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Royal London International 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 International 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.

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The fund

Fund performance objective and benchmark

The fund's investment objective is to achieve a total return over the medium term (3-5 years) by investing at least 80% in government bonds globally. The fund's performance target is to outperform, after the deduction of charges, the JP Morgan Global Bond Index ex UK (Traded) Total Return (GBP hedged) Index (the "Index") over rolling 5-year periods. For further information on the fund's index, please refer to the Prospectus.

Benchmark: JP Morgan Global Bond Index ex UK (Traded) Total Return (GBP hedged) Index

Fund value

	Total £m
31 December 2023	943.68

Asset allocation

	Fund (%)	Benchmark
Conventional foreign sovereign	93.53%	100.00%
Index linked foreign sovereign	5.54%	-
Conventional credit bonds	0.76%	-
Conventional gilts	0.17%	-

Fund analytics

	Fund	Benchmark
Fund launch date	1 November 2011	
Base currency	GBP	
Duration (years)	6.82	6.89
Real yield (%)	0.02	0.00
Number of holdings	110	1,004

Performance and activity

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Quarter	5.66	5.32	0.34
1 Year	5.89	5.11	0.78
3 Years (p.a.)	(2.04)	(3.36)	1.31
5 Years (p.a.)	1.05	0.16	0.89
10 Years (p.a.)	1.84	1.56	0.28
Since inception (p.a.)	1.97	1.76	0.20

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 International Government Bond Fund (M Inc). Source: Royal London Asset Management; Gross performance; Since inception date of the shareclass is 4 November 2011.

Performance commentary

The fund enjoyed a strong fourth quarter, and was slightly ahead of its benchmark in the three-month period, but saw a more impressive outperformance over the year. Our duration positioning and trading was a positive contributor to performance, with the fund having benefitted from being overweight into the rally and underweight into the sell-off over the last few days of the quarter.

The fund started the quarter with a long (relative to benchmark) duration position of 0.35yrs, as bond yields rose over the third quarter as the market priced further tightening of monetary policy by several major central banks.

We felt that markets were fairly priced and were happy to move into a long duration stance. The exception to this was Japan, where yields, despite having risen, still remained very low in a global context and the Bank of Japan had yet to embark on a tightening of monetary policy, despite inflation remaining above target and headwinds from incoming wage settlements suggesting that it may prove to remain so.

However, over the course of the last two months of 2023, there was a marked turnaround in government bond yields as the market began to price aggressive loosening of monetary policy following a pledge from central bankers to be “data dependant” when it came to the future path of policy decisions. US 10-year bond yields fell by around 70bps, whilst 10-year Bund yields fell by more than 80bps. The largest move in 10-year developed government bond yields was seen in Italy, falling by over 100bps.

We felt that this market optimism was somewhat misplaced, particularly as central bankers pushed back on the market pricing of aggressive rate cuts into 2024, coupled with the large amount of new debt being supplied to the market. Having initially taken the fund to nearly 0.6yrs long at the end of October, we gradually reduced the relative duration position into the market rally, taking the fund neutral at the end of November and ending the quarter at around 0.2yrs underweight versus the benchmark. This was accomplished via reducing exposure to a number of markets, including France, Germany, Italy, Japan and, to a lesser extent, the US.

The fund remains underweight Japan and Europe but has an overweight to dollar block duration, (largely in the US), as we feel that dollar block yields better reflect the prevailing market conditions and likely future path of monetary policy.

Performance and activity

Fund activity

Our inflation positioning remains relatively light in the portfolio, as many markets look, at best, fair value, in our view. Pockets of value are potentially emerging, particularly in the light of geo-political developments, but we remain on the side-lines for now, awaiting better levels for entering break-even inflation trades.

The fund maintains relatively small holdings in short-dated Japanese and Italian index linked bonds, both of which had a negligible impact on performance over the quarter.

The major curve position within the fund remains a curve steepener within the US, with the fund being underweight the 30-year part of the curve and overweight the 5-year area. The fund has held this position over a number of quarters as we believed the US curve further would struggle to remain inverted, given the actions and rhetoric of the Fed. The slope of the curve from the end of the third quarter to the end of the fourth quarter was broadly unchanged, albeit a fair degree of volatility was exhibited over the course of the quarter, but we retain conviction that the curve remains too flat and maintain our steepening exposure.

Overall, the US curve was a broadly neutral contributor to performance over the fourth quarter.

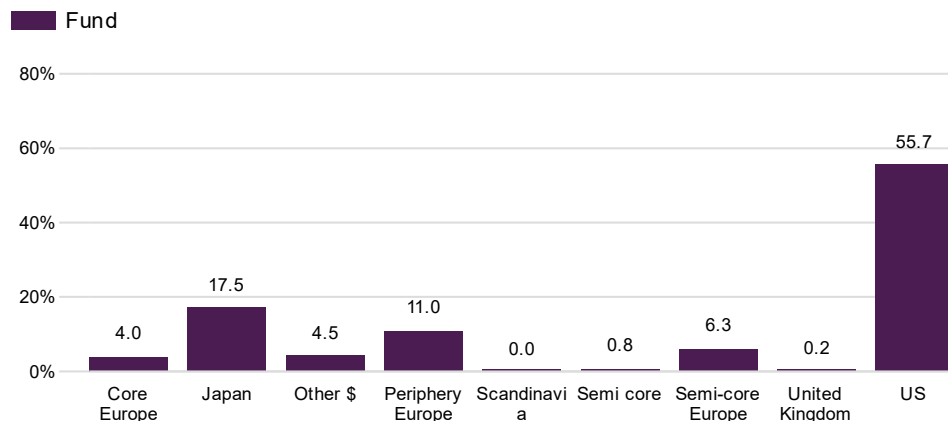
Elsewhere curve exposure remained limited, though toward the end of the quarter we started switching out of longer-dated European government debt into shorter-dated exposure to position for a steepening of European yield curves.

With the market moves over the quarter largely being directional, the majority of activity was focussed on outright duration trading, rather than cross market relative value. However, as we saw some outsize moves in markets such as Italy, we re-established cross market underweights in Italy versus Spain and Germany, actively traded France versus Belgium and reduced some European exposure via switching into the US. We also bought debt issued directly by the European Union, under its NGEU program, versus selling of French government bonds as the yield pickup looked attractive.

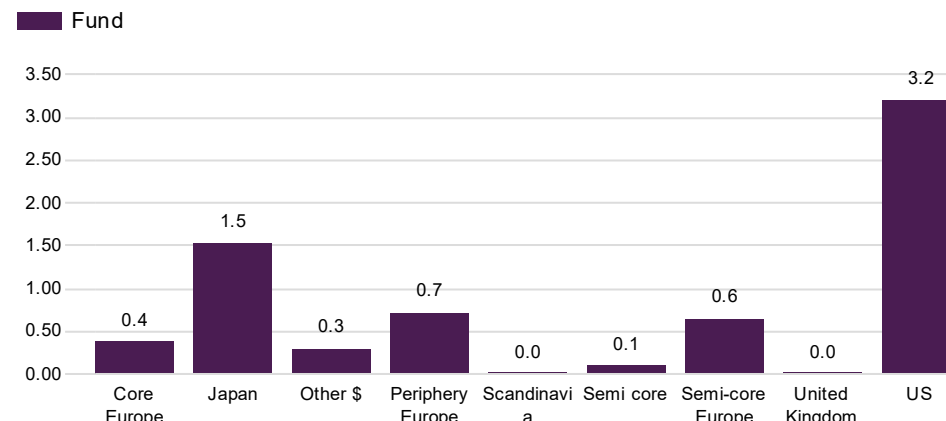
Cross market positioning will likely have had largely neutral impact on performance over the quarter.

Fund breakdown

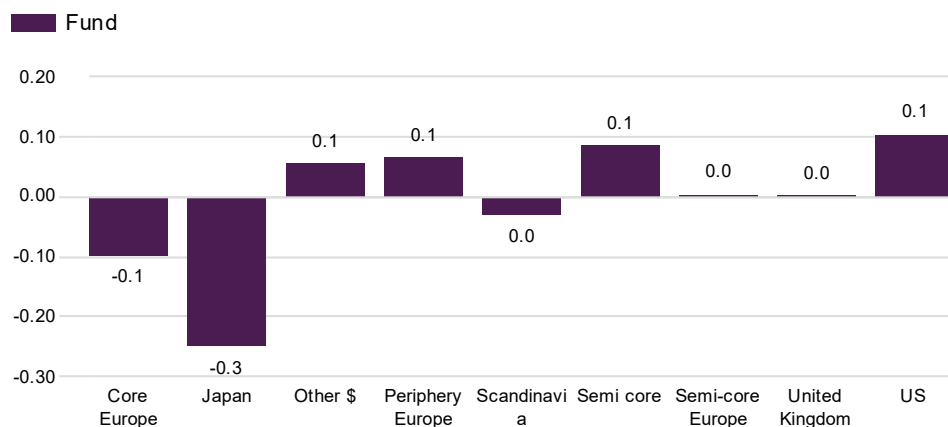
Geographic split by % weight



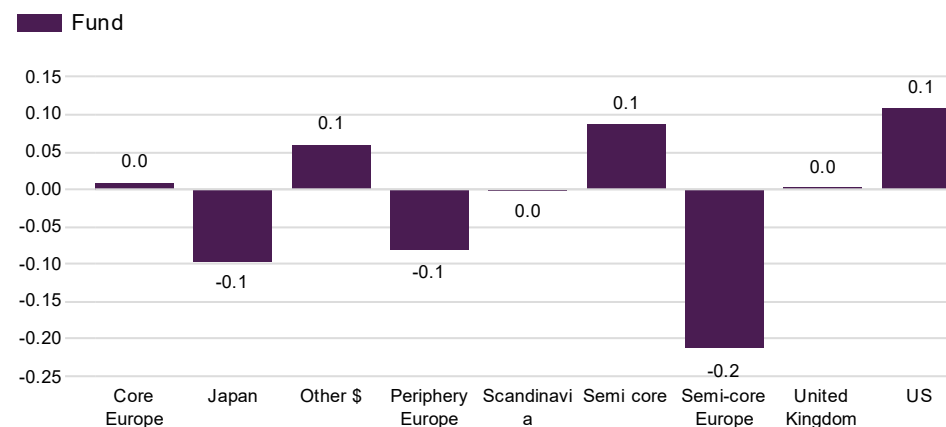
Geographic split by duration



Duration position relative to benchmark

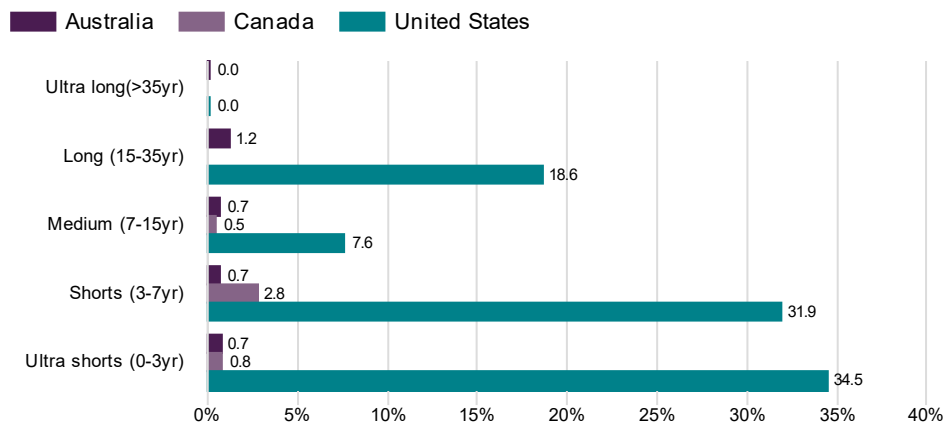


Relative duration quarter on quarter

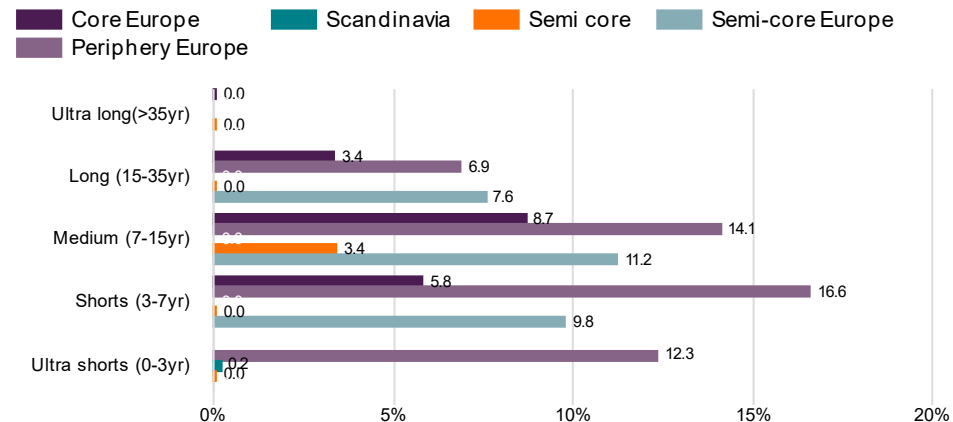


Fund breakdown

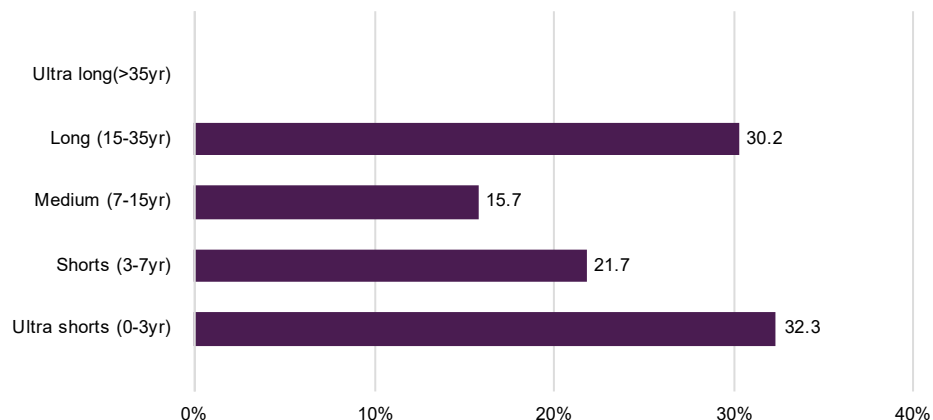
Dollar bloc



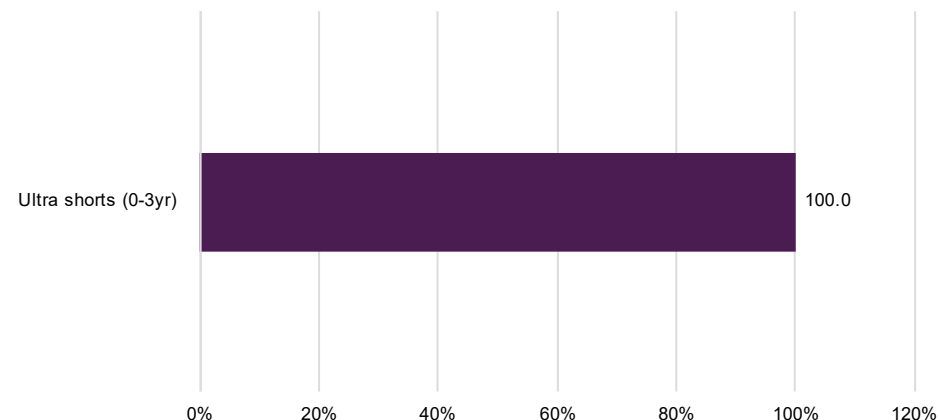
Euro bloc



Japan

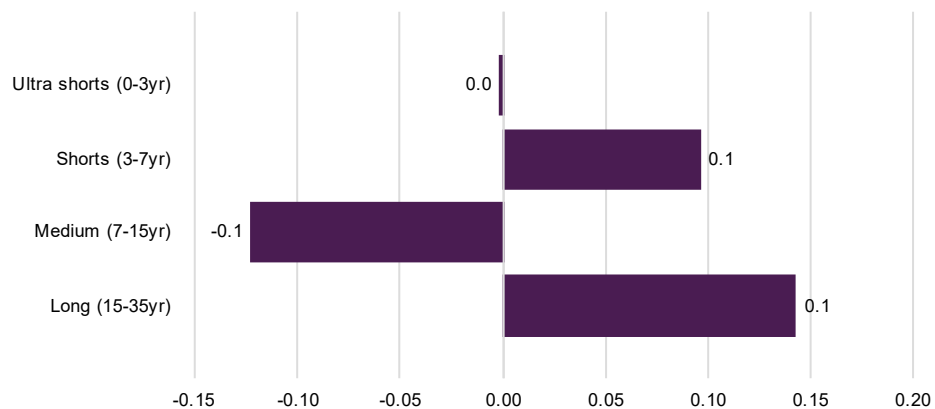


UK

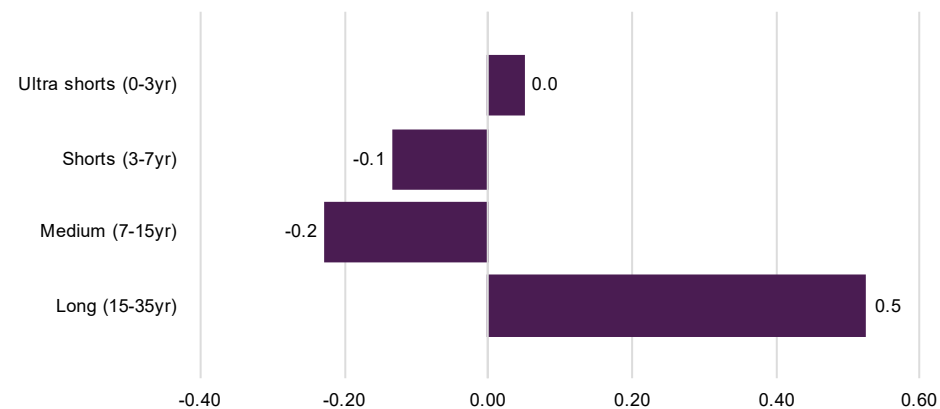


Fund breakdown

Maturity profile relative to benchmark

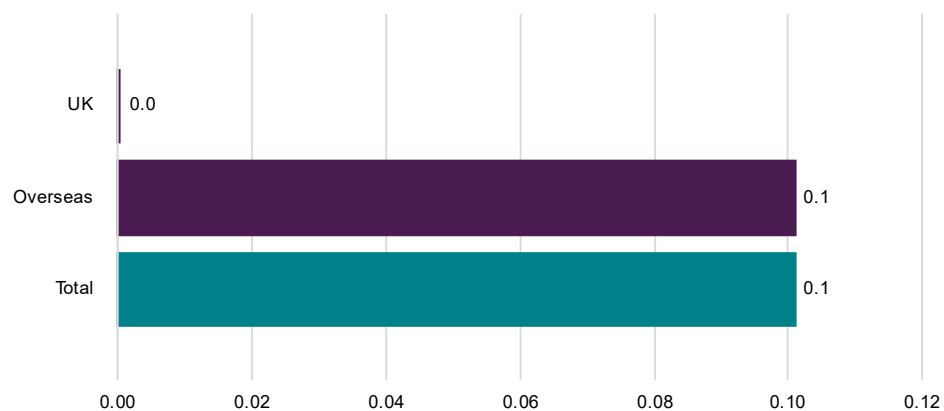


Maturity profile change on quarter

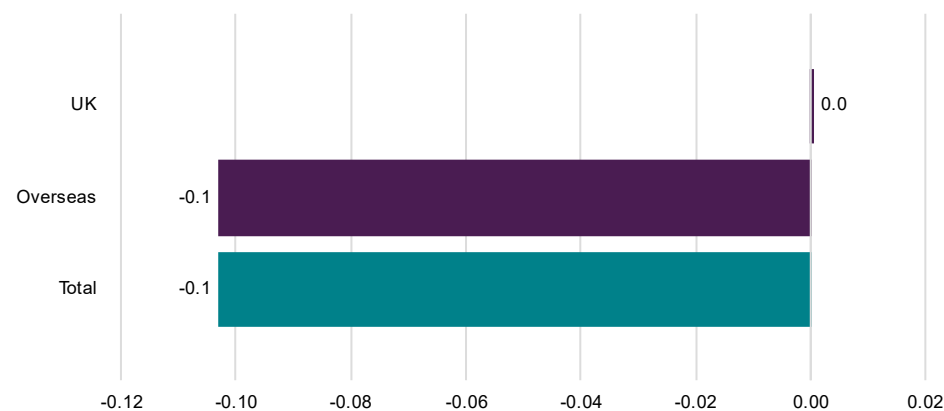


Exposure

Inflation exposure (duration)



Inflation exposure change on quarter (duration)



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.

UK government bonds produced strong returns due to falling yields, delivering an 8.1% return (FTSE Actuaries) over the fourth quarter with the benchmark 10-year gilt yield falling from 4.44% to 3.54%. The falling yield environment was helpful for longer duration assets, with longer-dated bonds outperforming shorter-dated bonds in total return terms. However, when looking at changes in yields, 5-year maturity bonds were the best performing area, and the curve steepened.

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: Year-on-year CPI inflation fell from 6.7% for the August release to 3.9% for the November release, largely due to year on year base effects. Core inflation fell from 6.2% to 5.1% over the same period. By the end of the quarter (the October data release) regular pay growth figures were showing more sign of slowing, at 7.3% for the 3-months to October (from 7.9% three-months earlier). The Autumn Statement saw

the Chancellor add more fiscal stimulus (tax cuts) than expected, spending the 'windfall' from the impact of high inflation on tax revenues.

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. The core PCE measure of inflation fell over the quarter and month-on-month was only 0.1% in November. Third quarter GDP recorded a strong 4.9% quarter-on-quarter annualised growth. More timely economic activity indicators were mixed over the fourth quarter. The House passed a spending package that pushed the effective next government spending deal/shutdown deadline into early 2024.

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. President Lagarde said that they did not discuss rate cuts in December and that "between hike and cut there is a whole plateau – a whole beach – of hold." Euro area CPI fell to only 2.4% year-on-year in November from 5.2% in August. Core CPI fell sharply over the same period too to 3.6%. The euro area economy (GDP) shrank by 0.1% quarter-on-quarter in the third quarter after recording only 0.1% GDP growth in both the first quarter and the second quarter. Germany's constitutional court put hurdles in the way of additional German government spending, ruling against the transfer of borrowing authorised during Covid to the Climate Fund (that decision was taken in 2021), in the name of protecting Germany's constitutional debt brake.

The sterling investment grade credit market (iBoxx non-gilt index) returned 7.35% over the quarter, helped by lower government bond yields and tighter credit spreads. The underperformance compared to the gilt market is the result of the shorter duration of the credit market index. The average sterling investment grade credit spread (the average extra yield

Market commentary

available from non-gilt bonds compared with government debt of equal maturity) tightened from 1.38% to 1.15% (iBoxx).

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. In terms of policy implications, the ECB has indicated that they are likely to wait until they see firm, sustainable evidence of inflation returning to target before they begin easing policy, whereas the US Federal Reserve has hinted at some flexibility in this regard, being led by incoming data. 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 5.5%, with the first cut priced in for the second quarter of 2024, and falling to a terminal level of around 3.00% by late-2025. For Europe, the first cut is priced for April 2024 (despite the pushback from the ECB), with a terminal rate of around 2% by the end of 2025. Contrast this with Japan, where rates have been left unchanged throughout the hiking cycle elsewhere, and the market pricing a withdrawal from NIRP (negative interest rate policy) by quarter 4 of 2024, albeit via a hike of only 10bps. Government bond markets have moved a long way during the last few months, alongside elevated volatility as markets try to second guess the central banks reaction function to incoming economic data.

Supply will be an issue for the majority of government bond markets over the next few years, particularly against a backdrop of significantly reduced central bank buying (and in some cases, central bank selling of holding in government bonds). Some markets, such as the US, are better priced to reflect this than others.

Further Information

Please click on the links below for further information:



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

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The Fund is a sub-fund of Royal London Bond Funds ICVC, an open-ended investment company with variable capital with segregated liability between sub-funds, incorporated in England and Wales under registered number IC000797.

The Authorised Corporate Director (ACD) is Royal London Unit Trust Managers Limited, authorised and regulated by the Financial Conduct Authority, with firm reference number 144037.

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.

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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.

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.

Emerging Markets Risk

Investing in Emerging Markets may provide the potential for greater rewards but carries greater risk due to the possibility of high volatility, low liquidity, currency fluctuations, the adverse effect of social, political and economic instability, weak supervisory structures and accounting standards.

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.

Government and Public Securities Risk

The Fund can invest more than 35% of net assets in different Transferable Securities and Money Market Instruments issued or guaranteed by any EEA State, its local authorities, a third country or public international bodies of which one or more EEA States are members.

Charges from Capital Risk

Charges are taken from the capital of the Fund. Whilst this increases the yield, it also has the effect of reducing the potential for capital growth.

Performance to 31 December 2023

Cumulative (%)

	3 Month	6 Month	1 Year	3 Years	5 Years	3 Years (p.a.)	5 Years (p.a.)
Fund (gross)	5.66	3.47	5.89	(6.00)	5.37	(2.04)	1.05
Fund (net)	5.58	3.31	5.57	(6.84)	3.74	(2.34)	0.74

Annualised (%)

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)	5.89	(10.17)	(1.18)	5.81	5.94
Fund (net)	5.57	(10.43)	(1.48)	5.49	5.56

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 International Government Bond Fund (M Inc).

Glossary

Asset allocation

Breakdown of the assets by asset classes. Based on RLAM asset classification scheme.

Duration

Measure of sensitivity of a Fixed Income instrument to changes in interest rates, indicating the potential impact of interest rate fluctuations on the value of the investment.

Fund Analytics

All figures exclude cash. Credit bonds include non-sterling bonds and CDs where held within the fund or benchmark.

This is applicable to the following sections: fund Asset Allocation, Duration, Yield curve, Sector breakdown, Financial holdings, Credit ratings.

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.

Number of holdings

Total number of unique holdings of the Fund excluding cash, currency and derivatives.

Performance

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

Real yield

Real yield shows the inflation-adjusted redemption yield for the underlying fund and therefore does not include the impact of fees. For share class level yields, please see the latest factsheet.