Vontobel Fund – TwentyFour

Absolute Return Credit Fund

This Commentary is a marketing communication for professional UK investors only

Market Commentary

July was a strong month for markets with sentiment rebounding after a very weak June. In equities the S&P 500 was up 9.1% for the month and the EuroStoxx 50 increased by 7.4%, while in credit the iTraxx Crossover Index tightened from 580bp to 509bp. The risk-on tone was driven by attractive valuations, a strong earnings season and a firmness in rates; the 10-year US Treasury yield finished the month 36bp lower at 2.65%, on expectations that the US Federal Reserve would not be as hawkish as previously feared.

The Fed was closely watched and as expected hiked rates by 75bp in July for the second meeting in a row. The market latched on to the FOMC statement that the US economy had "softened", as well as comments from Fed chair Jerome Powell that the pace of hikes was likely to slow, interpreting these as a signal for a Fed pivot and sparking a strong rally in USTs. This reinforced an earlier rally as market participants began to look at lead indicators of inflation, such as lower commodity prices, even though the headline inflation release in July still came in higher than expected at 9.1%.

Meanwhile, the European Central Bank exited negative rates at its July meeting and surprised markets by hiking 50bp. This was accompanied by the ECB's new anti-fragmentation tool (officially the Transmission Protection Instrument or TPI), however details were fairly vague; the indication was that purchases can be unlimited, but there was also an insinuation that countries must comply with the EU fiscal framework to be eligible for the tool, and that currently no states were suffering from interest costs that were "unwarranted" and thus none were eligible for the TPI.

A collapse of Mario Draghi's government in Italy saw fresh elections scheduled for September and increased volatility for Italian spreads. However, BTPs recovered after the Brothers of Italy party, currently leading the polls, committed to adhering to EU budget rules.

Elsewhere, volatility was elevated in Europe as various headlines emerged suggesting Russian gas supply could remain curtailed. After a 10-day period of gas being turned off for maintenance work, the gas supply ultimately resumed, though at a reduced capacity of 20-40%. EU countries did agree to a 15% reduction of gas demand, with the market viewing this cooperation as constructive.

Overall, second quarter earnings were strong in both the US and Europe and across financial institutions and corporates. The US banks were still positive on the state of the US consumer, with Bank of America CEO, Brian Moynihan, describing them as still "resilient".

In the UK, after Boris Johnson stepped down as Prime Minister, Rishi Sunak and Liz Truss were left as the final two candidates for the top job. At month-end Truss appeared to be the front runner and has promised tax cuts, which could ease pressure on consumers but also spur UK inflation.

Portfolio Commentary

ARC was up +1.51% after fees for the month (to July 29), taking year-to-date returns to -3.87%. This compares with -4.89% YTD for the ICE/BAML 1-5 Year Sterling Corporate Bond index, an outperformance of +101bp.

Looking at the attribution for the month, all fixed rate sectors had positive returns, with only floating rate ABS having slightly negative returns. Leading the returns was the corporate hybrid sector which recovered some, but not all, of its losses from June. Overall, hybrids were up +3.59%, contributing +48bp at the Fund level. Of particular note, Heimstaden's hybrid bonds held in the Fund were up more than 22% after the company raised equity capital in July to buy back its bonds at steep discounts, taking advantage of what it saw as completely disproportionate price action. This vote of confidence in the company in turn has helped lift valuations of many hybrids, and not just in the sub-sector of property but for others such as SSE (+3.95%), Southern (+6.45%) and EDP (+7.04%).

Banks returned +2.39%, with CoCos up 4.02% and Lower Tier 2s up 1.96%, seeing strength across the whole sector rather than any specific stock stories. In Insurance, RT1s were up 7.26% while broader insurance positions averaged +1.22%, taking average Insurance returns to +1.58%. Senior non-financial corps averaged +0.69%, with government bonds also making a positive return at +0.16%.

Given the large volume of bonds maturing in the Fund throughout 2022, the portfolio managers expect to continue to gain the ability to improve the portfolio yield further without taking any more credit risk by simply reinvesting the near term cashflows in a mix of one to three-year bonds and even three to five-year bonds if global yield curves have adjusted enough, and become steep enough, to warrant taking the duration of the Fund up a little by the time of each maturity. Further, if the portfolio managers are happy to reduce the government bond weighting, they can improve the yield of the Fund more.

In these times, liquidity is of course crucial. Therefore, the portfolio managers have temporarily decided to keep liquidity slightly higher than usual with around 12% in our liquidity bucket.

Market Outlook and Strategy

The near term end of extremely cheap money and expanding central bank balance sheets, now coupled with geopolitical risk, has led to sharp moves in all risk assets so far in 2022, and we expect volatility to continue to some extent throughout this year.

However, at the front end of yield curves, a lot of bad news has been priced in already: markets are pricing in multiple hikes in the US, and multiple hikes remain priced in to the UK curve by the end of 2022, taking all short dated bonds with them.

Given the above, the markedly higher yield on the Fund and the prospect of yield enhancing trades over the course of 2022, the portfolio managers expect the return profile of the Fund to improve from here. However, we are not necessarily calling the bottom of the market for short dated credit just yet. For now, we prefer to keep the beta of the Fund lower than normal until we see more clarity on the expected tightening in financial conditions that will ultimately be the story of 2022.

In these markets, we appreciate having access to portfolio managers 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 managers to go through anything you like in more detail.

Rolling Performance	30/07/2021 - 29/07/2022	31/07/2020 - 30/07/2021	31/07/2019 - 31/07/2020	31/07/2018 - 31/07/2019	31/07/2017 - 31/07/2018
Class G	-4.60%	3.27%	1.59%	3.29%	0.85%

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.

Fund Managers

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

Diana Chiu
Portfolio Management, industry experience since 2009.

Gordon Shannon
Partner, Portfolio Management, industry experience since 2007.

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

Jack Daley
Portfolio Management, industry experience since 2011.

Johnathan Owen
Portfolio Management, industry experience since 2018.

Further Information and Literature:
TwentyFour Asset Management LLP

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

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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