

Vontobel Fund – TwentyFour Absolute Return Credit Fund

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Market Commentary

December was a strong month for markets, as sentiment on the Omicron COVID-19 variant improved and markets digested the hawkish pivots taken by central banks. As a result, the S&P finished the month up by 4.4%, whilst the EuroStoxx50 was up by 5.8% in December. In credit, the iTraxx Xover index was 46bp tighter by the end of the month at 242 bp. Market participants were comforted by early data that suggested the Omicron variant of COVID-19 would prove less severe than previous strains. Furthermore, results from initial studies on the efficacy of existing vaccines were encouraging – three doses of Pfizer proved 75.5% effective against any symptomatic disease. At the same time, two doses offer 70% protection against hospitalisation. This positive news overshadowed the introduction of some restrictions in the developed world that mainly concentrated on international travel and the unvaccinated. The Fed's Open Market Committee (FOMC) took a hawkish tilt in their December meeting, announcing that they would double the pace of tapering to \$30bn a month, meaning it would end QE in March 2022. The new dot plots indicated three rate hikes in 2022, with an additional three in 2023 and two in 2024, representing a significant shift from the previous dot plots from September. Powell also officially dropped the term transitory with regards to inflation. The market processed this shift well, largely because it was extremely well flagged by Powell and a range of committee members in the weeks preceding the meeting. The Bank of England (BoE) on the margin surprised the market with a 15bp hike to 0.25% – the Monetary Policy Committee acted due to the labour market appearing 'very tight' and forecasting inflation to peak at 'around 6%' in 2022, an increase from their prior level of 5.1%. The small nature of the hike and the fact that the Bank of England was expected to hike back in November meant that the market's reaction was muted. The ECB on the same day announced that they would be ending net purchases of PEPP in March 2022, while transitioning to an increased APP of €40bn a month in Q2 2022, €30bn in Q3, and then to €20bn a month from October. Overall, the market viewed the European developments as a reasonably neutral outcome. In terms of data, the headline US CPI number release of 6.8% was the highest reading since 1982, and a strong household employment report resulted in the unemployment rate falling to 4.2%. The 10-year US Treasury yield finished the month 7bp higher at 1.51% – though perhaps this yield would have been higher if not for the technical factors affecting the year-end.

Portfolio Commentary

With two year US Treasury yields moving from 0.56% at the end of November to close 2021 at 0.73%, there was significant pressure on the front end of yield curves over December. Despite this, the fund managed to produce a positive return of +0.12% for the month, after fees, having sold all of its two year US Treasuries throughout late Q3 and early Q4. The managers placed the proceeds in three month US Treasury bills and one-year gilts, whilst credit generally did well. For Q4 overall, the fund was down -0.56%, as the market got to grips with hawkish commentary and ultimately moves in short term rates expectations. However, the fund's returns for both November and December combined were essentially flat, being down -0.01% after fees. In reality, the Q4 losses mainly occurred right at the start of the quarter in October. For the full calendar year of 2021, the fund had a positive return of +0.52% after fees during a challenging year for fixed income. For example, over the same period, gilts returned -5.16% (FT Gilt Index), and the iBoxx GBP Corporate Bond Index fell by -3.19%. In the US, Treasuries returned -2.32% (Bloomberg US Treasury Index, USD), while the iBoxx Liquid IG USD corporate bond index was down -1.49%. Similarly, in Europe, Bunds (Bloomberg Bund Index, EUR) produced returns of -0.92%, and the iBoxx EUR corporates index was down -1.08%. Against this backdrop, the fund's daily annualised volatility from inception remains very low, at 1.22% (Source: TwentyFour using GBP G share class). According to the full year (gross) attributions, the only negative returns came from the lowest yielding credit sector of non-financial investment grade corporates. The sector returned -0.29%, contributing just -1bp at the portfolio level given the minimal allocation to this sector throughout the year (given some of the poorest breakeven yields in the fund's investment universe). Perhaps surprisingly, given the short end yield curve moves, the attribution returns for government bonds were exactly flat for 2021. The only loss making position within this sector was the April 2023 US Treasury Bond holding, which was down -0.17% and contributed -1bp, whilst

the gilts held towards the end of the year, and indeed the US Treasury bills held more recently, have actually produced positive returns, offsetting the -1bp contribution loss from the US Treasury Bond. The portfolio's best performing sector was European ABS, which returned +1.96%, contributing +0.18%. While this sector (we only own RMBS) is entirely floating rate, it had a surprisingly good year and benefits from rising short rates. We kept exposure to this sector pretty much as high as we are allowed throughout the year (permitted maximum of 10%, average weight in 2021 was 9.09%). The fixed rate version of ABS, Secured Bonds, was the next best performing sector, returning +1.51% with a contribution of +4bp. The sector's contribution was so small simply because the average weight was just 3%. As much as we love this sector, the reality is that most of the bonds we like in this sector have maturities beyond what is allowed in the portfolio, so the few shorter-dated bonds in this sector that do match our preferences we held. While they performed well, we simply could not own more of them. Financials also performed well, returning +1.32%, with a contribution of +72bp and an average weight of 48.7%. The split within financials was returns of +1.67% and +1.01%, and contributions of +42bp and +30bp, respectively, from the Banks and Insurance sub-sectors. As much as the relative valuations of financials were more attractive than non-fins (and continue to be so), and the creditworthiness, if anything, improved during 2021 (strong and improving capital and solvency ratios), the managers are uncomfortable retaining more than half of the portfolio in financials from a diversification perspective. Thus, they kept the weighting just under 50% on average. Corporate Hybrids rounded out the returns, posting +1.14% and contributing +13bp with an average weight of 14.2%. Similar to financials, the yield advantage versus senior bonds was advantageous. However, the higher beta nature of the sector cannot be discounted and thus, the PM's have been careful to trim duration to this sector over recent months. In terms of the overall stance of the portfolio, from the end of Q3 to early Q4, the managers lowered the beta profile of the fund significantly against a background of more significant inflation and short rates uncertainty. As a result, the portfolio's duration fell from 2.4 years to 1.73 years by selling 3-5 year positions and buying 0-1 year bonds, taking the weighting of 0-1 year bonds to 33% of the portfolio. Further, in terms of credit beta, the managers increased the government bond allocation to around 15% of the fund and allowed the BB high yield weighting to decline slightly. However, within the government bond allocation, there were significant changes following the more pronounced sell-off at the front end of the UK yield curve. The team sold two year US Treasuries, reinvesting the proceeds in a combination of three month US Treasury bills (thereby dramatically lowering the duration of US dollar 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 is priced into the UK curve). Whilst this lowered the beta and risk profile of the fund, the managers believe this best positions the fund to handle potentially a more volatile marketplace leading through early 2022, and the additional liquidity will allow the team to take any forthcoming opportunities.

Market Outlook and Strategy

As we end the balance sheet expansion of both US and UK central banks, and with inflation remaining stubbornly high (and which may not have peaked yet), the risks appear skewed toward higher rates yields, and possibly steeper curves should short rate hikes continue to be slower to come through than in previous cycles. Thus the team prefer to keep portfolio duration under two years for now. Given the tighter nature of non-financial spreads in investment grade, we continue to focus slightly more on financials where the yield advantage is considerable (even within short-dated investment grade) and favour Hybrids within non-financials. Still, we are keeping spread duration very low (in fact 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 early 2022, but we still expect nothing like the volatility 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. By focusing 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	31/12/2020 - 31/12/2021	31/12/2019 - 31/12/2020	31/12/2018 - 31/12/2019	31/12/2017 - 31/12/2018	31/12/2016 - 31/12/2017
Class G	0.52%	2.47%	5.02%	-0.83%	5.25%

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.

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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Further information on fund charges and costs are included on our website at www.twentyfouram.com

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For definitions of the investment terminology used within this document please see glossary at: <https://twentyfouram.com/glossary>

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