TwentyFour
a boutique of Vontobel

Fund Commentary | 31 March 2024

Vontobel Fund – TwentyFour Absolute Return Credit Fund

This Commentary is a marketing communication for professional UK investors only

Market Commentary

The month of March was dominated by key central bank meetings and market participants dissecting every economic data point to anticipate when central banks would start their easing cycles. The overall risk sentiment was supported by the market's view that the start of the easing cycle for the Federal Reserve (Fed) was only a few months away.

The European Central Bank (ECB) was the first of the major central banks to hold its meeting in March. While the main rate was left unchanged, officials struck a dovish tone and revised their inflation forecast downwards. Core inflation is now expected to be 2.6% this year, 2.1% in 2025 and 2.0% in 2026; therefore, ECB officials are pointing to core inflation rates being back at their target rate in the near future. The near-term growth forecast was also revised down to 0.6%. Overall, the market started to increase the probability that the ECB could be first of the key central banks to start its cutting cycle. Over the month, the market pricing of a cut for the ECB's June meeting increased.

In the US, March was a heavy month for data releases. First, the jobs report depicted a more nuanced environment; while the non-farm payroll report showed continued strength in the economy (275k versus 200k expected), the unemployment rate rose to 3.9% (its highest level since December 2021) and average hourly earnings slowed to +0.1% (versus +0.2% expected). Subsequently, the US Consumer Price Index (CPI) report indicated that inflation remained sticky: headline CPI came in at a six-month high of +0.44% month-on-month, and core CPI was at +0.36%, which also meant that annual core CPI was above expectations at +3.8% (versus +3.7% expected). This was further confirmed by the Producer Price Index (PPI) as headline numbers came in at +0.6% (versus +0.3% expected).

Despite the stronger readings for inflation, the Fed meeting still struck a slightly dovish tone. They made no changes to the base rate, and the revised dot plots showed that the median dot for 2024 was unchanged, with three cuts for the year expected. The Fed's economic projections were revised higher, with real GDP growth revised up from 1.4% to 2.1%, core Personal Consumption Expenditures (PCE) inflation up to 2.6%, and unemployment revised lower to 4.0%. February core PCE deflator which was published at the end of the month was more supportive however (+0.26% versus +0.3% expected); and although it remained somewhat elevated, it eased considerably after the +0.45% January print. In the face of the mixed data, market pricing for a Fed cut in June was lower over the month.

The Bank of Japan also held an important meeting where it lifted its key short-term interest rate from -0.1% to a range of 0% to 0.1%, its first hike since 2007. Despite a set of measures making monetary policy more restrictive, the tone remained dovish, which led to the yen making a 34-year low against the US dollar towards the end of the month.

The positive risk sentiment was broad based with equity indices making new highs and credit spreads tightening, with European and US high yield spreads down to their lowest since January 2022. In rates, price action was mixed over the month but generally yields finished tighter; the 10-year German bund yield finished the month 11 basis points (bps) lower, the 10-year US Treasury yield declined by 5 bps, and the 10-year UK gilt yield was 19 bps lower.

Portfolio Commentary

With a rebound in government bond markets, and spread compression on top, the Fund returned a healthy +0.78% for the month after fees, finishing the month at an all-time high net asset value (NAV). This takes year-to-date returns to +1.41%, some +52bps higher than the short-dated BAML 1-5-year GBP Index.

Attribution for the month shows especially strong returns from financials, with banks strongly outperforming, delivering a return of +1.21% and a contribution of +32bps. Within subsectors of banks, lower tier 2s returned +1.41%, with Additional Tier 1s (AT1s) and senior having comparable returns of +1.15% and +1.09% respectively. Insurance was also strong, delivering +0.85%, which made a contribution of +13bps, led by the T3 subsector which returned +1.29%. In total, financials returned +1.08%, which made a contribution of +45bps.

Secured bonds produced the second-highest return, of +0.99%, with Center Parcs and Arqiva notable outperformers, with longer dated holdings producing the highest returns.

Corporate hybrids returned +0.72%, which outperformed senior non-financials, which returned +0.64%. However, senior non-financials made a higher contribution than hybrids, of +12bps versus +8bps, due to the almost double weighting of senior to hybrid non-financials in the Fund.

Lastly within credit, floating rate asset-backed securities (ABS) had a solid month, returning +0.58%, and a contribution of +4bps, but struggling to outperform fixed rate bonds as spreads tightened and yields fell across the broader market.

Government bonds returned a similar amount, at +0.57% and a contribution of +8bps, and the portfolio's newest holding of five-year German bunds returned +0.73%, outperforming gilts at +0.55% and US Treasuries at +0.44%.

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 views of the portfolio managers (PMs), 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 14% in our liquidity bucket of government bonds (US Treasuries, gilts and now bunds) 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, the PMs have 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.

Market Outlook and Strategy

With the Fed, ECB and Bank of England (BoE) now not only appearing to be at terminal rates, but actively talking of rate cuts, the risks to capital from duration risk have ended – but the significant yield curve inversion in rates curves still makes the three-to-five-year maturity sector look especially expensive, even allowing for the potential for rate cuts later this year. As such, a lower-than-average duration profile is still warranted, with peak yields still being less than two years to maturity, and that is predominantly where the Fund is focusing. As duration risks recede, however, the PMs are concerned that increasing unemployment rates across the US, UK and especially Germany signal worsening GDP data to come – and recession risks both remain significant and are not fully priced into non-financial spreads, in the views of the PMs. Therefore, a lower beta credit stance is still warranted, although the prospect of rate cuts possibly beginning from the ECB has led to the PMs slightly increasing portfolio rates duration, directly through purchasing five-year bunds given German economic weakness.

As such, we believe the combination of very low duration and high average yield, with high average credit quality, make short-dated investment grade (IG) still a fantastic risk-return opportunity. This is predominantly due to the very high breakeven yield the portfolio now exhibits, with a yield of 5.65% and a duration of 1.6 years meaning the breakeven yield is some +353bps. Although the PMs fully expect some volatility to remain in markets for some months yet, a scenario where the portfolio yield rises by more than +3.5% to around 9% over the next 12 months seems very remote, and as such the probability of positive total returns over the next 12 months remains very 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 portfolio managers to go through anything you would like in more detail.

					Annualised			
Cumulative Performance	1m	3m	6m	1y	3y	5y	10y	Since Inception*
Class G Acc	0.78%	1.41%	4.53%	6.85%	0.91%	1.65%	N/A	2.36%
SONIA + 250	0.66%	1.94%	3.93%	7.76%	5.07%	4.20%	N/A	3.68%

Discrete Performance	YTD	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Class G Acc	1.41%	6.08%	-4.80%	0.52%	2.47%	5.02%	-0.83%	5.25%	4.99%	N/A	N/A
SONIA + 250	1.94%	7.36%	3.97%	2.59%	2.73%	3.26%	3.11%	2.79%	2.91%	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-Fund's investments in the medium to long term due to the mitigating nature of the Sub-Fund's ESG approach
- The Sub-Fund's 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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