TwentyFour
a boutique of Vontobel

Fund Commentary | 31 March 2023

TwentyFour Select Monthly Income Fund

This Commentary is a marketing communication for professional UK investors only

Market Commentary

March kicked off with 10-year Treasury yields reaching new year-to-date highs, but it was the regional banking crisis in the US and the forced acquisition of Credit Suisse (CS) by UBS in Europe that captured investor attention. Despite a rally over the month for the S&P (+3.5%) and the Euro Stoxx (+1.8%), fixed income sentiment was much weaker, driven by the banking crisis; the iTraxx Crossover index widened by about 20 basis points (bps) to 436bps, having reached a high of c. 570bps on 20 March following the forced marriage of the two Swiss banking giants.

The US regional banking crisis came to the fore on 10 March, when Silicon Valley Bank was seized by the Californian authorities. Despite being the sixteenth largest bank in the US, Silicon Valley Bank appeared to have faced unique circumstances of poor risk management, a low level of insured deposits, very large deposit outflows and a very large concentration in long dated Treasuries, held with unrealised losses. This focused attention on the sector, which has enjoyed much lower regulation than that of larger US banks (or European banks), and deposit outflows continued and intensified. Ultimately, the Fed and Federal Deposit Insurance Corporation (FDIC) were forced to step in to help stabilise the sector and established a new Bank Term Funding Program that allowed repos of up to one year, at par, against high quality collateral. Authorities, however, stopped short of providing a guarantee on all deposits.

Although there was very little read-across to European banks, they nevertheless suffered contagion, and spreads began to widen across the capital structure. CS was caught by the negative sentiment, which intensified as the SEC forced the delay of the bank's results announcement. Following this, the Chairman of the Saudi National Bank, when asked whether he would support CS further, stated "absolutely not", which sent share and bond prices into a tailspin. With CS facing a liquidity crisis, the Swiss National Bank (SNB) provided a CHF 50bn liquidity line, which only partially stemmed the negative news flow. Although both the SNB and Swiss regulator, FINMA, had stated that CS was solvent and well capitalised, over the course of the weekend, it was decided that UBS would take over CS in was seemed a forced union. However, the most controversial decision taken was that CHF 3bn would be paid to CS shareholders but the Additional Tier1 (AT1) bonds would be written down to zero. This decision, which put equity holders in front of subordinated debt holders, led to a sharp move lower in European bank debt the following morning, until statements from the European Central Bank (ECB) and the Bank of England confirmed that hierarchy of payments would be respected and was enshrined in law, with ECB President Christine Lagarde adding: "Switzerland does not set standards in Europe". These statements led to a sharp rebound in Euro and UK bank debt, with Swiss banks unsurprisingly lagging.

On the data front, inflation remained high in the eurozone, with the CPI release for February coming in above expectations: headline CPI was +8.5% (+8.3% expected) and core CPI hit +5.6% (+5.3% expected). This led the ECB to maintain its hiking pace as previously communicated, despite the banking crisis, and increase the deposit rate by 50bps to a post-2008 high of 3.0%. In the US, inflation remained high, with headline CPI coming in at 6.0%, as expected, and core CPI remaining elevated at +5.5%, well above the Fed's target. The Fed followed the ECB and hiked interest rates by a further 25bps to put the policy rate in a target range of 4.75%-5.0%. The Fed also published an updated dot plot with a median projection showing the rate ending 2023 at 5.125% –much lower than many FOMC members had signalled just a few weeks previously – presumably driven by the tightening of financial conditions due to the regional bank problems. The environment was similar in the UK. Inflation surprised to the upside with headline CPI coming in at +10.4% (+9.9% expected) and core CPI rising by +6.2% (+5.7% expected). The Bank of England raised its base rate by 25bps as expected, taking it to 4.25% – also a post 2008 high.

The investor sentiment led to a comeback of the volatility in rates for March, best characterised by the moves along the US yield curve, with the US 2-year Treasury yield declining by 0.79% to 4.03% and the yield on the US 10-year declining by 0.45% to 3.47%. This move led to further divergence between the Fed and the market regarding the likelihood of rate cuts in the latter part of this year.

Portfolio Commentary

March was characterised by market concerns surrounding banks and increased volatility. As such, the primary market came to a near halt and market participant engagement was less conducive for active trading. The Fund took a more passive approach as the portfolio managers were monitoring the market and credit fundamentals.

An overall rally in rates helped the Bloomberg Global Aggregate index rebound from a difficult February, and it returned +3.16% for the month. Government bond indices enjoyed similar positive returns for the month, with the Treasury index returning 3.0%, the UK Gilt index returning 2.8% and the Euro government index returning 2.2%. Investment grade indices also enjoyed this this positive performance, with the US, Euro and Sterling indices returning respectively 2.6%, 1.1% and 0.9%. In corporate High Yield, there was some differentiation between US High Yield returning 1.1% and Euro and Sterling High Yield returning -0.4% and -0.8% respectively. The CoCo index was, unsurprisingly, the big underperforming asset class during the month, returning -10.8%.

The Fund was down -3.29% over the month. The biggest detractors were AT1s (-1.96%), followed by ABS- CLOs(-0.58%) and Insurance (-0.51%). The biggest contributor was ABS- non CLOs (0.12%).

Market Outlook and Strategy

Sentiment is likely to remain fragile with regards to any negative news relating US regional banks, which could continue to weigh negatively on Euro banks. Valuations for financials, however, have widened significantly and provide a cushion for any further negative news, while also providing very attractive entry points. The earnings season will become a key focus, starting with the US banks. We expect the new issue market to remain below trends, providing a helpful technical to the market.

The team will continue to be highly selective when looking for relative value switch opportunities.

					Annualised			
Cumulative Performance	1m	3m	6m	1y	3y	5y	10y	Since Inception*
NAV per share inc. dividends	-3.29%	1.46%	8.99%	-8.60%	8.03%	1.89%	N/A	3.87%

Discrete Performance	YTD	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
NAV per share inc. dividends	1.46%	-12.92%	7.48%	5.73%	11.94%	-1.41%	14.56%	8.20%	2.81%	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: 10/03/2014.

Key Risks

- **All financial investment involves risk. The value of your investment isn't guaranteed, and its value and income will rise and fall. Investors may not get back the full amount invested.**
- Past performance is not a reliable indicator of future performance, and the Fund may not achieve its investment objective.
- Fixed income carries two main risks, interest rate risk and credit risk: (1) Where long term interest rates rise, there is a corresponding decline in the market value of bonds and vice versa; (2) Credit risk refers to the possibility that the issuer of the bond will not be able to repay the principal and make interest payments.
- Typically, sub-investment grade securities will have a higher risk of issuer default, and are generally considered to be more illiquid than investment grade securities.
- The Fund can invest in structured credit products or asset-backed securities (ABS). The issuer of such products may not receive the full amounts owed to them by underlying borrowers, which would affect the performance of the Fund. Credit and prepayment risks also vary by tranche which may affect the Fund's performance.
- The Fund has the ability to use derivatives, including but not limited to FX forwards, for hedging only (EPM). This may magnify gains or losses.
- Investments in emerging markets may be affected by political developments, currency fluctuations, illiquidity and volatility.

Fund Managers

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Portfolio Management, industry experience since 2012.

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Head of US Credit, industry experience since 1988.

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Further information on fund charges and costs are included on our website at www.twentyfouram.com