TwentyFour ASSET MANAGEMENT

Vontobel Fund – TwentyFour Absolute Return Credit Fund

Monthly Commentary | 30 November 2021

Market Commentary

November was volatile for markets, with central banks and the new Covid-19 variant harming investor sentiment. The S&P 500 finished the month down by -1% after a positive performance of nearly 2% earlier in the month. European markets experienced a similar fate, with the EuroStoxx50 initially up by around 3.5% before closing the month lower by -4.42%. In credit, the iTraxx Xover index was 21bps tighter in the early part of November but ended the month 27bp wider at 288bps.

The underlying driver of sentiment remains rates and central bank policy. First, the Fed's Open Market Committee announced it would begin tapering at a pace of $15bn per month, in line with market expectations. However, a continual flow of hawkish comments from Fed members followed, and the FOMC minutes suggested some members perceived inflation as not purely transitory as previously reported. In addition, Chairman Powell, who was renominated as Fed Chair, commented at the Senate committee that the US economy might require a faster pace of tapering to give the Fed more flexibility for rate hikes next year. Likewise, he also reflected that retiring the description "transitory" regarding US inflation might be wise.

Unlike the Fed, the Bank of England didn't deliver on market expectations. After much anticipation of a rate hike at the November meeting, the Monetary Policy Committee kept rates unchanged after 7-2 vote, with Governor Bailey saying it was a close vote. Accordingly, it appears the MPC members wanted to wait for more labour data after the end of the UK's furlough schemes before making a change. Gilts tightened post the meeting, with the five-year gilt closing the day nearly 20bps tighter.

Towards the end of the month, news from South Africa regarding a new variant of COVID-19 led to a sell-off in risk assets, bolstering demand for Government bonds. As a result, the benchmark 10-year US Treasury tightened from 1.64% on Thanksgiving to close November at 1.45%. Meanwhile, 10-year gilts closed the month at 0.83%, having been 1.04% a week earlier and despite an eye-watering CPI print of 4.2% (with core CPI at 3.4%). In addition, some countries took steps to re-introduce restrictions to curtail the spread of the virus. As a result, risk assets will likely remain volatile until pharmaceutical companies determine how effectively vaccines might deal with the Omicron strain.

Elsewhere, the US and several other countries released oil from their emergency reserves to help curtail the rapid increase in energy prices. Also, tensions between the UK and Europe increased on various fronts, from fish to the migrant crisis.

Portfolio Commentary

November proved difficult for risk assets, with losses on the higher beta sectors within the portfolio exceeding modest gains in the lower beta sectors. Overall, the portfolio ended November down 13bp, or -0.13%, after fees and leaves YTD returns at +0.40%, again after fees. By comparison, the 0-5Yr iShares ETF is down -0.96% over the same period.

According to the attribution, losses were in Corporate Hybrids, down -0.55%, Insurance, down -0.20%, and Banks which returned -0.12%. Meanwhile, secured bonds were up +0.25%, Senior Non-Financial corporates were up +0.04%, and government bonds were just positive at +0.02%. Once again, floating rate ABS also produced a positive return of +0.02%.

The paradox here is that the most significant losses came through in sectors and positions we are most comfortable with from a pure credit perspective. Accordingly, all possess extremely strong earnings and capitalisation within financials is, in many cases, the best it has ever been, and upgrades are still outpacing downgrades. As such, we believe the mark to market volatility experience in November reflects uncertainty over interest rate policy and the new Omicron variant, rather than anything credit specific.

That said, over the last two months, the portfolio managers have taken reasonably significant action to lower the beta profile of the fund against this background of uncertainly. Portfolio duration has been reduced from 2.4 years to 1.9 years by selling 3-5 year positions and buying 0-1 year bonds, which has increased the weighting to 0-1 year bonds to 33% of the portfolio. Further, in terms of credit beta, the PM's have increased the government bond allocation to around 15% of the fund and allowed the BB HY weighting to decline a little.

However, within the government bond allocation, the team have made significant changes following the more pronounced sell-off at the front end of the UK yield curve. The team sold two-year US Treasuries were and reinvested the proceeds in a combination of three-month US Treasury bills (thereby dramatically lowering the duration of US$ curve exposure) and one-year UK gilts given the improvement in the relative value of UK gilts (and simultaneous reduction of near term risks given what the market has priced into the UK curve).

Whilst this lowers the fund's beta and risk profile, the team believes this best positions the fund to handle potentially a more volatile marketplace leading through the end of 2021. Moreover, the additional liquidity will allow them to take any forthcoming opportunities as they arise.

Market Outlook and Strategy

As we end the balance sheet expansion of both US and UK central banks, further rallies in government bonds in 2021 have further brought into sharp relief just how expensive bond markets have become – and the risks to capital from long-duration assets whilst yield curves steepen.

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

Recent hawkishness from central banks may well lead to continued periods of volatility into the end of 2021, but still 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 remain well compensated for future risks, and that is also the case in selective Hybrid non-financials.

Finally, by focussing on short-dated investment-grade 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 this fund can continue to generate some of the highest risk-adjusted returns in all of fixed income.

Rolling Performance	30/11/2020 - 30/11/2021	30/11/2019 - 30/11/2020	30/11/2018 - 30/11/2019	30/11/2017 - 30/11/2018	30/11/2016 - 30/11/2017
Class G	0.80%	2.47%	4.65%	-0.36%	5.40%

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.

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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.

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