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Royal London Index Linked Fund

Quarterly Investment Report

30 September 2023

Quarterly Report

The fund as at 30 September 2023

The purpose of this report is to provide an update on the Royal London 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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ROYAL LONDON
ASSET MANAGEMENT

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 index-linked bonds issued by the UK government, known as gilts. The fund's performance target is to outperform, after the deduction of charges, the FTSE Actuaries UK Index Linked Gilts (All Stocks) Total Return GBP Index (the "Index") over a rolling 5-year period. For further information on the fund's index, please refer to the Prospectus.

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

Fund value

	Total £m
30 September 2023	416.19

Asset allocation

	Fund (%)	Benchmark
Index linked gilts	95.32%	100.00%
Index linked foreign sovereign	3.48%	-
Index linked credit bonds	1.20%	-

Fund analytics

	Fund	Benchmark
Fund launch date	30 April 2010	
Base currency	GBP	
Duration (years)	15.24	14.57
Real yield (%)	1.10	1.09
Number of holdings	37	33

Performance and activity

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Quarter	(3.35)	(4.69)	1.34
YTD	(6.95)	(7.16)	0.21
1 Year	(7.72)	(12.75)	5.03
3 Years (p.a.)	(13.27)	(13.38)	0.11
5 Years (p.a.)	(4.51)	(5.02)	0.51
10 Years (p.a.)	1.63	1.18	0.45
Since inception (p.a.)	3.42	2.87	0.55

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 Index Linked Fund (M Inc). Source: Royal London Asset Management; Gross performance; Since inception date of the shareclass is 30 April 2010.

Performance commentary

Performance was ahead of benchmark over the quarter, with rising yields leading to negative absolute returns. As ever, it is worth noting that market moves the last day of the quarter can distort like for like returns between funds priced at midday and benchmarks priced at 4.15pm.

The trend of short-dated index linked bonds outperforming continued in the third quarter. Generally speaking, sub-10 year bonds delivered positive returns – the short end of the curve being supported by the belief that the peak in rates was near, as well as inflation being stickier than many had expected – the high spot inflation helping short-dated bonds provide high carry. Long-dated bonds performed poorly in most markets: markets can see a lot of supply coming down the line and demand remained weak for long-dated assets with LDI buyers notably quiet in both the UK and Europe.

Duration was the main negative over the quarter. With yields haven risen in the early months of the year we felt that yields were at attractive levels and took our duration positioning long as we came into the summer. With yields rising further over the quarter, this was negative for relative returns.

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. Curves were steeper over the quarter, with ultra-longs notably underperforming, and hence this positioning helped relative performance.

Cross-market positioning again added value over the quarter. We started the quarter with no non-UK exposure, reflecting our view that the UK offered value after a long period of underperformance. We traded both US and France on a tactical basis over the quarter, adding short-dated France after these underperformed early in the quarter and subsequently taking profits. In the US, we were more active in longer-dated TIPS, with this helpful early in the quarter but negative late on as US real yields rose sharply to their highest levels since the financial crisis.

Our inflation-linked strategies can move underweight inflation (selling linkers and buying conventionals) when market pricing presents opportunities. We traded syndications tactically but have a bias towards short inflation positioning as we felt that breakevens were higher than fundamentals justify, without hitting levels that justify an outright short position. One example during the quarter was the sale of 10-year breakevens ahead of the August auction of a 2033 index linked gilt, closing the position at a small profit.

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 looking for opportunities to add to duration. Over the quarter we increased our long position selectively. This reflects our view that real yields globally are now looking more attractive, and that after a sustained multi-year your period where duration positioning has often been either short or very short, there is now value in locking in real yields at these levels.

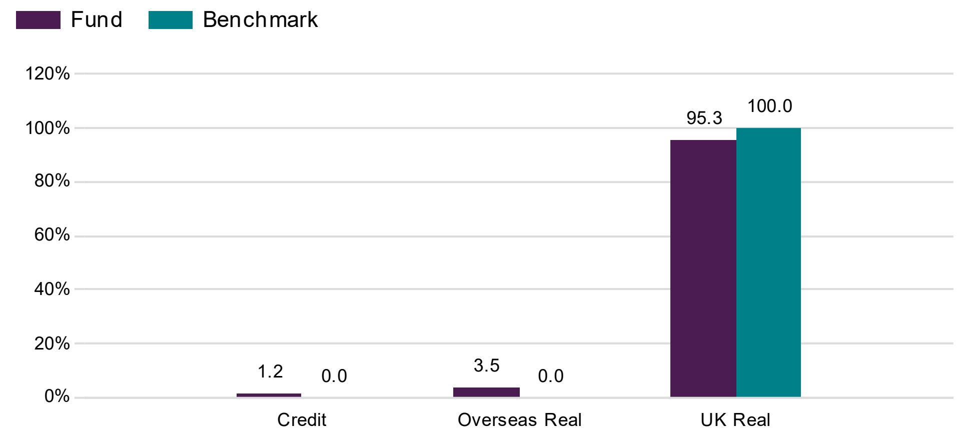
This has driven increased exposure to markets such as the US or Australia – where positioning is less driven by a relative judgement of value vs the UK, but more by levels in these markets looking attractive on a fundamental basis now that these are at multi-year highs.

Curve positioning generally moved longer during the quarter. In the UK, there is no issuance in the 20-year part of the curve and hence we were more comfortable adding to exposure here.

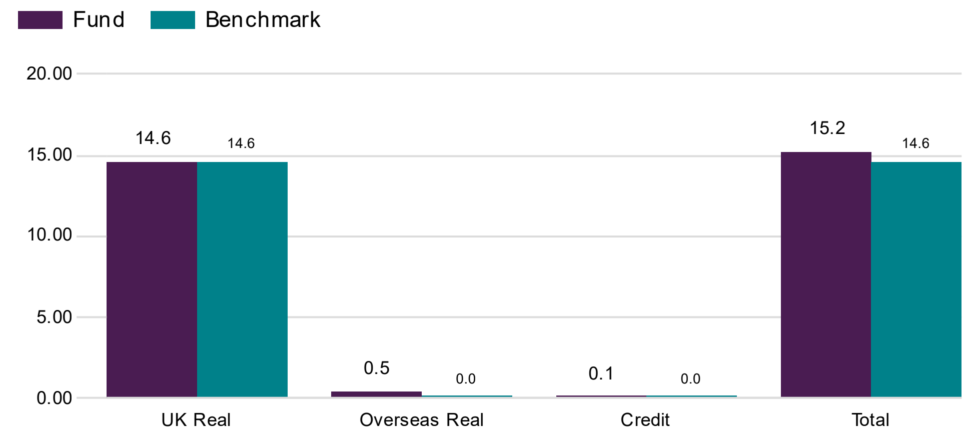
Cross market activity has been relatively muted, given our focus on duration. We do think that Australian and US markets look attractive and also added France late in the quarter, but activity is likely to be driven by pockets of value in these markets rather than outright country views.

Fund breakdown

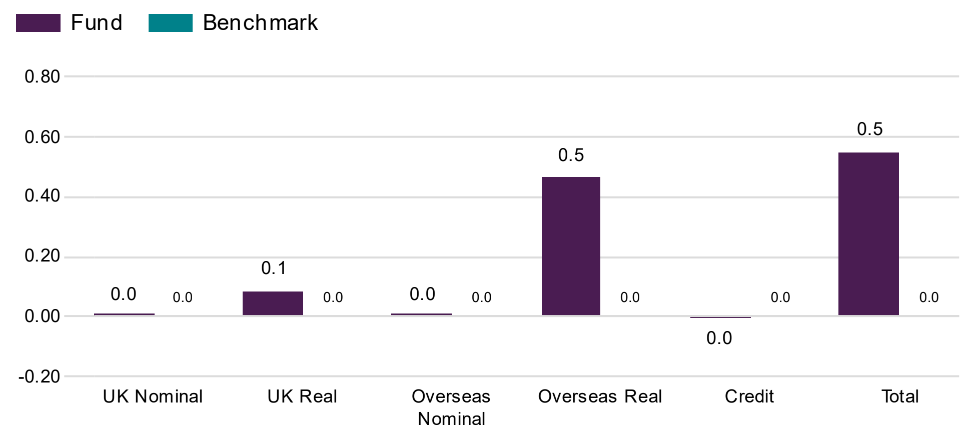
Asset split by percentage



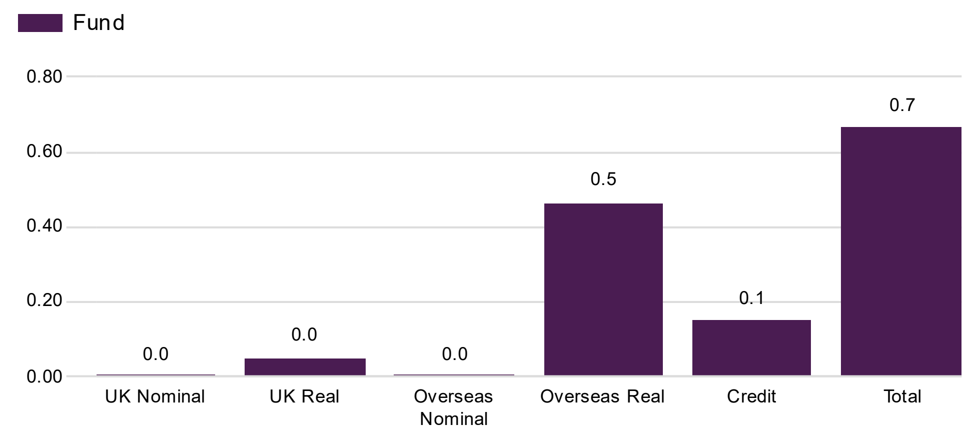
Asset split by duration



Asset split by duration change on quarter

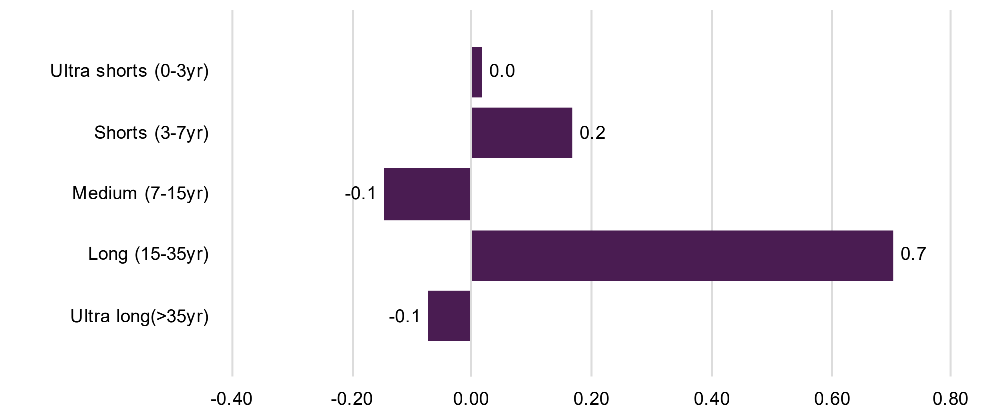


Asset allocation relative to benchmark (duration)

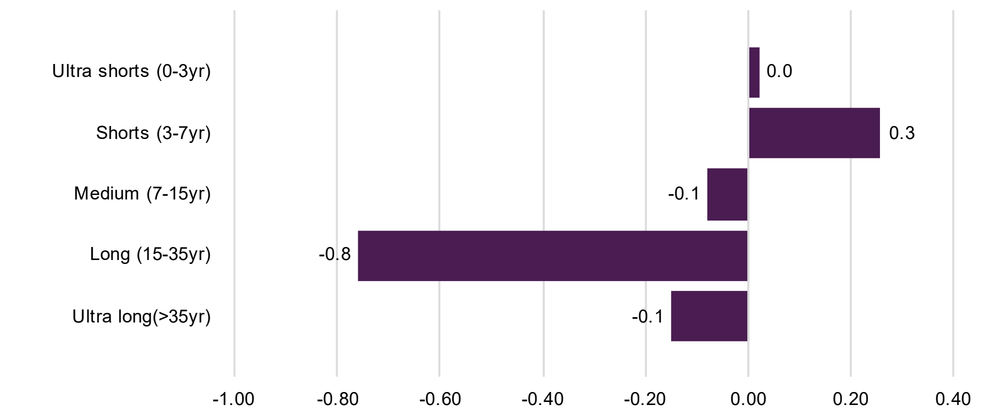


Fund breakdown

Maturity profile relative to benchmark

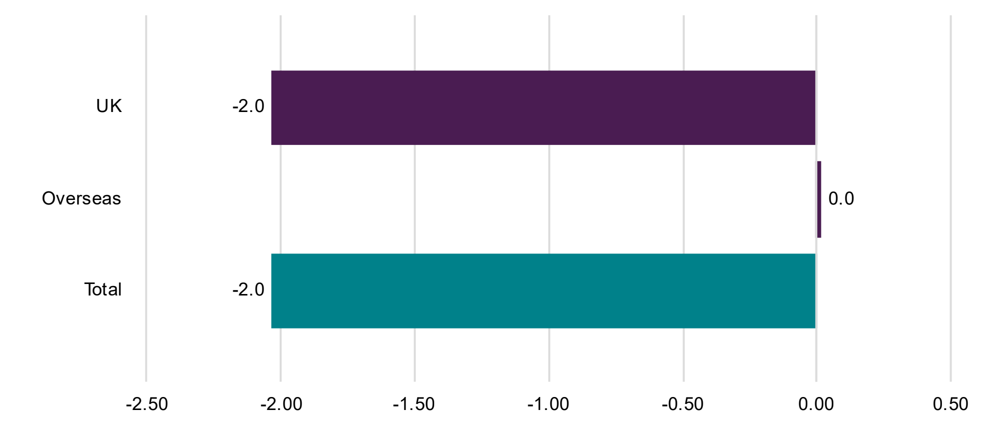


Maturity profile change on quarter

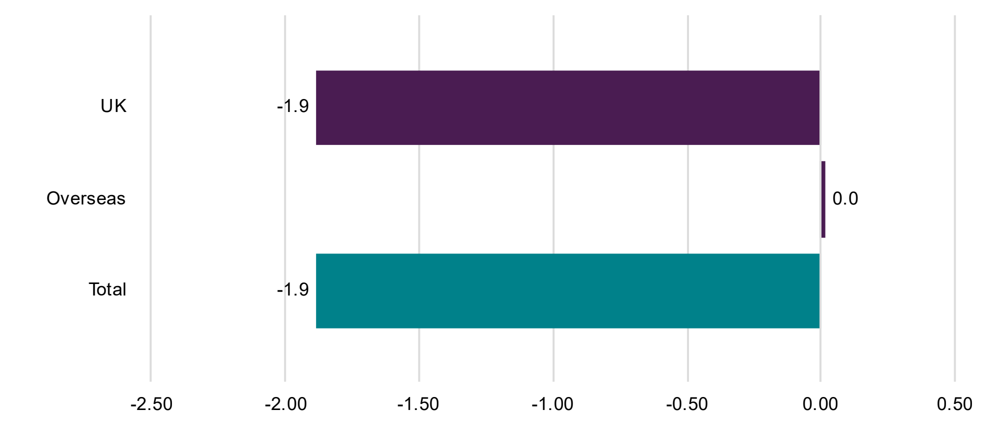


Exposure

Inflation exposure (duration)



Inflation exposure change on quarter (duration)



Market commentary

Market overview

The third quarter was characterised by mixed data around the world, with central banks coming towards the end of their rate hiking path, but with cuts still seemingly a while away. The global economic picture is rosier now than it was at the start of the year, but global growth is spluttering again amid a disappointing bounce in China activity, slow-to-no growth in Europe and against a backdrop of restrictive monetary policy. The US still looks at risk of recession too, even if activity data to date has been fairly robust.

Inflation has fallen significantly and, although higher energy prices threaten a widespread revival in headline inflation, other factors – including a weak economic activity backdrop – should pull inflation lower still. With taming inflation still the priority for central banks, there is still a possibility of further rate hikes from the Federal Reserve (Fed), European Central Bank (ECB) and Bank of England (BoE), but peak rates look to be near, with real rates now well into positive territory.

The outlook is still lacklustre in the UK. A technical recession is still assumed for the UK in the next 12 months, but a modest one. Inflation should fall significantly at headline level, but domestically driven inflation continues to look strong, despite higher interest rates.

In the US, the real economy has been surprisingly resilient in the face of tighter credit conditions. However, the fourth quarter looks set to see a few growth challenges, monetary policy is restrictive and employment growth has slowed.

The euro area economy may already be in mild recession and forecasts continue to pencil one in. Business surveys have deteriorated and look consistent with falling private sector output. Tighter monetary policy will still be feeding through to the real economy. High domestically driven inflation continues to point to the balance of risks being in the direction of further hikes.

Global government bond markets continued to see yields move higher – a trend that started in mid-2020, reflecting market views that rising inflation would necessitate higher interest rates and that the central banks and governments would ultimately have to withdraw the support measures put in place during the global financial crisis and then used further to help mitigate the economic impact of Covid. With the end of the rate rising cycle possibly in sight, but issuance expected to remain high, markets have become more volatile.

UK government bonds struggled, being impacted by the higher-than-expected inflation print. Gilts delivered a -0.63% return (FTSE Actuaries) over the third quarter with the benchmark 10-year gilt yield rising to 4.44% from 4.39% but pulled back from a 4.75% high seen in mid-August. There was a marked difference in maturities, with short-dated bonds materially outperforming longer-dated bonds, as expectations that rates may be at a peak helped short-dated bonds start to anticipate cuts in late 2024, while longer-dated bonds remained weak due to concerns about the long-term inflation environment and significant gilt supply. In the US, 10-year treasury yields rose to 4.57% from 3.84%, hitting heights not seen in fifteen years, while in Germany the 10-year bund yield increased to 2.84% from 2.39%.

UK index-linked markets significantly underperformed on a global basis, returning -4.69% (FTSE Actuaries) in the third quarter. Real yields on UK 10-year bonds saw a rise over the period, ending the quarter at 0.60%, up from 0.52%. On longer-term bonds, 30-year real yields increased 53bps to 1.48%. Yields on US 10-year index-linked bonds increased to 2.23% from 1.61%, while its German counterpart saw yields rise to 0.45% from 0.07%.

Outlook

We expect the downward trend in inflation to continue through the rest of 2023, as energy and food price increases moderate and sluggish GDP weakens the labour market. Nonetheless, UK interest rates are likely to rise further as the BoE continues to focus on bringing inflation under control.

We believe that whilst inflation will fall sharply this year, its likely to remain well above target in most economies by the end of the year, and particularly so in the UK. Shallow recessions are possible but are unlikely to be deep enough at this stage to ease the excessive tightness seen in labour markets. As a result, base rates will continue to trend higher, albeit at a much slower pace than over the last 18 months and are unlikely to be cut anytime soon.

In the UK, the market is now expecting base rates to peak around 5.4% later this year, before being cut in late 2024, and falling to a terminal level of around 4.25% by mid-2027. At one point in early July the market was pricing peak rates closer to 6.5%.

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 and we see similar impacts affecting other government bond markets.

Despite the impact of supply, with the peak of interest rates near and with real yields have risen considerably in recent months across most major government bond markets, we believe that yields are beginning to offer long-term value. At the margin, we are therefore looking for

Market commentary

opportunities to add duration to portfolios, using market volatility or weakness as attractive entry points.

Further Information

Please click on the links below for further information:

Stewardship and responsible investment at RLAM

TCFD climate report

Find out more

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. Notable publications in the third quarter include our annual Climate Report, as well as our annual Assessment of Value reports, available from the home page of www.rlam.com.

Disclaimers

Important information

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Issued in October 2023 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.

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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.

Liquidity Risk

In difficult market conditions the value of certain fund investments may be difficult to value and harder to sell, or sell at a fair price, resulting in unpredictable falls in the value of your holding.

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.

Performance to 30 September 2023

Cumulative (%)

	3 Month	6 Month	1 Year	3 Years	5 Years
Fund (gross)	(3.35)	(11.29)	(7.72)	(34.77)	(20.63)
Fund (net)	(3.43)	(11.43)	(8.00)	(35.41)	(21.91)

Annualised (%)

3 Years (p.a.)	5 Years (p.a.)
(13.27)	(4.51)
(13.56)	(4.82)

Year on year performance (%)

	30/09/2022 - 30/09/2023	30/09/2021 - 30/09/2022	30/09/2020 - 30/09/2021	30/09/2019 - 30/09/2020	30/09/2018 - 30/09/2019
Fund (gross)	(7.72)	(29.05)	(0.37)	2.37	18.87
Fund (net)	(8.00)	(29.28)	(0.73)	2.00	18.53

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 30 September 2023. All figures are mid-price to mid-price in GBP for the RL Index Linked Fund (M 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.

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.