



Royal London Short Duration Global Index Linked 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	0.0	0.0
Sterling index linked gilts	29.2	30.0
Foreign conventional sovereign	0.0	0.0
Foreign index linked sovereign	70.8	70.0
Derivatives	0.0	0.0
Other	0.0	0.0

Fund data

	Fund	Benchmark ¹
Duration ³	4.9 years	4.7 years
Real yield ⁴	-0.50%	-1.62%
No. of stocks	58	90
Fund size	£867.1m	-

Source: RLAM, based on the Z share class. Launch date: 23.02.2016.

¹Benchmark: 30% Barclays UK Government Inflation Linked Bond 1-10 year index, 70% Barclays World Government Inflation Linked Bond (ex UK) 1-10 year index (GBP hedged).

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

³Excluding cash.

⁴Real 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	-3.47	-3.02	-0.45
Year-to-date	-3.42	-3.12	-0.30
Rolling 12 months	-0.51	0.16	-0.68
3 years p.a.	2.34	2.17	0.17
5 years p.a.	2.21	2.15	0.06
Since inception p.a. 23.02.2016	2.43	2.35	0.08

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 Z share class.

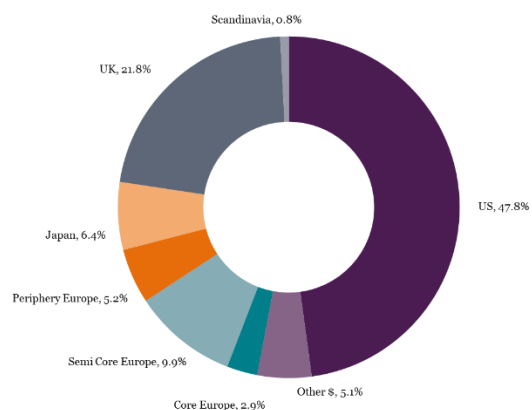
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Performance for the Royal London Global Index Linked Fund is based on pricing at noon, while index performance is based on pricing at close of business, preventing direct performance comparison. The significance of this timing discrepancy is likely to be greater for shorter measurement periods.

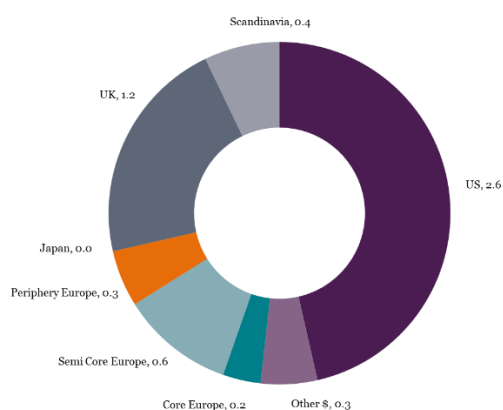
Ten Largest Holdings

	Weighting (%)
UK Treasury 0.125% IL 2026	10.0
UK Treasury 1.25% IL 2027	7.2
US Treasury 0.5% IL 2024	5.1
US Treasury 0.375% IL 2027	5.1
US Treasury Bond 0.125% IL 2026	4.1
UK Treasury 2.5% IL 2024	3.9
US Treasury 0.375% IL 2025	3.9
France (gov) 0.1% IL 2025	3.9
UK Treasury 0.125% IL 2029	3.6
US Treasury 0.125% IL 2030	3.5
Total	50.2

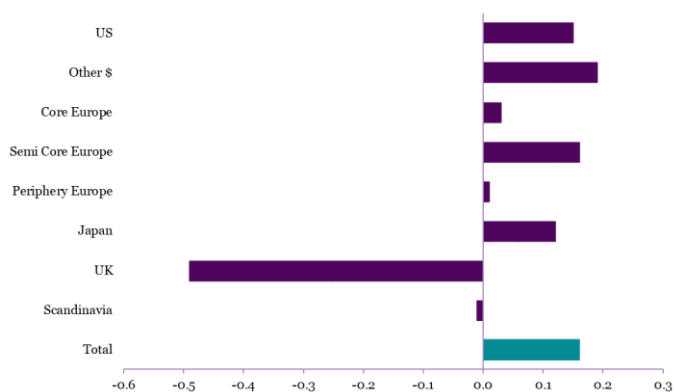
Geographic split by percentage



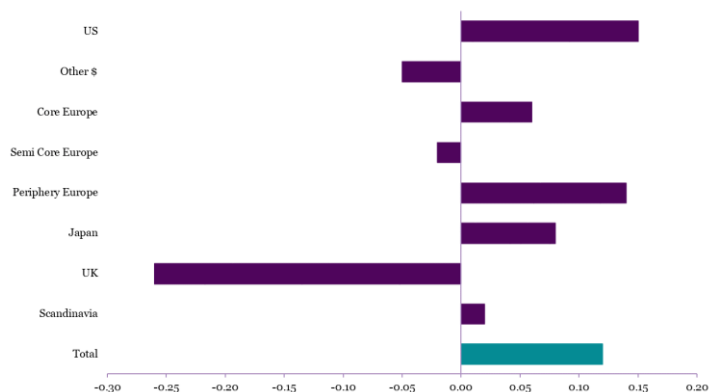
Geographic split by duration



Current position (by duration)

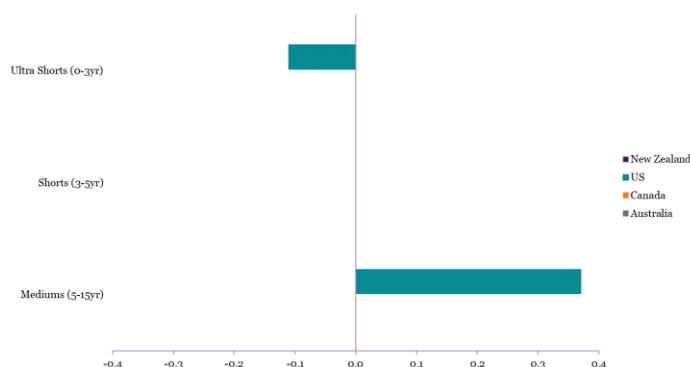


Change on the quarter by duration

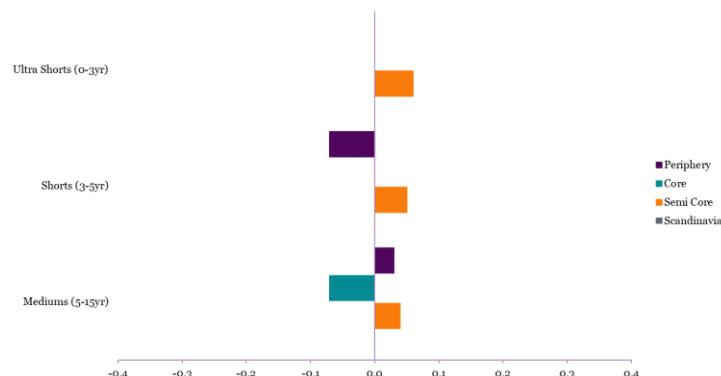


Yield Curve

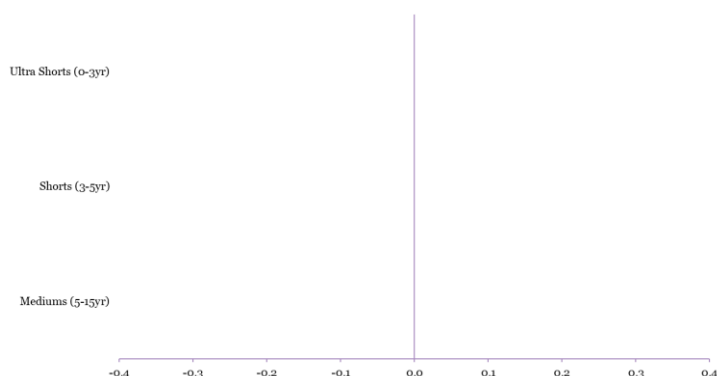
Dollar bloc



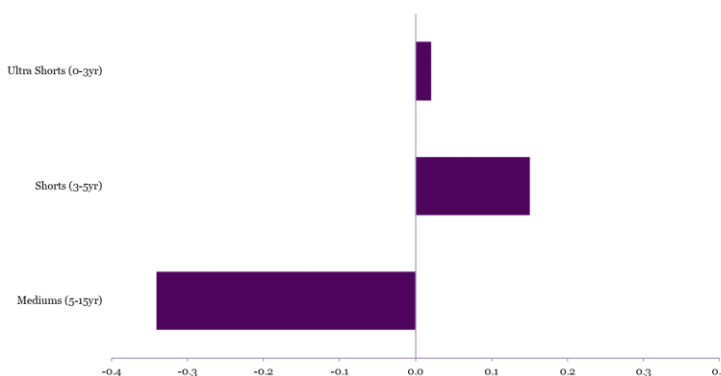
Euro bloc



Japan



UK



Executive summary

- Global markets have grappled with increasingly high inflation expectations in the second quarter. Inflation data has consistently exceeded 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. The combination of rising nominal yields *and* falling breakeven (implied) inflation rates has seen inflation-linked markets lead the bond market sell-off in the quarter, underperforming nominal government bonds. Longer dated bonds have generally performed worst, given their greater sensitivity to changes in interest rate expectations (known as duration).
- Over the period, RLAM's index-linked funds performed as follows:
 - RL Index Linked Fund: -19.59%, benchmark -17.54%**
 - RL Global Index Linked Fund: -10.24%, benchmark -9.79%**
 - RL Short Duration Global Index Linked Fund: -3.53%, benchmark -3.02%**
- These above performance data (all M share classes, net of fees), are distorted by timing differences, with funds priced at midday and indices at close of business. On a like-for-like basis, the **Index Linked Fund** outperformed by 25 basis points (bps) in the quarter (returning -17.29%) and by 53bps over 12 months (-15.80%); the **Global Index Linked Fund** outperformed by 12bps for the quarter (-9.68%) and by 85bps over 12 months (-7.17%); and the **Short Duration Global Index Linked Fund** underperformed by 7bps for the quarter (-3.09%) and by 29bps over 12 months (-0.29%).



- The bond bear market was led by inflation-linked issues in the period, with real yields rising by much further than nominals: 10-year UK real yields rose by 127bps -1.49%, 10-year US real yields rose by 116bps 0.66%; and 10-year German real yields by 150bps to 0.69%. This substantial rise was caused by the combination of rising nominal yields and falling breakeven (implied) inflation rates. Despite higher inflation over the quarter, future inflation expectations as measured by breakeven rates fell – in the UK, 10-year breakevens fell by 65bps to 3.7%, while US and German 10-year breakevens fell by 48bps to 2.34% and by 61bps to 2.03% respectively. However, investors should note that the extent to the fall in breakevens was exaggerated by the real yield adjustment needed to offset the substantial carry (inflation income) as inflation hit double digits – on a carry-adjusted basis breakevens were only 25bps lower in the UK.
- The funds were broadly strategically short throughout the period, which benefitted performance as real yields rose. However, trading tactically around extreme volatility was the major positive contributor to fund performance. Over the quarter, as spreads were volatile around central bank events and supply, we tactically traded positions in the US and Europe across all funds which added to performance as global bonds outperformed in June.
- All funds held a long strategic position in Australia over the quarter – the strategic position slightly detracted from performance, although this was mitigated through tactical trading in Australian bonds. The funds sold exposure to Japanese bonds after a strong relative performance – this has been aided by a weak yen supporting breakevens, while the Central Bank of Japan (BoJ) remains dovish and continues to maintain its yield curve control.
- Curve strategies were not a major driver of performance in the period for shorter dated funds, with the fund holding mainly steepening biases throughout the period. Longer dated funds though actively traded the yield curve turning a steepening bias to a flattener in May and benefitting as the curve flattened in early June.

Market overview

- Global markets have grappled with increasingly high inflation expectations in the second quarter. Inflation data has consistently exceeded 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).
- 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 and this continued through the quarter, with the fifth consecutive increase in June taking the UK base rate to 1.25%.
- Following this aggressive response by central banks bond yields rose sharply over the quarter. In nominal markets, the UK’s 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%. However, the bond bear market was led by inflation-linked issues in the period, with real yields rising by much further: 10-year UK real yields rose by 127bps -1.49%, 10-year US real yields rose by 116bps 0.66%; and 10-year German real yields by 150bps to 0.69%. This substantial rise was caused by the combination of rising nominal yields and falling breakeven (implied) inflation rates, leading inflation-linked markets to underperform nominal government bond market in the quarter.
- 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 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. However investors should note that the extent to the fall in breakevens was exaggerated by the real yield adjustment needed to offset the substantial carry (inflation income) as inflation hit double digits – on a carry adjusted basis breakevens were only 25bps lower in the UK.
- The UK index-linked market underperformed on a global basis in the period, providing negative returns of -17.54% (FTSE Actuaries UK IL Gilts All Maturities), compared to global index-linked returns of -9.76% (Barclays Global IL). Longer-dated bonds were weaker due to their greater sensitivity to changes in the interest rate (their longer duration). For example, the return on index-linked gilts with 5 years to maturity or less was positive in period, at 0.72%, while the return for bonds of a maturity greater than 15 years was -25.14%. Being the longest duration



market globally therefore added to the UK's relative weakness – this weakness was exaggerated by a lack of demand from liability driven investors (such as pension funds) in the long-end of markets in the period.

- Currency swings were notable in the quarter, following the volatility of the first quarter. The sharp rise in US interest rate expectations meant that the dollar was the strongest global currency: it appreciated significantly against the Swiss franc, euro and sterling, and rose over 11% against the yen. These movements will impact global trade and overseas earnings over coming months, and dollar strength will also be a risk for any emerging markets countries and companies that have borrowed in dollars. The price of Brent crude oil rose by another 6.4% to nearly \$112 a barrel, but copper futures fell 21.9% on fears of recession and renewed Covid restrictions in China during the quarter.

Performance and activity

- Duration ran as far as -0.5 years short relative to benchmark and stayed short across period, adding value as yields rose. We traded tactically around extreme volatility in the period, with tactical trading the major positive contributor to performance in the period. As spreads were volatile around central bank events and supply, we tactically traded positions in the US and Europe across all funds which added to performance as global bonds outperformed in June. This strong performance of global bonds took duration around flat 0.1 years long for the fund.
- The fund held a long strategic position in Australia over the quarter where real yields were positive and averaged 300 basis points higher than the UK. The strategic view slightly detracted from performance in the quarter as the spread widened. However we benefitted tactically by building the position into the widening of spreads and towards the end of the quarter, as the UK underperformed, we reduced the position back and locked in a positive tactical profit. The fund also sold exposure to Japanese bonds after a strong relative performance – this had been aided by a weak yen supporting breakevens, while the Central Bank of Japan (BoJ) remains dovish and continues to maintain its yield curve control.
- As the quarter progressed, we added to positions at the very front end of the market, buying two- and five-year real yields which had underperformed on the more hawkish central bank rhetoric. This led to a bias to steeper curves. Curve positioning was slightly detrimental to performance overall, and after switching from 10-year bonds and longer into shorter maturity bonds towards the end of the quarter, the fund closed the period broadly flat on the curve. The short fund also held five-year gilts were for most of the quarter but these were sold back into index-linked bonds after the weakness in breakevens during June.

Outlook

- 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 and price spirals, hence the hawkish stance from the majority of central banks. Inflation remains stronger in the UK, and the BoE sees less hawkish than other central banks as it keeps an eye on growth as well as inflation. However, we still feel the UK inflation market is overpriced relative to global markets, and will maintain our global overweights as a result.
- The speed of the sell-off has taken many by surprise and the lack of any structural buying of UK index-linked bonds has been puzzling. The UK, particularly at the long end, has reached support levels and with limited supply and the Judicial Review on RPI reform starting at the end of June we would anticipate some demand for long dated index-linked bonds.
- The short end of the UK curve is vulnerable to news regarding a possible VAT cut, however higher inflation prints will continue to support the very front end globally. We therefore would expect real curves to steepen.
- Breakeven inflation rates declined over the quarter in the majority of markets, as they reacted to the actions and policy signalling by central banks committing to tackle inflation. We held no breakeven positions at the end of the period, after the sharp fall in breakevens but expect breakevens to remain volatile driven by movements in energy prices, we would look to sell breakevens into any significant strength particularly at the longer end of the market.

More on government bonds

- 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 for further information.



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