

The case for a low volatility Absolute Return Government Bond fund

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Uncertainty can be an opportunity

Today's fixed income environment is an uncertain one. There are several factors behind this - both macroeconomic and geopolitical. Political developments are a key source of that uncertainty. The election of Donald Trump has reintroduced a more unpredictable US policy backdrop, with potential changes to trade, NATO commitments and energy strategy all in focus. This is already influencing behaviour elsewhere. European governments are signalling higher defence spending, with Germany prepared to loosen fiscal constraints to support this shift. At the same time, a busy electoral calendar in France and Italy, alongside a more challenging domestic backdrop for the UK government, adds to the sense of a less stable and less predictable policy environment.

Macro conditions are also becoming more challenging. Increased tensions leading to conflict in the Middle East have led to a significant supply shock, pushing oil prices higher and placing renewed upward pressure on inflation.

This comes at a point where despite inflation moderating it still remains above many central bank's targets. The result is a more complicated global policy backdrop. Central banks may now be forced to balance renewed inflationary pressures against already slowing growth, increasing the risk of tighter policy coinciding with a weaker economic environment.

In my view, absolute return funds can be considered a potential benefactor in a more volatile yield environment; theoretically, these funds are non-correlated with market beta and are designed and constructed to aim to deliver a repeatable absolute return - whatever the macroeconomic conditions. However, this has not always been the case and over the years these outcomes have given the sector a bad name. Is this the fault of the sector and the available products or perhaps the approach used to manage these strategies?

How should an absolute return government bond fund be structured and managed?

In my view, many managers think about absolute return in a long-only context. What do we mean by this? The manager constructs a portfolio of bonds that they believe could outperform a cash benchmark over time.

The problem with this approach is that it embeds significant interest rate risk and or credit risk into the portfolio and therefore, the absolute return of the portfolio is most likely determined purely by the direction of interest rates or credit spreads. If an investor wants exposure to rate moves or credit spreads, then they could just buy a plain government or corporate bond fund.

In my opinion an absolute return strategy should focus on providing an excess return over and above a cash rate in all market conditions. To achieve this, the manager must manage interest rate and credit risk and focus on delivering outperformance from a range of non-correlated diversified low-beta strategies.

At Royal London Asset Management, we run a range of sovereign funds, both nominal and inflation linked. These funds are benchmarked against underlying published bond indices and by using multiple diversified active strategies, are managed in a risk-aware style, accounting for volatility and market direction. Using this approach, we are seeking to add incremental outperformance versus the fund benchmarks, regardless of market direction. The best ideas approach that we apply to our long-only benchmarked funds is replicated in our Absolute Return Government Bond fund using a combination of assets as well as a derivative overlay strategy. In effect this portable alpha technique allows our clients to experience the same outperformance captured within our bond range but supplemented by a cash-based return as opposed to a bond-index based return.

We typically invest a significant majority of the portfolio in assets that are

linked to SONIA - aiming to provide a benchmark-like return and provide liquidity. We believe that this reduces volatility and risk compared to an approach seeking to achieve all of its return from alpha-based strategies.

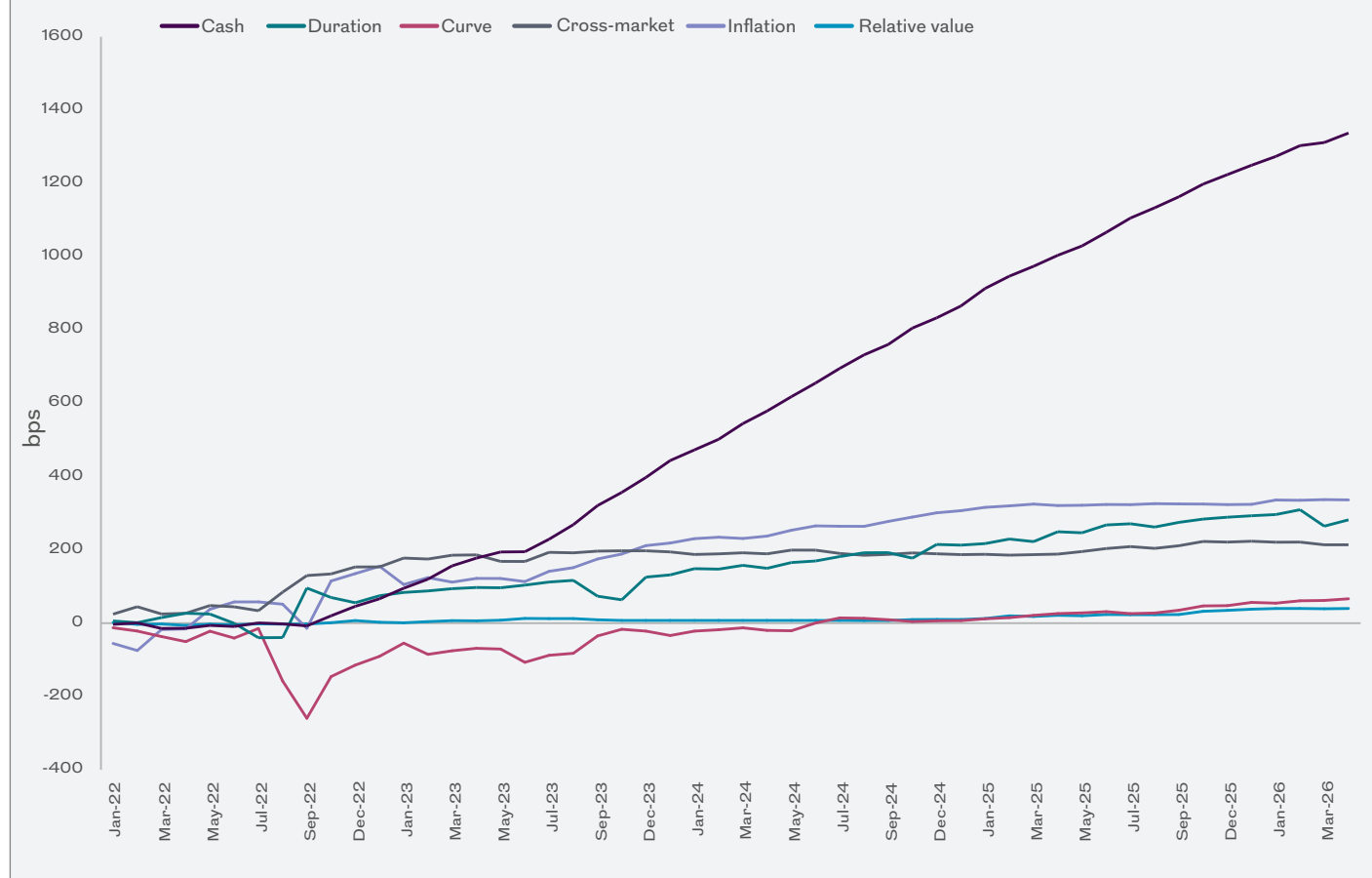
Our toolkit consists of six key strategies:

- **Cash:** Utilising money market instruments, secured credit and supranational bonds we can enhance portfolio yield by owning these low-risk SONIA plus assets.
- **Duration:** Central banks are likely to remain more reactive and flexible with their monetary policy toolkit, leading to greater volatility in the level of yields. We can take a long or short duration stance to capitalise on these moves.
- **Curve:** Greater monetary policy flexibility and changing supply/demand dynamics could lead to greater volatility in the shape of the yield curve. We can overweight or

underweight certain parts of the yield curve dependent on our view of the likely impact of these drivers.

- **Cross-market:** Central banks' monetary policy and supply profiles may diverge more over the coming decade, creating numerous cross-market trading opportunities. We can underweight bonds in one country versus another on a hedged basis to add value from spread moves.
- **Inflation:** The debate around hard versus soft landings, tight labour markets and geopolitical risks will lead to changing inflationary expectations and greater volatility in inflation breakevens. We can switch nominal bonds into index linked bonds or vice versa to reflect our inflation view.
- **Relative value:** Quantitative Tightening (QT) sales by central banks and heightened volume of supply will increase the opportunities available to trade the relationship between specific bonds along the yield curve.

Figure 1: The attribution of our six key strategies highlights strong added value



Source: Royal London Asset Management as at 30 April 2026.

Past performance is not a guide to future performance. Portfolio characteristics and holdings are subject to change without notice. This does not constitute an investment recommendation. For information purposes only.

In my view, the unfolding environment is comparatively favourable at present for an active manager in the sovereign bond space, and we see the following strategic and tactical opportunities persisting for several years:

Strategic (longer-term)

- Macro data surprises continuing to drive interest rate volatility and fiscal policy moves
- Geopolitical uncertainty impacting yield differentials and asset returns
- De-globalisation/onshoring themes raising inflation expectations

Tactical (shorter-term)

- Excess and frequent global bond supply and demand events (auctions and index changes)
- Central banks moving from buyers to sellers will increase the number of supply events (QE to QT)
- Changes to pension fund strategy creating bond volatility via restructuring
- Central banks pointing towards greater data dependency when it comes to monetary policy decisions has led to heightened market volatility around economic data releases. This can create opportunities for short-term tactical trading

The objective of the fund

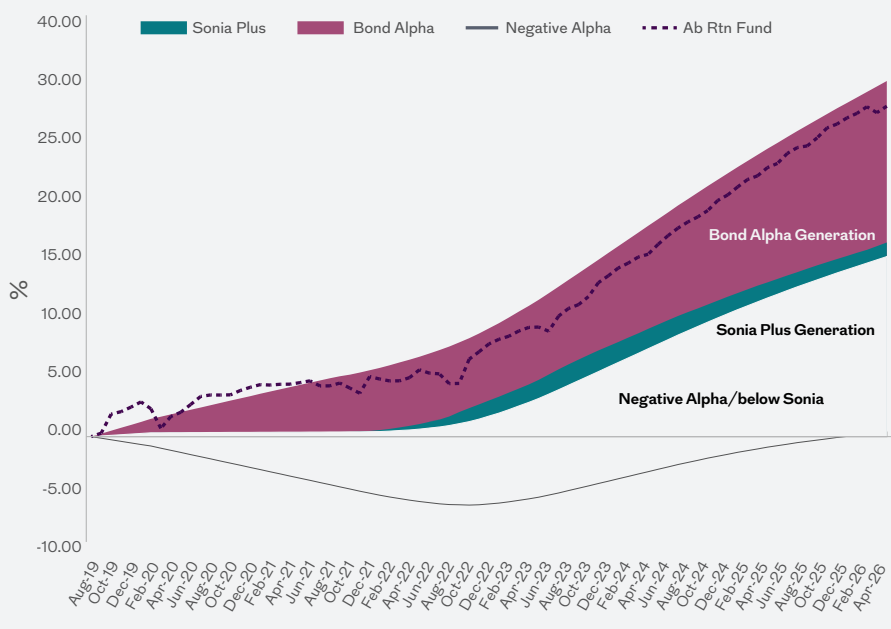
The objective of the Royal London (RL) Absolute Return Government Bond Fund (the 'fund') is to target absolute positive capital growth. The portfolio seeks to outperform its benchmark (SONIA) by +1.5 – 2.5% per annum over rolling three-year periods and aims for positive performance over rolling 12-month periods. To achieve this the fund invests in a diversified portfolio of global government bonds and short dated investment grade credit utilising a derivative overlay focusing on our six key alpha strategies. With a longer-term philosophy, driven by a strong risk management process, the fund seeks to achieve the performance with low volatility and minimal drawdowns, whilst maintaining high liquidity and low correlation to bond markets and other asset classes.

Performance, attribution and correlation of the fund

Looking at fund performance over the medium term highlights how our process of adding incremental performance in a low volatility style has proved beneficial throughout both the zero interest rate years as well as the recent period of extreme volatility.

Figure 2: Performance asymmetry is beneficial

The higher fund yield on offer seeks to reduce the impact of drawdown, and a larger proportion of the excess return will be delivered from SONIA plus assets.

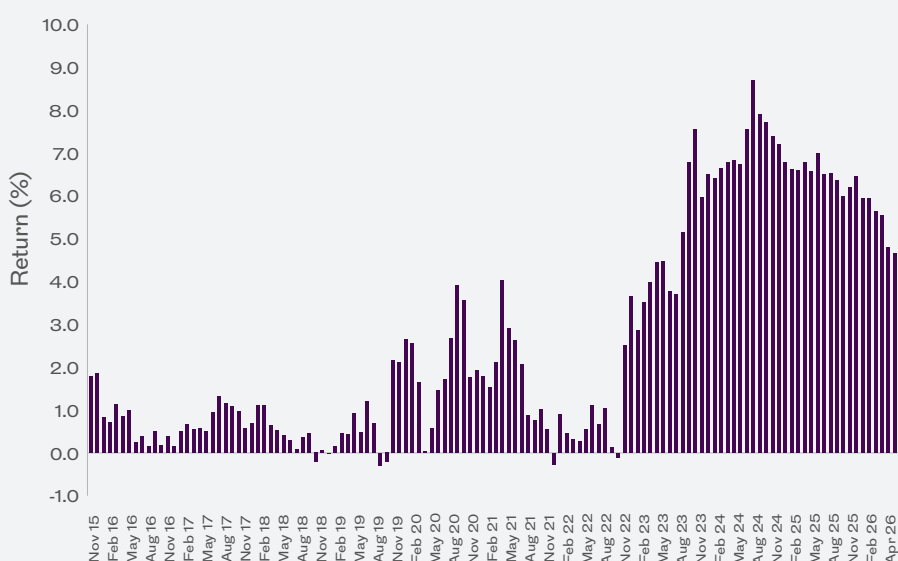


Source: Royal London Asset Management as at April 2026.

Past performance is not a guide to future performance.

Figure 3: The fund has avoided the negative returns experienced by global bond indices (monthly fund returns from November 2015 to April 2026)

Our absolute return philosophy and style helps mitigate market beta risk, in comparison to long only bond and cash funds.



Source: Royal London Asset Management and Bloomberg as at 30 April 2026 (Z Acc share class).

Past performance is not a guide to future performance. The value of investments and the income from them is not guaranteed and may go down as well as up and investors may not get back the amount originally invested. The impact of fees or other charges including tax, where applicable, can be material on the performance of your investment.

Figure 4: Low correlation of our fund against other asset classes

RL Absolute Return Government Bond Fund	3-year correlation
Morningstar short-term FI sector average	0.83
Bloomberg Global Aggregate 1–3 year Government (GBP Hedged)	0.59
Bloomberg Global Aggregate 1–3 year Corporate (GBP Hedged)	0.63
Bloomberg Global Inflation-Linked (GBP Hedged)	0.36
Bloomberg Global Aggregate – Corporate (GBP Hedged)	0.45
Bloomberg Global Aggregate Government (GBP Hedged)	0.43

Source: Royal London Asset Management, Bloomberg and MSCI as at 30 April 2026.

Purpose and benefit of Absolute Return within a balanced mandate

We believe that the following characteristics should be considered when choosing an Absolute Return manager.

- **Uncorrelated returns:** Aim to deliver a positive outcome in all market conditions with limited beta/correlation.
- **Diversification:** Numerous strategies (Cash, Duration, Curve, Cross-market, Inflation and Relative value) employed to deliver diverse sources of risk adjusted alpha, aiding repeatability, and limiting drawdown.
- **Low volatility:** Low market beta combined with diversified alpha sources helping to minimise market shocks and reduce overall volatility relative to fixed income markets.
- **Liquidity:** A strategy with high liquidity by design can fulfil an important role as part of a liquidity waterfall or aide asset allocation decisions.
- **Stability:** A stable and experienced government bond team with a proven track record.

Why Royal London Asset Management

Royal London Asset Management's Government Bond team averages over 20 years' investment experience and have worked together for over 10 years delivering strong performance through several market cycles including the Great Financial Crisis, Covid-19 pandemic, and the pension fund liquidity crisis.

We have developed a repeatable investment approach that combines research and portfolio construction to support strategic and tactical positioning across these six diversified strategies in a risk-controlled manner. This allows us to successfully achieve the objective of consistent and incremental outperformance across our range of funds.

The techniques used within our range of long only funds are used to the same effect within the Royal London Absolute Return Government Bond Fund. This allows us to create a 'portable alpha' source that we believe can be successfully applied to an underlying benchmark.

Fund performance

	Cumulative %					Annualised %	
	3M	6M	1Y	3Y	5Y	3Y	5Y
Fund (Gross)	0.52	1.59	4.65	19.49	25.52	6.11	4.65
Fund (Net)	0.42	1.39	4.22	18.09	22.64	5.69	4.16
Benchmark	0.90	1.86	3.95	14.49	17.59	4.61	3.29

Year on year performance %					
	Apr 26 to Apr 25	Apr 25 to Apr 24	Apr 24 to Apr 23	Apr 23 to Apr 22	Apr 22 to Apr 21
Fund (Gross)	4.65	6.99	6.73	4.48	0.54
Fund (Net)	4.22	6.59	6.30	4.01	-0.15
Benchmark	3.95	4.84	5.06	2.51	0.19

Past performance is not a guide to future performance. The value of investments and the income from them is not guaranteed and may go down as well as up and investors may not get back the amount originally invested.

Source: Royal London Asset Management as at 30 April 2026. All figures are mid-price to mid-price in GBP for the Royal London Absolute Return Government Bond (Z Acc) share class, net of fees and gross of taxes, with gross income reinvested unless otherwise stated. Benchmark is Sterling Overnight Index Average (SONIA). Benchmark performance is shown gross of fees and taxes. The impact of commissions, fees and other charges can be material on the performance of your investment. Rolling performance data shown using month end returns.

Risk 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.

Derivative Risk: Derivatives are highly sensitive to changes in the value of the underlying asset which can increase both Fund losses and gains. The impact to the Fund can be greater where they are used in an extensive or complex manner, where the Fund could lose significantly more than the amount invested in derivatives.

Efficient Portfolio Management 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: Investing in assets denominated in a currency other than the base currency of the Fund means the value of the investment can be affected by changes in exchange rates.

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.

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.

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For more information on the Fund or the risks of investing, please refer to the Prospectus or Key Investor Information Document (KIID).

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