

Vontobel Fund - TwentyFour Sustainable Short Term Bond Income

This Commentary is a marketing communication for professional UK investors only

Market Commentary

February was yet another month of conflicting economic data for investors to digest, but ultimately one where risk assets performed strongly, especially equity markets, with the S&P 500 going through 5,000 for the first time and the Nikkei finally getting back to 1989 highs. Tech companies were the main drivers behind equity indices reaching new highs, with the hype surrounding artificial intelligence (AI) continuing to drive very strong performance, and Nvidia added almost \$0.5tn to its valuation in February alone.

Kicking off the month in the US, ISM manufacturing, new orders and prices paid all came in well ahead of consensus, and, the following day, nonfarm payrolls added 353k jobs, when only an addition of 185k was expected, while the unemployment rate fell to just 3.7%. In addition, average hourly earnings were much stronger than expected and reinforced the message that inflation was likely to be sticky and that the easier progress had already been made. Inflation data for January, which was reported mid-February, supported this, with headline and core CPI coming in hotter than expected, for both monthly and yearly readings. In reaction to this, Treasury yields, which had fallen at the end of January on renewed fears around US regional banks (New York Community Bank equity down 25% for the month), began to climb; 10-year Treasury yields, which started the month at around 3.9%, reached year-to-date highs of 4.32%, as projections of interest rate cuts were moved further into 2024. Along with strong economic data and sticky inflation, US Federal Reserve (Fed) officials continued to play down any imminent cuts to base rates, with official after official emphasising the need to be patient while inflation came closer to target, as the economy remained robust.

In Europe, economic data continued to be mixed, supporting the view that rates could be cut sooner than in the US. However, European Central Bank (ECB) officials echoed the message from the Fed and stuck to the line that they needed to be patient until prices were under control; they pointed to wage expectations remaining high as a reason to stay restrictive. As the month wore on, manufacturing and services Purchasing Managers' Index (PMI) numbers came in ahead of expectations, adding to rhetoric that rate cuts could be slow to emerge in the EU, while regional CPI numbers at month end also suggested that inflation, which had fallen rapidly, was becoming stickier. In response to the better data, and to the move higher in Treasury yields, German bund yields also climbed over the month, with the 10-year maturity yield increasing from 2.16% to 2.40%. In the UK, economic data was even more mixed, with inflation data coming in lower than expected and the Office of National Statistics confirming the UK entered a technical recession in H2 2023. However, the consumer remained strong and average weekly earnings remained higher than expected.

All in all, the strong data continues to surprise market commentators, meaning that rate cut expectations are being re-examined and in the US over 50 basis points (bps) of expected cuts were removed for 2024, while 45bps of cuts were removed from the German bund curve.

Portfolio Commentary

With a significant sell off in government bonds over the month, the short-dated BAML 1-5 Year GBP Index also posted a negative return of -0.33%. In contrast, the Fund returned +0.14% after fees for the month, delivering outperformance of +47bps, helped by a low-duration stance and being positioned in bonds and sectors that produced good carry. In fact, the Fund achieved its all-time high in net asset value (NAV) high on the last day of the month, February 29, meaning that year-to-date returns are +0.64%, compared to -0.36% for the benchmark, an outperformance of +100bps.

Attribution for the month shows especially strong returns from floating-rate asset-backed securities (ABS), which returned +0.83% for a total contribution of +6bps, with strength across the highest quality AAA and also the lower rated AA and A sectors.

Financials overall returned +0.25%, contributing +10bps, with insurance outperforming banks by a decent margin. Insurance returned +0.34%, with the subordinated insurance subsector outperforming tier 3s (T3s), while banks returned +0.20%, though subsector returns were very differentiated. Within banks, the subordinated sectors outperformed, with lower T2s returning +0.21% and additional tier 1s (AT1s) returning +0.88%, compared to senior banks returning +0.02%.

Corporate hybrids also returned +0.17%, with a lower contribution however of +2bps, with utilities slightly outperforming telecoms.

Senior non-financials, in contrast, returned +0.15%, contributing +3bps, with returns pretty consistent across holdings, reflecting the lower beta nature of the sector.

Lastly, the government bonds held in the Fund returned -0.37%, making a contribution of -5bps. Within this, the longest dated US Treasury, the 4% of December 2025, was the worst performer, returning -0.51%, compared to a similar maturity gilt, the 3.5% of October 2025, which was down by -0.23%. During the month, the portfolio managers (PMs) added a position in five-year German bunds for the first time in several years, buying the DBR 0.25% of February 2029, in order to gently start raising the overall duration profile of the Fund as we edge closer to the first rate cuts globally, which may well end up being from the ECB: hence, adding a little Euro curve duration is prudent.

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 views of the PMs, are starting to look a little too tight for economic risks that still remain significant. Likewise, spread duration remains lower than normal, at 1.25 years, with around 14% in our liquidity bucket – of government bonds (US Treasuries, gilts and now bunds) – 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/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, maintaining the overall beta of the Fund slightly lower than before.

Market Outlook and Strategy

With the Fed, ECB and Bank of England (BoE) now not only appearing to be at terminal rates but actively talking of rate cuts, the risks to capital from duration risk have ended – but the significant yield curve inversion in rates curves still makes the three-to-five-year maturity sector look especially expensive, even allowing for the potential for rate cuts later this year. As such, a lower-than-average duration profile is still 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 views of the PMs. Therefore, a lower beta credit stance is still warranted, though the prospect of rate cuts, possibly beginning from the ECB, has led to the PMs slightly increasing portfolio rates duration, directly through purchasing five-year bunds, given German economic weakness.

As such, we believe the combination of very low duration and high average yield, with high average credit quality, make short-dated investment grade (IG) still a fantastic risk/return opportunity. This is predominantly due to the very high breakeven yield the portfolio now exhibits, with a yield of 5.81% and a duration of 1.6 years meaning the breakeven yield is some +363bps. 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 ~+3.5% to ~9.5% over the next 12 months seems very remote, and, as such, the probability of positive total returns over the next 12 months remains very 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 PMs to go through anything you would like in more detail.

Cumulative Performance	1m	3m	6m	1y	Annualised				Since Inception*
					3y	5y	10y		
Class G	0.14%	1.96%	4.07%	5.98%	0.98%	N/A	N/A	1.09%	
SONIA + 250	0.61%	1.93%	3.91%	7.65%	4.92%	N/A	N/A	4.31%	

Discrete Performance	YTD	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Class G	0.64%	6.52%	-4.21%	0.24%	N/A	N/A	N/A	N/A	N/A	N/A	N/A
SONIA + 250	1.27%	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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