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Royal London International Government Bond Fund

Quarterly Investment Report

31 March 2024

ROYAL LONDON
ASSET MANAGEMENT

Quarterly Report

The fund as at 31 March 2024

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.

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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 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. The Index is regarded as a good measure of the performance of government bonds across the developed markets. The Index is considered an appropriate benchmark for the Fund's performance, as the Fund's potential investments will predominantly be included in the Index. In addition to the benchmark for the Fund's performance as noted above (the "Index"), the IA Global Government Bond sector is considered an appropriate benchmark for performance comparison.

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

Fund analytics

	Fund	Benchmark
Fund launch date	4 November 2011	
Base currency	GBP	
Duration (years)	6.40	6.78
Real yield (%)	4.59	3.38
Number of holdings	120	1,019

Fund value

	Total £m
31 March 2024	1,003.98

Asset allocation

	Fund (%)	Benchmark
Conventional foreign sovereign	93.59%	100.00%
Index linked foreign sovereign	4.98%	-
Conventional gilts	1.43%	-

Performance and activity

Performance

	Fund (%)	Benchmark (%)	Relative (%)
Quarter	(0.41)	(0.41)	0.01
1 Year	2.74	1.65	1.09
3 Years (p.a.)	(1.26)	(2.49)	1.23
5 Years (p.a.)	0.52	(0.35)	0.87
10 Years (p.a.)	1.61	1.30	0.31
Since inception (p.a.)	1.89	1.69	0.20

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 broadly tracked its benchmark index in the first quarter.

In terms of portfolio performance, the negative duration stance at the start of the quarter was beneficial, as yields rose (largely in response to the incoming economic data rather than the bonds being supplied to the market). However, by the latter part of the quarter, whilst the fund remained underweight duration versus its benchmark, the main underweight was in Japan, and hence the portfolio was largely immune from the continued rise in yields.

Notwithstanding this, we remain comfortable with the underweight in Japan as we believe that yields will need to rise as the market prices further action for the BoJ, not least to address the continued weakness in its currency. We will also continue to trade duration tactically as market volatility persists around evolving economic data and central bank commentaries.

We remain underweight Japan but are now running a small overweight in Europe and has a larger overweight to dollar block duration, (mainly the US), as we feel that dollar block yields better reflect the prevailing market conditions and likely future path of monetary policy.

Inflation positioning remains relatively light in the portfolio, as many markets look, at best, fair value, in our view. Pockets of value are potentially emerging, particularly in the light of geopolitical developments, but we remain on the side-lines for now, awaiting better levels for entering break-even inflation trades.

Overall, the US curve was a broadly neutral contributor to performance over the quarter. While the European curve positioning will have been a small detractor to performance over the quarter.

The major cross market positioning in the fund is within Europe, with and underweight in Semi-core European markets, (France and Belgium) versus an overweight in Core (Germany) and Periphery (largely Spain). The spread of France over Germany compressed by a further 10bps over the quarter, though it did start to widen out towards the end of March as the market began to price the likelihood of France having to issue more debt to finance itself in the light of softening economic.

Germany continues to command a safe haven premium, thought its own economy faces challenges. A key beneficiary of the potential woes being experienced by the historically stronger northern European nations is the Periphery, where economic data has remained comparatively robust. This, combined with a somewhat benign risk environment and a central bank that has indicated an end to monetary policy tightening and laid out a clear plan for the

Performance and activity

Performance commentary (continued)

withdrawal of support from its PEPP program, saw the spread of Italy over Germany contract dramatically over the quarter, from around 160bps to a tight of close to 120bps.

Having historically been underweight Italy, we elected to take the fund neutral during the quarter, as there did not appear to be a valid catalyst for any spread widening and hence were happy to stay on the sidelines – though we did participate in a number of new bonds issued by Italy, taking advantage of new issue premiums.

We maintain our overweight in Spain, which will benefit from the same aforementioned factors as Italy, but with a lower debt burden and a brighter economic outlook. Spain also outperformed Germany over the quarter, albeit not to the same degree as Italy.

Overall, Cross Market positioning will have been a small positive contributor to performance over the quarter.

Performance and activity

Fund activity

The fund started the quarter with a small short (relative to benchmark) duration position of -0.2yrs, with bonds rallying in the last two months of 2023 as the market began to price aggressive loosening of monetary by the majority of major central banks, in the light of softening inflation and patches of weaker economic data, following a pledge from central bankers to be “data dependent” when it came to the future path of policy decisions.

We felt that this fall in yields was overdone, particularly in the light of the supply due in the early part of 2024 and the potential for inflation to remain above target, and so positioned the fund to take advantage of a re-pricing in bond markets to reflect this.

This proved to be the case, with new bonds being issued by the majority of European governments, mainly around the 10-year maturity point, with some longer dated debt being issued by France and Germany early in January and by Spain at the start of February. We used this supply as an opportunity to add duration, taking advantage of the discounts to fair value offered by issuers in order to attract demand for their bonds.

Central banks re-iterated their pledge to be led by the data when it comes to any easing of policy, and the market took note, pricing out the start of rate cutting cycles from the first quarter to the end of the second quarter, resulting in yields rising and curves generally flattening.

One market where the fund remained underweight in duration terms versus the benchmark was Japan, starting and ending the period at around 0.3yrs short. Japan was the one major economy that had not participated in the rate hiking cycle, despite inflation overshooting the central banks’ target.

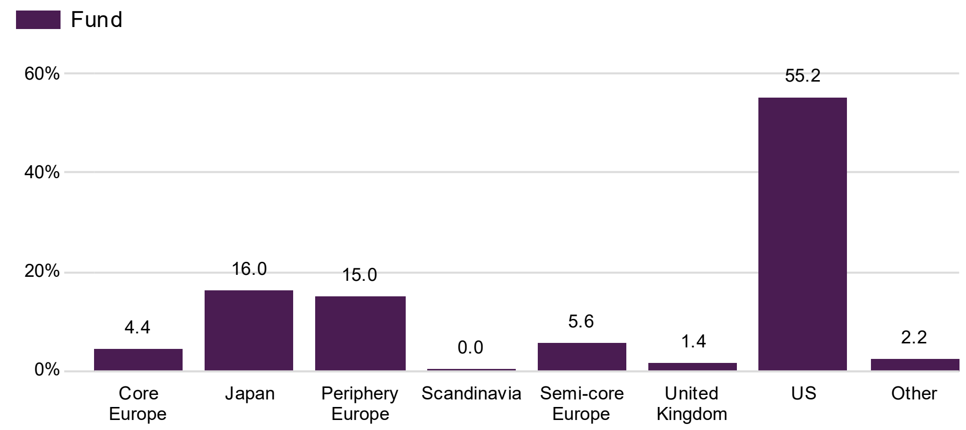
This changed in March as the Bank of Japan finally exited its Negative Interest Rate Policy (NIRP) by raising rates by 10bps and abandoning its Yield Curve Control (YCC) program. Despite this tightening of policy, the yields on Japanese Government Bonds remained largely unchanged (indeed they actually fell on the day of the announcement), as the BoJ simultaneously re-affirmed its commitment to its bond buying programs, and the market chose to focus on this element of the changes to policy.

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.

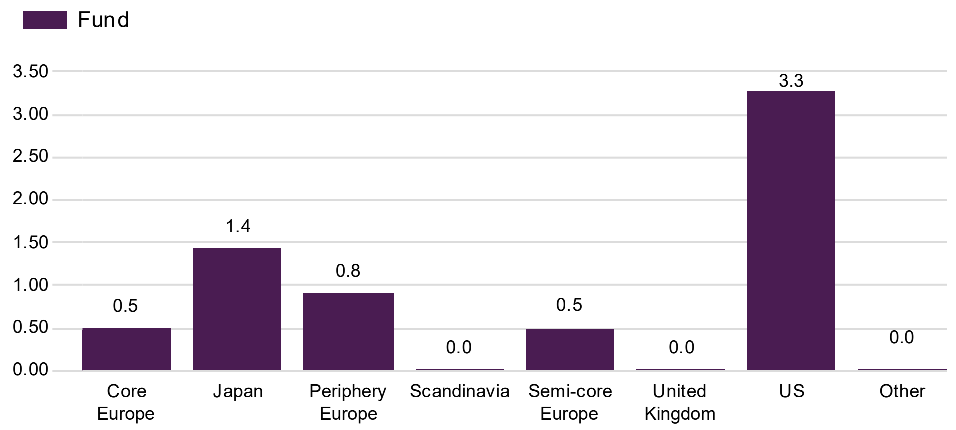
The major curve position within the fund remains a curve steepener within the US, with the fund being underweight the 30-year part of the curve and overweight the five-year area. The fund has held this position over a number of quarters as we believed the US curve further would struggle to remain inverted, given the actions and rhetoric of the Fed.

Fund breakdown

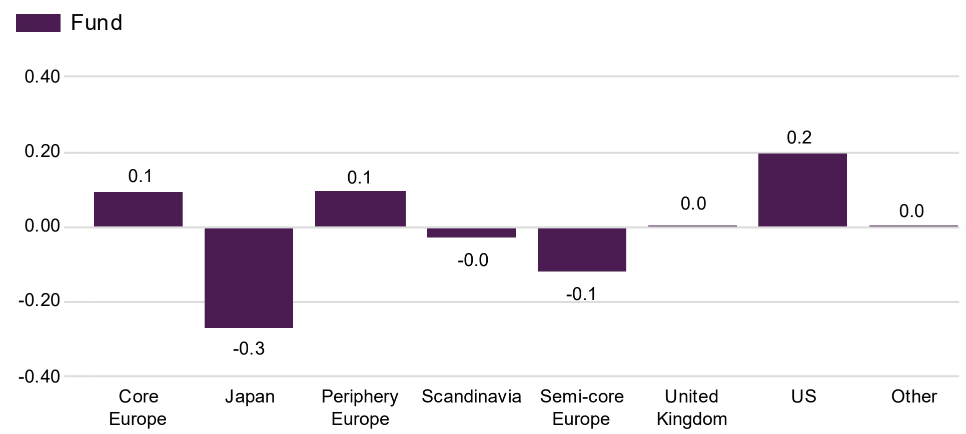
Geographic split by % weight



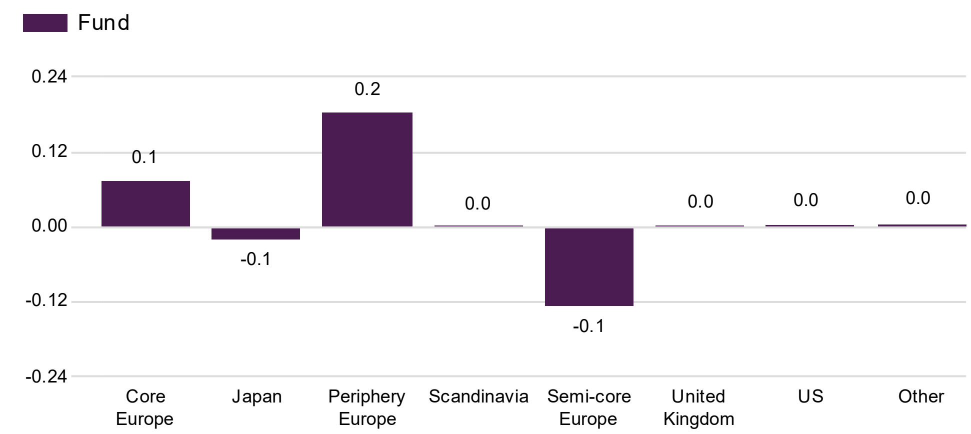
Geographic split by duration



Duration position relative to benchmark

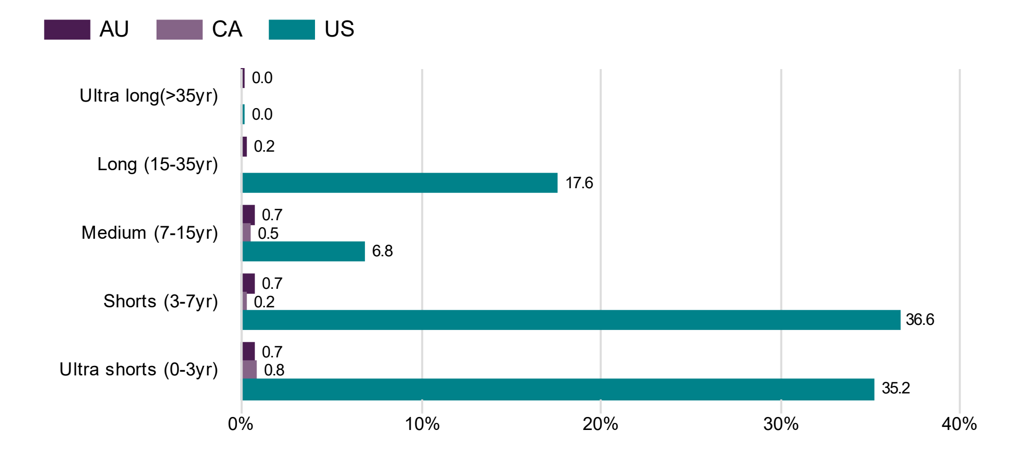


Relative duration quarter on quarter

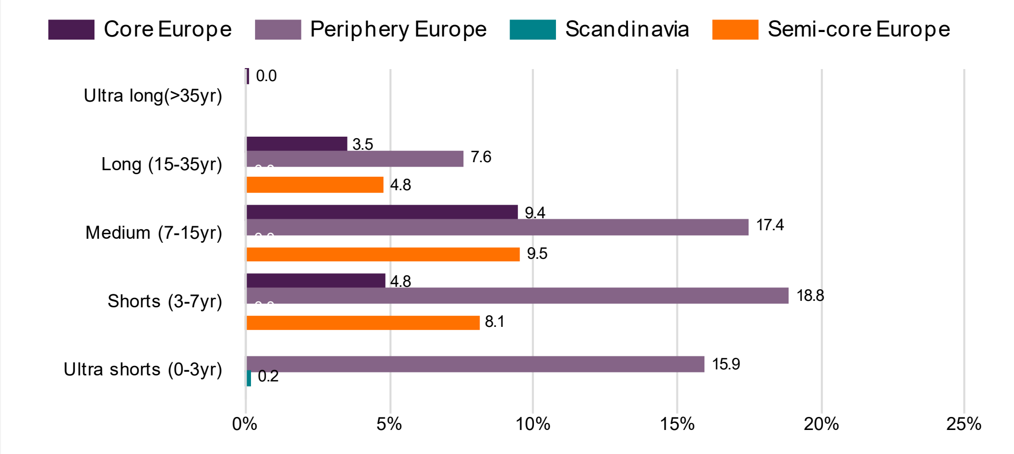


Fund breakdown

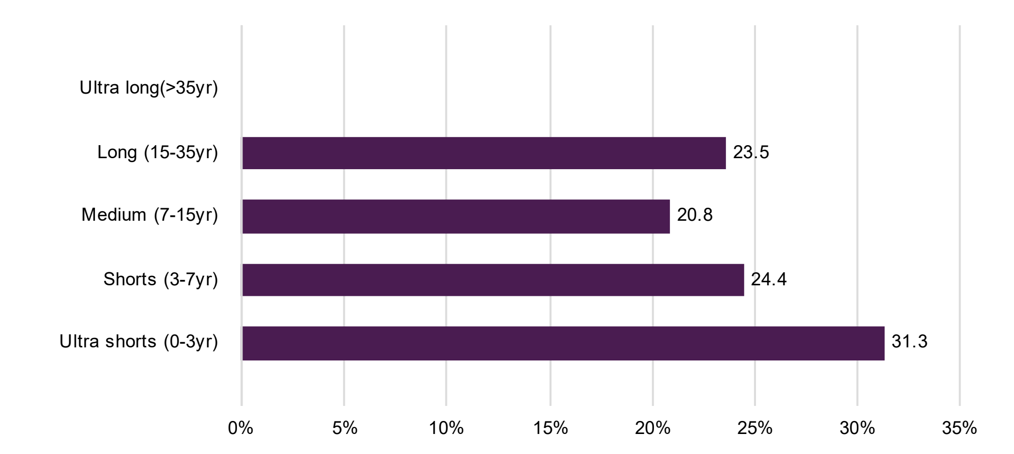
Dollar bloc



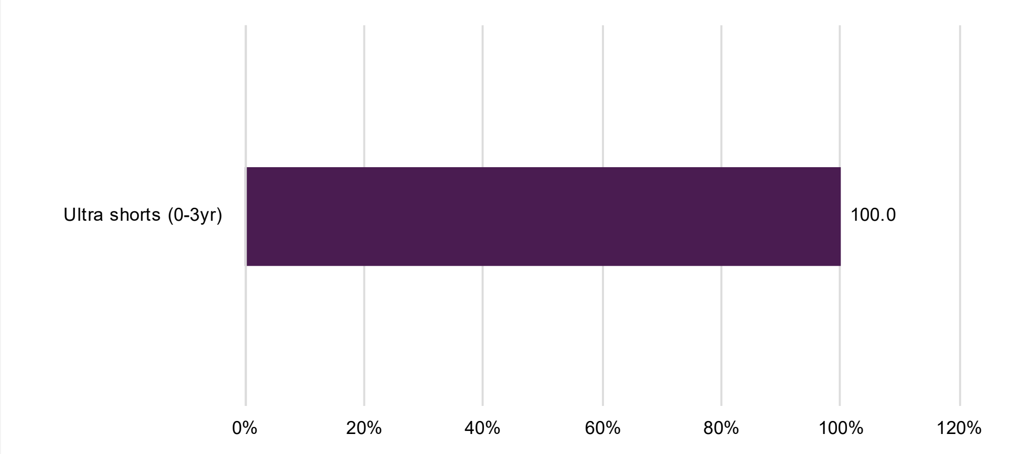
Euro bloc



Japan

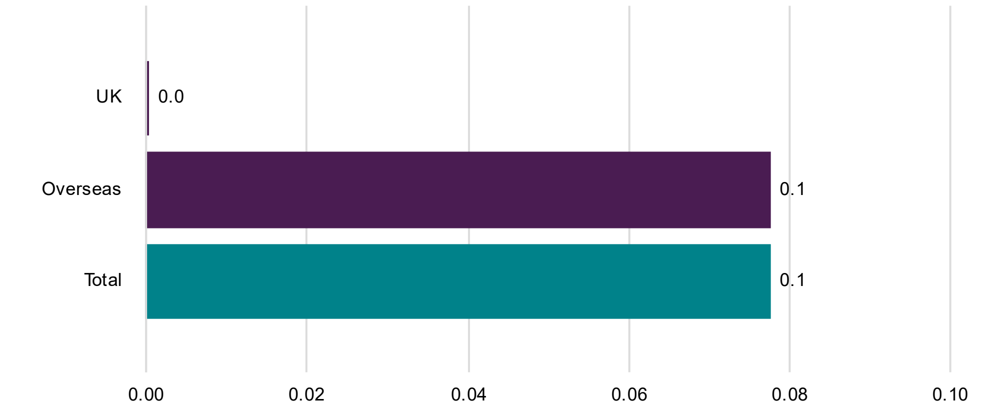


UK

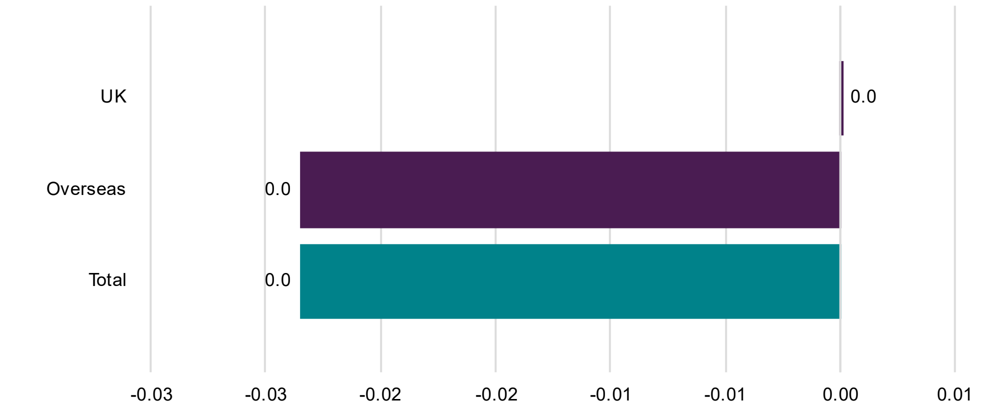


Exposure

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.

The US Federal Reserve continued to keep rates on hold at 5.25-5.50% over the quarter against a still resilient labour market backdrop, and after a couple of stronger than expected inflation prints. As of their March meeting, the median forecast of participants still had 75bps of rate cuts in it for 2024 though with 75bps rather than 100bps of cuts pencilled in for 2025. Over the quarter, CPI inflation was broadly stable, at 3.2% year-on-year in February, from 3.1% in November (briefly 3.4% in December). However, core CPI inflation rose a stronger than expected 0.4% month-on-month in both January and February. The core PCE measure of inflation fell over the quarter in year-on-year terms, but came in above 0.2% month-on-month in both January and February. Fourth quarter GDP recorded a strong 3.4% quarter-on-quarter annualised, weaker than in the third quarter but still well above trend. More timely economic activity indicators were broadly consistent with reasonable growth in the first quarter. Real personal spending grew. Non-farm payroll gains were above 200K in January and February, but the unemployment rate jumped two-tenths in February.

Over the first quarter, the European Central Bank kept rates on hold. As of the March meeting, the staff inflation forecasts were more consistent with sustainably hitting the target and President Christine Lagarde continued to emphasise that they wanted more data, more evidence, before cutting rates. She said that they would know a "little more in April, but we will know a lot more in June." Various ECB speakers have signalled that they think a rate cut is likely/possible in June. Euro area CPI rose in December, but fell back to 2.6% by February. Core CPI fell gradually over the same period too to 3.1% year-on-year. The euro area economy (GDP) was flat in Q4 at 0.0% quarter-on-quarter. Business surveys, however, were consistent with the economy remaining in (mild) recessionary territory, even if the composite PMI improved over the quarter.

Data released in the first quarter confirmed that the UK experienced a technical recession in the second half of 2023 but painted a picture of stronger economic activity in the first quarter, with falling inflation and more signs of softening underlying domestic inflationary pressure. Fourth quarter GDP fell 0.3% quarter-on-quarter in real terms after falling 0.1% in the third quarter. Meanwhile, CPI inflation fell a bit further to 3.4% year-on-year in February from 3.9% for the November release. Core inflation fell to 4.5% year-on-year from 5.1% over the same period. By the end of the quarter (the January data release) regular pay growth figures were showing more sign of slowing, at 6.1% (3M/Y) for the 3-months to January (from 7.2% three-months earlier). Consistent with falling – but still above target – inflation, but with activity and labour market data far from awful, the Bank of England continued keep rates on hold at 5.25%. The Budget saw the Chancellor present further tax cuts, adding net stimulus near term but with the projections for future years still implying sizeable real terms spending cuts for unprotected government departments.

In contrast to the losses in the government bond market, the sterling investment grade credit market (iBoxx non-gilt index) returned 0.06% over the quarter, with the effect of higher yields mitigated by tighter credit spreads and the higher carry in this area. The shorter duration of the credit market index also helped offset some of the government market headwind. The average sterling investment grade credit spread (the average extra yield available from non-gilt bonds compared with government debt of equal maturity) tightened from 1.15% to 1.02% (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. Shallow recessions are possible but are unlikely

Market commentary

to be deep enough at this stage to ease the excessive tightness seen in labour markets. As we move through 2024, central banks are likely to start reducing rates, but with yields below base rates in all markets, this is well priced.

In the US, the market is now assuming the first cut to come at the end of the second quarter or in the third quarter – but terminal rates have remained unchanged, meaning the level of easing has not changed but the market has shifted the rate cutting cycle by a quarter. In Europe, the ECB has found itself in a similar situation. Beyond the first move, the ECB remains fully data-dependent and noncommittal to a given rate path.

In Japan, the BoJ moved away from its NIRP (negative interest rate policy) but the adjustments to monetary policy were widely anticipated. Communication from the BoJ was also clear that this was not anticipated to be the start of an aggressive hiking cycle, but more of a move towards policy normalisation, and that they would act to ensure markets remained orderly and volatility remained suppressed, through flexible buying of bonds.

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.

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

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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.

Information has been obtained from sources believed to be reliable, but J.P. Morgan does not warrant its completeness or accuracy. The Index is used with permission. The Index may not be copied, used, or distributed without J.P. Morgan's prior written approval.

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 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.

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 31 March 2024

Cumulative (%)

	3 Month	6 Month	1 Year	3 Years	5 Years
Fund (gross)	(0.41)	5.23	2.74	(3.75)	2.64
Fund (net)	(0.48)	5.08	2.44	(4.61)	1.09

Annualised (%)

	3 Years (p.a.)	5 Years (p.a.)
Fund (gross)	(1.26)	0.52
Fund (net)	(1.56)	0.22

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)	2.74	(4.18)	(2.23)	(0.87)	7.57
Fund (net)	2.44	(4.47)	(2.52)	(1.17)	7.22

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 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.