Royal London Short Term Money Market Fund

Quarterly Report 31 March 2022

Fund data

	Fund
Gross redemption yield[1]	0.98%
No. of issuers	43
Fund size	£3,743.1m
Weighted average maturity	0.1 years
Weighted average life	0.2 years

Source: RLAM, based on the Y Inc share class. Launch date: 22.07.1999.[1]The gross redemption yield is calculated on a weighted average basis. [2]The underlying yield aligns closely with the gross redemption yield of the fund taking in account expenses. Please see glossary for more detail. 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] (%)
Q1 2022	**0.07**	**0.10**	**-0.03**
Year-to-date	0.07	0.10	-0.03
Rolling 12 months	0.13	0.14	-0.01
3 years p.a.	0.38	0.29	0.08
5 year p.a.	0.43	0.32	0.12
10 year p.a	0.43	0.34	0.09
Since inception p.a. 22.07.1999	1.19	0.94	0.24

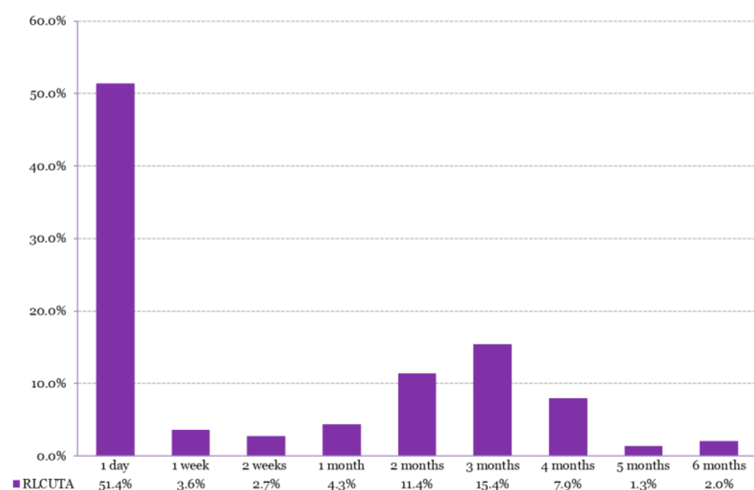
***Past performance is not necessarily a reliable indicator of future performance. The value of investments and the income from them is not guaranteed and may go down as well as up and investors may not get back the amount originally invested.** All performance figures stated gross of fees and tax unless otherwise stated. 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

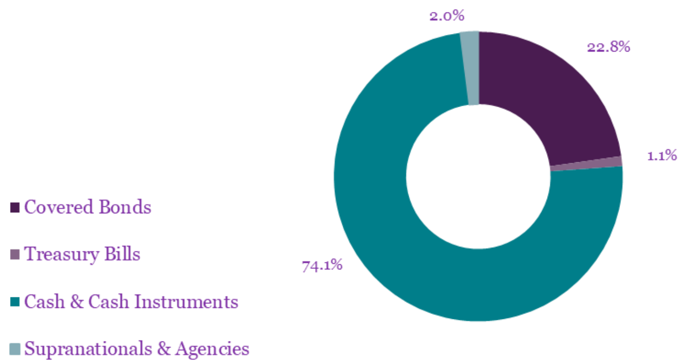
	Weighting (%)
Nationwide Building Society	7.2
Royal Bank of Canada	7.0
DZ Bank	6.3
Rabobank Group	6.0
Landesbank Hessen Thuringen	4.9
Toronto Dominion Bank	4.5
Sumitomo Mitsui Banking Corp	4.5
Barclays Bank	4.1
BNP Paribas	4.1
Sparebank 1 Boligkreditt	3.4
Total	**52.0**

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

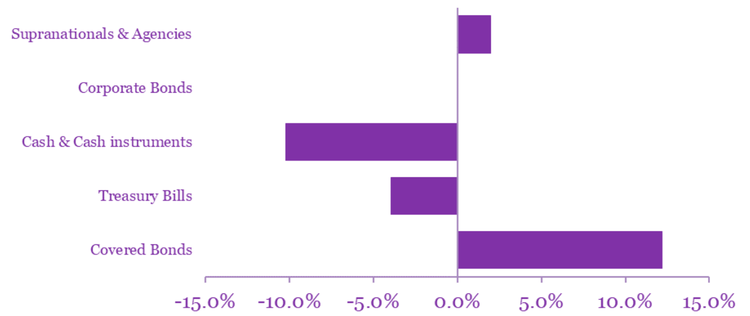
Duration profile



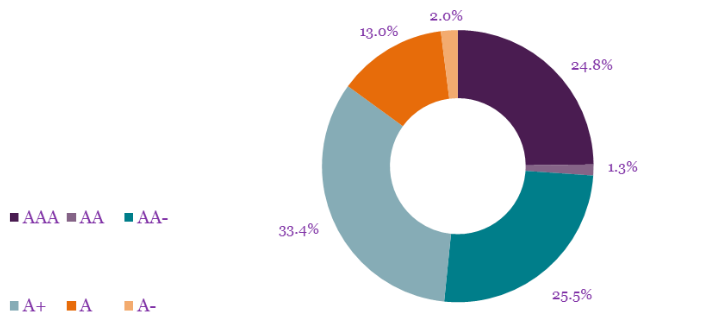
Asset allocation profile Q1 2022



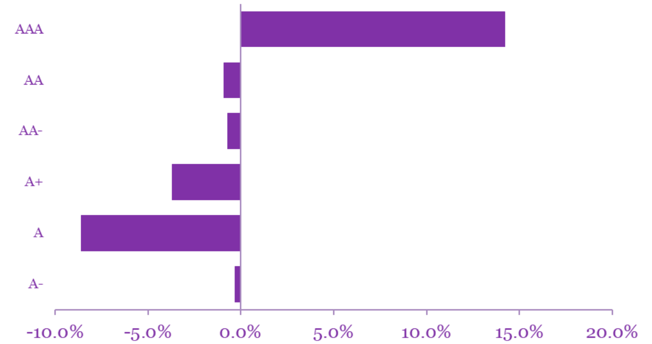
Change since last quarter



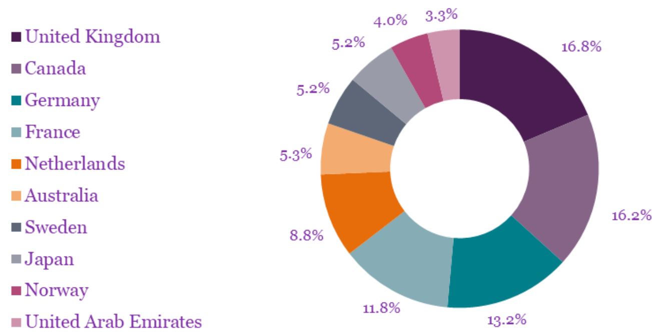
Credit rating profile Q1 2022



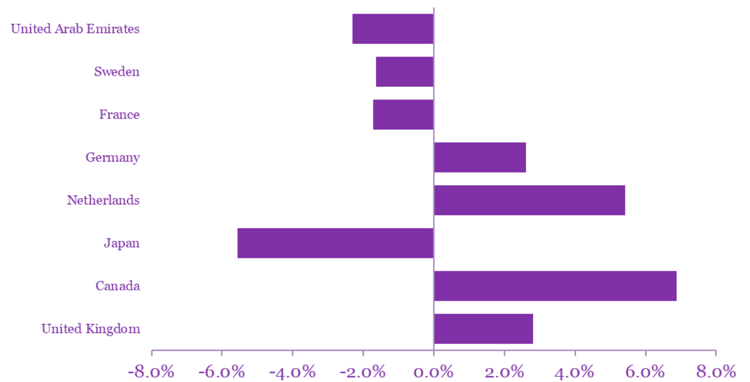
Change since last quarter



Top ten geographic allocation (ex gilts) Q1 2022



Change since last quarter



Market overview

- Geopolitical events and a changing outlook for growth and inflation have been the backdrop to a volatile quarter for investment markets. The year began with markets starting to focus on inflation, with hawkish comments from the Federal Reserve (Fed) and Bank of England (BoE) leading to expectations that rates would rise faster and further than just a few months ago. Both the Fed and BoE increased interest rates during the quarter citing inflation concerns, while European Central Bank has accelerated the end of its net asset purchases programme.
- The US showed a reasonably solid start to the year, with stronger than expected retail sales and industrial production. Although war in Ukraine has increased uncertainty in markets, Federal Reserve Chair Powell noted that "with inflation well above 2% and a strong labour market, we expect it will be appropriate to raise the target range for the federal funds rate." In the euro area consumer confidence weakened but the PMIs were consistent with a relatively strong pace of growth. Economists ramped up expectations for an ECB hike this year after a hawkish ECB press conference, although more recent comments have been more dovish, reflecting the Ukraine crisis. However, with inflation rising fast, the ECB has confirmed that it is accelerating its exit from its bond buying programme (the Pandemic Emergency Purchase Programme, or PEPP)
- In the UK, BoE hawkishness was the feature of the quarter. While the bank increased the base rate by 25bps to 0.50% in February, four Monetary Policy Committee (MPC) members voted for a 50bp hike. The BoE also decided to stop reinvesting maturing assets and signalled an intention to sell its holdings of corporate bonds. As a result, market pricing of future hikes changed dramatically: in the space of four months, expectations have gone from rates reaching 0.75% by 2024, to rates reaching 1.75% by the end of this year. The Russian invasion of Ukraine might have been expected to lead these expectations to be scaled down, but a consensus quickly emerged that while higher energy prices would slow growth, it would also push inflation still higher. February saw a CPI (inflation) print of 6.2% - the highest seen since 1992, with the BoE expecting this to rise to 8% or even higher this year.
- In UK bond markets, the benchmark 10-year gilt yield rose from 0.97% to 1.61%, leading gilts to return -7.2% on an all-maturities basis (FTSE Actuaries). Although newsflow during the quarter was dominated by Ukraine, government bonds did not exhibit their traditional safe haven status, with the combination of higher implied inflation and rising real yields proving a painful combination for investors. Although broad sterling credit indices outperformed government bonds, returning -6.2% in the period (iBoxx Sterling Non-Gilt index), this reflected their lower duration. Investment grade spreads (the average extra yield available from a corporate bond compared with government debt of equal maturity) widened by 22bps.
- UK money markets therefore unsurprisingly saw yields rise as well. After some 20 months trading at or just over 0.05%, SONIA had risen to 0.19% in December 2021, then jumped to 0.69% by the end of the first quarter of 2022. Three-month Libor rose from 0.48% at the start of the quarter to end March at 1.03%. Two-year gilts, often seen as a proxy for market expectations of BoE rates, rose from 0.68% at the end of 2021 to end the first quarter 1.35%.

Performance and activity

- Our cash funds are standalone vehicles. However, we know that many clients use a combination of these as part of a cash laddering strategy – using short maturity funds for more immediate liquidity needs and using other strategies for cash needs beyond six months or so. The return profiles of these funds will differ, but all are underpinned by a common philosophy and process. We focus on creating diversified portfolios that with high credit quality in the underlying banks. These portfolios also screen out tobacco, fossil fuel and armaments, but also factoring in ESG considerations when considering the banks that make up the majority of the portfolios. In this way we believe we create portfolios that meet client needs.
- There is no direct Russian exposure in our portfolios, and there has been no exposure given Russian banks failed our screening process. We are monitoring other names in the portfolios that may have indirect exposure to Russia. Where identified, we are allowing short-dated paper to mature and are not rolling this, using proceeds to reinvest elsewhere.
- Funds with a much greater focus on near-term liquidity such as the Short Term Money Market Fund are invested almost entirely in classic money market instruments such as treasury bills and short dated certificates of deposit. Money market exposure was generally a modest positive over the quarter. Although rising yields are a headwind for money market funds (as these yields often rise faster than a portfolio can rotate into those higher yielding securities), we had added selectively to longer date paper at the more attractive rates available in December, and were able to add further as market rates rose over the quarter. Over the quarter, activity remained focused on CDs out to around three month through names such as **Toronto Dominion** and **ING**, and with our view that the market was pricing in too many rate hikes, we added selectively beyond that, including four-month CDs from **Nordea.** We also added a short-dated covered bonds in the secondary market when

available. Purchases included **Toronto Dominion Bank**, **Royal Bank of Canada** and **TSB** – both providing a small premium over SONIA, but also mitigating interest rate risk due to their floating rate structure. We also added floating rate CDs – again, these providing some protection in a rising rate environment – including six-month paper paying a premium to SONIA from Norwegian bank **DNB**.

Outlook

- The market is pricing in five further rate hikes this year, which would take base rates to 1.75%. At the time of writing, we feel that the Bank may in fact hike less – rhetoric from MPC members in March were clearly around the impact of cost of living, and wanting to avoid hiking fast and helping push the economy into recession. While understandable, we see definite risks to this approach: historically, being slow to hike rates eventually means more hikes are needed. We also feel that inflation will be stickier than some are expecting. While it is tempting to see much of the recent increase as a year-on-ear 'base effect' phenomenon, we feel that this is only one aspect of recent inflation increases. Alongside the temporary effects of higher energy prices, we believe that the Russian invasion will have longer-term impacts: deglobalisation, as countries look to be more self-sufficient and move production close to local markets; and tighter labour markets, as more emphasis on local production and lower participation rates push wages higher.
- A background of rising rates is a difficult one for all cash and very short duration bond funds. As we said in January, with interest rates now having risen, and expectations of further increases already in prices, positioning around duration, becomes more dynamic, rather than simply sitting as short as possible. While we feel that the market is overly hawkish about the prospects for rate increases, we will generally look to extend maturities to pick up attractive yields in names we are comfortable with. Our strategy is to remain cautious, in keeping with the risk profile of our funds, ensuring that we continue to deliver on the security and liquidity expectations of the funds, looking for opportunities to mitigate the impact of rising yields on overall returns, while also taking advantage of market pricing in excessive rates to achieve additional yield.
- For exposure outside of these areas, our approach has always placed an emphasis on security and credit quality, both in the nature of assets we buy (such as covered bonds) but also in the way we assess credit quality, with our preference for bonds with security or covenants that we feel offer a degree of protection to investors. A high proportion of the assets in our funds are exempt from bail-in, and we will continue to favour such assets given these provide our clients with greater security.

Additional information

- RLAM recognises that the Ukraine invasion is a human tragedy, and one that we hope is resolved swiftly. As stewards of our investors' assets, we are monitoring the situation closely, and of course are complying with all restrictions and sanctions issued by relevant authorities. RLAM has no exposure to Russian companies in our active funds. We had limited exposure (less than 0.1% of total assets) in our tilt and Emerging Market Tracker funds at the time of the invasion, but subsequently sold every holding we were permitted to. In our Emerging Market Tracker fund, we removed this in line with the MSCI index changes in early March.
- You can find regular updates on our investment thinking in the *Our Views* section of www.rlam.co.uk. This includes regular updates from Head of Fixed Income Jonathan Platt, Head of Equities Peter Rutter, and Head of Sustainable Mike Fox.

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