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Royal London Index Linked Fund

Quarterly Investment Report

30 June 2024



Quarterly Report

The fund as at 30 June 2024

The purpose of this report is to provide an update on the Royal London Index Linked 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 (combination of capital growth and income) over the medium term (3-5 years) by investing at least 80% in index-linked bonds issued by the UK government, known as gilts. The Fund's performance target is to outperform, after the deduction of charges, the FTSE UK Gilts Index Linked Government (All Stocks) Total Return GBP Index (the "Index") over a rolling 5-year period. The Index is regarded as a good measure of the performance of index-linked UK government bonds. The Index is considered an appropriate benchmark for the Fund's performance, as many of the Fund's potential investments will be included in the Index. In addition to the benchmark for the Fund's performance as noted above (the "Index"), the IA UK Index Linked Gilts sector is considered an appropriate benchmark for performance comparison.

Benchmark: FTSE Actuaries UK Index Linked Gilts (All Stocks) Total Return GBP Index

Fund value

	Total £m
30 June 2024	440.12

Asset allocation

	Fund (%)	Benchmark
Index linked gilts	95.86%	100.00%
Index linked foreign sovereign	2.53%	-
Index linked credit bonds	1.18%	-
Conventional gilts	0.44%	-

Fund analytics

	Fund	Benchmark
Fund launch date	15 February 1990	
Base currency	GBP	
Duration (years)	15.11	14.71
Real yield (%)	1.06	1.16
Number of holdings	35	33

Performance and activity

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Quarter	(1.35)	(2.09)	0.74
YTD	(3.47)	(3.86)	0.39
1 Year	1.50	(0.38)	1.89
3 Years (p.a.)	(11.14)	(11.54)	0.40
5 Years (p.a.)	(5.45)	(5.97)	0.51
10 Years (p.a.)	1.70	1.29	0.41
Since inception (p.a.)	3.59	3.04	0.56

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 Index Linked Fund (M Inc). Source: Royal London Asset Management; Gross performance; Since inception date of the share class is 30 April 2010.

Performance commentary

Fund performance was broadly flat during the quarter. Duration effects were mixed. At a headline level, this was negative – due to our having a ‘neutral’ duration stance that is slightly long of benchmark. However, this was offset by tactical positioning around that stance, allowing us to benefit from the market overshooting, particularly on the spike in the oil price in April and then around inflation data over the rest of the quarter. Curve positioning was a slight negative – we had a bias towards flatter curves, but stickier inflation data supported short-dated bonds and hence curves were slightly steeper.

The major shock to global government bond markets over the quarter came from a somewhat unexpected source: France. French President Emmanuel Macron surprised markets (amongst other things) by dissolving the French parliament and calling an election for the end of June. The French market in particular took fright from this, which saw a flight to quality move, where the yield premium of 10-year French bonds over the equivalent German bonds doubled from around 0.4% to, at one point, over 0.8%, a level not seen since the ‘Frexit’ fears of 2017. It has retraced somewhat but the spread remains, in our view, rightly elevated as concerns remain over the future path for fiscal consolidation in France, and associated concerns of debt sustainability and rating agency downgrades.

Cross market positioning was negative for the period. We started the quarter with long positions in both France and Australia. As detailed above, French markets sold off on the snap election, while Australia was weaker as due to poor inflation data, with first quarter inflation falling less than expected and the RBA’s preferred inflation measure remaining outside of its target range. These effects were partially mitigated by our long position in the US. US Treasury Inflation Protected Securities (TIPS) performed strongly, with spreads over UK equivalents tightening by around 25bps over the period, helped by softer inflation data.

Our inflation-linked strategies can move underweight inflation (selling linkers and buying conventionals) when market pricing presents opportunities. Breakevens were generally lower over the quarter and we traded these tactically, selling 10-year breakevens ahead of CPI data in late May and using the 2073 index linked gilt auction in May, to sell 30-year breakevens. This helped performance over the quarter.

Performance and activity

Fund activity

Activity during the quarter continued to look for tactical opportunities to benefit from market issuance and ongoing volatility. We started the quarter with a small long position, and increased this following the weak US inflation data in April. This helped performance as weaker growth data, highlighted in soft US non-farm payrolls figures, pushed yields lower in May, and we reduced duration once more, ending the quarter marginally longer than where we started. This reflects our view that yields are looking more attractive given that inflation data is moderating and market expectations of future rate cuts are looking more realistic.

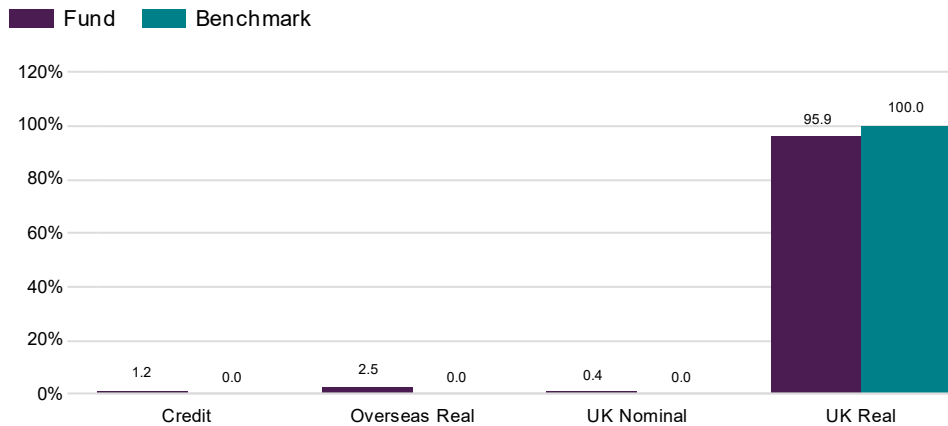
Our tactical approach around more important economic releases is a long-standing part of our process, and one that we feel exploits an inefficiency in what are often seen as highly efficient markets. However, in recent quarters we have adjusted this approach somewhat: we typically will not take material positions prior to economic releases due to the changing nature of market participants. In the past, passive funds, or more mechanical strategies such as LDI meant that positioning prior to an event could often be profitable given a rush to move into a position post-release. However, activity is now more driven by leveraged hedge funds – and these are much more likely to take very large positions prior to release and then be stopped out. Hence the pattern of volatility around an event has altered, and we have adjusted our activity to reflect this.

In terms of cross-market positioning, we maintained our long Australia position. Although this underperformed during the quarter, the absolute level of yields remains attractive relative to other markets, and the underlying fundamentals in Australia, with falling inflation and a strong fiscal position, remain supportive. We trimmed our overweight US position during the quarter, gradually taking profits on this as the US outperformed, but still ending the period with a modest long position. We also trimmed our French position towards neutral – reflecting our view that following the parliamentary elections, there will be multiple competing views of the direction of fiscal policy making for a very uncertain outlook.

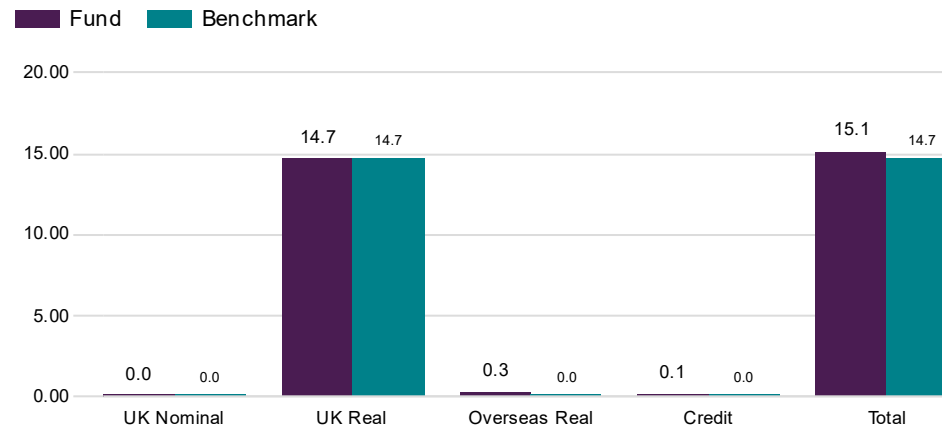
During the quarter we noted a market distortion, where European insurance companies were buying certain long-dated cash rich bonds for asset swap purposes – with UK 2042, 2047 and 2055 index linked bonds in demand. After strong performance in this area we moved underweight in these. Overall curve positioning remains biased towards flatter curves due to fundamentals but also with no long-dated index linked supply after early July until late in the quarter.

Fund breakdown

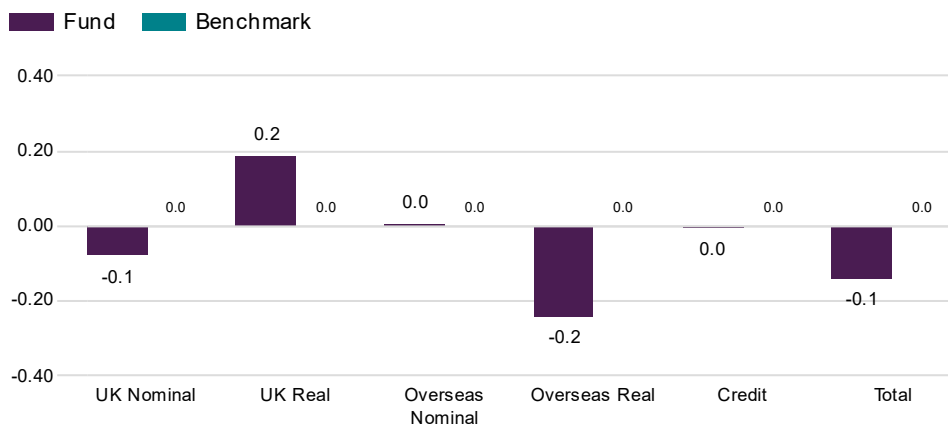
Asset split by percentage



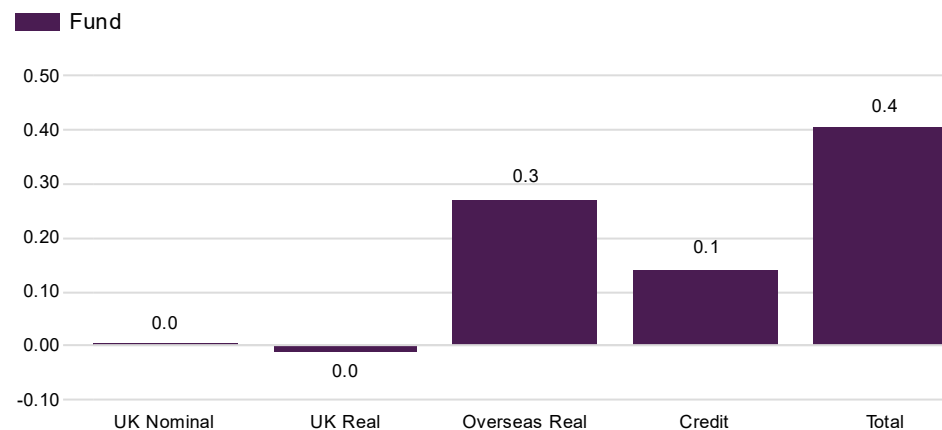
Asset split by duration



Asset split by duration change on quarter

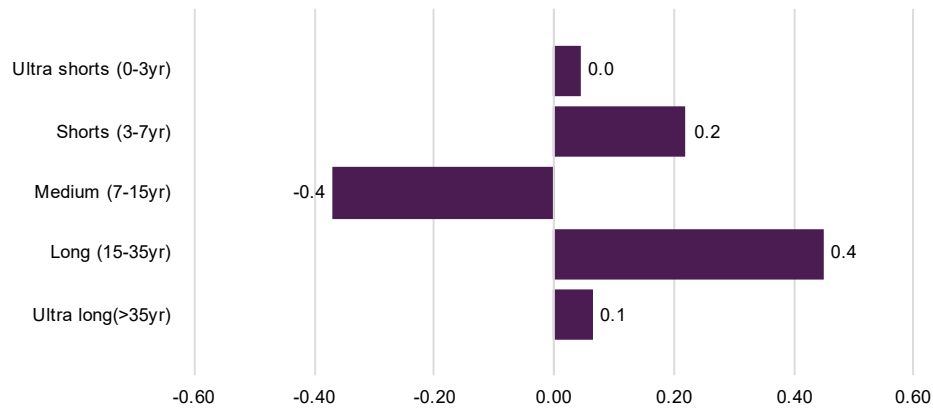


Asset allocation relative to benchmark (duration)

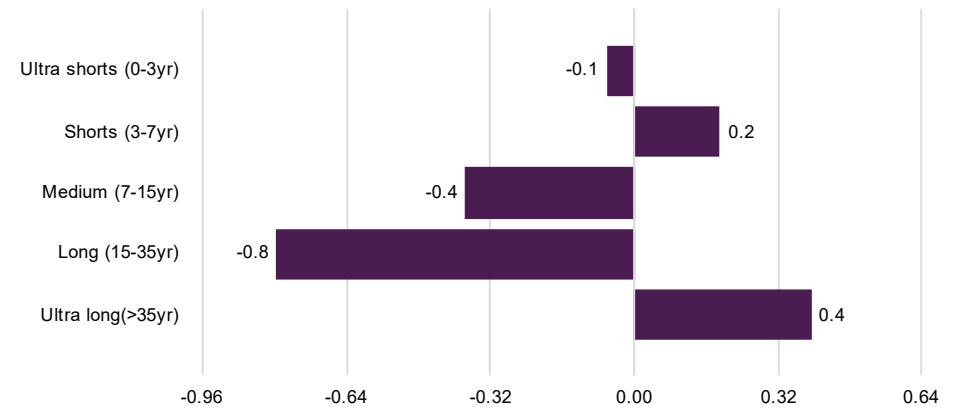


Fund breakdown

Maturity profile relative to benchmark



Maturity profile change on quarter



Market commentary

Market overview

Markets 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. 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. 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

Last quarter we highlighted that we expected yields to remain sensitive to economic data, and unless there was a significant deterioration in underlying trends, we expected this to lead to range-bound yields. This is the scenario that unfolded over the quarter, with markets seeming to mark time until central banks – notably the Federal Reserve – start to cut rates.

Headline inflation is now significantly lower in the US, euro zone and UK compared to 2023. Base effects account for a material part of these falls. Beyond the headline figures, the likes of services inflation and wage growth remain higher than most central bankers would prefer. That said, we do expect to see more movement from central banks in the second half of the year, even if the quantum of those moves is less than many were forecasting earlier in the year.

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 in the latter part of Q2 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. Although the UK election generated a lot of news, gilt markets have been fairly sanguine about the outlook, reflecting that the Labour party campaigned on a basis of spending controls and that its commitment to the OBR and independent assessment of fiscal policy would act as a check on excess spending.

Further Information

Please click on the links below for further information:



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

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Issued in July 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 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.

Performance to 30 June 2024

Cumulative (%)

Annualised (%)

	3 Month	6 Month	1 Year	3 Years	5 Years	3 Years (p.a.)	5 Years (p.a.)
Fund (gross)	(1.35)	(3.47)	1.50	(29.86)	(24.48)	(11.14)	(5.45)
Fund (net)	(1.42)	(3.61)	1.20	(30.52)	(25.72)	(11.42)	(5.77)

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)	1.50	(14.35)	(19.32)	(3.67)	11.77
Fund (net)	1.20	(14.61)	(19.59)	(4.02)	11.37

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 Index Linked Fund (M Inc).

Glossary

Asset allocation

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

Distribution yield

The distribution yield reflects the amounts that may be expected to be distributed over the next 12 months. It is calculated net of standard management charges. It reflects RLAM's current perception of market conventions around timing of bond cash flows.

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.