TwentyFour
a boutique of Vontobel

Fund Commentary | 29 November 2024

Vontobel Fund – TwentyFour Absolute Return Credit Fund

This Commentary is a marketing communication for professional UK investors only

Market Commentary

October's elevated volatility spilled into November as the outcome of the US election and escalating tensions in Eastern Europe drove meaningful government bond moves. Trump's election as the next US president led markets to price in a slower US Federal Reserve (Fed) monetary policy easing cycle, as the implementation of his stated policies is expected to result in higher inflation and a larger budget deficit over the medium term. The significance of Trump's election for financial markets was matched by news that conflict between Ukraine and Russia escalated, with both sides launching attacks.

The non-farm payroll number, released at the beginning of the month, revealed that 12,000 jobs were created in October. The reading represented a significant miss versus the expected 100,000 increase and was the weakest figure since the end of 2020. On top of this, there were significant downward revisions to the numbers for each of the previous two months. The unemployment rate remained flat at 4.1%, in line with market forecasts, although on an unrounded basis, the figure increased by almost a tenth, from 4.05% to 4.15%. As expected, it was announced that weather-related disruptions from Hurricane Milton, which affected large parts of Florida, and recent worker strikes reduced the reliability of the report. The market's attention quickly switched to the US presidential election. The eventual result of a 'red sweep', whereby the Republican Party will take control of the executive branch and both legislative houses, has made it more likely that Trump will be able to pass some of the policies highlighted in his manifesto. US benchmark 10-year Treasuries sold off by approximately 20 basis points (bps) on the day as the result of the election became more apparent, with investors taking the result to be 'pro-growth', inflationary and likely to lead to a higher US budget deficit. Spreads across all US fixed income asset classes tightened following the result as conditions for US corporates are expected to be more favourable. The Fed's decision to cut rates by 25bps at its meeting the following day was largely priced in by the market. The Fed funds rate target range now sits at 4.50-4.75%, but Fed Chairman Jerome Powell did not give any indication on how the cutting cycle would proceed in the December meeting. US core Consumer Price Index (CPI) printed at 0.3% month-on-month for the third consecutive month, in line with market expectations, which drove the three-month annualised core CPI rate to 3.6%, up materially from August's 1.6% figure. Headline inflation was also broadly as expected at 0.24% month-on-month, although this represented the fastest pace since April, which suggested that inflationary pressures have started to resurface and has left the Fed in a precarious position on how to proceed with its easing cycle. The US retail sales and headline personal consumption expenditures numbers, released towards the end of the month, contributed to these fears, with the latter coming in at a monthly pace of 0.24%, which was above the 0.2% expectation and the highest level since May. Scott Bessent's nomination as the new US Treasury secretary contributed to a sizeable Treasury rally towards the end of the month, with the appointment viewed as being market-friendly. Bessent has historically supported a gradualist approach on trade tariffs and argued in favour of cutting the budget deficit, both of which would likely require lower US base rates.

Similarly to the Fed, the Bank of England (BoE) delivered a quarter-point rate cut in November, as the Monetary Policy Committee (MPC) voted 8 to 1 in favour of the decision to take the policy rate down to 4.75%, in line with market expectations. The MPC's statement said October's Autumn Budget was "provisionally expected to boost CPI inflation by just under half of a percentage point at the peak", while it also indicated that rates would continue to be moved lower. The latest GDP release showed that, despite economists expecting growth of 0.2% for September, UK GDP fell by 0.1% over the month. This followed growth of just 0.2% in the previous month and brought third-quarter UK GDP to 0.1%, below both the anticipated 0.2% figure and second-quarter expansion of 0.5%. The UK's dominant services sector grew by just 0.1% on the quarter, while the construction component rose by 0.8%. Headline CPI surprised to the upside, with the figure rising by more than expected to 2.3% in October from 1.7% in the previous month, largely due to the jump in energy bills. Services inflation remained elevated at 5%, in line with the BoE's forecast, although market reaction was relatively muted as investors continued to price in two fewer cuts in 2025 than the five that the BoE has indicated. Core inflation was hotter than anticipated at 3.3%, which compared with the consensus forecast of 3.1%.

European government bonds outperformed US Treasuries and UK gilts in November as eurozone data continued to support the narrative that the European Central Bank (ECB) would continue to cut interest rates at a faster pace than the Fed. One of these data points included the eurozone composite Purchasing Managers' Index print, which fell meaningfully to 48.1 in November from 50.0 previously and was well below the consensus estimate. The drop was driven primarily by the services component, which weakened in all countries across the bloc and negatively impacted the economic outlook. Markets received positive news on inflation as releases across the continent were lower than forecasts, with the highlights being Germany at 2.4% and France at 1.7%, which were 0.2% and 0.1% lower than expectations, respectively. Eurozone aggregated numbers came to 2.3% and 2.7% for headline and core inflation, respectively, both of which were lower than forecasts. This was largely a result of the downside surprise in services inflation, which came in at 3.9% and compared with expectations of 4.1%. The ECB's inflation expectations survey showed 2.1% for three years ahead, which is the lowest since the first quarter of 2022 and suggests that the battle against inflation in the eurozone is in its final stages.

On the geopolitical front, there were material developments in Eastern Europe, where tensions between Russia and Ukraine escalated. Ukraine, for the first time, used US-supplied long-range missiles to target locations inside Russia. This prompted Russia to launch intense missile strikes across Ukraine that targeted residential areas. Russian President Vladimir Putin vowed retaliation if attacks on his country's territory continued, claiming strikes on UK or US military bases in Ukraine could be carried out.

Portfolio Commentary

With European rates markets performing well throughout the month, while US markets saw two-way volatility, the Fund returned +0.76% after fees. This took the year-to-date return to +5.66%.

Government bonds led returns in November, rising 1.16% and contributing +18bps. Within this, however, there was notable outperformance from the five-year German bund position, which returned +1.55% compared with +0.71% from the five-year US Treasury position. Correlations between the two markets weakened following the US election, given further poor economic data in Germany and more buoyant data and a better outlook in the US. Secured bonds returned a solid +0.97%, with the longer-dated positions such as Arqiva and Center Parcs returning more than a percent, while shorter-dated positions delivered closer to half a percent.

Financials returned +0.75%, although it was the longer maturity, higher-quality positions that outperformed in both banks and insurers. Overall, banks returned +0.72%, with Additional Tier 1s returning +0.58% and seniors +0.76%. Similarly in insurance, Restricted Tier 1s returned +0.59% while Tier 3s returned +1.06%. A similar theme was seen in non-financials, with senior investment grade positions returning +0.67%, beating corporate hybrids. Much like financials, longer-dated positions performed best, often returning more than 1% for the 2028 maturities, while the 2025/26 positions typically returned between 0.5% and 1%.

Asset-backed securities returned a solid +0.51%, which was very similar to one month's worth of yield, with the floating-rate nature of the asset class not impacted by the rates rally.

Lastly, corporate hybrids returned +0.48%, which was also similar to one month's worth of yield, without the capital gain impact that higher-quality, slightly longer-dated non-financials and financials achieved for the month.

The Fund retains a continued lower beta credit stance than normal given non-financial spreads that, in the portfolio managers' (PMs) views, are starting to look too tight for the economic risks that remain significant – and are even deepening. Likewise, spread duration remains lower than normal at 1.4 years, but interest rate duration is now close to two years, with around 15% in our liquidity bucket of government bonds (five-year US Treasuries and bunds). Furthermore, the PMs are concerned about the potential of commercial real estate issues in the US to create further insolvencies in the US regional banking sector. As a result, the PMs have retained higher credit quality within the banks and insurance sectors by staying invested in more senior financials than is typical when compared with the Fund's history. To be clear, the PMs have no credit quality concerns about the banks and insurers held in the Fund given their Basel III regulated status, high capital ratios, high-quality loan books and healthy loan/deposit ratios. However, a further liquidity squeeze cannot be ruled out in an environment where depositors could be reading stories of failing US regional banks over the next few months. As such, the PMs believe it prudent to retain a reduced level of risk in financials, keeping the Fund's overall beta slightly lower than before these CRE concerns materialised.

Market Outlook and Strategy

With the ECB having delivered its third rate cut, and the Fed dropping rates twice, the prospect of repeated reductions now look good through 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, taking interest rate duration up to two years, as noted earlier (please note, this was described in detail in a recent webinar "The Duration Deliberation", which remains available on our website). On the flip side, however, the remaining slight yield curve inversion in rates curves and tight credit spreads in some sectors still give the PMs concerns about adding credit spread duration into the Fund, with the biggest capital gains thought likely to be in short-dated bonds. As such, the PMs believe a modestly lower than average duration profile remains warranted, with peak yields still being less than two years to maturity, which is predominantly where the Fund has been focused. However, as duration risks start receding, the PMs are concerned that increasing unemployment rates across the US, UK and especially Germany signal worsening GDP data to come. Recession risks remain significant and are not fully priced into non-financial spreads, in the PMs' views. Therefore, a lower beta credit stance is also still thought to remain warranted, although the prospect of further rate cuts suggests total returns from short-dated credit can remain attractive for some considerable time yet.

We believe the combination of low duration and high average yield, with high average credit quality, make short-dated investment grade an attractive risk/return opportunity. This is predominantly due to the very high breakeven yield the Fund now exhibits, with a yield of 5.2% and a duration of two years, which means the breakeven yield is +260bps. Although the PMs expect some volatility to remain in the market for some months yet, a scenario where the Fund yield rises by more than 2.6% to about 7.8% over the next 12 months seems remote in our view. As such, the probability of positive total returns over the next 12 months is believed to remain high.

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.

Cumulative Performance	1m	3m	6m	1y	Annualised 3y	5y	10y	Since Inception*
Class G Acc	0.76%	1.35%	3.62%	7.22%	2.23%	1.99%	N/A	2.64%
SONIA + 250	0.60%	1.86%	3.83%	7.92%	6.25%	4.81%	N/A	3.97%

Discrete Performance	YTD	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Class G Acc	5.66%	6.08%	-4.80%	0.52%	2.47%	5.02%	-0.83%	5.25%	4.99%	N/A	N/A
SONIA + 250	7.21%	7.36%	3.97%	2.59%	2.73%	3.26%	3.11%	2.79%	2.91%	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: 28 August 2015. SONIA used as a proxy for cash as a performance reference for illustration purposes only, there is no specific return objective or benchmark for the fund.

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 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-Fund's investments in the medium to long term due to the mitigating nature of the Sub-Fund's ESG approach
- The Sub-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 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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Interested parties may obtain the above-mentioned documents free of charge from the authorized distribution agencies and from the offices of the fund at 11-13 Boulevard de la Foire, L-1528 **Luxembourg**. Refer for more information on the fund to the latest prospectus, annual and semi-annual reports as well as the key investor information documents ("KIID"). These documents may also be downloaded from our website at vontobel.com/am. A summary of investors rights is available in English under the following link: www.vontobel.com/vamsa-investor-information. The fund is authorised for distribution in the **United Kingdom** and entered into the UK's temporary marketing permissions regime can be viewed in the FCA register under the Scheme Reference Number 466625. The fund is authorised as a UCITS scheme (or is a sub fund of a UCITS scheme) in a European Economic Area (EEA) country, and the scheme is expected to remain authorised as a UCITS while it is in the temporary marketing permissions regime. This information was approved by Vontobel Asset Management S.A. which has its registered office at 3rd Floor, 70 Conduit Street, London W1S 2GF and is authorized by the Commission de Surveillance du Secteur Financier (CSSF) and subject to limited regulation by the Financial Conduct Authority (FCA). Details about the extent of regulation by the FCA are available from Vontobel Asset Management S.A. on request. The KIID can be obtained in English from Vontobel Asset Management S.A. 3rd Floor, 70 Conduit Street, London W1S 2GF or downloaded from our website vontobel.com/am.

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