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Royal London UK Government Bond 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 UK 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 (combination of capital growth and income) over the medium term (3-5 years) by investing at least 80% in UK government bonds, also known as gilts. The Fund's performance target is to outperform, after the deduction of charges, the FTSE UK Gilts Government (All Stocks) Total Return GBP Index (the "Index") over rolling 5-year periods. The Index is regarded as a good measure of the performance of every UK government bond quoted on the London Stock Exchange. 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 UK Gilts sector is considered an appropriate benchmark for performance comparison.

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

Fund value

	Total £m
30 June 2024	987.00

Asset allocation

	Fund (%)	Benchmark
Conventional gilts	96.16%	100.00%
Conventional foreign sovereign	2.45%	-
Money market instruments	0.52%	-
Conventional credit bonds	0.49%	-
Index linked foreign sovereign	0.38%	-

Fund analytics

	Fund	Benchmark
Fund launch date	8 February 1990	
Base currency	GBP	
Duration (years)	8.92	8.35
Gross redemption yield (%)	4.38	4.36
Number of holdings	27	65

Performance and activity

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Quarter	(0.32)	(0.89)	0.56
YTD	(1.94)	(2.49)	0.55
1 Year	6.53	4.76	1.77
3 Years (p.a.)	(6.79)	(8.17)	1.38
5 Years (p.a.)	(3.10)	(4.19)	1.09
10 Years (p.a.)	0.92	0.56	0.37
Since inception (p.a.)	2.11	1.92	0.19

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 UK Government Bond Fund (Z Inc). Source: Royal London Asset Management;Gross performance; Since inception date of the shareclass is 30 April 2010.

Performance commentary

The fund outperformed its benchmark during the second quarter, but delivered a negative absolute return.

As the second quarter got underway, government bond markets were still forecasting that the major central banks would start to cut interest rates during the summer of 2024. By the end of the quarter that narrative had shifted somewhat, most notably for the Federal Reserve, where the first and only cut for 2024 is now expected late in the final quarter. The ECB, having boxed themselves into a corner, fully delivered on the markets expectation of a 0.25% reduction in base rates at their June meeting. Early in the quarter, the BoE also put a rate cut in play for its June meeting, but by the time the meeting arrived, economic data didn’t support a move lower in rates, whilst the announcement of an election on the 4 July put pay to any remaining hopes of an interest cut in the UK.

Over the three-month period, 10-year gilt yields traded within a wide, but relatively well-defined trading range. Within that bond markets were notably volatile, particularly around economic data prints. That pattern held true in other markets such as the US and Europe where US treasuries and German bunds traded sideways,

In a similar story to yield moves, the curve did not see any dramatic shifts in the second quarter – with yields at the short-end and long-end trading in lockstep, and within a tight range.

As a result of the above, the strategic duration and curve positions within the fund added little to performance, with tactical activity more impactful.

Performance and activity

Fund activity

At the start of the quarter, the fund was marginally long versus the benchmark at around 0.2 years. This was gradually increased and peaked at 0.85 of a year long relative to the benchmark in late April as yields in the UK and US reached their highs for the year. As yields fell during the first few weeks in May, duration was gradually reduced to 0.5 years long, but the sell-off following the May US inflation print provided an opportunity to increase duration once again to 0.7 years long in late May. Markets remained volatile throughout June, and the fund ended the period 0.45 of a year long.

The volatile market conditions that prevailed for much of the quarter provided active investors with plenty of opportunities, particularly around economic data prints and bond supply (auctions and syndications). The tactical trading of our duration position was the primary driver for performance during the quarter.

During the period the fund added new strategic positions in overseas markets. Of note were new holdings in 30-year US TIPS, seven-year US treasury bonds and 30-year nominal Australian government bonds, which were bought early in the quarter. Overall, these positions were beneficial for the fund – particularly the two US positions as US bond markets outperformed UK gilts.

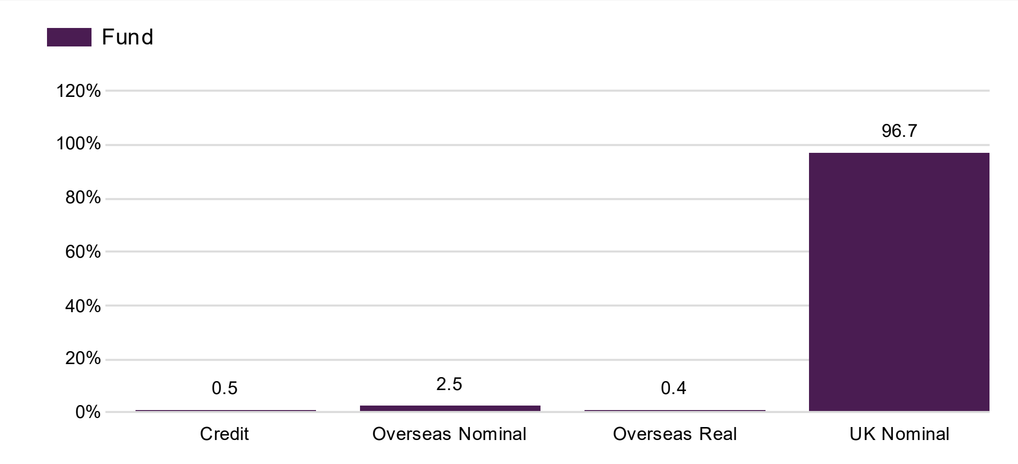
Our curve position did not change much in the quarter but we have increased our exposure to the 30-year portion of the curve as we bought 30 year maturity gilts when adding to our duration long.

A small portion of the fund is still invested in high quality credit, but it is now focused in bonds with maturities under five years, and is much reduced from prior levels.

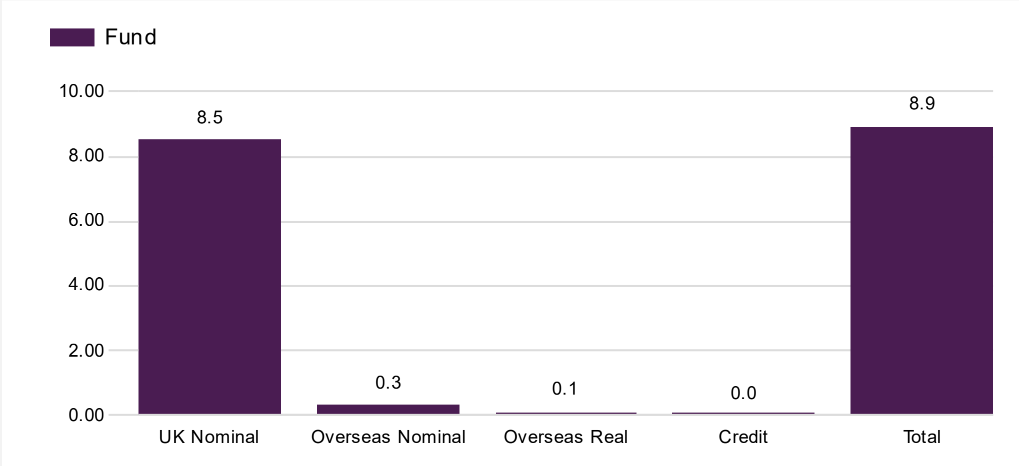
The fund has no exposure to UK inflation via breakevens.

Fund breakdown

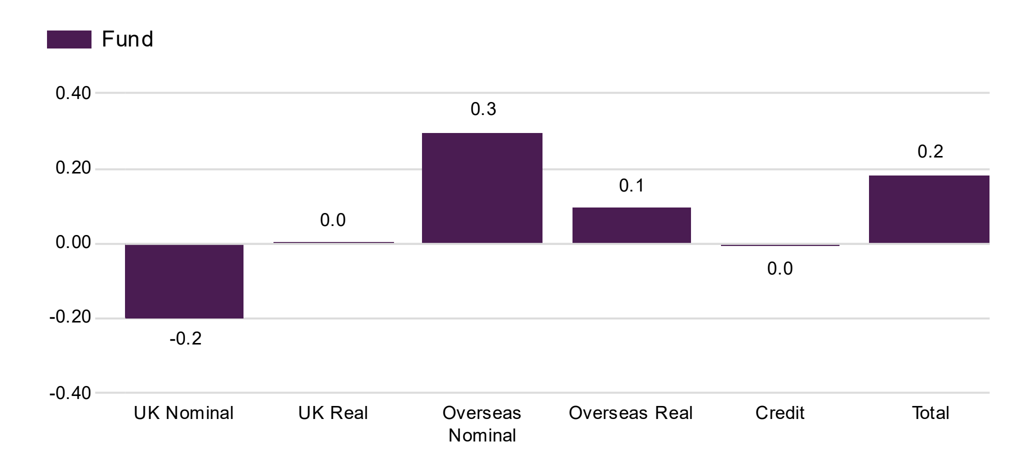
Asset split by percentage



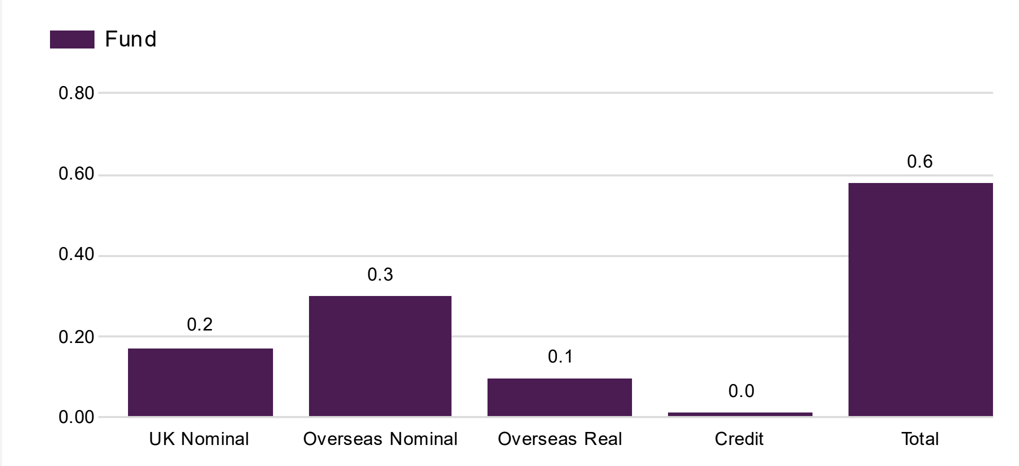
Asset split by duration



Asset split by duration change on quarter

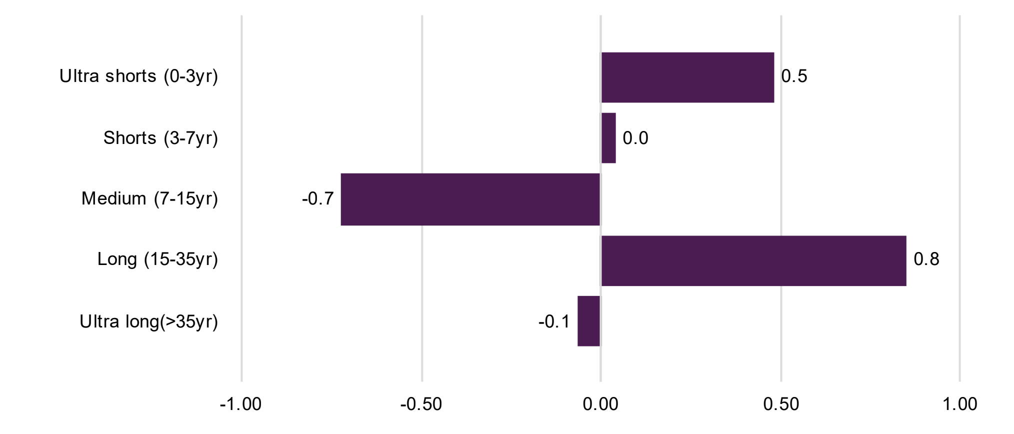


Asset allocation relative to benchmark (duration)

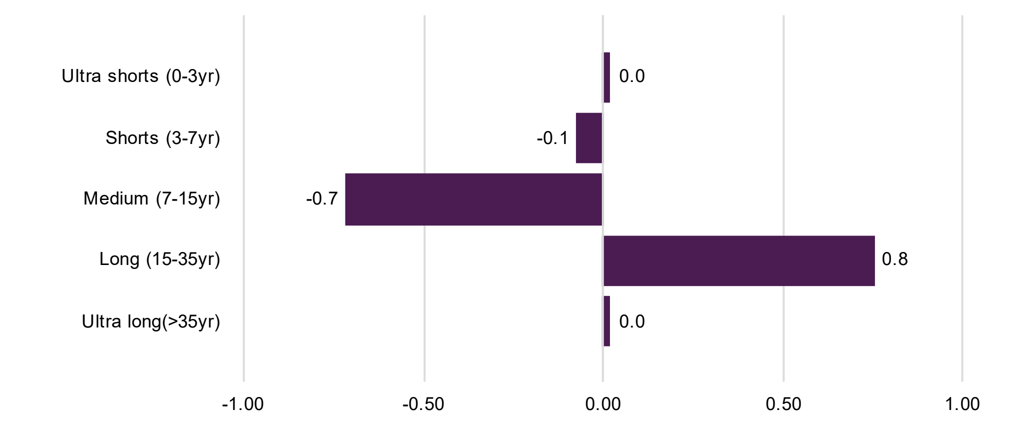


Fund breakdown

Maturity profile relative to benchmark



Maturity profile change on quarter



Market commentary

Market overview

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.

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 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).

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%.

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 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.

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.

In the UK, the market is now assuming base rates have peaked at 5.25%, with the first cut fully priced in for August 2024, and falling to a terminal level of around 3.5% by late-2026.

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.

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 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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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.

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 (%)

	3 Month	6 Month	1 Year	3 Years	5 Years
Fund (gross)	(0.32)	(1.94)	6.53	(19.04)	(14.60)
Fund (net)	(0.39)	(2.06)	6.26	(19.70)	(15.89)

Annualised (%)

3 Years (p.a.)	5 Years (p.a.)
(6.79)	(3.10)
(7.05)	(3.40)

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)	6.53	(12.07)	(13.57)	(5.78)	11.96
Fund (net)	6.26	(12.29)	(13.85)	(6.11)	11.56

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 UK Government Bond Fund (Z 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.

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.