TwentyFour ASSET MANAGEMENT

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Annual Fixed Income Conference

Vontobel

TwentyFour Asset Management | Annual Fixed Income Conference

Macroeconomic outlook

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The macro outlook has changed significantly – Is a recession upon us?

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Economic fundamentals have **deteriorated** significantly in 2022

Global GDP has **weakened** significantly

Geopolitical risks are **very elevated**

Very **difficult winter ahead for Europe**, with Russia looking likely to keep the pipelines closed

UK also looked **very vulnerable**, however the new energy support package has generated optimism

2yr-10yr Treasury curve has been **inverted** since the start of July – a closely watched recession predictor

However, the **US economy** continues to show **signs of strength**, with the labour market and consumers remaining robust, as are ISMs

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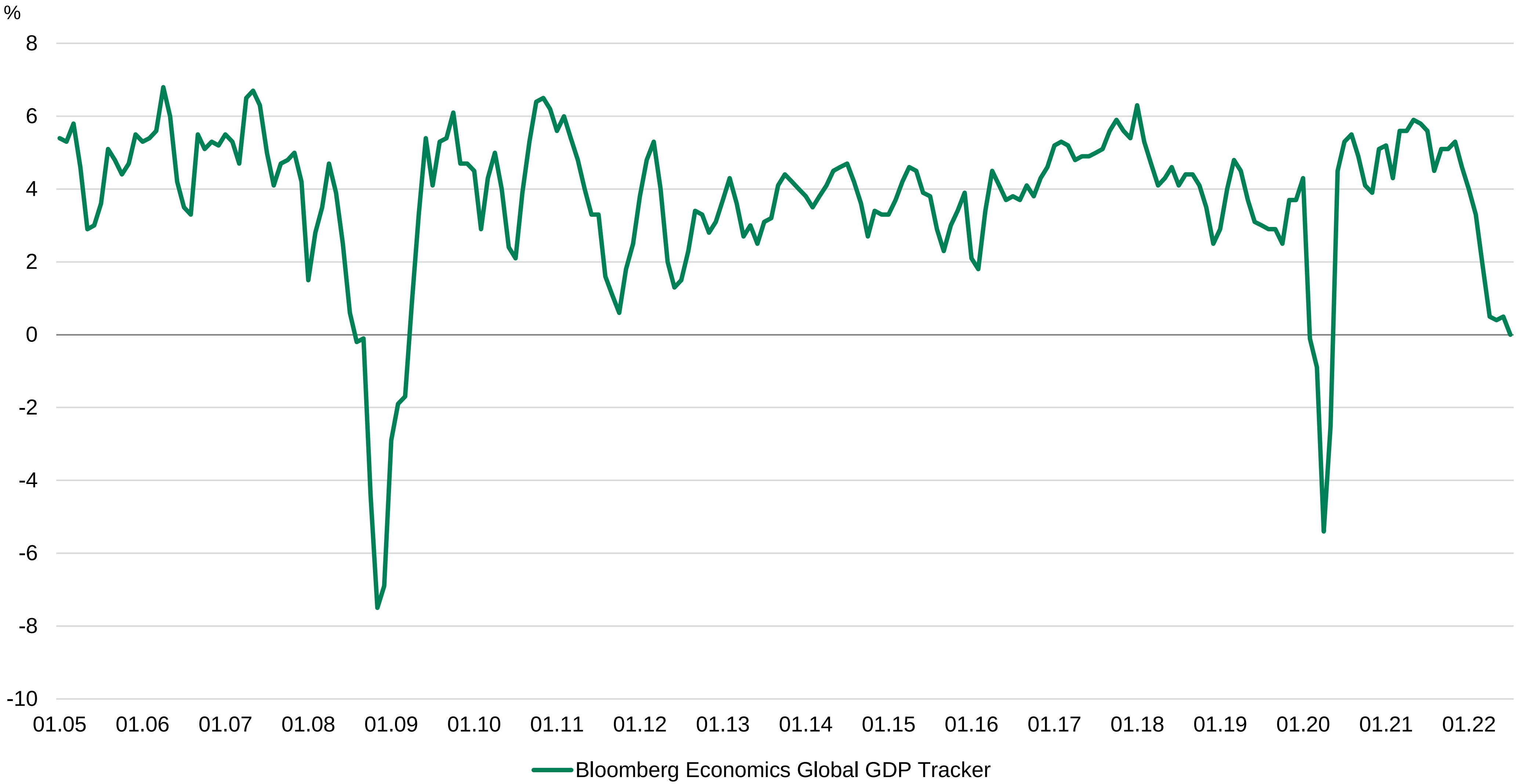
Global GDP declining rapidly



Source: Bloomberg
31 July 2022

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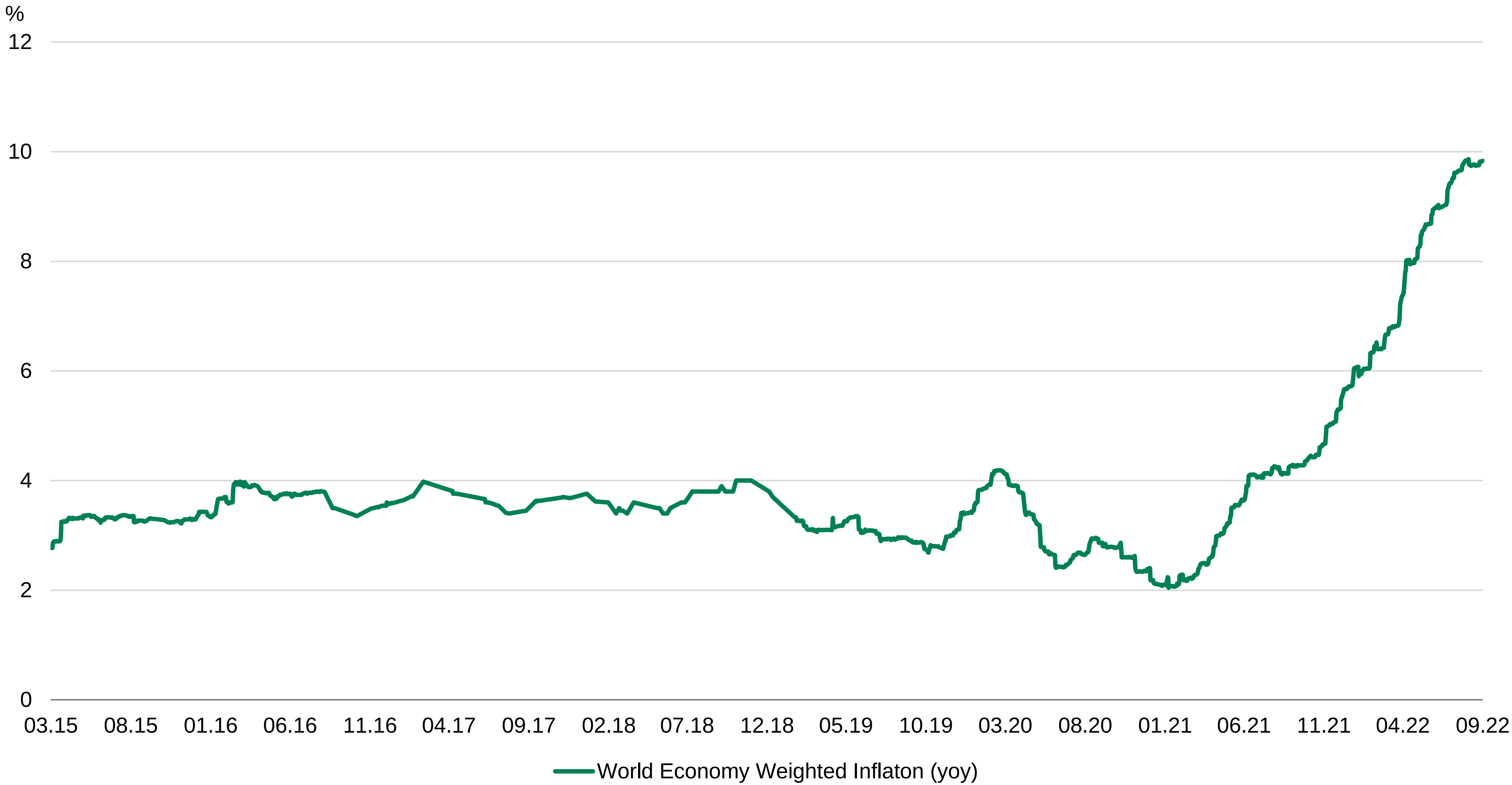
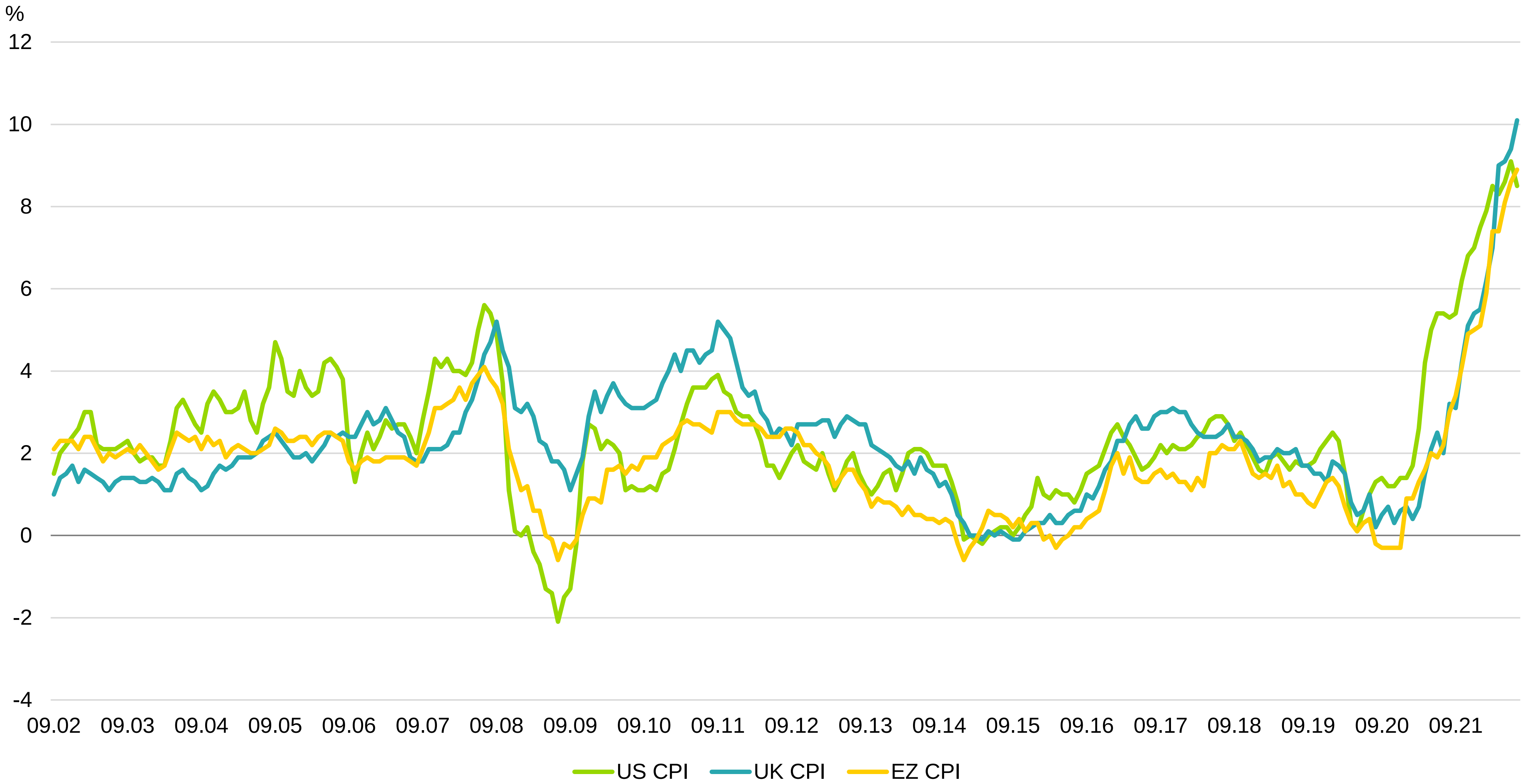
World economy inflation spiking higher



Source: Bloomberg
6 September 2022

CPI – US, UK, EZ



Source: Bloomberg
31 July 2022

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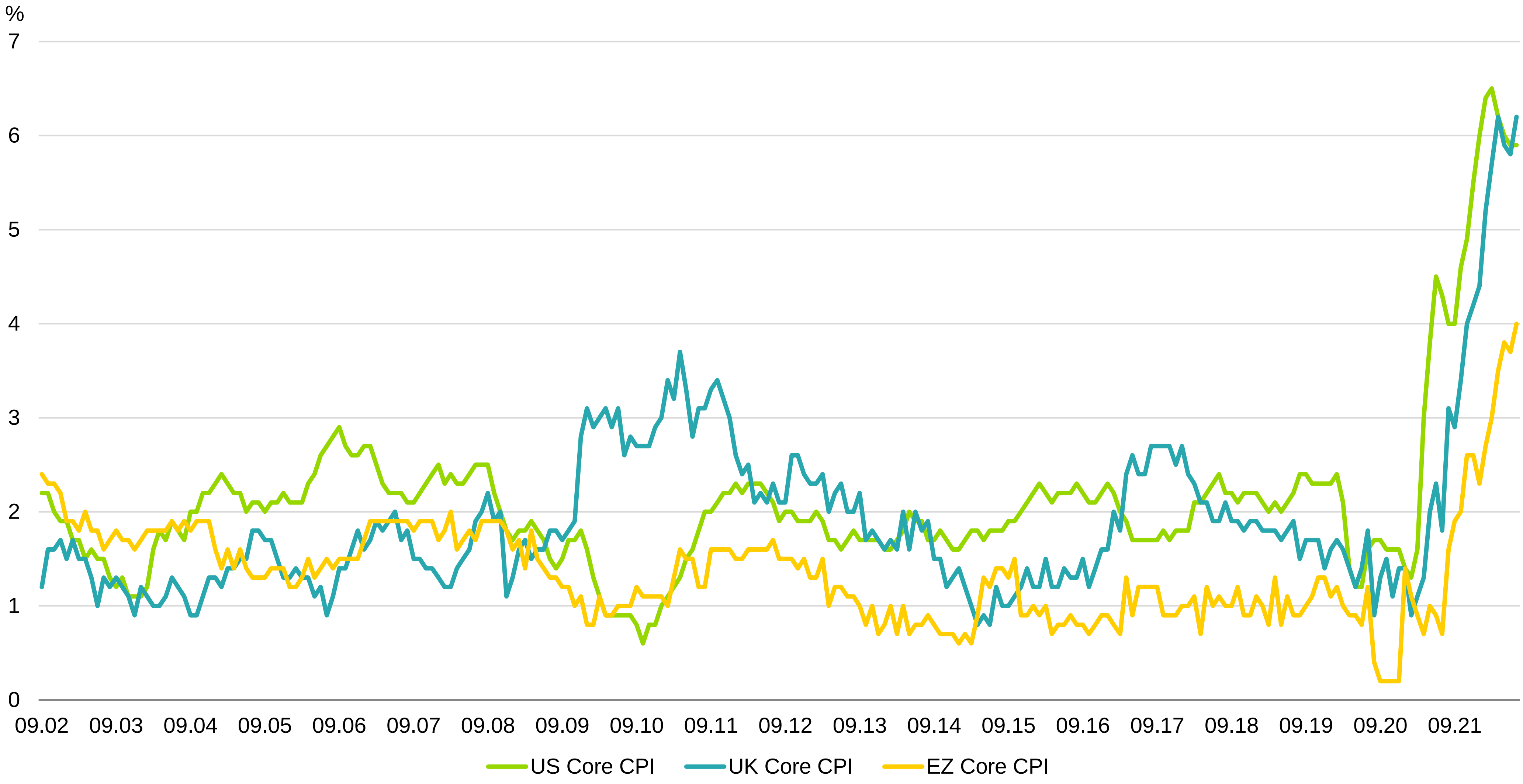
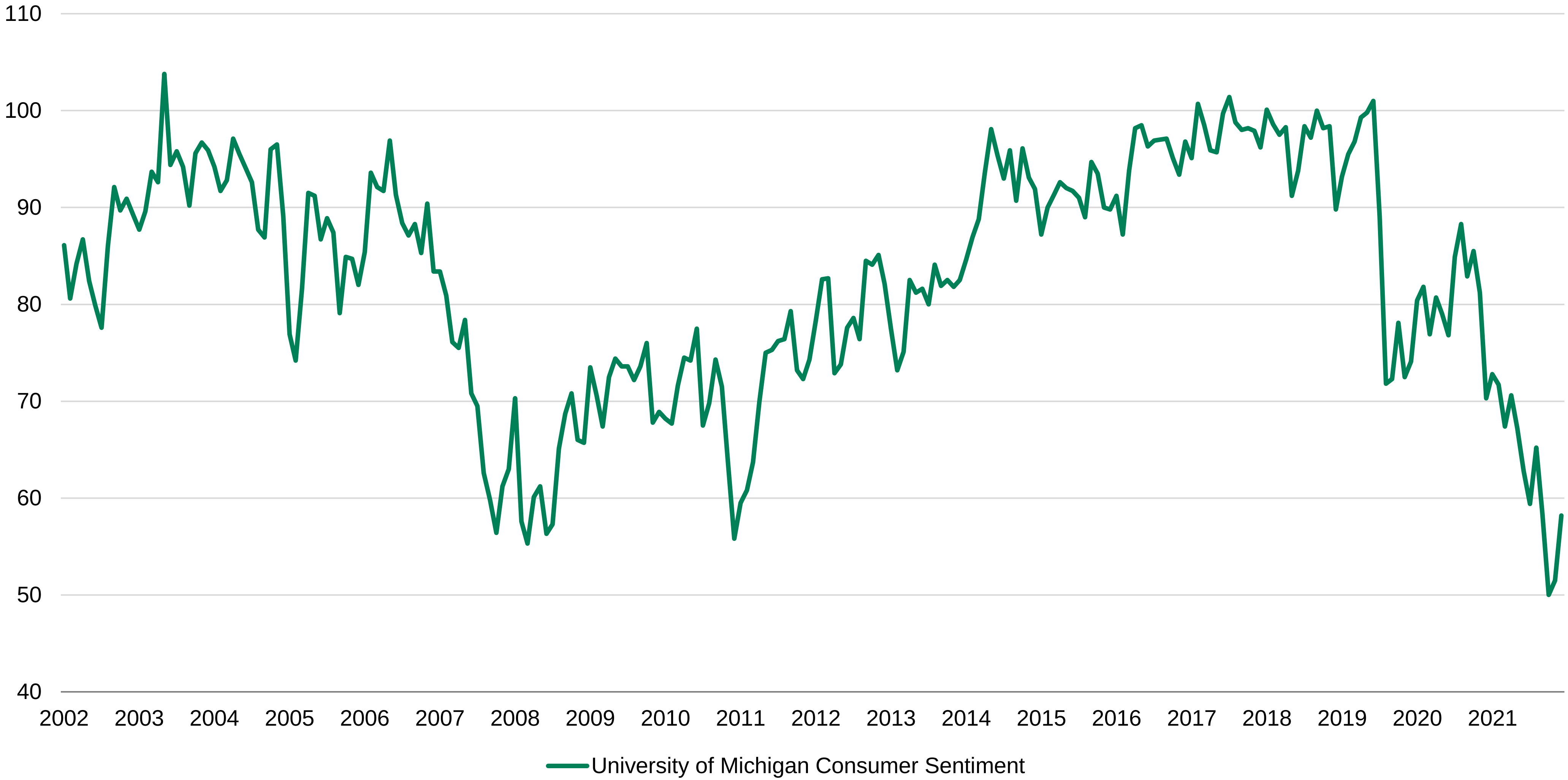
Core CPI – US, UK, EZ



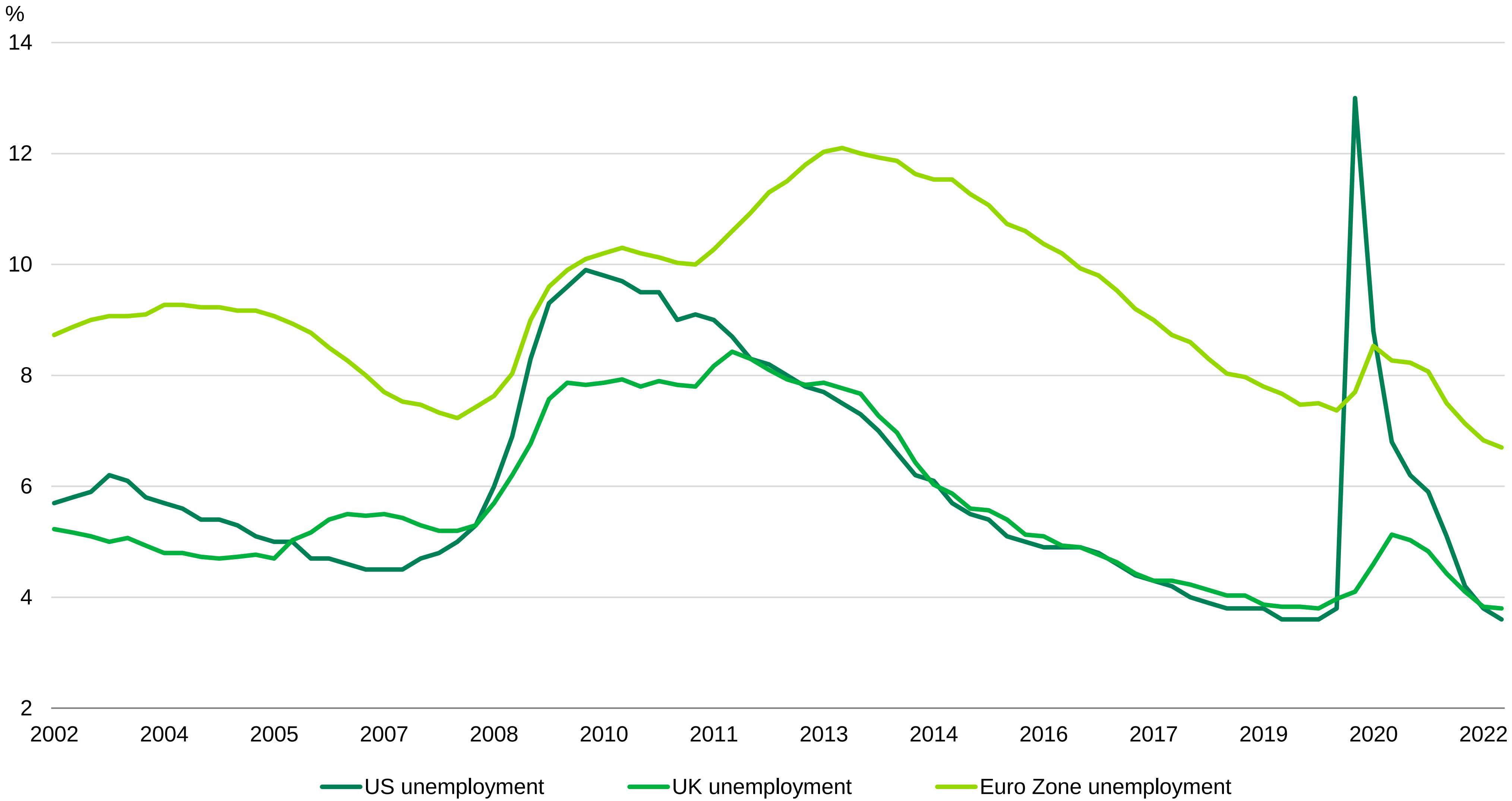
Source: Bloomberg
31 July 2022

Impact on sentiment is clear



Source: Bloomberg, 31 August 2022

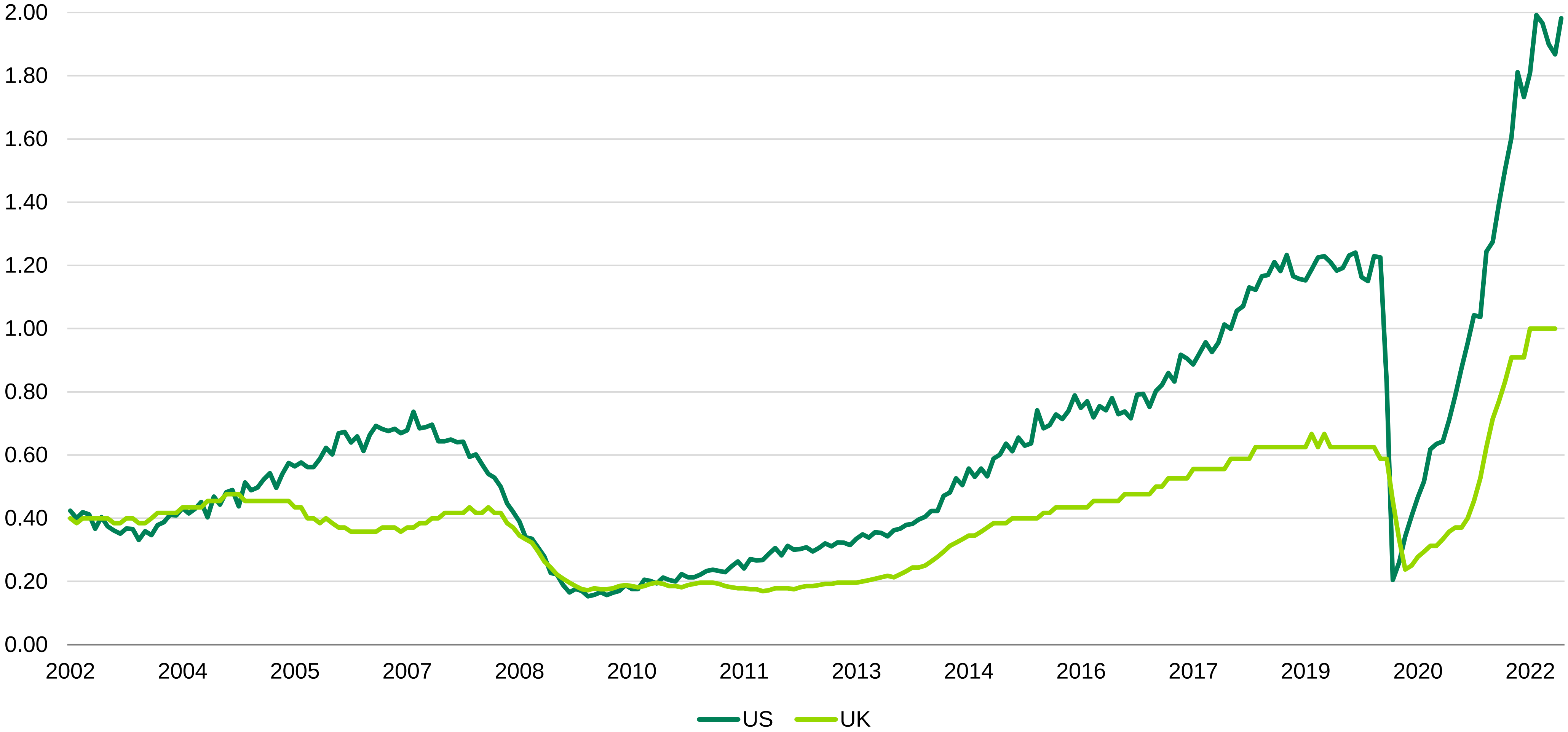
However, unemployment is staying (stubbornly) low



Source: Bloomberg, 30 June 2022

Unfilled job vacancies have also increased sharply

Vacancies to unemployment ratio



Source: Bloomberg
31 July 2022

Framing the market reaction

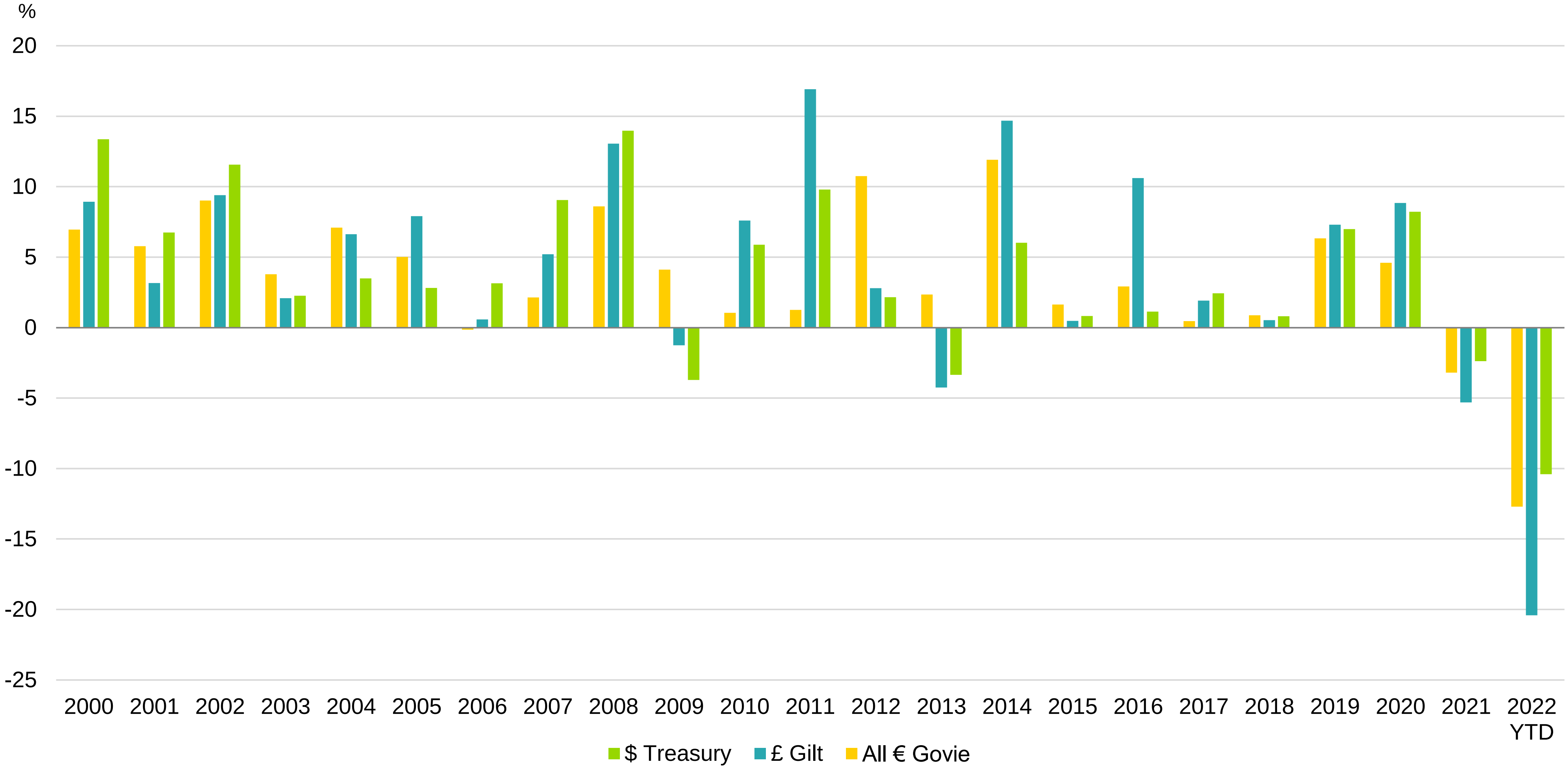
- **Weakening economic fundamentals**, driven by central bank actions, weighed heavily on markets
- **Government bonds sold off** as base rates moved higher, leaving investors without a hiding place
  > US Treasuries experienced worst H1 since 1788
  > The Bloomberg Global Agg is down 20% from its highs – first bear market since 1990 inception
- **Risk-On Fixed Income asset classes** have also **suffered significantly** as recession fears have spiked higher
- **Equity markets** also incredibly **hard hit**, especially the high-growth Nasdaq

	Performance	
	YTD	Inntra-year low
Nasdaq	-26%	-32%
S&P	-18%	-23%
Euro Stoxx	-19%	-20%

Data source: Bloomberg, 6 September 2022

Government Bond indices - total returns ($, £, €)

Total return (local ccy)



Past performance is not a reliable indicator of current or future performance. It is not possible to invest directly into an index and they will not be actively managed.
Source: Bloomberg
7 September 2022

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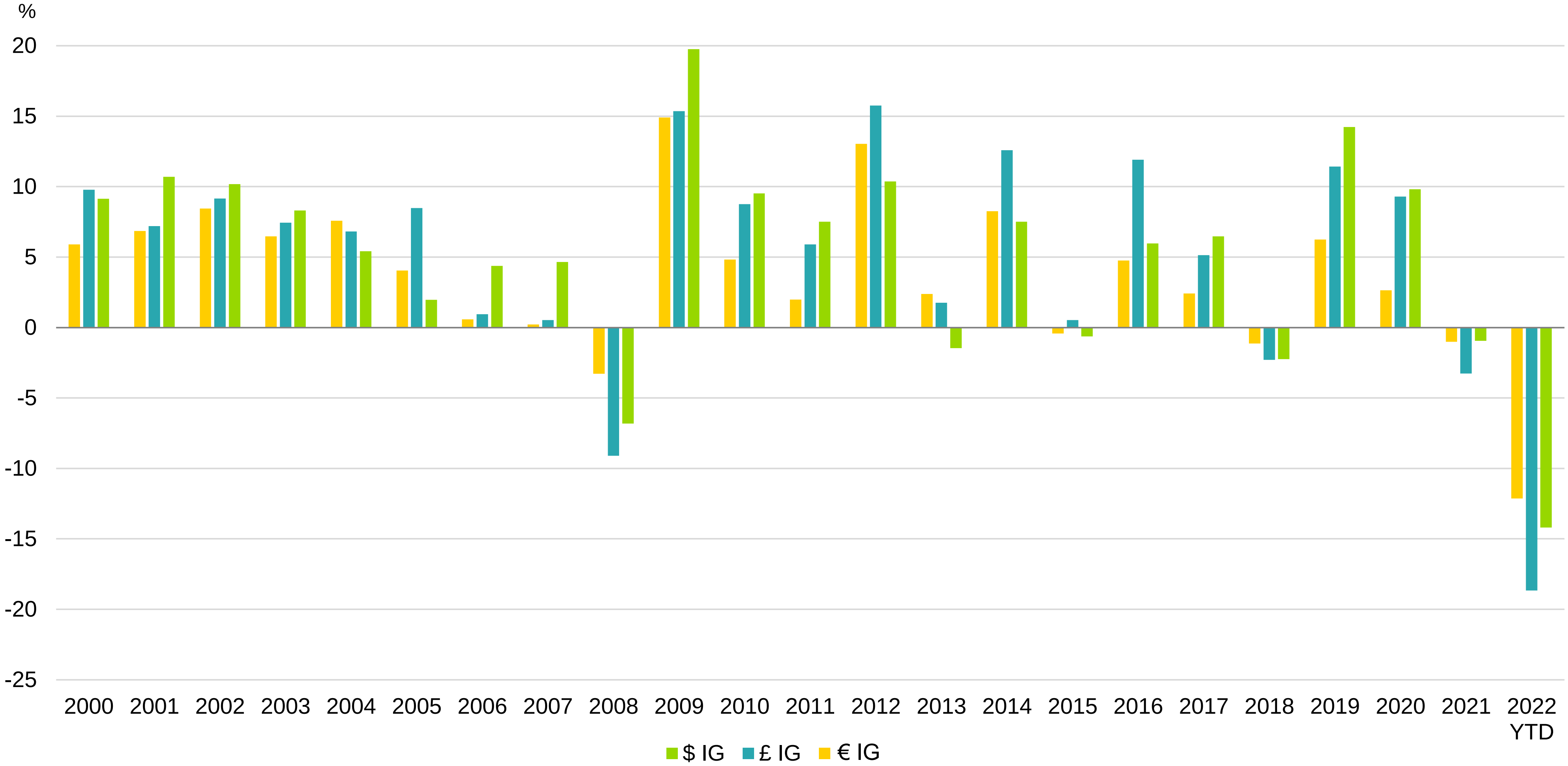
Investment Grade indices - total returns ($, £, €)

Total return (local ccy)



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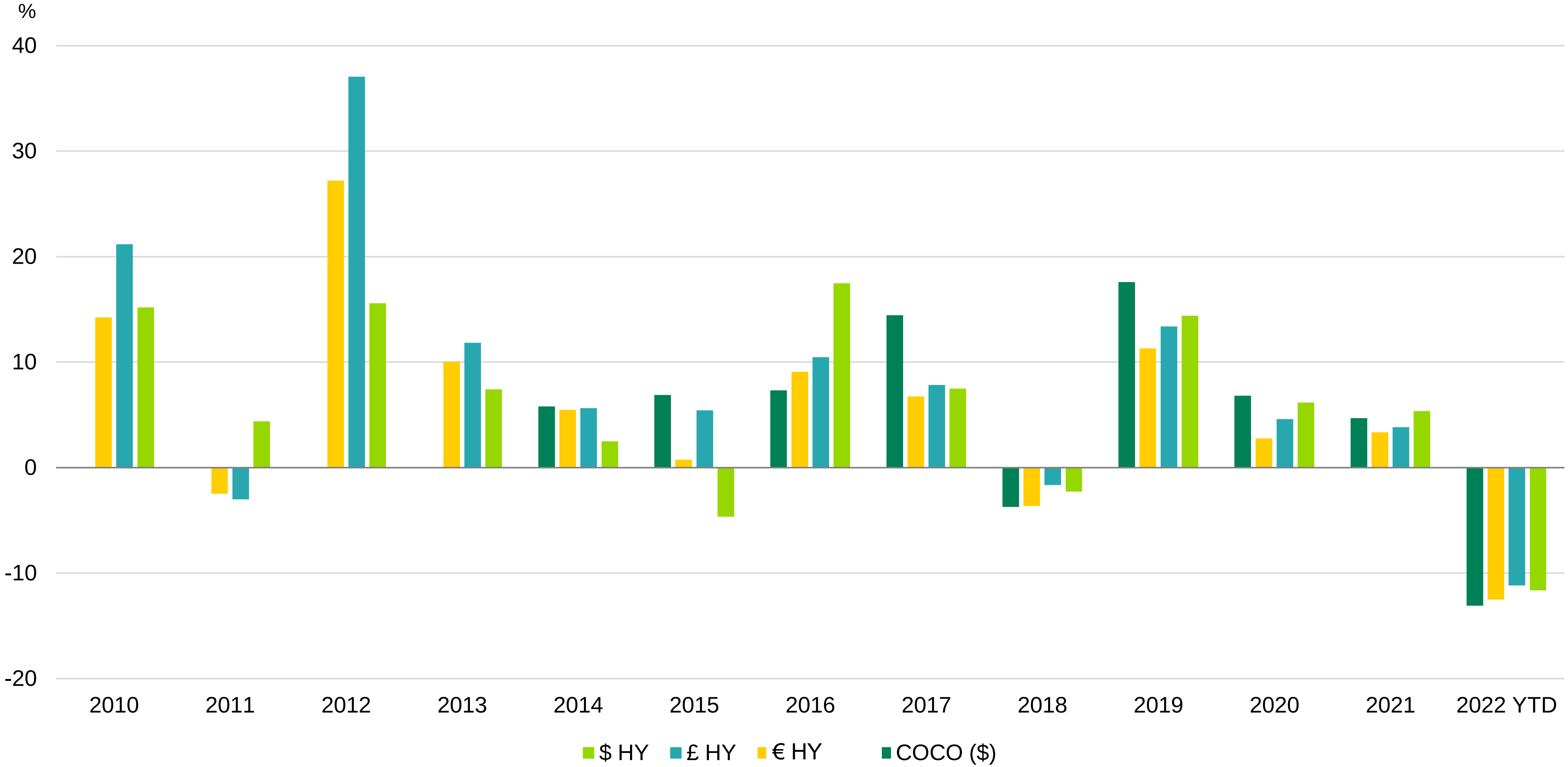
Source: Bloomberg
7 September 2022

High Yield and COCO indices - total returns ($, £, €)

Total return (local ccy)



Past performance is not a reliable indicator of current or future performance. It is not possible to invest directly into an index and they will not be actively managed.

Source: Bloomberg

7 September 2022

The style of this cycle – why is it so different?

- Central banks actively trying to slow their economies is a new phenomenon
  - > Rates policies are now generating a lot of uncertainty – used to generate certainty
- Hawkish rate risking policies is leading the weakness, not rapidly increasing credit fears
- Inflation is front and centre and is yet to peak in many areas (18-22% in UK?!)
- Not only is inflation proving to be sticky and stubborn, but much of it is also due to external factors, and out of the control of the central banks
- Geopolitical risks are pronounced and look unlikely to lessen in the short term
- The weaponizing of energy supply is a very recent development and very difficult to quantify
- Strong labour markets and a robust consumer in the US is forcing the Fed to be extremely hawkish
- Asset prices are typically elevated in late cycle, this time risk assets look particularly cheap

Overall, many elements seem out-of-control, which is weighing heavily on sentiment

The speed of the cycle

- Very rapid change in base rate targets from many central banks
  - > US base rates were 0.25% at the start of the year, they are 2.5% now, with 3.5-3.75% projected by year-end
  - > ECB have gone from -0.5% to 0.75%, with markets expecting another 125bps by year-end
- Economic growth projections have also turned down quickly
  - > US GDP growth close to 7% QoQ at Dec'21, but we've already had 2 negative quarters this year
  - > IMF project Advanced Economies to grow 2.5% in '22 and 1.4% in '23, down from 3.9% and 2.6% respectively in their January outlook
- Market participants had to quickly adjust, but struggled to keep up, and this hit prices very hard
- Impact of the war in Ukraine was probably underestimated; contributing to a big spike in commodity prices
  - > YTD: Brent crude +23%, Heating Oil +59%, ICE Nat Gas index +140%

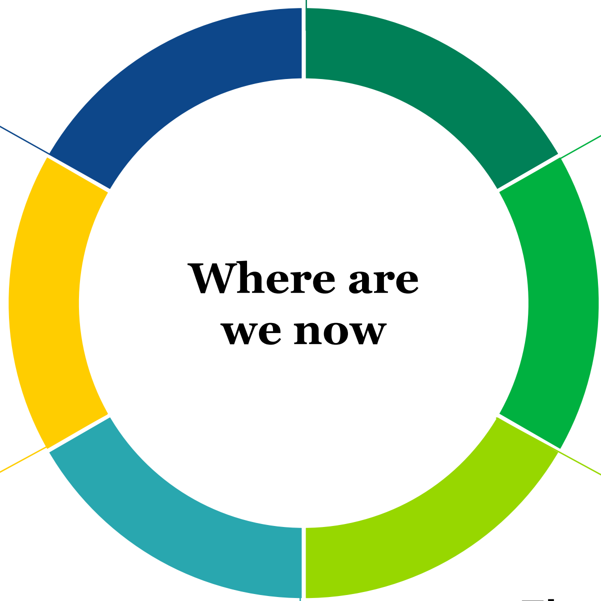
Data source: Bloomberg, 7 September 2022

Where are we now – Fundamentals vs. Valuations

Inflation is beginning to show signs of easing in the US

Central banks will hike further, but we think this has been mostly priced in

Markets have anticipated the bad news, but **Fiscal support** is growing



Default rates are not expected to increase significantly

Markets appear to be much better balanced now

Fixed Income valuations look attractive

PCE inflation is showing signs of rolling over

Source: Bloomberg
31 July 2022

Break-even suggests Fed is winning the inflation battle

Source: Bloomberg
7 September 2022

Government bond curves have reset aggressively this year

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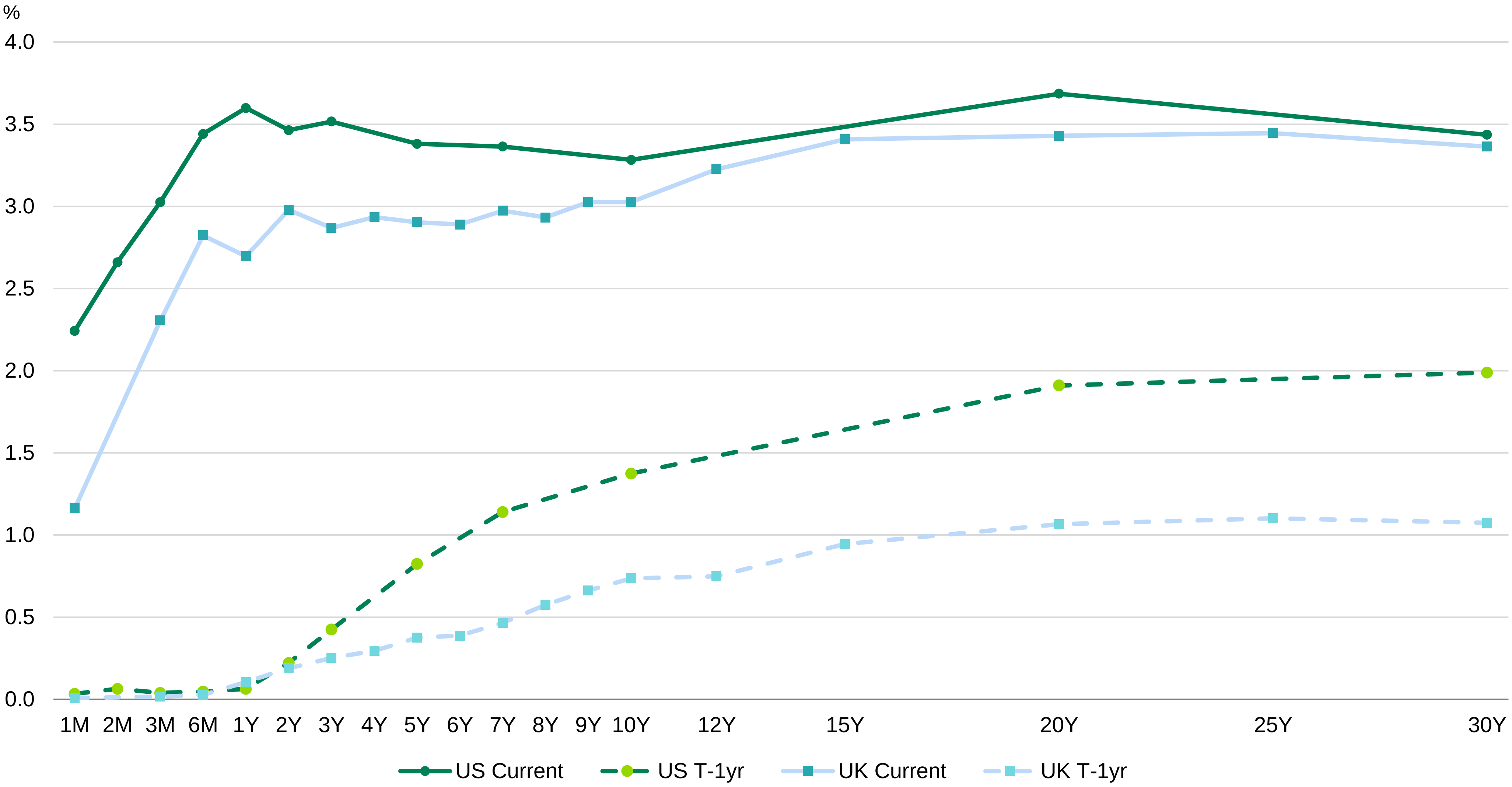
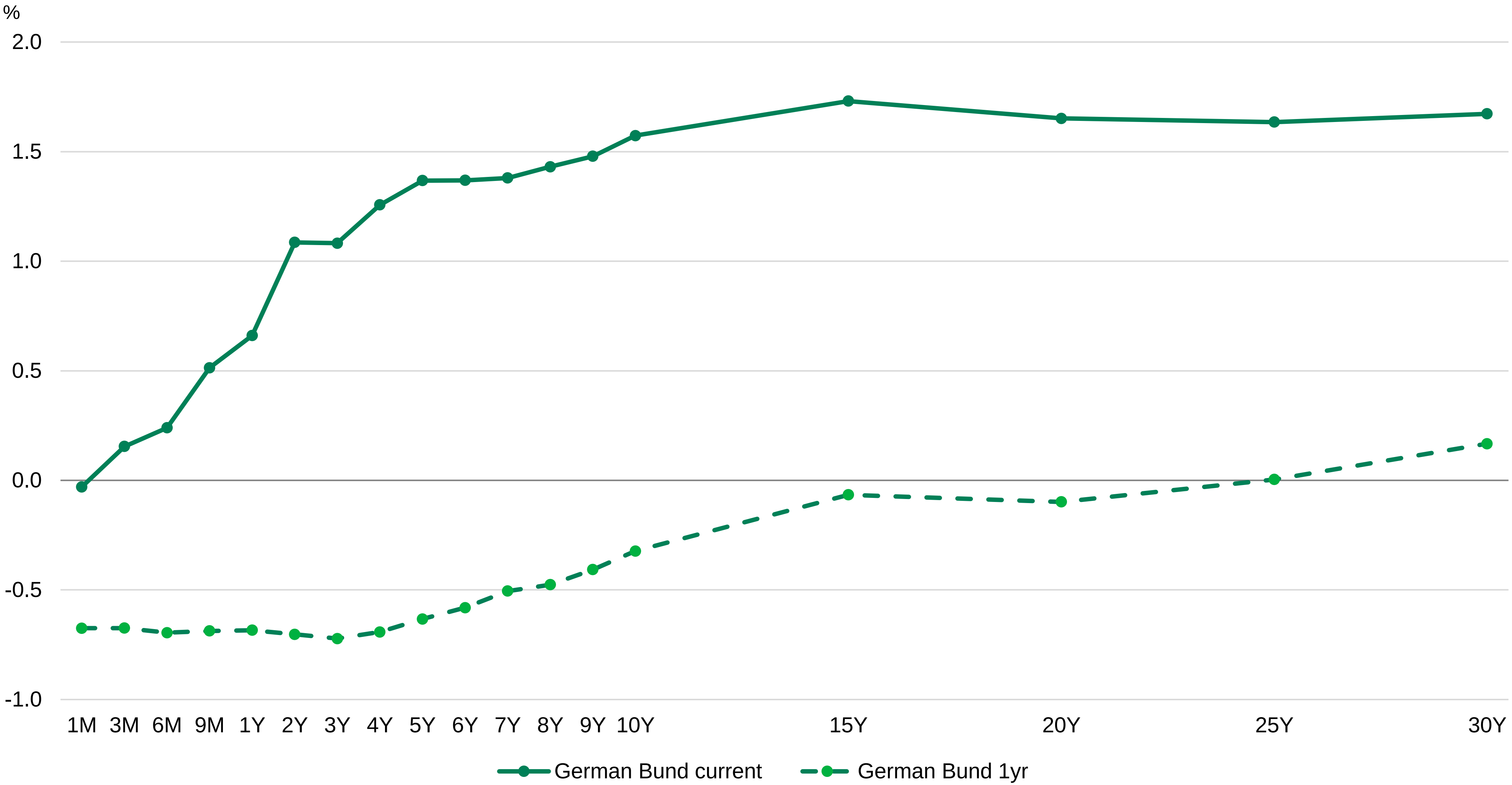


Past performance is not a reliable indicator of current or future performance.
Source: Bloomberg
7 September 2022

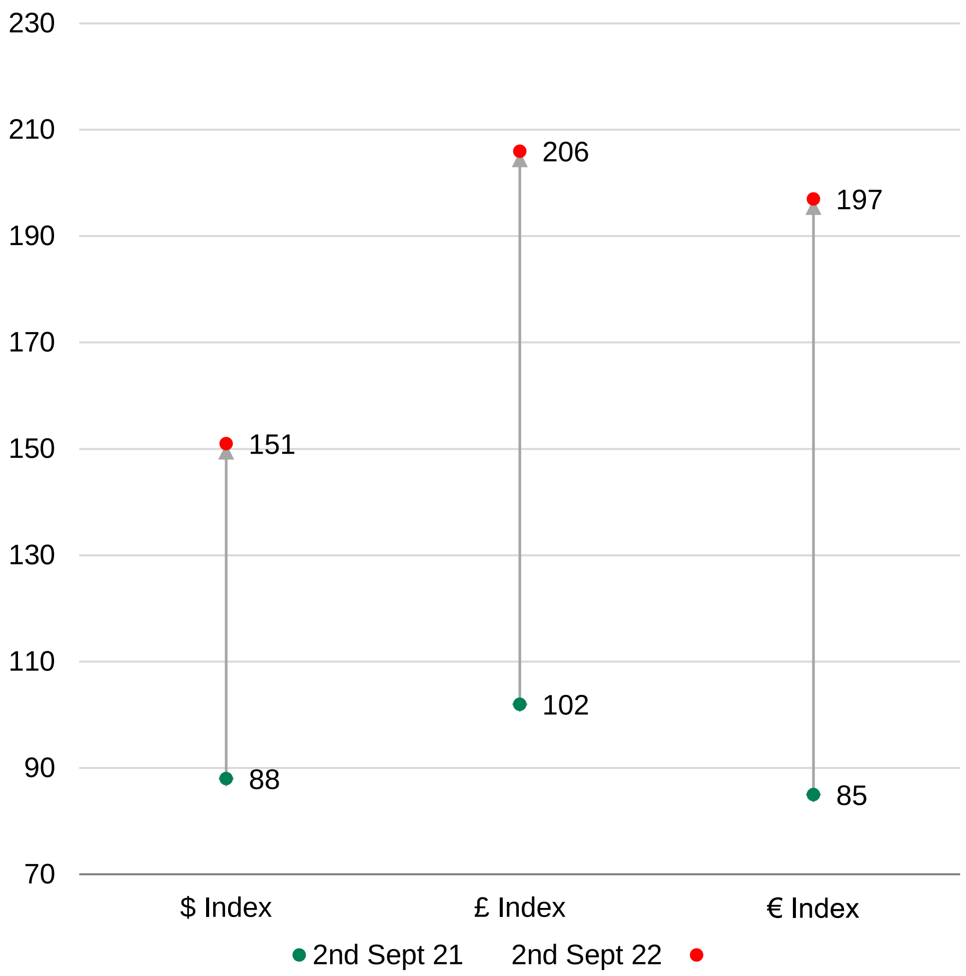
Euro bond curve



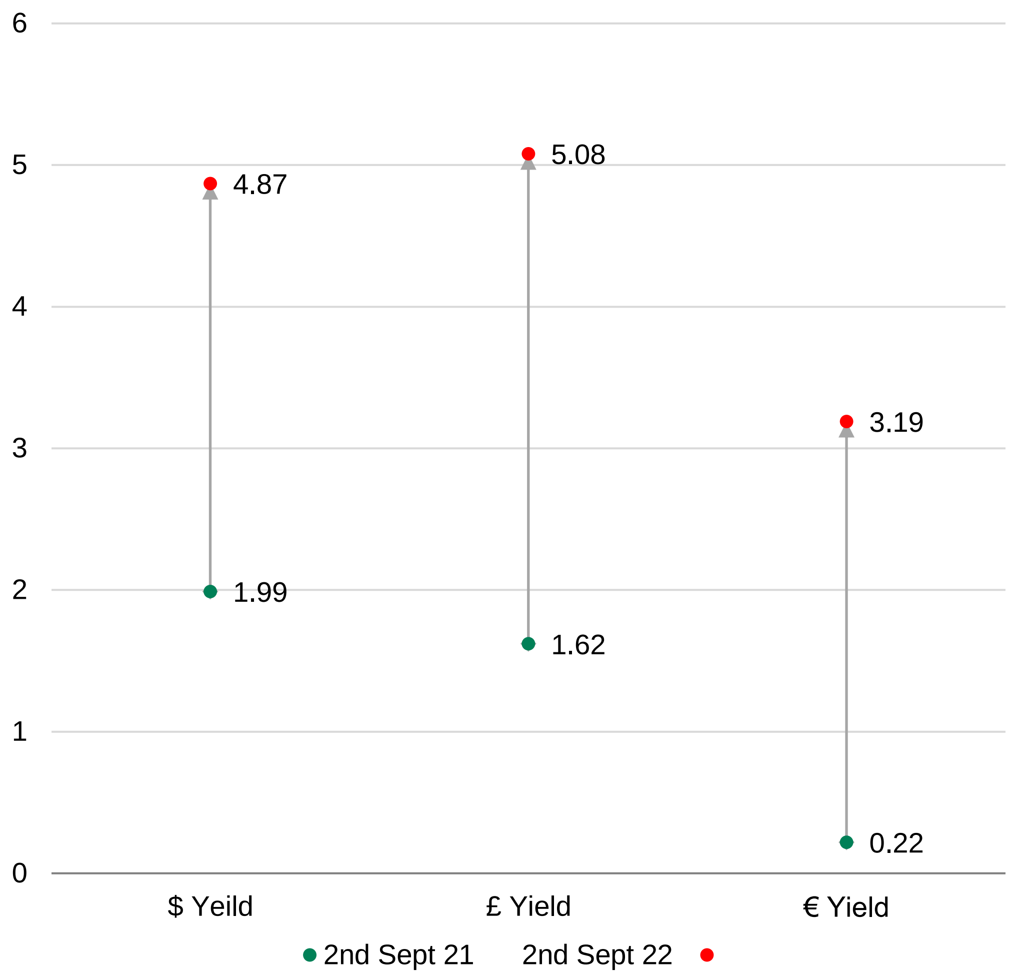
Past performance is not a reliable indicator of current or future performance.
Source: Bloomberg
7 September 2022

IG Spreads and Yields are significantly more attractive

IG spread to worst (bp)



IG effective yield (%)

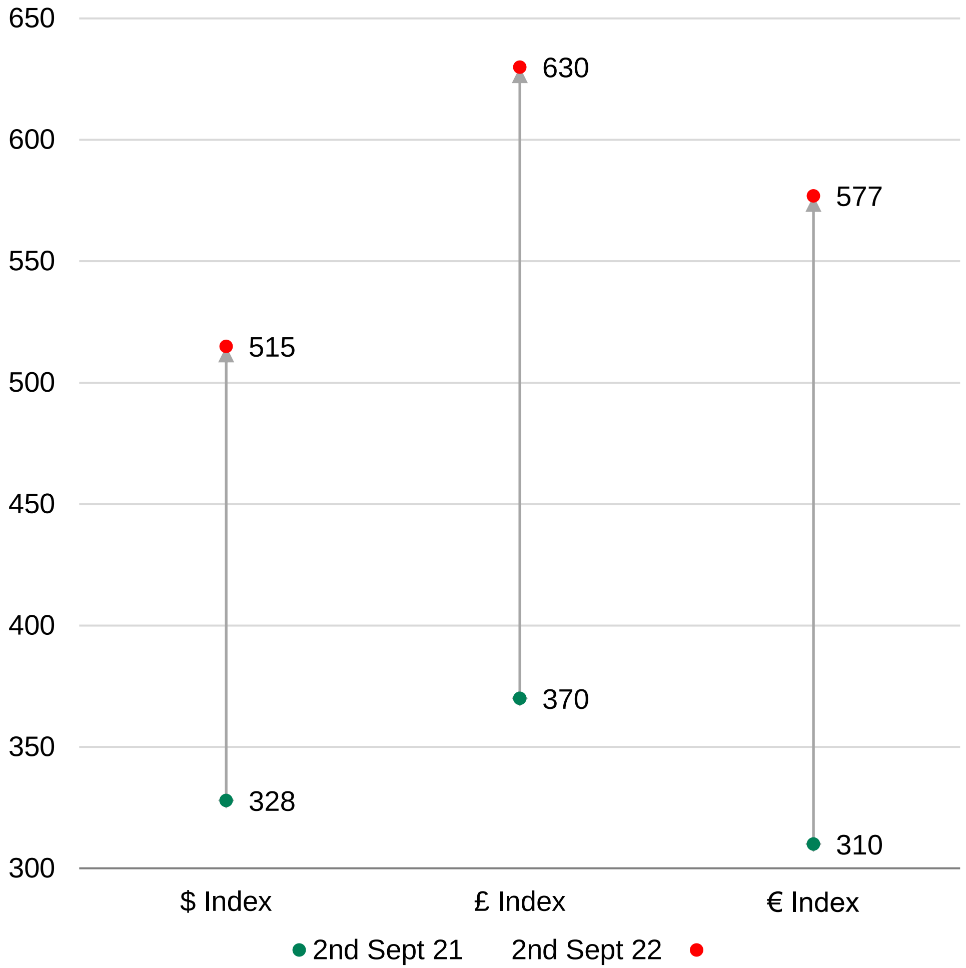


Past performance is not a reliable indicator of current or future performance. It is not possible to invest directly into an index and they will not be actively managed.

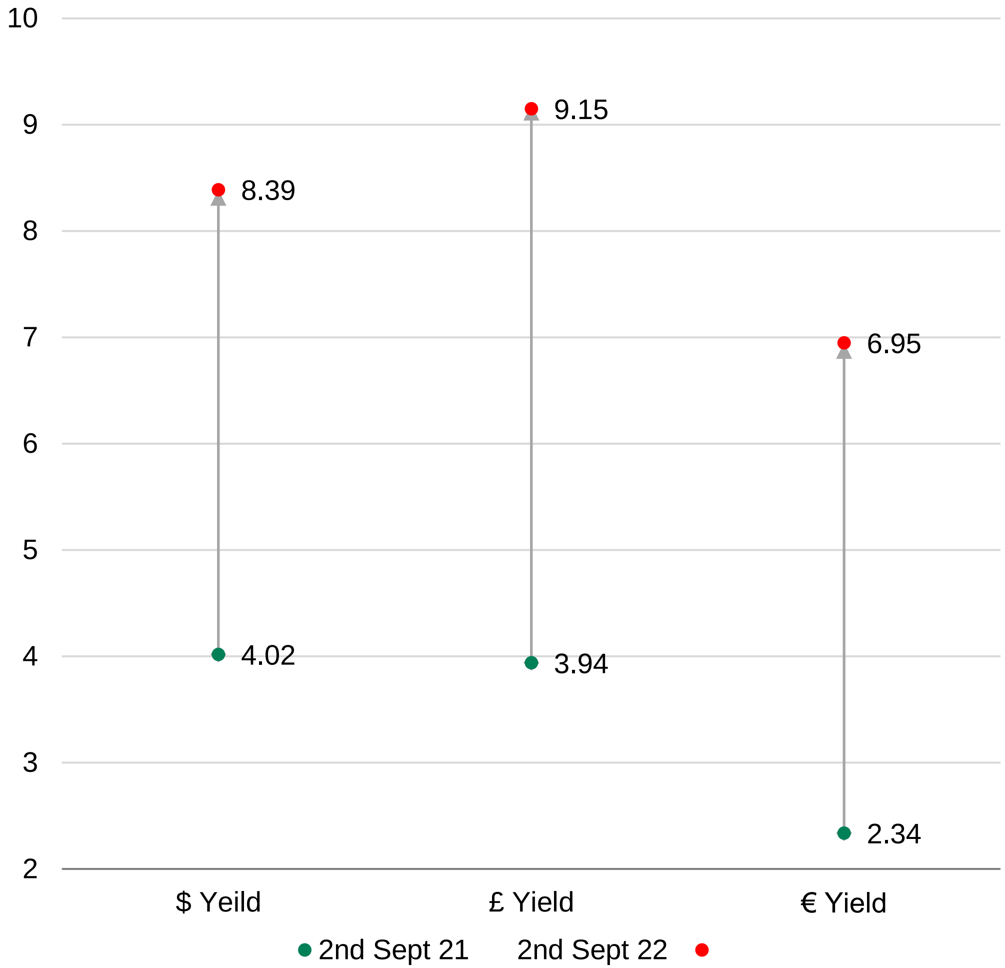
Source: ICE Indices

HY Yields and Spreads have reset even higher

HY spread to worst (bp)



HY effective yield (%)



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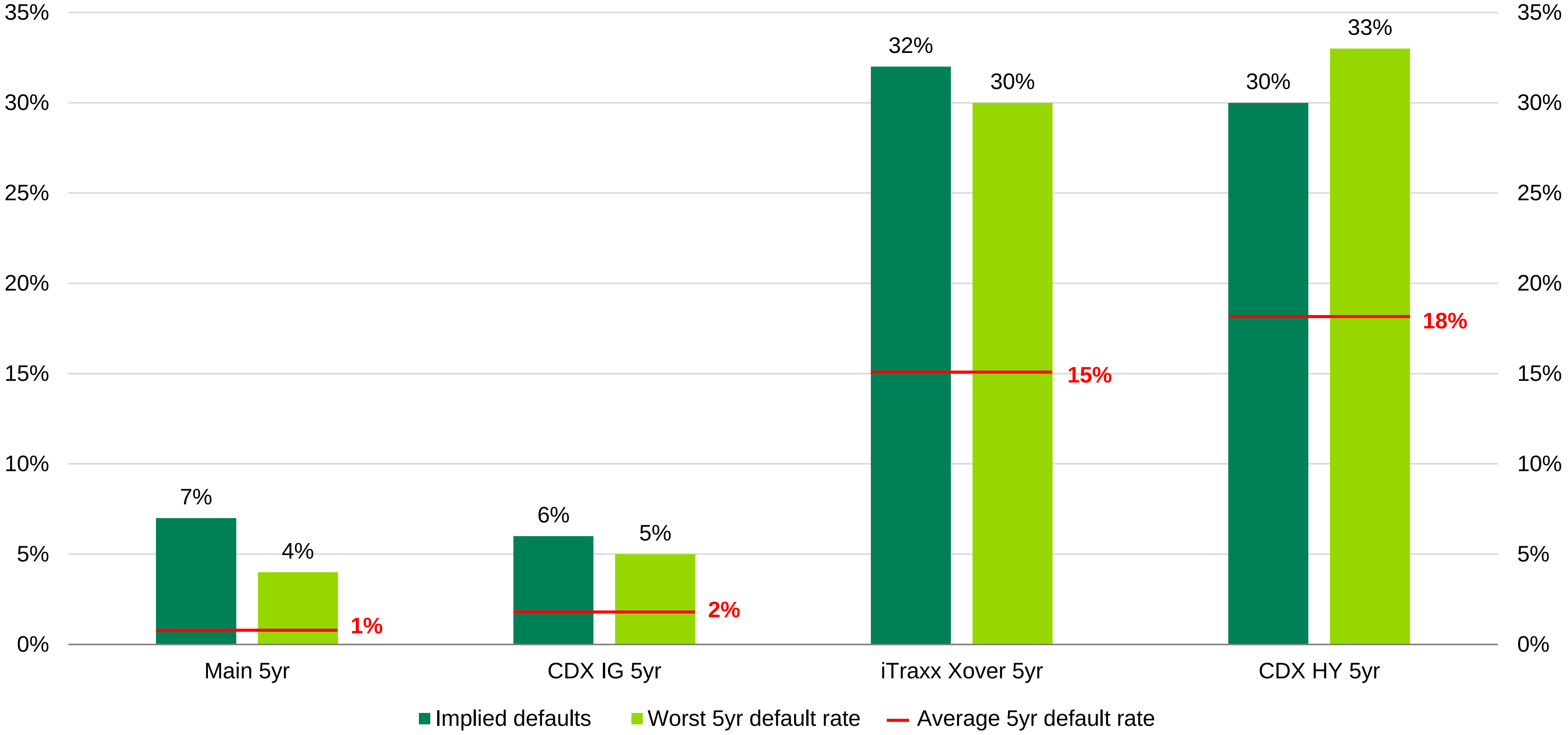
Source: ICE Indices

5-yr Default Rate expectations

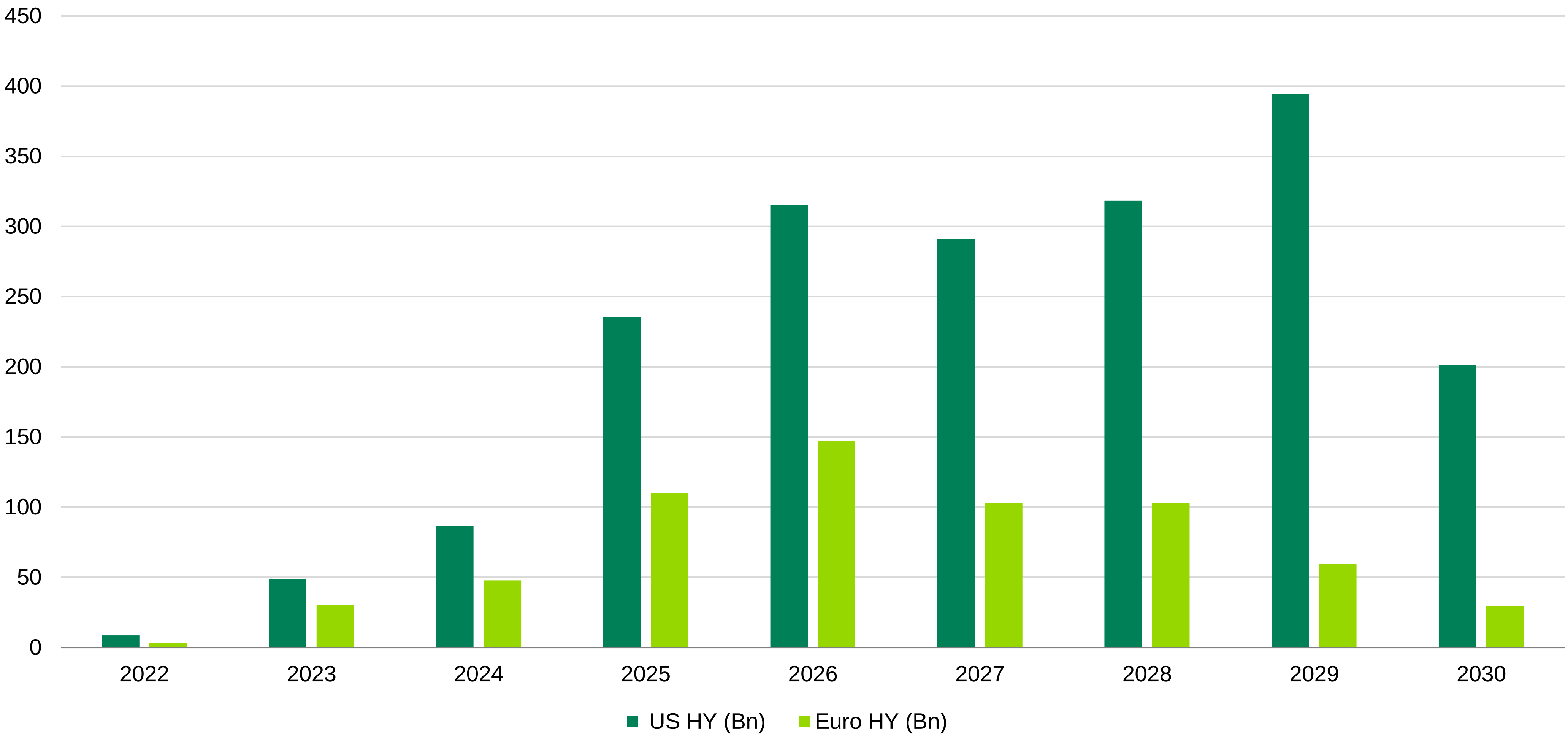
5yr cumulative default rate



Note: Implied defaults calculated using 35% recovery rate. Historic defaults calculated using Moody's default data since 1970 and current index ratings composition.
Source: Morgan Stanley Research, Bloomberg, Moody's; July 2022

Maturity wall is not significant in the near term

High Yield Maturities



Source: Bloomberg
September 2022

Interest coverage is also above long term average

Interest coverage

Source: Morgan Stanley
July 2022

What could the future hold?

Central banks will probably have to be lucky to **avoid a recession** – but if they don't we think it might be a mild one

The **US seems best placed**, but Fed remains hawkish

Stability in Government bonds essential to improving sentiment

External inflation pressures are expected to remain elevated in the medium term

Geopolitical risks are not going away

Energy support is coming in Europe, but not enough detail is available yet

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Positioning based on this?

- With volatility likely to remain elevated, we think portfolios need to be more cautiously positioned
- Build in long dated Treasuries – help to provide balance, protection, and now yield as well
- Defaults look likely to increase, but are not expected to increase significantly
- High yields available in risk-on credit should help provide some protection, but be stock specific
  - Focus on; shorter credit spread duration, higher quality, recession resilient, inflation resilient
- Pull to par is very strong in short dated bonds
- Forward break-evens for indices look attractive:

	Yield (%)	Spread Duration (yrs)	Forward B/E Yield (%)	Forward CS Dur (yrs)
$ HY	8.45	4.19	11.14	3.45
£ HY	9.30	4.01	12.36	3.30
€ HY	7.08	4.53	9.24	3.50
COCO	7.63	3.07	11.30	2.23

Data source: Bloomberg, 7 September 2022

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