



# Royal London Short Duration Gilt Fund

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Quarterly Report 30 June 2022



## Asset split

	Fund (%)	Benchmark <sup>1</sup> (%)
Conventional credit bonds <sup>2</sup>	5.1	0.0
Index linked credit bonds	0.0	0.0
Sterling conventional gilts	90.8	100.0
Sterling index linked gilts	0.0	0.0
Foreign conventional sovereign	4.1	0.0
Foreign index linked sovereign	0.0	0.0
Derivatives	0.0	0.0
Other	0.0	0.0

## Fund data

	Fund	Benchmark <sup>1</sup>
Duration <sup>3</sup>	1.9 years	2.1 years
Gross redemption yield <sup>4</sup>	1.96%	1.79%
No. of stocks	28	15
Fund size	£1,079.0m	-

Source: RLAM, based on the Z share class. Launch date: 07.11.2013.

<sup>1</sup>Benchmark: FTSE® Actuaries Gilt <5 years Index.

<sup>2</sup>Conventional credit bond allocation includes exposure to non-sterling credit bonds and CDs, where applicable.

<sup>3</sup>Excluding cash

<sup>4</sup>The gross redemption yield is calculated on a weighted average basis

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 <sup>1</sup> (%)	Relative (%)
<b>Q2 2022</b>	<b>-0.78</b>	<b>-0.76</b>	<b>-0.01</b>
Year-to-date	-1.93	-2.18	0.25
Rolling 12 months	-2.48	-3.08	0.60
3 years p.a.	-0.29	-0.68	0.40
5 years p.a.	0.09	-0.19	0.28
Since inception p.a. 07.11.2013	0.56	0.55	0.01

**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. 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.

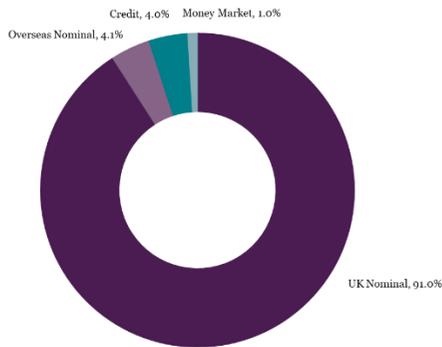
Source: RLAM, <sup>1</sup>Benchmark: FTSE® Actuaries UK Index Linked Gilts over 5 years.

### Ten Largest Holdings

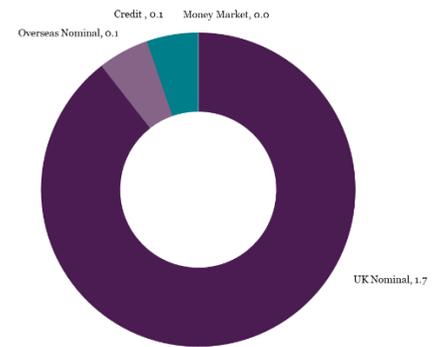
	Weighting (%)
UK Treasury 0.125% 2023	24.2
UK Treasury 0.125% 2024	16.5
UK Treasury 2.25% 2023	16.4
UK Treasury 0.25% 2025	15.6
UK Treasury 0.375% 2026	14.6
Canadian Government Bond 0.75% 2024	4.1
UK Treasury 5% 2025	3.5
PRS Finance 2026	0.6
Op Corporate Bank Plc 3.375% 2026	0.4
New York Life Global Funding 1.5% 2027	0.4
<b>Total</b>	<b>96.3</b>

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

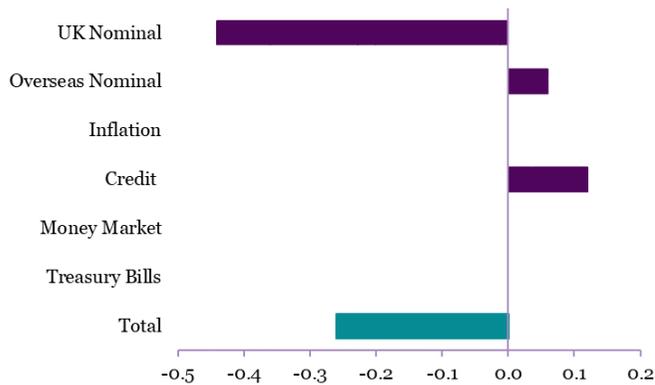
### Asset split by percentage



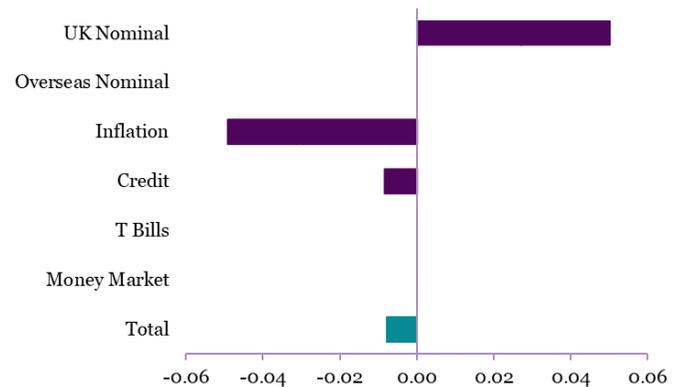
### Asset split by duration



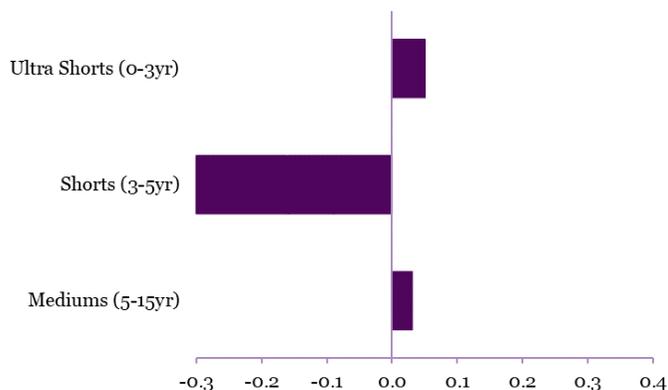
### Asset allocation relative to benchmark (duration)



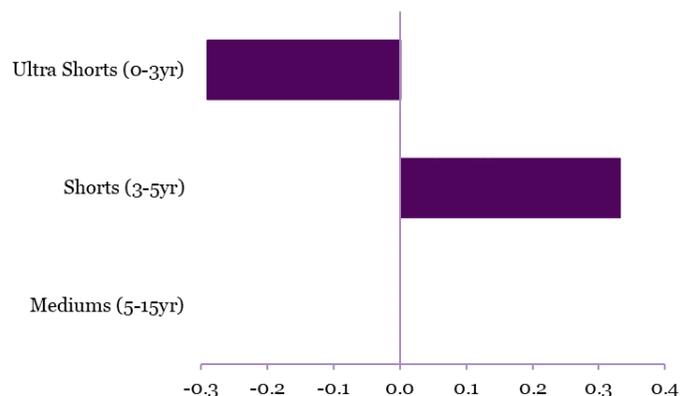
### Asset allocation change on the quarter (duration)



### Yield curve relative to benchmark (duration)



### Yield curve change on the quarter (duration)



### 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 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 – its clear threat 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 even another 50bps in September may both be possible. The Bank of England (BoE) has increased rates by 25bps at every meeting since December 2021, with the fifth consecutive increase in June taking the UK base rate to 1.25%. Nonetheless, commentary coming from the BoE is less hawkish than from other central banks.
- In the UK, economic data generally indicated that growth was slowing, while inflation rose each month – CPI inflation for May hit 9.1% and the BoE has suggested it could reach 11% by the autumn. Growth indicators were weaker, with composite PMI indicators deteriorating and consumer confidence still below pre-pandemic levels, and GDP underwhelming. A government £15bn fiscal package was designed to alleviate some concerns for consumers.
- Bond market returns were hit hard in the period, as rising interest rates drove government bond yields higher globally (prices move inversely to yields): the UK’s benchmark 10-year gilt yield rose by 62bps to 2.23%; 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%. 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%.
- Total returns for the sterling investment grade credit market of -6.79% were less negative than gilts in the second quarter, but this was still the worst calendar quarter for sterling credit market this century. However, the average sterling investment grade credit spread (the average extra yield available from a corporate bond compared with government debt of equal maturity) widened by 45bps to 1.74% (iBoxx). This means that, on average, corporate bonds underperformed gilts of an equal maturity.



## Portfolio commentary

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- The fund opened the quarter around -0.3 years short duration relative to its index, the FTSE Actuaries UK Conventional Gilts up to 5 years index – this benefitted fund performance, as yields rose in the period. The fund closed the period around -0.3 years short duration. Volatility was particularly high during the quarter, and was amplified by liquidity issues in very short dated government bonds. This benefitted the fund as it continued to trade tactically, buying bonds as yields rose and taking profit as yields fell.
- The fund's strategic short is held via an underweight in five-year gilts, the longest duration bonds in the benchmark – a bi-product of this underweight position is a steepening bias in the fund. This had a small positive impact on performance over the quarter, as yields on 5-year gilts rose by more than gilts of a shorter maturity.
- The fund's only cross-market exposure was a position in two-year Canadian bonds versus two-year gilts – the exposure tempered fund performance, as Canadian spreads widened to gilts in the period.
- The fund held no exposure to UK or global inflation markets in the period.
- The fund's highly rated sterling credit exposure had a small negative impact on performance in the quarter, as credit spreads (the average extra yield available from corporate bonds compared with government debt of equal maturity) widened by 45bps to 1.74% (iBoxx). The fund's credit exposure remains focused in highly rated fixed rate credit, and CDs

## Outlook

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- Inflation in the UK is high and rising. The latest government package to alleviate the cost-of-living crisis (0.6% of GDP) could add to inflationary pressures, and the outlook has the potential to deteriorate further given the themes dominating the political backdrop at present.
- Post the spring statement, gross gilt issuance for the fiscal year was set at £125bn, below market expectations of £145bn. However, it is our expectation that the volume of gilts that the Debt Management Office (DMO) may have to issue this year will rise above £125bn come the next update at the Autumn statement. Central to this is the slowing growth backdrop which could weigh on tax receipts. Furthermore, following disappointing bi-elections, and wider political difficulties, the Conservative government could look to loosen the fiscal purse strings, whilst also announcing further measures to support the consumer in the current high inflationary environment. Finally, the cost of servicing government debt is rising faster than was expected at the start of the year, so a higher realised interest burden could weigh on debt issuance.
- Rail worker strikes that took place in June could pave the way for broader strike action – a potential “summer of discontent” being muted by political commentators, which could lead to imbedded inflation and yet further price increases. All this would point towards the need for stronger action from the Bank of England on inflation, including more aggressive rate rises, which could see gilt yields trend yet higher still. However, markets are already pricing more aggressive policy than the BoE is suggesting, factoring in interest rates of around 2.75% in 12 months' time.
- With base rates now above 1%, the BoE can employ active quantitative tightening (QT) – i.e., selling bonds back into the market to reduce the size of its balance sheet holdings. Currently, the BoE holds around £850bn in gilts, or around a third of the entire gilt market. In our view this would help alleviate some of the liquidity issues and aid the smooth running of the gilt market. However, the Bank has stated that it will undertake a review over the summer months before updating markets on its QT plans, likely post August.

## Find out more

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- 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](http://www.rlam.com) for further information.



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