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Royal London International 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 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

ROYAL LONDON ASSET MANAGEMENT

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 September 2024	1,233.35

Asset allocation

	Fund (%)	Benchmark
Conventional foreign sovereign	86.79%	100.00%
Index linked foreign sovereign	7.33%	-
Conventional gilts	4.58%	-
Conventional credit bonds	1.30%	-

Fund analytics

	Fund	Benchmark
Fund launch date	4 November 2011	
Base currency	GBP	
Duration (years)	6.83	6.80
Gross redemption yield (%)	3.16	2.93
Number of holdings	123	1,030

Performance and activity

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Quarter	4.09	4.10	(0.01)
YTD	3.66	3.19	0.46
1 Year	9.52	8.69	0.84
3 Years (p.a.)	(0.37)	(1.62)	1.25
5 Years (p.a.)	0.32	(0.67)	0.99
10 Years (p.a.)	1.78	1.33	0.45
Since inception (p.a.)	2.13	1.91	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 traded in line with its benchmark during the third quarter. The majority of government bond markets rallied strongly over the quarter, as economic data began to soften and numerous central banks embarked on easing programs.

Our duration stance was a positive contributor to performance at the start of the quarter, with some of this being given back as markets continued to price further policy easing measures by the major central banks. The exceptions to this being the Bank of Japan (where further policy tightening is the most likely next move) and the Australian Central Bank, where future policy path is a less clear, given the mixed picture of incoming inflation and employment data.

July proved to be somewhat of a turning point for markets, as US data (in particular in relation to prices) saw some signs of softening, with official numbers coming in below market consensus expectations. This saw the market re-assess the future policy path of the Fed, believing that they would need to begin easing to stave off any recessionary threat.

Over the course of July, US 10-year yields fell by over 30bps, ending the month close to 4%, and then continued to decline over the majority of the rest of the quarter. The Fed themselves did little to pushback against market pricing, signalling that their next move would likely to be a cut in the Fed Funds Rate, and they duly delivered a 50bps cut in September.

The period also saw something of a duration shock in at the end of July and early August as the Bank of Japan unexpectedly increased its interest rates, causing a large sell off in Japanese equities, panic in markets as large Japanese carry trades began to be unwound and a flight to quality move in government bond markets.

Market moves were likely exacerbated as this occurred during a seasonal period when volumes are typically lower and risk appetites reduced. The period of market stress was relatively short lived and markets stabilised quickly. The neutral duration position of the fund, combined with an overweight exposure to German Bunds meant that the fund navigated this period successfully.

The fund increased its exposure to inflation markets of the course of the quarter by entering a position on five-year US breakevens. We entered the trade at a breakeven rate of around 2.2%, with the rationale that this was something of a ‘Trump hedge’, as we believe that should Donald Trump succeed in the US Presidential election, this will likely result in inflationary policies.

Establishing a position at only 20bps above the Fed’s inflation target offered an attractive asymmetric return profile. However, with the withdrawal of Biden from the presidential race and the Democratic nomination going to Harris, a shift in the polls away from Trump saw US five-

Performance and activity

Performance commentary (continued)

year breakeven rates decline and this will have been a negative contributor to performance over the quarter. However, we remain content to continue running the position and believe the trade can perform well across a number of scenarios.

Elsewhere, the fund maintains relatively small holdings in short-dated Japanese and Italian index linked bonds, both of which had a very limited impact on performance over the quarter, and a position on 30-year US real yields, which continue to perform well.

Our curve exposure was a small positive contributor to performance over the quarter, with the positive contributions from US and European curve positioning offsetting the flattening exposure in Japan.

Cross market positioning will have been a small positive contributor to performance over the quarter. Having started the quarter overweight the US and underweight Canada, we used the outperformance of US treasuries in July to move to a neutral position in Canada. We also maintained an overweight exposure to Australia, out of the US. Performance of this trade was disappointing over the period, as Australian Government bonds lagged the global rally, but we are happy to remain overweight given the economic fundamentals and supply outlook for Australia.

Germany also performed very strongly over the period and with 10-year yields approaching 2% and 30-year yields around 2.4%. We elected to switch our overweight in bunds into EU issued debt, which offers an attractive yield pick-up whilst maintaining a AAA credit rating. We have previously held EU debt versus France, but with the re-pricing of French government debt, we feel that bunds are a better comparator. EU debt widened versus bunds on fears of a large issuance program to fund aid to the Ukraine and we used this opportunity to add to the position. The spread has since normalised somewhat, but we are happy to continue to hold at these yield differentials.

Performance and activity

Fund activity

Following the sell-off in sovereign bond markets over the second quarter of the year, as economic data remained remarkably resilient and inflation proving to be "stickier" than anticipated, we started the third quarter of 2024 with a long duration exposure of around 0.4 years, largely in dollar markets (US and Australia) and European Core (0.3 yrs) and Periphery (0.1 yrs). The positive exposures to these markets were partially offset by underweights in Canada, Japan and Semi-Core Europe (France and Belgium).

Our view was that the market was too aggressive in its pricing of further rate cuts in the US, and the incoming data, whilst weakening, was inconsistent with the amount of monetary policy easing that had been priced. To reflect this, we trimmed our long duration position over the course of July and moved to small short duration position in August, before returning to a neutral stance at the end of the quarter. This was expressed by running an underweight to US and Japan duration, offset by overweight positions in Australia and peripheral Europe (Spain).

The major curve positions within the fund at the start of the quarter were curve steepeners within the US and Europe and a curve flattening exposure within Japan. Despite the hike from the Bank of Japan, the curve remains stubbornly steep and steepened dramatically during the above short-lived stress episode at the start of August, although has subsequently flattened a little.

This position detracted from performance over the quarter, but the exposure to a steeper US curve will have been a positive contributor. With the yield differential between US 30-year and 5-year yields increasing by over 35bps over the quarter as markets priced an aggressive easing path from the Fed, we elected to trim this position in September, but still maintain a steepening bias to US markets. The European yield curve also steepened over the quarter (as the market priced further easing from the ECB, following the 25bps cuts to the deposit rate in June and September), and we have now taken the fund to neutral exposure to European curve.

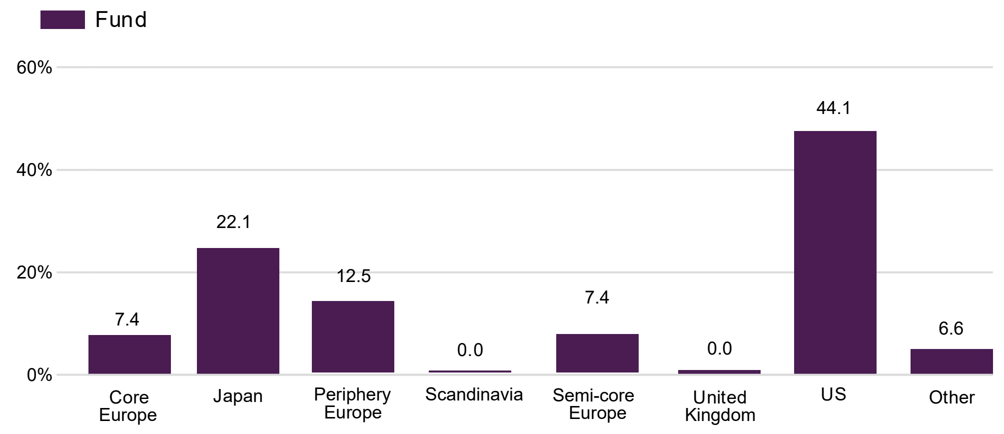
In Europe, we maintained our underweight in France, given the political headwinds and possible ratings actions over the future scale of budget deficits. France does now have a Prime Minister in place, but parliament remains fractious and with the European Commission placing France in its Excess Deficit Procedure (with a requirement to commit to fiscal deficit reduction measures), challenges lay ahead.

This underweight was partly versus Germany (where, whilst volatile, the spread ended the quarter largely where it began) and partly versus Spain, which outperformed France over the quarter and was a positive contributor to performance. Spain has benefitted from investors switching out of France and whilst we have seen Spanish yields fall by nearly 50bps over the quarter, the outlook for Spanish bonds remains positive and we are happy to continue running an overweight exposure. At the end of the quarter, we also participated in a syndication of a 12-year Spanish index linked bond, which performed very well.

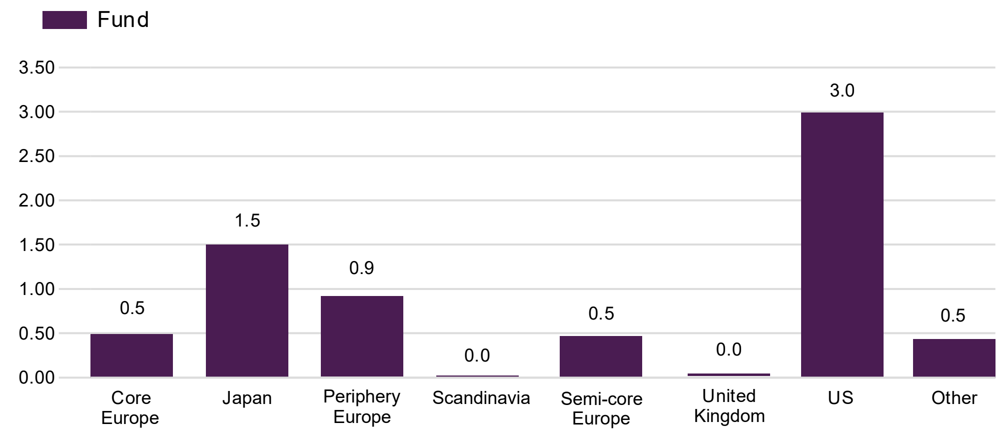
We have also tactically traded in Italian bonds over the period, sometimes on a cross-market basis versus Spain and on an outright basis on other occasions. Italy remains a high beta to global market sentiment and presents good opportunities to trade any outsized moves, and we typically do so using Italian bond futures. We ended the quarter with a broadly flat exposure to Italy.

Fund breakdown

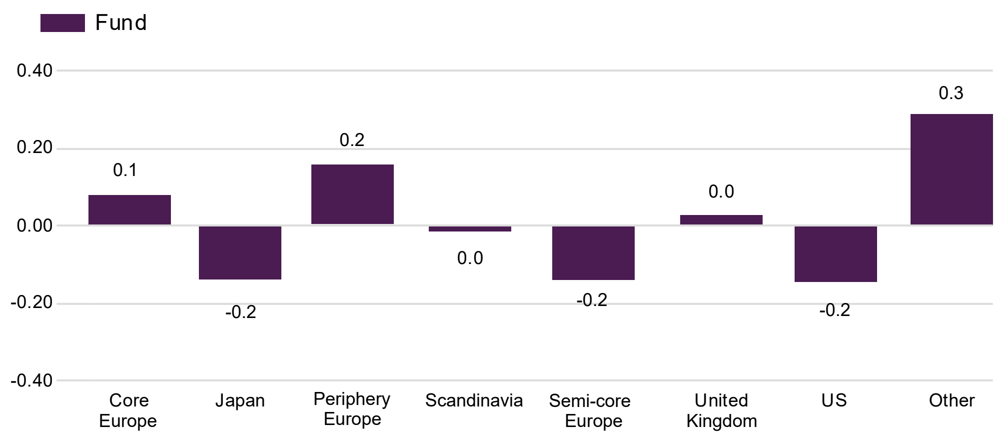
Geographic split by % weight



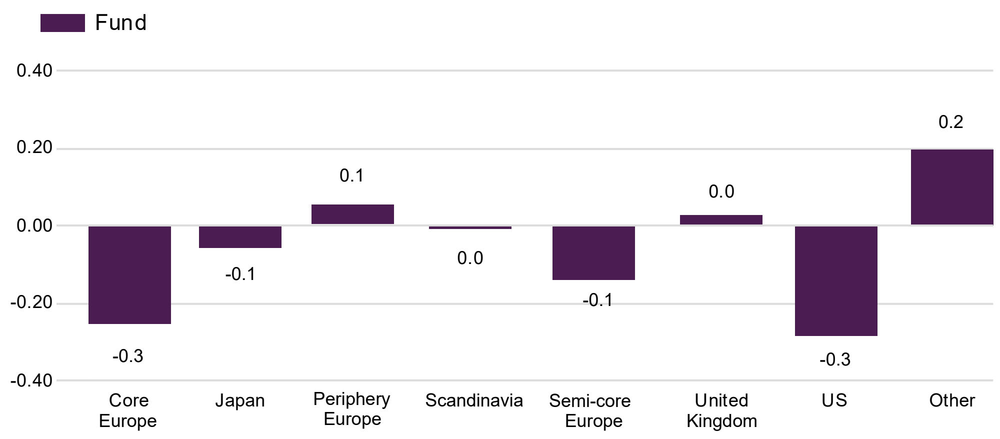
Geographic split by duration



Duration position relative to benchmark

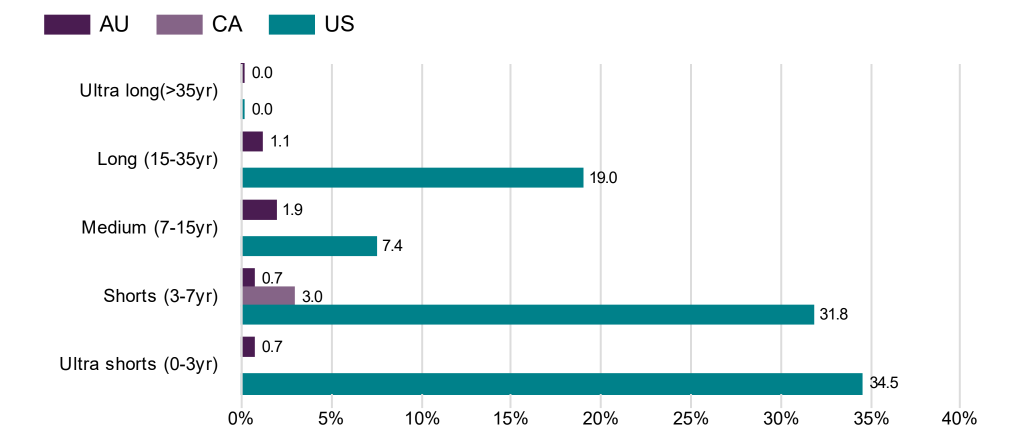


Relative duration quarter on quarter

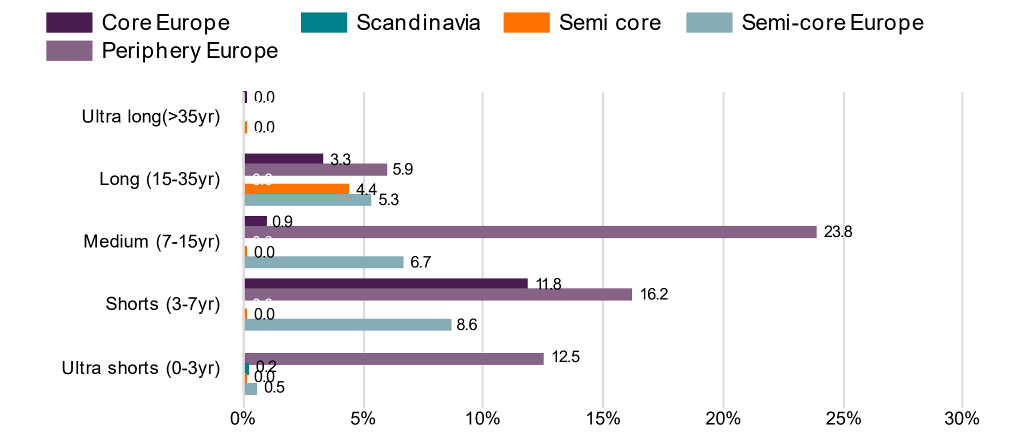


Fund breakdown

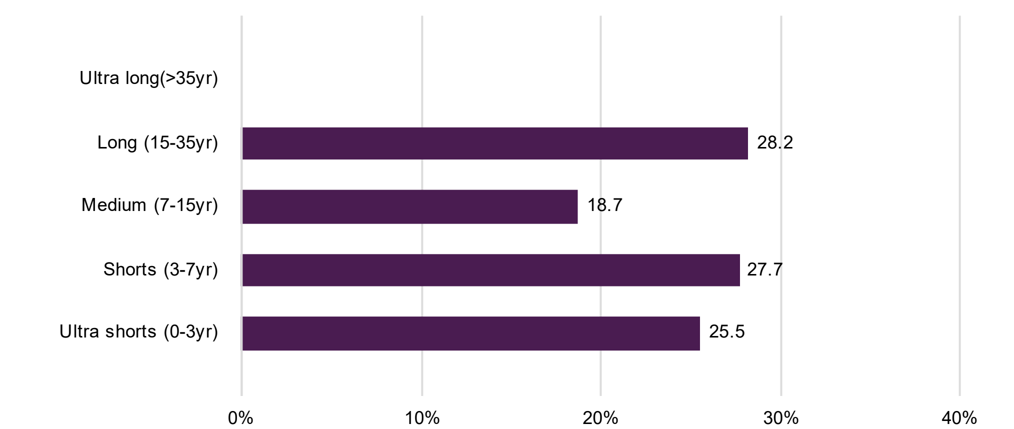
Dollar bloc



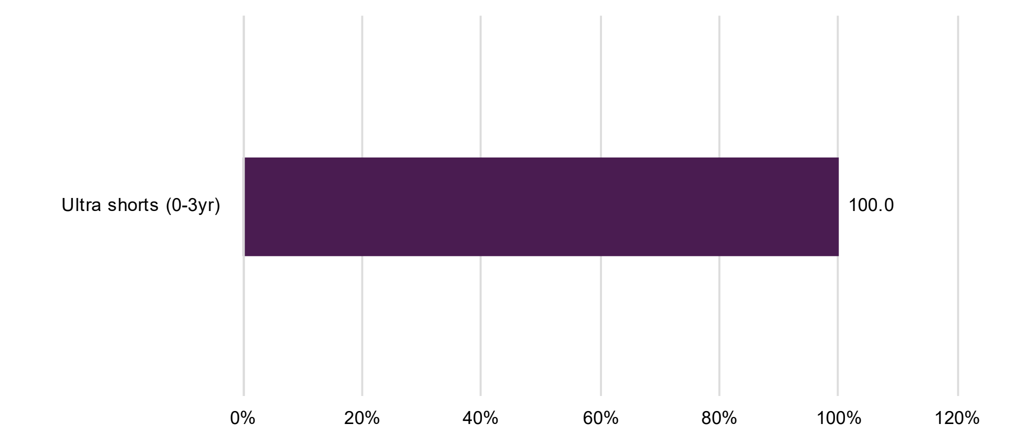
Euro bloc



Japan

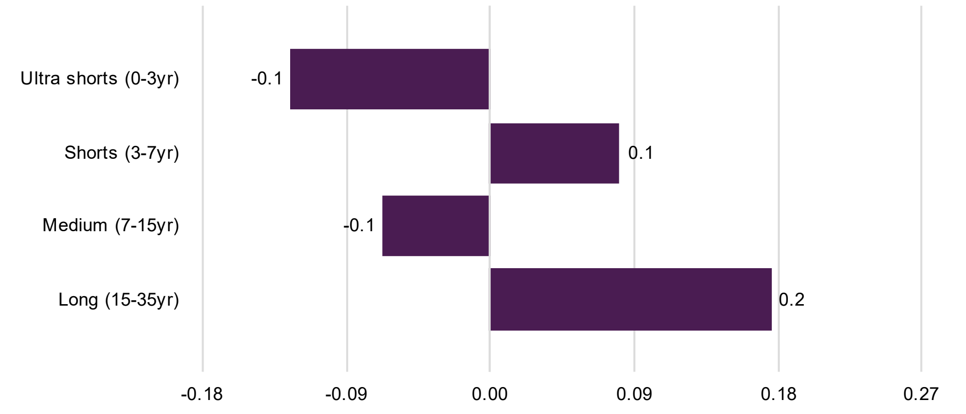


UK

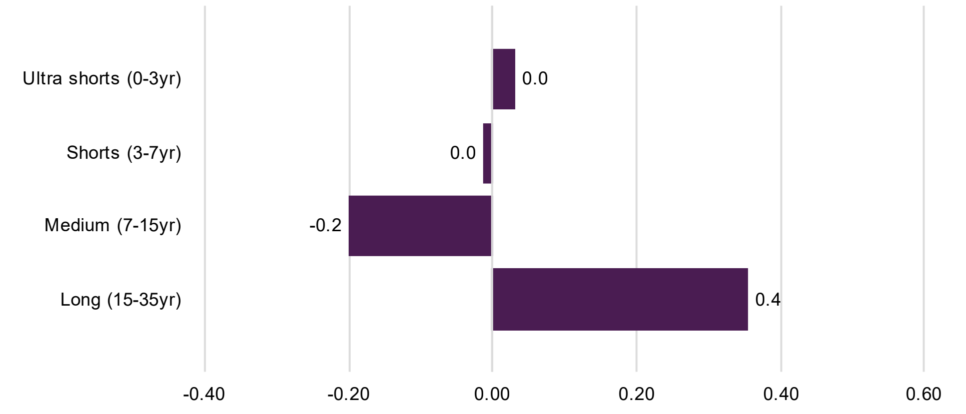


Fund breakdown

Maturity profile relative to benchmark

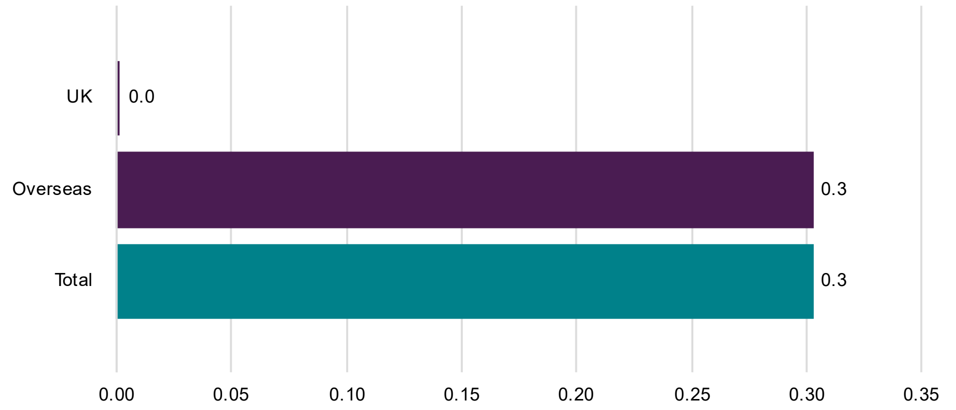


Maturity profile change on quarter

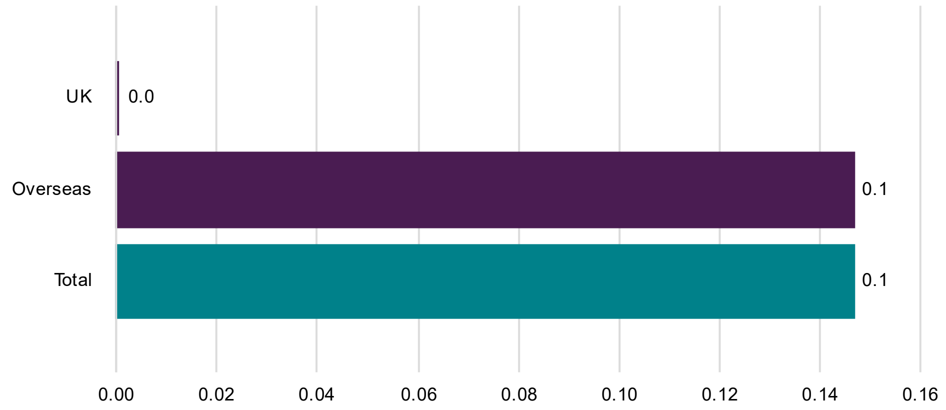


Exposure

Inflation exposure (duration)



Inflation exposure change on quarter (duration)



Market commentary

Market overview

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 (ECB) in making the first rate cuts after raising these significantly through 2022 and 2023 as part of efforts to reduce inflation. Along with a stimulus package in China, this generally helped markets, with bond markets seeing yields fall to reflect lower central bank interest rates, and equity markets recovering from initial weakness 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, and markets have 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.

In contrast to most economist expectations, but in line with what the market had been increasingly pricing, the Fed cut 50bps to 4.75%-5%. They saw diminished upside risks to inflation and increased downside risks to employment and cut accordingly. Their forecasts and language indicated that they anticipated that a series of cuts would follow, 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 over 2025. Inflation data released over the quarter was relatively reassuring both from a core CPI and core PCE perspective, with the latter recording either 0.1% month-on-month or 0.2% for each of the quarter’s releases. Second quarter GDP recorded a strong 3.0% quarter-on-quarter annualised and the Atlanta Fed Nowcast, for example, was consistent with a continued robust pace of growth in third quarter by the end of the quarter. Non-farm payroll gains cooled, below 200K in July and August.

As expected, 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. President Christine 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 cutting further).

Euro area CPI moved from 2.5% year-on-year in June to 2.2% in August, with member country CPI’s consistent with another fall in September by the end of the quarter. There wasn’t much movement in core or services inflation though. Euro area GDP grew 0.2% month-on-month in the second quarter. French politics were a focus for the early part of the quarter with a hung parliament the end result from the July election. Michel Barnier was selected as PM and delayed a target to bring the deficit back within EU rules until 2029.

In the UK, data released in the third quarter were consistent with the economy growing modestly, while CPI inflation has been running close to the 2% target. Second quarter GDP rose 0.5% quarter-on-quarter in real terms after rising 0.7% in the first quarter. July GDP was flat, but business surveys looked consistent with positive growth over the rest of the quarter. More worrying perhaps was the fall in consumer confidence in September, which may have reflected some concern over what the October Budget might bring after Prime Minister Keir Starmer warned of a “painful” Budget in late August. Meanwhile, CPI inflation rose from 2.0% year-on-year in June to 2.2% in July and August on data published over the quarter, with energy prices playing a role. Core inflation was still 3.6% in August with services inflation an upside surprise.

The BoE cut rates 25bps, though with (only) a 5-4 vote and with Governor Andrew Bailey saying that they need to be careful not to cut too quickly. They kept rates on hold at their September meeting. The Labour Party won the UK’s general election in July, winning a sizeable majority in parliament. Chancellor Rachel Reeves identified additional government spending required for 2024-25, to be addressed with some spending cuts and by further measures (“difficult decisions across tax and spending”) to be announced in the Autumn Budget.

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%. 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.

The sterling investment grade credit market (iBoxx non-gilt index) returned 2.28% 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) ending the period unchanged at 1.03% (iBoxx).

Outlook

We feel that the market may have got a little ahead of itself as regards the pace of additional easing, and a number of markets now look on the rich side of fair value. We are still seeing large

Market commentary

moves post any data surprises and volatility remains elevated. To reflect this, we have taken the fund to a broadly duration neutral stance overall and trimmed curve exposures. Against this, we have added to inflation exposure going in to a quarter which promises more central bank action, heightened geo-political risk and a potentially market moving US election.

Shallow recessions are possible but are unlikely to be deep enough at this stage to ease the excessive tightness seen in labour markets. Central banks are likely to continue on current rate cutting cycles, but with yields below base rates in all markets, this is well priced.

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 October 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 without J.P. Morgan's prior written 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 September 2024

Cumulative (%)

	3 Month	6 Month	1 Year	3 Years	5 Years
Fund (gross)	4.09	4.08	9.52	(1.12)	1.61
Fund (net)	4.01	3.92	9.20	(2.00)	0.10

Annualised (%)

	3 Years (p.a.)	5 Years (p.a.)
Fund (gross)	(0.37)	0.32
Fund (net)	(0.67)	0.02

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)	9.52	(0.33)	(9.42)	(1.61)	4.43
Fund (net)	9.20	(0.62)	(9.69)	(1.90)	4.12

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 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.