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Royal London Absolute Return Government Bond Fund

Quarterly Investment Report

30 September 2024

Quarterly Report

The fund as at 30 September 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.

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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 September 2024	1,258.89

Asset allocation

	Fund (%)
Conventional credit bonds	45.96%
Money market instruments	28.28%
Index linked foreign sovereign	11.39%
Conventional foreign sovereign	6.34%
Conventional gilts	5.82%
Securitised	1.10%
Index linked gilts	0.49%
Other	0.62%

Fund analytics

	Fund
Fund launch date	17 November 2014
Base currency	GBP

Performance and activity

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Quarter	1.48	1.25	0.24
YTD	4.83	3.83	1.00
1 Year	7.40	5.17	2.23
3 Years (p.a.)	4.88	3.27	1.61
5 Years (p.a.)	3.84	2.03	1.81
Since inception (p.a.)	2.22	1.25	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 significantly ahead of benchmark over one and three years. Year to date the fund has achieved higher returns than all government bond indices, reflecting the higher yield on the fund

The largest contributor to performance was again from the core holdings of sterling money market instruments. These assets yielded above 5% and benefited from expectations that UK rates would be cut significantly over the next 12 months]

Duration positions added value, particularly through tactically trading the volatility seen in markets as economic data continued to be mixed. Long positions in the US and Australia were the main positives for the portfolio.

Curve positions added value over the quarter particularly the US 5-30 steepener that benefitted from a more doveish outlook from the Federal Reserve. The curve flattener in Japan was a modest detractor from performance.

Inflation positions generally added value particularly a short position in the UK as breakeven rates fell over the quarter.

Cross market positions were mixed with the long UK vs US 1y1y detracting from performance whilst short positions in France added value.

Performance and activity

Return Contribution

	Quarter	1 year	Target return (of live trades)
Inflation	12.00	103.00	22.00
Curve	9.00	44.00	19.00
Duration	23.00	119.00	19.00
Relative Value	0.00	(2.00)	13.00
Cross Market	(12.00)	(9.00)	20.00
FX Hedges	0.00	0.00	0.00
Cash	105.00	440.00	480.00
Total	**137.00**	**695.00**	**573.00**

Top Contributors

	Strategy	Q3 Contribution (bps)
Cash	Cash	106.00
Duration	Australia	12.00
Inflation	UK	12.00
Curve	US	9.00
Duration	US	7.00

Bottom Contributors

	Strategy	Q3 Contribution (bps)
Cross Market	Europe	(7.00)
Cross Market	UK/US	(5.00)
Duration	Europe	(4.00)
Inflation	US	(3.00)
RV	UK swap spreads	(2.00)

Performance and activity

Portfolio Exposure

Trades	Position size	Net duration exposure	Market beta	Target return (bps)
Inflation				
Long Japanese Breakeven	0.15	0.00	0.00	5.00
Short 5y5y RPI	0.30	0.00	0.00	5.00
Long 5y5y cpi	0.20	0.00	0.00	5.00
Long 5y5y Hicp	0.10	0.00	0.00	5.00
Long US 5y Swap	0.20	0.00	0.00	2.00
Curve				
Japan 10-30 Flattener	0.30	0.00	0.00	15.00
Australia 3-30 flattener	0.15	0.00	0.00	4.00
Cross Market				
Long Spain vs France	0.10	0.00	0.00	5.00
Long UK vs Europe (7y swap)	0.10	0.00	0.05	5.00
Long UK vs Bunds	0.10	0.00	0.05	5.00
Long 30y euro vs Bunds	0.20	0.00	0.10	5.00
Relative Value				
Long 30 year Gilt Asset Swap	0.80	0.00	0.00	8.00
Short 30 year Iota	0.20	0.00	0.00	5.00
Duration				
Long 10 y UK	0.30	0.30	0.30	5.00

Performance and activity

Portfolio Exposure

Trades	Position size	Net duration exposure	Market beta	Target return (bps)
Duration				
Long Spanish RY	0.25	0.24	0.15	3.00
Long 30y Italy	0.05	0.05	0.10	2.00
Short 10y Italy	0.10	(0.10)	0.00	2.00
Short 7 y US	0.20	(0.20)	(0.10)	2.00
Long Australia 30y	0.10	0.10	0.05	5.00
Cash				
Cash	0.20	0.15	-	480.00
Overall Net Duration Position	**4.10**	**0.54**	**0.70**	**573.00**

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	0.02	(0.15)	0.00	0.14	0.15	0.00	0.00	0.16
Canada	0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.01
European Union	(0.01)	(0.16)	0.00	0.00	0.00	0.00	0.00	(0.17)
Finland	0.01	0.00	0.00	0.00	0.00	0.00	0.00	0.01
France	0.03	0.00	(0.10)	0.00	0.00	0.00	0.00	(0.07)
Germany	0.01	0.05	(0.10)	0.00	(0.22)	0.00	0.00	(0.26)
Italy	0.00	0.00	(0.10)	0.06	0.00	0.00	0.00	(0.05)
Japan	(0.01)	0.14	(0.55)	0.00	0.40	0.00	0.00	(0.01)
Netherlands	0.02	0.00	0.00	0.00	0.00	0.00	0.00	0.02
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	0.10	0.25	0.00	0.00	0.00	0.00	0.35
Supranational	0.00	0.00	0.00	0.00	0.20	0.00	0.00	0.20
Sweden	0.03	0.00	0.00	0.00	0.00	0.00	0.00	0.03
Switzerland	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
United Kingdom	0.08	0.16	0.29	0.22	0.04	(0.30)	0.00	0.50
United States	0.04	(0.20)	0.00	0.00	0.00	0.00	0.00	(0.16)
Total								0.57

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	0.00	0.00	0.00	0.00	0.00	0.00
Canada	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
European Union	0.00	(0.10)	0.20	0.00	0.00	0.00	0.00	0.10
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	0.00	0.00
Germany	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Italy	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Japan	0.04	0.15	0.00	0.00	0.00	0.00	0.00	0.19
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	0.10	0.14	0.00	0.00	0.00	0.00	0.24
Supranational	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	0.30	(0.60)	(0.00)	0.00	0.00	0.00	(0.30)
United States	0.00	0.00	0.40	0.00	0.00	0.00	0.00	0.40
Total								0.63

Performance and activity

Stand alone risk contribution

	Quarterly Vol (%)	Annual Vol (%)
Inflation	0.01	0.02
Curve	0.08	0.16
Duration	0.09	0.18
Relative Value	0.00	0.00
Cross Market	0.11	0.00
FX Hedges	(0.00)	0.22
Cash	0.10	0.19
Overall Volatility	**0.38**	**0.76**

Risk Model Factor Risk Breakdown

	Standalone Risk Portfolio (bp)	Risk Contribution Portfolio (bp)	% of overall risk
Rates	61.74	49.37	64.55
Inflation	42.75	18.03	23.57
Spreads	18.56	9.32	12.19
Foreign Exchange	3.00	(0.24)	(0.31)
Time	0.00	-	-
Other	0.00	-	-
Total	**126.05**	**76.48**	**100.00**

Diversification across Risk Factors (%)	**(39)**

Performance and activity

Fund activity

Duration was gradually reduced through the first half of the quarter selling a mix of US, UK and German bonds as yields fell sharply on expectations of faster rate cuts. Yields hit their lows in Early August following the sharp flight to quality as the Bank of Japan's larger than expected rate hike led to a sharp sell off in risk assets. By early Aust the duration on the fund was 0 having begun the quarter at 1.25 years. For the remainder of the quarter duration was traded tactically between flat and 0.5 long ending the quarter at 0.5 years long.

During the quarter we increased exposure to inflation – particularly in the US and Europe – buying Spanish teal yields towards the end of the quarter as new 10-year bond was issued via a syndication. The short position in the UK was increased as breakeven rates relative to global markets widened. The holding in Japan was reduced further.

We closed our cross market positions in UK and US 1y1y as the rhetoric from the Federal Reserve became more dovish. Towards the end of the quarter, after a period of underperformance, we closed out half of the short position in France.

Curve positions in the US and Europe were traded actively, after the sharp steepening over the quarter these positions were closed as markets begun to price in excessive rate cuts relative to our own view. We maintained the flattener in Japan.

We maintained our long gilts relative to swaps and short 30-year cash breakevens vs inflation swaps.

We used supply events across the globe to add duration when new issue premia were again attractive. We took part in three syndications in Australia, Italy and Spain.

Market commentary

Market Overview

Markets continued to focus on central bank actions during the quarter, as both the Federal Reserve (Fed) and Bank of England (BoE) followed the European Central Bank in making the first rate cuts this cycle. This follows the significant rises through 2022 and 2023 as part of efforts to reduce inflation. Along with a significant stimulus package in China, this policy shift generally helped fixed income markets to perform positively over the quarter as yields fell to reflect lower central bank interest rates. After initial weakness, equity markets started to rise once more, reflecting the hope that the policy easing would result in a soft landing for the economy with the US S&P 500 index hitting an all-time high. Despite guidance from central banks that further cuts will be measured, markets are still pricing in material rate cuts over the next year or so.

After elections in the UK and France grabbed headlines in the second quarter, attention moved firmly to the forthcoming US elections. Markets believe that a Trump presidency would see looser fiscal policy and higher tariffs and protectionism. Sentiment has swung on the fortunes of the early days of the race, first following the Trump assassination attempt and debate against President Biden, which appeared to favour Trump, but then swung back as Kamela Harris emerged as a credible candidate and performed strongly in her debate with the former president. Somewhat remarkably, markets have remained sanguine about rising geopolitical tensions in the Middle East.

As mentioned above, the Fed cut 50bps to 4.75%-5%. This was in contrast to most economist expectations, but in line with what the market had been increasingly pricing. The Fed see diminished upside risks to inflation and increased downside risks to employment and eased policy accordingly. Their forecasts and language indicated that they anticipate the change as the beginning of a series of cuts, returning rates “to a more neutral stance.” As of their September meeting, the median forecast of participants showed another 50bps of cuts over the rest of 2024, then a further 100bps easing over 2025. Inflation data released over the quarter was relatively reassuring, while Q2 GDP was strong and forward-looking indicators were consistent with a continued robust pace of growth in Q3 by the end of the quarter. These mixed data signals contributed to ongoing volatility in US treasury markets.

In the euro area, the ECB cut the deposit rate 25bps to 3.50% on the back of inflation data coming in “broadly as expected” and “still subdued” economic activity. Lagarde's comments at the time didn't give much away in terms of the likely pace of future cuts (beyond that they expect to be lowering rates further). French politics were a focus for the early part of the quarter with a hung parliament the end result from the July election. Following these election results Michel Barnier – who previously negotiated with the UK over the terms of Brexit - was selected as PM in September and delayed a target to bring the deficit back within EU rules until 2029.

UK data released in Q3 were consistent with the UK economy growing modestly, while headline inflation has been running close to the 2% target. Later in the period there was a worrying fall in consumer confidence in September, which may have reflected some concern over what the October Budget might bring after the new government flagged that ‘painful’ decisions may be required. The BoE cut rates 25bps, though with (only) a 5-4 vote, warning that they need to be careful not to cut too quickly – duly leaving rates unchanged in September.

Government yields generally fell over the quarter, reflecting the start of the rate cutting cycle. In the US, 10-year treasury yields fell from 4.40% to 3.79%, while German 10-year bunds similarly saw yields fall from 2.50% to 2.13%. Benchmark 10-year gilt yields dipped from 4.18% to 4.01%. These gilt yields had been as low as 3.75% in mid-September, many attributed the increase at the end of the quarter to concerns that the Budget might see a further increase in gilt issuance.

Index linked markets saw similar moves, with real yields on US and Germany 10-year real yields all ending the quarter lower than they started, while UK equivalents ended broadly unchanged at 0.58%, although this hid significant intra-quarter volatility, with these training as high as 0.67% and as low as 0.40%. Breakevens edged lower.

Outlook

We expect markets to remain volatile around economic data points and envisage to continue trading duration tactically. Markets continue to trade on sentiment with periods of peak optimism and pessimism.

We expect further rate cuts across the globe but significantly less than is priced in by markets. As a consequence, we will need to see yields higher before increasing duration significantly.

Inflation is now more fairly valued in Japan and any further tightening of monetary policy could impact break evens. We will use strength to reduce this position further. With the chances of Trump victory still material, we are long US breakevens on an outright basis and against the UK – where we feel breakevens look overvalued particularly in light of RPI reform in 2030.

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

Market commentary

The UK market has sold off relatively on fears of a large increase in supply following the budget in late October. We believe this to be overdone and have begun to increase the overweight 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 September 2024

Cumulative (%)

	3 Month	6 Month	1 Year	3 Years	5 Years
Fund (gross)	1.48	3.25	7.40	15.40	20.77
Fund (net)	1.41	3.09	7.07	14.26	18.61

Annualised (%)

3 Years (p.a.)	5 Years (p.a.)
4.88	3.84
4.54	3.47

Year on year performance (%)

	30/09/2023 - 30/09/2024	30/09/2022 - 30/09/2023	30/09/2021 - 30/09/2022	30/09/2020 - 30/09/2021	30/09/2019 - 30/09/2020
Fund (gross)	7.40	7.54	(0.08)	1.01	3.61
Fund (net)	7.07	7.22	(0.48)	0.59	3.21

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 September 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.