TwentyFour
a boutique of Vontobel

Fund Commentary | 31 August 2023

Vontobel Fund – TwentyFour Absolute Return Credit Fund

This Commentary is a marketing communication for professional UK investors only

Market Commentary

The strength seen in equity and credit markets through most of the summer softened slightly as we moved into August, with 10-year Treasury yields rising rapidly in the opening of the month. This was as the US Treasury announced a schedule of greater-than-expected supply, the country was surprisingly downgraded by Fitch (AAA to AA+), and the ADP payroll number came in significantly above expectations. A lower-than-expected nonfarm payroll print on the first Friday of the month, however, provided some relief, although the 10-year Treasury yield still ended the week 13 basis points (bps) higher at 4.08%.

The steady drip higher in rates continued in the second week of August as the 'soft landing' narrative started to take hold and central bank commentary remained hawkish – particularly from the Fed's Mary Daly – although the US inflation print on the Thursday continued to show a positive trend (headline CPI came in at 3.2% year-on-year versus 3.3% expected), which will be key to determining whether the Fed will hike again in September (the market currently views this as unlikely).

A topic that had been building for a number of months continued to dent sentiment in August, with data out of China showing the weakest exports since February of 2020, alongside some major companies in the real estate sector falling closer to bankruptcy. Emergency steps taken by the People's Bank of China (PBOC) were unable to turn things around, and so economists further downgraded their expectations for Chinese growth in 2023, a trend that could have a significant influence on global growth given China's size.

Contrary to the weaker data in China, however, we saw continued strength in US data through the middle of the month, with retail sales, initial jobless and manufacturing surveys all coming in stronger than expected, leading economists to increase their expectations for third-quarter US GDP (the Atlanta Fed at one point was predicting an extraordinary third-quarter GDP growth estimate of 5.8% annualised).

Stronger growth expectations led some investors to talk of the Fed having to go further than anticipated in terms of base rates, and with that 10-year Treasury yields peaked above their post financial crisis highs, reaching 4.36% intraday on 22 August, before falling into month end, amid weaker growth data out of Europe and a Jackson Hole speech from Jerome Powell that was less hawkish than some were expecting.

Total returns in financial markets in August were generally weaker than in prior months, with equity markets posting negative returns (-1.6% in the US, -2.5% in Europe) in addition to government bond markets (-0.6% for US Treasuries, -0.6% for UK Gilts, although Europe defied this trend, posting returns of +0.3%). Credit markets held up better, with high yield again outperforming, particularly in the US and the UK, where high yield outperformed investment grade (IG) by 100bps and 40bps respectively, returning 0.2% and 0.3%.

Portfolio Commentary

Despite government bond markets mostly selling off in August, the Fund had a positive return of +0.36%, with the yield (carry) more than offsetting capital moves. This takes year-to-date returns to +2.32%.

Attribution for the month shows positive returns across all sectors, with the secured bond sector leading the pack, producing a +0.82% return which contributed +4bps. Next was floating rate ABS, returning +0.62% with a bigger contribution of +5bps, helped again by their floating rate nature.

Government bonds, perhaps surprisingly (given negative returns across all-maturity government bonds), were next, with a total return of +0.49% and a contribution of +7bps. Within this, the two-year UK Gilt produced the highest return at +0.62%, with the two-year US Treasury returning +0.42%. This highlights the unusual degree of inversion in yield curves, which mostly steepened in August, allowing short-dated rates positions to post positive returns while longer dated positions had capital (and total return) losses.

Non financials were close behind government bonds, returning +0.44% and contributing +10bps, with strength broad based across Telcos, Utilities and other industrials.

Financials did well overall, with higher quality generally outperforming lower quality within the sector. For example, within Banks, senior positions returned +0.48%, tier 2 subordinated +0.43% and AT1s were down slightly at -0.11%, leading to total Bank sector returns of +0.39% and a contribution of +5bps. Within Insurance, seniors returned +0.51%, subordinated +0.40% and tier 3s +0.44%, which overall generated a total return of +0.41% and a +6bps contribution. Across financials overall, this meant a total return of +0.40% and contribution of +11bps.

Lastly, corporate hybrids returned +0.09%, with energy producing stocks such as BP losing ground slightly while Telcos and energy distribution companies made decent gains, taking the overall sector positive.

While a softer landing narrative appears to be increasing in terms of adoption by market participants, the Fund retains a continued lower beta stance than normal given non-financial spreads that, in the portfolio managers' views, are starting to look a little too tight for economic risks that still remain significant. Likewise, spread duration remains lower than normal at 1.4 years, with around 15% in our liquidity bucket – of government bonds (US Treasuries and now Gilts), supranationals and cash – also being higher than normal.

Further, given the PMs' concerns over commercial real estate (CRE) issues in the US having the potential to create further insolvencies in the US regional banking sector, they retained higher credit quality within both the Banks and Insurance sectors by staying invested in more senior financials than is typical compared to the Fund's history. To be clear, the PMs have no credit quality concerns over the banks and insurers held in the portfolio – given their Basel III regulated status, high capital ratios, high quality loan books and healthy loan/deposit ratios. However, a further liquidity squeeze cannot be ruled out in an environment where depositors could be reading stories of failing US regional banks over the next few months. As such, the PMs believe it prudent to keep a lower level of risk in financials, keeping the overall beta of the Fund slightly lower than before. Over the next few months, as we await further clarification on the likely tightening of monetary conditions from stricter lending standards in the banking sector, the PMs believe there will opportunities to add beta – but that right now is not the time to add significant portfolio risk.

Market Outlook and Strategy

With the Fed, BoE and ECB now appearing to be close to (or at) terminal rates, the risks to capital from duration risk are receding – but the significant yield curve inversion in rates curves still makes the three-to-five-year maturity sector look especially expensive in our view, even allowing for the potential for rate cuts later next year. As such, a lower-than-average duration profile is still considered warranted, with peak yields still being less than two years to maturity, and that is predominantly where the portfolio is focusing. As duration risks start receding, however, the PMs are concerned that increasing unemployment rates – across the US, UK and especially Germany signalling worsening GDP data to come – and recession both remain significant risks, and are not believed to be fully priced into non-financial spreads. Therefore, a lower beta credit stance is still warranted in the team's view.

As such, we believe the combination of very low duration and high average yield, with high average credit quality, make short-dated IG 'the best game in town' for 2023. This is predominantly due to the very high breakeven yield the portfolio now exhibits, with a yield of 6.38% and a duration of 1.5 years, meaning the breakeven yield is some +425bps. Although the PMs fully expect volatility to remain in markets for some months yet, a scenario where the portfolio yield rises by more than +4.25% to ~10.5% over the next 12 months seems particularly remote in their view, and as such the probability of positive total returns over the next 12 months are thought to remain high.

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 PMs to go through anything you would like in more detail.

Cumulative Performance	1m	3m	6m	1y	Annualised 3y	5y	10y	Since Inception*
Class G Acc	0.36%	1.23%	1.08%	2.52%	-0.19%	0.90%	N/A	1.89%
SONIA + 250	0.65%	1.88%	3.61%	6.41%	4.03%	3.66%	N/A	3.37%

Discrete Performance	YTD	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
Class G Acc	2.32%	-4.80%	0.52%	2.47%	5.02%	-0.83%	5.25%	4.99%	N/A	N/A	N/A
SONIA + 250	4.64%	3.97%	2.59%	2.73%	3.26%	3.11%	2.79%	2.91%	N/A	N/A	N/A

Past performance is not a reliable indicator of future performance. The performance figures shown are in GBP on a mid-to-mid basis inclusive of net reinvested income and net of all fund expenses. Performance data does not take into account any commissions and costs charged when shares of the fund are issued and redeemed. The value of an investment and the income from it can fall as well as rise as a result of market and currency fluctuations and you may not get back the amount originally invested. *Inception date: 28 August 2015.

Key Risks

- Limited participation in the potential of single securities
- Success of single security analysis and active management cannot be guaranteed
- It cannot be guaranteed that the investor will recover the capital invested
- Derivatives entail risks relating to liquidity, leverage and credit fluctuations, illiquidity and volatility
- Interest rates may vary, bonds suffer price declines on rising interest rates
- High-yield bonds (non-investment-grade bonds/junk bonds) may be subject to greater market fluctuations, risk of default or loss of income and principal than higher-rated bonds
- The Sub-Fund's investments may be subject to sustainability risks. The sustainability risks that the Sub-Fund may be subject to are likely to have an immaterial impact on the value of the Sub-Funds' investments in the medium to long term due to the mitigating nature of the Sub-Fund's ESG approach
- The Sub-Funds' performance may be positively or negatively affected by its sustainability strategy.
- The ability to meet social or environmental objectives might be affected by incomplete or inaccurate data from third-party providers
- Information on how environmental and social objectives are achieved and how sustainability risks are managed in this Sub-Fund may be obtained from Vontobel.com/SFDR

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The Fund considers environmental, social and governance (ESG) factors in the investment process, utilising an integrated approach.
Information on the integration approach may be obtained from **https://www.twentyfouram.com/responsible-investment-policy**

Further information on fund charges, costs and other important information pertaining to the fund can be found in English and free of charge on the fund pages of our website and/or in the relevant offering documents available at www.twentyfouram.com/document-library

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