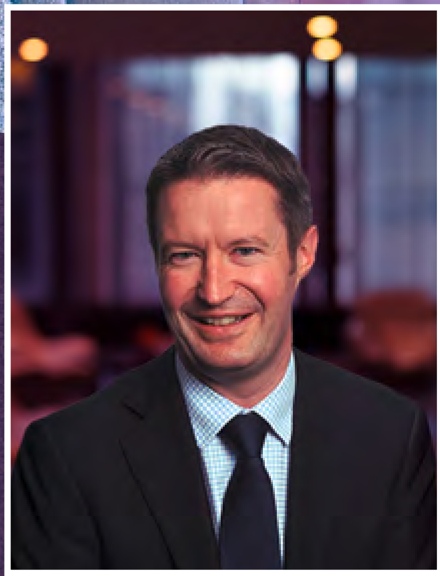
Managing liquidity funds through macro uncertainty

April 2025

Craig Inches, Head of Rates & Cash at Royal London Asset Management



Investment markets are always uncertain, but some periods are more unpredictable than others. The past two decades saw significant interventions by governments and central banks during the global financial crisis (GFC) and Covid-19, leading to record-low interest rates and quantitative easing. Now, the global economy faces higher, sticky inflation, complicating interest rate decisions. Government policy uncertainty is also higher due to reduced fiscal room after years of deficits.

Impact of tariffs and global trade

Trade wars, characterised by escalating tariffs and trade barriers, can significantly impact economic growth and interest rates. These conflicts disrupt trade, increase costs, and reduce consumer spending, leading to slower economic growth. Businesses may delay investments due to policy uncertainty, further hindering economic expansion. Central banks may adjust interest rates to mitigate the economic impact of trade conflicts.

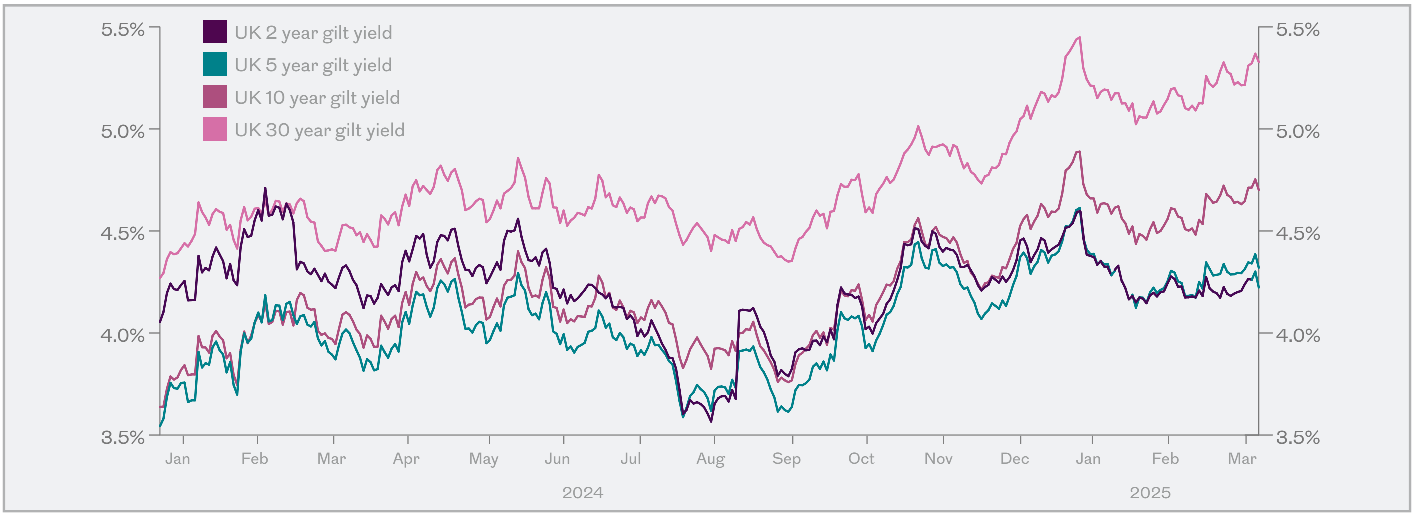
A principled approach

In uncertain times, sticking to a proven investment philosophy and team approach is crucial. For our liquidity and short-term fixed income strategies, we focus on liquidity, security, and yield. We also use qualitive and quantitative models to manage and give oversight to our liquidity, credit and ESG risk. This approach has been tested and proven robust through various market conditions.

Beware the obvious pitfalls

Our philosophy provides a framework for navigating uncertainty but doesn't dictate specific investments. Traditionally, extending duration in a falling interest rate environment can take advantage of what appears to be higher rates, but you need to be certain that interest rates will fall and consider what is priced in. In 2024, we felt markets were pricing in too many rate cuts and by late 2024 and into 2025, concerns about sticky inflation suggested the Bank of England could be reluctant to cut rates, as seen by the rise in gilt yields (see chart).

UK gilt yields



Source: Bloomberg. As at March 2025. For illustrative purposes only. **Past performance is not a guide to future performance.**

Outlook for interest rates and inflation

The impending national insurance increases and lack of fiscal headroom are expected to lead to government spending cuts and cost-cutting measures by businesses. We think this will likely increase unemployment and bring down wage growth, prompting the Bank of England to reduce rates over the course of 2025. While headline inflation may rise in the short term, the scenario we have painted would lead to slower inflation over the medium term.

Money market funds typically have strict limits on weighted average life, which means there is limited scope to add longer-dated exposure. For those with more flexibility, we may selectively add longer maturities but remain cautious as investors in liquidity and short-term fixed income funds typically expect lower-risk strategies. Taking larger duration positions against an uncertain backdrop as we explored above can be ill-advised, unless market pricing becomes extreme.

Key takeaways

In our view, managing investments during high uncertainty is best done by sticking to a proven philosophy and process. By working as a team with solid oversight, targeting liquidity, security, and yield we can better navigate the current economic landscape while controlling risk. Our approach remains focused on value, ensuring our strategies are robust and adaptable to changing market conditions.

Contact us

For more information about our range of products and services, please contact us.

Royal London Asset Management
80 Fenchurch Street,
London EC3M 4BY

For advisers and wealth managers
bdsupport@rlam.co.uk
+44 (0)20 3272 5950

For institutional client queries
institutional@rlam.co.uk
+44 (0)20 7506 6500

We are happy to provide this document in braille, large print and audio.

Important information

For Professional Clients only, not suitable for Retail Clients. 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.

This is a financial promotion and is not investment advice. The views expressed are those of the author at the date of publication unless otherwise indicated, which are subject to change. Telephone calls may be recorded. For further information please see the Privacy policy at **www.rlam.com**.

Issued in April 2025 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.

AL RLAM PD 0198