TwentyFour
a boutique of Vontobel

Fund Commentary | 28 February 2023

TwentyFour Corporate Bond Fund

This Commentary is a marketing communication for professional UK investors only

Market Commentary

After a strong rally in most parts of financial markets in January, February marked a return to negative investor sentiment. Renewed inflation fears and a strong labour market in the US lowered the likelihood of a dovish pivot by the Federal Reserve this year.

The month started with markets on a firm footing, helped by the Federal Open Market Committee (FOMC), who hiked interest rates by 25bps as expected. The subsequent press conference from Jerome Powell was seen as more dovish than anticipated, which caused 10yr Treasury yields to drop below 3.4%. However, the non-farm payrolls (NFPs) report changed the tone entirely, with over 500k new jobs created, compared to an expectation of less than 200k. Moreover, the unemployment rate fell to just 3.4%, which was a 53 year low. With the US economy seemingly firing on all cylinders, investors began to debate whether the Fed would ultimately hike above their 5-5.25% median dot plot, while at the same time, discounted the likelihood of interest rate cuts in 2023. As a result, 10yr Treasury yields increased by 25bps in short order. With ISM services and consumer confidence data also coming in better than expected, the mid-month inflation data was keenly anticipated by investors. Ultimately, the month-on-month Consumer Price Index (CPI) data increased from 0.1% to 0.5% and year-on-year CPI fell less than expected to 6.4%, which made it clear that the battle with inflation was not over.

This data caused year-end interest rate expectations to move aggressively higher from 4.4% at the start of February, to over 5.25% by month end. The 10yr Treasury yield also rose by 60bps to almost 4%.

The inflation story worsened in the Eurozone, and while headline inflation fell for the third consecutive month, supported by energy price caps, core inflation continued to rise, hitting 5.3%. This highlighted that the European Central Bank (ECB) has more work to do to get inflation under control. The UK, on the other hand, saw reasonable falls in core inflation, to below 6%, but headline inflation remained very elevated. Despite the challenges in Europe, European equities continued their impressive 2023 performance, with the STOXX 600 gaining almost 2%. Sentiment towards European equities improved as milder than expected weather meant that Europe avoided a full-blown energy crisis during the winter.

Away from the markets, the 24th of February saw the 1-year anniversary of the start of the war in Ukraine, with little hope of a ceasefire and fears of an escalation of the war by Russian forces. In the UK, the government entered advanced negotiations with the European Union to find a solution to the post-Brexit problems in Northern Ireland and on the 27th of February, Prime Minister Rishi Sunak announced that an agreement had been reached. This gained support from most parties, although somewhat muted support in some quarters.

Portfolio Commentary

The Fund was down -1.71% in February which was a strong relative outperformance in comparison to the iBoxx index's 2.38% fall and the IA sector's -2.12% loss. The move was primarily driven by a sell-off in gilts but also involved some spread widening in higher beta sectors.

The Fund's lower beta allocation relative to the benchmark, particularly the underweight duration position, helped to drive the outperformance. This prudent positioning has more than recovered the relative underperformance the Fund suffered during the rally in January, taking the Fund to +47bps ahead of the IA Corporate Bond sector and 75bps ahead of the iBoxx index year to date.

Looking in detail at the portfolio's attribution over the month, given that the sell-off was driven by gilt moves it was the higher duration sectors which contributed most to losses. Gilts were down 4.45%, contributing -40bps at the Fund level. Investment grade non-financial corporates were down -2.38%, with very little spread movement, contributing -53bps. Financials were down -1.17% contributing -59bps. It's interesting to note that corporate hybrids ,a sector which experienced heightened volatility in 2022, outperformed with a flat return. The managers reduced exposure within this sector to core European and US telecoms and utilities which helped lower the Fund's beta. We also gained some conviction in our view that the sector's current yield overcompensates for risk, as demonstrated by spreads compressing despite a negative backdrop.

Market Outlook and Strategy

The managers are wary of further volatility this year as the lagged impact of monetary policy tightening hits the real economy. That being said, the yields available on fixed income assets are cause for cautious optimism. The team's focus at this point in the cycle is on collecting yield through high-quality bonds which are less sensitive to recessions, rather than reaching for capital gains.

The managers believe rates markets look more fairly priced at this time. There is limited benefit to extending duration materially, so the managers prefer to collect the yield available with less potential volatility at the front end. The current duration of the portfolio is 5.6 years, compared to the index which is 6.6 years.

Cumulative Performance					Annualised			
	1m	3m	6m	1y	3y	5yr	10y	Since Inception*
GBP I Accumulation	-1.71%	0.81%	-0.79%	-11.62%	-4.52%	-0.70%	N/A	1.20%
iBoxx GBP Corporate Bond Index	-2.38%	-0.17%	-0.72%	-12.08%	-5.12%	-0.73%	N/A	1.09%

Discrete Performance	YTD	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
GBP I Accumulation	1.93%	-17.70%	-1.55%	7.56%	9.73%	-2.26%	7.21%	8.48%	-0.58%	N/A	N/A
iBoxx GBP Corporate Bond Index	1.52%	-18.37%	-3.19%	8.63%	11.03%	-2.20%	5.01%	11.83%	0.57%	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 15/01/2015.

Key Risks

- **All financial investment involves risk. The value of your investment isn't guaranteed, and its value and income will rise and fall. Investors may not get back the full amount invested.**
- Past performance is not a reliable indicator of future performance, and the Fund may not achieve its investment objective.
- Fixed income carries two main risks, interest rate risk and credit risk: (1) Where long term interest rates rise, there is a corresponding decline in the market value of bonds and vice versa; (2) Credit risk refers to the possibility that the issuer of the bond will not be able to repay the principal and make interest payments.
- Typically, sub-investment grade securities will have a higher risk of issuer default, and are generally considered to be more illiquid than investment grade securities.
- Overseas investment will be affected by movements in currency exchange rates.
- The Fund has the ability to use derivatives in order to meet its investment objectives. This may magnify gains or losses.

Fund Managers

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