Vontobel Fund – TwentyFour
Sustainable Short Term Bond Income

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Market Commentary

December was a strong month for markets, as sentiment on the Omicron COVID-19 variant improved and markets digested the hawkish pivots taken by central banks. As a result, the S&P finished the month up by 4.4%, whilst the EuroStoxx50 was up by 5.8% in December. In credit, the iTraxx Xover index was 46bp tighter by the end of the month at 242bp. Market participants were comforted by early data that suggested the Omicron variant of COVID-19 would prove less severe than previous strains. Furthermore, results from initial studies on the efficacy of existing vaccines were encouraging, with three doses of Pfizer found to be 75.5% effective against any symptomatic disease. At the same time, two doses offer 70% protection against hospitalisation. This positive news overshadowed the introduction of some restrictions in the developed world that mainly concentrated on international travel and the unvaccinated. The Fed's Open Market Committee (FOMC) took a hawkish tilt in their December meeting, announcing that they would double the pace of tapering to $30bn a month, meaning it would end QE in March 2022. The new dot plots indicated three rate hikes in 2022, with an additional three in 2023 and two in 2024, representing a significant shift from the previous dot plots from September. Powell also officially dropped the term transitory with regards to inflation. The market processed this shift well, mainly because it was extremely well flagged by Powell and a range of committee members in the weeks preceding the meeting. The Bank of England (BoE) on the margin surprised the market with a 15bp hike to 0.25% - the Monetary Policy Committee acted due to the labour market appearing 'very tight' and forecasting inflation to peak at 'around 6%' in 2022, an increase from their prior level of 5.1%. The small nature of the hike and the fact that participants expected the Bank of England to hike back in November resulted in a muted market reaction. The ECB on the same day announced that they would be ending net purchases of PEPP in March 2022, while transitioning to an increased APP of €40bn a month in Q2 2022, €30bn in Q3, and then to €20bn a month from October. Overall, the market viewed the European developments as a fairly neutral outcome. In terms of data, the headline US CPI number release of 6.8% was the highest reading since 1982, and a strong household employment report resulted in the unemployment rate falling to 4.2%. The 10-year US Treasury yield finished the month 7bp higher at 1.51%– though perhaps this yield would have been higher if not for the technical factors affecting the year-end.

Portfolio Commentary

With two-year US Treasury yields moving from 0.56% at the end of November to close 2021 at 0.73%, there was significant pressure on the front end of yield curves over December. Despite this, the fund managed to produce a positive return of +0.11% for the month, after fees, having sold all of its two-year US Treasuries throughout late Q3 and early Q4. Instead, the managers deployed the cash in three-month US Treasury bills and one-year gilts, whilst credit generally did well. For Q4 overall, the fund was down -0.53%, as the market got to grips with hawkish commentary and moves in short term rates expectations. Although the fund returns for both November and December combined were exactly flat, being 0.00% after fees, so in reality, the Q4 losses all occurred right at the start of the quarter in October. For the entire calendar year of 2021, the fund had a positive return of +0.24% after fees during a challenging year for fixed income. For example, gilts fell by -5.16% (FT Gilt Index), and the iBoxx GBP Corporate Bond Index was down -3.19%. Meanwhile, US Treasuries fell by -2.32% (Bloomberg US Treasury Index, USD), and the iBoxx Liquid IG USD corporate bond index was down -1.49%. Similarly, in Europe, Bunds (Bloomberg Bund index, EUR) were down -0.92%, and the iBoxx EUR corporates index was down -1.08%. If we analyse at the full year (gross) attributions, the negative returns came from the lowest yielding credit sector of non-financial investment-grade corporates, which returned -0.27% for the sector, contributing -3bp at the portfolio level given the fund's minimal allocation to this sector throughout the year (given some of the poorest breakeven yields in the fund's investment universe). Perhaps surprisingly, given the short end yield curve moves, the attribution contribution returns for government bonds were exactly flat for 2021. In fact, the major loss-making position within this sector was the April 2023 US Treasury Bond holding, which was down -0.17% and contributed -1bp, whilst the gilts held towards the end of the year, and indeed the US Treasury bills held more recently, have actually produced positive returns which exactly offset the -1bp contribution loss from the US Treasury Bond. ABS represented the best performing sector, returning +1.96%, contributing +0.17%. While this sector (we only own RMBS) is entirely floating rate, it had a surprisingly good year and actually benefited from rising short rates. As a result, we kept exposure to this sector as high as we are allowed throughout the year (max allowed of 10%, average weight in 2021 was 8.84%). The fixed-rate version of ABS, Secured Bonds, was the next best performing sector, returning +1.81% with a contribution of +4bp. The contribution was so small simply because the average weight was just 2.56%. As much as we love this sector, the reality is that most of the bonds we like in this sector have maturities beyond what is allowed in the portfolio, so the few shorter-dated bonds in this sector that do match our preferences, we owned. They performed well, but we could not hold more of them. Financials also performed well, returning +1.28%, with a contribution of +64bp and an average weight of 47.8%. The split within financials was returns of +1.52% and +1.06%, and contributions of +36bp and +27bp, respectively, from the Banks and Insurance sub-sectors. As much as the relative valuations of financials were more attractive than non-fins (and continue to be so), and the creditworthiness, if anything, improved during 2021 (strong and improving capital and solvency ratios), the managers are uncomfortable from a diversification perspective having more than half of the portfolio in financials. Thus the sector's weighting remained just under 50% on average. Corporate Hybrids rounded out the returns, up +1.27% and contributing +14bp with an average weight of 12.8%. Similarly to financials, the yield advantage versus senior bonds was advantageous. However, the higher beta nature of the sector cannot be discounted and thus, the managers have been careful to trim duration to this sector over recent months. In terms of the overall stance of the portfolio, the end of Q3 into early Q4 saw reasonably significant action to lower the beta profile of the fund against the background of more significant inflation and short rates uncertainly. Portfolio duration was reduced from 2.4 years to 1.7 years by selling 3-5 year positions and buying 0-1 year bonds, taking the weighting to 0-1 year bonds to 33% of the portfolio. Further, in terms of credit beta, the managers increased the government bond allocation to ~15% of the fund and allowed the BB high yield weighting to decline slightly. However, there were significant changes within the government bond allocation following the more pronounced sell-off at the front end of the UK yield curve. The managers sold two-year US Treasuries, and the proceeds reinvested in a combination of three month US Treasury bills (thereby dramatically lowering the duration of US$ curve exposure) and one-year UK gilts given the improvement in the relative value of UK gilts (and simultaneous reduction of near term risks given what is priced into the UK curve). Whilst this lowered the beta and risk profile of the fund, the managers believe this best positions the fund to handle potentially a more volatile marketplace leading through early 2022, and the additional liquidity will allow the team to take any forthcoming opportunities as they arise.

Market Outlook and Strategy

As we end the balance sheet expansion of both US and UK central banks, and with inflation remaining stubbornly high (and which may in fact not have peaked yet), the risks appear to be towards higher rates yields and possibly steeper curves should short rate hikes continue to be slower to come through than in previous cycles – thus the managers prefer to keep duration under two years for now. Given the tighter nature of non-financial spreads in investment grade, we continue to focus slightly more on financials where the yield advantage is considerable (even within short-dated investment grade) and favour Hybrids within non-financials. Still, we are keeping spread duration very low (taking it even lower) to protect capital while generating that yield. Recent hawkishness from central banks may well lead to continued periods of volatility into early 2022, but we still expect nothing like the volatility 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. By focusing 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 this fund can continue to generate some of the highest risk-adjusted returns in all of fixed income.

Rolling Performance	31/12/2020 - 31/12/2021	31/12/2019 - 31/12/2020	31/12/2018 - 31/12/2019	31/12/2017 - 31/12/2018	31/12/2016 - 31/12/2017
Class G	0.24%	1.58%	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.

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.

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