

Please see below for a summary of our latest views:

Over the last year, bond yields have fallen across the curve, both in the UK and the US. This has been a classic “bull steepening” with short-dated yields falling by more than long-dated yields as the market began to anticipate interest rate cuts.

This has led to an unusually steep yield curve ¹.

This means that roll is now a powerful determinant of returns. Roll is the additional return that arises from owning a bond whose yield falls as its duration shortens. The bond is said to “roll down the yield curve”.

Consider the UK Index Linked 2031, the single largest holding in the CG UK Index Linked Fund and our multi-asset funds. The headline real yield is just under 0.7% per annum – not shabby, but not very exciting. Adjusting for the difference in RPI & CPI this increases to 1.2%. We estimate roll adds a further 0.65% to this, giving an **expected real return of around 1.85%**.

The roll on our second largest holding – the UKTI 2033 – is even more dramatic and boosts the expected return from 1.45% to close to 2.4%.

Faced with such attractive returns, it is tempting to ask “what’s the catch?”. After all, there are few – if any – free lunches in finance.

Investors shouldn’t worry too much. An upwards sloping yield curve exists to compensate investors for the natural volatility in owning longer duration bonds. Roll returns are the inevitable consequence of this.

But capturing roll does require active portfolio management. Held to maturity the benefits of roll start to reverse and are ultimately extinguished. Instead, as the portfolio duration shortens we sell shorter bonds and reinvest further out the curve, seeking to maximise roll-down while simultaneously managing duration risk.

For the time being we judge the most attractive part of the UK index-linked curve is the 2031 to 2033 area and that is where our holdings are concentrated. Investors in the Dollar Fund and Real Return Fund should note that they should enjoy similar levels of roll on their holdings too.

¹ *I should qualify this statement. The curve is very steep outside of recessionary / ZIRP environments.*