Fund Commentary | 31 October 2024

TwentyFour Corporate Bond Fund

This Commentary is a marketing communication for professional UK investors only

Market Commentary

October was volatile for fixed income markets as a combination of resurgent economic data and the increasing probability of a Trump presidency led to a material sell-off in government bonds. Investors adjusted their expectations to anticipate a slower and more gradual rate-cutting cycle from the US Federal Reserve (Fed), which contributed to a 50 basis point (bps) rise in 10-year Treasury yields over the month. Credit performed well as a result of further spread tightening and the continuing strong financial performance from the majority of companies.

Markets started the month strongly, with a significantly better-than-expected US labour report surprising investors and easing fears that labour demand was deteriorating at an uncontrollable pace. The headline non-farm payroll number rose +254,000, which was materially higher than expectations of a +150,000 print. Meanwhile, the unemployment rate fell to 4.1% (4.05% on an unrounded basis), despite investors forecasting the figure to hold firm at 4.2%. The combination of stronger labour data and growing inflation risks, deriving from the rise in oil prices amid the escalating conflict in the Middle East at the beginning of the month, resulted in investors gradually pricing out the probability of a 50bps interest rate cut by the Fed at its next central bank meeting in November. This was compounded by the US inflation report, which showed the headline Consumer Price Index (CPI) decelerating less than anticipated to 2.4%, while core inflation accelerated to 3.3%, despite the median forecasts of around 3.2%. With progress stalling on the inflation front, the rates sell-off continued through the middle of the month, with investors beginning to price in only a 25bps rate cut by the Fed – a meaningful drop compared to the beginning of the month. Supporting the narrative that the battle over inflation is not yet won, the personal consumption expenditures (PCE) price index rose to a five-month high of 2.7% (on an annual basis), versus expectations of a 2.6% rise. However, the headline number fell to 2.1%, year on year (YoY), representing the lowest rate since February 2021.

Investors also focused on the release of the Fed minutes from the September meeting, which revealed that Chairman Jerome Powell had received pushback regarding the 50bps cut the central bank eventually delivered. Some members highlighted that they would have preferred a smaller cut to allow time to "assess the degree of policy restrictiveness as the economy evolved". Further strong US economic data included robust retail sales figures, which suggested US consumer resilience was still high. The month-on-month figure rose by 0.4%, versus expectations of 0.3%, contributing to a strong 1.7% YoY advance. Off the back of this, the Atlanta Fed raised its GDP growth estimate for the third quarter to 3.4% (annualised), from the previous 3.2% figure. As the month drew to a close, the increasing probability of a Trump presidency drove Treasury yields wider. A Trump victory is widely regarded as being inflationary and conducive to domestic growth, which suggests a higher rate environment over the medium and long term.

Being the only central bank of the 'Big Three' to host a monetary policy meeting last month, the European Central Bank (ECB) announced a 25bps rate cut, taking the level down to 3.25%, which was in line with expectations. The move represents the first back-to-back rate cut of any of them this cutting cycle as President Christine Lagarde recognised there were "probably more downside risks" on inflation, in alignment with the weak CPI data out of the eurozone in recent months. The decision came as headline CPI printed at 1.8% for the month of September, down from 2.2% in August but in line with investors' expectations. Core inflation also edged down from 2.8% to 2.7% as the economic environment in Europe continues to be characterised by declining inflation. The eurozone did, however, post stronger-than-anticipated growth data as third-quarter GDP grew by 0.4% (quarter on quarter). This was above the 0.2% expected rate, with upside surprises across several countries including Germany, France and Spain. Despite this, investors still expect the ECB to cut rates by 25bps at its next meeting, and 25bps in each of the subsequent meetings heading into 2025.

The UK experienced a significant bout of volatility at the end of the month as Chancellor of the Exchequer Rachel Reeves announced the Autumn Budget. There were significant losses among UK gilts across the curve following the announcement. Gilt yields rose materially in the aftermath as investors reacted negatively to the proposals of increased investment spending that will be financed by increased borrowing and higher domestic taxes on companies and individuals. On the macroeconomic front, October's UK CPI release fell well below forecasts, which helped to reassure investors that inflationary pressures were easing. The headline number ticked down to 1.7%, versus 1.9% expected, representing the lowest annual rate since April 2021; core inflation was also its weakest in over three years. The services inflation print was particularly encouraging, falling to 4.9%, from 5.6% previously, which contributed to investors now pricing in a 25bps cut at the next Bank of England meeting in November. The labour market is still going strong, with the three-month annualised rate from June to August (released in October) falling to 4.0%.

Portfolio Commentary

With sell-offs in government bonds, September was a tough month for the Fund, which was down -1.12% after fees. This was almost exactly the same as the benchmark's return of -1.13%.

For the year-to-date period ending October, the Fund has returned +3.87%, more than three times the benchmark return of +1.19%, generating alpha for the Fund of +268bps.

Similarly to last month, attribution for October shows performance contributions basically in line across many sectors, with two major standouts. Within credit, the bank sector positions combined well with an overweight to the sector, which, in total, added +8bps of contribution relative to the benchmark.

A similar level of relative contribution came from utilities, which generated +9bps of alpha compared to the benchmark, helped by a lower duration stance and higher hybrid exposure compared to the benchmark.

The portfolio managers (PMs) de-risked the credit portfolio early in the second quarter of 2023 due to concerns about the regional banking crisis in the US potentially spilling over into volatility in Europe. Moreover, there were concerns 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 start of 2024.

Market Outlook and Strategy

With the ECB having now delivered its third cut, and the Fed cutting rates by 50bps (marking its first rate cut this cycle), the prospects for repeated rate cuts now look excellent through 2024 and all of 2025. As such, the major risks to capital from duration risk look to have ended. Thus, 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 – and 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 still thought to remain warranted.

As such, we believe the combination of lower-than-benchmark duration (-0.20 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, meaning with a yield of 5.9% (benchmark yield = 5.5%) and a duration of 5.8 years, the breakeven yield is +102bps, 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	-1.12%	0.05%	4.01%	12.14%	-2.28%	-0.21%	N/A	2.09%
iBoxx GBP Corporate Bond Index	-1.13%	-0.47%	2.88%	9.60%	-3.26%	-0.96%	N/A	1.83%

Discrete Performance	YTD	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
GBP I Accumulation	3.87%	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	1.19%	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**

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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

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