Monthly commentary / 30.8.2024

Vontobel Fund – TwentyFour Strategic Income Fund

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.

Summary

— August was a highly volatile month for fixed income and equity markets. At the beginning of the month, the US labour report sparked recessionary fears and prompted negative market sentiment. However, these concerns were quickly offset by strong economic data showing the US economy was still performing well. In the UK, the Bank of England delivered its first interest-rate cut in four years. In Europe, headline inflation was at its lowest level for three years, opening up the potential for an interest-rate cut next month.

— With the primary market slowing considerably in August, as expected, the portfolio managers (PMs) looked to the secondary market for attractive relative value switches to keep the average credit quality of the portfolio high and maintain a compelling level of yield.

— All eyes will be on how labour markets across major economies develop over the next few weeks and months as the economy approaches a potential inflection point. As indicated by Fed Chair Powell, the labour market will be the primary driver of both the timing and magnitude of interest-rate cuts for the remainder of the year and beyond.

Market developments

August was a highly volatile month for fixed income and equity markets alike. At the beginning of the month, the US labour report sparked recessionary fears and prompted negative market sentiment. However, these concerns were quickly offset by strong economic data showing the US economy was still performing well. Although the data resulted in a sharp rebound in government bond yields and equity indices, the repercussions of the weak jobs report were present throughout the month as investors priced a more aggressive rate-cutting cycle by the US Federal Reserve (Fed) and other major central banks.

As with every month, the first Friday of August provided investors with the monthly US jobs report. However, in contrast to previous months, the labour market showed significant signs of weakening. The unemployment rate came in at 4.3% (higher than the expected reading of 4.1% and up from 3.7% at the beginning of the year), while non-farm payrolls printed at 114k, which was well below the anticipated 175k figure. In the immediate aftermath of the release, recessionary fears gripped markets, and economists began calling for meaningful action by the Fed in the form of rate cuts. Confidence of a soft landing diminished, which resulted in sharp negative moves across global equity markets, government bonds benefiting from a flight to quality, and growing expectations of a more aggressive rate-cutting cycle, with 10-year Treasuries having rallied to a yield of as low as 3.70%.

However, as the month unfolded, economic data pointed towards a US economy that was still performing well and, as a result, market sentiment began to improve. The supportive data included a very strong retail sales print, with the headline number accelerating to +1% month-on-month in July, significantly higher than the +0.4% expected and the fastest monthly retail sales increase since the beginning of 2023. The Fed also received positive news on the inflation front in August, with headline consumer price inflation undershooting expectations on a year-on-year basis, rising 2.9% (versus an expected 3%), which represents the slowest print since March 2021. Core inflation was in line with consensus at 3.2% at the year-on-year level. The revised estimates of second-quarter US GDP helped in painting an increasingly positive story for domestic economic growth. The headline GDP number was revised upwards to an annualised growth rate of 3% from 2.8% previously, and the Atlanta Fed increased its third-quarter GDPNow estimate to 2.5%. Nevertheless, Jerome Powell's speech at Jackson Hole at the end of August saw several dovish comments that all but confirmed the Fed will be cutting rates at its upcoming central bank meeting in September. Powell said "the time has come for policy to adjust" and acknowledged that "downside risks to employment have increased", suggesting the Fed is shifting its focus away from inflation and towards the employment side of the economy. Powell noted the recent uptick in the unemployment rate has been driven not just by weakening labour demand but very strong supply. He described the cooling in labour market conditions as "unmistakable", which resulted in markets increasing the probability that the Fed would execute a 50 basis point (bps) interest-rate cut in September to 33% by the end of the month.

In the UK, the Bank of England (BoE) delivered its first interest-rate cut in four years at the beginning of the month, with the 25 bps move made on a knife-edge 5-4 vote. Similarly to

the US, the UK had a soft inflation report. The headline number came in one-tenth below market expectations on both a monthly and annual basis, while core CPI also surprised on the downside, ticking down to 3.3% from 3.5% in the previous month. Services inflation fell noticeably from 5.7% in June to 5.2% in July, well below consensus expectations of 5.5%. UK unemployment also surprisingly fell to 4.2% in the second quarter, down from 4.4% in the first quarter, with the monthly reading of 3.6% for June representing the lowest reading since February 2022. Despite cutting rates at the beginning of August, the BoE struck a cautious tone at its last meeting and did not commit to further cuts in the near term, reiterating that it is now more focused on broader trends than individual data points.

In Europe, the preliminary headline CPI release for August was in line with expectations at 2.2%, as was core inflation at 2.8%. This figure represents the eurozone's lowest inflation figure for three years, opening up the opportunity for a second European Central Bank (ECB) rate cut in September, which the market is fully pricing in. There remain some doubts over the Eurozone's future economic growth prospects over the medium term. However, reassuringly, second-quarter GDP came in line with expectations at 0.6% year-on-year. Moreover, Purchasing Managers' Indices (PMI) posted a significant outperformance relative to expectations, with the composite PMI reading coming in at 51.2 (50.1 expected), supported by a strong reading from France amid the Olympics.

Portfolio review

With the primary market slowing considerably in August, as expected, the portfolio managers (PMs) looked to the secondary market for attractive relative value switches to keep the average credit quality of the portfolio high and maintain a compelling level of yield. The team changed the composition of the government bond bucket, switching 3% of 10-year bunds and 1.5% of short-dated Treasury bills out for 4.5% of 10-year Treasuries. The switch from bunds to Treasuries was due to the team's view that the ECB will no longer cut interest rates at a materially faster pace than the Fed. The reallocation from short-dated bills to 10-year US Treasuries was a function of the team's intention to increase the Fund's duration. Further spread tightening in Additional Tier 1 (AT1) bonds relative to more senior bank debt also resulted in the team trimming its AT1 target by 1% and reallocating this to Tier 2 bank bonds. The spread between AT1s and Tier 2s in some core bank names has tightened to as little as 150bps, which is towards the tight end of historical averages.

The strong government bond rally throughout August led the Treasury index to yet another positive month, returning +1.3% in August, while gilt and bund indices were up +0.53% and +0.40%, respectively. A dearth of primary issuance led corporate bond spreads to grind tighter throughout August, with the US high-yield (HY) index (+1.6%) outperforming both the European and sterling HY indices (both +1.2%). There was a similar divergence in total return performance between the two geographies on the investment-grade (IG) front (+1.5% and +0.30% for the US and European IG index, respectively). The Contingent Convertible (CoCo) bond index returned a healthy +1.5% over the month as banks continued to post impressive earnings.

Performance analysis

The Fund has delivered positive returns for the month, with the largest contributors being bank AT1s, rates and insurance. All sectors returned positive performance for the fourth consecutive month; however, the lowest contributor was non-CLO asset-backed securities. Higher beta sectors including high yield and CLOs also performed well given the underlying government bond performance and tighter credit spreads over the month.

Outlook

All eyes will be on how labour markets across major economies develop over the next few weeks and months as the economy approaches a potential inflection point. As indicated by Fed Chair Powell in his speech at Jackson Hole, the labour market will be the primary driver of both the timing and magnitude of interest-rate cuts for the remainder of the year and beyond. It is widely anticipated that the Fed will begin to cut rates in September, while the ECB is expected to cut rates for a second time this year. Investors will also receive updated dot plot projections from the Fed, which will guide market expectations for how the rate-cutting cycle will unfold.

Primary market activity should rebound sharply in September, which will give PMs an opportunity to add new names or top up on existing issuers. PMs will continue to keep average portfolio credit quality high and still see total returns driven primarily by carry for the remainder of the year.

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Fund characteristics

Fund name	Vontobel Fund – TwentyFour Strategic Income Fund
ISIN	LU1322871390
Share class	I GBP
Reference index	–
Inception date	30.11.2015

Historical performance (net returns, in %)

Time period	Fund	Ref. index
MTD	0.9%	–
YTD	7.3%	–
1 yr	14.1%	–
3 yrs p.a.	0.6%	–
5 yrs p.a.	2.9%	–
10 yrs p.a.	–	–
ITD p.a.	3.6%	–

Time period	Fund	Ref. index
2023	9.9%	–
2022	-12.7%	–
2021	2.1%	–
2020	7.5%	–
2019	9.4%	–
2018	-2.5%	–
2017	8.8%	–
2016	5.6%	–
2015	–	–
2014	–	–

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 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 creates significant leverage and entails valuation risks and operational risks. Leverage magnifies gains but also losses. Over-the-counter derivatives involve corresponding counterparty risks.
- CoCo-Bonds are associated with significant risks, including the risk of coupon payments being cancelled, capital structure inversion risk, and the risk of a CoCo-Bond's maturity being extended.
- 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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Vontobel Asset Management AG
Gotthardstrasse 43, 8022 Zürich
Switzerland
T +41 58 283 71 11, info@vontobel.com
vontobel.com/am