

For professional clients only, not suitable for retail clients.



# Royal London UK Government Bond 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 Royal London UK Government Bond 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.

# Contents

The fund	3
Performance and activity	4
Fund breakdown	6
Market commentary	8
Further information	10
Disclaimers	11
Performance net and gross	13
Glossary	14

# The fund

## Fund performance objective and benchmark

The fund's investment objective is to achieve a total return over the medium term (3-5 years) by investing at least 80% in UK government bonds, also known as gilts. The fund's performance target is to outperform, after the deduction of charges, the FTSE Actuaries UK Conventional Gilts (All Stocks) Total Return GBP Index (the "Index") over rolling 5-year periods. For further information on the fund's index, please refer to the Prospectus.

Benchmark: FTSE Actuaries UK Conventional Gilts (All Stocks) Total Return GBP Index

## Fund value

	Total £m
31 December 2023	909.64

## Asset allocation

	Fund (%)	Benchmark
Conventional gilts	95.04%	100.00%
Conventional credit bonds	2.11%	-
Money market instruments	1.60%	-
Conventional foreign sovereign	1.26%	-

## Fund analytics

	Fund	Benchmark
Fund launch date	30 January 1990	
Base currency	GBP	
Duration (years)	8.74	8.77
Gross redemption yield (%)	3.80	3.83
Number of holdings	40	62

# Performance and activity

## Performance

	Fund (%)	Benchmark (%)	Relative (%)
Quarter	8.78	8.11	0.67
1 Year	5.02	3.69	1.33
3 Years (p.a.)	(7.88)	(9.18)	1.31
5 Years (p.a.)	(1.74)	(2.81)	1.07
10 Years (p.a.)	1.43	1.13	0.30
Since inception (p.a.)	2.34	2.18	0.15

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 RL UK Government Bond Fund (Z Inc). Source: Royal London Asset Management; Gross performance; Since inception date of the shareclass is 30 April 2010.

## Performance commentary

The fund enjoyed a strong fourth quarter, outperforming its benchmark, which capped off an impressive year of outperformance.

The two key factors during the final quarter of the year was our duration and curve positioning. Our strategic decision to take the fund long duration versus its benchmark was beneficial to performance but we have slowly reduced this position – taking profit as yields fell. However, in the final few days of the period, we took the fund slightly short versus the benchmark.

We started the quarter just short of a year long, but reduced this position gradually to the point we ended marginally short. The position was a significant contributor to performance over the quarter. Volatile markets have also provided ample opportunity to add value through tactically trading duration around the core strategic long duration position.

The curve in gilt markets steepened in the fourth quarter – which benefited the fund's curve steepening bias. We remain overweight the front end of the gilt curve via 5-6 year maturity gilts.

# Performance and activity

## Fund activity

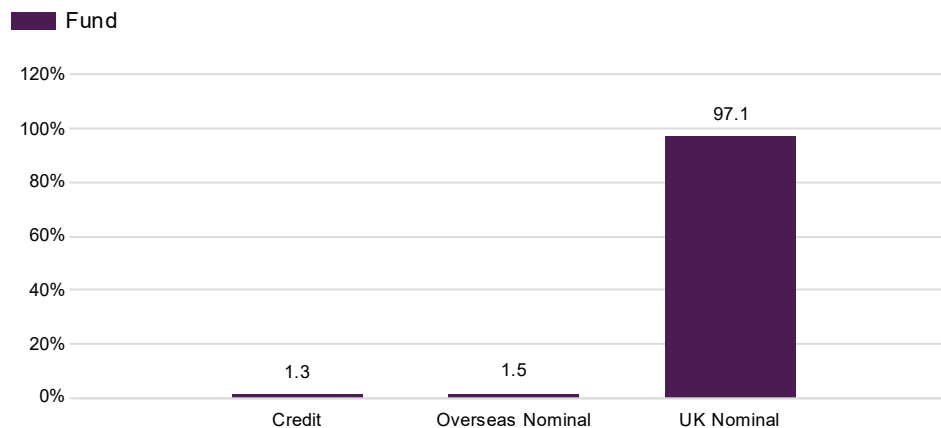
Gilt supply in 2024 is expected to be broadly similar to last year. In gross issuance terms the latest estimates show that around £1.5 trillion will be issued in the next five years – or around £120bn a year net when adjusting for redemptions. Supply is likely to be skewed towards short and medium maturities and away from long bonds and index linked gilts versus prior years, but not materially so. This tweak reflects declining demand for longer maturity gilt and index linked bonds. Nevertheless, the UK gilt market remains uniquely long-dated with a maturity of nearly thirteen years, compared with a global average of around nine years.

Our cross-market position was slightly negative for performance over the quarter as we had been overweight Aussie bonds which underperformed versus gilts. Although this was marginally detrimental to performance as yields on Australian bonds rose, we still view Australia as an attractive market to invest in at these yield levels, particularly in a global context.

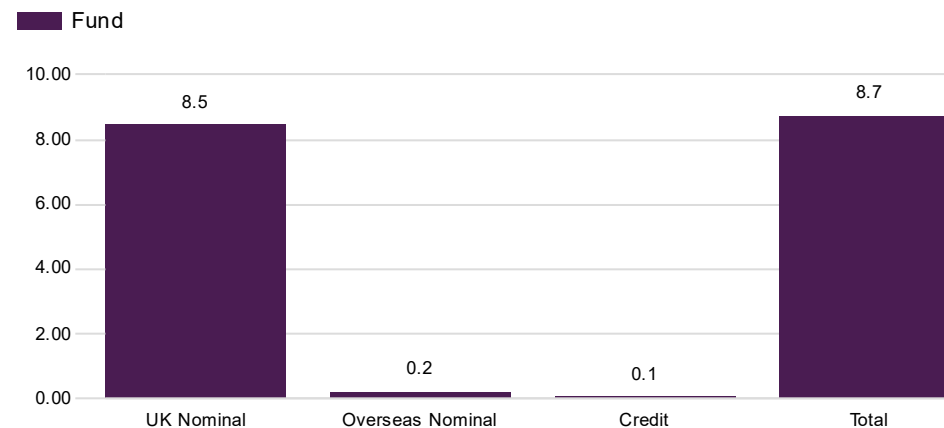
The fund has no inflation exposure.

# Fund breakdown

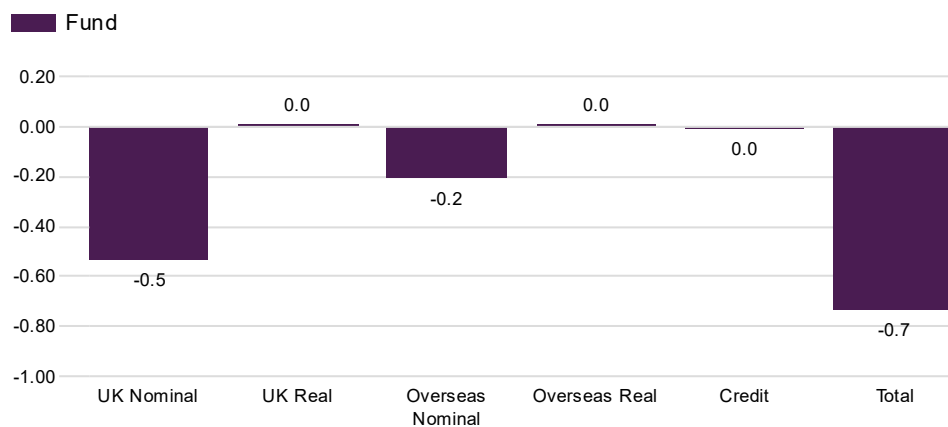
## Asset split by percentage



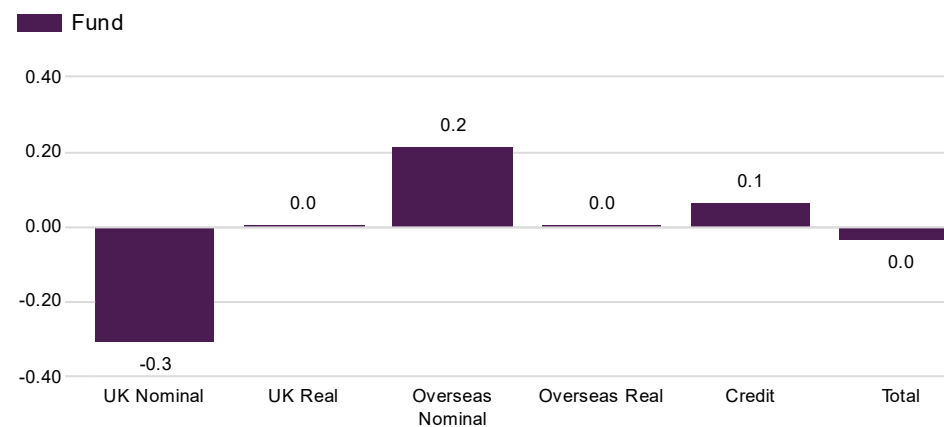
## Asset split by duration



## Asset split by duration change on quarter

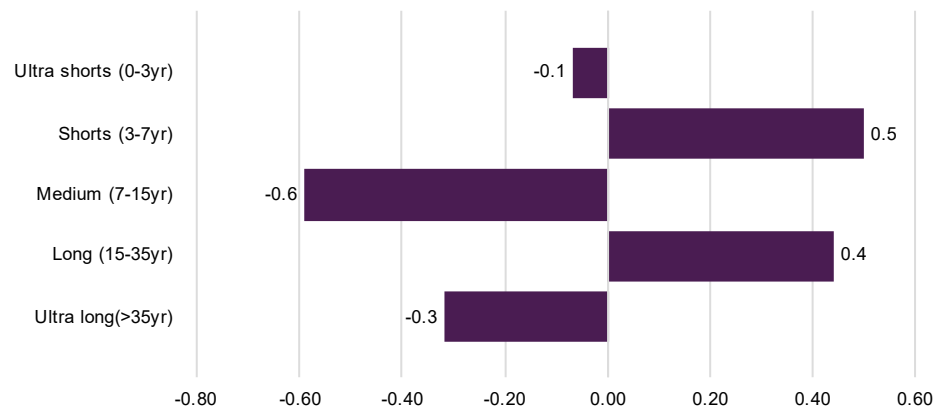


## Asset allocation relative to benchmark (duration)

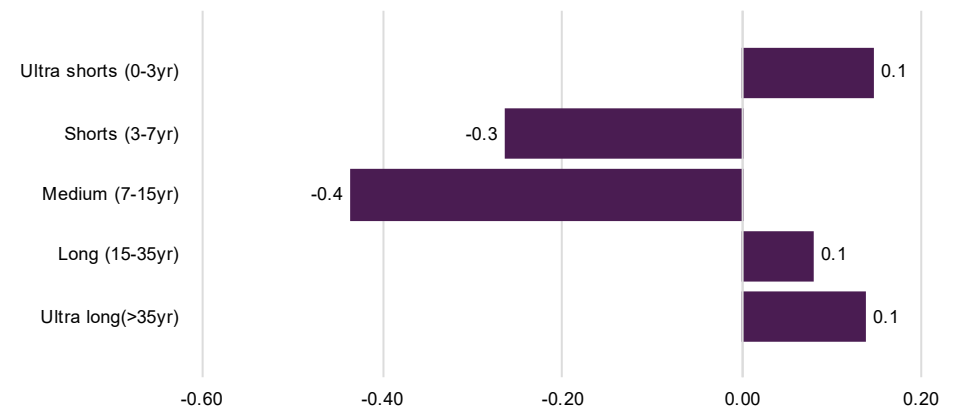


# Fund breakdown

## Maturity profile relative to benchmark



## Maturity profile change on quarter



# 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.

UK government bonds produced strong returns due to falling yields, delivering an 8.1% return (FTSE Actuaries) over the fourth quarter with the benchmark 10-year gilt yield falling from 4.44% to 3.54%. The falling yield environment was helpful for longer duration assets, with longer-dated bonds outperforming shorter-dated bonds in total return terms. However, when looking at changes in yields, 5-year maturity bonds were the best performing area, and the curve steepened.

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). The Autumn Statement saw

the Chancellor add more fiscal stimulus (tax cuts) than expected, spending the 'windfall' from the impact of high inflation on tax revenues.

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. Over the quarter, 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. The core PCE measure of inflation fell over the quarter and month-on-month was only 0.1% in November. Third quarter GDP recorded a strong 4.9% quarter-on-quarter annualised growth. More timely economic activity indicators were mixed over the fourth quarter. The House passed a spending package that pushed the effective next government spending deal/shutdown deadline into early 2024.

Over the fourth quarter, the ECB kept rates on hold. Going into the December meeting, various ECB speakers had already broached the topic of rate cuts, effectively opening the door for cuts in the second half of 2024 while pushing back on the chance of a near term cut. President Lagarde said that they did not discuss rate cuts in December and that “between hike and cut there is a whole plateau – a whole beach – of hold.” Euro area CPI fell to only 2.4% year-on-year in November from 5.2% in August. Core CPI fell sharply over the same period too to 3.6%. The euro area economy (GDP) shrank by 0.1% quarter-on-quarter in the third quarter after recording only 0.1% GDP growth in both the first quarter and the second quarter. Germany's constitutional court put hurdles in the way of additional German government spending, ruling against the transfer of borrowing authorised during Covid to the Climate Fund (that decision was taken in 2021), in the name of protecting Germany's constitutional debt brake.

The sterling investment grade credit market (iBoxx non-gilt index) returned 7.35% over the quarter, helped by lower government bond yields and tighter credit spreads. The underperformance compared to the gilt market is the result of the shorter duration of the credit market index. The average sterling investment grade credit spread (the average extra yield



# Market commentary

available from non-gilt bonds compared with government debt of equal maturity) tightened from 1.38% to 1.15% (iBoxx).

## 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 where five-year gilts have fallen significantly from their summer peak.

Supply will be an issue for the market over the next few years, with around £200bn per annum forecast over each of the next five years. Alongside quantitative tightening (where the BoE is selling its gilt holdings back into the market), this will represent a headwind for gilts. However, when considering gilts in a global context, we believe the gilt market is somewhat priced for this.

## 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](http://www.rlam.com), including regular updates from our Fixed Income, Global Equity, Sustainable and Multi Asset teams.

# Disclaimers

## Important information

For professional clients only, not suitable for retail clients.

This is a financial promotion and is not investment advice.

Telephone calls may be recorded. For further information please see the Privacy Policy at [www.rlam.com](http://www.rlam.com).

Issued in January 2024 by Royal London Asset Management Limited, 80 Fenchurch Street, London EC3M 4BY. Authorised and regulated by the Financial Conduct Authority, firm reference number 141665. A subsidiary of The Royal London Mutual Insurance Society Limited.

The Fund is a sub-fund of Royal London Bond Funds ICVC, an open-ended investment company with variable capital with segregated liability between sub-funds, incorporated in England and Wales under registered number IC000797.

The Authorised Corporate Director (ACD) is Royal London Unit Trust Managers Limited, authorised and regulated by the Financial Conduct Authority, with firm reference number 144037.

For more information on the fund or the risks of investing, please refer to the Prospectus or Key Investor Information Document (KIID), available via the relevant Fund Information page on [www.rlam.com](http://www.rlam.com).

FTSE indexes and data are an intellectual property of FTSE International Limited ("FTSE"). "FTSE®" is a trade mark of the London Stock Exchange Group companies and is used by FTSE under licence. The Index is calculated by FTSE or its agent.

FTSE makes no claim, prediction, warranty or representation either as to the results to be obtained from the Fund or the suitability of the Index for the purpose to which it is being put by Royal London Asset Management.

# Risks and Warnings

## Investment Risk

The value of investments and any income from them may go down as well as up and is not guaranteed. Investors may not get back the amount invested.

## Concentration risk

The price of Funds that invest in a reduced number of holdings, sectors, or geographical areas may be more heavily affected by events that influence the stockmarket and therefore more volatile.

## Credit Risk

Should the issuer of a fixed income security become unable to make income or capital payments, or their rating is downgraded, the value of that investment will fall. Fixed income securities that have a lower credit rating can pay a higher level of income and have an increased risk of default.

## EPM Techniques

The Fund may engage in EPM techniques including holdings of derivative instruments. Whilst intended to reduce risk, the use of these instruments may expose the Fund to increased price volatility.

## Interest Rate 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.

## Counterparty Risk

The insolvency of any institutions providing services such as safekeeping of assets or acting as counterparty to derivatives or other instruments, may expose the Fund to financial loss.

## Government and Public Securities Risk

The Fund can invest more than 35% of net assets in different Transferable Securities and Money Market Instruments issued or guaranteed by any EEA State, its local authorities, a third country or public international bodies of which one or more EEA States are members.

## Charges from Capital Risk

Charges are taken from the capital of the Fund. Whilst this increases the yield, it also has the effect of reducing the potential for capital growth.

# Performance to 31 December 2023

## Cumulative (%)

	3 Month	6 Month	1 Year	3 Years	5 Years	3 Years (p.a.)	5 Years (p.a.)
<b>Fund (gross)</b>	8.78	8.63	5.02	(21.81)	(8.41)	(7.88)	(1.74)
<b>Fund (net)</b>	8.71	8.50	4.76	(22.49)	(9.80)	(8.14)	(2.04)

## 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
<b>Fund (gross)</b>	5.02	(21.89)	(4.68)	9.34	7.14
<b>Fund (net)</b>	4.76	(22.10)	(5.02)	8.96	6.81

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 RL UK Government Bond Fund (Z Inc).

# 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.

## Gross redemption yield

Gross redemption yield is the rate of discount at which a bond's future obligations of interest and capital payments equates to its current price. The gross redemption yield shown for the fund is the average for its individual holdings, weighted by their current value, net of relevant fund management costs and gross of tax.

## 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.