TwentyFour
a boutique of Vontobel

Fund Commentary | 30 September 2024

Vontobel Fund - TwentyFour Strategic Income 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

With the primary market slowing considerably in August, as expected, the primary market activity ticking up considerably in September as the portfolio managers (PMs) looked to new issues to optimise the portfolio, while keeping options open to attractive relative value switches in the secondary market. New issues were met with healthy demand from investors, with books in the financials, investment grade (IG) and high yield (HY) spaces multiple times oversubscribed, and deals often tightening considerably from initial price thoughts. PMs selectively participated in deals where they saw value but remained disciplined on price tightening.

With the aim of keeping the average credit quality of the portfolio high while maintaining a compelling level of yield, the team decided to switch 2% of short-dated Treasury bills out for 2% of primarily BBB US corporates. Market conditions are becoming increasingly favourable for credit, with central banks (now including the Fed) cutting rates, inflation seemingly under control and heading towards target, and economic growth forecasted to be in the +2% range in the US throughout 2025 and heading into 2026. In this environment, corporates are expected to perform strongly. The team also decided to reduce the non-Additional Tier 1 (AT1) bank target by 0.5%, redeploying this into AT1s, as new issues in the Tier 2 space underwhelmed relative to AT1s. Within the asset-backed securities (ABS) bucket, the team will look to gradually rotate out of AAA ABS and into AAA collateralised loan obligations (CLO) given the additional liquidity and more attractive relative value they think is available here. Furthermore, the team will aim to further rotate its European BB CLO book into US CLOs, improving liquidity and adding geographical diversity within the bucket.

As investors priced in a more aggressive rate-cutting cycle by the Fed and the ECB, Treasury and bund indices rallied significantly last month, returning +1.23% and +1.21%, respectively, while gilts were up a modest +0.05%. Corporate bond spreads across HY remained broadly flat, so total returns for the US HY (+1.6%) and European HY (+1.0%) indices were comfortably in positively territory. Total return performance among IG corporates was also strong, with US, European and UK IG indices returning +1.7%, +1.2% and +0.32%, respectively. The Contingent Convertible bond index returned +1.4% over the month, outperforming large parts of European credit markets once again.

The Fund was up +1.24% over the month, with the largest contributors being rates (+0.31%) and bank AT1s (+0.28%). All sectors returned positive performance for the fifth consecutive month; however, the lowest contributor was asset-backed securities at +0.02%.

Market Outlook and Strategy

Markets will continue to keep a close eye on labour data out of the US while also remaining focused on central bank comments to assess the scale of rate cuts for the remainder of the year and beyond. The US Presidential election in November is also beginning to come into focus and could emerge as a key risk driver in the coming weeks. In Europe, investors will focus on how the economic growth landscape evolves and whether further weakening will lead to weakness in other sectors of the economy (auto manufacturers have recently been negatively impacted by slowing consumer demand trends, for example).

In October, attention will turn to the third-quarter reporting season, which will provide information on the strength of consumers and the wider economy. Primary market activity rebounded sharply in September and is expected to remain lively, which will give PMs opportunities to execute relative value switches and optimise the portfolio further.

					Annualised			
Cumulative Performance	1m	3m	6m	1y	3y	5y	10y	Since Inception*
Class G Acc	1.24%	4.06%	5.48%	16.75%	1.30%	3.22%	N/A	3.88%
ICE BoAML Global Broad Market	1.17%	4.35%	4.17%	10.08%	-1.71%	-0.54%	N/A	1.11%

Discrete Performance	YTD	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Class G Acc	8.69%	10.04%	-12.61%	2.30%	7.71%	9.59%	-2.36%	8.99%	5.90%	N/A	N/A
ICE BoAML Global Broad Market	3.80%	5.67%	-13.46%	-1.73%	5.30%	6.49%	0.02%	1.97%	3.64%	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 30/11/2015. 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 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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The Fund considers environmental, social and governance (ESG factors in the investment process, utilising an integrated approach. Information on the integration approach may be obtained from **https://www.twentyfouram.com/responsible-investment-policy**

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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