For professional clients only, not suitable for retail clients.

Royal London Absolute Return Government Bond Fund

Quarterly Investment Report

31 March 2024

ROYAL LONDON
ASSET MANAGEMENT

Quarterly Report

The fund as at 31 March 2024

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 and the fund will seek to achieve its objective on an active basis. The Fund seeks to achieve its investment objective by outperforming its benchmark, the Sterling Overnight Index (the "Benchmark") on an annual basis by 2.5% over rolling three year periods and aims to provide positive performance over 12 month periods. The Benchmark is an index which tracks overnight funding rates in the Sterling market. The Benchmark is being used by the Fund for performance comparison purposes only and the Fund does not intend to track the Benchmark.

Benchmark: SONIA (Sterling Overnight Index Average)

Fund value

	Total £m
31 March 2024	1,206.09

Asset allocation

	Fund (%)
Conventional credit bonds	39.73%
Money market instruments	39.10%
Index linked foreign sovereign	16.19%
Conventional foreign sovereign	3.54%
Conventional gilts	1.37%
Index linked gilts	0.07%

Fund analytics

	Fund
Fund launch date	17 November 2014
Base currency	GBP

Performance and activity

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Quarter	1.53	1.27	0.27
1 Year	6.82	4.97	1.85
3 Years (p.a.)	3.81	2.42	1.38
5 Years (p.a.)	3.09	1.60	1.49
Since inception (p.a.)	1.99	1.05	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 over the quarter, outperforming its cash benchmark. This was a pleasing result given that most major sovereign bond indices saw negative returns as yields partially reversed some of the gains seen in the final quarter of 2023.

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 returns on expectations that UK interest rates will be cut in 2024.

Duration positioning added value over the quarter, particularly through tactically trading the volatility seen in markets as economic data continued to be mixed. Buying of syndications in the UK, Italy, France and Spain added value as new issue premiums tended to be higher given the vast amount of supply expected to hit markets in 2024. The more structural short duration positions in Germany and Japan added value as yields rose.

Curve positions added value particularly in the UK where steepeners were entered during the quarter and closed profitably.

Inflation positioning was also helpful. US and European breakevens were bought close to 2% early in the quarter and added value as breakeven rates rose alongside the rise in commodity prices. Japanese inflation positions were also helpful as breakeven rates rose to their highest levels in over five years as Japanese inflation remained at higher levels.

Cross market positions were fairly limited but we added value receiving 1y1y UK swaps relative to the US and also benefitted the UK outperforming France early in the quarter.

Performance and activity

Return Contribution

	Quarter	1 year	Target return (of live trades)
Inflation	12.00	119.00	39.00
Curve	21.00	63.00	30.00
Duration	26.00	64.00	50.00
Relative Value	0.00	1.00	0.00
Cross Market	(2.00)	7.00	24.00
FX Hedges	0.00	0.00	0.00
Cash	101.00	388.00	490.00
Total	**158.00**	**642.00**	**633.00**

Top Contributors

	Strategy	Q1 Contribution (bps)
CASH	Floating	51.00
CASH	Fixed	50.00
Curve	UK	14.00
Inflation	Japan	14.00
Duration	Germany	10.00

Bottom Contributors

	Strategy	Q1 Contribution (bps)
Cross Market	UK/EUR	(6.00)
Duration	AUS	(6.00)
Inflation	UK	(5.00)
Duration	US	(4.00)
Curve	Japan	(2.00)

Performance and activity

Portfolio Exposure

Trades	Position size	Net duration exposure	Market beta	Target return (bps)
Inflation				
Long Japanese Breakeven	0.50	0.00	(0.10)	15.00
Long US 5 year Cpi	0.40	0.00	0.10	4.00
Short UK 10 year RPI	0.90	0.00	(0.20)	20.00
Curve				
US 5/30 Steepener	0.10	0.00	0.00	15.00
Germany 5-30 steepener	0.30	0.00	0.00	10.00
Aussie 10/30 flattener	0.20	0.00	0.00	5.00
Cross Market				
Long Aus ry vs uk	0.10	0.00	0.00	2.00
Long US ry vs uk	0.20	0.00	0.10	5.00
Long France ry vs UK	0.20	0.00	(0.10)	2.00
Long Spain vs France	0.20	0.00	(0.10)	5.00
Long UK vs Europe	0.20	0.00	0.10	5.00
Long US vs Canada	0.20	0.00	0.05	5.00
Duration				
Short 10 year Japan	(0.20)	(0.20)	0.00	10.00
Tactical Duration Trading	-	-	-	40.00

Performance and activity

Portfolio Exposure

Trades	Position size	Net duration exposure	Market beta	Target return (bps)
Cash				
Cash	0.20	0.20	-	490.00
Overall Net Duration Position	**3.50**	**0.00**	**(0.15)**	**633.00**

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	0.03	0.00	(0.15)	0.21	0.00	0.00	0.00	0.09
Canada	0.01	0.00	(0.21)	0.00	0.00	0.00	0.00	(0.19)
European Union	(0.00)	(0.16)	0.00	0.00	0.00	0.00	0.00	(0.16)
Finland	0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.01
France	0.06	0.00	(0.15)	0.00	0.00	0.00	0.10	0.02
Germany	0.02	0.28	0.00	0.00	(0.29)	0.00	0.00	0.01
Japan	0.06	0.48	(0.74)	0.00	0.00	0.00	0.00	(0.21)
Netherlands	0.02	0.00	0.00	0.00	0.00	0.00	0.00	0.02
Norway	0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.01
Singapore	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Spain	0.00	0.00	0.18	0.00	0.00	0.00	0.00	0.18
Sweden	0.01	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	0.08	0.17	(0.10)	0.21	(0.14)	(0.44)	0.00	(0.22)
United States	0.00	0.31	0.00	(0.12)	0.00	0.21	0.00	0.40
Total								(0.04)

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	0.05	0.00	0.00	0.00	0.00	0.05
Canada	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
European Union	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Finland	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	0.10
Germany	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Japan	0.06	0.48	0.00	0.00	0.00	0.00	0.00	0.54
Netherlands	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
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
United Kingdom	(0.85)	0.00	(0.10)	0.00	0.00	(0.45)	0.00	(1.40)
United States	0.39	0.00	0.00	0.00	0.00	0.21	0.00	0.60
Total								(0.10)

Performance and activity

Stand alone risk contribution

	Quarterly Vol (%)	Annual Vol (%)
Inflation	0.37	0.75
Curve	0.02	0.04
Duration	(0.01)	(0.03)
Relative Value	0.00	0.00
Cross Market	(0.00)	(0.01)
FX Hedges	0.07	0.14
Cash	0.02	0.04
Overall Volatility	**0.46**	**0.93**

Risk Model Factor Risk Breakdown

	Standalone Risk Portfolio (bp)	Risk Contribution Portfolio (bp)	% of overall risk
Rates	46.31	21.56	23.26
Inflation	81.58	69.15	74.61
Spreads	20.47	1.95	2.10
Foreign Exchange	1.80	0.03	0.04
Other	0.00	-	-
Time	0.00	-	-
Total	**150.17**	**92.69**	**100.00**

Diversification across Risk Factors (%)	**(38)**

Performance and activity

Fund activity

Having begun the quarter short duration we moved to a long position as yields rose sharply in the first two weeks of January. This was primarily through buying UK after it had underperformed as well as German futures. For the remainder of the quarter, duration was traded tactically around supply events and market volatility as the market priced in and priced out expected rate cuts as data remained mixed. Duration was generally between flat and 1 year long.

Inflation positions were increased early in the quarter buying both the US and Europe, these positions were sold as breakevens rose in line with higher oil prices. The main activity in inflation was towards the end of the quarter, after a particularly strong rally in UK index linked bonds and RPI. We sold linkers on a cross market basis against Australia, buying the 2035 syndication and long-dated French and US bonds as real yields in the US rose above 2.1%.

We went long five-year US CPI at the end of the quarter whilst selling 10-year RPI as rates rose close to 3.7%, with RPI expected to fall below 3% by the end of the year.

After a strong performance from Canada we moved to an underweight position versus the US.

The fund actively traded curve positions in the US, UK, Australia and Europe. We favoured steepeners in the US and Europe and flatteners in the UK and Australia. Curves were very volatile around data points and central bank meetings and we used this volatility to tactically trade curve positions.

We used supply events across the globe to add duration where new issue premiums were again attractive.

Market commentary

Market Overview

A key theme to emerge during the quarter was indication of a more favourable global macro backdrop. Despite some mixed signals, the US economy remains resilient, while Europe and the UK show signs of gradually exiting their recessions. Activity in China also seems to be stabilising. At the same time, core central banks are still confident that the disinflation trend remains intact, despite some recent setbacks in inflation prints. Policymakers have often highlighted that they are in no rush to cut rates – with markets now generally pricing the start of the easing cycles to begin this summer. The Federal Reserve, European Central Bank and Bank of England all left interest rates unchanged over the quarter.

One major development over the quarter is that markets have recalibrated their pricing for expected central bank cuts over this year. At the end of last year, markets were pricing in an aggressive rate cutting cycle, but then swiftly move to temper those forecasts. This re-pricing contributed to negative returns for global government bond markets over the quarter. Despite the belief of many that it was the anticipation of a 'Fed-pivot' that contributed to the rally in equity markets in late 2023, equity markets proved to be immune to this bond market sell-off as global growth and business confidence showed signs of resilience and investors focused on the potential offered by AI.

Government yields rose in all the major markets. In the US, 10-year treasury yields rose from 3.88% to 4.21%, while German 10-year bunds similarly saw yields rise from 2.01% to 2.30%. Mirroring this backdrop of rising yields, UK government bonds produced a return of -1.62% (FTSE Actuaries) over the first quarter, with the benchmark 10-year gilt yield rising from 3.54% to 3.94%. The bulk of this move occurred in the first two weeks of January, before largely trading in a range between 4% and 4.2% for the rest of the quarter. The rising yield environment helped short-dated bonds to outperform their longer-dated equivalents.

UK index-linked markets saw similar increases in yields and as a result saw a negative returns for the quarter at -1.81% (FTSE Actuaries All-maturities). Real yields on UK 10-year bonds rose from 0.05% to 0.28% with 30-year real yields rising from 0.95% to 1.13% while yields on US 30-year index-linked bonds similarly increased, from 1.90% to 2.07%.

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.

We believe the markets are still too optimistic in the number of rate cuts that central banks will deliver this year. However, curves have unwound some of the extreme moves seen into year end. We still expect curves to steepen over the longer term and will gradually build steepening risk into the portfolio. We expect markets to remain volatile around economic data points and envisage trading duration more tactically in the medium term.

Inflation remains undervalued in Japan, and this is our major overweight position in inflation. The Bank of Japan is expected to raise short-term rates further, particularly given the weakness of the yen, and we are therefore running a short position overall in Japan.

After the recent push higher in UK breakevens we believe they are overvalued, particularly with five linker auctions in the second quarter. This applies to UK real yields where TIPs (US index linked treasuries) above 2% and Australia at 1.75% offer more attractive yields.

Further Information

Please click on the links below for further information:

Stewardship and responsible investment at RLAM

TCFD climate report

Find out more

In an uncertain geopolitical and economic environment, we recognise the importance of keeping our clients updated on our current investment thinking.

Articles, videos, podcasts and webinars giving the latest views of our investment experts 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 April 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 risk

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 March 2024

Cumulative (%)

	3 Month	6 Month	1 Year	3 Years	5 Years
Fund (gross)	1.53	4.02	6.82	11.87	16.46
Fund (net)	1.46	3.86	6.50	10.69	14.35

Annualised (%)

3 Years (p.a.)	5 Years (p.a.)
3.81	3.09
3.44	2.72

Year on year performance (%)

	31/03/2023 - 31/03/2024	31/03/2022 - 31/03/2023	31/03/2021 - 31/03/2022	31/03/2020 - 31/03/2021	31/03/2019 - 31/03/2020
Fund (gross)	6.82	4.45	0.26	4.06	0.05
Fund (net)	6.50	4.10	(0.16)	3.62	(0.31)

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 March 2024. 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.