TwentyFour
a boutique of Vontobel

Fund Commentary | 30 April 2024

Vontobel Fund – TwentyFour Absolute Return Credit Fund

This Commentary is a marketing communication for professional UK investors only

Market Commentary

April was a more difficult month for markets, with the 'higher-for-longer' sentiment strengthening, as continued strong macroeconomic data, combined with stubbornly high inflation readings, pushed global yields higher. Treasury yields, which had been slowly moving higher so far this year, rose sharply in response to the strong data, with 10-year yields spiking from 4.2% at the start of the month, to finish just shy of 4.7%, with these moves echoed by UK and European government bonds. The outlook for rate cuts also changed significantly once again, with just one cut now expected from the Federal Reserve (Fed), when between two and three cuts were expected for the year at the start of the month, and almost six cuts were expected at the beginning of the year – this optimism has faded markedly. The higher rates also, finally, negatively impacted on equity markets, with most indices falling by between 3.5% and 4.5%, albeit from near record high levels.

The tone was set by the US at the start of the month, with ISM Manufacturing and Prices Paid Data coming in stronger than the consensus, followed by strong Job Openings and Labor Turnover Survey (JOLTS) and factory orders data. While ISM Services data was weaker than expected, it was followed by employment data pointing firmly to a strong economy, with a 303k non-farm payroll print, compared to an expectation of 214k, and average hourly earnings remaining unchanged at high levels. When inflation data came in hotter than expected, for both headline and core readings, the rates selloff gathered pace and most Treasury bulls seemed to throw in the towel on any significant cuts this year. In light of the strong data, and inflation that was proving to be stickier than expected, Fed officials also began to guide markets towards fewer cuts, with most emphasising the need to be patient "until inflation was moving sustainably towards 2%".

The data in Europe during the month was more mixed, with core inflation continuing to decline, and, although services PMIs continued to show strength, manufacturing PMIs remained in contractionary territory. Importantly, however, and although euro rates weakened in sympathy with US Treasuries, there seems to be consensus from European Central Bank (ECB) officials that data supports a rate cut in June, and markets still expect between two and three cuts by year-end. Similarly, in the UK, economic data was mixed but generally weak. However, inflation continued to fall, and Bank of England (BoE) officials, including governor Andrew Bailey, seemed confident that this trajectory will continue and support rate cuts later this year. However, despite hopes of cuts to come, gilts continued to give back some of the aggressive rally at the end of last year.

Although macroeconomic data in the US remained robust, there were signs of weakness in various segments, with small businesses reporting continued struggles due to high inflation and tight financial conditions. In addition, small businesses reported much lower hiring expectations, almost the lowest reading in a decade, highlighting that although the job market remained tight, higher rates are taking a toll. Subprime delinquencies and defaults for credit cards and auto loans also continued to increase, suggesting that excess savings have been extinguished, for less affluent segments at least.

April also saw an increase in idiosyncratic risks, especially in the high yield sector, as a number of businesses hired advisors to advise on their capital structures. Altice France reversed an announcement it made last year to use the proceeds of sales of non-core businesses to reduce their leverage, and instead tried to force bond holders to the negotiating table and to include them in the deleveraging process by haircutting the bonds. Although the companies in question were already trading at distressed levels, and these actions are not symptomatic of the market, it highlights the impact that higher yields are having on companies that over-levered on low yields during the post-Covid era of quantitative easing.

Portfolio Commentary

With pressure on both government bonds and risk assets, the Fund's return was just negative at -0.07%, comparing favourably to -0.63% for the ICE BAML 1-5Yr GBP IG Index. Year to date, this means the Fund has now returned +1.34% after fees, some +108 basis points (bps) more than the benchmark over the same period.

With tougher interest rate markets, the floating rate nature of asset-backed securities (ABS) helped produce a solid return for the sector, delivering +0.59% and a contribution of +4bps, with strength broad based across the sector.

Corporate hybrids were the next best, returning +0.25%, with a contribution of +3bps, again with broad-based strength, although Southern Energy was notable in returning +0.64%, more than double the average for the sector.

Senior non-financials had a positive month, returning +0.11% and a contribution of +2bps. This was one sector, however, where strength was not broad based, with the longer dated positions (two- to three-year maturities mostly) tending to have negative returns, while the shorter dated 2024 and 2025 maturities had enough carry to offset modest capital losses and therefore produce positive returns.

Financials overall had a negative month, returning -0.08% and a contribution of -4bps. Within the sector, banks and insurance at the top level were very similar at -0.08% and -0.09% respectively. However, within banks, the breakdown of returns was interesting in that the lower carry senior sector was what drove the negative returns, delivering -0.27% and a contribution of -4bps. This contrasts with Tier 2s, which produced a just positive return of +6bps, while contingent convertible bonds (CoCos) returned an impressive +0.69%, contributing +2bps.

Lastly, government bonds had the biggest losses, returning -1.24%, with a contribution of -19bps, with similar losses coming from the five-year bund and US Treasury holdings respectively.

While a softer landing narrative appears to be increasing in terms of adoption by market participants, the Fund retains a continued lower beta stance than normal given non-financial spreads that, in the views of the portfolio managers (PMs), are starting to look a little too tight for economic risks that still remain significant. Likewise, spread duration remains lower than normal at 1.4 years, but interest rate duration is now close to two years with around 15% in our liquidity bucket of government bonds (US Treasuries and now bunds). Further, given the PMs' concerns over commercial real estate (CRE) issues in the US having the potential to create further insolvencies in the US regional banking sector, the PMs have retained higher credit quality within both the banks and insurance sectors by staying invested in more senior financials than is typical compared to the Fund's history.

To be clear, the PMs have no credit-quality concerns over the banks and insurers held in the portfolio, given their Basel III regulated status, high capital ratios, high-quality loan books and healthy loan/deposit ratios. However, a further liquidity squeeze cannot be ruled out in an environment where depositors could be reading stories of failing US regional banks over the next few months. As such, our PMs believe it prudent to keep a lower level of risk in financials, keeping the overall beta of the Fund slightly lower than before.

Market Outlook and Strategy

With the Fed, BoE and ECB now not only appearing to be at terminal rates but suggesting rate cuts could be as early as June (from the ECB, although later in the year from the Fed and the BOE), the risks to capital from duration risk have ended. However, the significant yield curve inversion in rates curves still makes the three- to five-year maturity sector look especially expensive, even allowing for the potential for rate cuts later this year. As such, a lower-than-average duration profile is still warranted, with peak yields still being less than two years to maturity, and that is predominantly where the Fund is focusing. As duration risks start receding, however, our PMs are concerned that increasing unemployment rates across the US, UK and especially Germany signal worsening GDP data to come – and, in the views of our PMs, recession risks both remain significant and are not fully priced into non-financial spreads. Therefore, a lower beta credit stance is still warranted, although the prospect of rate cuts, possibly beginning with the ECB, has led to the PMs slightly increasing portfolio rates duration, directly through purchasing five-year bunds given German economic weakness.

As such, we believe the combination of low duration and high average yield, with high average credit quality, make short-dated investment grade still a fantastic risk/return opportunity. This is predominantly due to the very high breakeven yield the portfolio now exhibits, with a yield of 5.70% and a duration of 1.9 years meaning the breakeven yield is some +300bps. Although our PMs fully expect some volatility to remain in markets for some months yet, a scenario where the portfolio yield rises by more than 3%, to 9%, over the next 12 months seems very remote, and as such the probability of positive total returns over the next 12 months remains very high.

In these markets, we appreciate having access to portfolio managers is more important than in 'normal' times. Therefore, we would encourage you to reach out to your sales contacts and set up meetings with the PMs to go through anything you would like in more detail.

					Annualised			
Cumulative Performance	1m	3m	6m	1y	3y	5y	10y	Since Inception*
Class G Acc	-0.07%	0.82%	4.04%	6.29%	0.75%	1.53%	N/A	2.32%
SONIA + 250	0.63%	1.91%	3.91%	7.85%	5.22%	4.28%	N/A	3.72%

Discrete Performance	YTD	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Class G Acc	1.34%	6.08%	-4.80%	0.52%	2.47%	5.02%	-0.83%	5.25%	4.99%	N/A	N/A
SONIA + 250	2.58%	7.36%	3.97%	2.59%	2.73%	3.26%	3.11%	2.79%	2.91%	N/A	N/A

Past performance is not a reliable indicator of future performance. The performance figures shown are in GBP on a mid-to-mid basis inclusive of net reinvested income and net of all fund expenses. Performance data does not take into account any commissions and costs charged when shares of the fund are issued and redeemed. The value of an investment and the income from it can fall as well as rise as a result of market and currency fluctuations and you may not get back the amount originally invested. *Inception date: 28 August 2015.

Key Risks

- Limited participation in the potential of single securities
- Success of single security analysis and active management cannot be guaranteed
- It cannot be guaranteed that the investor will recover the capital invested
- Derivatives entail risks relating to liquidity, leverage and credit fluctuations, illiquidity and volatility
- Interest rates may vary, bonds suffer price declines on rising interest rates
- High-yield bonds (non-investment-grade bonds/junk bonds) may be subject to greater market fluctuations, risk of default or loss of income and principal than higher-rated bonds
- The Sub-Fund's investments may be subject to sustainability risks. The sustainability risks that the Sub-Fund may be subject to are likely to have an immaterial impact on the value of the Sub-Fund's investments in the medium to long term due to the mitigating nature of the Sub-Fund's ESG approach
- The Sub-Fund's performance may be positively or negatively affected by its sustainability strategy
- The ability to meet social or environmental objectives might be affected by incomplete or inaccurate data from third-party providers
- Information on how environmental and social objectives are achieved and how sustainability risks are managed in this Sub-Fund may be obtained from Vontobel.com/SFDR

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The Fund considers environmental, social and governance (ESG) factors in the investment process, utilising an integrated approach.
Information on the integration approach may be obtained from **https://www.twentyfouram.com/responsible-investment-policy**

Further information on fund charges, costs and other important information pertaining to the fund can be found in English and free of charge on the fund pages of our website and/or in the relevant offering documents available at www.twentyfouram.com/document-library

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