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Royal London International Government Bond 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 International 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

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 government bonds globally. The fund’s performance target is to outperform, after the deduction of charges, the JP Morgan Global Bond Index ex UK (Traded) Total Return (GBP hedged) Index (the "Index") over rolling 5-year periods. For further information on the fund's index, please refer to the Prospectus.

Benchmark: JP Morgan Global Bond Index ex UK (Traded) Total Return (GBP hedged) Index

Fund value

	Total £m
30 September 2023	916.53

Asset allocation

	Fund (%)	Benchmark
Conventional foreign sovereign	92.41%	100.00%
Index linked foreign sovereign	7.59%	-

Fund analytics

	Fund	Benchmark
Fund launch date	1 November 2011	
Base currency	GBP	
Duration (years)	6.61	6.54
Real yield (%)	1.66	1.56
Number of holdings	109	1,001

Performance and activity

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Quarter	(2.07)	(2.59)	0.51
YTD	0.21	(0.20)	0.42
1 Year	(0.33)	(0.71)	0.39
3 Years (p.a.)	(3.87)	(5.03)	1.16
5 Years (p.a.)	0.31	(0.47)	0.78
10 Years (p.a.)	1.31	1.05	0.26
Since inception (p.a.)	1.54	1.36	0.18

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 International Government Bond Fund (M Inc). Source: Royal London Asset Management; Gross performance; Since inception date of the shareclass is 4 November 2011.

Performance commentary

The fund saw a negative total return in the third quarter but outperformed its benchmark in the period. The fund is also ahead of the benchmark year-to-date. Our duration positioning was a positive contributor to fund performance over the quarter, particularly so in July, as the fund ran an underweight exposure in a rising yield environment.

The fund started the quarter 0.34yrs shorter than the benchmark but moved to a long position of 0.35yrs by the end the quarter, gradually adding duration as yields rose across all markets, albeit to varying degrees. The shift to a neutral duration position largely took place in July, as the fund reduced underweight exposures in Italy, the US and Canada in addition to trimming our Japan underweight. The Japanese market sold off as a result of comments from the Bank of Japan regarding a potential tightening of their loose monetary policy, which is now at odds with every other major central bank.

Aside from the US, yields held pretty steady throughout the course of August and we continued to run a neutral duration position. Over the course of September, the fund's relative duration moved long as the bond sell-off resumed. The weakness was particularly marked in the US and Europe as the Fed and ECB, respectively, guided the market toward policy rates being higher for longer, in the face of stubbornly high inflation prints and reasonably robust economic data. This increase in fund duration, was achieved through adding to longs in semi-core Europe, reducing underweights in Italy and Germany and moving to a long duration position in the US as yields reached multi-year highs.

The fund remains underweight Japan, has an overweight to dollar block duration (largely in the US) and is overweight Europe. Within our Europe position, we are underweight Core and overweight semi-core and Peripheral Europe.

The fund's inflation positioning remains relatively light in the portfolio, as many markets look, at best, fair value and a number remain overvalued, in our view. One market where we believe value does exist is the five-year US inflation market, where we entered into a moderate sized position in early September at a break-even level of around 2.25%. This is marginally higher than the Fed's 2% target, but with inflation proving to be "sticky", alongside potential headwinds to getting further reductions, we're happy to be long inflation at these levels.

The fund maintains relatively small holdings in short-dated Japanese and Italian index linked bonds, both of which had a negligible impact on performance over the quarter.

Performance and activity

Fund activity

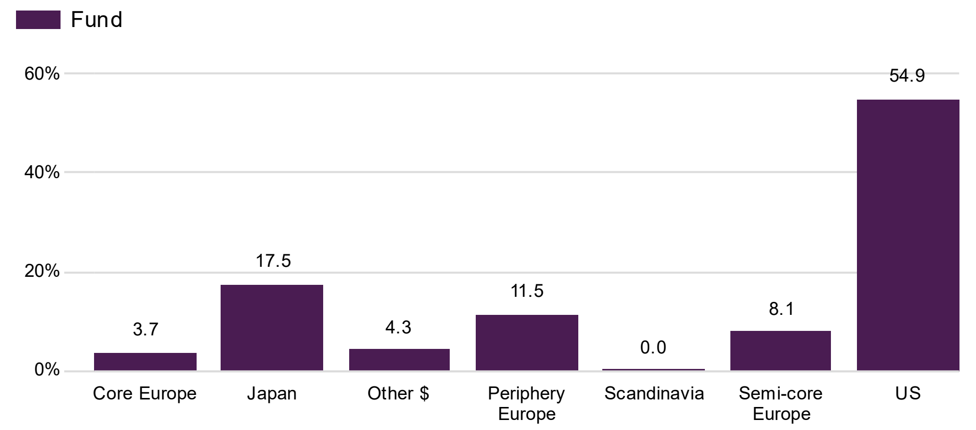
The major curve position within the fund remains a curve steepener within the US, with the fund being underweight the 30-year part of the curve and overweight the five-year area. The fund has held this position over the past couple of quarters as we believed the US curve would further struggle to remain inverted, given the actions and rhetoric of the Fed. This has proved to be the case from the end of the second quarter to the end of the third quarter. Within the period, however, there was large volatility in curve positioning as the market reacted to data prints, policy rate changes and central bank commentary. Overall, the US curve positioning added to performance, but we maintain that there is still scope for additional steepening in the coming months, whilst recognising the path to this is unlikely to be particularly smooth.

In Europe, yield curves also steepened over the quarter, again with volatility, though our exposure to European curve moves was reasonably light (having exited curve flatteners in French government bonds early in the quarter), and hence had an insignificant impact on performance.

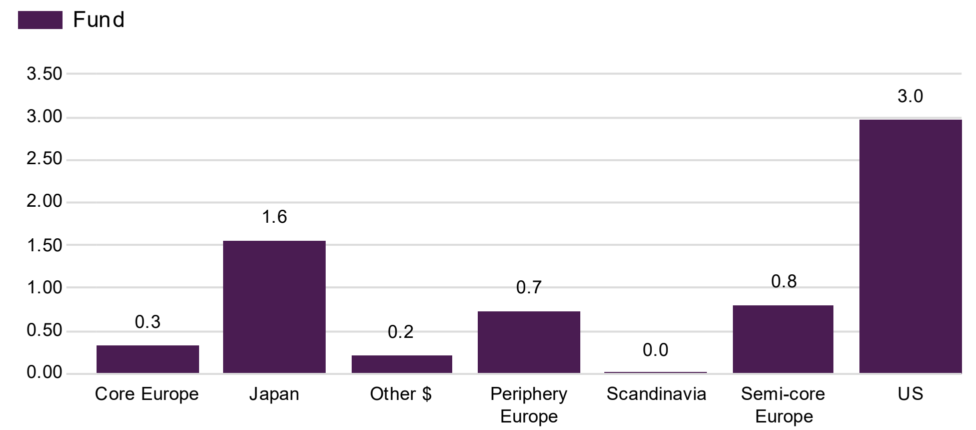
Our cross-market strategy was particularly active during the quarter, with opportunities presenting themselves as the pace of central bank policy tightening, (and associated guidance), varied across markets. Early in the quarter, the fund added to an off-benchmark position in UK gilts, following a period of underperformance from the UK market, with yields in excess of 5%. As the UK market recovered, these were switched in equivalent maturity French government bonds. Another example of a cross market trade undertaken during the quarter was a switch out of 30-year Italian government Bonds into 30-year Australian government bonds, with the yield differential between the two markets reaching very stretched levels. This proved to be a successful trade, with the spread subsequently correcting by around 20bps. Other examples of cross market activity over the quarter include Belgium into France, Australia into the US, followed by the US into Canada.

Fund breakdown

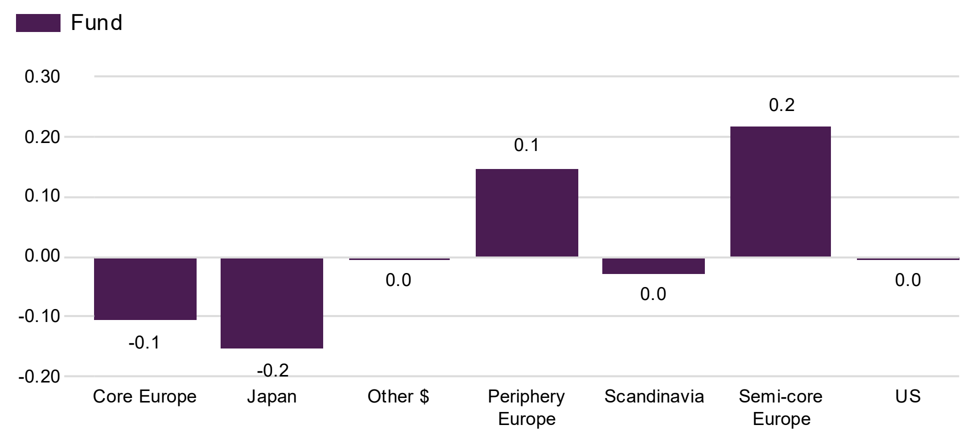
Geographic split by % weight



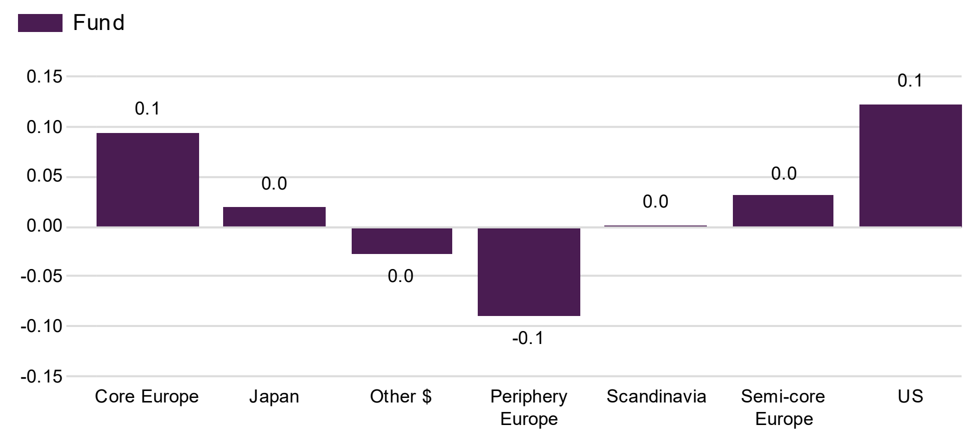
Geographic split by duration



Duration position relative to benchmark

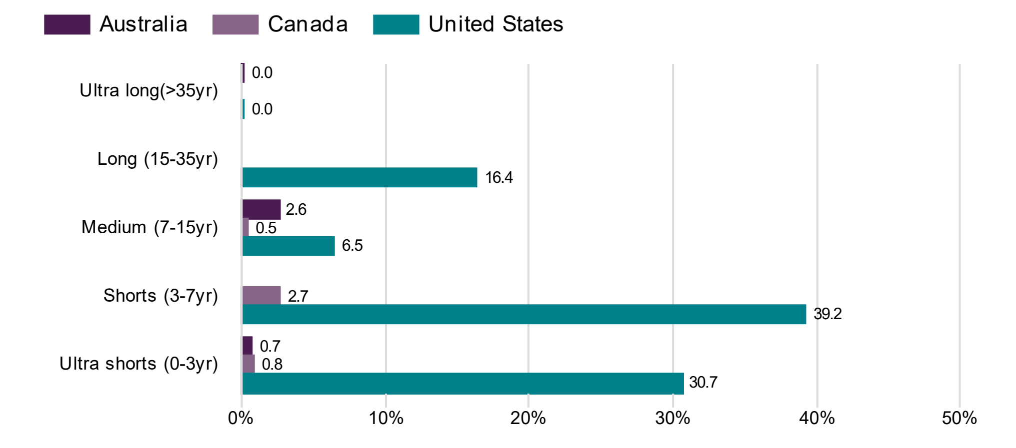


Relative duration quarter on quarter

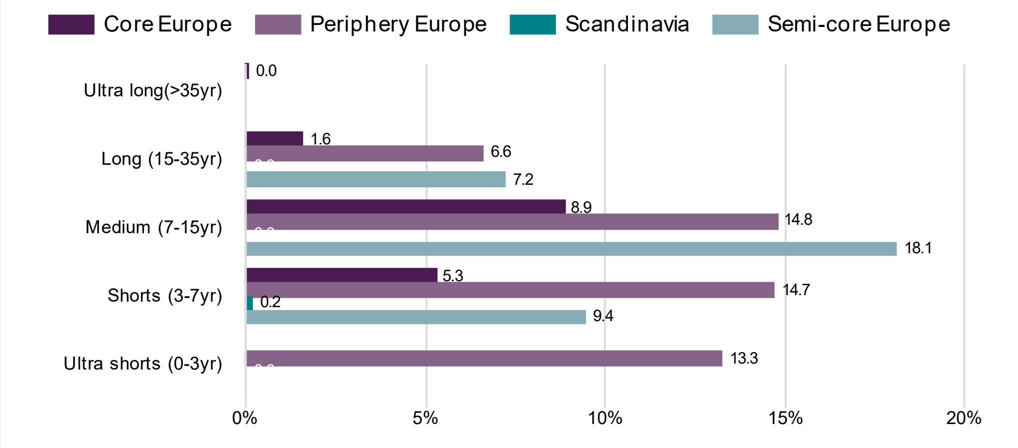


Fund breakdown

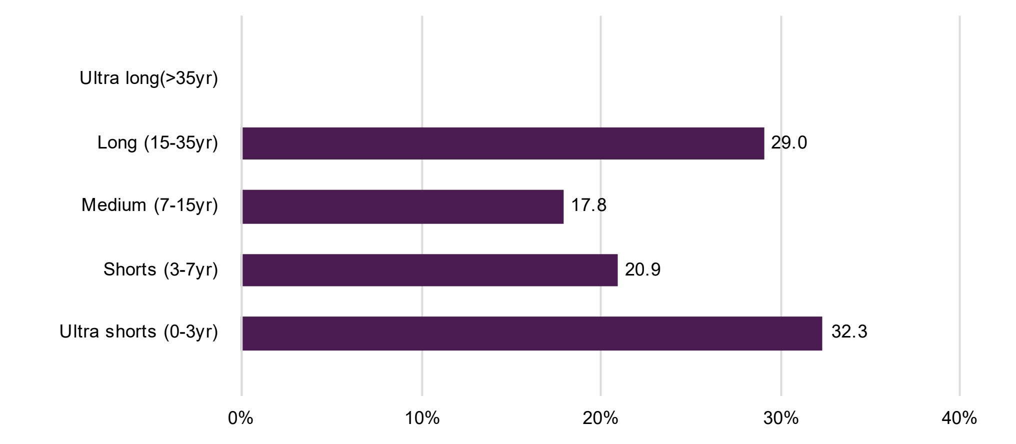
Dollar bloc



Euro bloc

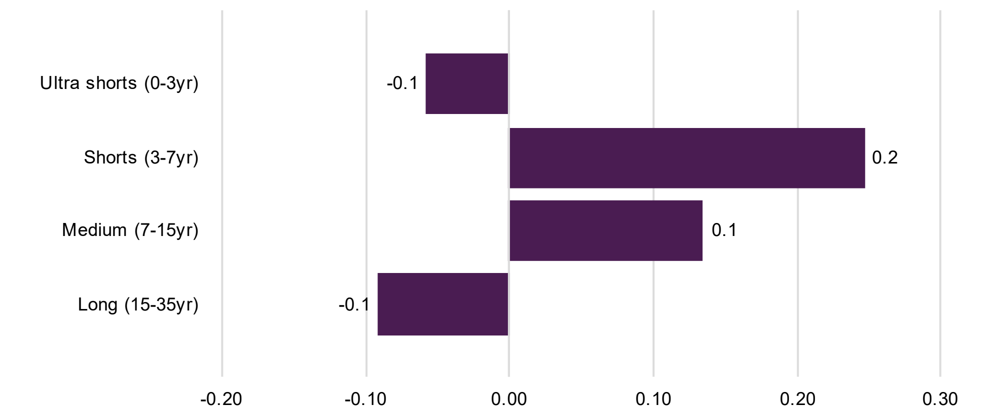


Japan

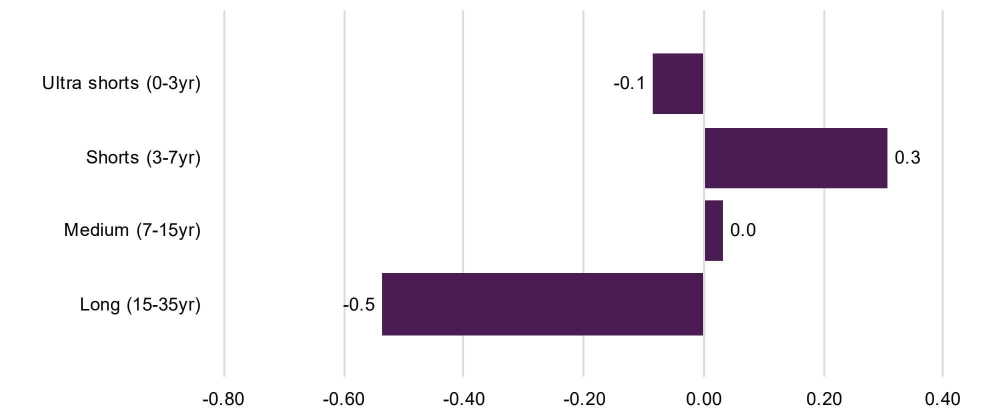


Fund breakdown

Maturity profile relative to benchmark

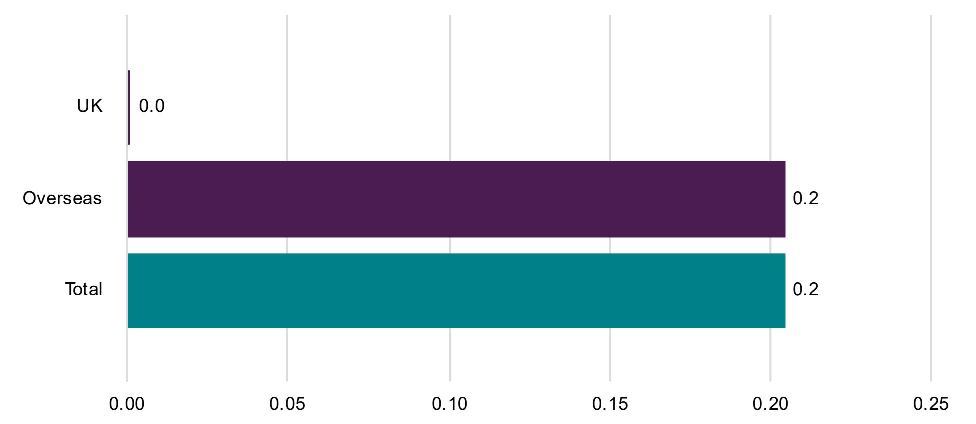


Maturity profile change on quarter

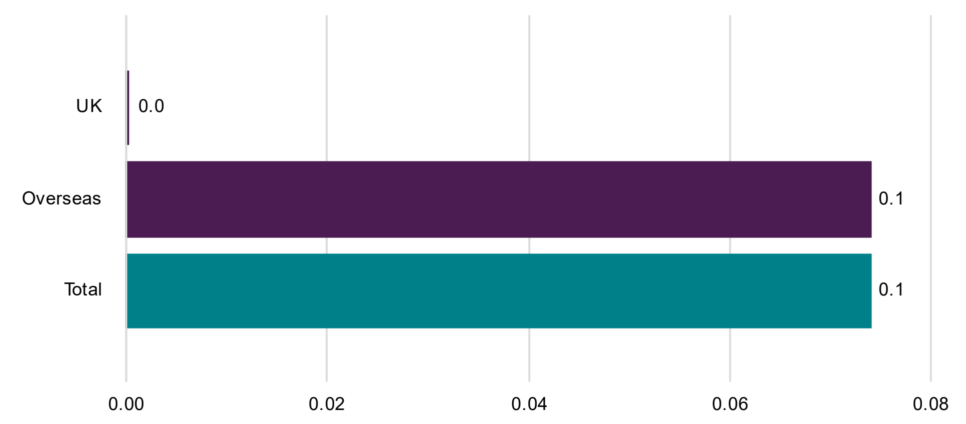


Exposure

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 soggy 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.

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. A number of recession indicators are still flashing. Business survey data paints a mixed picture, with PMIs consistent with flattish growth while ISM surveys look more upbeat. Employment gains have slowed on the non-farm payrolls data and job openings have fallen a long way from their highs consistent with a less tight labour market. Housing-related activity remain subdued.

The Fed continued to hike rates over the quarter against a still resilient labour market backdrop, to help ensure inflation returns sustainably to target. Over the third quarter, the Fed raised the Fed Funds target range by another 25bps to 5.25-5.50%. As of their September meeting, the mean forecast of participants still had one more rate increase in it for the rest of 2023, but removed some of the rate cuts that participants had pencilled in for 2024. Over the quarter, CPI inflation rose to 3.7% year-on-year by August, from 3.0% in June driven by higher energy inflation, but with core continuing to drift lower over the period. The core PCE measure of inflation fell over the quarter and month-on-month was only 0.1% in August. Second quarter GDP recorded a steady-ish 2.1% quarter-on-quarter annualised. More timely economic activity indicators were mixed over the quarter. The government shutdown stand-off was eventually resolved at the last minute, but with a stop-gap measure that will fund the government only through to mid-November 2023.

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. Bank lending conditions have tightened and loan growth has slowed.

Over the third quarter, the ECB again raised rates 50bps. At the September meeting, they signalled that current levels would potentially mark the peak, while leaving the door open for further rate hikes if necessary. Euro area CPI fell to 4.3% year-on-year in September from 5.5% in June. Core CPI fell over the same period too and showed a clearer downward trend than over the previous quarter. The euro area economy grew (only) 0.1% on a quarterly basis in the second quarter - the same outcome as seen in the first three months of the year. However, business surveys signalled a deterioration in activity into more recessionary territory by the end of the quarter.

UK data released in the third quarter painted a picture of slower economic activity, with high but falling inflation albeit featuring still-strong domestic inflationary pressure. Second quarter GDP grew 0.2% quarter-on-quarter in real terms. Upward back revisions to GDP over the quarter showed Q2 GDP as 1.8% above pre-pandemic levels (0.2% previously), with the bulk of revisions from before 2022. The data showed that the UK economy experienced a less-bad pandemic in GDP terms than first estimated. Meanwhile, inflation fell, and tended to surprise on the downside at headline level: year-on-year CPI inflation fell from 8.7% for the May release to 6.7% for the August release. Core inflation fell from 7.1% to 6.2% over the same period. Consistent with a somewhat looser-looking labour market and lower than expected inflation, the Bank of England raised rates another 25bps in August to 5.25% but chose to keep rates on hold at their September meeting.

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. There are still risks from the housing sector and consumer spending has yet to respond fully to tighter monetary policy. GDP growth has been weak since late 2021 and PMI business surveys point to deterioration, falling into recessionary territory over the summer. Inflation should fall significantly at headline level, but domestically driven inflation continues to look strong, despite higher interest rates. The labour market is starting to look less tight and lead indicators of wage growth suggest some slowing ahead but so far, pay growth remains much too strong to be consistent with hitting a 2% inflation target.

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.

Market commentary

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%.

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. 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%.

Outlook

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.

Central banks are faced with a dilemma as to when to stop tightening and all are pointing towards a greater emphasis on data prints in order to direct policy going forward. We are undoubtedly nearer the end of the tightening cycle than the start, and data has started to show signs of weakening as a result of policy tightening to date. However, the job may not yet be done and we may well see further hikes going forward, and we believe that the timeline for the banks to start cutting rates is longer that the market is currently pricing. All this adds up to the potential for further volatility in reaction to data points, and we remain positioned to trade tactically and take advantage of this.

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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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.

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.

Exchange Rate Risk

Changes in currency exchange rates may affect the value of your investment.

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.

Emerging Markets Risk

Investing in Emerging Markets may provide the potential for greater rewards but carries greater risk due to the possibility of high volatility, low liquidity, currency fluctuations, the adverse effect of social, political and economic instability, weak supervisory structures and accounting standards.

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 30 September 2023

Cumulative (%)

	3 Month	6 Month	1 Year	3 Years	5 Years
Fund (gross)	(2.07)	(2.37)	(0.33)	(11.17)	1.57
Fund (net)	(2.15)	(2.51)	(0.62)	(11.96)	(0.04)

Annualised (%)

3 Years (p.a.)	5 Years (p.a.)
(3.87)	0.31
(4.16)	(0.01)

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)	(0.33)	(9.42)	(1.61)	4.43	9.49
Fund (net)	(0.62)	(9.69)	(1.90)	4.12	9.05

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 International Government Bond 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.

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.