TwentyFour
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Fund Commentary | 31 May 2024

TwentyFour Corporate Bond Fund

This Commentary is a marketing communication for professional UK investors only

Market Commentary

If April was a difficult month for markets, May proved to be almost the exact opposite, with rates rallying, credit spreads tightening and US equity markets recovering from the April dip and hitting new highs.

Starting in the US, strong economic data and persistent inflation had pushed 10-year Treasury yields to year-to-date highs of over 4.7% in late April. At the start of May, the Job Openings and Labor Turnover Survey (JOLTS) data came in much weaker than predicted, while the ISM Manufacturing New Orders index also fell to contraction territory, giving some respite to the markets. Later that evening, the Federal Reserve (Fed) kept rates on hold and, although Chairman Powell was not dovish in his comments, the pace of quantitative tightening (QT) was slowed by more than expected, with Treasury runoff dropping to $25bn per month, from $60bn per month, and with mortgage-backed securities (MBS) kept at $35bn. With the statement being less hawkish than markets feared, and QT slowing significantly, markets enjoyed a relief rally. This gained traction later in the week, when non-farm payroll data fell to 175k, much lower than the 240k expected, while the unemployment rate rose slightly to 3.9%, and average hourly earnings also fell, to 0.2% for the month and 3.9% year-over-year (YoY). This data supported arguments that the labour market was finally loosening and wage inflation was slowly normalising – important factors if the Fed is to cut rates later this year.

The rally continued through mid-month, with inflation data mainly coming in as expected, with the core Consumer Prices Index (CPI) at 3.6% YoY, and monthly headline CPI slightly lower than expected at 0.3%. However, with 10-year yields back down to 4.34%, and a plethora of Fed speakers emphasising the need to be patient to see a clear trend before cutting rates, rates began to retrace some of the rally. Yields then fell again near month-end on further signals that the US economy was weakening and high base rates were lowering economic activity.

Economic data in the eurozone was mixed but with signs of economic activity picking up and growth returning. However, a rate cut from the European Central Bank (ECB) has been fully priced in for June, and there was considerable debate as to how far the ECB would be willing to diverge from the US should the Fed continue to hold firm on rates. Rate cut expectations for the ECB were maintained at between two and three by year-end. In the UK, inflation came in hotter than expected but continued to fall; headline UK inflation at 2.3%, below both the US and eurozone, which would have been seen as unlikely a year ago. However, with GDP growth coming in better than expected, the outlook for rate cuts is also mixed, and just over one cut is expected this year.

Away from macro data, the political scene hotted up, with a general election being announced in the UK for July 4, with the Labour party well ahead in the polls, although both the Labour and Conservative parties are perceived as being fairly centralist, and little economic impact is expected. The Bank of England (BoE) announced that it would cease communications until after the election (although it remains unclear whether anyone noticed!).

The US election season took a bizarre turn, when Donald Trump, who is expected to be confirmed as the Republican party's candidate, was found guilty of 34 felony counts in his 'hush money' case. He is due for sentencing just before the Republican National Convention and is the first former or sitting president to be convicted of a crime, although the guilty verdict didn't seem to have much of an impact on his popularity and he remains slightly ahead in polls for the presidential election.

Portfolio Commentary

May was a good month for the Fund both in absolute and relative return terms, with the Fund returning +1.08% after fees, compared to the benchmark's return of +0.91%, meaning the Fund generated alpha of +17bps for May.

For the year-to-date period, this takes returns to a positive +0.94% for the Fund, compared to a negative -0.74% for the benchmark, substantial alpha for the first five months of the year of +168bps.

Attribution for the month shows strong performance in relative terms from financials, with banks and insurance having similar positive effects. Banks held in the portfolio returned +1.21%, compared to +1.12% from the benchmark. Similarly, the insurance sector also saw outperformance versus the benchmark, returning +1.39% versus +1.19%. Financials overall returned +1.23%, contributing +12bps more than the benchmark.

Utilities also saw outperformance, returning +1.18% at the portfolio level, compared to +0.78% from the benchmark, with the focus on shorter dated hybrid utilities with higher yields generating greater returns.

Underweight positions in sectors such as consumer discretionary, consumer staples, materials and healthcare also helped the Fund outperform, with these benchmark sectors returning between +0.58% and +0.69% less than both the benchmark and portfolio averages.

Having de-risked the credit portfolio in early Q2 2023 due to concerns about the regional banking crisis in the US potentially spilling over into volatility in Europe (which are coming to the fore again in 2024), plus concerns about the lagged impact of significant rate hikes in 2022 leading to economic slowdowns and even ultimately contractions, the portfolio managers (PMs) kept a lower level of beta and credit spread duration than the benchmark throughout most of last year, and this has continued into early 2024.

Interest rate duration, however, was significantly increased in 2023 compared to 2022, although a slight bias towards yield curve steepening was retained. In February, and further in March, April and May, duration was further increased to lock in some of the outperformance versus benchmark, given the rise in yields seen so far in 2024. As such, the portfolio's duration is the closest to 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, BoE and ECB now appearing to be at terminal rates, the large risks to capital from duration risk have ended – but the significant yield curve inversion in rates curves still makes very long-dated credit look especially 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 is still warranted. However, the PMs remain concerned that increasing unemployment rates across the US, UK and especially Germany signal worsening GDP data to come – and that recession risks both remain significant and are not fully priced into non-financial spreads. Therefore, a lower beta credit stance is still warranted.

As such, we believe the combination of lower-than-benchmark duration (-0.25 years versus benchmark) and higher average yield, with high average credit quality, is the best way to address the likely volatility in the broader market 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, meaning, with a yield of ~5.75% and a duration of 5.75 years, the breakeven yield is exactly +100bps, which provides more protection against rising yields than the benchmark.

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 like in more detail.

Cumulative Performance	1m	3m	6m	1y	Annualised 3y	5y	10y	Since Inception*
GBP I Accumulation	1.08%	1.35%	5.64%	9.72%	-3.19%	0.09%	N/A	1.87%
iBoxx GBP Corporate Bond Index	0.91%	0.78%	3.86%	8.70%	-3.79%	-0.34%	N/A	1.70%

Discrete Performance	YTD	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
GBP I Accumulation	0.94%	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	-0.74%	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**

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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

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