Royal London International Government Bond Fund

Quarterly Report 30 June 2022

Asset split

	Fund (%)	Benchmark[1] (%)
Conventional credit bonds[2]	0.0	0.0
Index linked credit bonds	0.0	0.0
Sterling conventional gilts	2.8	0.0
Sterling index linked gilts	0.0	0.0
Foreign conventional sovereign	87.4	100.0
Foreign index linked sovereign	9.8	0.0
Derivatives	0.0	0.0
Other	0.0	0.0

Fund data

	Fund	Benchmark[1]
Duration[3]	6.8 years	7.1 years
Gross redemption yield [4]	2.11%	2.23%
No. of stocks	104	967
Fund size	£593.5m	-

Source: RLAM, based on the M share class. Launch date: 01.11.2011.

[1]Benchmark: JPMorgan Traded World ex-UK Government Bond Index (£ Hedged).

[2]Conventional credit bond allocation includes exposure to non-sterling credit bonds and CDs, where applicable.

[3]Excluding cash

[4]The gross redemption yield is calculated on a weighted average basis.

[4]Real yield shows the inflation-adjusted redemption yield for the underlying portfolio and therefore does not include the impact of fees. For share class level yields, please see the latest factsheet.
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 (%)
Q2 2022	**-3.85**	**-4.21**	**0.36**
Year-to-date	-7.47	-8.50	1.03
Rolling 12 months	-6.72	-8.47	1.74
3 years p.a.	-0.76	-1.62	0.86
5 years p.a.	0.77	0.31	0.46
10 years p.a.	1.93	1.72	0.20
Since inception p.a. 0.11.2011	2.10	1.94	0.16

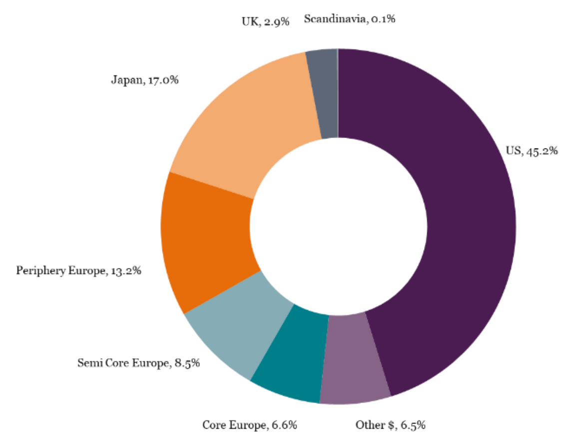
Past performance is not necessarily a reliable indicator of future performance. The value of investments and the income from them is not guaranteed and may go down as well as up and investors may not get back the amount originally invested.

All performance figures stated gross of fees and tax unless otherwise stated, subject to rounding. 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 M share class.
[1]Benchmark: JPMorgan Traded World ex-UK Government Bond Index (£ Hedged).
Performance for the Royal London International Government Bond fund is based on pricing at noon, while index performance is based on pricing at close of business, preventing direct performance comparison. The significance of this timing discrepancy is likely to be smaller for longer measurement periods.
As of 6 April 2017, the UK Government announced that funds paying interest distributions will be required to pay those distributions gross of tax.

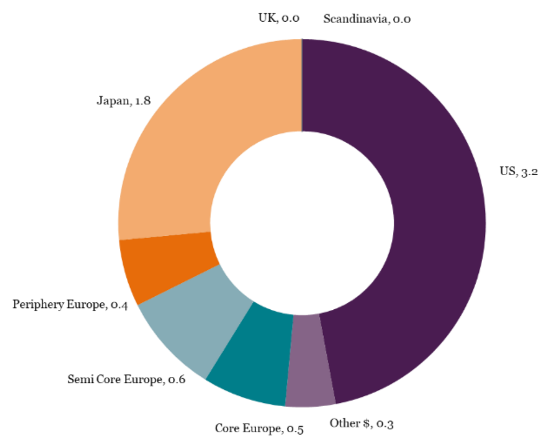
Ten Largest Holdings

	Weighting (%)
Japan Govt 0.1% IL 2026	3.5
France (Republic of) 0% 2023	3.4
Italy (Republic of) 0.9% 2022	3.2
US Treasury 2.25% 2024	3.0
Italy Buoni Poliennali Del Teso 1.4% IL 2025	2.9
UK Treasury 0.125% 2023	2.8
US Treasury 0.375% 2024	2.8
Deutschland 0.1% IL 2026	2.6
US Treasury 0.625% 2026	2.5
US Treasury 2.375% 2029	2.4
Total	**29.1**

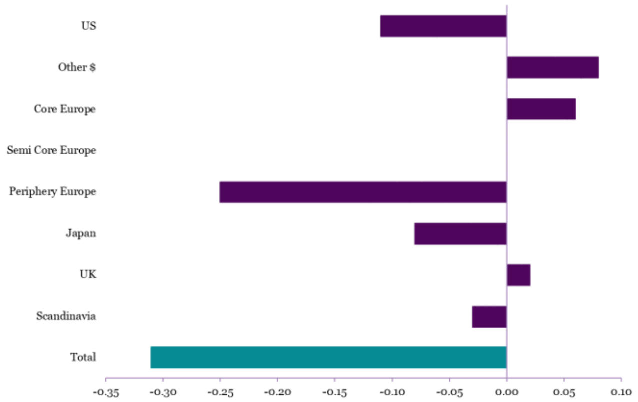
Geographic split by percentage



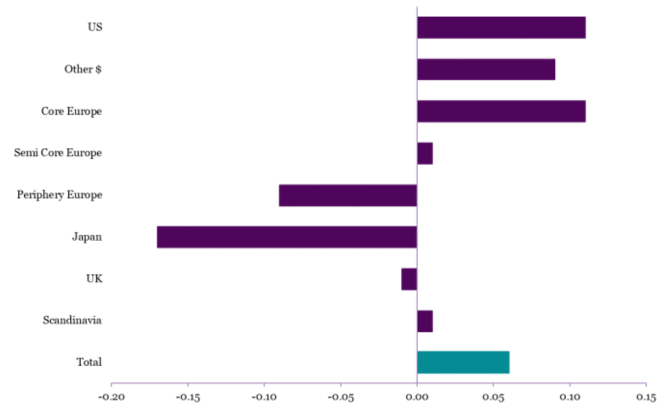
Geographic split by duration



Current position (by duration)

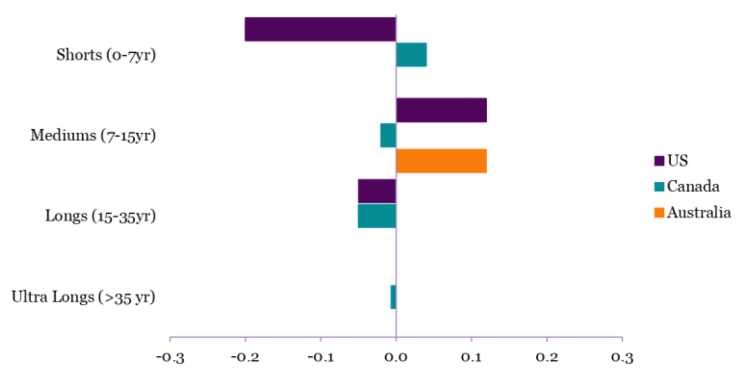


Change on quarter by duration

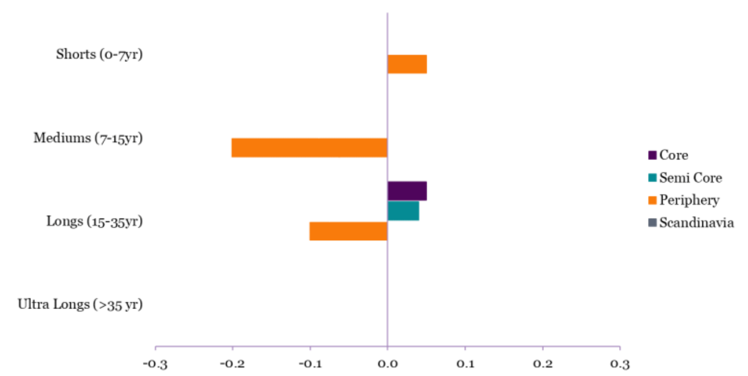


Yield curve

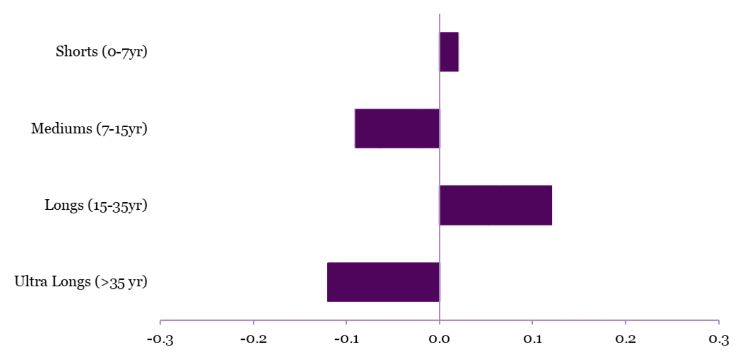
Dollar bloc



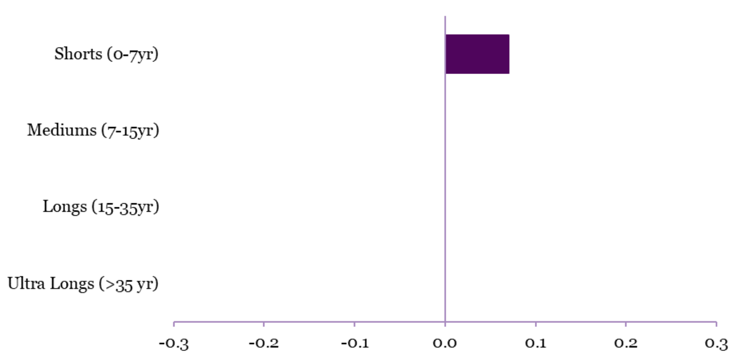
Euro bloc



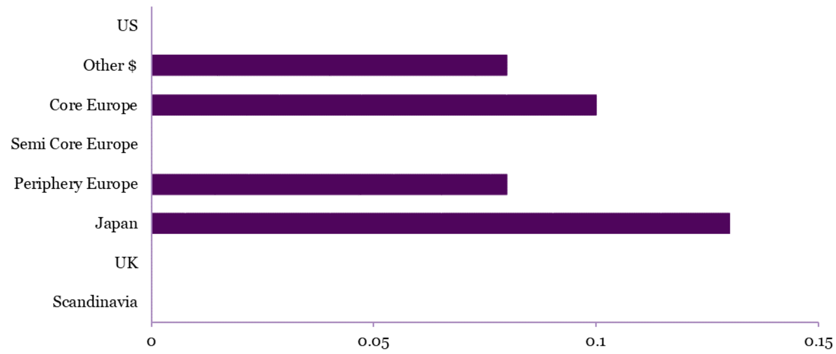
Japan



UK



Inflation breakeven



Market Overview

- Global markets have grappled with increasingly high inflation expectations in the second quarter. Inflation has not just risen, but has consistently exceeded lofty consensus expectations, as inflationary pressures continue to be exacerbated by the ongoing crisis in Ukraine. Central banks globally have turned far more hawkish in recent months as a result, and bond yields have continued to rise in anticipation of more aggressive monetary tightening – bond prices have been badly impacted globally as a result. Longer dated bonds have generally performed worst, given their greater sensitivity to changes in interest rate expectations (known as duration). The UK government bond market, which is the longest government bond market globally in terms of duration, has therefore underperformed on a relative basis, delivering weaker total returns than other major markets, including Germany, and the US.

- Central banks have responded to rising inflation by tightening monetary policy and indicating that there is more to come. The US Federal Reserve (Fed) has led the way, increasing rates by 1.25% over the quarter to 1.75% – its clear plan to do more has led markets to price in a further 2% of hikes in 2022. The European Central Bank (ECB) was less aggressive – partly due to a more fragmented backdrop with the gap between German and 'peripheral' bonds widening in recent months – but confirmed that it will end its bond buying programme in July and signalled that a 25bps hike in July and possibly as much as 50bps in September, should the data support such a move.. This aggressive rate hiking cycle from the ECB has led to particularly large increases in interest rate expectations priced by financial markets, as a result of the bank significantly lagging other central banks in beginning monetary tightening. The Bank of England has now increased interest rates at it last five consecutive opportunities, taking the base rate 25bps higher in June to 1.25%.
- Markets were very volatile in response to central bank actions, commentary and policy announcements, as well as important data points regarding inflation, growth and confidence during the period. Volatility was exacerbated by low volumes, as investors sought to reduce risk exposures, both in the light of this volatility and due to the uncertain outlook. Towards the end of the quarter, volatility was compounded by the growing concern over the outlook for growth and the potential for recession in 2023.
- Inflation across the majority of areas remains above central bank targets, with projections for it to continue to do so for some time, leading central banks to worry about second round effects and the potential for wage/price spirals. Markets recognise this and have priced a number of future rate hikes and tighter monetary policy. Globally, amongst major markets, rate hikes were seen in the US, Australia, the UK, Canada, Sweden, Norway and Switzerland during the quarter. The Japanese market is the exception at present, where inflation has increased but core inflation remains below target. The Bank of Japan (BoJ) has committed to maintain its policy of yield curve control, but has expressed concern regarding the significant fall in the value of the yen.
- In nominal government markets, the UK's benchmark 10-year gilt yield rose by 62bps to 2.23% (bond prices fall as yields rise); the 10-year US treasury yield rose by 67bps to 3.01%; and the 10-year German bund yield rose by 78bps to 1.34%. Periphery markets were weaker still – 10-year yields in Italy and Spain rose by 123bps and 99bps respectively. Longer-dated bonds performed worst in the period due to their greater sensitivity to interest rates (known as duration risk). In the UK, for example, gilt markets returned -7.42% on an all-maturities basis (FTSE Actuaries), whereas gilts with 5 years to maturity or less provided negative returns of just -0.76%.
- European periphery market spreads widened in the period, with fears over debt sustainability for peripheral debt driving Italian 10-year yields in excess of 4% during June. This peak followed the ECB's June meeting, where the bank failed to communicate a clear message on how they would prevent this fragmentation of periphery market yields. Four days after the scheduled meeting, the bank held an emergency "ad-hoc" meeting, after which they outlined their flexibility to use PEPP re-investments (e.g., using proceeds from maturing German bunds to buy periphery bonds) to limit spread widening and, perhaps more importantly, a firm commitment to a new anti-fragmentation tool set to be announced at the July ECB meeting. The market took a lot of comfort from this and spreads compressed back to pre-ECB meeting levels, as peripheral yields fell in response.
- Inflation data continued to come in above consensus expectations over the quarter, although this was mostly already reflected in the price of breakevens in a number of markets. As a result, despite higher inflation over the quarter, with markets pricing even greater rate rises and with concerns about an economic slowdown growing, inflation expectations as measured by breakeven (implied) inflation rates fell in the period. In the UK, 10-year breakevens fell by 65bps to 3.7% in the quarter, while US and German 10-year breakevens fell by 48bps to 2.34% and by 61bps to 2.03% respectively. Once again, the exception to this was Japan, where breakevens continued to rise.

Portfolio commentary

- The fund performed strongly relative to its benchmark over the quarter, returning -3.85% gross of fees (M class) versus -4.21% benchmark returns (JP Morgan Traded World ex-UK Government Bond Index - hedged). However, the fund and the benchmark are priced at different times – on a like-for-like basis, the fund outperformed by around 63 basis points.
- Cross market strategies were a key driver of relative outperformance in the period. The fund benefitted specifically from being underweight the US, as the Fed delivered on rate hikes and yields rose, and benefitted from being underweight peripheral Europe versus core and semi-core Europe, as peripheral spreads widened – the spread between the 10-year Italian BTP and German bund widened by around 50bps in a matter of days following the ECB meeting in June, where the bank failed to deliver a clear message on how they would go about preventing market fragmentation. We trimmed the peripheral underweight following this yield spike, benefitting overall as yields fell back again following

the ECB's subsequent meeting four days later on tackling the fragmentation of its markets. We remain underweight as we are yet to be convinced on the ability of the ECB to deliver a fragmentation tool that satisfies the market and is agreeable to all member states.

- An overweight in Japan was also beneficial in the quarter, as yield curve control and a commitment to maintaining loose monetary policy by the BoJ meant that Japanese government bonds (JGBs) outperformed over the quarter, particularly in the 10-year space. Towards the end of the quarter, we reduced the underweight in the US by selling Japan and investing in US treasuries, as we believe it will become increasingly difficult for the BoJ to remain accommodative in the light of all other central banks tightening, the global inflation pulse, and the severe weakening of the yen.
- In inflation, after having trimmed our inflation exposure in the first quarter, we went in to the second quarter holding breakeven positions in Japan, Australia and Italy. Japanese breakevens performed well in the period, while Australian breakevens delivered negative performance, however they remain attractively priced. Similarly, our Italian exposure via short-dated Italian index-linked bonds slightly detracted from performance, but remain attractively valued. Broadly, return from inflation strategies was flat over the quarter, with gains from Japan offsetting losses in Australia and Italy. Towards the end of the quarter, we added a position in shorter dated German breakevens, with inflation in Europe continuing to rise, and the ability of policy to tackle it being more limited, especially compared to the US for example – a key driver of European inflation is imported resources, such as gas, which interest rate rises are unlikely to be able to tackle. Additionally, a weak euro will lead to further inflationary pressures in the eurozone.
- Curve positioning was broadly neutral for performance over the quarter, as most markets saw broadly parallel moves in yield curves across the quarter as a whole, although there were large curve moves in both directions during the quarter. However, the rise in yields across curves saw the fund's strategic short duration position benefit performance during the period.

Outlook

- There has been a very definite shift over recent weeks in markets, away from "out of control" inflation and requiring aggressive policy tightening from central banks, and towards fears of future recession potentially driving central banks to loosen policy a couple of years out. Early indicators have started to show that the confidence in a number of economies has started to wane, and the market is starting to question whether the nascent bear market in sovereign bonds has run its course. Despite this, inflation remains in excess of target across most regions, and central banks appear to remain committed to tightening monetary policy and. In the case of the ECB, it has yet to embark on its rate hiking cycle, a decision it could come to rue if it fails to tackle inflation prior to a recessionary dip.
- There are widespread concerns over the "cost of living crises" and with the conflict in the Ukraine showing no signs of abating, there remains plenty of causes of uncertainty on the global landscape. Volatility in bond markets remains highly elevated, liquidity low and a reduced level of risk appetite is serving to produce outsized moves in yields, often on very little hard data. We have elected to dial back risk in the fund, preferring to trade tactically to take advantage of the short-term anomalies that these markets present.

Find out more

- Fund managers and other in-house specialists regularly address the issues that they consider in managing their funds via blogs, articles, webinars, and other mediums. Please visit the RLAM Digital Insight Hub, or the *Our Views* section of www.rlam.com, including regular *JP Journal* updates from Head of Fixed Income Jonathan Platt.

IMPORTANT INFORMATION

For professional clients only, not suitable for retail investors. The views expressed are the author's own and do not constitute investment advice. This document is a financial promotion. It does not provide, and should not be relied on for, accounting, legal or tax advice, or investment recommendations. For more information on the fund or the risks of investing, please refer to the fund factsheet, Prospectus or Key Investor Information Document (KIID), available on www.rlam.com.

Past performance is not a reliable indicator of future results. 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.

Portfolio characteristics and holdings are subject to change without notice. This does not constitute an investment recommendation. For information purposes only, methodology available on request. Unless otherwise noted, the information in this document has been derived from sources believed to be accurate. Information derived from sources other than Royal London Asset Management is believed to be reliable; however, we do not independently verify or guarantee its accuracy or validity.

All confidential information relating to any Royal London Group company must be treated by you in the strictest confidence. It may only be used for the purposes of assessing the proposal to engage Royal London Asset Management Limited (RLAM). Confidential information should not be disclosed to any third party and should only be disclosed to those of your employees and professional advisers who are required to see such information for the purpose set out above. You should ensure that these persons are made aware of the confidential nature of such information and treat it accordingly. You agree to return and/ or destroy all confidential information on receipt of our written request to do so.

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

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.

Issued by Royal London Asset Management Limited, Firm Registration Number: 141665, registered in England and Wales number 2244297; Royal London Unit Trust Managers Limited, Firm Registration Number: 144037, registered in England and Wales number 2372439; RLUM Limited, Firm Registration Number: 144032, registered in England and Wales number 2369965. All of these companies are authorised and regulated by the Financial Conduct Authority. Royal London Asset Management Bond Funds Plc, an umbrella company with segregated liability between sub-funds, authorised and regulated by the Central Bank of Ireland, registered in Ireland number 364259. Registered office: 70 Sir John Rogerson's Quay, Dublin 2, Ireland.

All of these companies are subsidiaries of The Royal London Mutual Insurance Society Limited, registered in England and Wales number 99064. Registered Office: 55 Gracechurch Street, London, EC3V 0RL. The Royal London Mutual Insurance Society Limited is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. The Royal London Mutual Insurance Society Limited is on the Financial Services Register, registration number 117672. Registered in England and Wales number 99064. FQR RLAM EM 1328.