TwentyFour
a boutique of Vontobel

Fund Commentary | 30 June 2024

Vontobel Fund - TwentyFour Sustainable Strategic Income Fund

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Market Commentary

June was another volatile month for rates as mixed economic data releases and increased political uncertainty led to wavering market sentiment. Credit spreads widened marginally off the back of this uncertainty. However, US equities continued their impressive year-to-date rally, while rates across both Europe and the US returned positive performance despite a late sell-off at the end of the month.

In line with what markets have seen for much of this year, Treasuries continued to trade in a range over June. A stronger-than-expected US labour report at the beginning of the month saw a sharp sell-off in rates as markets moved to reduce the probability of cuts by the Federal Reserve (Fed) this year. A non-farm payroll gain of +272k was well ahead of the +180k anticipated by the market, while a 0.4% increase in average hourly earnings printed a tenth higher than expected, pointing towards a stubbornly resilient labour market. The following week, however, saw encouraging inflation data out of the US contributing to an equally significant Treasury rally, with the downside surprise in core CPI of +0.16% (versus the +0.3% print anticipated by markets), representing the lowest monthly figure since August 2021, and the headline number coming down to 3.3% on an annual basis. Markets also received updated dot plot projections by the Fed, which showed the median dot pencilling in just one cut by year-end 2024, having signalled three cuts back in March. The FOMC, who as expected kept rates unchanged, also released an updated Summary of Economic Projections (SEP) in which their year-end 2024 core PCE inflation projection was revised up from 2.6% to 2.8%, while the 2025 predicted figure was raised one-tenth to 2.3%. An in-line headline and core PCE release at the end of the month brought both year-on-year (YoY) figures down to 2.6%. On the core side, this represented the lowest annual core PCE figure since April 2021, adding to the growing evidence that US inflation is cooling.

Economic data in Europe has pointed towards a cooling inflationary environment for much of this year, a trend which enabled the European Central Bank (ECB) to cut rates by 25 basis points (bps) at the beginning of June, representing the first major central bank to begin its cutting cycle. There remains considerable debate surrounding the extent to which the ECB is willing to diverge from the US should the Fed continue to hold firm on rates, particularly as the last leg of inflation is proving to be stickier than previously anticipated in Europe. Over in the UK, the Bank of England (BoE) held rates at 5.25% as expected, with the decision split 7-2 (seven members voting to hold and the remaining two opting for a 25bps cut) and the central bank's statement revealing that "the policy decision was finely balanced" for some members. Despite this, it was the inflation print a day prior which caught the attention of markets, with YoY headline inflation falling to the BoE's target of 2% for the first time since July 2021. The details of the release were less promising, however, as services inflation remained stubbornly high at 5.7% (only a slight decrease from previous months) and materially higher than the BoE's forecast of 5.3%.

For much of June, European markets were weighed down by the political uncertainty which ensued after French President Emmanuel Macron called a snap election in response to his party's poor performance in the EU parliamentary elections. Having hovered around the 50bps mark for much of this year, the 10-year OAT-Bund spread (the difference between French and German yields) rose sharply to over 80bps following the election announcement, representing a significant surge in risk premium required on French assets given the insecurity surrounding the future political landscape in the country. The first of two election rounds, at the end of the month, however, delivered a slightly less convincing victory for Le Pen's far-right party than polls initially suggested. Ahead of the second round, the National Rally is expected to win 34% of the vote, while the left-wing NPF coalition and Macron's party are set to be at around 29% and 21%, respectively, suggesting a hung parliament is the most likely scenario at this stage.

Portfolio Commentary

Primary market activity picked up slightly in June. In the financials space, books on Additional Tier 1 (AT1) deals at the beginning of the month were multiple times oversubscribed, implying a continuation of healthy investor demand for subordinated bank debt, while, in European high yield (HY), floating rate issuance began taking an increasingly large proportion of total primary issuance. Given the demand for these new issues, coupons on new deals tightened fairly significantly from initial pricing talks (IPTs). As such, our portfolio managers (PMs) remained selective over playing in new issues and continued to find superior relative value in secondary markets. The focus on high-quality assets was maintained, with the allocation to AAA-rated asset-backed securities (ABS) and collateralised loan obligations (CLOs) being increased throughout the month. The composition of the Fund's rates allocation also changed as the team switched a further 2% of 10-year Treasuries out for 2% of 10-year bunds, leaving rates positioning at 11% for 10-year bunds, 12% in 10-year Treasuries and 2% in short-dated Treasury bills.

Despite the market volatility which ensued following mixed economic data releases and political uncertainty, the Treasury index enjoyed back-to-back positive months, returning just over 1% in June, while gilts and bund indices were up +1.3% and +1.4%, respectively. Given the political news out of France, the US HY index (+0.97%) outperformed the European HY index (+0.54%) by some margin, while investment grade (IG) indices across the two geographies were more aligned (+0.64% and +0.75% for the US and European IG indices, respectively). The contingent convertible (CoCo) bond index returned a more modest +0.27% over the month, continuing the strong rally witnessed thus far this year.

The Fund was up 0.82% over the month, with the largest contributors being rates (+0.35%), CLOs (+0.30%) and investment grade corporates (+0.05%). While all sectors returned a positive performance, the lowest contributors were the non-CLO ABS and the insurance buckets at 0.01% and 0.0%, respectively. Higher beta sectors such as high yield and AT1s performed well on a total return basis, despite the volatility.

Market Outlook and Strategy

Economic data will continue to play a pivotal role in determining both the timing and extent of interest rate cuts this year given the continued importance central bankers are placing on being "data dependent". Markets will be keen to see whether central bankers adopt a more dovish rhetoric ahead of upcoming elections in France, the UK, and the US further down the line. Mid-year outlooks have generally pointed towards low but positive economic growth in developed economies, while inflation is proving stickier than previously expected and will still take some time to reach central bank targets of 2%.

As we enter the second half of the year, the second round of elections in France, and UK general elections at the beginning of July, have the potential to be key drivers of market sentiment. Barring a surprise, the market should be able to digest political news fairly well, and volatility should be well contained. Primary issuance and market activity is likely to slow heading into the summer months. The PMs will continue to keep average portfolio credit quality high and still see total returns driven primarily by carry in the foreseeable future.

					Annualised			
Cumulative Performance	1m	3m	6m	1y	3y	5y	10y	Since Inception*
Class G Acc	0.82%	1.35%	4.38%	12.68%	N/A	N/A	N/A	7.64%
ICE BoAML Global Broad Market	0.85%	-0.17%	-0.53%	2.97%	N/A	N/A	N/A	1.79%

Discrete Performance	YTD	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Class G Acc	4.38%	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
ICE BoAML Global Broad Market	-0.53%	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	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. 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 26/01/2023.

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

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