

For professional clients only, not suitable for retail clients.



Royal London Short Duration Gilts 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 Short Duration Gilts 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	3
Performance and activity	4
Fund breakdown	6
Market commentary	8
Further information	10
Disclaimers	11
Performance net and gross	13
Glossary	14

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 short-duration (1-5 years) UK government bonds, which are also known as gilts. The Fund's performance target is to outperform, after the deduction of charges, the FTSE UK Gilts Government up to 5 Years Total Return GBP Index (the "Index") over rolling 5-year periods. The Index is regarded as a good measure of the performance of short duration UK government bonds quoted on the London Stock Exchange. 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 up to 5 Years Total Return GBP Index

Fund value

	Total £m
30 September 2024	1,440.41

Asset allocation

	Fund (%)	Benchmark
Conventional gilts	96.52%	100.00%
Conventional credit bonds	3.48%	-

Fund analytics

	Fund	Benchmark
Fund launch date	7 November 2013	
Base currency	GBP	
Duration (years)	2.34	2.14
Gross redemption yield (%)	4.10	3.98
Number of holdings	27	18

Performance and activity

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Quarter	2.01	1.79	0.22
YTD	2.73	2.40	0.33
1 Year	6.36	5.60	0.76
3 Years (p.a.)	1.24	0.48	0.76
5 Years (p.a.)	0.88	0.25	0.63
10 Years (p.a.)	0.98	0.80	0.18
Since inception (p.a.)	0.95	0.82	0.13

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 Royal London Short Duration Gilts (Z Inc). Source: Royal London Asset Management; Gross performance; Since inception date of the share class is 8 November 2013.

Performance commentary

The fund outperformed its benchmark during the third quarter.

The quarter started off with the market rallying in July, with 10-year gilts yields falling; that decline in yields accelerated into month-end following rate decisions from the Bank of Japan and the US Federal Reserve. While the BoJ decision to hike rates was priced in by the market, the timing of the decision may have caught markets off guard slightly. Global bond yields generally shifted lower in the quarter, with the rally led by US treasury bonds.

To start the period, sentiment towards gilts was relatively positive, thanks in part to labours large general election victory and the political stability that might bring. Compare this to overseas markets where in Europe, markets became nervous about France following president Macron's decision to call a snap election, whilst in the US, Trump led President Biden in the polls.

Towards the end of the period, however, gilts started to underperform on a cross-market basis as investors began to sharpen focus on the upcoming government budget from the new Labour government. On top of this, fears around the outcome of the US election began to fade with Biden stepping down from the Democrat nomination and Harris stepping up – seeing polls tighten.

There was also a shift in sentiment around the strength of the US economy. Non-farm payroll gains cooled, undershooting expectations, which is testing the hopes for a 'soft landing'. As a result, and in the hopes of avoiding a recession, the market is now pricing for the Fed to cut fast and hard.

Base rates for the US at year-end are now expected to be below 4%, whereas it was 4.8% at the start of the period. Therefore, the market now sees three additional cuts for the fourth quarter. For the end of 2025, base rates are seen at 3%, which is below the 4% expected at the start of the third quarter.

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

We retained our strategic curve position – remaining overweight in the two-to-three-year part of the curve – as the UK curve was largely unchanged in the period. Our relative-value positioning retains a large overweight position in certain higher coupon 2025 and 2027 bonds.

Performance and activity

Fund activity

At the start of the quarter, the fund held a small long duration position, which was reduced during the period to end only marginally long. We trimmed our long exposure most notably into the rally at the start of August, where the fund was moved broadly neutral, then added a slight duration position back as yields drifted higher into quarter-end – which was beneficial for performance.

We retained our strategic curve position – remaining overweight in the two-to-three-year part of the curve – as the UK curve was largely unchanged in the period. Our relative-value positioning retains a large overweight position in certain higher coupon 2025 and 2027 bonds.

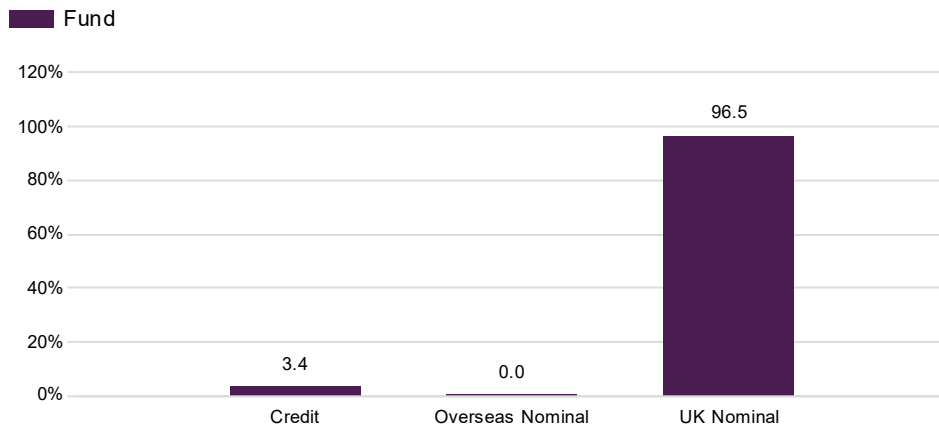
Our cross-market positioning was beneficial for performance, as our dollar market government bonds in Australia outperformed gilts. The fund has exited this position, selling our seven-year bonds at a profit.

We made an allocation for six-month UK treasury bills, with the yield on them being around 65bps higher than equivalent six-month gilts.

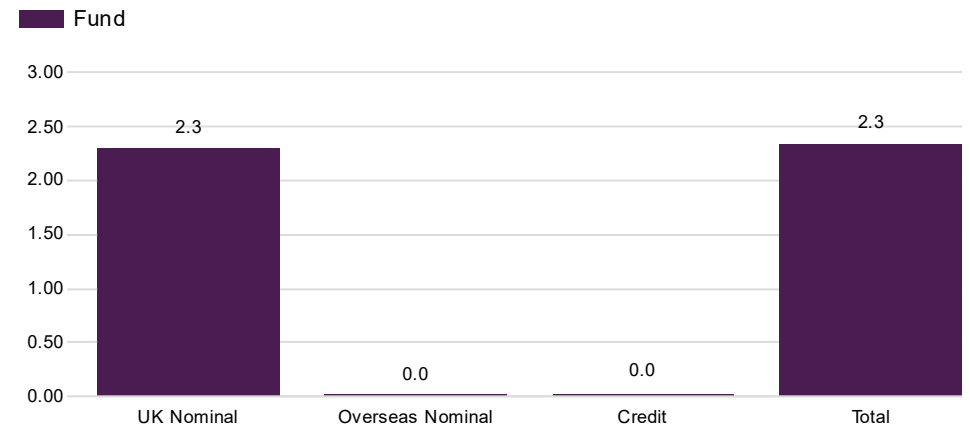
The fund has no ongoing exposure to UK inflation via breakevens.

Fund breakdown

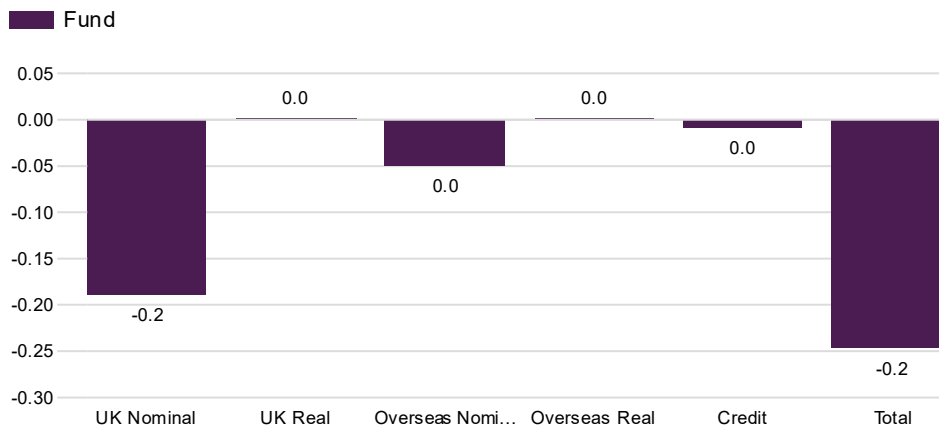
Asset split by percentage



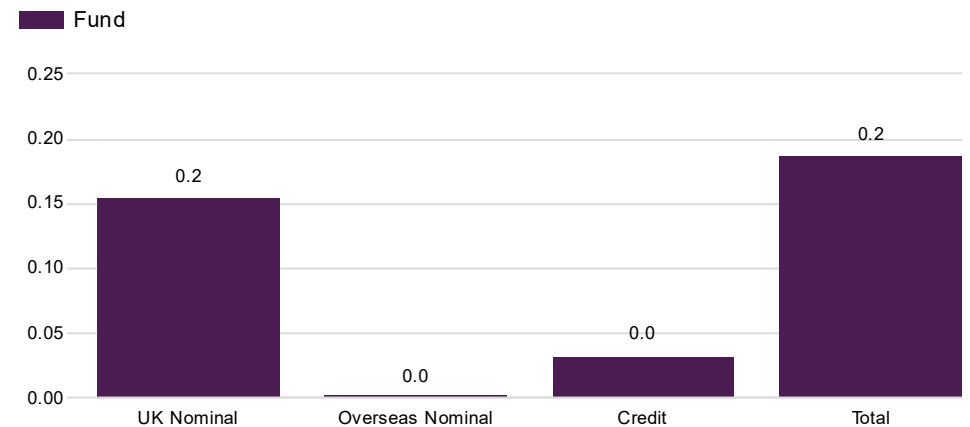
Asset split by duration



Asset split by duration change on quarter

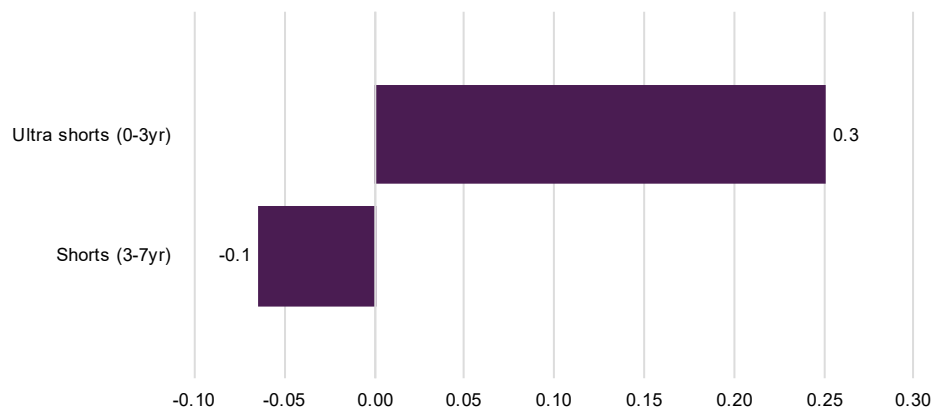


Asset allocation relative to benchmark (duration)

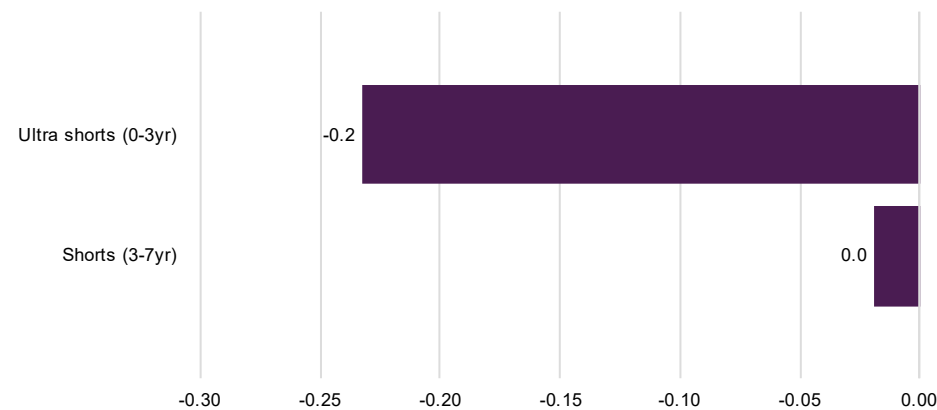


Fund breakdown

Maturity profile relative to benchmark



Maturity profile change on quarter



Market commentary

Market overview

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%.

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). Given the modest fall in yields, sectors such as social housing performed due to the greater proportion of long-dated bonds, while real estate also did well due to the sensitivity of the real estate market to interest rates. Of the major sectors, supranationals slightly lagged the market, while banks and insurance outperformed.

Outlook

We believe that spot inflation will rise into year-end and is likely to remain above central bank targets 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. Central banks are likely to continue on current rate cutting cycles, but with yields below base rates in all markets, this is well priced.

Market commentary

In the UK, the market is now assuming base rates have peaked at 5.25%, with a second cut fully priced in for November 2024, and falling to a terminal level of around 3.0% by the end of 2025. The market will be paying close attention to the economic data as well as the actions of other central banks to determine whether a further rate cut is warranted. We also note that the BoE's footprint on the gilt market will be significantly reduced; with only £13bn of active sales for the next 12 months, which is a significant reduction from the prior year.

Focus for the fourth quarter will also be on the UK budget. Gilts have underperformed into this as fears have grown about the new Labour government's spending plans. Whilst they look cheap on a cross-market basis, and versus other global markets, that may remain the case until the full picture emerges on 30th October.

Further Information

Please click on the links below for further information:



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

For professional clients only, not suitable for retail clients.

This is a financial promotion and is not investment advice.

Telephone calls may be recorded. For further information please see the Privacy Policy at www.rlam.com.

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.

FTSE indexes and data are an intellectual property of FTSE International Limited ("FTSE"). "FTSE®" is a trade mark of the London Stock Exchange Group companies and is used by FTSE under licence. The Index is calculated by FTSE or its agent.

FTSE makes no claim, prediction, warranty or representation either as to the results to be obtained from the Fund or the suitability of the Index for the purpose to which it is being put by Royal London Asset Management.

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.

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 (%)

Annualised (%)

	3 Month	6 Month	1 Year	3 Years	5 Years	3 Years (p.a.)	5 Years (p.a.)
Fund (gross)	2.01	2.69	6.36	3.78	4.47	1.24	0.88
Fund (net)	1.96	2.57	6.12	3.10	3.33	1.02	0.66

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)	6.36	3.95	(6.13)	(0.55)	1.22
Fund (net)	6.12	3.72	(6.33)	(0.77)	1.00

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 Royal London Short Duration Gilts (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.