

# Vontobel Fund - TwentyFour Sustainable Short Term Bond Income

This Commentary is a marketing communication for professional UK investors only

## Market Commentary

October was volatile for fixed income markets as a combination of resurgent economic data and the increasing probability of a Trump presidency led to a material sell-off in government bonds. Investors adjusted their expectations to anticipate a slower and more gradual rate-cutting cycle from the US Federal Reserve (Fed), which contributed to a 50 basis point (bps) rise in 10-year Treasury yields over the month. Credit performed well as a result of further spread tightening and the continuing strong financial performance from the majority of companies.

Markets started the month strongly, with a significantly better-than-expected US labour report surprising investors and easing fears that labour demand was deteriorating at an uncontrollable pace. The headline non-farm payroll number rose +254,000, which was materially higher than expectations of a +150,000 print. Meanwhile, the unemployment rate fell to 4.1% (4.05% on an unrounded basis), despite investors forecasting the figure to hold firm at 4.2%. The combination of stronger labour data and growing inflation risks, deriving from the rise in oil prices amid the escalating conflict in the Middle East at the beginning of the month, resulted in investors gradually pricing out the probability of a 50bps interest-rate cut by the Fed at its next central bank meeting in November. This was compounded by the US inflation report, which showed the headline Consumer Price Index (CPI) decelerating less than anticipated to 2.4%, while core inflation accelerated to 3.3%, despite the median forecasts of around 3.2%. With progress stalling on the inflation front, the rates sell-off continued through the middle of the month, with investors beginning to price in only a 25bps rate cut by the Fed – a meaningful drop compared to the beginning of the month. Supporting the narrative that the battle over inflation is not yet won, the personal consumption expenditures (PCE) price index rose to a five-month high of 2.7% (on an annual basis), versus expectations of a 2.6% rise. However, the headline number fell to 2.1%, year on year (YoY), representing the lowest rate since February 2021.

Investors also focused on the release of the Fed minutes from the September meeting, which revealed that Chairman Jerome Powell had received pushback regarding the 50bps cut the central bank eventually delivered. Some members highlighted that they would have preferred a smaller cut to allow time to "assess the degree of policy restrictiveness as the economy evolved". Further strong US economic data included robust retail sales figures, which suggested US consumer resilience was still high. The month-on-month figure rose by 0.4%, versus expectations of 0.3%, contributing to a strong 1.7% YoY advance. Off the back of this, the Atlanta Fed raised its GDP growth estimate for the third quarter to 3.4% (annualised), from the previous 3.2% figure. As the month drew to a close, the increasing probability of a Trump presidency drove Treasury yields wider. A Trump victory is widely regarded as being inflationary and conducive to domestic growth, which suggests a higher rate environment over the medium and long term.

Being the only central bank of the 'Big Three' to host a monetary policy meeting last month, the European Central Bank (ECB) announced a 25bps rate cut, taking the level down to 3.25%, which was in line with expectations. The move represents the first back-to-back rate cut of any of them this cutting cycle as President Christine Lagarde recognised there were "probably more downside risks" on inflation, in alignment with the weak CPI data out of the eurozone in recent months. The decision came as headline CPI printed at 1.8% for the month of September, down from 2.2% in August but in line with investors' expectations. Core inflation also edged down from 2.8% to 2.7% as the economic environment in Europe continues to be characterised by declining inflation. The eurozone did, however, post stronger-than-anticipated growth data as third-quarter GDP grew by 0.4% (quarter on quarter). This was above the 0.2% expected rate, with upside surprises across several countries including Germany, France and Spain. Despite this, investors still expect the ECB to cut rates by 25bps at its next meeting, and 25bps in each of the subsequent meetings heading into 2025.

The UK experienced a significant bout of volatility at the end of the month as Chancellor of the Exchequer Rachel Reeves announced the Autumn Budget. There were significant losses among UK gilts across the curve following the announcement. Gilt yields rose materially in the aftermath as investors reacted negatively to the proposals of increased investment spending that will be financed by increased borrowing and higher domestic taxes on companies and individuals. On the macroeconomic front, October's UK CPI release fell well below forecasts, which helped to reassure investors that inflationary pressures were easing. The headline number ticked down to 1.7%, versus 1.9% expected, representing the lowest annual rate since April 2021; core inflation was also its weakest in over three years. The services inflation print was particularly encouraging, falling to 4.9%, from 5.6% previously, which contributed to investors now pricing in a 25bps cut at the next Bank of England meeting in November. The labour market is still going strong, with the three-month annualised rate from June to August (released in October) falling to 4.0%.

## Portfolio Commentary

With the tough environment for rates markets globally, and with two-year US Treasury yields rising by more than 50bps during October, the Fund was down 0.12%.

Corporate hybrids led returns, generating a solid +0.65%, with strength seen across the sector where the combination of good carry with low

with low duration helped returns, along with a small amount of spread tightening.

Asset-backed securities also had a good month, returning +0.55%, again helped by general spread tightening. However, the floating-rate nature of this sector was the real driver of its performance over the month.

Financials eked out a small positive return of +0.07%, with both the banks and insurance sectors seeing stronger positive returns from subordinated sub-sectors, while the senior sub-sectors in both cases were negative. Contingent Convertible bonds did particularly well, generating a return of +0.36% but only a modest contribution of +2bps, given their low weighting in the Fund. Lower Tier 2 banks, which have a bigger weighting within the portfolio, generated a similar contribution, with a sector return of +0.11%, for example. By contrast, senior banks were negative, returning -0.02%, where the carry was not quite enough to counteract the higher yields due to rates moves (even with modest spread tightening).

Similarly, in insurance, Restricted Tier 1s and subordinated insurance returned +3bps to +6bps, whereas Tier 3 (senior) insurers were down -0.08%.

Senior non-financials fared better than senior financials, returning +0.19% overall, although the slightly longer dated holdings within the sector typically had small negative returns.

Lastly, government bonds were down the most, given these are the longest dated bonds in the portfolio. The total losses from this sector were -1.65%, a contribution of -25bps, with the five-year US Treasury positions contributing more to the losses than the five-year bund positions.

The Fund retains a continued lower beta credit stance than normal given non-financial spreads which, in the portfolio managers' (PM) views are starting to look too tight for the economic risks that still remain significant – and are even deepening. Likewise, spread duration remains lower than normal at 1.4 years, but interest-rate duration is now close to two years, with around 15% in our liquidity bucket of government bonds (five-year US Treasuries and bunds). 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 sector 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, keeping the overall beta of the Fund slightly lower than before these CRE concerns materialised.

## Market Outlook and Strategy

With the ECB having now delivered its third cut, and the Fed cutting rates by 50bps for its first rate cut this cycle, the prospects for repeated rate cuts now look excellent through 2024 and all of 2025. As such, the major risks to capital from duration risk have ended, and thus the PMs have continued to become more tolerant of duration in the Fund, taking interest-rate duration up to 2.0 years, as noted earlier (please note: this was described in detail in a recent webinar "The Duration Deliberation" which remains available on our website). However, on the flip side, the remaining yield curve inversion in rates curves and tight credit spreads in some sectors still give the PMs concerns about adding credit spread duration into the Fund right now, with the biggest capital gains thought likely to be in short dated bonds. As such, the PMs believe a modestly lower-than-average duration profile remains 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 also still thought to remain warranted, although the prospect of further rate cuts suggests total returns from short dated credit can remain attractive for some considerable time yet.

In summary, we believe the combination of low duration and high average yield, with high average credit quality, make short dated 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 5.31% and a duration of two years, meaning the breakeven yield is +266bps. 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 +2.66% to 8% over the next 12 months seems very remote in our view. 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 PMs 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*
Class G	-0.12%	1.13%	3.38%	7.29%	2.24%	N/A	N/A	1.79%
SONIA + 250	0.63%	1.90%	3.89%	7.95%	6.11%	N/A	N/A	4.81%

Discrete Performance	YTD	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Class G	4.76%	6.52%	-4.21%	0.24%	N/A	N/A	N/A	N/A	N/A	N/A	N/A
SONIA + 250	6.58%	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, if applicable. 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. SONIA used as a proxy for cash as a performance reference for illustration purposes only, there is no specific return objective or benchmark for the fund.

## 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](http://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](http://www.twentyfouram.com/document-library)**

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