Royal London Short Term Money Market Fund

Quarterly Report

31 December 2022

For professional clients only, not suitable for retail clients

Fund data

	Fund
Yield	3.51%
No. of issuers	42
Fund size	£5,005.0m
Weighted average life	63.6 days
Duration	19.9 days

Source: RLAM, based on the Y Inc share class. Launch date: 22.07.1999.
Reported yields reflect RLAM's current perception of market conventions around timing of bond cash flows. Heightened uncertainty due to the COVID 19 crisis may impact these timings for bonds with callable feature.

Performance

	Fund (%)	Benchmark[1](%)	Relative[2] (%)
Q4 2022	**0.76**	**0.69**	**0.09**
Year-to-date	1.48	1.40	0.09
Rolling 12 months	1.48	1.40	0.09
3 years p.a.	0.64	0.54	0.09
5 year p.a.	0.67	0.55	0.12
10 year p.a	0.51	0.43	0.08
Since inception p.a. 22.07.1999	1.22	0.98	0.24

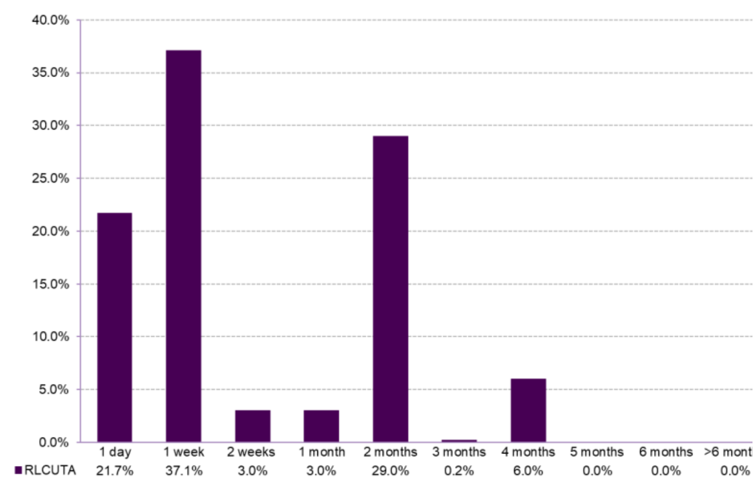
Past performance is not a guide to future performance. The value of investments and the income from them is not guaranteed and may go down as well as up and investors may not get back the amount originally invested.
All performance figures stated gross of fees and tax unless otherwise stated. The impact of fees or other charges including tax, where applicable, can be material on the performance of your investment. The impact of fees reduces your return.
Source: RLAM, based on the Y Inc share class.
[1]Benchmark: SONIA. Please note that this changed from 3-month LIBOR, effective March 20, 2019, and is reflected in the returns shown above.
As of 6 April 2017, the UK Government announced that funds paying interest distributions will be required to pay those distributions gross of tax. Following the implementation of the Regulation (EU) 2017/1131 of the European Parliament and of the Council of 14 June 2017 on Money Market Funds ("MMFs"), the fund is subject to the following risks: The fund is not a guaranteed investment. An investment in the fund is different from an investment in deposits. The principal invested in the fund is capable of fluctuation in value. The fund does not rely on external support for guaranteeing the liquidity of the fund or stabilising the NAV per unit or share. Any risk of loss of the principal is to be borne by the investor.

Top ten issuers

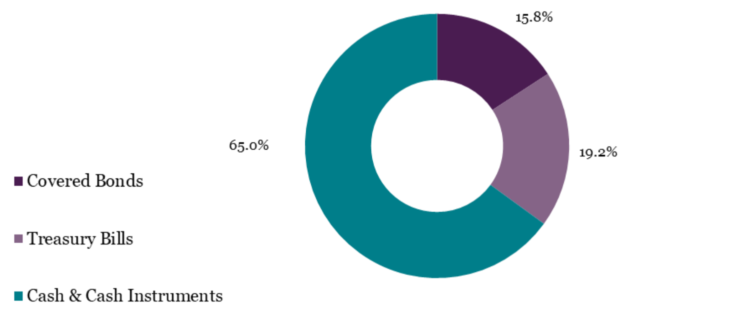
	Weighting (%)
UK Government	19.2
Lloyds Bank Plc	4.8
Toronto Dominion Bank	4.8
Nordea Bank AB	4.5
Barclays Banks	4.5
National Westminster Bank	4.1
Bank of Montreal	3.7
Nationwide Building Society	3.5
Mizuho Bank	3.4
Bank of Nova Scotia	3.2
Total	**55.6**

Source: RLAM. Figures in the table above exclude derivatives where held, subject to rounding.

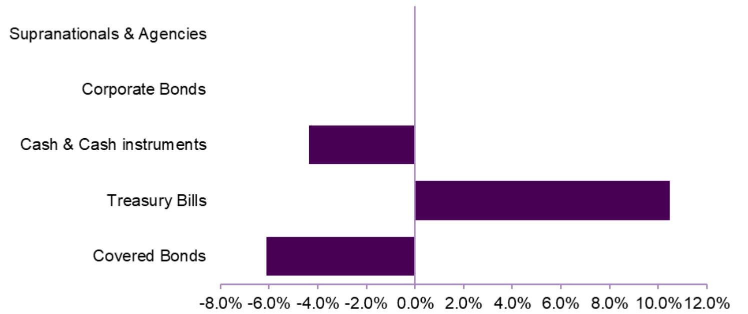
Duration profile



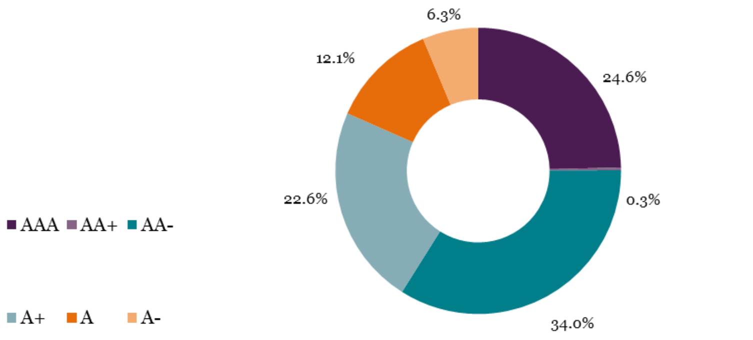
Asset allocation profile Q4 2022



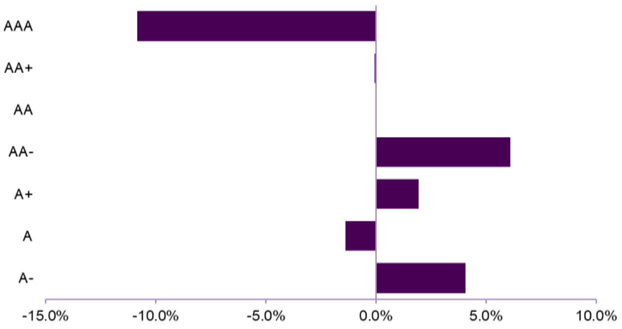
Change since last quarter



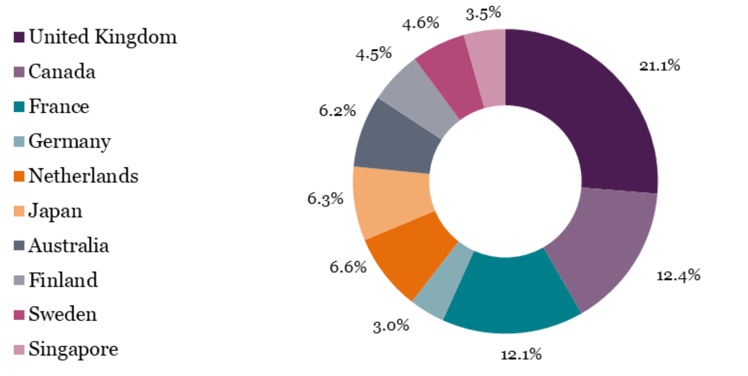
Credit rating profile Q4 2022



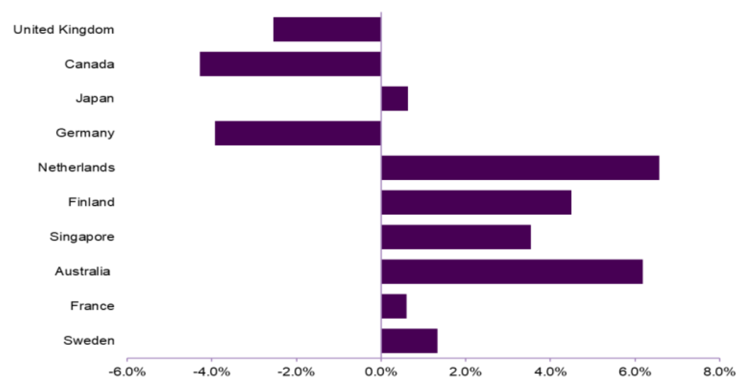
Change since last quarter



Top ten geographic allocation (ex gilts) Q4 2022



Change since last quarter



Market overview

- The macroeconomic backdrop was little changed in the fourth quarter: the outlook for growth remained poor, while inflation and its impact remained a key concern for policymakers, investors and consumers alike.
- Central banks responded to the continued strength of inflation in the fourth quarter by further tightening monetary policy and reiterating that they will do whatever it takes to suppress rising prices. The US Federal Reserve (Fed), European Central Bank (ECB) and Bank of England (BoE) each raised rates by 1.25% in aggregate over the period. Since March, the Fed has raised rates seven times by 4.25% in total – its 0.75% increases in June, July, September and November were the biggest single increases for nearly 30 years. Investors expect further hikes in 2023 as the services sector of the US economy has remained notably strong.
- The ECB was slower to react, partly due to a more fragmented backdrop with a gap between Germany and 'peripheral' economies. However, it ended its bond buying programme in July and increased rates by 0.75% (its first hike for 11 years and a bigger increase than the 0.50% expected by economists). Further increases followed in September, October and December with a clear commitment to raise rates further in 2023. The BoE increased rates to 3.5% over the quarter, taking its tally to eight increases in 2022 and nine so far in this cycle.
- The UK economy continued to be impacted by the ill-fated experiment with Liz Truss and Kwasi Kwarteng as Prime Minister and Chancellor, respectively. Following the 'mini-Budget' on 23 September, after comments in support of sterling, the BoE was forced to intervene in the gilt market in the last week of the third quarter as problems with levels of collateral in the 'liquidity-driven investing' (LDI) part of the pensions industry pushed down the prices of long-dated gilts. Although this calmed financial markets temporarily, the volatility continued for several weeks until Mr Kwarteng was sacked on 14 October and replaced by Jeremy Hunt, and Rishi Sunak took over as Prime Minister on 25 October. The policies adopted by Mr Hunt and further detailed in the Autumn Statement in mid-November served to stabilise sterling and reduce the yield premium demanded by investors in UK government bonds.
- As a result, the UK gilt market was the strongest major government bond market over the quarter, delivering a return of +1.7% as the benchmark 10-year gilt yield fell by 42 basis points (bps) from 4.09% to 3.61%. Shorter-dated gilts performed best; gilts with five years to maturity or less provided positive returns of 2.7%, whereas the 15 years or more to maturity segment returned -1.9%. Otherwise, most other significant markets delivered negative returns over the period as yields rose (prices move inversely to yields): the 10-year US treasury yield rose by 5bps to 3.87%; and the 10-year German bund yield rose by 46bps to 2.57%. The sterling investment grade credit market returned 5.74% over the quarter, boosted by the fall in gilt yields and the significant tightening of the average sterling investment grade credit spread (the average extra yield available from a corporate bond compared with government debt of equal maturity) from 1.99% to 1.61% (iBoxx).
- UK money markets therefore saw mixed moves on yields, with short rates moving higher with BoE moves, while longer tenors generally moved less due to expectations around where the BoE may peak in this rate cycle, while longer maturity yields fell in line with the gilt market. SONIA started the quarter at 2.19% and ending at 3.43%, while ICE Term SONIA three-month rates rose from 3.23% to 3.75%. Two-year gilts, often seen as a proxy for market expectations of BoE rates, dipped from 3.92% to 3.56%. Reverse repo rates also increased over the quarter, ending at around 3.30% for high quality names, although this was slightly constrained late in the quarter as year-end approached.

Performance and activity

- The latter months of 2022 are dominated by the events around the short-lived Truss premiership and impact this had on pension funds, and in turn, gilt and cash markets. Following the change of leadership, markets were relatively normal – able to focus on macro backdrop and the impact on rates and rate expectations. For the various funds we manage, we saw investors start to come back to liquidity funds as volatility subsided and the short-term dash for cash ended.
- During this period, we have been able to continue to increase the yields on the various strategies we manage right across the range of assets we invest in, including traditional money market instruments such as treasury bills and certificates of deposit (CDs), as well as other assets such as repo, covered bonds, mortgage-backed securities and short-dated investment grade credit. While the mix of such instruments varied according to the strategy risk / reward target, we were able to find opportunities to add yield to our portfolios.
- Money market exposure was generally a modest positive over the quarter, as the additional yield on paper bought in previous months continued to outpace the rise in SONIA. For most of the quarter, we were happy to add slightly longer paper – meaning three-four months for the Sterling Liquidity and Short Term Money Market funds, or anything up to one year for the funds with longer investment horizons. At the margin, we were inclined to go slightly longer as short-dated paper increasingly looked expensive as investors wanted to avoid having excessive exposure to 2022 paper, and hence we saw rates in January 2023 fall as investors chased this. We were happy to selectively sell some of our January 2023 exposure into that additional demand and roll into February / March and April maturities.

- For the **Short Term Money Market Fund**, we focus on short paper – reflecting the fund's objective. This means we focused on three-month maturities and overnight deposits to provide a good yield but keeping a very liquid profile, with a particular emphasis on this earlier in the quarter when clients were looking for liquidity, and then looking to take advantage of distortions caused by year end later in the quarter. As volatility subsided, we focused more on short-dated gilts, treasury bills and three- and four-month maturity CDs, both to push maturity beyond year-end where liquidity can be lower, but also reflecting that current market demand for very short-dated paper meant that rates available looked less attractive. Examples included **BNP, KBC, Santander UK and Credit Agricole**. We also used the market dislocation early in the period to make opportunistic purchases of covered bonds, adding 2023 bonds from **Toronto Dominion** and **Barclays** at attractive levels over SONIA. We also added six-month floating rate CDs – these also came with attractive spreads over SONIA – from the likes of **Toronto Dominion, CBA, BMO, CIC** and **Lloyds**.
- At the end of 2022, the yields on our funds have risen materially –the Short Term Fixed Income Fund is yielding around 4.3%, a significant premium to current SONIA levels, while Short Term Fixed Income Enhanced yields around 4.9%. We believe that the funds are well-positioned for the uncertain rate environment in 2023.

Outlook

- Having started 2022 knowing that rate rises were coming – although underestimating just how many – the market has ended 2022 with the expectation that although there are still rises to come, these will be more limited, and will reach a peak. In the UK, the market is pricing in around 100bps of rate increases from the BoE, expecting a peak in late summer / autumn, and then holding steady before starting to come down in 2024.
- Assessing whether these expectations are realistic is obviously dependent on central banks. We believe that the BoE and other central banks will remain very focused on the labour market and unemployment rate. If labour markets are buoyant and unemployment remains low, then the wage pressure we have seen in 2022 will continue. Headline inflation will probably fall in 2023 simply due to base effects, but if wage inflation remains in the 5-6% range, then even a fall in CPI back towards 3-4% will not be enough to stay the BoE's hand. If the expected recession turns out to be deeper than expected, then a rise in unemployment and knock-on effect to wage increases could mean we reach the peak earlier.
- When looking at portfolio strategy, we are not attempted to decide between those two scenarios. If we see base rates and short yields hit 4% and above, then we will consider shifting overall portfolio durations longer. Until then, we are comfortable with a more tactical approach – picking up occasional paper at higher yields to boost returns, but without taking a material position on where rates peak. History suggests that the latter can be very painful if called incorrectly, and we believe that there are enough opportunities to help our investors meet their needs without such increases in risk.

Find out more

- Our 2023 Outlook is available here, and includes an overview from RLAM Chief Investment Officer Piers Hillier, as well as individual articles from RLAM investment managers providing a unique insight into the risks and opportunities in their asset classes for the new year. Articles, videos and webinars explaining our investment thinking can be found in the Our Views section of www.rlam.com, which also contains includes regular updates from Head of Fixed Income Jonathan Platt, Head of Equities Peter Rutter, and Head of Sustainable Mike Fox.

Risk 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:** 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.
- **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.
- **Inflation risk:** Where the income yield is lower than the rate of inflation, the real value of your investment will reduce over time.
- **Money Market Fund Risks:** A Money Market Fund is not a guaranteed investment, and is different from an investment in deposits. The principal invested in the Fund is capable of fluctuation and the risk of loss of the principal is to be borne by the investor. The Fund does not rely on external support for guaranteeing the liquidity of the Fund or stabilising the NAV per share. The Fund has been authorised as a Variable Net Asset Value (VNAV) MMF and is a short term money market fund in accordance with MMF Regulation. The NAV is calculated using mark to market prices where possible otherwise mark to model prices are used. The redemption or issue of Shares will be undertaken at a price that is equal to the Net Asset Value per Share.

Performance to 31 December 2022

	Cumulative (%)					Annualised (%)	
	3M	6M	1Y	3Y	5Y	3Y	5Y
Fund (gross)	0.76	1.17	1.48	1.92	3.41	0.64	0.67
Fund (net)	0.74	1.12	1.37	1.62	2.93	0.54	0.58

	Year on year performance (%)				
	Q4 2021 to Q4 2022	Q4 2020 to Q4 2021	Q4 2019 to Q4 2020	Q4 2018 to Q4 2019	Q4 2017 to Q4 2018
Fund (gross)	1.48	0.08	0.36	0.83	0.63
Fund (net)	1.37	-0.02	0.26	0.74	0.55

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 31 December 2022. All figures are mid-price to mid-price in GBP for the Y Inc share class.

IMPORTANT INFORMATION

For professional clients only, not suitable for retail investors.

This is a financial promotion and is not investment advice.

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