Royal London Government Bond Funds

Fund Manager Commentary

31 August 2024

ROYAL LONDON
ASSET MANAGEMENT

Fund Manager Commentary

31 August 2024

The purpose of this report is to provide an update on the Royal London Fixed Income Funds. The report has been produced by Royal London Asset Management. The report starts with a performance summary followed by Fund Manager commentary for each of the Funds. All data within this report is at the report date unless otherwise stated.

Contents

Performance

	1 month (%)	Rolling 12 months (%)
RL Global Index Linked Bond Fund Z Inc	**0.99**	**5.26**
Bloomberg World Government Inflation-Linked Bond Index – Total Return (GBP Hedged)	0.32	4.50
Gobal Inflation Linked Bond Sector	0.51	4.61
RL Index Linked Bond Fund M Inc	**0.28**	**3.35**
FTSE Actuaries UK Index-Linked All Stocks Index	-0.21	3.02
IA UK Index Linked Gilts Sector	0.27	2.93
RL Short Duration Gilts Fund Z Inc	**0.51**	**6.55**
FTSE Actuaries UK Conventional Gilts up to 5 Years Index	0.40	5.95
IA UK Gilts Sector	0.79	6.84
RL Short Duration Global Index Linked Bond Fund Z Inc	**0.74**	**6.00**
RL Short Duration Global Index Linked Composite Benchmark[1]	0.34	5.57
Global Inflation Linked Bond Sector	0.51	4.61
RL UK Government Bond Fund Z Inc	**1.05**	**7.96**
FTSE Actuaries UK Conventional Gilts All Stocks Index	0.52	6.81
IA UK Gilts Sector	0.79	6.84

Past performance is not a guide to 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.

Source: Royal London Asset Management and FE, correct as of 31 August 2024. Returns quoted are net of fees. Please note the fund returns are based on mid-day pricing, and benchmark returns are priced at end of day. Please note that with effect from 1 February 2024 RLAM are using peer group comparisons provided by Morningstar. Prior to this peer comparisons were provided by Lipper so there may be some differences compared to the data provided historically. All IA sector performance shown is for the median. [1] The composite benchmark consists of: 30% Bloomberg UK government Inflation Linked Bond 1-10 year index, 70% Bloomberg World Government Inflation Linked Bond (Ex UK) 1-10 year index (GBP Hedged).

Government Bond Market Review

Market highlights

Global government bond yields fell slightly in August as comments from the US Federal Reserve put investors alert for impending interest rate cuts. US Treasury 10-year yields fell to 3.92% from 4.05%, while German bund 10-year yields inched lower to 2.23% from 2.24%. In the UK, however, 10-year gilt yields rose slightly, rising to 4.02% from 3.97%, with the FTSE UK Conventional Gilt All-Stocks index returning 0.50%.

The Bank of England cut Base Rates 25 basis points, on a 5-4 vote, with Governor Andrew Bailey saying that they need to be careful not to cut too quickly. As of the end of August, the market was priced for the next rate cut to come at the BoE's November monetary policy meeting. Public sector finances came in worse than expected in July. As a result, UK Prime Minister Keir Starmer warned that the Autumn Budget is "going to be painful" and that the burden will fall on those with the broadest shoulders.

Meanwhile, UK data released in August painted a relatively robust picture of economic activity, while inflation rose a bit less than expected (even if it did move back above the central bank's 2% target). Year-on-year July CPI inflation was a touch softer than expected but rose two-tenths to 2.2%. Core inflation was also a tenth lower than expected – falling two-tenths to 3.3% year-on-year. Services inflation was also weaker than forecast, falling to 5.2% (down 5-tenths). Second quarter GDP rose 0.6% quarter-on-quarter after 0.7%, confirming robust economic activity growth in the first half.

At his Jackson Hole speech, US Federal Reserve Chair Jerome Powell signalled a stronger likelihood of a September rate cut, saying that the "time has come for policy to adjust." He also indicated a significant amount of sensitivity to labour market data, saying that: "We do not seek or welcome further cooling in labour market conditions." The FOMC minutes for the July meeting also showed that the "vast majority" of participants said that "it would likely be appropriate to ease policy at the next meeting" if the economy evolves as expected. Early in August, the weak payrolls figures helped raise US recession fears. July nonfarm payrolls were much weaker than expected at 114K (consensus: 175K) and, during the month, the benchmark revisions also lowered the recent run rate of payroll gains.

Overall, though, US data was relatively mixed in August and, by the end of the month, the Atlanta Fed's nowcast for third quarter GDP was at a robust 2.5% quarter-on-quarter annualised and second quarter GDP itself was revised up to 3.0%. Other activity indicators included July real personal spending rising 0.4% month-on-month and headline durable goods orders rose strongly. Inflation data was again relatively reassuring from a Fed perspective. July CPI fell from 3.0% year-on-year to 2.9%; core rose 0.2% month-on-month as did the core PCE deflator. So-called 'super-core' inflation also rose 0.2% month-on-month on both CPI and PCE measures.

The European Central Bank did not have a meeting in August, but a number of ECB speakers indicated that they would support a September rate cut although there were more cautious voices too. August CPI was in line with consensus with headline CPI at 2.2% year-on-year after 2.6%, drawing close to the ECB's 2% target. Core CPI also fell a tenth as expected to 2.8%. However, services inflation rose to 4.2% year-on-year after 4.0%. Activity data released over the month were mixed, but indicated relatively subdued activity growth.

The sterling investment grade market (iBoxx) produced positive returns in August, with a return of 0.36%. The average investment grade credit spread (the average extra yield available from a corporate bond compared with government debt of equal maturity) widened marginally to 1.05% from 1.04%.

Royal London Global Index Linked Bond Fund

Portfolio commentary

Net of fund management fees, the fund produced positive returns in August. It should be noted that returns can be distorted by the differing valuation points of the fund and index. On a like-for-like basis, the fund outperformed the index over the month. Overweight positions in Australia and the US added value during August.

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Early August saw extreme volatility in markets post the higher-than-expected hike in Japanese rates and weaker US employment data. Japanese breakeven rates fell 50bp in one day as the Nikkei fell by over 10% and US breakeven rates by 25 basis points. Breakeven rates recovered most of the losses over the remainder of the month. Real yields were generally lower over the month on overseas markets as the prospect of larger interest rate cuts grew.

CITYWIRE A

Paul Rayner

Head of Alpha Strategy

CITYWIRE A

Gareth Hill

Senior Fund Manager

Royal London Global Index Linked Bond Fund continued

Investment outlook

We remain of the view that global interest rates will come down in the second half of the year. August inflation data was supportive of this view, particularly in the US.

Central banks will pay attention to upcoming inflation data releases. Whilst service inflation and wage growth remain elevated, good progress has been made on bringing down headline inflation. We expect the Bank of England to further reduce the Base Rate in Q4 and see scope for a modest reduction in gilt yields.

Key views within the fund

The portfolio has a long duration position, as we expect rate cuts in the second half of 2024, as seen with both the ECB and Bank of Canada cutting rates in recent months.

Breakeven rates in the US and Europe are marginally cheap to fair value whereas the UK looks closer to fair value. We like US breakevens as a Trump hedge.

The fund has no strategic curve position, but with inflation data improving, we have a broad preference to hold 5-10 year bonds over short-dated bonds.

•On a cross market basis the funds favour UK and European bonds relative to Japan and dollar markets.

Royal London Index Linked Bond Fund

Portfolio commentary

Net of fund management fees, the fund produced negative returns in August. It should be noted that returns can be distorted by the differing valuation points of the fund and index. On a like-for-like basis, the fund outperformed the index over the month. Overweight positions in Australia and the US added value during August.

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Breakeven rates in the US and Europe are marginally cheap to fair value whereas the UK looks closer to fair value. We like US breakevens as a Trump hedge.

The fund has no strategic curve position, but with inflation data improving, we have a broad preference to hold 5-10 year bonds over short-dated bonds.

At the end of August no cross market positions were held.

Royal London Short Duration Gilts Fund

Portfolio commentary

Net of fees, the fund was ahead of its benchmark in August. Year-to-date, the fund has recorded a positive return and remains ahead of the benchmark.

Despite the low variance in yields from the beginning of the month to the end, this does not tell the story of the volatility seen in bond markets. At the tail end of July, 10-year gilt yields fell, with the drop coming in the first few days on August, following rate decisions from the Bank of Japan and the US Federal Reserve in late July. While the BoJ decision to hike rates was priced in by the market, the timing of the decision may have caught markets off guard slightly.

At the July meeting, the Fed was much more in line with expectations, but Chair Jerome Powell’s press conference following the release of the decision to stay put indicated a slight softening in tone. Then, in August, while at the Jackon Hole Economic Symposium, Powell signalled a strong likelihood of a September rate cut. Markets took this as very dovish as the data did not necessarily back this shift in tone. Markets have now moved to price in five rate cuts from the Fed this year.

Following this rally early in the month, yields ground higher through the rest of the month.

The slight rise in 10-year gilt yields over the month was generally similar across the curve, with the front-end seeing a slight drop while the long-end was largely flat.

The Bank of England cut in August was largely seen coming by markets. As of the end of August, the market was priced for the next rate cut to come at the BoE’s November monetary policy meeting.

The fund started the month 0.25 of a year long and ended the period 0.15 of a year long. We took duration off the fund into the rally at the start of the month, taking the fund 0.05 of a year long, then added duration back as yields drifted higher as the month progressed – which was beneficial for performance.

Our cross-market positioning was beneficial for performance, as our dollar market government bond in Australia outperformed gilts.

During the month, we exited our position in Australia government bonds, selling our 7-year bonds and taking profit on the position.

The fund has no inflation exposure.

Investment outlook

We believe that inflation will rise into the end of the year, before falling back towards target during 2025. 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 move through the second half of 2024, central banks are likely to start reducing rates, but with yields below base rates in all markets, this is well priced.

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Royal London Short Duration Gilts Fund continued

Supply will remain high for the next few years, with around £200bn per annum forecast over each of the next five years. Alongside quantitative tightening (where the BoE is selling its gilt holdings back into the market), this could represent a headwind for gilts. However, when considering gilts in a global context, we believe the gilt market is somewhat priced for this, with the UK curve much steeper than both the US and German bonds.

Key views within the fund

The portfolio's duration is marginally long of the benchmark, including the impact of cash holdings on duration.

The portfolio has allocations to high quality corporate bonds, which we expect to outperform gilts.

Royal London Short Duration Global Index Linked Bond Fund

Portfolio commentary

Net of fund management fees, the fund produced positive returns in August. It should be noted that returns can be distorted by the differing valuation points of the fund and index. On a like-for-like basis, the fund outperformed the index over the month. Overweight positions in Australia and the US added value during August.

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Investment outlook

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Central banks will pay attention to upcoming inflation data releases. Whilst service inflation and wage growth remain elevated, good progress has been made on bringing down headline inflation. We expect the Bank of England to further reduce the Base Rate in Q4 and see scope for a modest reduction in gilt yields.

Key views within the fund

The portfolio has a long duration position, as we expect rate cuts in the second half of 2024, as seen with both the ECB and Bank of Canada cutting rates in recent months.

Breakeven rates in the US and Europe are marginally cheap to fair value whereas the UK looks closer to fair value. We like US breakevens as a Trump hedge.

The fund has no strategic curve position, but with inflation data improving, we have a broad preference to hold 5-10 year bonds over short-dated bonds.

On a cross market basis the funds favour UK and European bonds relative to Japan and dollar markets.

Royal London UK Government Bond Fund

Portfolio commentary

Net of fees, the fund was ahead of its benchmark in August. Year-to-date, the fund has recorded a positive return and remains ahead of the benchmark.

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At the July meeting, the Fed was much more in line with expectations, but Chair Jerome Powell's press conference following the release of the decision to stay put indicated a slight softening in tone. Then, in August, while at the Jackon Hole Economic Symposium, Powell signalled a strong likelihood of a September rate cut. Markets took this as very dovish as the data did not necessarily back this shift in tone. Markets have now moved to price in five rate cuts from the Fed this year.

Following this rally early in the month, yields ground higher through the rest of the month.

The slight rise in 10-year gilt yields over the month was generally similar across the curve, with the front-end seeing a slight drop while the long-end was largely flat.

The Bank of England cut in August was largely seen coming by markets. As of the end of August, the market was priced for the next rate cut to come at the BoE's November monetary policy meeting.

The fund started the period 0.3 of a year long and ended the month neutral duration versus the benchmark. We took profits on our duration position into the rally at the start of the month, taking the fund 0.1 of a year long. We did this by selling 5-year gilts, 7-years US TIPS and 30-year Aussie government bonds.

Selling duration was positive for the fund as yields rose as the month progressed. Our strategic position was beneficial to performance and then we traded around the market volatility.

Our curve positioning was beneficial to performance. We hold a 5/10s steepening bias, which was particularly fruitful in the early stages of the month as the front-end of the curve led the gilt rally. At this stage, we looked to sell our heavy overweight in 5-year gilts, selling into 7-year gilts – which again proved beneficial as 5-year gilts then underperformed over the remainder of the month.

Our overweight position in 30-year gilts was broadly neutral for performance as the long-end of the curve did not see much movement in yields over the month.

Our cross-market positioning was also beneficial. We seen our holdings in 30-year US TIPS and 30-year Aussie government bonds outperform gilts in the month. By month-end, we took profit on the positions, exiting the 30-year US TIPS position and reducing exposure to long-end Aussie bonds.

Craig Inches

Head of Rates and Cash

Ben Nicholl

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Royal London UK Government Bond Fund continued

Investment outlook

We believe that inflation will rise into the end of the year, before falling back towards target during 2025. 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 move through the second half of 2024, central banks are likely to start reducing rates, but with yields below base rates in all markets, this is well priced.

Supply will remain high for the next few years, with around £200bn per annum forecast over each of the next five years. Alongside quantitative tightening (where the BoE is selling its gilt holdings back into the market), this could represent a headwind for gilts. However, when considering gilts in a global context, we believe the gilt market is somewhat priced for this, with the UK curve much steeper than both the US and German bonds.

Key views within the fund

The portfolio's duration is flat versus the index, including the impact of cash holdings on duration, although we continue to trade around this as market volatility provides opportunities to add value.

The fund retains an exposure to steepening via its overweight in 5-year maturity bonds versus 10-year maturity bonds, but then a flattening bias thereafter due to an overweight in 30-year maturity bonds.

The fund holds positions in overseas government bonds.

The portfolio has a small allocation to high quality corporate bonds which provide additional yield for the portfolio.

Disclaimers

Important information

For professional clients only, not suitable for retail clients.

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RL Global Index Linked Fund, RL UK Government Bond fund, RL Index Linked, RL Short Duration Global Index Linked Fund and RL Short Duration Gilts Fund

The Funds are sub-funds 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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Risk 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.

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.

Concentration risk

The price of Funds that invest in a reduced number of holdings, sectors, or geographical areas may be more heavily affected by events that influence the Stockmarket and therefore more volatile.

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.

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

Derivatives are highly sensitive to changes in the value of the underlying asset which can increase both Fund losses and gains. The impact to the Fund can be greater where they are used in an extensive or complex manner, where the Fund could lose significantly more than the amount invested in derivatives.

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.

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.

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.

Performance to 31 August 2024

Cumulative (%) / Annualised (%)

		3 Month	6 Month	1 Year	3 Years	5 Years	3 Years (p.a)	5 Years (p.a)
RL Global Index Linked Bond Fund Z Inc	Gross	3.66	4.53	5.64	-10.93	-1.89	-3.78	-0.38
RL Global Index Linked Bond Fund Z Inc	Net	3.57	4.35	5.26	-11.89	-3.64	-4.13	-0.74
RL Index Linked Bond Fund M Inc	Gross	3.15	4.50	3.66	-33.93	-29.99	-12.89	-6.87
RL Index Linked Bond Fund M Inc	Net	3.07	4.34	3.35	-34.55	-31.13	-13.16	-7.18
RL Short Duration Gilts Fund Z Inc	Gross	2.48	3.30	6.78	2.90	4.09	0.96	0.80
RL Short Duration Gilts Fund Z Inc	Net	2.43	3.19	6.55	2.22	2.96	0.73	0.58
RL Short Duration Global Index Linked Bond Fund Z Inc	Gross	2.80	4.10	6.24	3.77	11.75	1.24	2.24
RL Short Duration Global Index Linked Bond Fund Z Inc	Net	2.75	3.98	6.00	3.09	10.53	1.02	2.02
RL UK Government Bond Fund Z Inc	Gross	4.81	4.96	8.23	-19.07	-17.33	-6.81	-3.73
RL UK Government Bond Fund Z Inc	Net	4.74	4.82	7.96	-19.72	-18.56	-7.06	-4.02

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 August 2024. All figures are mid-price to mid-price in GBP unless otherwise stated.

Performance to 31 August 2024

Year on year performance (%)

		30/06/2023 – 30/06/2024	30/06/2022 – 30/06/2023	30/06/2021 – 30/06/2022	30/06/2020 – 30/06/2021	30/06/2019 – 30/06/2020
RL Global Index Linked Bond Fund Z Inc	Gross	2.96	-4.11	-8.15	3.22	7.47
RL Global Index Linked Bond Fund Z Inc	Net	2.59	-4.46	-8.48	2.86	7.09
RL Index Linked Bond Fund M Inc	Gross	1.50	-14.35	-19.32	-3.67	11.77
RL Index Linked Bond Fund M Inc	Net	1.20	-14.61	-19.59	-4.02	11.37
RL Short Duration Gilts Fund Z Inc	Gross	7.23	-2.95	-2.48	-0.16	1.82
RL Short Duration Gilts Fund Z Inc	Net	7.00	-3.16	-2.70	-0.37	1.60
RL Short Duration Global Index Linked Bond Fund Z Inc	Gross	4.78	-0.56	-0.51	4.50	3.09
RL Short Duration Global Index Linked Bond Fund Z Inc	Net	4.55	-0.78	-0.73	4.27	2.86
RL UK Government Bond Fund Z Inc	Gross	6.53	-12.07	-13.57	-5.78	11.96
RL UK Government Bond Fund Z Inc	Net	6.26	-12.29	-13.85	-6.11	11.56

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