Monthly commentary / 30.8.2024

# Vontobel Fund – Euro Corporate Bond

**Marketing document for institutional investors in:** AT, CH, DE, ES, FI, FR, GB, IT, LI, LU, NL, NO, PT, SE, SG (Professional Investors only).

**Investors in France should note that, relative to the expectations of the Autorité des Marchés Financiers, this fund presents disproportionate communication on the consideration of non-financial criteria in its investment policy.**

**Market developments**
August is usually the month of the Jackson Hole symposium sponsored by the Federal Reserve Bank of Kansas City held in Jackson Hole, Wyoming. The event is designed as a forum for policy makers and economists to discuss and consider the mechanics of monetary policies, their transmissions, and effect on economies. It is also a time for policy makers to reflect on the bigger picture, with this year's gathering being quite novel in that it was used by Chair Powell to highlight major policy guidance and change for the future in his opening remarks. This is a rare occurrence for a Fed Chair to do so at such venue.
We suspect this resulted from the fact that August saw important economic releases in the US that have moved the markets quite a lot. Indeed, there was a big miss for the US non-farm payroll monthly indicator for July and there were major revisions that the payrolls in the year ending March 2024 have been overstated by 818,000, or by nearly 70,000 per month. This therefore led to significant risk-off markets at the beginning of the month as seen, and a quick repricing of the government bond markets especially in the US as market participants and traders reverted to pricing a larger number of rate cuts implying that a series of cuts would begin in earnest from September.
Most importantly in the month however, the retail sales advance print was stronger than expected and this keeps the view that the US should soft land rather than enter a recession. The CPI and PPI data also continued to show progress towards disinflation and the risk-off mood soon dissipated returning to some form of Goldilocks scenario as the Federal Reserve is in fact in a good place with quite some rate margin to ease more aggressively to sustain good labor markets and the economy, or if considerable downside risks to employment materialize.
A lot has happened hence during the holiday month of August and we would now like to turn and spend some time on what Chair Powell communicated in his remarks, especially given that they seem to have cemented the decisive drop experienced in US yields, and the disappearance of the higher for longer narrative.
"The time has come for policy to adjust. The direction of travel is clear, and the timing and pace of rate cuts will depend on incoming data, the evolving outlook, and the balance of risks" declared Chair Powell. He could not have been clearer. Prior to this he indicated that inflation "has declined significantly" and that it "seems unlikely that the labor market will be a source of elevated inflationary pressures anytime soon". "The upside risks to inflation have diminished and the downside risks to employment have increased. We do not seek or welcome further cooling in labor market conditions".
Lately Powell has repeated that policy is well-positioned to respond to data and referenced the risk of more rapid loosening of the labor market in his opening remarks. This implies in our view that the focus has firmly shifted to labor market conditions with the FOMC prepared to react more aggressively should the next set of data deteriorates unexpectedly (100 basis points of cuts versus our base case that has consistently highlighted 3 rate cuts until the year end). We will continue to monitor the macro data, including the weekly initial jobless claims. However we continue to believe that the US economy should continue to grow at a decent pace, and we do not see big red flags for the foreseeable future at this time. Therefore, absent any extreme shock, there should not be any uncertainty about the next steps of the FOMC, and for that matter the ECB, as they should both cut or continue to cut gradually and by 25 basis points in September.
Indeed, we continue to expect the ECB to pursue their cuts in September and December alongside fresh staff forecasts. This was recently echoed by Finnish central bank head Olli Rehn that declared that increasing negative risks to Eurozone growth have re-enforced the case for gradual cuts until the year end.
August flash PMIs paint a mixed picture for Q3 with the strength in the composite and services headline indicators unlikely to hold as July shows some distortion given a one-off French Olympics boost in service activities. Disinflation is also on track as for instance European Area wages fell 1.1 percent to 3.6 percent year on year in Q2 down from 4.7 percent the preceding period on the back of softer numbers in the largest economies of Germany and France.
Philip Lane, the ECB's chief economist, stated on the 29th of August that pay growth in the Eurozone should slow down sharply in 2025 and 2026 according to their wage growth forward looking trackers, suggesting that wage growth likely passed its peak in the Eurozone. This augurs well then for the ECB as this deceleration ensures that they remain on track for

their September 12 cut. Finally, headline inflation in August should see a sizeable step down to 2.2 percent year on year from 2.6 percent driven by energy and lower oil prices, while core should hold more steady but slightly down to 2.8 percent and in line with the ECB year end forecast.
In other developments, we would like to take the opportunity to highlight that the Q2 earnings season was quite solid with 56 percent of S&P 500 firms beating consensus estimates, above the long-term average of 46 percent according to Goldman Sachs. Earnings surprises were consistently close to 5 percent, representing a sound balance across most sectors. This tends to augur well for corporate margins both in the US and Europe with 12 months forward profit margins estimates at their highest since the end of Covid-19 for the latter region. And last but not least, Vice President Kamala Harris seems to have regained the upper hand in the polls, and the betting market. The betting market has reversed the projection for the US presidential election winner and is now pricing about 55 percent winning probabilities for Mrs. Harris. We find this quite supportive news, as her presidency would be much preferable for macro credit fundamentals.
As for the European corporate investment grade index, it is finishing the month at 114 basis points (bp) Govt OAS and that is 4 bp wider than the preceding period given the volatility experienced at the beginning of this month. Intra month the index was as wide as 127 bp so it has recovered substantially from the episode described earlier. Performance was aided and offset by government benchmark yields with 10-year USTs outpacing 10 year Bunds (both narrower and by 20 and 5 bp respectively at the end of the month). Overall though, it was a broadly stable month with AT1 subordinated instruments performing the best and finishing the month 11 bp tighter. Other subs including Lower Tier Twos and Corporate Hybrids were stable whilst senior bonds were not able to fully retrace their widening. Best behaved were non-cyclical industrials finishing the period 4 bp wider whilst cyclicals were out 6 bp on average. The senior banks were on a par with cyclical industrial bonds, and it is interesting to note that the European IG market has underperformed the US one in August. Finally, BBs were in demand on both sides of the Atlantic performing by 5 to 6 bp.

**Portfolio review**

During the month of August, we maintained our composure despite early market turmoil, which we assessed as an overreaction. We continued our strategy of optimizing our coupon income through selective switches (i.e. up in coupon for the same or comparable credit quality). In the secondary market, we were particularly active in the hybrid space, increasing the diversification within the utilities space while also securing a higher coupon. Additionally, we increased our position in a satellite operator, seeing a good chance that the company can maintain its investment-grade rating due to a stronger business model following their announced merger. On top, we switched bonds of a financial services provider into bonds of its close peer, given increased M&A risk at the first one while we fundamentally like both names.
Moreover, adjustments were made in the REITS and Commercial Services sectors, where we trimmed several positions. These trades were part of a broader portfolio management strategy focused on maintaining liquidity and balancing sectoral weightings.

**Performance analysis**

The Vontobel Fund – Euro Corporate Bond (I Share Class) outperformed its benchmark during the month of August. The performance was primarily driven by strong selection, with additional positive contributions from allocation and the curve.
In terms of selection, the contribution within banking, insurance, telecommunications, and utilities sectors significantly added to performance, largely due to the higher beta subordinated notes held within these sectors. Subordinated instruments such as AT1s, hybrids, and T2s outperformed the broader market during the month, tightening modestly while the benchmark widened around 4 basis points. We continue to like the subordinated segment given the very high coupons on offer making it a favorable space from a carry perspective.
In allocation, our sovereign exposure and our underweight in healthcare added to performance while our underweight in real estate partly offset these positive effects. Lastly, also our government bond futures position added to performance as the hedge overlay worked well during the market turmoil in the beginning of the month.

**Outlook**

The spread widening seen in August, offers a buying opportunity in our view and we believe the positive drivers seen YTD are still intact. Credit fundamentals as well as technical drivers remain solid and with our outlook for rate cuts on the horizon risk assets could well see a goldilocks scenario play out.
According to UBS research, in the US Q2 money market fund assets have surged to above USD 6tn, up from 5.4tn in the Q2 2023 and 3.2tn in 2Q 2019. With rate cuts on the table in the US and ongoing in the Eurozone, we expect to see a shift from money market funds into corporate funds, supporting credit spreads.
US recession and labor market concerns that flared up in August have faded towards month end and most importantly – and as highlighted in the market section – the ‘Fed put’ brought positive sentiment back to our markets and could spark a further rally in risk assets.
We therefore stick to our strategy, favoring subordinated bonds, non-cyclical industrial names and bank bonds over cyclical industrials and keep a slightly higher risk level in the portfolio compared to the benchmark. Carry remains king.

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**Fund characteristics**

| | |
|---|---|
| **Fund name** | Vontobel Fund – Euro Corporate Bond |
| **ISIN** | LU0278087860 |
| **Share class** | I EUR |
| **Reference index** | ICE BofAML A-BBB Euro Corporate Index |
| **Inception date** | 13.7.2007 |

**Historical performance (net returns, in %)**

| Time period | Fund | Ref. index |
|---|---|---|
| MTD | 0.4% | 0.3% |
| YTD | 3.2% | 2.7% |
| 1 yr | 8.7% | 7.5% |
| 3 yrs p.a. | -2.2% | -2.0% |
| 5 yrs p.a. | -0.5% | -0.8% |
| 10 yrs p.a. | 1.5% | 1.1% |
| ITD p.a. | 3.1% | 2.8% |

| Time period | Fund | Ref. index |
|---|---|---|
| 2023 | 8.5% | 8.2% |
| 2022 | -15.2% | -14.1% |
| 2021 | -0.6% | -0.9% |
| 2020 | 3.9% | 2.8% |
| 2019 | 8.8% | 6.6% |
| 2018 | -2.9% | -1.3% |
| 2017 | 4.1% | 2.6% |
| 2016 | 4.4% | 4.8% |
| 2015 | 0.9% | -0.4% |
| 2014 | 9.8% | 8.2% |

**Past performance is not a reliable indicator of current or future performance. Performance data does not consider any commissions and costs charged when shares of the fund are issued and redeemed, if applicable. The return of the fund may go down as well as up due to changes in the rates of exchange between currencies.**

**Investment risks**

- Securities with a lower credit quality means a higher risk that an issuer may fail to meet its obligations. The investment value may fall if an issuer's credit rating is downgraded.
- Asset-backed and mortgage-backed securities, and their underlying receivables are often intransparent. The sub-fund may also be subject to a higher credit and/or prepayment risk.
- Using derivatives generally creates leverage and entails valuation risks and operational risks. Leverage magnifies gains but also losses. Over-the-counter derivatives involve corresponding counterparty risks.
- CoCo-Bonds may entail significant risks such as coupon cancellation risk, capital structure inversion risk, call extension risk.
- 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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