TwentyFour
a boutique of Vontobel

Fund Commentary | 31 March 2024

TwentyFour Corporate Bond Fund

This Commentary is a marketing communication for professional UK investors only

Market Commentary

The month of March was dominated by key central bank meetings and market participants dissecting every economic data point to anticipate when central banks would start their easing cycles. The overall risk sentiment was supported by the market's view that the start of the easing cycle for the Federal Reserve (Fed) was only a few months away.

The European Central Bank (ECB) was the first of the major central banks to hold its meeting in March. While the main rate was left unchanged, officials struck a dovish tone and revised their inflation forecast downwards. Core inflation is now expected to be 2.6% this year, 2.1% in 2025 and 2.0% in 2026; therefore, ECB officials are pointing to core inflation rates being back at their target rate in the near future. The near-term growth forecast was also revised down to 0.6%. Overall, the market started to increase the probability that the ECB could be first of the key central banks to start its cutting cycle. Over the month, the market pricing of a cut for the ECB's June meeting increased.

In the US, March was a heavy month for data releases. First, the jobs report depicted a more nuanced environment; while the non-farm payroll report showed continued strength in the economy (275k versus 200k expected), the unemployment rate rose to 3.9% (its highest level since December 2021) and average hourly earnings slowed to +0.1% (versus +0.2% expected). Subsequently, the US Consumer Price Index (CPI) report indicated that inflation remained sticky: headline CPI came in at a six-month high of +0.44% month-on-month, and core CPI was at +0.36%, which also meant that annual core CPI was above expectations at +3.8% (versus +3.7% expected). This was further confirmed by the Producer Price Index (PPI) as headline numbers came in at +0.6% (versus +0.3% expected).

Despite the stronger readings for inflation, the Fed meeting still struck a slightly dovish tone. They made no changes to the base rate, and the revised dot plots showed that the median dot for 2024 was unchanged, with three cuts for the year expected. The Fed's economic projections were revised higher, with real GDP growth revised up from 1.4% to 2.1%, core Personal Consumption Expenditures (PCE) inflation up to 2.6%, and unemployment revised lower to 4.0%. February core PCE deflator which was published at the end of the month was more supportive however (+0.26% versus +0.3% expected); and although it remained somewhat elevated, it eased considerably after the +0.45% January print. In the face of the mixed data, market pricing for a Fed cut in June was lower over the month.

The Bank of Japan also held an important meeting where it lifted its key short-term interest rate from -0.1% to a range of 0% to 0.1%, its first hike since 2007. Despite a set of measures making monetary policy more restrictive, the tone remained dovish, which led to the yen making a 34-year low against the US dollar towards the end of the month.

The positive risk sentiment was broad based with equity indices making new highs and credit spreads tightening, with European and US high yield spreads down to their lowest since January 2022. In rates, price action was mixed over the month but generally yields finished tighter; the 10-year German bund yield finished the month 11 basis points (bps) lower, the 10-year US Treasury yield declined by 5 bps, and the 10-year UK gilt yield was 19 bps lower.

Portfolio Commentary

With both government bonds performing and credit spreads contracting, the Fund posted a strong return of +2.03% over the month, comfortably outperforming the benchmark return of +1.74% by +29bps, after fees.

For the first quarter and the year to date, this takes the Fund returns to +1.62%, compared to the benchmark return of just +0.21%, reflecting a strong outperformance of +141bps.

Attribution for the month shows strong performance, both in absolute and relative terms, from financials – especially insurance. For example, the portfolio returned +2.51% from the insurance sector versus the benchmark return of +2.05%. Given an overweight to the sector, the relative contribution was therefore +20bps. Similarly, banks outperformed, returning +1.93% versus +1.71%, with Virgin Money 2029 bonds (with a yield of 7.63%) a notable outperformer, returning +4.11% and contributing +2bps due to the Nationwide takeover.

Off-benchmark positions in gilts also produced above-average returns, with every gilt in the portfolio returning at least +2.00%. The best performer was the 2049 gilts (with a yield of 1.75%), returned +2.69%. For reference, the FT Gilt Index returned +1.73%.

Underweight positions in sectors such as consumer discretionary, consumer staples, materials and healthcare also contributed to the Fund's outperformance. These benchmark sectors returned between +1.39% and +1.81%, respectively – less than the portfolio average.

The portfolio managers (PMs) de-risked the credit portfolio early in the second quarter of 2023. This was due to concerns (which are rearing their heads again this year) about the regional banking crisis in the US potentially spilling over into Europe, plus worries about the lagged impact of significant rate hikes in 2022 leading to economic slowdowns and ultimately contractions. Thus, throughout most of last year, the PMs kept a lower level of beta and credit spread duration than the benchmark, and this has continued into early 2024. However, interest-rate duration was significantly increased in 2023 compared to 2022, although a slight bias towards yield-curve steepening was retained. In February and March, duration was further increased to lock in some of the outperformance versus the benchmark, given the rise in yields seen so far in 2024. As such, the portfolio's duration is the closest to the benchmark in many years, reflecting the large-scale rise in yields seen globally in 2022, the first three quarters of 2023 and the start of 2024.

Market Outlook and Strategy

With the Fed, Bank of England (BoE) and ECB now appearing to be at terminal rates, the large risks to capital from duration risk have ended. However, the significant yield-curve inversion in rates curves still makes very long dated credit look expensive, even allowing for the potential for rate cuts later this year, which may take yield curves back towards historic levels of steepness. As such, a modestly lower-than-average interest-rate duration profile remains warranted. However, the PMs remain concerned that increasing unemployment rates across the US, UK and especially Germany signal worsening GDP data to come. Moreover, the PMs believe recession risks not only remain significant but are not fully priced into non-financial spreads. Therefore, a lower beta credit stance remains warranted.

As such, we believe the combination of lower than benchmark duration (-0.4 years versus the benchmark) and higher average yield, with high average credit quality, is the best way to address the likely volatility in the broader market that we expect over the next few months, while still producing a solid income. This stance is designed to maximise the breakeven yield as much as possible within the constraints of the Fund. This means that, with a yield of 5.73% and a duration of 5.74 years, the breakeven yield is almost +100bps, which provides more protection against rising yields than the benchmark.

In these markets, we appreciate having access to PMs 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 discuss anything you like in more detail.

					Annualised			
Cumulative Performance	1m	3m	6m	1y	3y	5y	10y	Since Inception*
GBP I Accumulation	2.03%	1.62%	9.55%	8.54%	-2.64%	0.40%	N/A	1.98%
iBoxx GBP Corporate Bond Index	1.74%	0.21%	8.40%	7.45%	-3.15%	-0.01%	N/A	1.84%

Discrete Performance	YTD	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
GBP I Accumulation	1.62%	9.09%	-17.70%	-1.55%	7.56%	9.73%	-2.26%	7.21%	8.48%	N/A	N/A
iBoxx GBP Corporate Bond Index	0.21%	9.70%	-18.37%	-3.19%	8.63%	11.03%	-2.20%	5.01%	11.83%	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

- 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 Fund's investments may be subject to sustainability risks. The sustainability risks that the Fund may be subject to are likely to have an immaterial impact on the value of the Fund's investments in the medium to long term due to the mitigating nature of the Fund's ESG approach
- The 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 Fund may be obtained from **www.twentyfouram.com/responsible-investment**

Fund Managers

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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