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Royal London Short Duration Gilts Fund

Quarterly Investment Report

31 December 2024

Quarterly Report

The fund as at 31 December 2024

The purpose of this report is to provide an update on the Royal London Short Duration Gilts 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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ASSET MANAGEMENT

The fund

Fund performance objective and benchmark

The Fund's investment objective is to achieve a total return (combination of capital growth and income) over the medium term (3-5 years) by investing at least 80% in short-duration (1-5 years) UK government bonds, which are also known as gilts. The Fund's performance target is to outperform, after the deduction of charges, the FTSE UK Gilts Government up to 5 Years Total Return GBP Index (the "Index") over rolling 5-year periods. The Index is regarded as a good measure of the performance of short duration UK government bonds quoted on the London Stock Exchange. In addition to the benchmark for the Fund's performance as noted above (the "Index"), the IA UK Gilts sector is considered an appropriate benchmark for performance comparison.

Benchmark: FTSE Actuaries UK Conventional Gilts up to 5 Years Total Return GBP Index

Fund analytics

	Fund	Benchmark
Fund launch date	7 November 2013	
Base currency	GBP	
Duration (years)	2.70	2.09
Gross redemption yield (%)	4.40	4.30
Number of holdings	24	20

Fund value

	Total £m
31 December 2024	1,474.71

Asset allocation

	Fund (%)	Benchmark (%)
Conventional gilts	96.95	100.00
Conventional credit bonds	3.05	-

Performance and activity

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Quarter	0.05	0.14	(0.08)
1 Year	2.79	2.54	0.25
3 Years (p.a.)	1.37	0.65	0.72
5 Years (p.a.)	0.94	0.36	0.58
10 Years (p.a.)	0.88	0.65	0.23
Since inception (p.a.)	0.93	0.81	0.12

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 Z Inc GBP. Source: Royal London Asset Management; Gross performance; Since inception date of the share class is 8 November 2013.

Performance commentary

The key event for markets in the fourth quarter was undoubtedly the US election, and markets reacted decisively to the result. With US yields having reached the lows of the year late in the third quarter, Treasury yields rose steadily during the fourth quarter as markets reacted to both stronger domestic economic data, and re-evaluated the outlook for both growth and inflation in the US.

The impact of the US election was global, with yields rising around the world. But whilst the impact of President Trump's policies may be positive for US growth, there is a risk that they are more negative for global growth, particularly in Europe.

Whilst yields rose in Europe during the fourth quarter, they did so by less than the US and markets are now starting to price a greater divergence in Monetary policy as we head into 2025. Political instability, particularly in Europe, is also starting to have an effect on markets, and that may be something to watch more closely during 2025.

In the UK, gilts were caught between the volatility in the US, the instability in Europe. And whilst the move in bond yields was global, this Labour government's first budget had an important role to play in influencing the direction of UK gilt yields.

For much of the summer markets had hoped that a stable government with a clear majority would be able to deliver a favourable budget that boosted growth, albeit with a slight increase in borrowing. What transpired was a budget the market wasn't quite prepared for. The OBR's assessment was somewhat negative: inflation up, growth down (across the parliament), and borrowing up; a toxic mix for bond markets that saw yields rise and gilts underperform.

As a result of the above, our strategic duration position was a detractor while the curve position within the fund added little to performance, with tactical activity more impactful.

Performance and activity

Fund activity

We tactically traded around the market volatility during the quarter, which helped to offset some of the drag on performance that resulted from adding to duration as yields rose through the period.

The fund ended the quarter just shy of half a year long versus the benchmark after starting the period 0.2 of a year long.

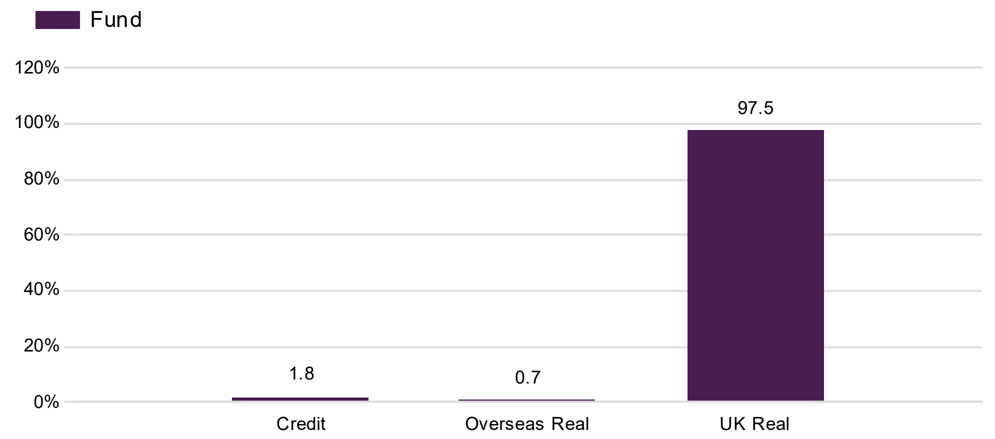
Our relative value positioning contributed to performance. Our overweighting in certain 2027 and 2029 bonds proved positive for performance as they outperformed versus neighbouring bonds. The fund remains biased towards the higher yielding high coupon bonds at the front end of the yield curve.

The fund has no inflation exposure.

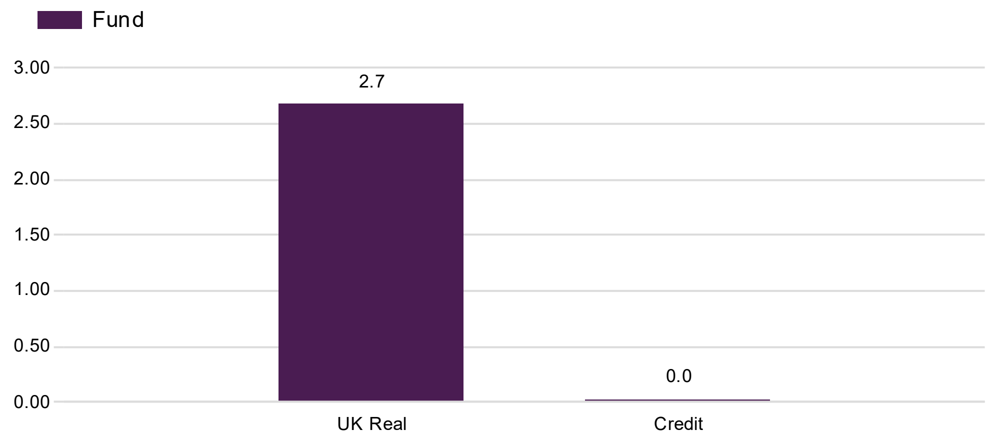
The fund has no cross-market exposure.

Fund breakdown

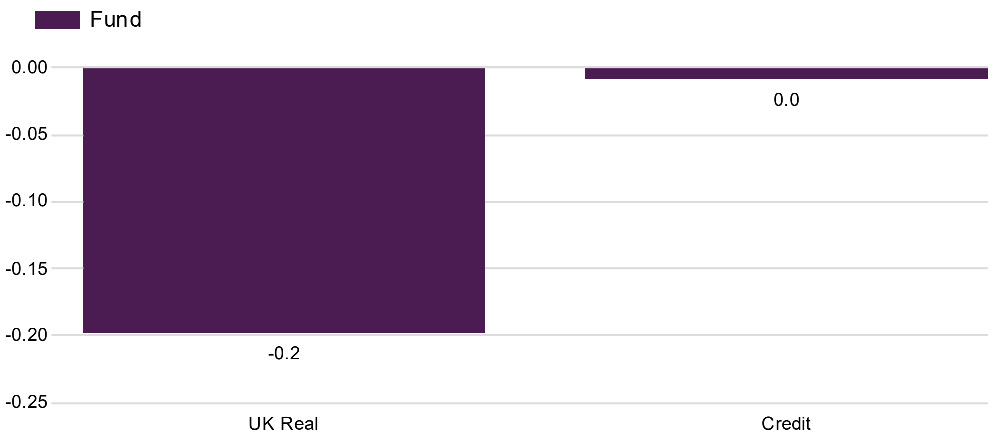
Asset split by percentage



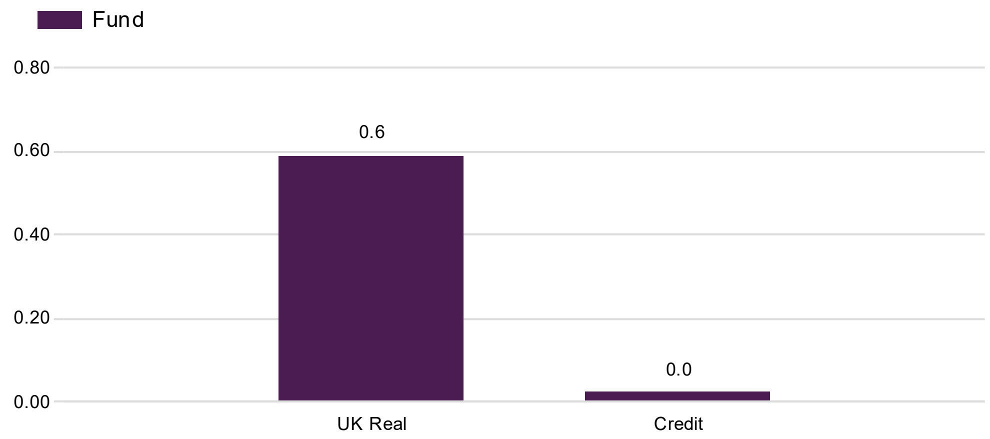
Asset split by duration



Asset split by duration change on quarter

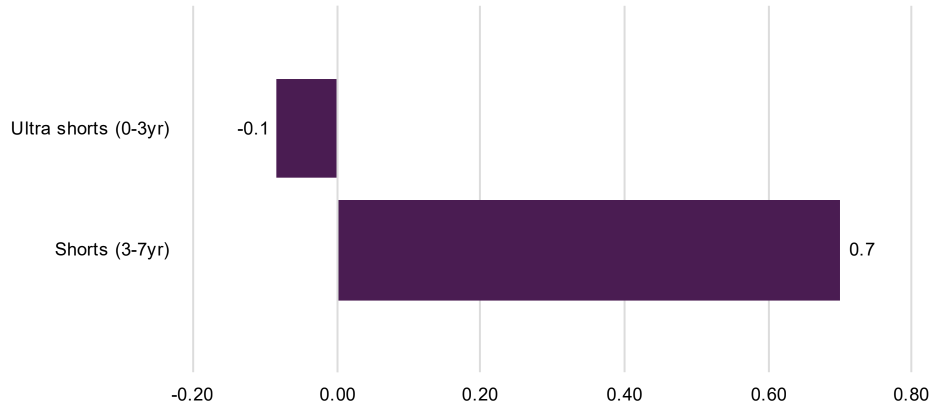


Asset allocation relative to benchmark (duration)

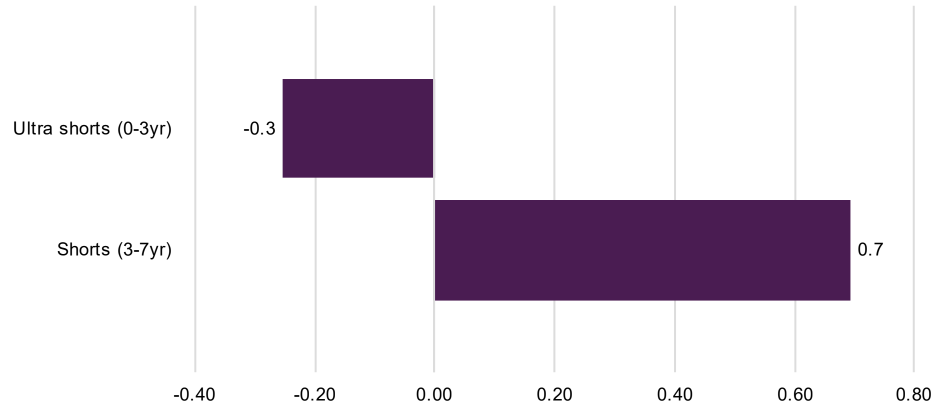


Fund breakdown

Maturity profile relative to benchmark



Maturity profile change on quarter



Market commentary

Market overview

Markets were volatile during the fourth quarter – geopolitical events, most notably the US election, UK budget, and French politics, took centre stage. The events in the US dominated, with markets reacting swiftly and decisively to the election of Donald Trump as US President, sending government bond yields higher across the world.

Alongside political events, attention remained on the Federal Reserve, European Central Bank and Bank of England to see if expected rate cuts would materialise. However, with inflation remaining higher than central bankers would like, expectations for rate cuts during 2025 were revised down during the final quarter of 2024. This backdrop pushed government bond yields higher, leading to negative returns for most government bond and investment grade credit markets.

At its final meeting of 2024, and as expected, the Bank of England kept rates on hold at 4.75%. Meanwhile, according to the minutes, “a gradual approach to removing monetary policy restraint remains appropriate.” November CPI inflation rose to 2.6% year on year as expected on ‘base effects’. Pay growth was however much stronger than expected. October GDP shrank month-on-month after falling in September, with this contraction (and subdued business surveys since) raising the risk of a mild GDP contraction in the fourth quarter. Away from economic data, the new Labour government presented its first budget. This was less obviously a budget for growth than one for public services repair with a substantial proposed increase in day-to-day fiscal spending and net investment. Public spending was increased substantially, but at the cost of a big increase in taxes. Since the Budget, business optimism has dropped, and firms are indicating a mix of responses to the rise in National Insurance contributions including hiring less and raising prices.

The Federal Reserve cut rates 50bps over the quarter to a 4.25% - 4.5% target range. They signalled fewer cuts for 2025 than previously indicated, indicating only 50bps cuts for 2025 (100bps previously). Third quarter GDP (released over the quarter) rose at an above trend pace, supported by strong consumer spending growth. The US PMI composite meanwhile rose further and continued to signal a robust pace of US private sector output growth, although manufacturing business survey measures remain more subdued than services ones. In November, Donald Trump was elected US President for the second time. A Trump presidency will likely bring a change in both policymaking style and substance. It was a clean sweep for the Republicans, winning the White House, Senate and House of Representatives, increasing the prospects of Trump getting his fiscal policies through. Business optimism on the PMI survey rose, hitting a two and a half year high in December, “reflecting growing optimism about business conditions under the incoming Trump administration,” though manufacturers flagged concerns about tariffs (where Trump has promised increases) and inflation.

As widely expected, the European Central Bank’s final decision of the year saw another 25bps rate cut, taking with the deposit rate to 3.00%. The bank continues to note that domestic inflation remains high but attribute that “mostly” to wages and prices in certain sectors “still adjusting to the past inflation surge with a substantial delay.” Third quarter GDP released over the quarter was stronger than expected. The PMI business survey composite, however, remained consistent with subdued private sector activity growth throughout the fourth quarter, ending the quarter below the 50 ‘no growth’ level. The picture for activity outside Germany and France was somewhat better than for those two economies though, with both France and Germany affected in recent months by political/policy uncertainty. France’s finance minister was replaced after Barnier’s budget failed to pass and Germany will now have early elections in the first quarter of 2025. CPI inflation rose on data released over the quarter, reaching 2.3% in November.

Government yields rose over the quarter, as central banks continue to struggle to bring inflation back to target levels and amid ongoing political volatility with elections across Europe and the US. In the US, 10-year treasury yields rose to 4.57% from 3.78%, while German 10-year bunds similarly saw yields rise to 2.36% from 2.06%. Benchmark 10-year gilt yields increased to 4.57% from 4.01%.

The sterling investment grade credit market (iBoxx non-gilt index) returned -0.49% over the quarter, with the average sterling investment grade credit spread (the average extra yield available from non-gilt bonds compared with government debt of equal maturity) tightening over the period from 1.03% to 0.86% (iBoxx). The negative returns were broad based across sterling investment grade credit market with the only sectors seeing positive returns banks and real estate, with both markets benefitting from the potential of higher interest rates for longer. Consumer services and social housing were the relative laggards.

Outlook

We believe that spot inflation will remain stubborn and is likely to remain above central bank targets in most economies as we progress through 2025. We still forecast central banks to be cutting rates during 2025 as they move from being restrictive to somewhat more neutral.

In the UK, the BoE faces a unique set of challenges. With economic growth in decline, and expected to stagnate for much of 2025, the BoE should be cutting rates from their current restrictive levels. However, with inflation remaining sticky, and forecast to remain well above the BoE’s CPI target for much of 2025, delivering cuts in a ‘stagflationary’ environment may be

Market commentary

somewhat more challenging. Royal London Asset Management still forecasts four cuts from the BoE this year to leave rates at 3.75% at year end, with markets starting the year with just one and a half cuts priced in, we think there are opportunities for longer term investors, particularly in shorter maturity bonds.

One area that remains a concern for the market is the sheer amount of bond supply to come in gilts over the next few years; a feature that has only been exacerbated by Labours economic budget. The market has reacted by pushing longer maturity government bond yields higher, steepening the curve and leaving 30-year maturity bonds yields above 5%. We believe these yield levels are attractive for longer term investors, particularly if the UK Debt Management office reacts to changing market dynamics by reducing longer issuance as a portion of the overall gilt remit even further.

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

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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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FTSE makes no claim, prediction, warranty or representation either as to the results to be obtained from the Fund or the suitability of the Index for the purpose to which it is being put by Royal London Asset Management.

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.

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.

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 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.

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.

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 2024

Cumulative (%) / Annualised (%)

	3 Month	6 Month	1 Year	3 Years	5 Years	3 Years (p.a.)	5 Years (p.a.)
Fund (gross)	0.05	2.07	2.79	4.18	4.79	1.37	0.94
Fund (net)	(0.00)	1.95	2.56	3.49	3.65	1.15	0.72

Year on year performance (%)

	31/12/2023 - 31/12/2024	31/12/2022 - 31/12/2023	31/12/2021 - 31/12/2022	31/12/2020 - 31/12/2021	31/12/2019 - 31/12/2020
Fund (gross)	2.79	5.07	(3.54)	(0.98)	1.58
Fund (net)	2.56	4.84	(3.76)	(1.20)	1.36

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 2024. All figures are mid-price to mid-price for the Royal London Short Duration Gilts Fund Z Inc GBP share class.

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.

Gross redemption yield

Gross redemption yield is the rate of discount at which a bond's future obligations of interest and capital payments equates to its current price. The gross redemption yield shown for the fund is the average for its individual holdings, weighted by their current value, net of relevant fund management costs and gross of tax.

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.