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Royal London Index Linked Fund

Quarterly Investment Report

30 September 2024

ROYAL LONDON
ASSET MANAGEMENT

Quarterly Report

The fund as at 30 September 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.

Contents

ROYAL LONDON
ASSET MANAGEMENT

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 analytics

	Fund	Benchmark
Fund launch date	15 February 1990	
Base currency	GBP	
Duration (years)	15.45	15.27
Real yield (%)	1.00	0.95
Number of holdings	33	32

Fund value

	Total £m
30 September 2024	435.20

Asset allocation

	Fund (%)	Benchmark
Index linked gilts	97.82%	100.00%
Index linked credit bonds	1.22%	-
Index linked foreign sovereign	0.97%	-

Performance and activity

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Quarter	1.76	1.42	0.34
YTD	(1.77)	(2.49)	0.72
1 Year	6.87	6.01	0.87
3 Years (p.a.)	(11.21)	(11.80)	0.59
5 Years (p.a.)	(6.52)	(7.10)	0.58
10 Years (p.a.)	1.41	0.91	0.49
Since inception (p.a.)	3.65	3.08	0.57

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

The fund produced a positive return over the quarter, outperforming its benchmark, and remains ahead of benchmark over one and three years.

Duration positioning was helpful over the period. While we felt overall levels did not support a material strategic stance, the volatility in real yields over supply events and economic data gave opportunities to trade duration tactically, particularly around the more volatile environment after the Bank of Japan interest rate move in July.

Cross market positioning was the key driver of performance over the period. With real yields falling globally led by the US, our overweight positions in the US, France and Australia added value.

Curve positioning also helped performance, thanks to our 10-30 year curve steepening positions (short-dated yields to outperform long-dated yields).

Our inflation-linked strategies can move underweight inflation (selling linkers and buying conventionals) when market pricing presents opportunities. Breakevens were generally lower during the period and we traded these tactically, particularly arounds supply events, helping performance over the quarter.

Performance and activity

Fund activity

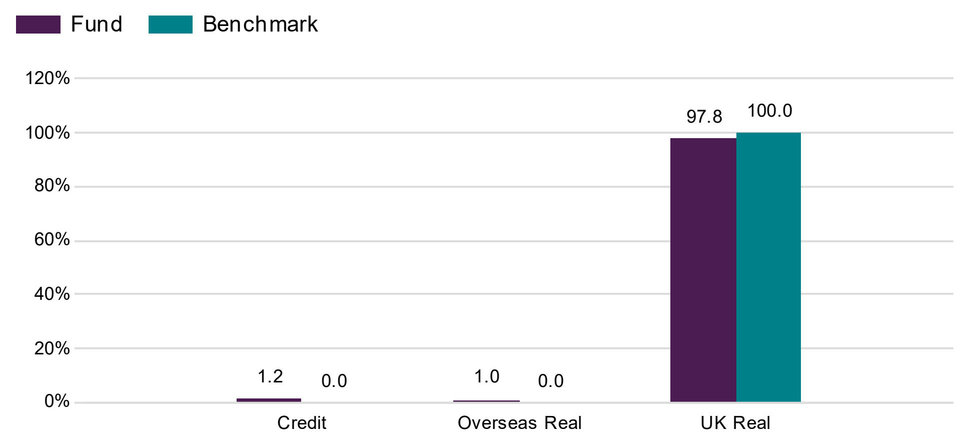
Activity during the quarter continued to look for tactical opportunities to benefit from market issuance and ongoing volatility. We started the quarter with a small long position, and generally remained long or neutral through the period, with brief moves short after yields moved lower in early August after the mini-collapse in equity markets. Duration was increased later on after the cut in US interest rates due to the more hawkish rhetoric from the Federal Reserve.

In terms of cross-market positioning, having started with long positions in the US, Australia and France, we initially added further to the US position. After strong performance from the US, we trimmed the position, closing these off-benchmark positions. Later in the quarter we saw opportunities to take cross-market positions once more, buying shorter dated Spanish secondary bonds, as well as US TIPS and Australia, taking the US to flat once more before the end of the quarter. We sold the Spain positions at a profit before the end of the quarter.

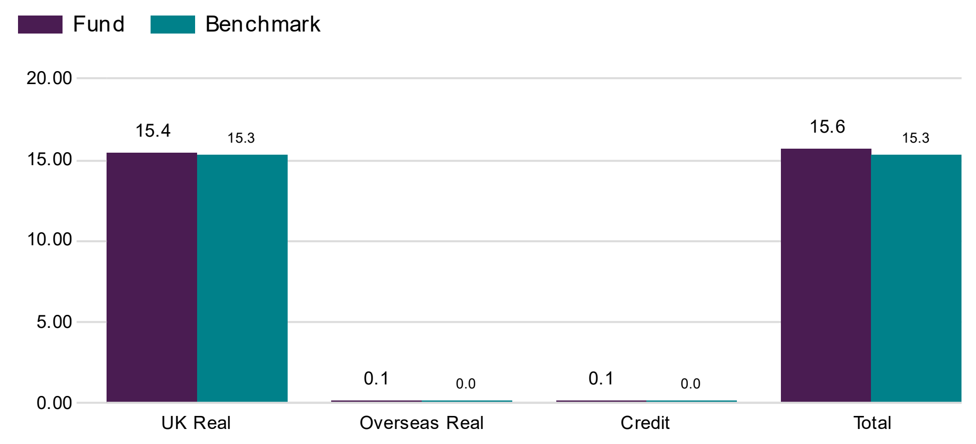
During the quarter we continued to benefit from the market distortion where European insurance companies were buying certain long-dated cash rich bonds for asset swap purposes. As noted last quarter, this meant that the UK 2042, 2047 and 2055 index linked bonds were in high demand in demand and we moved further underweight in these issues. In addition, we moved further underweight in 30-year UK index linked gilts with a 30-year syndication expected in the final months of 2024. We reduced our underweight in 15-year gilts, selling 25-year bonds that had performed well after buying from LDI strategies.

Fund breakdown

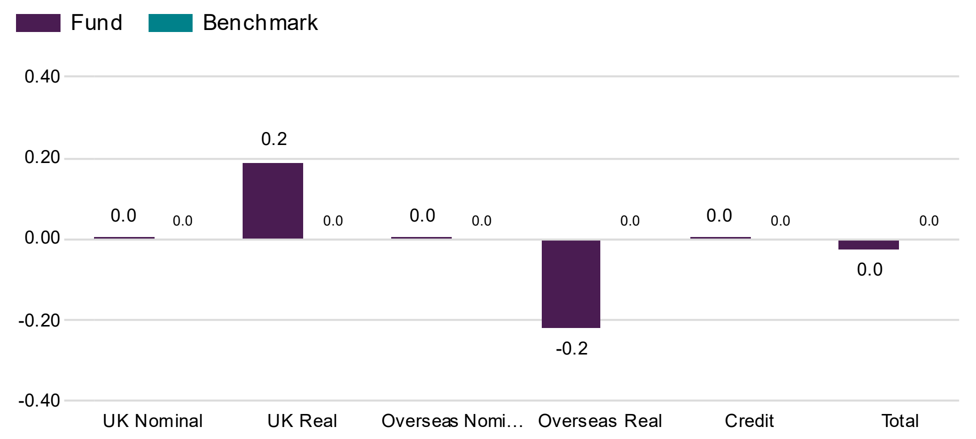
Asset split by percentage



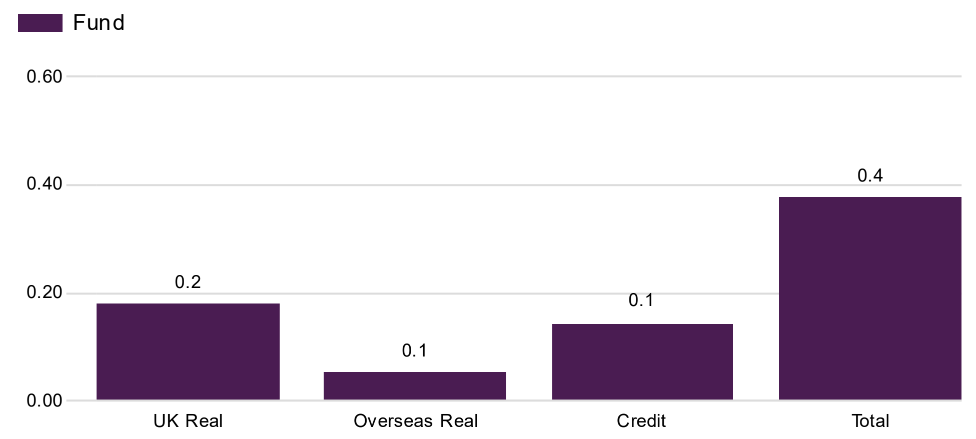
Asset split by duration



Asset split by duration change on quarter

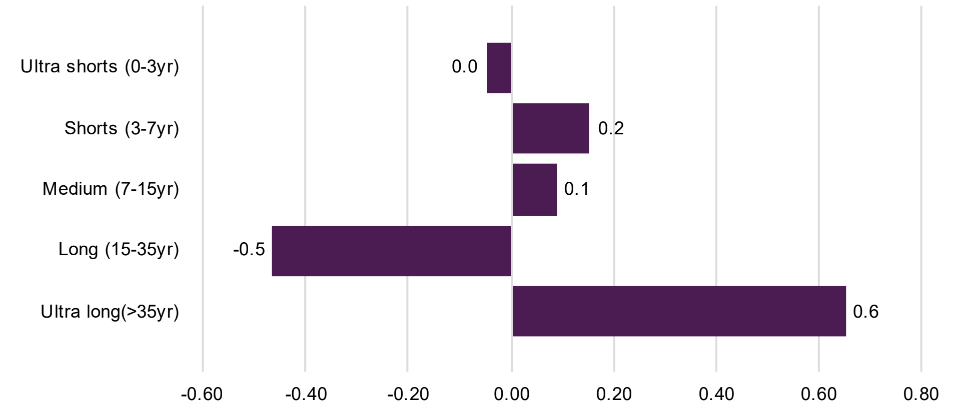


Asset allocation relative to benchmark (duration)

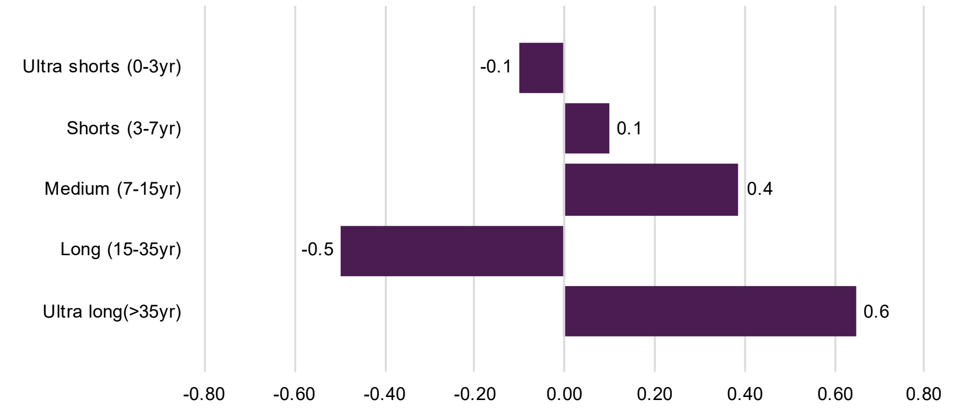


Fund breakdown

Maturity profile relative to benchmark



Maturity profile change on quarter



Market commentary

Market overview

Markets 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 Kamala 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. 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.

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.

UK data released in Q3 were consistent with the UK economy growing modestly, while headline inflation has been running close to the 2% target. 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

At the start of this year we mentioned ‘peak optimism’ – the idea that markets were pricing in far more rate cuts than we felt were likely. This was swiftly followed by ‘peak pessimism’ – an expectation that rate cuts would be much slower and fewer than previously thought. In practice, at various points this year, markets have expected only a single rate cut in 2024, or as many as six. The volatility seen in government bond markets this year reflects these extremes and the changes from one to the other. We saw this again in the third quarter, with soft data in August / September pushing markets to once again price in many rate cuts.

This volatility provides opportunities for active managers. We have actively traded duration this year to benefit from these swings and expect to continue to do so. Duration has been pared back again towards the end of the quarter with excessive rate cuts priced into markets.

As well as changing market expectations, supply remains a factor in short-term movements, generating discounts prior to pricing. Over the past quarter, fears of increased supply auctions have offered good opportunities to add UK risk. The UK budget will be a key event at the end of October. UK bonds have underperformed on fears of a substantial increase in supply to favour Labours spending plans. We believe the cheapening has gone too far and will begin to increase UK positions.

Having steepened in the third quarter, we expect curves to flatten as we expect the market pricing of interest rate cuts to become less aggressive. In the UK, we expect increased supply to be targeted more at shorter maturities, reflecting decreased buy-out and LDI demand for long-dated bonds.

Given the underperformance of the UK in the third quarter we expect the UK to outperform and are running long positions in the UK across all funds. Australian bonds cheapened towards the end of the quarter and we believe look attractive relative to the US and Canada, so all funds have maintained a long position in Australia.

Breakeven rates in the US and Europe are marginally cheap to fair value whereas the UK looks closer to fair value. With the US presidential election in early November, we like US breakevens as a potential hedge against a Trump presidency (which we would expect to be reflationary), and protection from any further deterioration in the geopolitical situation.

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

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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.

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 September 2024

Cumulative (%)

	3 Month	6 Month	1 Year	3 Years	5 Years
Fund (gross)	1.76	0.39	6.87	(30.03)	(28.64)
Fund (net)	1.68	0.24	6.55	(30.67)	(29.80)

Annualised (%)

3 Years (p.a.)	5 Years (p.a.)
(11.21)	(6.52)
(11.49)	(6.83)

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)	6.87	(7.72)	(29.05)	(0.37)	2.37
Fund (net)	6.55	(8.00)	(29.28)	(0.73)	2.00

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 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.