TwentyFour
a boutique of Vontobel

Fund Commentary | 30 September 2024

TwentyFour Corporate Bond Fund

This Commentary is a marketing communication for professional UK investors only

Market Commentary

September was characterised by a material repricing in the market's expectations for the future path of interest rates, with investors pricing in a more aggressive rate-cutting cycle by major central banks. This led to a bull steepening of yield curves and helped drive strong returns across a host of sectors within fixed income. Encouraging data out of the US supported the soft landing narrative, while economic growth in large parts of the Eurozone continued to weaken.

Given the weaker than anticipated labour data out of the US in August, the US jobs report at the beginning of September was a key date in investors' diaries last month. The highly anticipated report provided something for everyone. The unemployment rate ticked down to 4.2% from 4.3% previously (as expected), but non-farm payrolls (NFP) only rebounded to +142k, below the forecasted +165k figure. This came alongside downward revisions to NFP numbers for both July and June, which drove the narrative that the US labour market is still seeing tangible signs of weakening. Volatile moves followed the report on the rates side, with the 10-year Treasury yield dropping by almost 20 basis points (bps) over the week to 3.71%, representing the lowest closing level since June 2023. The 2s10s curve rose into positive territory following the report, marking the end of the latest period of Treasury curve inversion that dated back to July 2022. US headline consumer price inflation (CPI) later in the month came in at 0.19%, taking the year-on-year figure down to 2.5%, which was in line with expectations but represented the lowest annual rate since February 2021. However, there was an upside surprise for core inflation, which printed at +0.28% on a month-on-month basis, primarily driven by an uptick in owner equivalent rent, which came in at a seven-month high of +0.5% for August alone. Despite the labour market and inflation reports coming broadly in line with expectations, reports from well-sourced journalists suggesting a 50bps interest rate cut was on the table for the US Federal Reserve (Fed)'s September meeting fuelled a growing and subsequently dominant narrative that the Fed would indeed deliver a half-point cut. The Federal Open Market Committee (FOMC) eventually did announce a 50bps interest rate cut, marking the beginning of the cutting cycle for the US central bank as it lowered the Fed funds rate to 5%. The decision was split 11-1, with member Michelle Bowman becoming the first Fed governor to dissent since 2005, opting for a 25bps cut instead. The FOMC also revealed downward revisions to inflation projections, with 2025 personal consumption expenditures (PCE) lowered by 0.2% to 2.1%, and upward revisions to the unemployment rate forecast to 4.4% from 4.2% previously. Updated dot plot projections showed that the median FOMC member expects the Fed to cut by a further 50bps to 4.5% by year-end and 3.5% by the end of 2025, which was more hawkish than what the market was perhaps expecting. US economic data in the days following pointed towards the US economy remaining resilient and inflationary pressures being kept under control. Retail sales were stronger than anticipated at +0.1% versus -0.2% expected and headline PCE inflation printed marginally below expectations at +2.2% on a year-on-year basis versus the expected +2.3% figure (the lowest reading since February 2021). In line with Fed commentary throughout September, the data served as further evidence that inflation is being tamed, although the battle is not yet completely won.

In Europe, the European Central Bank (ECB) delivered a 25bps rate cut, in line with market expectations, reducing its deposit rate to 3.5%. Updated forecasts showed marginally downgraded growth projections to +0.8% for year-end 2024, +1.3% for 2025 and +1.5% for 2026. Headline inflation forecasts were kept unchanged, but core CPI forecasts were raised. Purchasing Managers' Indices (PMI) towards month-end were very weak, with signs of significant economic weakness across large parts of the Eurozone. The Eurozone's composite PMI figure printed at 48.9 in September, down from 51.0 in August and materially underperforming the 50.5 expectation, driven by a continued decline in manufacturing activity across the bloc. The print led some investment banks to downwardly revise their GDP forecasts for the Eurozone for the remainder of the year. Markets began pricing in another quarter-point rate cut by the ECB in its October meeting as weak economic data emerged.

The Bank of England (BoE) bucked the trend and kept its policy rate unchanged at 5% last month, with members voting 8-1 in favour of holding rates, broadly in line with market forecasts. The announcement followed UK headline CPI coming in line with expectations at +2.2%. However, core inflation ticked up to 3.6% on a year-on-year basis, with the move largely driven by an increase in services inflation to 5.6% from 5.2% previously. In light of this, Governor Andrew Bailey stated that BoE members "need to be careful not to cut too fast or by too much" as core inflation is still running significantly higher than the bank's 2% target. Economic activity is not yet showing signs of material weakening in the UK; strong PMIs suggest net economic expansion as the composite figure printed at 52.9 and retail sales outperformed economist forecasts at +1% month-on-month. On the labour side, the unemployment rate fell by one-tenth to 4.1% in September, as did average weekly earnings to 4.0% on a year-on-year basis.

Portfolio Commentary

September was also a good month for the Fund, which returned +0.72% (after fees). This was ahead of the benchmark return (+0.39% for the month) by +33bps, rounding out a solid quarter for the Fund in absolute and relative terms. During the third quarter, the Fund returned +3.31%, generating alpha of +97bps versus the benchmark return of +2.34%.

This means for the year-to-date period ending September, the Fund has returned +5.05%, more than double the benchmark return of +2.34%, generating alpha for the Fund of +271bps.

Similarly to last month, attribution for September shows performance contributions basically in line across many sectors, with two major standouts. Within credit, the insurance positions combined well with an overweight to the sector, which, in total, added +12bps of contribution relative to the benchmark.

However, by far the biggest relative contribution came from off-benchmark positions, mainly government and supranational bonds, which generated +17bps of alpha compared to the benchmark. At the very long end of the yield curve, the portfolio managers' (PM) preference for gilts and supranationals compared to expensive (in spread terms) high-quality corporates generated strong relative gains.

Similarly, the Fund's preference for shorter-dated hybrid utilities versus longer-dated senior utilities generated +4bps of contribution alpha in the utilities sector.

The PMs de-risked the credit portfolio early in the second quarter of 2023. This was due to concerns (which are coming to the fore again in 2024) about the regional banking crisis in the US potentially spilling over into volatility in Europe. Moreover, there were worries about the lagged impact of significant rate hikes in 2022 leading to economic slowdowns and even, ultimately, contractions. The PMs kept a lower level of beta and credit spread duration than the benchmark throughout most of 2023 and 2024. However, interest rate duration was significantly increased in 2023 compared to 2022, although a slight bias towards yield curve steepening was retained. In February, and further in March, April and May, duration was further increased to lock in some of the outperformance versus the benchmark given the rise in yields seen so far in 2024. As such, the portfolio's duration is the closest to the benchmark in many years, reflecting the large-scale rise in yields seen globally in 2022, the first three quarters of 2023 and the start of 2024.

Market Outlook and Strategy

With the ECB having now delivered its second interest rate cut, and the Fed cutting rates by 50bps in its first rate cut this cycle, the prospects for repeated cuts now look excellent through 2024 and 2025. As such, the major risks to capital from duration risk look to have ended; the PMs have continued to become more tolerant of duration in the Fund. However, they think the significant yield curve inversion in rates curves still makes very long-dated credit look especially expensive, even allowing for the potential for rate cuts later this year and next, which may take yield curves back towards historic levels of steepness. As such, a modestly lower than average interest rate duration profile is still believed to be warranted. However, the PMs remain concerned that increasing unemployment rates across the US, UK, and especially Germany signal worsening GDP data to come. Moreover, recession risks both remain significant and are not fully priced into non-financial spreads, in the PMs' views. Therefore, a lower beta credit stance is also still thought to remain warranted.

As such, we believe the combination of lower-than-benchmark duration (-0.25 years versus the benchmark) and higher average yield, with high average credit quality, is the best way to address the likely volatility in the broader market that we expect over the next few months, while still producing a solid income. This stance is designed to maximise the breakeven yield as much as possible within the constraints of the Fund. This means that, with a yield of 5.7% (benchmark yield = 5.2%) and a duration of 5.9 years, the breakeven yield is +97bps, which helps to provide more protection against rising yields than the benchmark.

In these markets, we appreciate having access to PMs 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 like in more detail.

					Annualised			
Cumulative Performance	1m	3m	6m	1y	3y	5y	10y	Since Inception*
GBP I Accumulation	0.72%	3.31%	3.37%	13.24%	-2.02%	-0.01%	N/A	2.23%
iBoxx GBP Corporate Bond Index	0.39%	2.34%	2.13%	10.71%	-2.75%	-0.77%	N/A	1.96%

Discrete Performance	YTD	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
GBP I Accumulation	5.05%	9.09%	-17.70%	-1.55%	7.56%	9.73%	-2.26%	7.21%	8.48%	N/A	N/A
iBoxx GBP Corporate Bond Index	2.34%	9.70%	-18.37%	-3.19%	8.63%	11.03%	-2.20%	5.01%	11.83%	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, if applicable. 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 15/01/2015.
The benchmark of the Fund is the IA £ Corporate Bond Sector however the secondary reference benchmark against which performance of the Fund may be compared is the iBoxx GBP Corporate Bond Index.

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 Fund's investments may be subject to sustainability risks. The sustainability risks that the Fund may be subject to are likely to have an immaterial impact on the value of the Fund's investments in the medium to long term due to the mitigating nature of the Fund's ESG approach
- The 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 Fund may be obtained from **www.twentyfouram.com/responsible-investment**

Fund Managers

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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