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Royal London International 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 International 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

The fund

Fund performance objective and benchmark

The Fund's investment objective is to achieve a total return over the medium term (3-5 years) by investing at least 80% in government bonds globally. The Fund's performance target is to outperform, after the deduction of charges, the JP Morgan Global Bond Index ex UK (Traded) Total Return (GBP hedged) Index (the "Index") over rolling 5-year periods. The Index is regarded as a good measure of the performance of government bonds across the developed markets. The Index is considered an appropriate benchmark for the Fund's performance, as the Fund's potential investments will predominantly be included in the Index. In addition to the benchmark for the Fund's performance as noted above (the "Index"), the IA Global Government Bond sector is considered an appropriate benchmark for performance comparison.

Benchmark: JP Morgan Global Bond Index ex UK (Traded) Total Return (GBP hedged) Index

Fund value

	Total £m
30 June 2024	1,136.55

Asset allocation

	Fund (%)	Benchmark
Conventional foreign sovereign	92.37%	100.00%
Index linked foreign sovereign	4.70%	-
Conventional gilts	2.93%	-

Fund analytics

	Fund	Benchmark
Fund launch date	4 November 2011	
Base currency	GBP	
Duration (years)	7.04	6.59
Gross redemption yield (%)	4.61	3.61
Number of holdings	120	1,024

Performance and activity

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Quarter	(0.01)	(0.46)	0.45
YTD	(0.42)	(0.87)	0.46
1 Year	3.04	1.70	1.34
3 Years (p.a.)	(1.53)	(2.92)	1.39
5 Years (p.a.)	0.01	(0.99)	0.99
10 Years (p.a.)	1.47	1.06	0.41
Since inception (p.a.)	1.85	1.62	0.23

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 International Government Bond Fund (M Inc). Source: Royal London Asset Management; Gross performance; Since inception date of the share class is 4 November 2011.

Performance commentary

The fund outperformed its benchmark during the second quarter. Following tactical moves in the quarter, duration positioning was a small positive contributor to performance over the quarter. As was the case at end of 2023 when the market became convinced that central banks were about to embark on an aggressive easing cycle, we felt that this time the market had gone too far the other way, pricing out rate cuts in a number of markets for the majority of 2024, and were happy to begin building long duration positions. Over the course of the rest of the quarter, US yields were reasonably stable, in comparison to other global markets, even re-tracing somewhat from their highs, and we maintain our overweight exposure.

The quarter also saw Japan yields rise significantly; the exit of Negative Interest Rate Policy (NIRP) in March was actually met by a reasonably muted response by markets, but subsequent reductions in bond buying by the Bank of Japan (BoJ), along with robust data, a continued weakening in the yen and somewhat hawkish comments by BoJ officials, has seen 10yr yields increase by around 0.3% over the quarter. We maintained our overall underweight exposure to Japan, but elected to partially reduce it.

The major shock to global duration over the quarter came from a somewhat unexpected source: France. French President Emmanual 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.

Over the quarter, the US and European curves ended approximately where they began, with a premium of 15-20 bps between 10-year and 30-year yields meaning US and EU curve positioning had minimal impact on performance. The Japan curve actually steepened over the quarter, though since we put the flattener on towards the end of the quarter (once the majority of the steepening had occurred), the negative impact on performance was limited.

The major curve positions within the fund are curve steepeners within the US and Europe and a curve flattening exposure within Japan. In the US and Europe, we feel that shorter end rates are reasonably good value and should benefit most when data turns and the rate cutting cycle begins to be priced by markets. The reason for the curve flattener exposure in Japan is that it is becoming increasingly likely that a rate hiking program is to be undertaken and long end Japanese forward rates are already reflecting this.

Performance and activity

Fund activity

Once again, the fund started the quarter with a small short duration position relative to its benchmark of around -0.15 years. April saw bond markets sell off sharply as incoming data remained robust, with US inflation data in particular surprising to the upside, causing the market to re-assess the future policy path of the US Federal Reserve. Despite the US CPI miss being relatively small versus the consensus estimate, yields still rose sharply on the day, and we used this weakness, and that on subsequent days, to take the fund into a long (relative) duration stance.

We were active primarily in dollar markets, US and Australia, where we felt that the idea of "peak pessimism" prevailed and with nominal yields in excess of 4.5%, the risk/reward favoured being long these markets. There was no better evidence than in the long end of the US inflation market, where 30-year US Treasury Inflation Protected Securities (TIPS) were trading at a real yield in excess of 2.25%, and we established a position in these bonds. Elsewhere in dollar markets, we entered an overweight position in attractively priced long-dated Australian government bonds, where supply is to be limited given the strong fiscal position of the Australian Government, and also participated in the inaugural 'Green' bond issued by Australia. At the end of the quarter, we were around 0.1yrs overweight the Australian market.

The main change to the inflation positioning within the fund is the aforementioned purchase of long dated US TIPS. We initially bought some at a real yield of around 2.25%, added to the position at 2.4% and trimmed some at 2.15%. The fund maintains relatively small holdings in short-dated Japanese and Italian index linked bonds, both of which had a small positive impact on performance over the quarter.

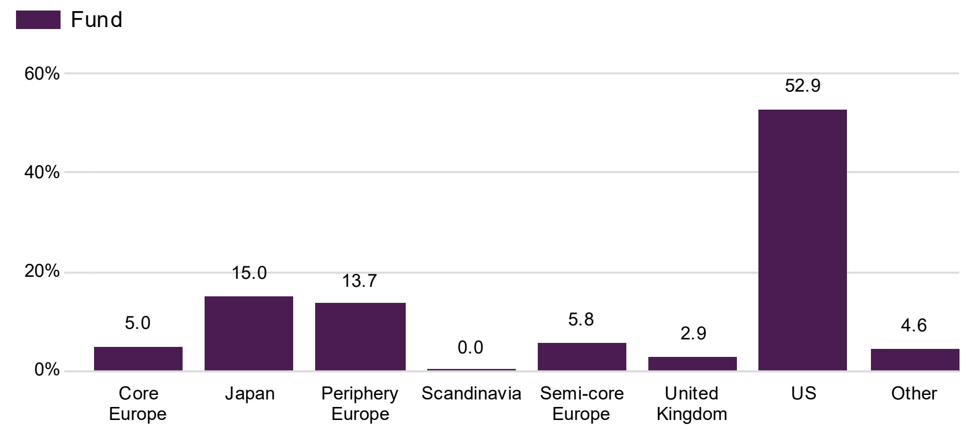
Overall, cross market positioning will have been a positive contributor to performance over the quarter, with a negative impact from dollar markets more than offset by a positive effect from Europe. Our focus is on dollar markets, comprised of an overweight to Australia out of the US, and an underweight in Canada into the US.

Within Europe, as previously discussed, much of the action was focused on France. Prior to the shock announcement of the French parliamentary election in late June, we had already taken the fund underweight France into Germany and Spain, as we felt that the market was not fully reflecting the poor fiscal outlook for France, which would be brought into focus by the EU and its new fiscal rules which are to be implemented later this year.

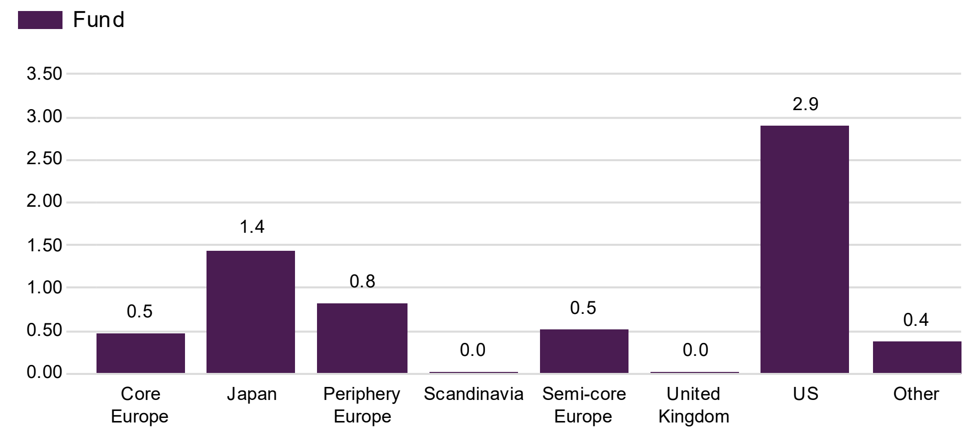
Consequently, upon the widening of the spread to bunds post the election announcement, and the flight to quality move into German bunds, the fund benefitted. We're happy to remain underweight France as we believe that faced with concerns over future deficits and uncertain growth prospects arising from a muddled political backdrop, it will be hard for French bonds to outperform from here. The overweight to Spain across the quarter also proved beneficial as Spain outperformed most other European markets. We also participated in a new 30-year bond issued by the government of Portugal, but elected to exit the position and add to the overweight in long-dated Japanese bonds, following a period of outperformance.

Fund breakdown

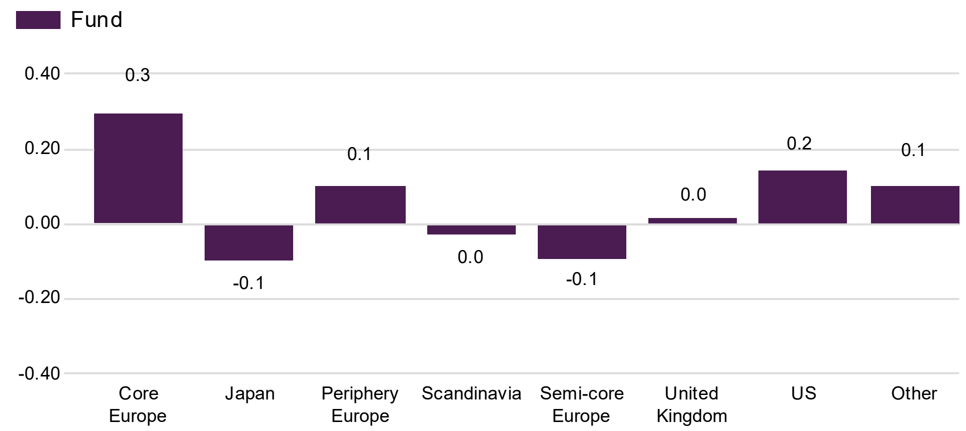
Geographic split by % weight



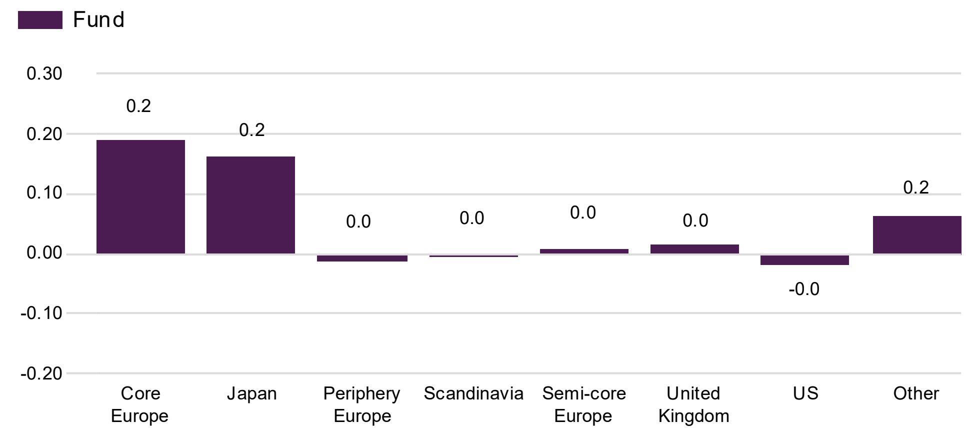
Geographic split by duration



Duration position relative to benchmark

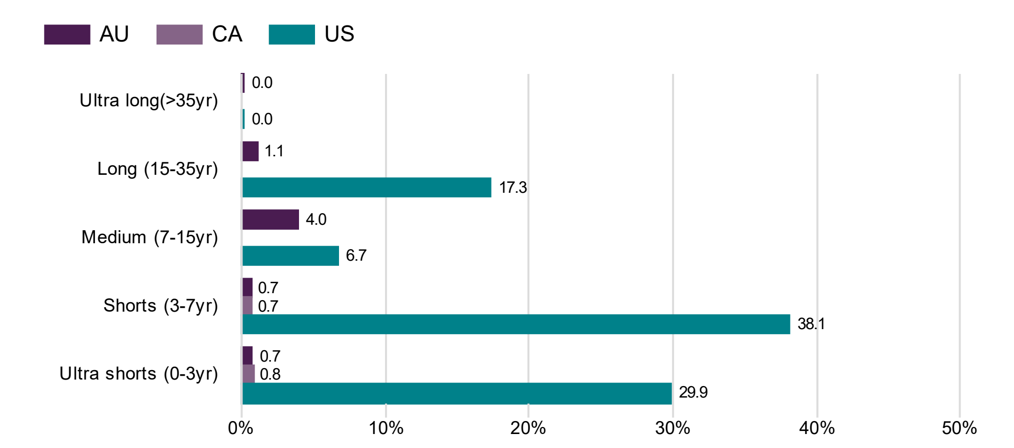


Relative duration quarter on quarter

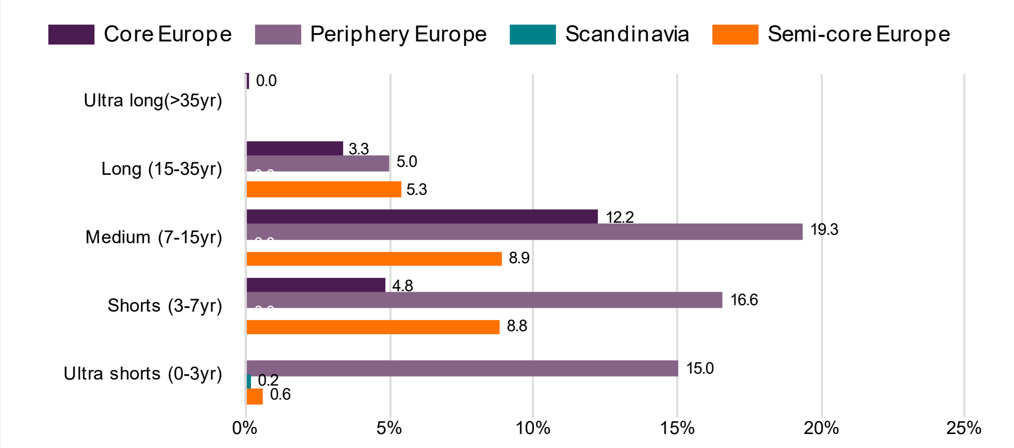


Fund breakdown

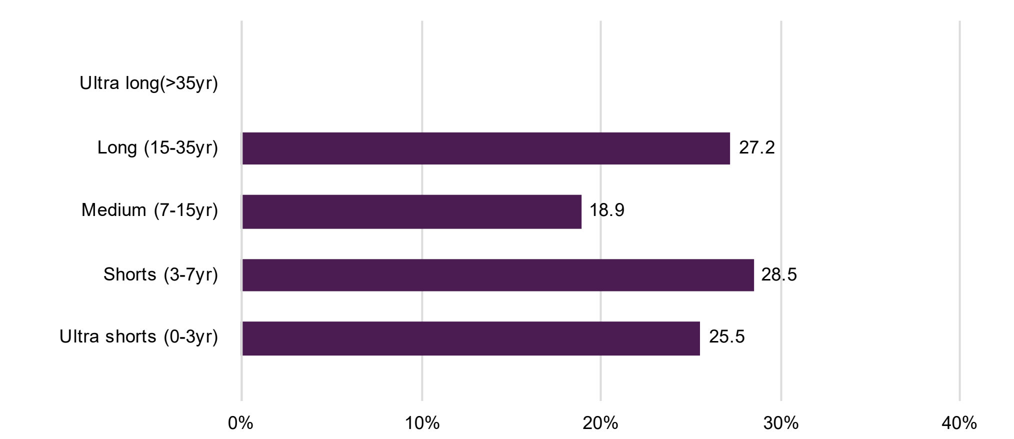
Dollar bloc



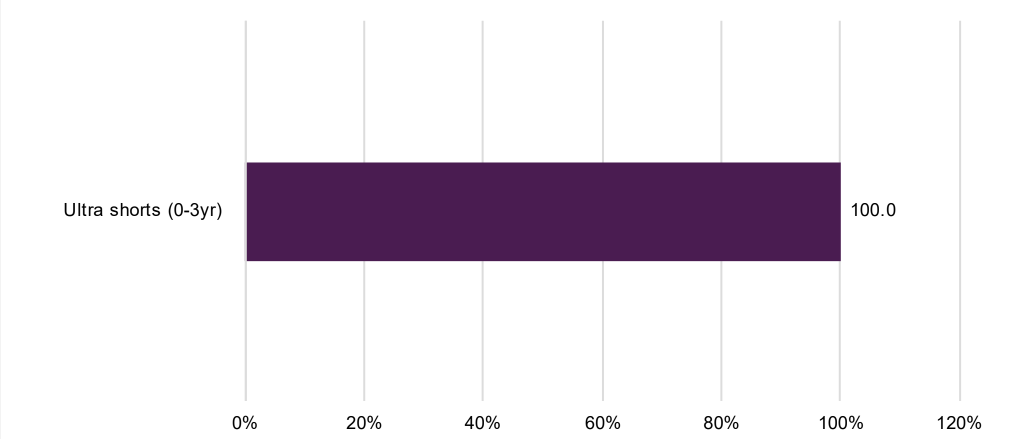
Euro bloc



Japan

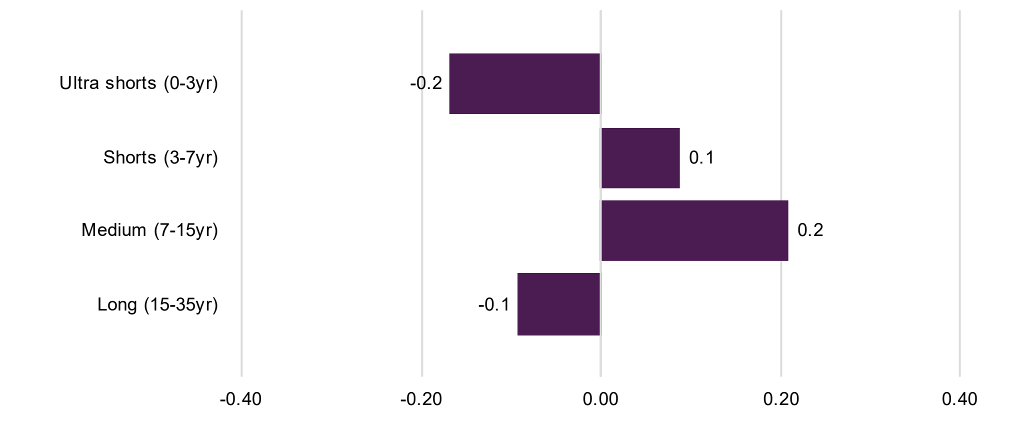


UK

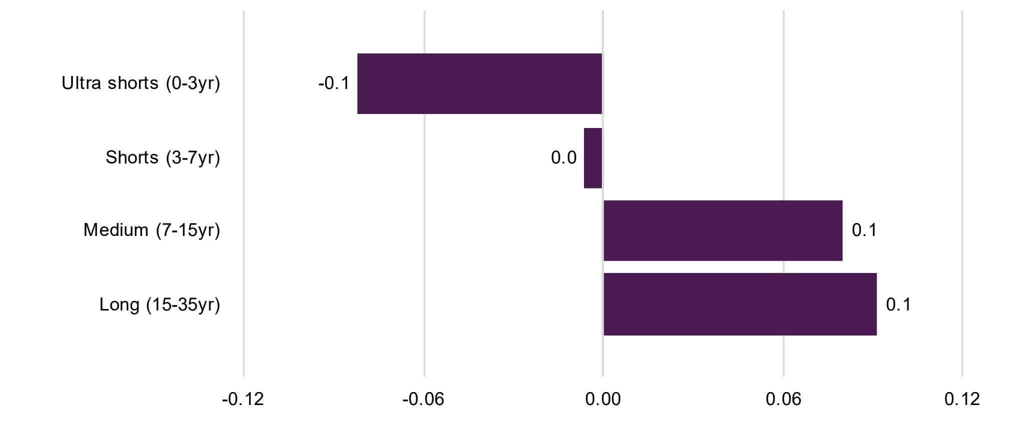


Fund breakdown

Maturity profile relative to benchmark

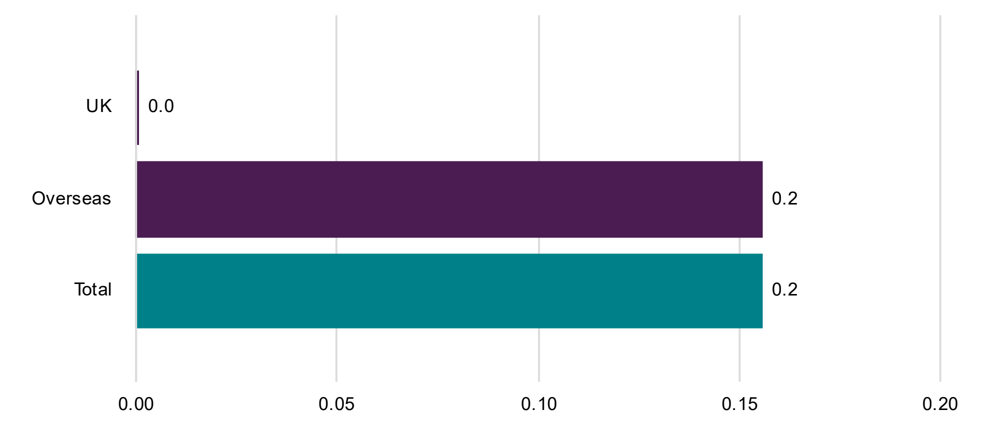


Maturity profile change on quarter

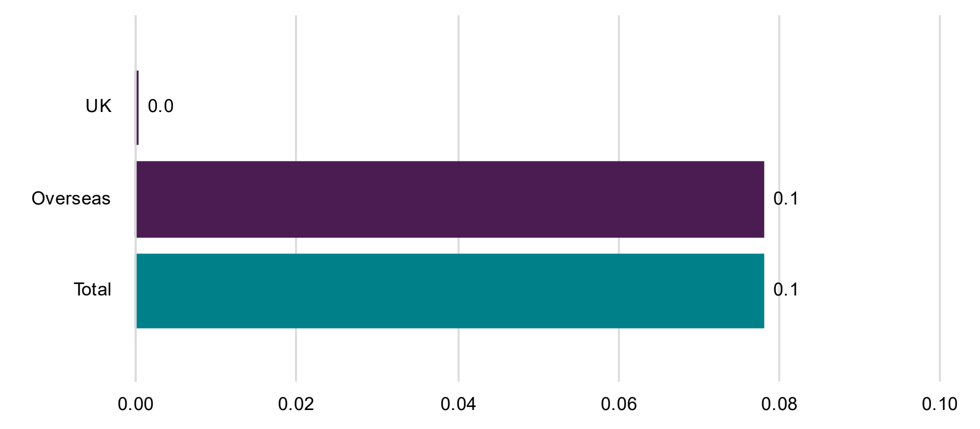


Exposure

Inflation exposure (duration)



Inflation exposure change on quarter (duration)



Market commentary

Market Overview

Financial markets have once again been dominated by macroeconomic data and the market's expectation of the direction for interest rates during the quarter. Although interest rates have remained largely unchanged in most countries, market pricing of when interest rate cuts might start, and by how much they might fall, is constantly changing. 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 unchanged for the Federal Reserve and Bank of England, whilst the European Central Bank cut rates by 0.25% 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.

Government yields rose in all the major markets. 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 2.5%. UK government bonds produced negative returns due to rising yields, delivering a -1.62% return (FTSE Actuaries) over the second quarter with the benchmark 10-year gilt yield rising from 3.94% to 4.18%. Yields rose for much of April then largely traded in a range between 4.0% and 4.4% for the rest of the quarter – a similar pattern to that seen in the first quarter.

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.

The sterling investment grade credit market (iBoxx non-gilt index) returned -0.13% 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) widening marginally from 1.02% to 1.03% (iBoxx).

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. 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 2024, central banks are likely to start reducing rates, but with yields below base rates in all markets, this is well priced.

Markets remained volatile over the second quarter, with yields higher across the board. The pricing of interest rate cuts has been pushed back to later in the year, even though the ECB did follow through on its heavily signposted June cut, but we feel that it is right to maintain a small long bias, and use market volatility as an opportunity to generate positive active returns. When we see clearer evidence of economic data – particularly inflation and labour markets – moving sustainably weaker, we will look to take the fund longer still.

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

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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.

Information has been obtained from sources believed to be reliable, but J.P. Morgan does not warrant its completeness or accuracy. The Index is used with permission. The Index may not be copied, used, or distributed w ithout J.P. Morgan's prior w ritten approval.

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.

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.

Emerging markets risk

Investing in Emerging Markets may provide the potential for greater rewards but carries greater risk due to the possibility of high volatility, low liquidity, currency fluctuations, the adverse effect of social, political and economic instability, weak supervisory structures and accounting standards.

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 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)	(0.01)	(0.42)	3.04	(4.51)	0.04	(1.53)	0.01
Fund (net)	(0.09)	(0.57)	2.73	(5.37)	(1.45)	(1.82)	(0.29)

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)	3.04	(0.65)	(6.72)	(1.12)	5.95
Fund (net)	2.73	(0.95)	(7.00)	(1.41)	5.63

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 International Government Bond 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.

Real yield

Real yield shows the inflation-adjusted redemption yield for the underlying fund and therefore does not include the impact of fees. For share class level yields, please see the latest factsheet.