TwentyFour
a boutique of Vontobel

Fund Commentary | 30 August 2024

Vontobel Fund - TwentyFour Sustainable Strategic Income Fund

This Commentary is a marketing communication for professional UK investors only

Market Commentary

August was a highly volatile month for fixed income and equity markets alike. At the beginning of the month, the US labour report sparked recessionary fears and prompted negative market sentiment. However, these concerns were quickly offset by strong economic data showing the US economy was still performing well. Although the data resulted in a sharp rebound in government bond yields and equity indices, the repercussions of the weak jobs report were present throughout the month as investors priced a more aggressive rate-cutting cycle by the US Federal Reserve (Fed) and other major central banks.

As with every month, the first Friday of August provided investors with the monthly US jobs report. However, in contrast to previous months, the labour market showed significant signs of weakening. The unemployment rate came in at 4.3% (higher than the expected reading of 4.1% and up from 3.7% at the beginning of the year), while non-farm payrolls printed at 114k, which was well below the anticipated 175k figure. In the immediate aftermath of the release, recessionary fears gripped markets, and economists began calling for meaningful action by the Fed in the form of rate cuts. Confidence of a soft landing diminished, which resulted in sharp negative moves across global equity markets, government bonds benefiting from a flight to quality, and growing expectations of a more aggressive rate-cutting cycle, with 10-year Treasuries having rallied to a yield of as low as 3.70%.

However, as the month unfolded, economic data pointed towards a US economy that was still performing well and, as a result, market sentiment began to improve. The supportive data included a very strong retail sales print, with the headline number accelerating to +1% month-on-month in July, significantly higher than the +0.4% expected and the fastest monthly retail sales increase since the beginning of 2023. The Fed also received positive news on the inflation front in August, with headline consumer price inflation undershooting expectations on a year-on-year basis, rising 2.9% (versus an expected 3%), which represents the slowest print since March 2021. Core inflation was in line with consensus at 3.2% at the year-on-year level. The revised estimates of second-quarter US GDP helped in painting an increasingly positive story for domestic economic growth. The headline GDP number was revised upwards to an annualised growth rate of 3% from 2.8% previously, and the Atlanta Fed increased its third-quarter GDPNow estimate to 2.5%. Nevertheless, Jerome Powell's speech at Jackson Hole at the end of August saw several dovish comments that all but confirmed the Fed will be cutting rates at its upcoming central bank meeting in September. Powell said "the time has come for policy to adjust" and acknowledged that "downside risks to employment have increased", suggesting the Fed is shifting its focus away from inflation and towards the employment side of the economy. Powell noted the recent uptick in the unemployment rate has been driven not just by weakening labour demand but very strong supply. He described the cooling in labour market conditions as "unmistakable", which resulted in markets increasing the probability that the Fed would execute a 50 basis point (bps) interest-rate cut in September to 33% by the end of the month.

In the UK, the Bank of England (BoE) delivered its first interest-rate cut in four years at the beginning of the month, with the 25 bps move made on a knife-edge 5-4 vote. Similarly to the US, the UK had a soft inflation report. The headline number came in one-tenth below market expectations on both a monthly and annual basis, while core CPI also surprised on the downside, ticking down to 3.3% from 3.5% in the previous month. Services inflation fell noticeably from 5.7% in June to 5.2% in July, well below consensus expectations of 5.5%. UK unemployment also surprisingly fell to 4.2% in the second quarter, down from 4.4% in the first quarter, with the monthly reading of 3.6% for June representing the lowest reading since February 2022. Despite cutting rates at the beginning of August, the BoE struck a cautious tone at its last meeting and did not commit to further cuts in the near term, reiterating that it is now more focused on broader trends than individual data points.

In Europe, the preliminary headline CPI release for August was in line with expectations at 2.2%, as was core inflation at 2.8%. This figure represents the eurozone's lowest inflation figure for three years, opening up the opportunity for a second European Central Bank (ECB) rate cut in September, which the market is fully pricing in. There remain some doubts over the Eurozone's future economic growth prospects over the medium term. However, reassuringly, second-quarter GDP came in line with expectations at 0.6% year-on-year. Moreover, Purchasing Managers' Indices (PMI) posted a significant outperformance relative to expectations, with the composite PMI reading coming in at 51.2 (50.1 expected), supported by a strong reading from France amid the Olympics.

Portfolio Commentary

With the primary market slowing considerably in August as expected, the portfolio managers (PMs) looked to the secondary market for attractive relative value switches to keep the average credit quality of the portfolio high and maintain a compelling level of yield. The team changed the composition of the government bond bucket, switching 3% of 10-year bunds and 1.5% of short-dated Treasury bills out for 4.5% of 10-year Treasuries. The switch from bunds to Treasuries was due to the team's view that the ECB will no longer cut interest rates at a materially faster pace than the Fed. The reallocation from short-dated bills to 10-year US Treasuries was a function of the team's intention to increase the Fund's duration. Further spread tightening in Additional Tier 1 (AT1) bonds relative to more senior bank debt also resulted in the team trimming its AT1 target by 1% and reallocating this to Tier 2 bank bonds. The spread between AT1s and Tier 2s in some core bank names has tightened to as little as 150bps, which is towards the tight end of historical averages. The strong government bond rally throughout August led the Treasury index to yet another positive month, returning +1.3% in August, while gilt and bund indices were up +0.53% and +0.40%, respectively. A dearth of primary issuance led corporate bond spreads to grind tighter throughout August, with the US high-yield (HY) index (+1.6%) outperforming both the European and sterling HY indices (both +1.2%). There was a similar divergence in total return performance between the two geographies on the investment-grade (IG) front (+1.5% and +0.30% for the US and European IG index, respectively). The Contingent Convertible (CoCo) bond index returned a healthy +1.5% over the month as banks continued to post impressive earnings. The Fund was up +0.88% over the month, with the largest contributors being bank AT1s (+0.30%), rates (+0.22%) and insurance (+0.13%). All sectors returned a positive performance for the fourth consecutive month; however, the lowest contributor was non-collateralised loan obligation (CLO) asset-backed securities at +0.00%. Higher beta sectors including HY also performed well given the underlying government bond performance and tighter credit spreads over the month.

Market Outlook and Strategy

All eyes will be on how labour markets across major economies develop over the next few weeks and months as the economy approaches a potential inflection point. As indicated by Fed Chair Powell in his speech at Jackson Hole, the labour market will be the primary driver of both the timing and magnitude of interest-rate cuts for the remainder of the year and beyond. It is widely anticipated that the Fed will begin to cut rates in September, while the ECB is expected to cut rates for a second time this year. Investors will also receive updated dot plot projections from the Fed, which will guide market expectations for how the rate-cutting cycle will unfold. Primary market activity should rebound sharply in September, which will give PMs an opportunity to add new names or top up on existing issuers. PMs will continue to keep average portfolio credit quality high and still see total returns driven primarily by carry for the remainder of the year.

					Annualised			
Cumulative Performance	1m	3m	6m	1y	3y	5y	10y	Since Inception*
Class G Acc	0.88%	3.47%	5.77%	13.90%	N/A	N/A	N/A	8.53%
ICE BoAML Global Broad Market	1.14%	4.02%	3.90%	6.60%	N/A	N/A	N/A	3.59%

Discrete Performance	YTD	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Class G Acc	7.13%	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
ICE BoAML Global Broad Market	2.60%	N/A	N/A	N/A	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 26/01/2023.

Key Risks

- Limited participation in the potential of single securities
- Investments in foreign currencies are subject to currency fluctuations
- 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
- Investment universe may involve investments in countries where the local capital markets may not yet qualify as recognised capital markets
- Money market investments are associated with risks of a money market, such as interest rate fluctuations, inflation risk and economic instability
- 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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