

Vontobel Fund – TwentyFour Absolute Return Credit Fund

This Commentary is a marketing communication for professional UK investors only

Market Commentary

October was a firmer month in risk assets, and with no obvious catalyst it could largely be described as a relief rally after a very weak September. The S&P 500 was up by 8% over the month and the Eurostoxx 50 returned 9%, while in credit, the iTraxx Crossover index tightened from 641bp to 555bp. Risk-off assets meanwhile drifted wider, with the exception of UK Gilts, which rallied after the news that Rishi Sunak was going to replace Liz Truss as UK prime minister.

Once again all eyes were on the US CPI inflation print, and once again it came in above expectations. The headline year-on-year and month-on-month numbers of 8.2% and 0.4% respectively were both higher than market consensus, but unlike previous periods this year when we'd seen similar beats, there was no sharp sell-off in risk assets and instead equities and credit rallied – perhaps a sign of just how much bad news was priced into markets. The US labour market offered mixed messages as the number of job openings fell by over 1m, but job creation remained strong with an increase of 288k in non-farm payrolls. The unemployment number also fell from 3.7% to 3.5%, helped by a decline in the participation rate, in more evidence that the labour market remains very tight.

The CPI print did lead to a cycle-high yield on the 10-year US Treasury of around 4.25%, aided by FOMC members pointing towards a 'raise and hold' policy. For example, Atlanta Fed President Raphael Bostic stated: "I am not advocating a quick turnaround toward accommodation. On the contrary." Treasury yields did come off their highs however as the Wall Street Journal's Nick Timiraos – a journalist considered well connected at the Fed – reported that officials would be debating a slowdown in hikes and a change in rhetoric after November's FOMC meeting.

European government bonds remained fairly flat across October, after an initial sell-off was reversed following the European Central Bank's October 27 policy meeting. The expected 75bp hike was followed by a dovish-leaning press conference from ECB president Christine Lagarde, where a reference to "several" more hikes was notably absent but the lagged effect of monetary policy and an increase in the probability of recession were both discussed.

UK Gilts outperformed in October after Liz Truss was replaced by Rishi Sunak as prime minister. Sunak and Jeremy Hunt, the new Chancellor, reversed almost all of Truss' mini-Budget policies which had destabilised the UK market. Furthermore, Sunak appears generally regarded as a safe pair of hands thanks to the markedly different economic policies on which he ran against Truss in the previous Conservative leadership campaign, which has reassured markets and saw 10-year Gilt yields tighten from 4.08% to 3.50% over the month.

Elsewhere in October there was some weakness in Chinese assets as President Xi Jinping began his third term by surrounding himself with loyalists, which made investors nervous about future shifts in domestic and foreign policy. In addition, OPEC+ decided to reduce output by 2m barrels per day to help prop up oil prices in the face of anticipated faltering global demand.

Portfolio Commentary

The Fund was up 1.32% after fees for the month, taking year-to-date returns to -6.34% versus index returns of -9.71%, outperformance of 337bp. The bulk of this has been generated by keeping portfolio duration substantially lower than that of the benchmark (1.6 vs 2.8 years), and also allocating almost 30% of the portfolio to an 'off-benchmark' position in the 0-12m sector of the yield curve, which is not a part of the benchmark.

Looking at the attribution for the month, all fixed rate credit sectors had positive returns, with only floating rate ABS having negative returns at -0.22%, contributing -1bp of losses at the portfolio level. Government bonds returned exactly 0.00% for the month, though within that the November 2022 US Treasury position posted gains of 0.22%, contributing 1bp, whereas the May 2024 US Treasury position had losses of -0.18% and contributed -1bp.

Financials led the positive returns with a total gain of 2.29%, split between 2.22% in banks and 2.35% in insurance. Given insurance has a slightly higher weighting in the portfolio, the contribution was 54bp versus 47bp from Banks. Secured bonds had the next best returns at 1.54%, contributing 7bp, and both senior non-financials and corporate hybrids had identical returns at 0.97%, though again the greater weighting of senior non-financials meant a greater contribution of 19bp versus 10bp for hybrids.

While the rally in October has been very welcome, the yield on the Fund remains much higher than in recent years at 6.47%, and further, with the large volume of bonds maturing in the Fund throughout the remainder of 2022 and into early 2023, the portfolio managers expect to continue to gain the ability to improve the portfolio yield further without taking any more credit risk. This will occur by simply reinvesting the near term principal cashflows in a mix of one- to three-year bonds, and possibly 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 managers have temporarily decided to keep liquidity slightly higher than usual, with around 17% in the liquidity bucket.

Market Outlook and Strategy

The 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 huge amount of bad news has been priced in already: multiple hikes remain priced in for 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 late 2022 and early 2023, 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 peak in inflation, which we estimate will likely occur in H1 2023.

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 setup meetings with the portfolio managers to go through anything you like in more detail.

Rolling Performance	29/10/2021 - 31/10/2022	30/10/2020 - 29/10/2021	31/10/2019 - 30/10/2020	31/10/2018 - 31/10/2019	31/10/2017 - 31/10/2018
Class G	-6.35%	1.79%	1.80%	3.71%	0.38%

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
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Portfolio Management, industry experience since 2011.



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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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