TwentyFour
a boutique of Vontobel

Fund Commentary | 31 December 2024

MI TwentyFour Investment Funds - Dynamic Bond Fund

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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

Primary issuance slowed significantly in December as the seasonal decline in market activity took hold. However, the portfolio managers were active in the secondary market, conducting relative value switches where appropriate. Following the Treasury rally at the beginning of the month, the team decided to switch 1.5% of 30-year Treasuries and 1% of 30-year German bunds for 2.5% of 10-year Treasuries. As a result, the team booked some profits following the initial trade into 30-year sovereign bonds in November. The switch left the portfolio's interest rate duration at 4.4 years. Furthermore, in line with the continuing theme to increase the portfolio's average credit quality, the team decided to switch 50bps of BB/B collateralised loan obligations (CLOs) for AAA-rated CLO paper. Occurring gradually as mezzanine CLOs roll off, this trade will also improve the portfolio's liquidity given the more liquid nature of AAAs relative to BB/B-rated paper. Lastly, due to the elevated uncertainty around the war in Ukraine and the increasingly aggressive rhetoric and actions from Russian President Vladimir Putin, the team opted to hedge part of the portfolio's credit risk by purchasing out of the money iTraxx Crossover index payer options at a strike of between 462.5 and 500.

The significant sovereign bond sell-off witnessed throughout December led the US Treasury index to post a total return of -1.69% over the month. The UK gilt (-2.55%) and bund (-1.34%) indices were also comfortably in negative territory, as they tracked Treasury moves. Credit outperformed as spreads tightened across high-yield (HY) indices, including US HY (-0.43%) and European HY (+0.63%), and investment-grade (IG) indices, with US and European IG at -1.78% and -0.43%, respectively. The Contingent Convertible bond index outperformed most other areas of fixed income as banks enjoyed a strong reporting season.

As a result of the rates sell-off, the Fund posted a total return of -0.19% in December. The largest detractors were government rates (-0.60%) and IG corporates (-0.08%), with the latter dragged down by the sovereign bond move. Despite this, multiple sectors within credit benefited from spread tightening and consequently contributed positively to the Fund's performance, including bank Additional Tier 1s (+0.23%), CLOs (+0.16%) and insurance (+0.12%).

Market Outlook and Strategy

The market will pay particularly close attention to whether there are any further developments in the Russia-Ukraine conflict as 2025 unfolds. Donald Trump's inauguration for a second term as US president on 20 January will serve as a key driver of risk sentiment at the beginning of the year, as his desired policies can begin to take shape. Investors will keep a close eye on how key macroeconomic data, particularly US inflation, develops given that this will be an important determinant of how central banks proceed with their rate-cutting cycles in 2025. Central bank commentary will also play a significant role in shaping the market's views on the future path of interest rates across the US, UK and Europe.

After a typically slow December, the primary market is widely anticipated to burst into life in the first few weeks of 2025, which will give the PMs the opportunity to add new names and optimise existing holdings. Executing duration and liquidity switches will remain an option to PMs, who would expect to use this to respond to any material geopolitical or economic developments should they see fit.

					Annualised			
Cumulative Performance	1m	3m	6m	1y	3y	5y	10y	Since Inception*
Class I Acc (Gross)	-0.19%	0.49%	4.53%	9.10%	1.23%	2.45%	3.67%	5.21%
ICE BoAML Global Broad Market	-1.18%	-1.72%	2.56%	2.02%	-2.29%	-0.70%	0.97%	2.19%

Discrete Performance	2024	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Class I Acc (Gross)	9.10%	9.61%	-13.26%	2.13%	6.55%	9.43%	-2.42%	8.89%	5.44%	3.60%	6.81%
ICE BoAML Global Broad Market	2.02%	5.67%	-13.46%	-1.73%	5.30%	6.49%	0.02%	1.97%	3.64%	1.37%	8.07%

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 26/04/2010. ICE Global Broad Market Index has been chosen as a proxy for the fixed income market overall and is used as reference index for illustration purposes only, there is no fund benchmark. Please see Important Information slides for further information on the index.

Key Risks

- Limited participation in the potential of single securities
- Investments in foreign currencies are subject to currency fluctuations
- 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
- Investment universe may involve investments in countries where the local capital markets may not yet qualify as recognised capital markets
- Money market investments are associated with risks of a money market, such as interest rate fluctuations, inflation risk and economic instability
- 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 Funds' investments in the medium to long term due to the mitigating nature of the Fund's ESG approach
- The Funds' 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 twentyfouram.com/sustainability

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 and/or www.fundrock.com/mi-funds/twentyfour-asset-management/

ICE BofAML Global Broad Market Index - tracks the performance of investment grade debt publicly issued in the major domestic and eurobond markets, including sovereign, quasi-government, corporate, securitized and collateralized securities.