



Royal London Absolute Return Government Bond Fund

Quarterly Report 30 September 2022



Asset split

	Fund (%)
Cash ¹	39.1
UK sovereign bonds	12.5
Sterling FRNs and Short Dated Corporates	32.6
Foreign sovereign bonds	19.5
Derivatives	-3.6

Fund data

	Fund
Duration ²	0.5 years
VaR ³	1.13%
Fund size	£1,903.6m

Source: RLAM. Based on the Z share class. Launch date: 17.11.2014.

¹Cash allocation includes exposure to Certificates of Deposit (CDs), where applicable.

²Excluding cash

³Value at Risk: The level of financial risk within the fund over a specific time.

Figures in relation to the asset split table include net derivative positions where held.

Performance

	Fund (%)	Benchmark ¹ (%)	Relative (%)
Q3 2022	-0.92	0.39	-1.31
Year-to-date	-0.62	0.71	-1.32
Rolling 12 months	-0.06	0.72	-0.78
3 years p.a.	1.51	0.38	1.13
5 years p.a.	0.95	0.46	0.49
Since inception p.a. 17.11.2014	0.93	0.42	0.51

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 in sterling, gross of fees and tax unless otherwise stated, subject to rounding. The impact of fees or other charges including tax, where applicable, can be material on the performance of your investment. The impact of fees reduces your return.

Source: RLAM. Based on the Z share class. Performance for the fund is calculated on a mid basis with income re-invested. Performance for other share classes available at www.rlam.com

¹Benchmark: Overnight Cash Rate (SONIA).

Return contribution

Strategy	Month to Date	Quarter to Date	Year to Date	1 Year	Target Return (of Live trades)
Inflation	-51	-55	-12	51	111
Curve	-78	-168	-216	-387	135
Duration	104	74	80	133	10
Relative Value	0	2	-2	-10	0
Cross Market	35	66	108	196	75
FX Hedges	0	0	0	0	0
Cash	-4	1	-6	-7	200

Total	6	-81	-48	-24	531
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Source: RLAM

Contributors

Top Contributors	Strategy	Q3 Contribution (bps)
UK	Duration	148
UK/US	Cross Market	20
Europe	Curve	13
AUS/UK	Cross Market	12
US/EUR	Cross Market	10
Bottom Contributors	Strategy	Q3 Contribution (bps)
UK	Curve	-178
Germany	Duration	-60
UK	Inflation	-56
France	Duration	-11
US	Duration	-10

Source: RLAM

Performance

- The Absolute Return Fund returned -0.92% over the third quarter, compared to a benchmark return of 0.39%. For wider context around market moves over the past three months, UK index linked bonds fell 9.3% on the quarter and gilts by 10.12% (based on FTSE Actuaries All-Maturities indices).
- Global bond yields continued to rise as inflation remained persistently high with the pace of hikes increasing. The UK market was at the epicentre of the bearish sentiment. The mini-budget at the end of September announcing unfunded tax cuts led to yields rising to levels not seen since before the financial crisis – with 30-year gilt yields rising to over 5% and 30-year real yields to 2.5%. The moves were halted by Bank of England intervention buying UK gilts and index link bonds that saw real yields fall close to 250 basis points in just two days.
- Performance was hit by our two key strategic positions: first, a yield curve steepener where we believed that one-year rates would not rise by as much as priced in by the market and that long gilts were overvalued given the expected increase in supply; and second, that UK inflation was overpriced relative to Europe and too high relative to our longer term forecast.
- During the quarter the UK curve continued to invert and the move was exacerbated by the fall in sterling following the mini-budget. This led the market to start to price in more than 250bps of rate hikes by the year end, and at its most inverted, one-year rates were 315bps above long-dated equivalents, leading to a substantial underperformance from this position. Following the end of the quarter, this differential has fallen back to 180bps.
- UK inflation breakevens had been weak most of the quarter but the intervention by the bank of England saw these rise by close to 1% over the last days of the quarter. This was more than 80bps more than moves seen in Europe and again impacted performance substantially. UK inflation has also reversed a lot of these moves following the end of the quarter.
- Both the strategic positions were reviewed constantly and the team had high conviction in both strategies. However when long-dated gilts hit 5% and real yields reached 2.5%, we decided to offset some of the curve and inflation risk by buying long gilts and linkers. This duration position and the subsequent 150bps fall in yields on the Bank of England intervention offset a substantial portion of the underperformance on curve and inflation.
- Cross market positions added value over the quarter namely our long positions in the US, Sweden, Japan and UK relative to an underweight position in Germany.
- Cash positions were flat with the higher yield offset by widening spreads on covered floating rate notes.

Portfolio exposure and target return analysis

Strategy	Trades	Position size	Net duration exposure	Market beta	Target return (bps)
Inflation	Short UK 10 year	0.3	0.0	-0.05	15
	Short US 5y5y Fwd	0.3	0.0	-0.05	6
	Long 5-10yr Japan	0.6	0.0	-0.05	30
	Europe 10/20 curve	0.3	0.0	0.00	10
	Long 10 yr HICP vs RPI	0.7	0.0	0.00	50
Curve	UK 1y vs 30y steepener	0.7	0.0	0.10	70
	UK 15y vs 30y steepener	0.7	0.0	0.00	40
	Germany 2/10 flattener	0.4	0.0	-0.05	10
	Germany 5/30 flattener	0.2	0.0	-0.05	10
	US 20/30 flattener	0.2	0.0	0.0	5
Cross Market	Long 30yr Sweden vs Germany	0.1	0.0	-0.05	5
	Long 30y Jap vs Germany	0.3	0.0	0.00	10
	Long 10y Belg vs Germany	0.2	0.0	0.00	5
	Long 30y US vs Germany	0.5	0.0	0.00	20
	Long 30y UK vs Germany	0.3	0.0	0.15	20
	Long 10y France vs Ger	0.2	0.0	0.00	5
	Long US 10 vs Can	0.3	0.0	0.10	10
Duration	Long UK 1y and CDS	0.4	0.4	0.4	10
FX Hedging	FX Hedge				
Cash	Cash	0.1	0.1	0	200
	Overall Net Duration Position		0.5	0.45	531

Source: RLAM

Asset allocation - duration

Country	0 -5 yrs	5 -10 yrs	10 - 15 yrs	15 - 20 yrs	20 -25 yrs	25 -30 yrs	>30 yrs	Total
UK	1.01	0.31		0.45	0.37	0.08	-1.39	0.82
Japan	0.08	-0.28	-0.15				0.32	-0.04
US	-0.02	0.44	-0.01	-0.13	-0.11	0.75		0.91
Canada	0.03	-0.07		-0.20				-0.24
Singapore								0.00
Australia	0.01							0.01
Belgium			0.06			0.10		0.16
Europe	-0.10	-0.03	0.27				-0.07	0.05
France	0.06	0.11						0.16
Germany	-0.40	-0.23	0.26	0.05	0.05	-1.29		-1.55
Italy			-0.08					-0.07
Netherlands	0.01							0.01
Norway								0.00
Spain								0.00
Portugal								0.00
Sweden	0.09	0.01	-0.01	0.05				0.15
Switzerland								0.00

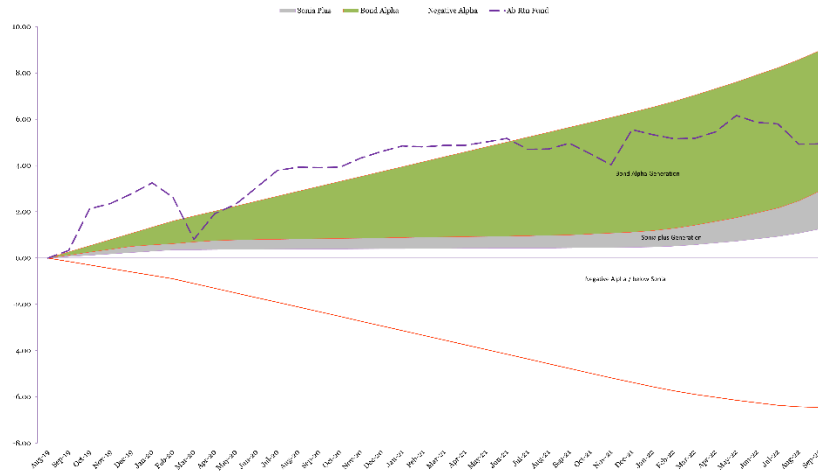
Asset allocation – inflation

Country	0 -5 yrs	5 -10 yrs	10 - 15 yrs	15 - 20 yrs	20 -25 yrs	25 -30 yrs	>30 yrs	Total
UK	0.01	0.23	-1.24	-0.10	-0.01	0.13		-0.97
Japan		0.56						0.56
US		0.27	-0.51					-0.25
Canada								0.00
Singapore								0.00
Australia								0.00
Belgium								0.00
Europe		0.03	0.87	-0.02	-0.21			0.67
France								0.00
Germany								0.00
Italy								0.00
Netherlands								0.00
Norway								0.00
Spain								0.00
Portugal								0.00
Sweden								0.00
Switzerland								0.00

Stand-alone risk contribution

Strategy	Quarterly Vol %	Annual Vol %
Inflation	0.93	1.85
Curve	0.53	1.05
Duration	0.33	0.67
Relative Value	0.08	0.16
Cross Market	0.47	0.94
FX Hedges	0.18	0.36
Cash	0.16	0.32
Total standalone volatility	2.68	5.35
Diversification	1.37	3.19
Overall Volatility	1.31	2.16

Projected performance path



Portfolio activity

- Activity early in the quarter was spent building cross market positions relative to Germany through purchases of Japanese and US longer dated bonds to go alongside the overweight in France and Sweden. As the UK underperformed, we switched out of Australian and US bonds back into the UK.
- Inflation was actively traded, buying back five-year RFP shorts into the weakness seen early in the quarter, and selling longer dated real yields into global counterparts. Towards the end of the quarter European real yields were switched back into the UK with spreads at the years lows. By the end of the quarter the fund was flat inflation overall, with longs in Europe and Japan and corresponding short positions in the UK and the US.
- Duration was increased to 1.5 years long into the blowout in UK yields buying 30-year index-linked and conventional gilts outright. This was partially reversed into the quarter end but the fund remained overweight the UK and marginally long duration overall.



- We added to curve flattening risk in Germany over the quarter, selling two-year futures. In the UK we trimmed the UK steepening risk by selling 10-year futures relative to longer dated bonds and selling two-year gilts via a total return swap.
- Within swaps, after the strong outperformance of longer dated gilts on the announcement of gilt buying and a delay to quantitative tightening, we switched long gilts into 30-year swaps reducing our underweight in swaps.

Outlook

- The fund is marginally long duration at the end of the quarter through investments in shorter dated UK assets with yields close to 5%.
- We favour longs in the UK,US, semi core Europe and Japan relative to Germany where talk of quantitative tightening in Europe could see long-dated bunds underperform.
- The fund maintains a steepening bias in the UK and flattening in Europe where we expect the shorter end to underperform on a more hawkish ECB.
- The fund is overall neutral inflation but we anticipate moving to a long position with breakeven rates close to the years lows across the globe despite strong core inflation.
- Given extreme volatility and liquidity we are generally putting tactical trades on in smaller sizes to manage our overall risk, and awaiting further central bank and fiscal updates.

Additional information

- As we highlighted in our Annual Report, RLAM has ambitious targets for the next few years, notably in international growth as well as investment in infrastructure and people. This investment is to make sure that we continue to provide clients with the service they need and positioning us to for future regulation changes and market development.
- As part of that ambition, we are pleased to announce that we are moving to a new investment platform and have selected the industry leading 'Aladdin' platform. This decision has followed months of analysis and pre-implementation planning with the vendor BlackRock. Aladdin will help us improve our service offerings to our clients, as well as delivering operational efficiencies.
- As you would expect, implementation is an extended task, and the project is expected to complete in 2024, but we believe it is important to be transparent about such projects with our clients. Throughout the implementation, the project and management of your client portfolios will be closely monitored by our Board and Risk functions to ensure that this transition is achieved smoothly, and we will keep you updated on our progress. This is an important part of our long-term strategic goal to ensure that we continue to meet your needs today and into the future.



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