Vontobel Fund – TwentyFour Absolute Return Credit Fund

Monthly Commentary | 31 December 2020

Market Commentary

2020 was a year like no other as COVID-19 brought most major economies to a standstill and threw financial markets into turmoil, with the speed and magnitude of the sell-off on a scale not even seen during the global financial crisis. However, the unprecedented intervention from central banks and governments spurred a strong recovery in asset prices with high quality assets leading the charge.

December is typically a benign period for markets as borrowers and investors gradually wind down towards year-end vacations. This year was different with investor appetite for risk assets very much in evidence throughout the month, resulting in a strong finish for credit markets as euphoria over the release of a number of vaccines outweighed the announcement of new COVID variants that appear more infectious than the original. As 2020 ended, the S&P 500 reached an all-time high, up 16.26% on the year. The iTraxx Crossover index finished the year at 242bp, 23bp tighter over the month and a level last seen in late February before the March sell-off took hold.

2020 also finally brought an end to the Brexit saga, and thus the removal of one big market uncertainty, as the UK and Europe signed a bilateral trade agreement on Christmas Eve, just a week before the end of the transition period. The deal saw significant backing from the UK parliament, with 521 MPs in support and only 73 against. While there are still a couple of topics to be ratified, the agreement has removed one of 2020's key tail risks and prevented a no-deal Brexit, which looked likely at several points in December.

In the US, President Trump signed a bill allowing $900bn of COVID-19 relief to be released after many lost unemployment benefits over the holiday period. He also demanded that Congress increase the amount per individual from $600 to $2000, in line with what the Democrats have been requesting, but as expected Republican hardliners helped scupper the deal. Trump also continued to call for an investigation into voter fraud but to little avail as state legislators refused the legal arguments put forward.

The ECB had its final meeting of 2020 and announced further stimulus, most significantly expanding the PEPP programme up to €1.85tr (an increase of €500bn) and extending the duration for another nine months until at least March 2022. The market reaction was relatively muted as the increase in stimulus had been well flagged. The Fed and the BoE followed but there were no changes from either. Fed chair Jerome Powell stressed that the current pace of QE would remain in place for some time and BoE governor Andrew Bailey said that while the Bank expects Q1 growth to be impacted by the heavy restrictions, the positive vaccine news should be supportive.

Portfolio Commentary

Positive market momentum continued throughout December, generating a Fund return of +0.39%. This took Q4 returns to +1.40%, and for the full calendar year 2020 the Fund returned +2.47% after fees. This is very close to the target return of Libor+250bp after fees, as 3m Libor today is just 0.025%, or 2.5bp.

All things considered, with what happened in 2020, the portfolio managers are pleased with the performance, given from a tactical perspective the portfolio had de-risked to its lowest ever level of beta by the end of February. Of course, de-risking the Fund did not stop losses through March, but it did significantly ameliorate them. Given the wild sell-off and the 'dash for cash' that saw extreme movements in all assets, including IG credit, the Fund suffered a peak-to-trough drawdown of -4.16%, the biggest drawdown in its history. Compared to peers, however, the Fund outperformed strongly, with many other short dated and low risk funds being down 8%, 9% or even more than 10% in some cases. Portfolio volatility has remained towards the low end of the allowable range, rising from 1.1% since inception prior to COVID-19, to 1.3% immediately after, closing 2020 at 1.28% from inception.

For December, the theme of Q4 continued with every credit sector posting positive returns, with higher beta sectors generally doing better. Banks returned +0.55% for the month, insurance +0.51%, secured bonds +0.50%, hybrids +0.46%, senior non-fins +0.39% and ABS +0.28%. US government bonds returned -0.01%, essentially flat in local currency terms but just negative taking into account hedging costs.

Looking at the full year attribution is interesting, but only tells part of the story. For example, financials returned an impressive +3.85% for the year, a full percent more than senior non-fins, which returned +2.80% despite strong government support for that sector. Government bonds were the laggard, producing +0.52% for the whole year, but it is worth remembering they were the only sector with positive returns in March, while many credit sectors were down -3.4% (financials), -4.1% (ABS) or even -5.0% (corporate hybrids), so they performed their risk-off hedging role perfectly and still have a role to play in the Fund going forward.

Market Outlook and Strategy

The issues of 2020 have taken us to the point where sovereign yields have collapsed globally, and with some sub-sectors of non-financial IG credit looking tight in spread terms, the continual challenge of maximising income while protecting capital remains ever present.

We believe credit will significantly outperform equities for a number of years, firstly because this has been the case in both of the other significant distress periods this century, but secondly because rewards to shareholders from dividends and buybacks are likely to be significantly curtailed. These are discretionary payments, after all, while coupons in the sorts of bonds we hold in the Fund are not.

Given the tighter nature of non-financial spreads in IG, we are focusing slightly more on financials where the yield advantage is considerable (even within short dated IG), and also favour hybrids within non-financials, but we are keeping spread duration very low to also protect capital while generating that yield.

Ultimately this means we think markets are likely to exhibit brief periods of volatility in 2021, but nothing like what we saw in March 2020. However, the valuations in some parts of financial credit remain attractive enough that in our view investors are being well compensated for future risks, and that is also the case in selective hybrid non-financials. By focusing on short dated IG, 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 some of the highest risk-adjusted returns in all of fixed income can continue to be generated by this Fund.

Rolling Performance	31/12/2019 - 31/12/2020	31/12/2018 - 31/12/2019	29/12/2017 - 31/12/2018	30/12/2016 - 29/12/2017	31/12/2015 - 30/12/2016
Class G	2.47%	5.02%	-0.83%	5.25%	4.99%

The performance figures shown are in GBP on a mid-to-mid basis inclusive of net reinvested income and net of all fund expenses. Past performance is not a reliable indicator of future performance. Performance data does not take into account any commissions and costs charged when shares of the portfolio are issued and redeemed. *Inception date 28/08/2015.

The Team

Chris Bowie
Partner, Portfolio Management, industry experience since 1992.

Gordon Shannon
Portfolio Management, industry experience since 2007.

Graeme Anderson
Chairman, Portfolio Management, industry experience since 1986.

Jack Daley
Portfolio Management, industry experience since 2011.

Johnathan Owen
Portfolio Management, industry experience since 2018.

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.
- Fixed income carries two main risks, interest rate risk and credit risk: (1) Where long term interest rates rise, there is a corresponding decline 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.
- 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.

Further Information and Literature: TwentyFour Asset Management LLP

T. 020 7015 8900 E. sales@twentyfouram.com W. www.twentyfouram.com