for the first half 2024 and falling to a terminal level of around 3.25% by late-2026, similar moves are priced into the UK and Europe. At one point in early July in the UK the market was pricing peak rates closer to 6.5%. Government bond markets have moved a long way during the last few months.

Breakevens globally have fallen sharply as inflation data weakened. However, with labour markets remaining tight, average earnings high and geopolitical risk growing we think inflation could remain sticky supporting shorter dated index link bonds. Breakeven rates in Japan and the US still look attractive to longer term forecasts for inflation.

Supply will be an issue for global market over the next few years, with global net supply to be more than US$2 trillion per annum over the next year. The outlier to this is Australia where the fiscal position is close to neutral and limited supply of longer dated bonds is expected.

Further Information

Please click on the links below for further information:

Stewardship and responsible investment at RLAM

TCFD climate report

Find out more

Royal London Asset Management's Outlook 2024 document and podcasts are both available on our website. In this year's Outlook document, our fund managers assess the challenges and opportunities in their respective asset classes for 2024. With an environment of falling inflation and modest recession, the benefits or risk for equities or credit is not so clear cut and knowing your companies is key. We analyse the areas of concern and potential growth within this environment.

In our Outlook 2024 podcast, Piers Hillier, CIO, looks ahead to 2024 and discusses the issues he believes will be prominent over the next 12 months, and where the key investment risks and opportunities may lie.

Articles, videos and webinars explaining our investment thinking can be found in the Our Views section of www.rlam.com, including regular updates from our Fixed Income, Global Equity, Sustainable and Multi Asset teams.

Disclaimers

Important information

For professional clients only, not suitable for retail clients.

This is a financial promotion and is not investment advice.

Telephone calls may be recorded. For further information please see the Privacy Policy at www.rlam.com.

Issued in January 2024 by Royal London Asset Management Limited, 80 Fenchurch Street, London EC3M 4BY. Authorised and regulated by the Financial Conduct Authority, firm reference number 141665. A subsidiary of The Royal London Mutual Insurance Society Limited.

The Fund is a sub-fund of Royal London Asset Management Funds plc, an open-ended investment company with variable capital (ICVC), with segregated liability between sub-funds.

Incorporated with limited liability under the laws of Ireland and authorised by the Central Bank of Ireland as a UCITS Fund. It is a recognised scheme under the Financial Services and Markets Act 2000.

The Management Company is FundRock Management Company SA, Registered office: 33 rue de Gasperich, L - 5826 Hesperange, Luxembourg and is authorised and regulated by the Commission de Surveillance du Secteur Financier (CSSF).

The Investment Manager is Royal London Asset Management Limited.

For more information on the Fund or the risks of investing, please refer to the Prospectus or Key Investor Information Document (KIID), available via the relevant Fund Information page on www.rlam.com.

Most of the protections provided by the UK regulatory system, and the compensation under the Financial Services Compensation Scheme, will not be available.

The "SONIA" mark is used under licence from the Bank of England (the benchmark administrator of SONIA), and the use of such mark does not imply or express any approval or endorsement by the Bank of England. "Bank of England" and "SONIA" are registered trademarks of the Bank of England.

Risks and Warnings

Investment Risk

The value of investments and any income from them may go down as well as up and is not guaranteed. Investors may not get back the amount invested.

Credit Risk

Should the issuer of a fixed income security become unable to make income or capital payments, or their rating is downgraded, the value of that investment will fall. Fixed income securities that have a lower credit rating can pay a higher level of income and have an increased risk of default.

Derivative Risk

This fund may undertake transactions in derivatives and forward transactions (both on exchange and over the counter (OTC)). These may include interest rate swaps and interest rate futures for the purposes of meeting the investment objective, protecting the risk to capital, duration and credit management, as well as for hedging. While the discerning use of derivatives can be beneficial, derivatives also involve specific risks. These risks relate specifically to market risk, management risk, credit risk, liquidity risk, the risk of mispricing or improper valuation of derivatives and the risk that derivatives may not correlate perfectly with underlying assets, interest rates and indices. The use of derivative instruments may from time to time alter the economic exposure of the fund causing it to deviate significantly from the performance of the market as a whole. The use of these derivatives will be within the parameters allowed for linked funds by the Financial Conduct Authority and Prudential Regulation Authority.

EPM Techniques

The Fund may engage in EPM techniques including holdings of derivative instruments. Whilst intended to reduce risk, the use of these instruments may expose the Fund to increased price volatility.

Exchange Rate Risk

Changes in currency exchange rates may affect the value of your investment.

Interest Rate Risk

Fixed interest securities are particularly affected by trends in interest rates and inflation. If interest rates go up, the value of capital may fall, and vice versa. Inflation will also decrease the real value of capital. Unlike the income from a single fixed interest security, the level of income (yield) from a fund is not fixed and may go up and down. Bond yields (and as a consequence bond prices) are determined by market perception as to the appropriate level of yields given the economic background.

Liquidity Risk

In difficult market conditions the value of certain fund investments may be difficult to value and harder to sell, or sell at a fair price, resulting in unpredictable falls in the value of your holding.

Counterparty Risk

The insolvency of any institutions providing services such as safekeeping of assets or acting as counterparty to derivatives or other instruments, may expose the Fund to financial loss.

Performance to 31 December 2023

Cumulative (%)

	3 Month	6 Month	1 Year	3 Years	5 Years
Fund (gross)	2.45	5.23	6.40	10.45	15.44
Fund (net)	2.37	5.07	6.08	9.26	13.34

Annualised (%)

	3 Years (p.a.)	5 Years (p.a.)
Fund (gross)	3.37	2.91
Fund (net)	3.00	2.53

Year on year performance (%)

	31/12/2022 - 31/12/2023	31/12/2021 - 31/12/2022	31/12/2020 - 31/12/2021	31/12/2019 - 31/12/2020	31/12/2018 - 31/12/2019
Fund (gross)	6.40	2.88	0.90	1.82	2.65
Fund (net)	6.08	2.51	0.48	1.41	2.29

Past performance is not a guide to future performance. The impact of fees or other charges including tax, where applicable, can be material on the performance of your investment.

Source: RLAM as at 31 December 2023. All figures are mid-price to mid-price in GBP for the RL Absolute Return Government Bond Fund (Z Acc).

Glossary

Fund value

Total value of the fund as of the last business day of the calendar month. The fund value is as at close of business and on a mid-price basis.

Performance

Performance is calculated using the daily end of day NAV per share produced by HSBC based on the mid price.

VaR

VaR is a statistical measure of the level of financial risk within the fund over a specific time.