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RLPPC Index Linked Fund

Quarterly Investment Report

31 December 2023

Quarterly Report

The fund as at 31 December 2023

The purpose of this report is to provide an update on the RLPPC Index Linked Fund. The report has been produced by Royal London Asset Management. The report starts with a summary dashboard showing key information about the fund. A glossary is located at the end of the report covering the description of some of the more technical terms used within the report. All data is as at the report date unless otherwise stated.

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The fund

Fund performance objective and benchmark

To outperform its benchmark by 0.50% per annum net of fees (on a rolling three year basis). The RLPPC Index Linked Fund invests in a broad range of UK government index-linked bonds. The fund may also invest in index-linked credit bonds, overseas index-linked bonds and UK conventional government bonds.

Benchmark: FTSE Actuaries UK Index-Linked Gilts over 5 Years index

Fund value

	Total £m
31 December 2023	181.61

Asset allocation

	Fund (%)	Benchmark
Index linked gilts	98.08%	100.00%
Index linked foreign sovereign	1.59%	-
Conventional gilts	0.32%	-

Fund analytics

	Fund	Benchmark
Fund launch date	31 May 2000	
Base currency	GBP	
Duration (years)	18.54	18.36
Real yield (%)	0.96	0.70
Number of holdings	32	28

Performance and activity

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Quarter	10.76	10.53	0.22
1 Year	0.64	0.16	0.48
3 Years (p.a.)	(12.91)	(13.49)	0.58
5 Years (p.a.)	(4.35)	(4.92)	0.57
10 Years (p.a.)	2.39	1.94	0.45
Since inception (p.a.)	4.92	4.43	0.49

Past performance is not a guide to future performance. Please refer to the Glossary for the basis of calculation and impact of fees. Performance and since inception date based on RLPPC Index Linked Fund (Acc). Source: Royal London Asset Management; Gross performance; Since inception date of the shareclass is 31 May 2000.

Performance commentary

Performance was strong at a portfolio level during the quarter, although market moves on the last afternoon of the quarter meant that official fund performance was broadly in line with the benchmark – with this difference due to fund pricing at midday and index at close of business.

Our duration position was the main positive impact over the quarter, with yields falling sharply. We took a modest long duration position some time ago on the basis that yields had risen to very attractive levels. While this was a negative in October as yields rose as volatility increased due to the ongoing crisis in the Middle East, this effect unwound as the growing market expectation that central banks would be in rate-cutting mode in 2024 helped yields fall materially across most major markets.

Curve positioning was helpful over the quarter. Although we were long duration, the fund was underweight in ultra-long bonds which we felt offered little value, with a bias towards 20-year bonds. Higher yields have led to increased buy-out activity in the market, with pension funds effectively swapping portfolios of longer dated government bonds for portfolios of shorter dated credit. This helped the UK curve steepen over the period.

Our cross-market positioning produced modest positive results for performance, primarily due to long positions in the US and Australia.

Our inflation-linked strategies can move underweight inflation (selling linkers and buying conventionals) when market pricing presents opportunities. We traded syndications tactically, including a 2033 auction in October, have no strategic inflation position in the portfolio at present.

Performance and activity

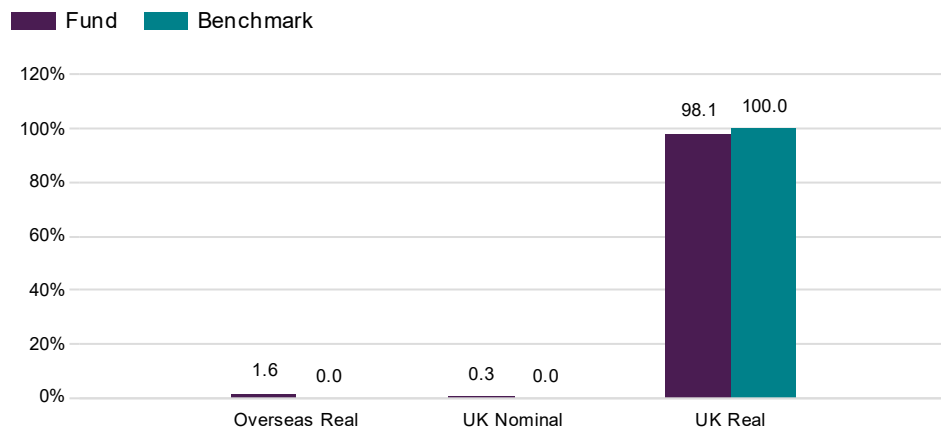
Fund activity

Activity during the quarter continued to look for tactical opportunities to benefit from market issuance and ongoing volatility, but the main focus during the period was duration. The surge lower in real yields late in 2023, coupled with the rise in issuance expected in 2024 meant that we started to trim our duration exposure in December, initially moving neutral but then moving to a short position by the end of the year.

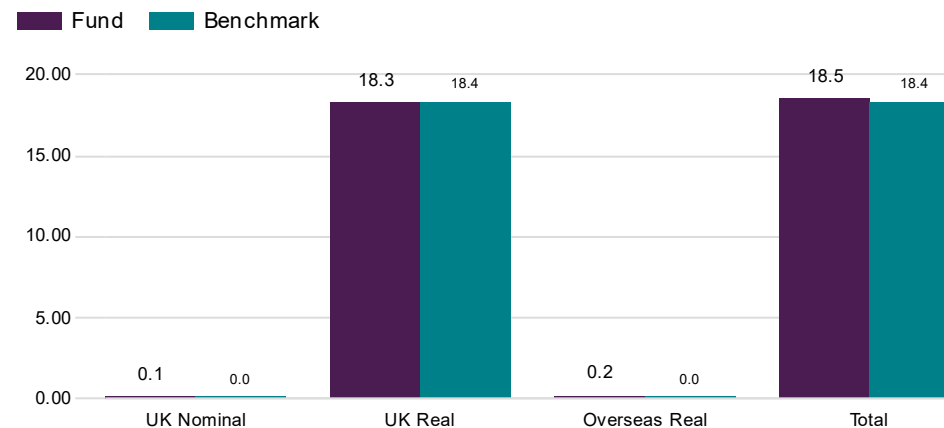
In cross market terms, after removing all non-UK exposure earlier in 2023, we were long US, Australia and core Europe. We retain a bias towards Australia: real yields are around 130bps higher than equivalents in the UK, which we view as attractive, and it has a more favourable supply outlook given that Australia's fiscal position, with a budget in near balance compared to many other developed countries. We also bought a new issue of 2039 Spanish index linked bond – the first since Covid – which came at a generous new issue premium and we took profits after strong performance.

Fund breakdown

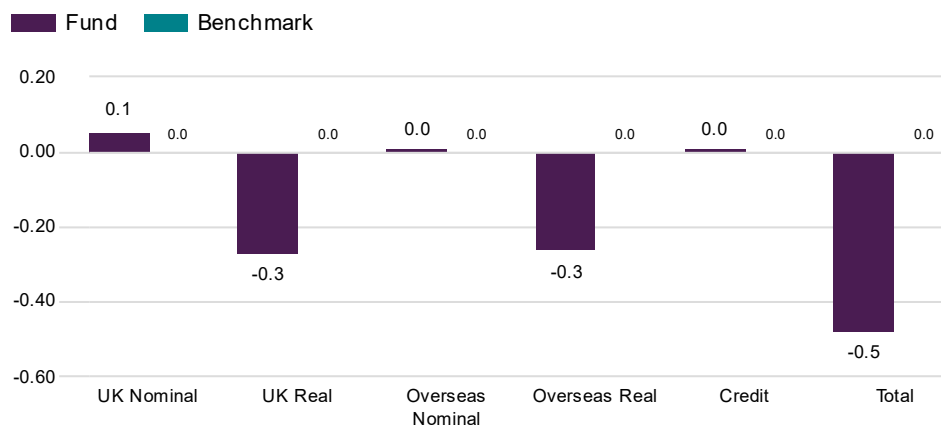
Asset split by percentage



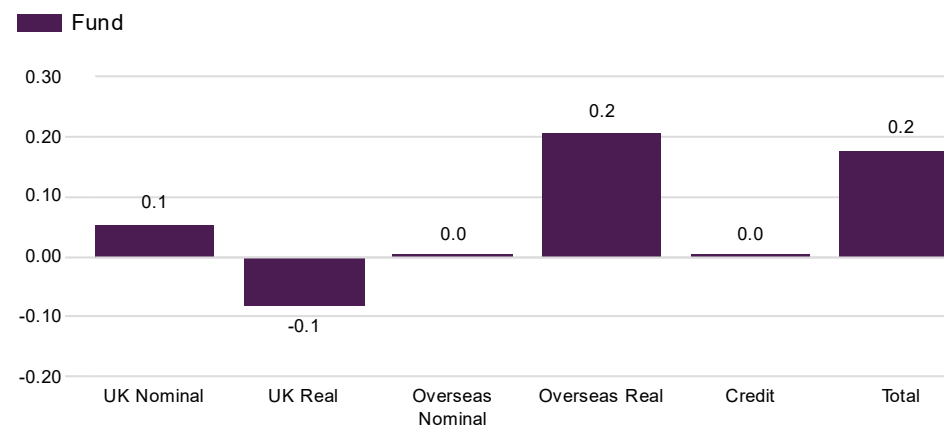
Asset split by duration



Asset split by duration change on quarter

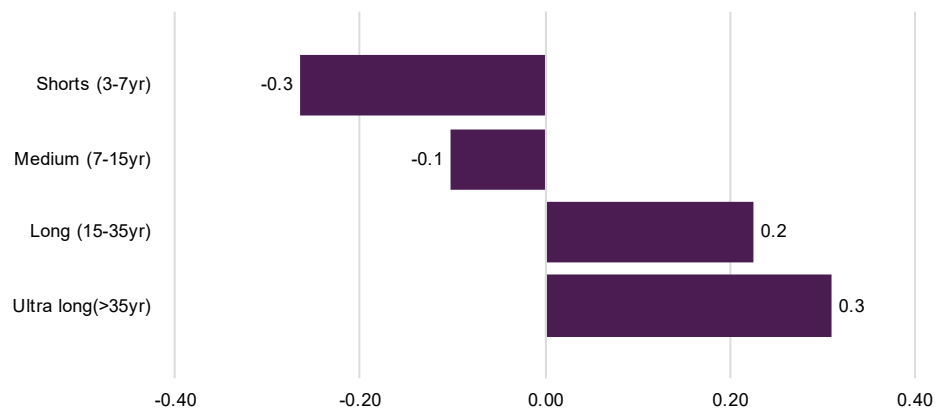


Asset allocation relative to benchmark (duration)

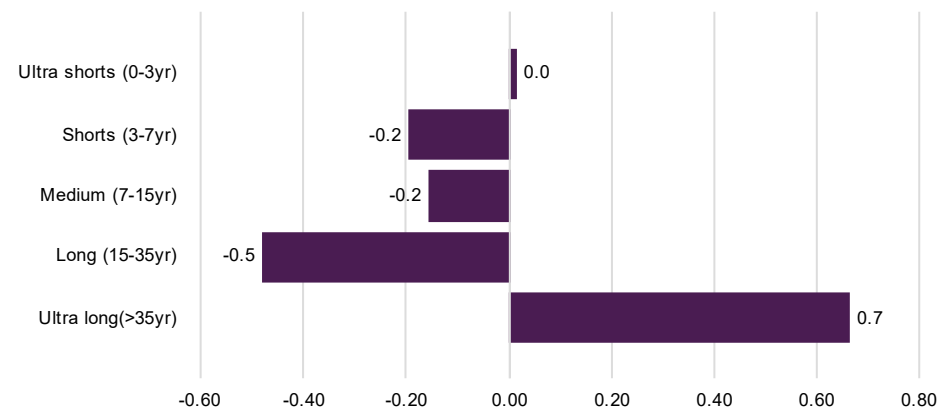


Fund breakdown

Maturity profile relative to benchmark

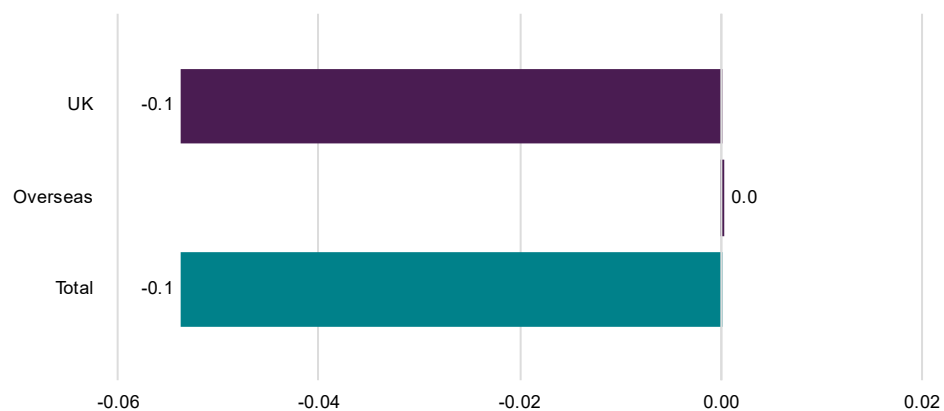


Maturity profile change on quarter

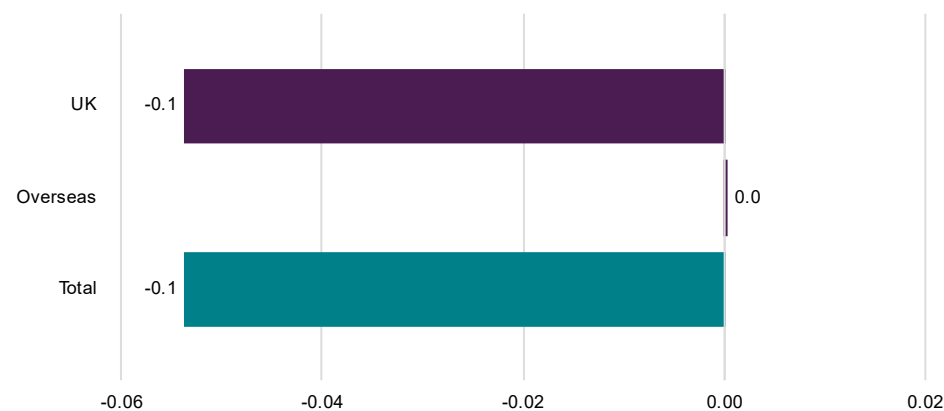


Exposure

Inflation exposure (duration)



Inflation exposure change on quarter (duration)



Market commentary

Market overview

Economic attention over the quarter has been on inflation. At the start of the quarter investors focussed on the persistence of large price increases and central bank messaging on rates being held higher for longer. Yet, as headline inflation fell, sentiment swung dramatically towards the end of the quarter, pushing markets to price in interest rate cuts in 2024. The Federal Reserve (Fed), European Central Bank (ECB) and Bank of England (BoE) all left rates unchanged over the quarter, maintaining official rates at multi-year highs. The Fed has now held rates unchanged at its last three meetings. There has however been a significant shift in messaging, with the US central bank now indicating that it expects to cut rates by 0.75% in 2024. The ECB has similarly kept rates steady at its two most recent meetings, but central bankers in the eurozone said that no rate cuts have yet been discussed.

In tune with the other major central banks, and potentially marking the high point in the UK interest rate cycle, the Bank of England left interest rates unchanged over the period. The Monetary Policy Committee continued to be split – at the December meeting three of the nine members were still voting for a rate hike. UK inflation has fallen significantly, with the annual inflation rate falling to 3.9% in November. This is the lowest rate of increase in over two years. However, this remains well above the BoE 2% target, with core and wage inflation significantly higher than the headline rate.

Data released in the UK in the fourth quarter painted a picture of sluggish economic activity, with falling inflation and more signs of softening underlying domestic inflationary pressure. Third quarter GDP fell 0.1% quarter-on-quarter after 0.0% quarter-on-quarter in the second quarter. PMI business survey data signalled some improvement in private sector activity though, with the composite PMI indicator rising back above the 50 'no growth' level. Inflation fell, and tended to surprise on the downside at headline level versus expectations: Year-on-year CPI inflation fell from 6.7% for the August release to 3.9% for the November release, largely due to year on year base effects. Core inflation fell from 6.2% to 5.1% over the same period. By the end of the quarter (the October data release) regular pay growth figures were showing more sign of slowing, at 7.3% for the 3-months to October (from 7.9% three-months earlier).

Global government bond yields continued their upward path at the start of the quarter– a trend that began in mid-2020, reflecting market views that rising inflation would necessitate higher interest rates. With inflation starting to come down, expectations of rate cuts in 2024 meant that bond yields fell in November and December, ending the quarter lower than they started, and ending 2023 at roughly the same levels as they started. In the US, 10-year treasury yields fell from 4.57% to 3.88%, falling back from 15-year highs to reverse virtually all of the rise seen in

the prior quarter, and ending the year only modestly higher despite rising for most of 2023. German 10-year bunds similarly saw material falls in the fourth quarter, falling from 2.84% to 2.01%.

The Fed kept rates on hold at 5.25-5.50% over the quarter against a still resilient labour market backdrop, but with inflation continuing to cool. As of the December meeting, the median forecast of voting regional bank governors had 75bp of cuts for 2024 with a further 100bp of cuts pencilled in for 2025. CPI inflation fell from 3.7% year-on-year in August, to 3.1% in November. That is still above June 2023 levels, but core continued a more consistent drift lower over the period.

UK index-linked markets performed strongly over the quarter, returning 8.72% (FTSE Actuaries All-maturities). Falling inflation and expectations of rate cuts in 2024 helped push real yields lower. UK 10-year real yields fell from 0.60% to 0.17% with 30-year real yields dropping from 1.48% to 0.95% while yields on US 10-year index-linked bonds fell from 2.23% to 1.76%.

Outlook

We believe that inflation will continue to drift lower in 2024, although it is likely to remain above target in most economies by the end of the year, particularly so in the UK, which appears more at risk of inflation becoming more embedded and persistent, than other G10 economies. Shallow recessions are possible but are unlikely to be deep enough at this stage to ease the excessive tightness seen in labour markets. As we approach 2024, central banks are at peak rates, and markets are preparing themselves for cuts, starting in the first half of 2024.

In the UK, the market is now assuming base rates have peaked at 5.25%, with the first cut priced in for the first half 2024 and falling to a terminal level of around 3.25% by late-2026. At one point in early July the market was pricing peak rates closer to 6.5%. Government bond markets have moved a long way during the last few months, particularly in the UK.

Breakevens globally have fallen sharply as inflation data weakened. However with labour markets remaining tight, average earnings high and geopolitical risk growing we think inflation could remain sticky supporting shorter dated index link bonds. The UK still remains expensive but we will look for better opportunities to sell UK breakevens.

Supply will be an issue for the UK market over the next few years, with around £200bn per annum forecast over each of the next five years, and four auctions and one syndication expected in the first quarter alone. Alongside quantitative tightening (where the BoE is selling its gilt holdings back into the market), this will represent a headwind for gilts, particularly given decreased demand for longer-dated assets from LDI investors.

Further Information

Please click on the links below for further information:



Find out more

Royal London Asset Management's Outlook 2024 document and podcasts are both available on our website. In this year's Outlook document, our fund managers assess the challenges and opportunities in their respective asset classes for 2024. With an environment of falling inflation and modest recession, the benefits or risk for equities or credit is not so clear cut and knowing your companies is key. We analyse the areas of concern and potential growth within this environment.

In our Outlook 2024 podcast, Piers Hillier, CIO, looks ahead to 2024 and discusses the issues he believes will be prominent over the next 12 months, and where the key investment risks and opportunities may lie.

Articles, videos and webinars explaining our investment thinking can be found in the Our Views section of www.rlam.com, including regular updates from our Fixed Income, Global Equity, Sustainable and Multi Asset teams.

Disclaimers

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Risks and Warnings

General Risks

The degree of investment risk depends on the fund you choose.

The prices of units can go down as well as up.

The return from your investment is not guaranteed; therefore, you may get back less or more than shown in the illustrations.

You may not get back the amount that you originally invested.

Past performance is not a guide to future return.

Inflation may, over time, reduce the value of your investments in real terms.

There may be a variation in performance between funds with similar objectives owing to the different assets selected.

Funds aiming for relatively high performance can incur greater risk than those adopting a more standard investment approach.

The use of derivatives in pursuit of a fund's objective may cause its risk profile to change and this may be material.

Fixed interest security risk

Fixed interest securities are particularly affected by trends in interest rates and inflation. If interest rates go up, the value of capital may fall, and vice versa. Inflation will also decrease the real value of capital. Unlike the income from a single fixed interest security, the level of income (yield) from a fund is not fixed and may go up and down. Bond yields (and as a consequence bond prices) are determined by market perception as to the appropriate level of yields given the economic background. Key determinants include economic growth prospects, inflation, the government's fiscal position, short-term interest rates and international market comparisons. The returns from bonds are fixed as at the time of purchase. Therefore the fixed coupon payable and the final redemption proceeds are known at the outset. This means that if a bond is held until its redemption date, the total return that could be expected is unaltered from its purchase date, subject to counterparty default (see 'Credit risk' below). However, over the life of a bond, the yield priced by the market (as opposed to actual fixed coupons payable) at any given time will depend on the market environment at that time. Therefore, a bond sold before its redemption date is likely to have a different price to its purchase price and a profit or loss may be incurred.

Derivatives risk for Efficient Portfolio Management:

Derivatives may be used by this Fund for the purpose of efficient portfolio management. This restricts the use of derivatives to the reduction of risk and the reduction of cost. Such transactions must be economically appropriate and the exposure fully covered.

Performance to 31 December 2023

Cumulative (%)

	3 Month	6 Month	1 Year	3 Years	5 Years	3 Years (p.a.)	5 Years (p.a.)
Fund (gross)	10.76	3.62	0.64	(33.94)	(19.95)	(12.91)	(4.35)
Fund (net)	10.68	3.47	0.36	(34.49)	(21.01)	(13.15)	(4.60)

Annualised (%)

Year on year performance (%)

	31/12/2022 - 31/12/2023	31/12/2021 - 31/12/2022	31/12/2020 - 31/12/2021	31/12/2019 - 31/12/2020	31/12/2018 - 31/12/2019
Fund (gross)	0.64	(37.32)	4.72	12.90	7.35
Fund (net)	0.36	(37.49)	4.43	12.61	7.08

Past performance is not a guide to future performance. The impact of fees or other charges including tax, where applicable, can be material on the performance of your investment.

Source: RLAM as at 31 December 2023. All figures are mid-price to mid-price in GBP for the RLPPC Index Linked Fund (Acc).

Glossary

Asset allocation

Breakdown of the assets by asset classes. Based on RLAM asset classification scheme.

Duration

Measure of sensitivity of a Fixed Income instrument to changes in interest rates, indicating the potential impact of interest rate fluctuations on the value of the investment.

Fund Analytics

All figures exclude cash. Credit bonds include non-sterling bonds and CDs where held within the fund or benchmark.

This is applicable to the following sections: fund Asset Allocation, Duration, Yield curve, Sector breakdown, Financial holdings, Credit ratings.

Fund value

Total value of the fund as of the last business day of the calendar month. The fund value is as at close of business and on a mid-price basis.

Number of holdings

Total number of unique holdings of the Fund excluding cash, currency and derivatives.

Performance

Performance is calculated using the daily end of day NAV per share produced by HSBC based on the mid price.

Real yield

Real yield shows the inflation-adjusted redemption yield for the underlying fund and therefore does not include the impact of fees. For share class level yields, please see the latest factsheet.