February 2019

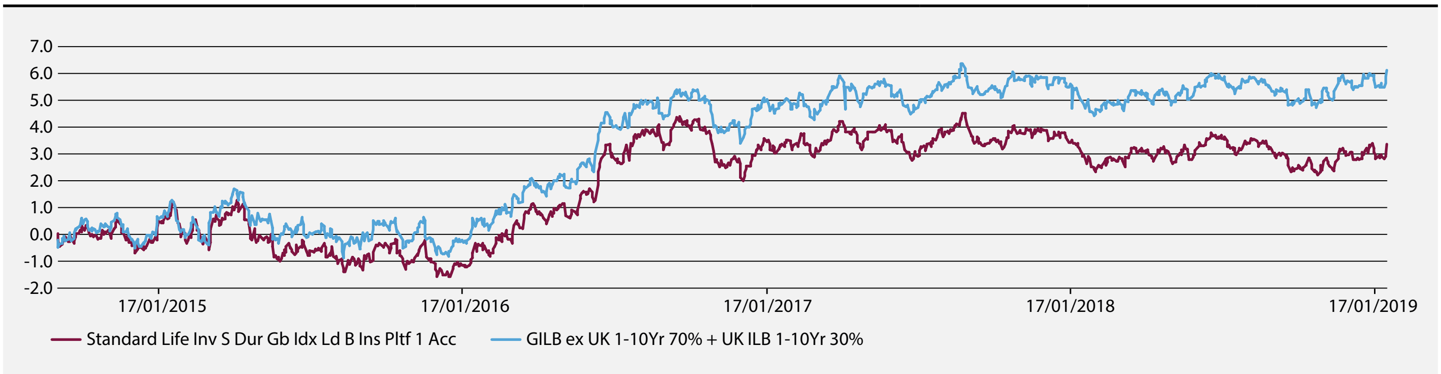
InFocus

Standard Life Investments Short Duration Global Index-Linked Bond Fund

Key features

Aims to deliver attractive inflation-linked returns with reduced exposure to interest-rate risk	A dedicated and highly experienced real returns team	A focus on stable, low-volatility returns

Performance



	31/01/2018 to 31/01/2019	31/01/2017 to 31/01/2018	31/01/2016 to 31/01/2017	31/01/2015 to 31/01/2016	31/01/2015 to 31/01/2016	Since Inception to 31/01/2019
Standard Life Investments Short Duration Global Index Linked Bond Platform 1 Acc GBP	0.43	-0.25	3.91	-1.39	N/A	3.26
Benchmark: GILB ex UK 1-10Yr 70% + UK ILB 1-10Yr 30%	1.12	0.06	4.26	-0.61	3.00	6.12

Source: Lipper IM, data to 31/01/2019, net of charges, inception 16/09/2014

In the Short Duration Global Index-Linked Bond Fund, we aim to provide investors with attractive inflation-linked returns, with reduced exposure to interest rate risk. We do this by investing in a portfolio of shorter-dated bonds. Our dedicated real returns team manages the Fund through a combination of quantitative and qualitative analysis. Through a range of diversified strategies, including inflation, duration, curve and cross market, the team targets consistent, incremental returns with low volatility. This disciplined process has allowed us to build a strong track record relative to the benchmark index since the Fund launched in 2014.

UK - Brexit volatility continues

While Brexit continues to dominate the UK political landscape, the economic picture remains one of subdued growth. Purchasing Managers' Index data was modestly better than expected in January. Headline inflation has steadied at 2.1%, while retail price inflation (RPI) was a bigger miss at 2.7% versus 2.9% expected. This has helped push the market lower in January. Ten-year index-linked breakevens (the difference in yield between conventional and index-linked issues) were modestly lower. However, this masked significant intra-month volatility, with Brexit headlines pulling the market in different directions. Another influential factor was the release of the House of Lords report on RPI reform. This went further than expected in suggesting material improvements to the methodology and a move towards Consumer Price Inflation-linked issuance by the government. That report caused a sharp drop in breakevens on the morning of its release. Inflation continues to trend downwards, bolstered by falling petrol prices, the result of a big fall in the cost of crude oil. We expect inflation to retreat to the Bank of England's 2% target, and we believe the Bank will be content to hold interest rates at current levels until the Brexit murk begins to clear. However, we will remain vigilant around Brexit-related volatility, trading duration alongside our strategic inflation short.

US – a significant change in language

US economic data remains strong. But the future path of financial markets has been clouded by a variety of factors. These include concerns about US-China trade relations, the outlook for global growth, and oil prices. President Trump continues to push a hard line regarding potential trade negotiations. While the US central bank, the Federal Reserve (Fed), raised interest rates in December, the accompanying statement was interpreted as dovish. This did little to quell risk-averse market sentiment, and bonds rallied in response. Waters were further muddied by what looked like a Fed U-turn late in January, when the market was surprised by a significant change in language. The Fed signalled a pause in its rate-hiking cycle, citing concerns about the global trade and growth outlook, while noting that the US domestic inflation outlook was not causing any immediate concerns. This caused a strong real yield-led rally. Inflation data was in line with expectations, with base effects pushing headline down to 1.9%, while the core figure remained robust at 2.2%.

Europe – still lacklustre

European inflation data remains disappointing, and continues to come in below expectations. Amid a global backdrop of falling oil prices, breakevens continued to weaken significantly. Inflation data has also been lacklustre, with the headline figure falling to 1.6% while core inflation is 1.0%. Inflation pricing continues to grind lower amid the economic malaise, and the five-year/five-year forward inflation swap rate, used as a benchmark of inflation expectations, ended January at 1.1%. The European Central Bank, which brought its quantitative easing programme to an end in December, now acknowledges downside risks. Market pricing for an interest rate hike has now been pushed out into 2020. Purchasing Managers' Index data has fallen, and the composite figure for January was below expectations.

Adam Skerry
Fund Manager

"The UK outlook became slightly more noisy around the Brexit negotiations and UK RPI rallied as the currency weakened"

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