TwentyFour
a boutique of Vontobel

Fund Commentary | 31 January 2024

Vontobel Fund - TwentyFour Sustainable Short Term Bond Income

This Commentary is a marketing communication for professional UK investors only

Market Commentary

January was a busy month for markets in terms of issuance and news flow. While government bond yields initially moved higher, reversing the strong rally at the end of 2023, these moves reverted again at the end of the month with the US 10-year Treasury yield just three basis points (bps) higher, at 3.91%. In risk assets, the S&P and Euro Stoxx were up 1.6% and 2.8% respectively, while the iTraxx Crossover moved 17bps wider from 311 to 328bps.

At the beginning of the month, the US job market showed that it was still in a very healthy condition, with 216k added to payrolls (versus 173k expected) and the unemployment number coming in lower than expected at 3.7%. Meanwhile, headline inflation came in at 3.4% year-on-year (YoY), versus 3.2% expected, with core inflation at 3.9%, versus 3.8% expected. The main driver was shelter, which was up by 0.46% month-on-month (MoM). The strong data was combined with comments from Federal Open Market Committee (FOMC) members to result in higher bond yields – Federal Reserve Bank of Atlanta President, Raphael Bostic, said he saw the first cut "in the third quarter this year", while fellow FOMC member Christopher Waller said any cuts would be done "methodically and carefully". The 10-year US Treasury yield saw a high of 4.17% in January.

The European Central Bank (ECB) also attempted to temper the market's moves from the end of 2023, with President Lagarde stating at the ECB press conference that it was "premature to discuss rate cuts". Meanwhile, in the UK, the January Consumer Price Index (CPI) print saw a rebound in headline CPI, coming in at 4% YoY (versus 3.8% expected). Gilts sharply sold off, with the 10-year gilt yield climbing back above 4%.

Government rates did, however, move lower towards the end of January. This was driven first by the announcement that the US treasury was lowering its borrowing estimate for Q1 from $816bn to $760bn, a larger decline in supply than expected by the market, and then from the news that New York Community Bancorp had posted a surprise loss that saw shares fall by 38% and led to some market fears again about the US regional banking sector.

The first month of 2024 saw a huge amount of issuance across the board, with Europe breaking its previous record of €293bn, with €351bn for the month of January. Meanwhile, in the US, there was $176bn of issuance in investment grade alone, another January record. Credit overall performed well in the face of the large issuance, with book coverage strong.

Increased geopolitical tension was seen in the month as the US and the UK carried out strikes against Houthi rebels in Yemen following attacks on commercial ships in the Red Sea, which sparked some volatility in oil prices. Meanwile, in US politics, Donald Trump won the first two primaries in the race for the Republican nomination and so seemingly only the courts can stand in the way of him being the Republican candidate for the 2024 presidential race.

Portfolio Commentary

With a significant sell-off in UK government bonds over the month, the iBoxx GBP Corporate Bond Index was also down -0.87%, with the short-dated BAML 1-5Yr GBP Index also posting a negative return of -0.01%. In contrast, the Fund returned +0.50% after fees for the month, helped by a low-duration stance and its positioning in bonds and sectors that produced good carry. In fact, the month's return was very close to one twelfth of the portfolio yield.

The floating-rate ABS sector led the returns, delivering +1.27% and a contribution of +8bps, helped by modest spread contraction which produced a return slightly in excess of the yield for the month.

Next, corporate hybrids returned +0.89% for a total contribution of +9bps, with strength across the telecoms and utilities sub-sectors.

Financials overall returned +0.52%, contributing +21bps, with insurance exactly matching banks, with both producing +0.52%, although the contribution from banks was higher at +14bps versus +8bps. Within the insurance sub-sectors, T3 and subordinated insurance were slightly different, T3 returning +0.63% with subordinated returning +0.60%. Turning to banks, the subordinated sectors outperformed, with lower tier 2s returning +0.91% and AT1s returning +0.72%, compared to senior banks returning +0.32%.

Senior non-financials, in contrast, were below the portfolio average at +0.32%, contributing +7bps, with returns pretty consistent across holdings, reflecting the lower beta nature of the sector.

Lastly, the government bonds held in the Fund returned +0.24%, with a contribution of +3bps.

While a softer landing narrative appears to be increasing in terms of adoption by market participants, the Fund retains a continued lower beta stance than normal given non-financial spreads that, in the portfolio managers' (PMs') views, are starting to look a little too tight for the economic risks that still remain significant. Likewise, spread duration remains lower than normal at 1.3 years, with around 15% in our liquidity bucket – of government bonds (US Treasuries and now gilts), supranationals and cash – also being higher than normal.

Further, given the PMs' concerns over commercial real estate (CRE) issues in the US having the potential to create further insolvencies in the US regional banking sector, the PMs have retained higher credit quality within both the banks and insurance sectors by staying invested in more senior financials than is typical compared to the Fund's history. To be clear the PMs have no credit-quality concerns over the banks and insurers held in the portfolio, given their Basel III regulated status, high capital ratios, high-quality loan books and healthy loan to deposit ratios – however, a further liquidity squeeze cannot be ruled out in an environment where depositors could be reading stories of failing US regional banks over the next few months.

As such, the PMs believe it prudent to keep a lower level of risk in financials, keeping the overall beta of the Fund slightly lower than before. Over the next few months as we await further clarification on the likely tightening of monetary conditions from stricter lending standards in the banking sector, the PMs believe there will be opportunities to add beta – but that right now is not the time to add significant portfolio risk.

Market Outlook and Strategy

With the Federal Reserve (Fed), Bank of England (BoE) and ECB now not only appearing to be at terminal rates, but actively talking of rate cuts, the risks to capital from duration risk appear to have ended – but the significant yield curve inversion in rates curves still makes the three-to-five-year maturity sector look especially expensive in our view, even allowing for the potential for rate cuts later this year. As such, a lower-than-average duration profile is still thought to be warranted, with peak yields still being less than two years to maturity, and that is predominantly where the portfolio is focusing. As duration risks start receding, however, the PMs are concerned that increasing unemployment rates across the US, UK and especially Germany signal worsening GDP data to come – and recession risks both remain significant and are not fully priced into non-financial spreads, in the PMs' views. Therefore, a lower beta credit stance is still considered warranted.

As such, we believe the combination of very low duration and high average yield, with high average credit quality, make short-dated investment grade still an attractive risk-return opportunity. This is predominantly due to the very high breakeven yield the portfolio now exhibits, with a yield of 5.82% and a duration of 1.5 years meaning the breakeven yield is some +382bps. Although the PMs fully expect some volatility to remain in markets for some months yet, a scenario where the portfolio yield rises by more than around +4% to around 10% over the next 12 months seems remote, and as such the probability of positive total returns over the next 12 months is believed to remain high.

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 portfolio managers to go through anything you would like in more detail.

					Annualised			
Cumulative Performance	1m	3m	6m	1y	3y	5y	10y	Since Inception*
Class G	0.50%	2.93%	4.27%	5.70%	0.91%	N/A	N/A	1.08%
SONIA + 250	0.65%	1.96%	3.95%	7.52%	4.77%	N/A	N/A	4.24%

Discrete Performance	YTD	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Class G	0.50%	6.52%	-4.21%	0.24%	N/A	N/A	N/A	N/A	N/A	N/A	N/A
SONIA + 250	0.65%	7.36%	3.97%	2.59%	N/A	N/A	N/A	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.

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

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The Fund considers environmental, social and governance (ESG) factors in the investment process, utilising an integrated approach. Information on the integration approach may be obtained from **https://www.twentyfouram.com/responsible-investment-policy**

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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