TwentyFour
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Fund Commentary | 31 December 2024

TwentyFour Corporate Bond Fund

This Commentary is a marketing communication for professional UK investors only

Market Commentary

Hawkish central bank meetings and the renewed risk of inflation in the US economy drove a significant sell-off in fixed income markets in December. Increasing caution over the pace of rate-cutting cycles across major economies pushed the 10-year Treasury yield up by 38 basis points (bps) during the month. The rise came as investors lowered their expectations for extensive interest rate cuts by the Federal Reserve (Fed) and other central banks in 2025. Equity markets also reacted negatively, with the 'higher-for-longer' interest rate narrative gaining traction.

Following November's somewhat unreliable US labour report, given weather-related disruptions to employment, the market paid particularly close attention to December's numbers. The mixed jobs report saw the headline non-farm payroll figure rise by 227,000 month-on-month, which was broadly in line with the consensus number of a 220,000 increase. However, the unemployment rate ticked up to 4.2%, which represented a significant upside surprise relative to the 4.1% expected by economists. The 10-year Treasury yield, which bottomed out at 4.13% in the immediate aftermath of December's labour report release, spent the rest of the month on the rise as a slew of economic data led investors to reduce the probability of significant interest rate cuts by the Fed in 2025. The most significant of these data releases was for US inflation. The monthly headline and core Consumer Price Index (CPI) readings both came in at 0.3%, which took the year-on-year numbers to 2.7% and 3.3%, respectively. Although these figures were broadly in line with expectations, longer-term inflation trends were of concern to investors as the three-month annualised pace of core CPI ticked up again to 3.7%. The headline Producer Price Index print was stronger than expected, with the year-on-year rate edging up to 3.0% for the first time since the beginning of 2023, as did the US retail sales release prior to the Fed meeting. The Fed's meeting in the middle of the month compounded the growing narrative that it would pursue a more hawkish approach next year than previously anticipated. An expected 25bps cut (which took the Fed funds rate down to 4.25-4.50%) was accompanied by an updated set of 'dot-plot' projections showing just 50bps of cuts for 2025, down from 100bps previously. Furthermore, the long-run median dot shifted up to 3.0%, while inflation projections were increased significantly, with personal consumption expenditures (PCE) inflation now predicted to be 2.5% by the end of 2025, up from 2.1% previously. Fed Chairman Jerome Powell highlighted that the Federal Open Market Committee members would need to see more "progress on inflation" in order to cut rates further as risks to inflation tilted to the upside. Towards the end of the month, it emerged that the core PCE price index rose by 0.1% month-on-month in November, versus a consensus estimate of a 0.2% increase, which helped to partially reverse some of the negative sentiment around re-accelerating inflation.

Similarly to the Fed, the European Central Bank (ECB) adopted a more hawkish approach than many had expected at its meeting, despite delivering its own 25bps rate cut to take the deposit rate down to 3.0%. Updated forecasts saw both economic growth and inflation projections downgraded over the years ahead, with GDP growth at just 1.1% (down by 0.2 percentage points from the previous quarter) and headline CPI at 2.1% (down from 2.2%) by the end of 2025. However, ECB President Christine Lagarde made some surprising comments, including that eurozone inflation risks were still "two-sided", which cast doubt over how aggressively the ECB would reduce rates in 2025. Many of the same economic data trends persisted in the eurozone, with weaker growth and slowing inflation continuing. There was political turmoil in France, however, as Marine Le Pen's party, backed by left-wing parties, announced that it would support a no-confidence motion in the government of Prime Minister Michel Barnier. Barnier went on to lose the vote, with the National Assembly choosing to oust his government, with 331 votes in favour out of 577. The result was somewhat expected and markets did not move much. Emmanuel Macron confirmed his intention to remain as president for the remainder of his term, which runs out in 2027.

The Bank of England (BoE) bucked the trend in its meeting, striking a more dovish tone than anticipated. The decision to hold rates at 4.75% was widely expected, but this outcome was only made by a 6-3 vote, with the minority opting for a 25bps cut. The BoE's statement pointed towards further easing in the near future as a "gradual approach to removing monetary policy restraint remained appropriate". Tracking US Treasury moves, UK gilts remained under pressure throughout the month, however. The CPI print did little to help matters, with December's reading showing that headline inflation accelerated to an eight-month high of 2.6% and that core inflation ticked up again to 3.5%. The final number for third-quarter GDP came in a tenth below expectations at 0%, which, when combined with the aforementioned inflation picture, led to growing concerns that the country was potentially heading towards a stagflationary environment.

Portfolio Commentary

With the backdrop of a tough month for rates markets globally, the Fund was down -0.59% in December, some -14bps lower than the benchmark return.

For the full year, the Fund significantly outperformed the benchmark, generating +273bps of alpha on a net basis after fees. This is the biggest alpha for a single year in the Fund's10-year history. After fees, the Fund returned +4.91% for the 2024 calendar year, more than double the benchmark return of +2.18%.

The attribution for the year shows a narrative of being well-positioned versus the benchmark for the significant yield-curve steepening that occurred. This was despite the portfolio's duration moving very close to the benchmark earlier in the year. Similarly, having the highest beta credit positions in short-term securities played well in terms of benefitting from yield-curve steepening as the gilt curve pivoted around the two-year point. The benchmark's longer-dated, higher-quality positions experienced capital losses due to the gilt curve moves. At the same time, the Fund's shorter-dated beta positions not only had modest capital gains due to the gilt curve moves, but had high carry returns on top of this.

Financials did the heavy lifting in terms of both absolute and relative returns, with the Fund's insurance holdings returning +10.20% versus +5.63% for the index. This, coupled with the Fund's significant overweight to the sector, meant that insurance contributed +106bps to the portfolio's total return versus +15bps for the benchmark. As such, the Fund's insurance exposure alone delivered +92bps of alpha contribution.

Banks delivered a good return of +7.25% for the Fund versus +4.80% for the benchmark, which helped to drive +25bps of alpha contribution.

In terms of both financials subsectors, subordinated positions performed the best. In insurance, many subordinated positions delivered double-digit returns, while in banks, many generated high single-digit returns. While senior financials witnessed spread tightening over the year, their lower-yielding nature did not quite match the total returns of subordinated positions. Ultimately, financials returned +8.18% for the Fund versus +4.93% for the benchmark.

In non-financials, the utilities, telecommunications and industrials sectors outperformed strongly for similar reasons. In all three cases, the portfolio was overweight shorter-dated hybrid bonds from these sectors (higher yielding but with call features) versus being underweight long-dated senior bonds contained in the benchmark. While the benchmark's longer-dated bonds saw good spread tightening over the year, they could not overcome the steepening in that part of the gilt curve, which meant that total returns from those positions were poor. For example, in utilities, the Fund generated a return of +7.25% while the benchmark delivered -1.15%. This added +43bps of alpha contribution for the Fund. Similarly, in telecommunications, the Fund returned +5.05% while the benchmark produced -0.09%. Telecommunications added +24bps of alpha contribution to the portfolio, and in industrials, the Fund returned +3.34% versus +1.28% for the benchmark, making an alpha contribution of +10bps.

The Fund retains a slightly lower beta credit stance than the benchmark overall, with notable overweight risk positions in very selective sectors and shorter-dated parts of the yield curve where all-in credit yields remain attractive. This lower beta stance is predicated on mark-to-market risks from wider spreads, rather than default risk per se, given the tight levels of overall credit spreads compared with the post-global financial crisis market environment. That said, the portfolio managers (PMs) still believe that all-in credit yields remain attractive. As such, the portfolio retains several higher beta credit positions in subordinated financials and corporate hybrids where yields, and especially breakeven yields, remain highly favourable. The maturity profile of these higher beta positions are, however, deliberately very near term to both maximise carry and minimise capital risks from the threat of further yield-curve steepening.

Market Outlook and Strategy

With the ECB having delivered its fourth interest-rate cut, and the Fed dropping rates three times, the prospect of repeated reductions now looks modest through 2025. As such, the major risks to capital from duration risk have ended, and thus the PMs have continued to become more tolerant of duration in the Fund. The emerging steepness in rates curves still has a little further to go, in the PMs' view, with very long-dated credit still looking expensive as curves move back towards historical levels of steepness. A modestly lower-than-average interest-rate duration profile remans warranted. However, the PMs remain concerned that increasing unemployment rates across the UK and especially Germany, coupled with worsening inflation data globally, signal worsening GDP data to come. Consequently, recession risks in Europe remain significant and are not fully priced into non-financial spreads, in the PMs' view. Therefore, a lower beta credit stance remains warranted.

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 about 5.9% (the benchmark yield at 5.4%) and duration of 5.9 years, the breakeven yield is +100bps, which provides more protection against rising yields than the benchmark.

Cumulative Performance	1m	3m	6m	1y	Annualised 3y	5y	10y	Since Inception*
GBP I Accumulation	-0.59%	-0.13%	3.18%	4.91%	-1.98%	-0.05%	N/A	2.16%
iBoxx GBP Corporate Bond Index	-0.45%	-0.16%	2.18%	2.18%	-2.92%	-0.77%	N/A	1.90%

Discrete Performance	2024	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
GBP I Accumulation	4.91%	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	2.18%	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