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# Royal London Index Linked Fund

## Quarterly Investment Report

## 31 March 2024

# Quarterly Report

## The fund as at 31 March 2024

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.

# Contents


| | |
|---|---|
| The fund | 3 |
| Performance and activity | 4 |
| Fund breakdown | 6 |
| Exposure | 8 |
| Market commentary | 9 |
| Further information | 10 |
| Disclaimers | 11 |
| Performance net and gross | 13 |
| Glossary | 14 |


ROYAL LONDON
ASSET MANAGEMENT

# The fund

## Fund performance objective and benchmark

The Fund's investment objective is to achieve a total return (combination of capital growth and income) 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 UK Gilts Index Linked Government (All Stocks) Total Return GBP Index (the "Index") over a rolling 5-year period. The Index is regarded as a good measure of the performance of index-linked UK government bonds. The Index is considered an appropriate benchmark for the Fund's performance, as many of the Fund's potential investments will be included in the Index. In addition to the benchmark for the Fund's performance as noted above (the "Index"), the IA UK Index Linked Gilts sector is considered an appropriate benchmark for performance comparison.

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

## Fund value

| | Total £m |
|---|---|
| 31 March 2024 | 451.69 |

## Asset allocation

| | Fund (%) | Benchmark |
|---|---|---|
| Index linked gilts | 94.43% | 100.00% |
| Index linked foreign sovereign | 3.89% | - |
| Index linked credit bonds | 1.18% | - |
| Conventional gilts | 0.49% | - |

## Fund analytics

| | Fund | Benchmark |
|---|---|---|
| Fund launch date | 15 February 1990 | |
| Base currency | GBP | |
| Duration (years) | 15.76 | 15.22 |
| Real yield (%) | 0.94 | 0.93 |
| Number of holdings | 40 | 33 |

# Performance and activity

## Performance

| | Fund (%) | Benchmark (%) | Relative (%) |
|---|---|---|---|
| Quarter | (2.15) | (1.81) | (0.34) |
| 1 Year | (5.56) | (4.98) | (0.58) |
| 3 Years (p.a.) | (9.48) | (9.87) | 0.39 |
| 5 Years (p.a.) | (4.77) | (5.22) | 0.44 |
| 10 Years (p.a.) | 2.03 | 1.61 | 0.43 |
| Since inception (p.a.) | 3.76 | 3.25 | 0.51 |

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 strong at a portfolio level during the quarter, although market moves on the last afternoon of the quarter and at the end of 2023 meant that official fund performance was behind the benchmark – with this difference due to fund pricing at midday and index at close of business.

The first quarter had three distinct phases; first, having started the year pricing in around six US interest rate cuts, markets rapidly realised that this was overly optimistic, and yields rose to reflect this. For the middle part of the period, markets were volatile but relatively range-bound, reacting to economic data that did not really give a clear indication as to when and how far rates would be cut. Finally, towards the end of the quarter, with data finally suggesting that rate cuts seemed unlikely before summer and with fewer priced in, yields rose once more to finish at highs for the period.

Our duration position was the main positive impact over the quarter. Starting the year, we had a modest short position, reflecting our view that the market was far too optimistic regarding the timing and quantity of central bank interest rate cuts. We then traded this position tactically during the main part of the quarter, before going long later on as we felt that overall yield levels were attractive.

Cross market activity had a modest positive impact over the quarter. We started the year with a slight underweight in the UK and corresponding overweights in France, US and Australia but trimmed this early on to lock in profits. We traded around the 2033 index linked gilt auction and US index linked 30-year supply, before adding to France, Australia and the US again later in the quarter with the spread over gilts at attractive levels, the latter notably helping performance as long-dated US index linked bonds outperformed UK equivalents. Our short Japan position had little impact on performance.

Our inflation-linked strategies can move underweight inflation (selling linkers and buying conventionals) when market pricing presents opportunities. Breakevens generally increased over the quarter, reflecting higher oil prices and geopolitical risk. We traded breakevens tactically during the period, ending the quarter with a short breakeven position in the UK as breakevens looked elevated and we expected 10-year index linked gilts to underperform given supply at this tenor in April.

# Performance and activity

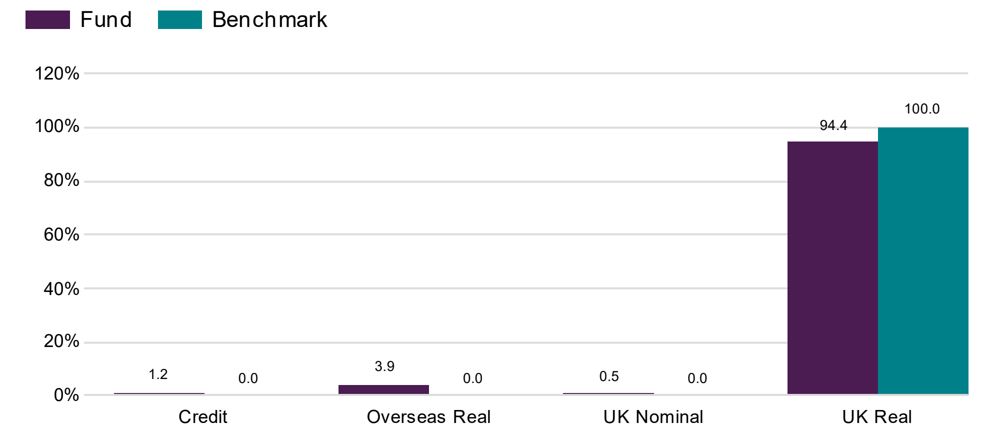
## Fund activity

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 sharp change in market expectations for rate cuts in the US, euro zone and UK, coupled with the end of the yield curve controls in Japan, helped create a volatile environment with opportunities to take small short and long positions as real yields moved within a relatively narrow range. However, with UK real yields reaching around 1.25% in the UK and 2% in the US, we have moved to a long overall duration position, but expect to continue trading tactically around this.

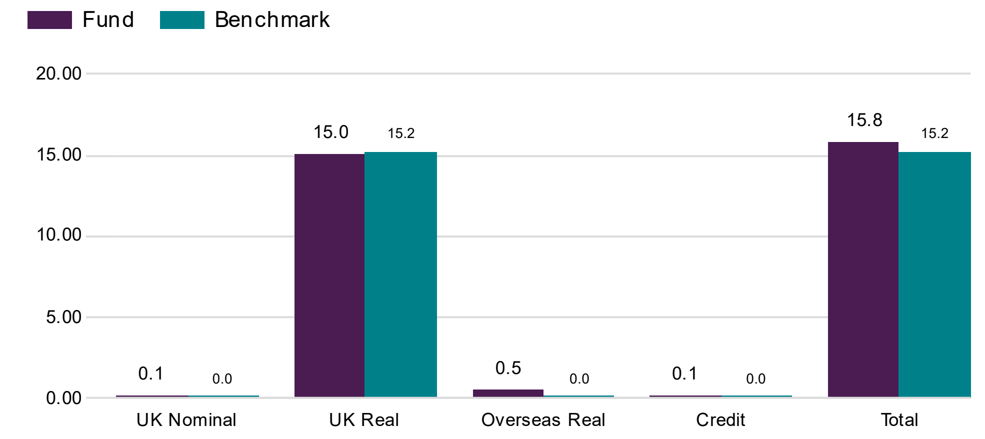
Issuance expectations have been a factor in the UK positioning. As part of the UK Budget, it was announced that there will be five index linked gilt auctions in the second quarter, which was more than the market was expecting, particularly given the inclusion of a 50-year auction. Issuance continues to provide opportunities, particularly in tactical curve and cross market positioning. The second quarter provides 10-year, 15-year and 50-year supply, and we are underweight in these areas to reflect the weakness we expect as the market absorbs this supply.

# Fund breakdown

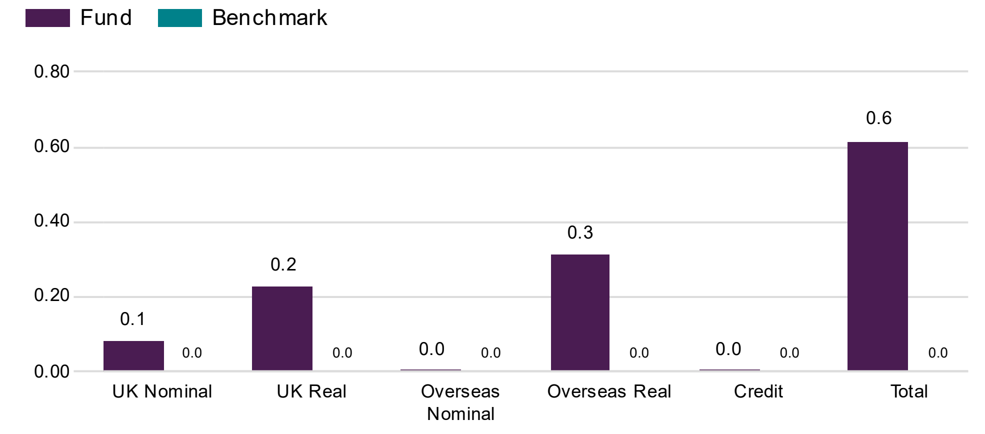
## Asset split by percentage



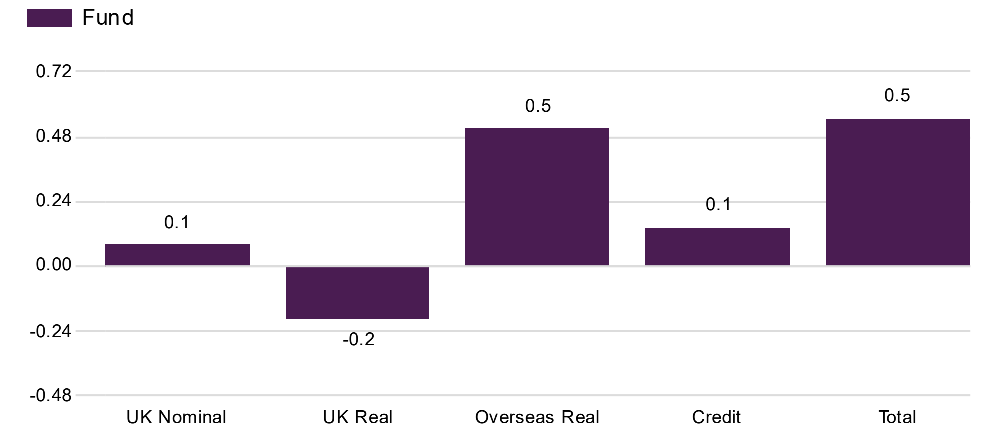

## Asset split by duration




## Asset split by duration change on quarter

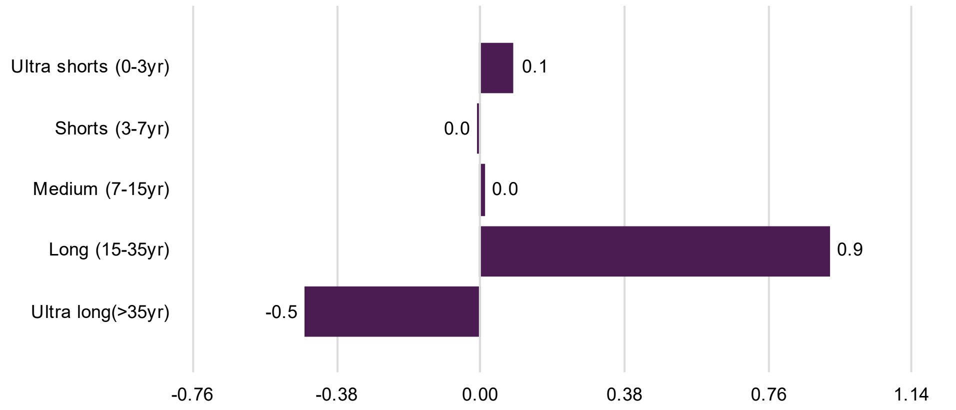



## Asset allocation relative to benchmark (duration)

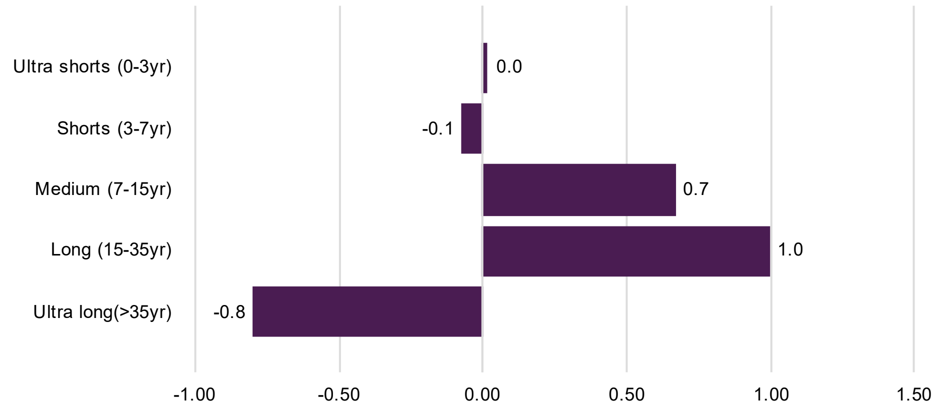


# Fund breakdown

## Maturity profile relative to benchmark

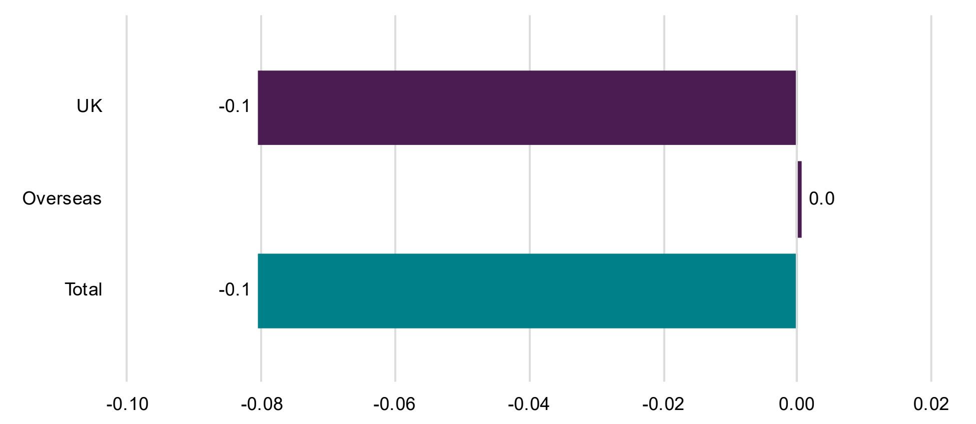



## Maturity profile change on quarter

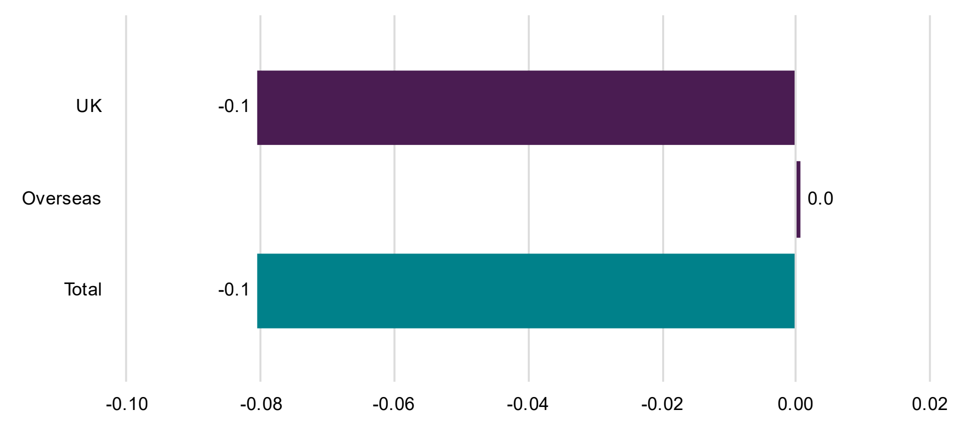


# Exposure

## Inflation exposure (duration)




## Inflation exposure change on quarter (duration)



# Market commentary

## Market overview

A key theme to emerge during the quarter was indication of a more favourable global macro backdrop. Despite some mixed signals, the US economy remains resilient, while Europe and the UK show signs of gradually exiting their recessions. Activity in China also seems to be stabilising. At the same time, core central banks are still confident that the disinflation trend remains intact, despite some recent setbacks in inflation prints. Policymakers have often highlighted that they are in no rush to cut rates – with markets now generally pricing the start of the easing cycles to begin this summer. The Federal Reserve, European Central Bank and Bank of England all left interest rates unchanged over the quarter.

One major development over the quarter is that markets have recalibrated their pricing for expected central bank cuts over this year. At the end of last year, markets were pricing in an aggressive rate cutting cycle, but then swiftly move to temper those forecasts. This re-pricing contributed to negative returns for global government bond markets over the quarter. Despite the belief of many that it was the anticipation of a 'Fed-pivot' that contributed to the rally in equity markets in late 2023, equity markets proved to be immune to this bond market sell-off as global growth and business confidence showed signs of resilience and investors focused on the potential offered by AI.

Government yields rose in all the major markets. In the US, 10-year treasury yields rose from 3.88% to 4.21%, while German 10-year bunds similarly saw yields rise from 2.01% to 2.30%. Mirroring this backdrop of rising yields, UK government bonds produced a return of -1.62% (FTSE Actuaries) over the first quarter, with the benchmark 10-year gilt yield rising from 3.54% to 3.94%. The bulk of this move occurred in the first two weeks of January, before largely trading in a range between 4% and 4.2% for the rest of the quarter. The rising yield environment helped short-dated bonds to outperform their longer-dated equivalents.

UK index-linked markets saw similar increases in yields and as a result saw a negative returns for the quarter at -1.81% (FTSE Actuaries All-maturities). Real yields on UK 10-year bonds rose from 0.05% to 0.28% with 30-year real yields rising from 0.95% to 1.13% while yields on US 30-year index-linked bonds similarly increased, from 1.90% to 2.07%.

## 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. In terms of policy implications, the ECB has indicated that they are likely to wait until they see firm, sustainable evidence of inflation returning to target before they begin easing policy, whereas the US Federal Reserve has hinted at some flexibility in this regard, being led by incoming data. 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 US, the market is now assuming base rates have peaked at 5.5%, with the first cut priced in for the second quarter of 2024, and falling to a terminal level of around 3.00% by late-2025. For Europe, the first cut is priced for April 2024 (despite the pushback from the ECB), with a terminal rate of around 2% by the end of 2025. Contrast this with Japan, where rates have been left unchanged throughout the hiking cycle elsewhere, and the market pricing a withdrawal from NIRP (negative interest rate policy) by quarter 4 of 2024, albeit via a hike of only 10bps. Government bond markets have moved a long way during the last few months, alongside elevated volatility as markets try to second guess the central banks' reaction function to incoming economic data.

Supply will be an issue for the majority of government bond markets over the next few years, particularly against a backdrop of significantly reduced central bank buying (and in some cases, central bank selling of holding in government bonds). Some markets, such as the US, are better priced to reflect this than others.

We believe the markets are still too optimistic in the number of rate cuts that central banks will deliver this year. However, curves have unwound some of the extreme moves seen into year end. We still expect curves to steepen over the longer term and will gradually build steepening risk into portfolios.

# Further Information

## Please click on the links below for further information:

Stewardship and responsible investment at RLAM

TCFD climate report

## Find out more

In an uncertain geopolitical and economic environment, we recognise the importance of keeping our clients updated on our current investment thinking.

Articles, videos, podcasts and webinars giving the latest views of our investment experts 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

## 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.

Issued in May 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.

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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 risk**

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 31 March 2024

## Cumulative (%)

| | 3 Month | 6 Month | 1 Year | 3 Years | 5 Years |
|---|---|---|---|---|---|
| **Fund (gross)** | (2.15) | 6.46 | (5.56) | (25.85) | (21.71) |
| **Fund (net)** | (2.22) | 6.30 | (5.84) | (26.56) | (22.99) |

## Annualised (%)

| | 3 Years (p.a.) | 5 Years (p.a.) |
|---|---|---|
| **Fund (gross)** | (9.48) | (4.77) |
| **Fund (net)** | (9.77) | (5.09) |

## Year on year performance (%)

| | 31/03/2023 - 31/03/2024 | 31/03/2022 - 31/03/2023 | 31/03/2021 - 31/03/2022 | 31/03/2020 - 31/03/2021 | 31/03/2019 - 31/03/2020 |
|---|---|---|---|---|---|
| **Fund (gross)** | (5.56) | (24.91) | 4.56 | (0.98) | 6.64 |
| **Fund (net)** | (5.84) | (25.14) | 4.19 | (1.33) | 6.27 |

**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 March 2024. 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.