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TwentyFour ASSET MANAGEMENT

Vontobel Fund – TwentyFour Sustainable Short Term Bond Income

Monthly Commentary | 29 October 2021

Market Commentary

October was a challenging month for credit, as volatility in rates weakened investor sentiment. Conversely, the S&P 500 index was up 6.9%, and the Eurostoxx 50 was up +5.0%, supported by primarily strong earnings releases. The iTraxx Xover index was wider by around 11bp, and key rates markets saw front-end yields move higher over the month

Central bank rhetoric and the subsequent move in rate yields were the key focus, with the BoE and the gilts market stealing the limelight as the market moved forward its expectations of a rate hike by the end of this year. The new Bank of England chief economist Huw Pill stated that inflation could rise higher than the central bank's 2% target and implied that the November committee meeting was "live" regarding a move in monetary policy. This followed comments from Governor Bailey that he expected inflation to last for longer, and the bank would have to act accordingly. In response, the market is now pricing in a rate hike at the BoE's next meeting on November 4th, followed by another hike February 2022 meeting. As a result, the five-year gilt yield widened by nearly 20bp over the month, finishing at 0.83%.

Inflation continued to be the key focus for fixed income participants as the evidence mounts that it may not be merely transitory as some central bankers maintain. Rising energy prices, supply chain disruptions, shortage of labour, infrastructure and transport problems and record lead times on raw materials are all compounding, leading to a continuation of high inflation prints from the summer, thereby fuelling a steady increase in average hourly earnings. In addition, US CPI beat expectations, coming in at +5.4% YoY and +0.4% MoM, which added weight to the discussion that the Fed would have to hike rates earlier than expected. Likewise, German CPI moved from 4.1% to 4.5%, with PPI in Germany now running at a staggering 14.2%.

Earnings season kicked off as usual with the US banks. Overall, earnings numbers were solid. However, there were some key misses; Apple, noticeably disappointed versus expectations, with the company citing "larger than expected supply constraints" as a factor, adding to the argument that supply chain disruptions will likely persist well into next year.

There were various other economic data releases over the month. China Q3 GDP was a small miss versus expectations at 4.9% (5.0% consensus), as was US Q3 GDP (2.0% vs consensus 2.6%). US non-farm payrolls also disappointed, coming in at 194k for September versus expectations of 500k whilst average hourly earnings ticked higher to +0.6% MoM and the unemployment rate was lower at 4.8% as the labour force participation rate declined.

Portfolio Commentary

Aggressive bear flattening characterised UK and US government bond curves, led by significant sell-offs in two-year to five-year maturities (moves higher of +32bp to +20bp for Gilts and +23bp to +25bp for UST's), which came with a pivot around the 10-year points. Therefore, placing short-dated credit under a large amount of pressure purely from rates risk in October. As such, the fund was down -0.53% for the month after fees. Although the fund is not explicitly measured against a benchmark, for reference, the iShares GBP 0-5-year IG Credit ETF was down -0.66%. Year-to-date that takes the fund to +0.24%, versus -1.11% for the iShares ETF.

According to the fund's attribution, the weakness was broad-based across fixed-rate credit, with notable outperformance of the floating rate side of the portfolio, where RMBS returned +0.04%, and the fund's US Treasury holdings returned -0.06%. Significantly correlated losses occurred in the remaining fixed-rate sectors, with losses of -0.70% in Corporate Hybrids, -0.53% in Banks, -0.55% in Insurance and -0.44% in Senior Non-Financials.

The persistence of global inflation risk, a pickup in PPI input prices (Germany currently 14.2% and Spain 23.6%) and more hawkish noises from both the Federal Reserve and the Bank of England led the PMs to reduce the duration of the fund slightly further, to 1.86 years from 2.33 years. In addition, the team increased the liquidity bucket to 18%.

Furthermore, the PM's view the underperformance of UK short rates as an opportunity to move some of the fund's short-dated US Treasury exposure into short-dated gilts, taking advantage of the improving relative valuations and reducing exposure to the front end of the US curve should a readjustment be imminent.

Whilst this lowers the beta and risk profile of the fund, the PM's believe this best positions the fund to handle potentially a more volatile marketplace leading through the end of 2021, and the additional liquidity will allow them to grasp any forthcoming opportunities when they occur.

On ESG specifically, the team pushed HSBC for detail on its plans around its gender pay gap, motivated by recent revelations that it possesses one of the largest in the industry. HSBC acknowledged the issue and described their plan to address this and, more generally, on improving diversity across their business. As well as assigning a team to ensure and promote D&I across the company, they have set 2025 targets. We appreciate that this is not a quick fix, so we will review the stats in six months when HSBC provide updated figures in their CSR report.

Market Outlook and Strategy

Continued rallies in fixed income during 2021 have further brought into sharp relief just how expensive bond markets have become – and the risks to capital from long-duration assets whilst yield curves steepen.

Given the tighter nature of non-financial spreads in IG, we focus slightly more on financials where the yield advantage is considerable (even within short-dated IG) and favour Hybrids within non-financials. Still, we are keeping spread duration very low (taking it even lower) to protect capital whilst generating that yield.

Recent hawkishness from central banks may well lead to continued periods of volatility into the end of 2021, but still nothing like what we saw in March 2020. However, the valuations in some parts of financial credit remain attractive enough that, in our view, investors remain well compensated for future risks, and that is also the case in selective Hybrid non-financials. Finally, by focussing on short-dated investment-grade and keeping positions restricted to our best ideas only (that is why we limit portfolio line items to a maximum of around 100 bonds), we believe some of the highest risk-adjusted returns in all of fixed income can continue to be generated by this fund.

Rolling Performance	30/10/2020 - 29/10/2021	31/10/2019 - 30/10/2020	31/10/2018 - 31/10/2019	31/10/2017 - 31/10/2018	31/10/2016 - 31/10/2017
Class G	1.30%	N/A	N/A	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 22/01/2020.

The Team

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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.
- 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.
- The fund can invest in structured credit products or asset-backed securities (ABS). The issuer of such products may not receive the full amounts owed to them by underlying borrowers, which would affect the value of the fund. Credit and prepayment risks also vary by tranche which may affect the fund's performance.
- The fund has the ability to use derivatives, including but not limited to FX forwards, for hedging purposes only (EPM). This may magnify gains or losses.
- Fixed income carries two main risks, interest rate risk and credit risk: (1) Where long term interest rates rise, there is a corresponding decline the 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.
- Sustainable investing is qualitative and subjective by nature, and there is no guarantee that the criteria utilised, or judgement exercised by will reflect the beliefs or values of any one particular investor or that all sustainability criteria will always be met for every investment. Negative impact on performance due to pursuing sustainable economic activity rather than a conventional investment policy is possible.

Further Information and Literature: TwentyFour Asset Management LLP

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Further information on fund charges and costs are included on our website at www.twentyfouram.com

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For definitions of the investment terminology used within this document please see glossary at: https://twentyfouram.com/glossary

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