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Royal London Absolute Return Government Bond Fund

Quarterly Investment Report

30 June 2024

ROYAL LONDON ASSET MANAGEMENT

Quarterly Report

The fund as at 30 June 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
30 June 2024	1,246.53

Asset allocation

	Fund (%)
Conventional credit bonds	43.69%
Money market instruments	34.00%
Index linked gilts	8.99%
Index linked foreign sovereign	8.24%
Conventional foreign sovereign	2.58%
Conventional gilts	1.09%
Securitised	1.08%
Other	0.33%

Fund analytics

	Fund
Fund launch date	17 November 2014
Base currency	GBP

Performance and activity

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Quarter	1.74	1.27	0.47
YTD	3.30	2.56	0.74
1 Year	8.70	5.18	3.51
3 Years (p.a.)	4.30	2.85	1.45
5 Years (p.a.)	3.34	1.82	1.52
Since inception (p.a.)	2.12	1.15	0.97

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 share class is 17 November 2014.

Performance commentary

The fund posted a strong return over the quarter, outperforming its cash benchmark, and remains ahead of benchmark over one and three years.

The largest contributor to performance was again from the core holdings of sterling money market instruments. These assets yielded well in excess of 5% and benefited from expectations that UK rates would be cut in 2024.

Duration positions added value, particularly through tactically trading the volatility seen in markets as economic data continued to be mixed. Long positions in the UK, US, Australia and a short position in Japan all added value.

Curve positions were mixed, leading to an aggregate small loss for the quarter. Our flattener position in the UK detracted from performance, as did the steepener in the US. However, curve positions in Australia, Japan and Europe all added value.

Inflation positions were again a strong source of alpha particularly Japan, where breakevens continued to rise as the yen weakened. The short position in the UK also added to returns as UK inflation weakened – particularly towards the end of the quarter.

Cross market positions added value, particularly long UK positions relative to Europe and long peripheral positions in Europe relative to core markets.

Performance and activity

Return Contribution

	Quarter	1 year	Target return (of live trades)
Inflation	33.00	151.99	25.00
Curve	(7.00)	107.21	25.00
Duration	25.00	65.88	65.00
Relative Value	0.00	(5.48)	0.00
Cross Market	14.00	30.90	16.00
FX Hedges	0.00	0.00	0.00
Cash	112.00	460.36	520.00
Total	**177.00**	**810.85**	**651.00**

Top Contributors

	Strategy	Q2 Contribution (bps)
Cash	Fixed	57.00
Cash	Floating	54.00
Inflation	Japan	25.00
Cross Market	EUR	12.00
Inflation	UK	11.00

Bottom Contributors

	Strategy	Q2 Contribution (bps)
Cross Market	USD	(9.00)
Curve	GBP	(7.00)
Inflation	EUR	(4.00)
Curve	US	(2.00)

Performance and activity

Portfolio Exposure

Trades	Position size	Net duration exposure	Market beta	Target return (bps)
Inflation				
Long Japanese Breakeven	0.20	0.00	(0.10)	10.00
Long UK Cash Breakevens	0.30	0.00	(0.15)	5.00
Short UK 10 Year RPI	0.50	0.00	0.20	10.00
Curve				
US 5/30 Steepener	0.10	0.00	0.05	5.00
Germany 5-30 Steepener	0.10	0.00	0.05	5.00
UK/US Box (10-30)	0.20	0.00	0.00	5.00
Japan 10-30 Flattener	0.30	0.00	(0.10)	10.00
Cross Market				
Long Aus ry vs UK	0.10	0.00	0.00	5.00
Long France ry vs UK	0.10	0.00	0.00	5.00
Long UK vs US 1y1y	0.10	0.00	0.00	3.00
Long UK vs Europe (7y swap)	0.10	0.00	0.00	3.00
Duration				
Long 30 Year UK	0.15	0.15	0.10	5.00
Long 20 year RY	0.30	0.30	0.15	5.00
Long 30 Year Australia	0.20	0.20	0.10	5.00
Long 30 Year Germany	0.10	0.10	0.10	5.00

Performance and activity

Portfolio Exposure

Trades	Position size	Net duration exposure	Market beta	Target return (bps)
Duration				
Long 7 year US	0.15	0.15	0.25	5.00
Tactical Duration Trading	-	-	-	40.00
Cash				
Cash	0.20	0.20	0.20	520.00
Overall Net Duration Position	**-**	**1.10**	**0.85**	**651.00**

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	0.01	0.00	0.10	0.19	0.00	0.00	0.00	0.30
Canada	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
European Union	(0.00)	(0.12)	0.00	0.00	0.00	0.00	0.00	(0.12)
Finland	0.02	0.00	0.00	0.00	0.00	0.00	0.00	0.02
France	0.06	0.00	0.00	0.00	0.00	0.00	0.07	0.13
Germany	0.01	0.17	0.00	0.00	(0.05)	0.00	0.00	0.13
Japan	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Netherlands	(0.02)	0.20	(0.50)	0.00	0.00	0.29	0.00	(0.03)
Norway	0.02	0.00	0.00	0.00	0.00	0.00	0.00	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	0.00
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	0.34	0.12	(0.32)	0.03	0.71	(0.25)	0.00	0.62
United States	(0.10)	0.50	0.00	(0.40)	0.00	0.00	0.00	0.00
Total								1.09

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	0.10	0.00	0.00	0.00	0.00	0.10
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	0.06	0.06
Germany	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Japan	0.04	0.16	0.00	0.00	0.00	0.00	0.00	0.20
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	0.00	0.00	0.42	(0.00)	(0.31)	0.05	0.00	(0.17)
United States	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Total								0.19

Performance and activity

Stand alone risk contribution

	Quarterly Vol (%)	Annual Vol (%)
Inflation	0.17	0.34
Curve	(0.01)	(0.03)
Duration	0.13	0.27
Relative Value	0.00	0.00
Cross Market	0.17	0.35
FX Hedges	0.02	0.03
Cash	0.11	0.23
Overall Volatility	**0.71**	**1.19**

Risk Model Factor Risk Breakdown

	Standalone Risk Portfolio (bp)	Risk Contribution Portfolio (bp)	% of overall risk
Rates	117.88	114.97	96.95
Inflation	15.55	3.00	2.53
Spreads	21.65	1.09	0.91
Foreign Exchange	1.48	(0.47)	(0.40)
Time	0.00	-	-
Other	0.00	-	-
Total	**156.56**	**118.59**	**100.00**

Diversification across Risk Factors (%)	**(24)**

Performance and activity

Fund activity

Duration was increased significantly during April. Having begun the month flat, we ended April 1.5 years long, taking the opportunity to add duration on days where we saw oversized moves on small misses on economic data. We bought US 7-year and 30-year US real yields as bonds sold off sharply on the US inflation data. We also bought back the short in Australian 10-year futures, remaining long 30-year Australia when again yields rose sharply on the back of higher Australian inflation. For the remainder of the quarter duration was traded tactically around economic and central bank events. After April, overall duration ranged between 0.75 and 1.75 years long, ending the quarter around 1 year long.

The main activity in inflation markets during the quarter was reducing the long Japanese exposure as breakeven rates on some off-the-run issues rose towards 2%. We also reduced the short in the UK as breakeven rates fell towards the end of the quarter. The long position in the US was sold early in the quarter.

Cross market positions were traded actively, taking profits on the long Spain vs France position and short Canada versus the US. We also entered a long in UK 1y1y vs US 1y1y after some weak US data pushed US rates lower. We still expect the UK to cut rates before the US. This position was trimmed after weaker UK inflation saw the UK outperform.

Curve positions in the US and Europe were traded actively, increasing exposure early in the quarter but reducing both the US and European steepening positions later in the quarter. With the UK curve relatively steep compared to the US we entered a 10/30 box trade.

With longer Japanese yields rising and long forwards hitting 3%, we bought longer-dated Japanese bonds, turning the short Japanese position into a curve flattener.

We used supply events across the globe to add duration when new issue premia were again attractive. We also participated in the inaugural Australian green bond, with proceeds used to finance government programs to support Australia’s net zero transition and deliver broader environmental benefits.

Market commentary

Market Overview

Markets have once again been dominated by interest rates during the quarter, despite little or no movement in this area. 2024 started with expectations that central banks would cut early and cut often. However, as the year has progressed, those expectations have changed. Inflation has generally not come down quite as fast as hoped, with services inflation proving sticky, particularly in the UK, while growth has generally not been as weak as feared – particularly in the US. Interest rates were cut just once across the Federal Reserve, European Central Bank and Bank of England, with the ECB cutting rates in June. Most central bank forecasters now only expect one or two cuts from each of these banks over the course of 2024 as a whole.

Ahead of the US Presidential elections in November, snap parliamentary elections were called in the UK and France, providing reminders that voter dissatisfaction with the seeming consensus on economic policy and ongoing lack of consensus on longer-term issues such as climate change create an uncertain backdrop for businesses and consumers alike.

The US Federal Reserve continued to keep rates on hold at 5.25-5.50% over the quarter against a still resilient labour market backdrop, and the relatively strong core CPI inflation seen over January to April. The May data (released in June) was more reassuring both from a CPI and core PCE perspective. As of their June meeting, the median forecast of participants changed from showing 75 basis points of rate cuts for 2024 to only 25bps of cuts.

The ECB lowered rates by 25bps in June, following good inflation progress and previous hints from ECB speakers. Further rate moves after June are less certain and depend on data. Euro area CPI went up from 2.4% to 2.6% year-on-year in May, which was unexpected, and services inflation rose above 4.0%. The European elections saw incumbent parties suffer a loss of support and prompted President Macron to call an early parliamentary election. This uncertainty saw French government bonds weaken in relation to German government debt.

Data released in the UK in the second quarter confirmed that the country bounced out of technical recession in the Q1 and painted a picture of continued positive economic growth. First quarter GDP rose 0.7% quarter-on-quarter in real terms after falling 0.3% in the fourth quarter. Meanwhile inflation also dropped back to the Bank of England's 2% target. The rate of change in the CPI basket fell from 3.4% year-on-year in February to 2.0% in May, helped by lower electricity and gas bills. The Bank of England kept rates at 5.25%, even though headline inflation dropped. This reflected concern about services inflation and pay growth, both of which remain elevated. The calling of UK general election, which has resulted in a change of government, had minor impact on sterling asset prices, reflecting a view that there would be little shift in economic policy.

Government yields generally rose over the quarter, particularly following poor US inflation data released in April with yields largely range-bound through May and June. In the US, 10-year treasury yields rose from 4.21% to 4.40%, while German 10-year bunds similarly saw yields rise from 2.30% to 2.50%. Benchmark 10-year gilt yields rose from 3.94% to 4.18%.

UK index-linked markets saw similar increases in yields and as a result saw a negative returns for the quarter at -2.09% (FTSE Actuaries All-maturities). Real yields on UK 10-year bonds rose from 0.28% to 0.60% with 30-year real yields rising from 1.13% to 1.36%. Looking at index linked returns on a global basis, US and Japan markets posted positive returns for the quarter, while UK, Australia and notably France were negative.

Outlook

We expect markets to remain volatile around economic data points and envisage to continue trading duration tactically. However, we feel valuations in certain markets have now reached valuations that look attractive to hold a long duration position on a more strategic basis.

We have moved from peak optimism at the end of 2023 when economists were calling for five or six rate cuts in the US in 2024. We have arguably now almost reached peak pessimism as the same economists are calling for only one cut. We still expect the Federal Reserve, ECB and Bank of England to cut rates in 2024 and rates to fall more aggressively in 2025. This we believe will lead to lower yields and steeper curves particularly in the UK and dollar markets. Softer data of late has added to this expectation.

Inflation is now more fairly valued in Japan and any further tightening of monetary policy could impact breakevens. We will use strength to reduce this position further.

The Bank of Japan is expected to raise short-term rates further, particularly given the weakness of the yen. We expect the Japanese curve to flatten – this currently the steepest amongst G10 nations

UK breakevens still look overvalued but with seasonals tending to support breakevens in the summer we expect to run less of a short position in the UK.

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.

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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.

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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.

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 30 June 2024

Cumulative (%)

	3 Month	6 Month	1 Year	3 Years	5 Years
Fund (gross)	1.74	3.30	8.70	13.49	17.85
Fund (net)	1.66	3.14	8.37	12.33	15.73

Annualised (%)

3 Years (p.a.)	5 Years (p.a.)
4.30	3.34
3.95	2.96

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
Fund (gross)	8.70	3.71	0.67	2.06	1.75
Fund (net)	8.37	3.40	0.25	1.63	1.37

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 30 June 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.