Royal London Fixed Income Funds

Fund Manager Commentary – May 2022

FOR PROFESSIONAL INVESTORS ONLY, NOT SUITABLE FOR RETAIL INVESTORS.

Contents

Economic Developments

- The Bank of England (BoE) increased interest rates by another 25bps to 1% in May, as the highest inflation print since the 1980s saw CPI inflation jump from 7% to 9%. Retail sales remained strong despite weak consumer confidence, and business optimism fell on concerns about tighter margins and weaker order books. However, £15bn fiscal package has alleviated some concerns for consumers, although it has also made further rate hikes more likely.
- The Federal Reserve (Fed) increased rates a further 50bps to 1%, with Chair Powell noting that 50bps rises should be “on the table at the next couple of meetings”. Inflation remains high, with CPI at 8.3% in April, while the composite PMI business survey indicator deteriorated, and consumer confidence remained well below pre-pandemic levels.
- Euro area CPI hit 8.1% in May, stronger than expected. European Central Bank (ECB) commentary became more hawkish over the month – a blog from ECB President Lagarde outlined expectations for winding down the Asset Purchase Program (APP). She also commented on the eurozone exiting negative interest rates by the end of the third quarter, implying multiple 25bps hikes in the period.

RLAM Credit Fund Performance

	1 month (%)	Rolling 12 Months (%)
RL Corporate Bond Fund Z Inc	**-1.18**	**-6.57**
IA Sterling Corporate Bond Sector	-0.92	-8.70
iBoxx Sterling Non-Gilts All Maturities Index	-1.37	-9.87
RL Ethical Bond Fund Z Inc	**-1.10**	**-7.56**
IA Sterling Strategic Bond Sector	-0.75	-6.91
iBoxx Sterling Non-Gilts All Maturities Index	-1.37	-9.87
RL Global Bond Opportunities Fund Z Inc	**-0.67**	**-1.97**
RL Investment Grade Short Dated Credit Fund Z Inc	**0.07**	**-3.80**
IA Sterling Corporate Bond Sector	-0.92	-8.70
ICE BofA ML 1-5 year Sterling Non-Gilt All Stocks Index	0.02	-4.39
RL Short Duration Credit Fund Z Inc	**-0.09**	**-2.98**
IA Sterling Strategic Bond Sector	-0.75	-6.91
ICE BofA ML 1-5 year Sterling Non-Gilt All Stocks Index	0.02	-4.39
RL Sterling Credit Fund Z Inc	**-1.04**	**-7.26**
IA Sterling Corporate Bond Sector	-0.92	-8.70
iBoxx Sterling Non-Gilts All Maturities Index	-1.37	-9.87
RL Sterling Extra Yield Bond Fund A Inc	**-0.15**	**1.09**
RL Sterling Extra Yield Bond Fund B Inc	**-0.19**	**0.56**
RL Sterling Extra Yield Bond Fund Y Inc	**-0.11**	**1.54**
RL Sterling Extra Yield Bond Fund Z Inc	**-0.12**	**1.36**
IA Sterling Corporate Bond Sector	-0.92	-8.70
IA Sterling High Yield Sector	-1.16	-5.64
IA Sterling Strategic Bond Sector	-0.75	-6.91

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.
SOURCE: RLAM AND FE, CORRECT AS OF 31 MAY 2022. RETURNS QUOTED ARE NET OF FEES.
ALL IA SECTOR PERFORMANCE SHOWN IS FOR THE MEDIAN.
[1]PLEASE NOTE THAT THE BENCHMARK PRICING IS END-OF-DAY AND ENTAILS NO CURRENCY CONVERSION.

Credit Market Review

Market highlights – Sterling investment grade credit

- The themes driving markets were unchanged in May, as the inflationary impact of war in Ukraine continued to drive both headlines and the policy agenda. Central banks remained very hawkish, and bond yields continued to rise, leading to negative returns for bond markets. Longer-dated fixed income securities were the weakest performers globally given their greater sensitivity to changes in rate expectations, which turned even more aggressive in May.
- In the UK, the benchmark 10-year gilt yield rose by 20 basis points to 2.10% in the month, with gilts returning -2.97% to investors (FTSE Actuaries) on an all-maturities basis. In comparison, sterling investment grade markets returned -1.37% (iBoxx) on an all-maturities basis. The total return for gilts was below that of sterling credit due the longer duration of the gilt market: on a spread basis, which compares the performance of bonds of equal maturity, sterling credit marginally underperformed gilts. In May, the average investment grade credit spread (the average extra yield available from a corporate bond compared with government debt of equal maturity) widened by 2 basis points to 1.47%.
- Total returns remained negative for all sterling credit sectors in May. Defensive sectors such as supranational and covered were the strongest relative performers, while financials (banks and insurance) also performed well on a relative basis, following a period of weakness. Longer duration utilities and real estate sectors were weak. The AAA rating band was the strongest section of the market in the period on a total returns basis, while A rated bonds lagged investment grade returns. However, when looking at excess returns – which removes the impact of duration on performance – returns across ratings bands were less dispersed, with the BBB sector lagging overall.
- Sterling investment grade issuance fell significantly in May to just £1.4bn, far below the £6.1bn of issuance seen in May 2021, reflecting elevated levels of volatility in markets. Net issuance for the period was -£0.8bn (£2.2bn of debt matured).

Royal London Corporate Bond Fund

Portfolio commentary

- The fund recorded a net return of -1.21% (M, Acc) in May, performing broadly in line with its benchmark, the iBoxx Sterling Non-Gilts All Maturities Index, which returned -1.37%. For the rolling 12-month period the fund has returned -6.70%, outperforming the index by 369 basis points (bps) to deliver top-quartile performance relative to the Investment Association Sterling Corporate Bond sector.
- In certain sectors, such as insurance and banks, our exposure to selected long-dated or perpetual bonds was particularly negative, as yields continued to rise. Our underweight to supranationals was also negative, as the sector continues to outperform the broader market. These effects were broadly mitigated by the strong performance of our real estate and asset backed bond holdings relative to the benchmark, as well as the fund's slight short duration position versus the benchmark of -0.4 years.
- Overweight exposure to subordinated financials, a substantial underweight in supranational bonds, and a bias towards secured issues (such as social housing) and structured issues are the most noticeable features of sector positioning.
- The fund participated in a small number of new issues in May, including a short-dated senior issue from **Deutsche Bank**, and a 2031 secured bond issue from **Telsec**. We also took an allocation in a 2029 new issue from **Macquarie**, preferring the shorter-dated bond to the existing 2031 security held by the fund, as it offered a greater spread on the curve – we sold the existing 2031 bond in the period.
- In the secondary market we purchased a number of perpetual bonds which we felt offered attracted yields for a range of reasons. In the insurance sector, for example, we bought a perpetuity from **Utmost Group** at a yield we felt more than compensated for its lower rating in comparison to peers. In the banking sector, we bought perpetuals from **HSBC**, where yields looked attractive given a strong balance sheet, and from **Lloyds Bank**, which looked particularly attractive versus very long-dated gilts. Bond disposals were mainly undertaken in order to raise liquidity – we sold assets across sectors in the period, including supranational bonds from **Temasek Financial**, a structured bond from **Octagon Healthcare**, and financial sector bonds from **Natwest Group** and **DNB**.

Investment outlook

- The latest government package (0.6% of GDP) to alleviate the cost-of-living crisis makes further rate hikes more likely, and UK markets are now factoring in interest rates of around 2.75% in 12 months' time. However, it is possible that the Office of National Statistics will treat the energy bill discount as a price cut, lowering the Consumer Price Index (CPI) inflation expected in the fourth quarter. Although helpful, this may not be sufficient to stem the energy price hikes likely to come later in the year.
- In the US, the Fed signalled of two further 50bps rate rises and re-iterated a commitment to achieving 2% inflation. With core CPI above 6%, the market is factoring in short term rates of 3% within a year.
- The widening in credit spreads has taken valuations to attractive levels, relative to government bonds. Credit spreads discount a significant portion of bad news, and investors are being paid well to take credit over government bond risk. Although some further volatility is likely, our recent preference for short-dated credit bonds is gradually morphing as we begin to take on more duration risk – not at the long end of markets where all-in yields still look challenging, but just slightly further along the curve.
- The BoE announced in May that it will begin the sale of its holdings of corporate bonds from the week commencing 19 September, via a regular multi-stock auction – further operational details will be published in August. While its buy programme had a significant (if only temporary) impact on sterling credit markets, we do not expect the same for the sale. Although the holding is material in size, it is not a structurally significant portion of the market, and with the proposed sale's timescale of more than three years, it is unlikely that markets will see enough concentrated activity to generate large swings in pricing.
- We will maintain our long-standing focus on risk management by seeking to identify companies with strong balance sheets, favouring issues with security and downside protection, and ensuring that portfolios are diversified across issuers, sectors, and other factors. In addition, we expect to maintain an overweight position in subordinated financial bonds where credit spreads remain attractive.

Key views within the fund

- Well diversified, with over 300 holdings, in order to improve overall portfolio liquidity and to reduce the effect on overall fund performance of any deterioration in the creditworthiness of an individual holding.

- A significant underweight in supranational bonds, as we expect corporate bonds to outperform over the medium term.
- Duration slightly below benchmark.
- An overweight position in subordinated financial debt, where we believe yields are attractive.
- Orientated towards secured bonds in the asset-rich investment trust, property and social housing sectors, and towards structured bonds, which benefit from a claim on assets and cashflows.
- Environmental, social and governance (ESG) risk factors are fully integrated in the management of the portfolio. The WACI (weighted average carbon intensity) of the portfolio is below that of the index.

Shalin Shah
Senior Fund Manager

Matt Franklin
Fund Manager

Jonathan Platt
Head of Fixed Income

Royal London Ethical Bond Fund

Portfolio commentary

- The fund recorded a net return of -1.04% (M Acc) in May, outperforming the iBoxx Sterling Non-Gilts All Maturities Index, which returned -1.37%. For the rolling 12-month period the fund has returned -7.67%, outperforming the index by 2.20%.
- In certain sectors, such as insurance and banks, our exposure to selected long-dated or perpetual bonds was particularly negative, as yields continued to rise. Our underweight to supranationals was also negative, as the sector continues to outperform the broader market. These effects were mitigated by the strong performance of our real estate and asset backed bond holdings relative to the benchmark.
- The fund participated in a single new issue in May, a 2031 secured bond issue from **Telsec**.
- In the secondary market we took advantage of market demand earlier in the month to sell a number of holdings that had held up well, including **Intercontinental Hotels** and short dated bonds from **Anglian Water**. We used this liquidity to invest in attractive bonds later in the month, including a cheap unrated secured real estate bond from **Shaftesbury Carnaby**. We also effected a switch in **Deutsche Bank** bonds, selling 2024 senior bonds and buying 2026 senior bonds, picking up around 30bps in spread for a modest extension of maturity.

Investment outlook

- The latest government package (0.6% of GDP) to alleviate the cost-of-living crisis makes further rate hikes more likely, and UK markets are now factoring in interest rates of around 2.75% in 12 months' time. However, it is possible that the Office of National Statistics will treat the energy bill discount as a price cut, lowering the Consumer Price Index (CPI) inflation expected in the fourth quarter. Although helpful, this may not be sufficient to stem the energy price hikes likely to come later in the year.
- In the US, the Fed signalled of two further 50bps rate rises and re-iterated a commitment to achieving 2% inflation. With core CPI above 6%, the market is factoring in short term rates of 3% within a year.
- The widening in credit spreads has taken valuations to attractive levels, relative to government bonds. Credit spreads discount a significant portion of bad news, and we believe investors are being paid well over the medium term to take credit over government bond risk. Although some further volatility is likely, our recent preference for short-dated credit bonds is gradually changing as we begin to take on more duration risk – although the focus is more in medium-dated bonds rather than the long end of markets where yields still look challenging.
- The BoE announced in May that it will begin the sale of its holdings of corporate bonds from the week commencing 19 September, via a regular multi-stock auction – further operational details will be published in August. While its buy programme had a significant (if only temporary) impact on sterling credit markets, we do not expect the same for the sale. Although the holding is material in size, with the proposed sale's timescale of more than three years, it is unlikely that markets will see enough concentrated activity to generate large swings in pricing.
- We will maintain our long-standing focus on risk management by seeking to identify companies with strong balance sheets, favouring issues with security and downside protection, as well as those that align with the fund's ethical objective, and ensuring that portfolios are diversified across issuers, sectors, and other factors. In addition, we expect to maintain an overweight position in subordinated financial bonds where credit spreads remain attractive.

Key views within the fund

- The fund is diversified in order to improve portfolio liquidity and to reduce the effect on overall performance of any deterioration in the creditworthiness of an individual holding.
- The fund has a significant underweight position in supranational bonds, as we expect corporate bonds to outperform over the medium term.

- Duration broadly in line with the benchmark.
- The fund has an overweight position in subordinated financial debt, where we believe yields are attractive.
- The fund remains orientated towards secured bonds in the asset-rich property and social housing sectors, and towards structured bonds, which benefit from a claim on assets and cashflows.

ALPHA MANAGER 2020
Eric Holt
CITYWIRE AA

Eric Holt
Senior Fund Manager

Royal London Global Bond Opportunities Fund

Market highlights

Index	Total return (%)	Spread movement (basis points)
HY global non-financial corps **ICE BofA ML global non-financial high yield index**	-0.4	+27
AT1 **ICE BofA ML contingent capital index**	0.1	+1
HY non-financial emerging markets **ICE BofA ML emerging markets high yield ex. subordinated financial index**	-1.9	-54
IG global non-financial hybrid corps **ICE BofA ML global hybrid non-financial corporate index**	-1.8	+11
HY global non-financial hybrid corps **ICE BofA ML global hybrid non-financial high yield index**	-0.4	-5
Dollar investment grade corporate bonds **ICE BofA ML US corporate index**	0.5	-1
Sterling investment grade corporate bonds **ICE BofA ML sterling corporate and collateralised index**	-1.6	+6
Euro investment grade corporate bonds **ICE BofA ML euro corporate and Pfandbriefe index**	-1.2	+9

- The themes driving markets were unchanged in May, as the inflationary impact of war in Ukraine continued to drive both headlines and the policy agenda. Central banks remained very hawkish, and bond yields continued to rise, leading to negative returns for bond markets. Longer-dated bonds were the weakest performers globally given their greater sensitivity to changes in rate expectations, which turned even more aggressive.
- In the US, the Federal Reserve (Fed) raised interest rates 50bps. Activity data were mixed: while the unemployment rate remained 3.6%, the May composite PMI business survey indicator deteriorated, consumer confidence remained well below pre-pandemic levels and housing activity data has disappointed consensus. Inflation remains high, with CPI higher than expected at 8.3%Y in April. High inflation and central bank hawkishness were also a theme in the euro area. CPI hit 8.1%Y, stronger than expected, with core inflation also surprising on the upside. European Central Bank (ECB) President Lagarde outlined expectations for winding down the Asset Purchase Program: she also commented on the ECB exiting negative interest rates by the end of the third quarter, implying multiple 25bps hikes in the period. As expected, the Bank of England (BoE) raised rates 25bps to 1.00%. April saw the highest inflation since the 1980s as CPI jumped to 9.0%Y. A £15bln fiscal package alleviated some of the worries about the outlook for consumer spending, while making further interest rate hikes more likely. In China, business surveys were very weak in the data released at the start of May as the Covid situation and associated lockdowns (and worries about lockdowns) constrained business activity. Industrial production and retail sales were both much weaker than expected in April. However, the authorities signalled a package of economic support measures.
- After the sharp rise in April, the benchmark 10-year US treasury yield ended the month slightly lower at 2.84% (a decrease of 9bps over the month). Meanwhile, the equivalent bund yield rose another 18bps to 1.12% - it's only a matter of months since this was still in negative territory.

Portfolio commentary

- The fund (Z, Acc) recorded a return, net of fees, of -0.67% in May. Although returns were negative, this was against a volatile backdrop in which many credit markets saw significantly larger falls than the fund. The nature of the bonds we buy, high level of portfolio diversification, our relatively low duration stance and the high level of income built into the portfolio were all beneficial to the fund's return relative to relevant indices.

- Due to the ongoing volatility, issuance in the high yield market was a fraction of the levels seen through much of 2021. New issuance came predominantly from the US, with minimal high yield issuance in the eurozone. Investment grade credit issuance in the eurozone recovered to €60.4bn in May, above what might have otherwise been expected given that spreads continued to widen and markets remained volatile. Issuers had to pay up for this level of access, however – resulting in elevated new issue concessions. Conversely, after last month's recovery, sterling investment grade issuance fell significantly in May to just £1.4bn.
- In terms of secondary market activity, we added to our existing holdings of **EdF** hybrids and **Legal & General** subordinated bonds, and switched between holdco and opco issues of Swedish real estate company **Heimstaden** to reduce default risk. Otherwise, we sold relatively expensive bonds of **Standard Chartered** and **Achmea**, and reduced our holding in **Getlink**, to maintain liquidity.
- In corporate actions, there were partial calls of **Beerenberg** 2023, **DNO** 2024 and **Sand Hill Petroleum** September 2022 bonds.

Investment outlook

- There is considerable uncertainty about the outlook for the rest of 2022. The invasion of Ukraine and subsequent sanctions gave central banks a dilemma: tighten policy to address inflation or give some slack on further policy moves until the growth consequences become more evident? Having already raised interest rates in March and early May, the Fed has raised rates again – with inflation rising at its fastest rate since 1981, the 75bps increase in mid-June was the largest for nearly 30 years. Some investors fear that this could tip the US into a hard-landing recession.
- The picture is only marginally different in the UK, although the BoE increased rates sooner and seems aware that the UK is more vulnerable to recession. Nonetheless, it raised rates again in June to 1.25%. There has also been a significant shift in the eurozone, with tightening now expected in the third quarter. Although we expect a slowdown in medium term, we believe that market expectations may be too aggressive at present. However, we must highlight the uncertainty of any market forecasts at present, given the unpredictability of the situation in Ukraine.
- Some see the longer-term risk of recession as the key driver for credit markets over the rest of 2022. However, at a macroeconomic level, the US economy is better insulated from rising commodity prices as it is a net energy exporter. Meanwhile, credit spreads on euro and sterling investment grade credit indices have widened sharply this year and now offer even better compensation for the risk of default: it is still expected that credit will outperform government debt over the medium term. The biggest driver of the high yield market is the default rate forecast. While the default rate ticked up in May for the first time since June 2020, this was from ultra-low levels: given the unprecedented levels of liquidity injected into the global financial system since March 2020, we expect default rates to remain benign for some time to come.
- Crucially, the fund's unconstrained approach across a broad spectrum of fixed income opportunities – encompassing investment grade, sub-investment grade and unrated bonds in a wide range of credit markets – means that risks are diversified, while providing considerable opportunities. Furthermore, the short duration of the fund should protect it from some of the volatility that may impact government bond markets.

ALPHA MANAGER 2020 Eric Holt

CITYWIRE AA

Eric Holt
Senior Fund Manager

CITYWIRE A

Rachid Semaoune
Senior Fund Manager

Royal London Investment Grade Short Dated Credit

Portfolio commentary

- Net of fees, the fund delivered a return of 0.07% in May (Z class, income), broadly in line with the ICE BofAML 1-5yr Sterling Non-Gilt All Stocks Index, which returned 0.02%, and well above the -0.97% average return for its all-maturities peer group (IA Sterling Corporate Bond). On a rolling 12-month basis, the fund has outperformed both the benchmark and the IA sector, delivering top-decile returns.
- In certain sectors, such as insurance and banking, our exposure to specific callable bonds was particularly negative. Our underweight to supranationals was also negative, as the sector continues to outperform the broader market. These effects were broadly mitigated by the strong performance of our real estate and asset backed bond holdings relative to the benchmark. The marginal long duration position was a small negative for performance for the period.
- The overweight exposure to subordinated financial debt, substantial underweight in supranational bonds, and bias towards secured and structured issues remained the most noticeable features of sector positioning.
- The fund participated in a small number of new issues in May. In the financial sector, the fund took an allocation in a senior issue from **Deutsche Bank**; we also bought a hybrid perpetual issue from **Volkswagen**.
- In the secondary market we were particularly active in the financial sector, which was offering attractive spreads after a period of underperformance. Insurance sector purchases included an upper tier two (UP2) perpetuity from **Zurich Insurance Group**, a lower tier two (LT2) offering from **Scottish Widows**, and a tier three offering from **Rothesay Life**. In the banking sector, purchases included a senior **Lloyds Banking Group** bond, and an LT2 issue from **Investec Bank**, both of which were trading at wider spreads than comparable credits. We also added to our secured holdings via structured bonds from **Octagon Healthcare** and **Broadgate Financing**, and a real estate bond from **MPT Operating Partnership**. With regard to the disposal of assets, the fund sold a number of senior bank bonds in order to raise liquidity, including issues from the **Bank of Nova Scotia**, **Credit Suisse Group**, and **Royal Bank of Canada**, and **First Abu Dhabi Bank**.

Investment outlook

- The latest government package (0.6% of GDP) to alleviate the cost-of-living crisis makes further rate hikes more likely, and UK markets are now factoring in interest rates of around 2.75% in 12 months' time. However, it is possible that the Office of National Statistics will treat the energy bill discount as a price cut, lowering the Consumer Price Index (CPI) inflation expected in the fourth quarter. Although helpful, this may not be sufficient to stem the energy price hikes likely to come later in the year.
- In the US, the Fed signalled of two further 50bps rate rises and re-iterated a commitment to achieving 2% inflation. With core CPI above 6%, the market is factoring in short-term rates of 3% within a year.
- The widening in credit spreads has taken valuations to attractive levels, relative to government bonds. Credit spreads discount a significant portion of bad news, and investors are being paid well to take credit over government bond risk. Although some further volatility is likely, our recent preference for short-dated credit bonds is gradually morphing as we begin to take on more duration risk – not at the long end of markets where all-in yields still look challenging, but just slightly further along the curve.
- The BoE announced in May that it will begin the sale of its holdings of corporate bonds from the week commencing 19 September, via a regular multi-stock auction – further operational details will be published in August. While its buy programme had a significant (if only temporary) impact on sterling credit markets, we do not expect the same for the sale. Although the holding is material in size, it is not a structurally significant portion of the market, and with the proposed sale's timescale of more than three years, it is unlikely that markets will see enough concentrated activity to generate large swings in pricing.
- We will maintain our long-standing focus on risk management by seeking to identify companies with strong balance sheets, favouring issues with security and downside protection, and ensuring that portfolios are diversified across issuers, sectors, and other factors. In addition, we expect to maintain an overweight position in subordinated financial bonds where credit spreads remain attractive.

Key views within the fund

- The fund is diversified, with almost 300 holdings, in order to improve general portfolio liquidity and to reduce the effect on overall performance of any deterioration in the creditworthiness of an individual holding.
- It has a minimal weighting in supranational bonds, as we expect corporate debt to outperform over the medium term.

- Fund duration is marginally longer than the benchmark.
- It has an overweight position in subordinated financial debt, where we believe yields are attractive.
- The fund remains orientated towards structured debt, which benefits from a claim on assets and cashflows; secured issues in the asset-rich property and social housing sectors; and covered bonds (i.e. senior bank debt benefiting from a first claim on a specified over-collateralised pool of assets).

Paola Binns
Head of Sterling Credit

Royal London Short Duration Credit Fund

Portfolio commentary

- Net of fees, the fund delivered a return of -0.09% in May (M class, Income), underperforming the ICE BofAML 1-5yr Sterling Non-Gilt All Stocks Index, which returned 0.02%, but outperforming the -0.84% average return for its all-maturities peer group (IA Sterling Strategic Bond sector). It has outperformed the index and all-maturities peer group on a rolling 12-month basis.
- In certain sectors, such as insurance and banking, our exposure to specific callable bonds was particularly negative due to technical factors. Our underweight to supranationals was also negative, as the sector continues to outperform the broader market. These effects were broadly mitigated by the strong performance of our real estate and asset backed bond holdings relative to the benchmark. The marginal long duration position was a small negative for performance for the period.
- The overweight exposure to subordinated financial debt, substantial underweight in supranational bonds, and bias towards secured and structured issues remained the most noticeable features of sector positioning.
- The fund participated just one new issue in May, a 2026 senior issue from **Deutsche Bank**.
- In the secondary market we were particularly active in the financial sector, which was offering attractive spreads after a period of underperformance. In the insurance sector we purchased a lower tier two (LT2) bond from **JRP Group**, while in the banking sector we added a senior non-preferred bond from **KBC Group** to the portfolio, as well as a slightly longer-dated 2030 issue from the **Royal Bank of Scotland**. We also added an issue from **Thames Water Kemble Finance**, extending our preference for structured bonds. We sold bonds across sectors in the period to raise liquidity, including a senior bond from **First Abu Dhabi Bank**, structured bonds from **Thames Water** and **Southern Water**, and a supranational bond from the **UK Municipal Bonds Agency**.

Investment outlook

- The latest government package (0.6% of GDP) to alleviate the cost-of-living crisis makes further rate hikes more likely, and UK markets are now factoring in interest rates of around 2.75% in 12 months' time. However, it is possible that the Office of National Statistics will treat the energy bill discount as a price cut, lowering the Consumer Price Index (CPI) inflation expected in the fourth quarter. Although helpful, this may not be sufficient to stem the energy price hikes likely to come later in the year.
- In the US, the Fed signalled of two further 50bps rate rises and re-iterated a commitment to achieving 2% inflation. With core CPI above 6%, the market is factoring in short-term rates of 3% within a year.
- The widening in credit spreads has taken valuations to attractive levels, relative to government bonds. Credit spreads discount a significant portion of bad news, and investors are being paid well to take credit over government bond risk. Although some further volatility is likely, our recent preference for short-dated credit bonds is gradually morphing as we begin to take on more duration risk – not at the long end of markets where all-in yields still look challenging, but just slightly further along the curve.
- The BoE announced in May that it will begin the sale of its holdings of corporate bonds from the week commencing 19 September, via a regular multi-stock auction – further operational details will be published in August. While its buy programme had a significant (if only temporary) impact on sterling credit markets, we do not expect the same for the sale. Although the holding is material in size, it is not a structurally significant portion of the market, and with the proposed sale's timescale of more than three years, it is unlikely that markets will see enough concentrated activity to generate large swings in pricing.
- We will maintain our long-standing focus on risk management by seeking to identify companies with strong balance sheets, favouring issues with security and downside protection, and ensuring that portfolios are diversified across issuers, sectors, and other factors. In addition, we expect to maintain an overweight position in subordinated financial bonds where credit spreads remain attractive.

Key views within the fund

- The fund is diversified, with more than 300 holdings, in order to improve overall portfolio liquidity and to reduce the effect on overall performance of any deterioration in the creditworthiness of an individual exposure.
- The fund has a significant underweight in supranational bonds, as we expect corporate debt to outperform over the medium term.

- Fund marginally duration shorter the benchmark.
- The fund has an overweight position in subordinated financial debt, where we believe yields are attractive.
- The fund remains orientated towards secured bonds in the asset-rich investment trust, property and social housing sectors, and towards structured issues, which benefit from a claim on assets and cashflows.

Paola Binns
Head of Sterling Credit

Royal London Sterling Credit Fund

Portfolio commentary

- Net of fees, the fund delivered a return of -0.96% in May (M class, Accumulation), outperforming the benchmark returns of -2.71% (iBoxx Sterling Non-Gilts All Maturities Index) and the -1.37% average return of the peer group (IA Sterling Corporate Bond). The fund has significantly outperformed the index and peer group on a 3-year and 5-year basis.
- In certain sectors, such as insurance and banks, our exposure to selected callable bonds was particularly negative. Our underweight to supranationals was also negative, as the sector continues to outperform the broader market. These effects were broadly mitigated by the strong performance of our real estate and asset backed bond holdings relative to the benchmark. The slight long duration position had a small negative impact on performance for the period.
- The overweight exposure to subordinated financial debt, substantial underweight in supranational bonds, and bias towards secured and structured issues remained the most noticeable features of sector positioning.
- The fund participated in a small number of new issues in May. In the financial sector, the fund took an allocation in a short-dated senior issue from **Deutsche Bank** and a perpetuity from **SEB Group**. We also bought a hybrid perpetual issue from **Volkswagen**.
- In the secondary market we were particularly active in the financial sector, which was offering attractive spreads after a period of underperformance. Insurance sector purchases included a restricted tier one (RT1) perpetuity from **Allianz**, and lower tier two (LT2) offerings from **Pensions Insurance Corporation** and **Scottish Widows**. In the banking sector, purchases included a senior **BNP Paribas** bond, and an LT2 issue from **Investec Bank** which traded at a wider spread to other comparable credits. The fund also sold a select number of financial bonds back to the market to fund these purchases – we took profit on an LT2 insurance bond from **PICORP** where spreads were narrower than similar bonds.

Investment outlook

- The latest government package (0.6% of GDP) to alleviate the cost-of-living crisis makes further rate hikes more likely, and UK markets are now factoring in interest rates of around 2.75% in 12 months' time. However, it is possible that the Office of National Statistics will treat the energy bill discount as a price cut, lowering the Consumer Price Index (CPI) inflation expected in the fourth quarter. Although helpful, this may not be sufficient to stem the energy price hikes likely to come later in the year.
- In the US, the Fed signalled of two further 50bps rate rises and re-iterated a commitment to achieving 2% inflation. With core CPI above 6%, the market is factoring in short-term rates of 3% within a year.
- The widening in credit spreads has taken valuations to attractive levels, relative to government bonds. Credit spreads discount a significant portion of bad news, and investors are being paid well to take credit over government bond risk. Although some further volatility is likely, our recent preference for short-dated credit bonds is gradually morphing as we begin to take on more duration risk – not at the long end of markets where all-in yields still look challenging, but just slightly further along the curve.
- The BoE announced in May that it will begin the sale of its holdings of corporate bonds from the week commencing 19 September, via a regular multi-stock auction – further operational details will be published in August. While its buy programme had a significant (if only temporary) impact on sterling credit markets, we do not expect the same for the sale. Although the holding is material in size, it is not a structurally significant portion of the market, and with the proposed sale's timescale of more than three years, it is unlikely that markets will see enough concentrated activity to generate large swings in pricing.
- We will maintain our long-standing focus on risk management by seeking to identify companies with strong balance sheets, favouring issues with security and downside protection, and ensuring that portfolios are diversified across issuers, sectors, and other factors. In addition, we expect to maintain an overweight position in subordinated financial bonds where credit spreads remain attractive.

Key views within the fund

- Well diversified, with around 350 holdings, in order to improve overall portfolio liquidity and to reduce the effect on overall performance of any deterioration in the creditworthiness of an individual holding.
- A significant underweight in supranational bonds, as we expect corporate bonds to outperform over the medium term.
- Duration slightly longer than the benchmark.
- Orientated towards subordinated financial debt, where we believe yields are attractive.

- The fund remains orientated towards secured bonds in the asset-rich investment trust, property and social housing sectors, and structured bonds, which benefit from a claim on assets and cashflows.

Paola Binns
Senior Fund Manager

Royal London Sterling Extra Yield Bond Fund

Portfolio commentary

- In May, the fund posted returns of -0.15%, -0.19%, -0.11% and -0.13% for the A, B, Y and Z class shares, respectively. These bring 2022 year-to-date returns for these share classes to -2.37%, -2.58%, -2.20% and -2.26%, respectively.
- Against a background of evident inflationary pressures, actual and anticipated interest rate rises and slowing economic activity, financial markets remained fragile in May, extending the period of marked weakness prevailing so far in 2022. While short-dated gilts held up well in the month, yields on longer-dated gilts moved up about 20bps, resulting in an index return for gilts of -3.12% in May. Sterling investment grade corporate bonds were more resilient, reflecting their shorter average duration and thus price sensitivity to higher yields, posting an index return of -1.39% in May. European sub-investment grade bonds and global sub-investment grade bonds posted index returns of -1.25% and -0.37% respectively in May, the latter asset class holding up relatively well because of its orientation to dollar-denominated bonds and its higher weighting to the energy sector. Year-to-date index returns for these four asset classes are -13.06%, -9.99%, -8.72% and -8.94%, each impacted by the deterioration in market sentiment. The severity of the price impact of the recent shift up in yields is particularly marked in long-dated gilts; at the end of May, the 1⅝% 2071 gilt was down 45% from its early December 2021 peak, while the ⅛% 2073 index linked gilt lost 55% of its value over a similar period.
- There were several features underlying the fund’s relatively resilient performance in May, when compared to bond market index returns. It was by no means insulated against the setback in markets, with investments in the insurance sector – including **Allianz**, **Bupa**, **Just Group** and **Scottish Widows –** each down around 3% in price in the month. A similar setback in pricing occurred among some of the longer-dated structured bonds in the fund, including **Progress Heathcare**, **Punch Taverns, Tesco Property** and **Unique Pub Finance**, as these were more sensitive to the rise in gilt yields; while bonds in the retail sector, including **Co-op Group** and **John Lewis**, were also down in price on deteriorating sentiment in the sector in the context of the squeeze on consumer spending. These particular points of weakness were, however, largely offset by the short average duration of the fund, and therefore moderate sensitivity to the environment of rising government bond yields; by robust income generation, which even over the relatively short period of a month is helpful; and by holdings related to the energy sector – including offshore service companies **BOA** and **DOF Subsea,** shipping group **SD Standard** and production companies **Norwegian Energy** and **Shamaran**, each of which benefitted from improving pricing in their businesses and corresponding improvement in their finances.
- Activity in the month included participation in new issues of Scandinavian transport fuel provider **Greenbit**, orientated towards increasing provision of renewable products, and of **Bayport**, the microloans company operating in developing countries, which was refinancing the maturity of an existing bond held in the fund. Market purchases included financials **Allianz**, **Bupa** and **Virgin Money**, each of which had fallen markedly in price on the recent downturn in markets, utilities **EDF** and **Thames Water,** together with materials business **Monaco Resources** and BBB rated bonds of **MPT**, the US healthcare property group. Sales included shipping group **Klaveness Combination Carriers**, energy group **Norwegian Energy** and banking business **Standard Chartered.** Finally, activity in short-dated **UK gilts** reflected both short-term liquidity management in the fund, while net sales of gilts in the month provided capacity to invest proceeds at the much higher yield levels presently prevailing in corporate bond markets.

Investment outlook

- The latest government package (0.6% of GDP) to alleviate the cost-of-living crisis makes further rate hikes more likely, and UK markets are now factoring in interest rates of around 2.75% in 12 months’ time. However, it is possible that the Office of National Statistics will treat the energy bill discount as a price cut, lowering the Consumer Price Index (CPI) inflation expected in the fourth quarter. Although helpful, this may not be sufficient to stem the energy price hikes likely to come later in the year.
- In the US, the Fed signalled of two further 50bps rate rises and re-iterated a commitment to achieving 2% inflation. With core CPI above 6%, the market is factoring in short-term rates of 3% within a year.
- The widening in credit spreads has taken valuations to attractive levels, relative to government bonds. Credit spreads discount a significant portion of bad news, and investors are being paid well to take credit over government bond risk. Although some further volatility is likely, our recent preference for short-dated credit bonds is gradually morphing as we begin to take on more duration risk – not at the long end of markets where all-in yields still look challenging, but just slightly further along the curve.
- The BoE announced in May that it will begin the sale of its holdings of corporate bonds from the week commencing 19 September, via a regular multi-stock auction – further operational details will be published in August. While its buy programme had a significant (if only temporary) impact on sterling credit markets, we do not expect the same for the sale. Although the holding is material in size, it is not a structurally significant portion of the market, and with the proposed

sale's timescale of more than three years, it is unlikely that markets will see enough concentrated activity to generate large swings in pricing.

- We will maintain our long-standing focus on risk management by seeking to identify companies with strong balance sheets, favouring issues with security and downside protection, and ensuring that portfolios are diversified across issuers, sectors, and other factors. In addition, we expect to maintain an overweight position in subordinated financial bonds where credit spreads remain attractive.

Key views within the fund

- The fund's objective is to achieve a high level of income by seeking attractive investments across a broad spectrum of fixed income opportunities, encompassing investment grade, sub-investment grade and unrated bonds.
- The fund mitigates stock-specific risk by holding a diversified portfolio of investments, so that no individual investment can in isolation have an undue impact on overall performance. In addition, where possible within the yield objective of the fund, investments are focused on bonds where risk is mitigated by structure or a claim on assets or cashflows.

CITYWIRE A

Rachid Semaoune
Senior Fund Manager

ALPHA MANAGER 2020 Eric Holt

CITYWIRE AA

Eric Holt
Senior Fund Manager

RLAM Government Bond Fund Performance

	1 month (%)	Rolling 12 Months (%)
RL Global Index Linked Bond Fund Z Inc	**-3.04**	**-2.20**
IA Global Bonds Sector	-2.47	-1.52
Barclays World Government Inflation-Linked Bond Index (hedged)	-3.49	-4.30
RL Index Linked Bond Fund M Inc	**-5.19**	**-8.09**
IA UK Index Linked Gilts Sector	-5.77	-10.26
FTSE Actuaries UK Index-Linked All Stocks Index	-7.76	-12.50
RL Short Duration Gilt Fund Z Inc	**0.19**	**-2.03**
IA UK Gilts Sector	-2.27	-10.41
FTSE Actuaries UK Conventional Gilts up to 5 Years Index	0.12	-2.69
RL Short Duration Global Index Linked Bond Fund Z Inc	**-0.57**	**2.31**
IA Global Bonds Sector	-2.47	-1.52
RL Short Duration Global Index Linked Composite Benchmark[1,2]	-0.46	2.48
RL UK Government Bond Fund Z Inc	**-2.07**	**-9.50**
IA UK Gilts Sector	-2.27	-10.41
FTSE Actuaries UK Conventional Gilts All Stocks Index	-2.97	-11.36

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.
SOURCE: RLAM AND FE, CORRECT AS OF 31 MAY 2022. RETURNS QUOTED ARE NET OF FEES.
ALL IA SECTOR PERFORMANCE SHOWN IS FOR THE MEDIAN.
1PLEASE NOTE THAT THE BENCHMARK IS PRICED END-OF-DAY.
2THE COMPOSITE BENCHMARK CONSISTS OF: 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).

Government Bond Market Review

Market highlights

- The themes driving markets were unchanged in May, as the inflationary impact of war in Ukraine continued to drive both headlines and the policy agenda. Central banks remained very hawkish, and bond yields broadly rose globally, leading to negative returns for the majority of markets. Longer-dated securities fared worst, given their greater sensitivity to changes in rates expectations, which turned even more aggressive in May. The Bank of England (BoE) increased interest rates by 25bps to 1% in May, as the highest inflation print since the 1980s saw CPI inflation jump from 7% to 9%. And while a £15bn fiscal package has alleviated some concerns for consumers, it has also made further rate hikes more likely. In the US, the Federal Reserve (Fed) increased rates a further 50bps to 1%, with Chair Powell noting that 50bps rises should be “on the table at the next couple of meetings”. The European Central Bank (ECB) President Lagarde also outlined expectations for winding down the Asset Purchase Program (APP) in the third quarter and potentially exiting negative interest rates, implying multiple 25bps hikes in the period.

Gilts

- In the UK, the benchmark 10-year gilt yield rose by 20 basis points to 2.10% in the month, with gilts returning -2.97% to investors (FTSE Actuaries) on an all-maturities basis. In comparison, sterling investment grade markets returned -1.37% (iBoxx) on an all-maturities basis. The total return for gilts was below that of sterling credit due the longer duration of the gilt market: on a spread basis, which compares the performance of bonds of equal maturity, sterling credit marginally underperformed gilts. For example, shorter-dated gilt indices performed much better than long-dated indices in May, with gilts of less than five years to maturity providing positive returns of 0.17%. The average investment grade credit spread (the average extra yield available from a corporate bond compared with government debt of equal maturity) widened by 2 basis points to 1.47%.

Index linked gilts

- UK index-linked gilts posted negative returns of -7.76% in May (FTSE Actuaries), underperforming conventional gilts as breakeven (implied) inflation rates fell across the curve – the UK’s 10-year breakeven rate fell by 22bps to 4.23%. Real gilt yields rose across the curve in the month, with the benchmark 10-year real yield up by 40bps to -2.15%. Long-dated bond prices have been hit hard in the last 6-months, with the price of longest dated gilt falling by around 60%.
- The UK lagged global index-linked markets in the month, which returned -3.49% to investors (Barclays hedged £). This was in part due to duration, as the UK index-linked market is the longest duration market globally. In the US, 10-year breakevens fell by 29bps to 2.65%, leading US real yields higher by 20bps to 0.19%; in Germany, 10-year breakevens fell by 71bps to 2.27%, leading 10-year German real yields to rise by around 70bps, to -1.46%.

Overseas

- Government bond markets were broadly negative globally in May. Euro area periphery markets continued to lag, compounded by ECB President Lagarde’s blog comments, pointing towards imminent rate hikes and a withdrawal of policy accommodation. Italy was the worst performing market, as the 10-year yield rose by 35bps to 3.12%. The US was the strongest of major global markets as yields fell 9bps in the period to 2.84%, with the market already having priced much of the tightening and turning to fears of a possible future recession. Swedish 10-year yields also fell in the period, by 10bps, to 2.10%, settling down after soaring late in April as the Riksbank raised rates and signalled potential further hikes.

Royal London Global Index Linked Bond Fund

Portfolio commentary

- Gross of fund management fees, the fund returned -3.08% (M inc) to investors in May, outperforming the benchmark returns of -3.49%. Investors should note a timing difference between the valuation of the fund, which takes place at midday, and the valuation of the benchmark, with which takes place at the end of the day. On a like for like basis the outperformed the benchmark by around 12bps.
- The themes driving markets were unchanged in May, as the inflationary impact of war in Ukraine continued to drive both headlines and the policy agenda. Central banks remained very hawkish, and real bond yields rose globally, leading to negative returns for the majority of markets. Longer-dated securities fared worst given their greater sensitivity to changes in rate expectations, which turned even more aggressive in May. Both the UK and US rose interest rates in the period, by 25bps and 50bps respectively, to 1%.
- Global index-linked markets returned -3.49% to investors (Barclays hedged £), outperforming the UK which returned -7.76% for the month (FTSE Actuaries). This was in part due to duration, as the UK linker market is the longest duration index-linked market globally. The US led global markets with breakevens falling by 29bps to 2.65%, leading US real yields higher by 20bps into positive territory at 0.19%; in comparison, UK 10-year real yields rose by 40bps to -2.15%, while 10-year German real yields rose by an enormous 70bps, to -1.46%. However, when adjusted for the inflation carry, 10-year price moves were less than implied by yield moves. Volatility remained high in the period, especially in the UK, which witnessed one of its largest one day moves ever as long dated real yields rose by 25bps on the last day of the month.
- The fund's performance was mainly driven by overweights in global markets – US and European positions particularly benefitted, although the long position in Australia marginally tempered returns. We added to long positions in Australia and Germany into market weakness, and bought the first ever green index-linked bond, issued by France. The French bond was sold towards the end of the month after strong performance, which saw it outperform the UK by 25 basis points post issue.
- The fund's strategic duration was broadly flat to benchmark through the period, and had little impact on returns. Curve was more positive for performance – while the fund's flattening bias in the UK between 10- and 30-year sectors was negative, the overweight at the front end, via holdings in two-year bonds, saw the fund benefit on the curve overall. The fund also tactically traded duration 0.2 years either side of neutral in the period, this included purchase in the 20-year part of the UK real curve prior to the 2039 auction – prices rose in the lead up to the auction, and we sold back to the market post-auction taking profits.
- The fund held a small exposure to short and ultra-long dated gilts at the beginning of the period. The positions benefitted the fund, as breakevens fell across the curve in May. We sold the long-dated nominal bonds back into the index-linked market in the period, taking profits, and closed the month with just a small, short-dated nominal gilt position.

Investment outlook

- The speed of the sell-off has taken many by surprise and the lack of any structural buying of UK index-linked bonds, as witnessed by the sharp sell-off on the last day of the month, has been puzzling. The UK, particularly at the long end, has reached support levels at -1% real yields – with no supply and the Judicial Review on RPI reform to start 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 flatten.
- On a cross market basis longer dated index-linked bonds have cheapened with best value now in the 10-year area of the curve, where Australia still yields 300bps higher than the UK.
- Breakevens remain volatile at higher levels and we are still waiting to sell breakevens nearer to the peak in inflation prints, which should be later in the summer.

Key views within the fund

- We remained tactically active in May, trading duration 0.2 years either side of neutral, ending the period marginally long duration.
- The fund holds a UK flattening bias via an underweight in 10-year bonds relative to 30-year bonds.

- The fund closed the period short the UK, and predominantly in favour of Australia and the US, as well as Japan and Germany.
- The fund held a small short in UK inflation at the end of the period.

Paul Rayner
Head of Alpha Strategies

Gareth Hill
Fund Manager

Royal London Index Linked Bond Fund

Portfolio commentary

- Gross of fund management fees, the fund returned -5.19% (M Acc) to investors in May, compared to benchmark returns of -7.76%. However, there is a slight timing difference between valuation of the fund, which takes place at midday, and the valuation of the benchmark, which takes place at the end of the day. On a like for like basis the fund outperformed by 20 basis points during.
- The themes driving markets were unchanged in May, as the inflationary impact of war in Ukraine continued to drive both headlines and the policy agenda. Central banks remained very hawkish, and real bond yields rose globally, leading to negative returns for the majority of markets. Longer-dated securities fared worst given their greater sensitivity to changes in rate expectations, which turned even more aggressive in May. Both the UK and US rose interest rates in the period, by 25bps and 50bps respectively, to 1%.
- Global index-linked markets returned -3.49% to investors (Barclays hedged £), outperforming the UK which returned -7.76% for the month (FTSE Actuaries). This was in part due to duration, as the UK linker market is the longest duration index-linked market globally. The US led global markets with breakevens falling by 29bps to 2.65%, leading US real yields higher by 20bps into positive territory at 0.19%; in comparison, UK 10-year real yields rose by 40bps to -2.15%, while 10-year German real yields rose by an enormous 70bps, to -1.46%. However, when adjusted for the inflation carry, 10-year price moves were less than implied by yield moves. Volatility remained high in the period, especially in the UK, which witnessed one of its largest one day moves ever as long dated real yields rose by 25bps on the last day of the month.
- The fund's performance was mainly driven by overweights in global markets – US and European positions particularly benefitted, although the long position in Australia marginally tempered returns. We added to long positions in Australia and Germany into market weakness, and bought the first ever green index-linked bond, issued by France. The French bond was sold towards the end of the month after strong performance, which saw it outperform the UK by 25 basis points post issue. We also moved further overweight the US in the period.
- The fund's strategic duration was broadly flat to benchmark through the period, and had little impact on returns. Curve was more positive for performance – while the fund's flattening bias in the UK between 10- and 30-year sectors was negative, the overweight at the front end, via holdings in two-year bonds, saw the fund benefit on the curve overall. The fund also tactically traded duration 0.2 years either side of neutral in the period, this included purchase in the 20-year part of the UK real curve prior to the 2039 auction – prices rose in the lead up to the auction, and we sold back to the market post-auction taking profits.
- The fund held a small exposure to short and ultra-long dated gilts at the beginning of the period. The positions benefitted the fund, as breakevens fell across the curve in May. We sold the long-dated nominal bonds back into the index-linked market in the period, taking profits, and closed the month with just a small, short-dated nominal gilt position.

Investment outlook

- The speed of the sell-off has taken many by surprise and the lack of any structural buying of UK index-linked bonds, as witnessed by the sharp sell off on the last day of the month, has been puzzling. The UK, particularly at the long end, has reached support levels at -1% real yields – with no supply and the Judicial Review on RPI reform to start 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 flatten.
- On a cross market basis longer dated index-linked bonds have cheapened with best value now in the 10-year area of the curve, where Australia still yields 300bps higher than the UK.
- Breakevens remain volatile at higher levels and we are still waiting to sell breakevens nearer to the peak in inflation prints, which should be later in the summer.

Key views within the fund

- We remained tactically active in May, trading duration 0.2 years around neutral, ending the period marginally short duration relative to the benchmark.
- The fund holds a UK flattening bias via an underweight in 10-year bonds relative to 30-year bonds.

- The fund closed the period long global bonds. We remain predominantly in favour of European and Australian bonds, and remain slightly overweight Japan and the US.
- The fund held a small short UK inflation at the end of the period.

CITYWIRE +

Paul Rayner
Head of Alpha Strategies

MORNINGSTAR Bronze

SQUARE MILE A

CITYWIRE A

Ben Nicholl
Fund Manager

Royal London Short Duration Global Index Linked Bond Fund

Portfolio commentary

- Gross of fund management fees, the fund returned -0.64% (M Class) to investors in May, compared to benchmark returns of -0.46%. However, there is a timing difference between the valuation of the fund, which takes at midday, and the valuation of the benchmark, with which takes at the end of the day. On a like for like basis the fund outperformed by 1 basis point.
- The themes driving markets were unchanged in May, as the inflationary impact of war in Ukraine continued to drive both headlines and the policy agenda. Central banks remained very hawkish, and real bond yields rose globally, leading to negative returns for the majority of markets. Longer-dated securities fared worst given their greater sensitivity to changes in rate expectations, which turned even more aggressive in May. Both the UK and US rose interest rates in the period, by 25bps and 50bps respectively, to 1%.
- Global index-linked markets returned -3.49% to investors (Barclays hedged £), outperforming the UK which returned -7.76% for the month (FTSE Actuaries). This was in part due to duration, as the UK linker market is the longest duration index-linked market globally. The US led global markets with breakevens falling by 29bps to 2.65%, leading US real yields higher by 20bps into positive territory at 0.19%; in comparison, UK 10-year real yields rose by 40bps to -2.15%, while 10-year German real yields rose by an enormous 70bps, to -1.46%. However, when adjusted for the inflation carry, 10-year price moves were less than implied by yield moves. Volatility remained high in the period, especially in the UK, which witnessed one of its largest one day moves ever as long dated real yields rose by 25bps on the last day of the month.
- The fund's performance was mainly driven by overweights in global markets – US and European positions particularly benefitted, although the long position in Australia marginally tempered returns. We added to long positions in Australia and Germany into market weakness, and bought the first ever green index-linked bond, issued by France. The French bond was sold towards the end of the month after strong performance, which saw it outperform the UK by 25 basis points post issue. We slightly trimmed exposure to the US, taking some profit.
- The fund's strategic duration was broadly flat to benchmark through the period, and had little impact on returns. Curve was more positive for performance –the fund's overweight at the front end via holdings in 2-year bonds saw benefitted performance. The fund also tactically traded duration 0.2 years either side of neutral in the period,
- The fund held a small exposure to five-year gilts at the end of the period, having taken some profits in the month.

Investment outlook

- The speed of the sell-off has taken many by surprise and the lack of any structural buying of UK index-linked bonds, as witnessed by the sharp sell off on the last day of the month, has been puzzling. The UK, particularly at the long end, has reached support levels at -1% real yields – with no supply and the Judicial Review on RPI reform to start at the end of June we would anticipate some demand for long dated index link 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 flatten.
- On a cross market basis longer dated index-linked bonds have cheapened with best value now in the 10-year area of the curve, where Australia still yields 300bps higher than the UK.
- Breakevens remain volatile at higher levels and we are still waiting to sell breakevens nearer to the peak in inflation prints, which should be later in the summer.

Key views within the fund

- Fund duration remained around neutral in May, ending the period around 0.2 years long of the benchmark.
- The fund has a US curve flattening bias, via an overweight in 10-year bonds relative to shorter dated bonds.
- The fund closed the period long global bonds. We extended our global overweights in May and remain predominantly in favour of Australia, Germany and France, with small long positions in the US and Japan.
- The fund held a small underweight to UK breakevens at the end of the month.

Paul Rayner
Head of Alpha Strategies

Gareth Hill
Fund Manager

Royal London Short Duration Gilt Fund

Portfolio commentary

- The themes driving markets were unchanged in May, as the inflationary impact of war in Ukraine continued to drive both headlines and the policy agenda. Central banks remained very hawkish, and bond yields broadly rose globally, leading to negative returns for the majority of markets. Longer-dated securities fared worst, given their greater sensitivity to changes in rates expectations, which turned even more aggressive in May.
- The Bank of England (BoE) increased interest rates by 25bps to 1% in May, as the highest inflation print since the 1980s saw CPI inflation jump from 7% to 9%. Furthermore, while a £15bn fiscal package has alleviated some concerns for consumers, the extra fiscal expenditure has also added to inflationary pressures. In the UK, the benchmark 10-year gilt yield rose by 20 basis points to 2.10% in the month, with gilts returning -2.97% to investors (FTSE Actuaries) on an all-maturities basis.
- The fund's relative duration remained shorter than the benchmark, but had limited impact on overall performance, while the fund's small curve steepening bias had no impact, as yields at the front-end of the curve remained relatively unchanged for the period. The fund tactically traded 2026 dated gilts during the month, which was positive for performance.
- The fund's only cross-market exposure in May was a position in two-year Canadian bonds versus two-year gilts – the exposure had no impact on performance, as Canadian spreads to the UK were unchanged.
- The fund held no exposure to UK inflation markets in the period.
- The fund's highly rated sterling credit holdings had little impact on performance in the period. Sterling investment grade markets returned -1.37% (iBoxx) on an all-maturities basis in May, providing less negative total returns than gilts. However, the apparent outperformance of credit is due to the longer duration of the gilt market: on a spread basis, which compares the performance of bonds of equal maturity, sterling credit marginally underperformed gilts. The average investment grade credit spread (the average extra yield available from a corporate bond compared with government debt of equal maturity) widened by 2 basis points to 1.47%.

Investment outlook

- The latest government package to alleviate the cost-of-living crisis (0.6% of GDP) adds to inflationary pressures and could make further rate hikes more likely: UK markets are now factoring in interest rates of around 2.75% in 12 months' time. However, it is possible that the Office of National Statistic will treat the energy bill discount as a price cut, lowering the Consumer Price Index (CPI) inflation expected in the fourth quarter. Although helpful, this may not be sufficient to stem the energy price hikes likely to come later in the year.
- With base rates now at 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. This would certainly aid the smooth running of the gilt market, where a lack of liquidity during periods over the past six months has led to some sharp swings in prices. 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.
- Post the spring statement, gross gilt issuance for the fiscal year was expected to be £125bn, below market expectations of £145bn. However, a number of developments since, suggest this borrowing number could rise further; increased fiscal expenditure to support UK households already under pressure from rising inflationary pressures, the deteriorating growth outlook, and the higher cost of financing debt due to rising interest rates. This could weigh on the market in the second half of the year.

Key views within the fund

- The portfolio's duration is shorter than the benchmark, including the impact of cash holdings on duration.
- The fund holds a small cross-market exposure in Canada and will continue to look for opportunities to take such positions on a relative basis.

- The portfolio has allocations to high-quality corporate bonds, which we expect to outperform gilts in a low-yielding environment.
- The portfolio may look to tactically trade index-linked gilts to take advantage of mispricing opportunities, but had no exposure to UK inflation at the end of the month.

Craig Inches
Head of Rates and Cash

Ben Nicholl
Fund Manager

Royal London UK Government Bond Fund

Portfolio commentary

- The themes driving markets were unchanged in May, as the inflationary impact of war in Ukraine continued to drive both headlines and the policy agenda. Central banks remained very hawkish, and bond yields broadly rose globally, leading to negative returns for the majority of markets. Longer-dated securities fared worst, given their greater sensitivity to changes in rates expectations, which turned even more aggressive in May.
- The Bank of England (BoE) increased interest rates by 25bps to 1% in May, as the highest inflation print since the 1980s saw CPI inflation jump from 7% to 9%. And while a £15bn fiscal package has alleviated some concerns for consumers, the extra fiscal expenditure has also added to inflationary pressures. In the UK, the benchmark 10-year gilt yield rose by 20 basis points to 2.10% in the month, with gilts returning -2.97% to investors (FTSE Actuaries) on an all-maturities basis.
- The fund's relative duration short was a key driver of outperformance in May, as yields continued to move upwards. Duration versus the benchmark was around -0.4 years at the beginning of the period – we covered the duration short to -0.2 years by the end of the month, locking in some profits. The fund's steepening bias also benefitted performance in May, as gilt curves steepened aggressively in the period. The biases were held at both the front and ultra-long ends of the curve, via a long position in two-year maturity gilts versus five-year gilts, and favouring 30-year gilts relative to the 50-year sector.
- In inflation markets, the holdings of five-year Japanese index-linked bonds benefitted the fund as they outperformed nominal gilts. The fund held no exposure to UK inflation markets in the period.
- Cross market exposures added to performance in May. We reduced the long US position early in the period, locking in positive returns after a period of outperformance; we also reduced the long in Australia towards the end of the period, taking profits following narrowing of spreads to the UK. The fund also traded tactically through the period to the benefit of fund performance, through the buying and selling of 30-year French bonds versus the UK.
- The fund's highly rated sterling credit holdings had little impact on performance in the period. Sterling investment grade markets returned -1.37% (iBoxx) on an all-maturities basis in May, providing less negative total returns than gilts. However, the apparent outperformance of credit is a due to the longer duration of the gilt market: on a spread basis, which compares the performance of bonds of equal maturity, sterling credit marginally underperformed gilts. The average investment grade credit spread (the average extra yield available from a corporate bond compared with government debt of equal maturity) widened by 2 basis points to 1.47%.

Investment outlook

- The latest government package to alleviate the cost-of-living crisis (0.6% of GDP) adds to inflationary pressures and could make further rate hikes more likely; UK markets are now factoring in interest rates of around 2.75% in 12 months' time. However, it is possible that the Office of National Statistic will treat the energy bill discount as a price cut, lowering the Consumer Price Index (CPI) inflation expected in the fourth quarter. Although helpful, this may not be sufficient to stem the energy price hikes likely to come later in the year.
- With base rates now at 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. This would certainly aid the smooth running of the gilt market, where a lack of liquidity during periods over the past six months has led to some sharp swings in prices. 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.
- Post the spring statement, gross gilt issuance for the fiscal year was expected to be £125bn, below market expectations of £145bn. However, a number of developments since, suggest this borrowing number could rise further; increased fiscal expenditure to support UK households already under pressure from rising inflationary pressures, the deteriorating growth outlook, and a higher realised interest burden on financing borrowing due to rising interest rates. This could weigh on the market in the second half of the year

Key views within the fund

- The portfolio's duration is around -0.2 years short of the benchmark, including the impact of cash holdings on duration.
- The fund is now overweight 10-year maturity bonds versus shorter maturities, and keeps its steepening bias in longer maturity bonds (over 30 years).

- The fund has a small overseas exposure mainly through a position in 30-year maturity Australian bonds, and we continue to look for opportunities to take such positions on a relative basis.
- The portfolio has allocations to high-quality corporate bonds, which we expect to outperform gilts in a low-yielding environment.
- The portfolio may look to tactically trade index-linked gilts to take advantage of mispricing opportunities, but had no exposure to UK inflation during April.

CITYWIRE A

Craig Inches
Head of Rates and Cash

Bronze

CITYWIRE A

Ben Nicholl
Fund Manager

RLAM Global High Yield Fund Performance

	1 month (%)	Rolling 12 Months (%)
RL Global High Yield Bond Fund M Inc	**-1.25**	**-7.96**
RL Global High Yield Bond Fund Z Inc	**-1.21**	**-7.70**
IA Sterling High Yield Sector	-1.16	-5.64
ICE BofA ML BB-B Global Non-Financial High Yield Constrained Index	-0.07	-8.46
RL Short Duration Global High Yield Bond Fund A Inc	**0.09**	**-1.56**
RL Short Duration Global High Yield Bond Fund M Inc	**0.12**	**-1.17**
RL Short Duration Global High Yield Bond Fund Z Inc	**0.13**	**-1.06**
IA Sterling High Yield Sector	-1.16	-5.64
Sterling Overnight Index Average Rate (SONIA)[1]	0.08	0.26

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.
SOURCE: RLAM AND FE, CORRECT AS OF 31 MAY. RETURNS QUOTED ARE NET OF FEES.
ALL IA SECTOR PERFORMANCE SHOWN IS FOR THE MEDIAN.
[1] BENCHMARK: SONIA. PLEASE NOTE THAT THIS CHANGED FROM 3-MONTH LIBOR, EFFECTIVE 15 DECEMBER 2020, AND IS REFLECTED IN THE RETURNS SHOWN ABOVE.

Royal London Global High Yield Bond Fund

Portfolio commentary

- The fund's Z class returned -1.25%, net of fees, in May, compared with -0.07% for the ICE BofA Merrill Lynch BB-B Global Non-Financial High Yield Constrained Index (100% GBP hedged). It has, however, outperformed the index over one, three and five years.
- The yield-to-worst* on the benchmark ended May at 6.59%. The fund yield stood at 7.85%, excluding the impact of cash, and its duration was slightly lower than the index.
- The global high yield market produced a total return of -0.07% in May, with price and income returns of -0.55% and 0.45%, respectively. The themes driving markets were unchanged in May, as the inflationary impact of war in Ukraine continued to drive both headlines and the policy agenda. Central banks remained very hawkish and bond yields continued to rise, leading to negative returns for bond markets. Within global high yield, shorter-dated credits were the weaker performers, when compared to longer-dated bonds.
- Returns from index sectors were mixed for the month. However, the dispersion of returns was relatively wide, reflecting deteriorating credit fundamentals that could affect some sectors more than others – real estate and retail were notably weak. US high yield produced positive returns and outperformed the European, UK and emerging market regions, which were all negative. Meanwhile, BB rated bonds outperformed B and CCC rated bonds.
- The US default rate was 0.01% in May – it ticked up from below 0.01%, the first monthly increase since June 2020 (although the rate has been higher in the meantime).
- Due to the ongoing volatility, issuance in the high yield market was on a fraction of the levels seen through much of 2021. New issuance came predominantly from the US, with minimal high yield issuance in the eurozone.

*YIELD-TO-WORST REFERS TO THE REDEMPTION DATE THAT PRODUCES THE LOWEST RETURN.

Investment outlook

- Anyone who read our *2022 Outlook* article may be surprised that we have moved decisively away from the strongly bullish position that we had taken since March 2020 (when central banks stepped in with unprecedented speed to support financial markets from the full effects of the Covid-19 lockdown). After all, the fundamentals of the high yield market remain very positive with the record new issuance over 2020-21 and very low default levels. However, the key lies in the following excerpt from the outlook in our report for the fourth quarter of 2021: "While the average yield may still be low by historical standards, the improved economic prospects… continue to bode well for the asset class for the next few quarters at least. Arguably, the biggest concern for high yield markets is the tail risk of recession. However, the Fed remains acutely aware of the risks of premature tightening and choking off the nascent recovery, so this seems more of a risk for the end of 2023 at the earliest."
- Had the travails of 2022 to date been confined to higher and more persistent inflation than expected and the risks of monetary policy over-tightening, we may have remained relatively bullish as the market fundamentals remain positive and high yield markets are unquestionably higher quality and more robust than in previous recessionary environments (such as the early 2000s or heading into the Global Financial Crisis). However, the combination of this risk factor with the uncertainty and disruption caused by the invasion of Ukraine and retaliatory sanctions means that the change in sentiment that started in March is likely to endure and it would be negligent not to see that as a turning point.
- Unlike equities, the risks in high yield investing are asymmetric and it rarely pays to take excessive risks when heading into periods of more negative sentiment. High yield investors are feeling more risk-averse and will seek to be compensated by higher spreads, so we are now positioned more in favour of defensive sectors and short duration. Given the rise in the reference yield and sharply wider spreads, we believe we will be paid sufficiently for adopting a lower-risk position and expect this to continue for at least the next three quarters until the outlook becomes clearer – perhaps surprisingly, given the volatility we have been able to do this without paying a premium for exposure to safer havens.

Key views within the fund

- The fund's objective is to achieve a combination of capital growth and income. The fund seeks to achieve its investment objective by outperforming its benchmark, the BofA Merrill Lynch BB-B Global Non-Financial High Yield Constrained index, 100% hedged to sterling, by 1% per annum over rolling three-year periods.
- The fund seeks to mitigate stock-specific risk by holding a diversified portfolio of investments, so that no individual investment can, in isolation, have an excessive adverse impact on overall fund performance. Currency risk associated with holdings of bonds is hedged through the use of forward currency transactions.

- We expect bouts of market volatility due to market expectations surrounding US Federal Reserve monetary policy. As such, we believe bonds with near-term catalysts, which mitigate market risk, are an important attribute underpinning investment performance over the medium term. We also expect ongoing volatility until there is a resolution of the conflict in Ukraine – this also has significant implications for the global economy, particularly if sharply higher energy prices and supply chain disruption exacerbate a global economic slowdown.

CITYWIRE A

Azhar Hussain
Head of Global Credit

CITYWIRE A

Stephen Tapley
Global Credit Fund Manager

Royal London Short Duration Global High Yield Bond Fund

Portfolio commentary

- The fund's Z class returned -0.12%, net of fees, in May, compared with 0.08% for SONIA.
- At month end, the expected yield on the fund was 6.96% (7.00% on an FX-adjusted basis), with an expected maturity of 1.64 years.
- The global high yield market produced a total return of -0.07% in May, with price and income returns of -0.55% and 0.45%, respectively. The themes driving markets were unchanged in May, as the inflationary impact of war in Ukraine continued to drive both headlines and the policy agenda. Central banks remained very hawkish and bond yields continued to rise, leading to negative returns for bond markets. Within global high yield, shorter-dated credits were the weaker performers, when compared to longer-dated bonds.
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Investment outlook

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Key views within the fund

- The fund's objective is to provide income. The manager seeks to achieve this by outperforming the benchmark, SONIA, by 2% per annum over rolling three-year periods.
- The fund is diversified in order to improve overall portfolio liquidity and to reduce the effect on overall fund performance of any deterioration in the creditworthiness of an individual holding.
- We expect bouts of market volatility due to changing market expectations surrounding monetary policy worldwide as well as the invasion of Ukraine. As such, we believe companies with strong liquidity characteristics are an important element in underpinning investment performance over the medium term.

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Head of Global Credit

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ROYAL LONDON ASSET MANAGEMENT