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Why Short Dated IG is the “best game in town” for 2023

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Recap of market moves in 2022
“the worst year for bonds in living memory”

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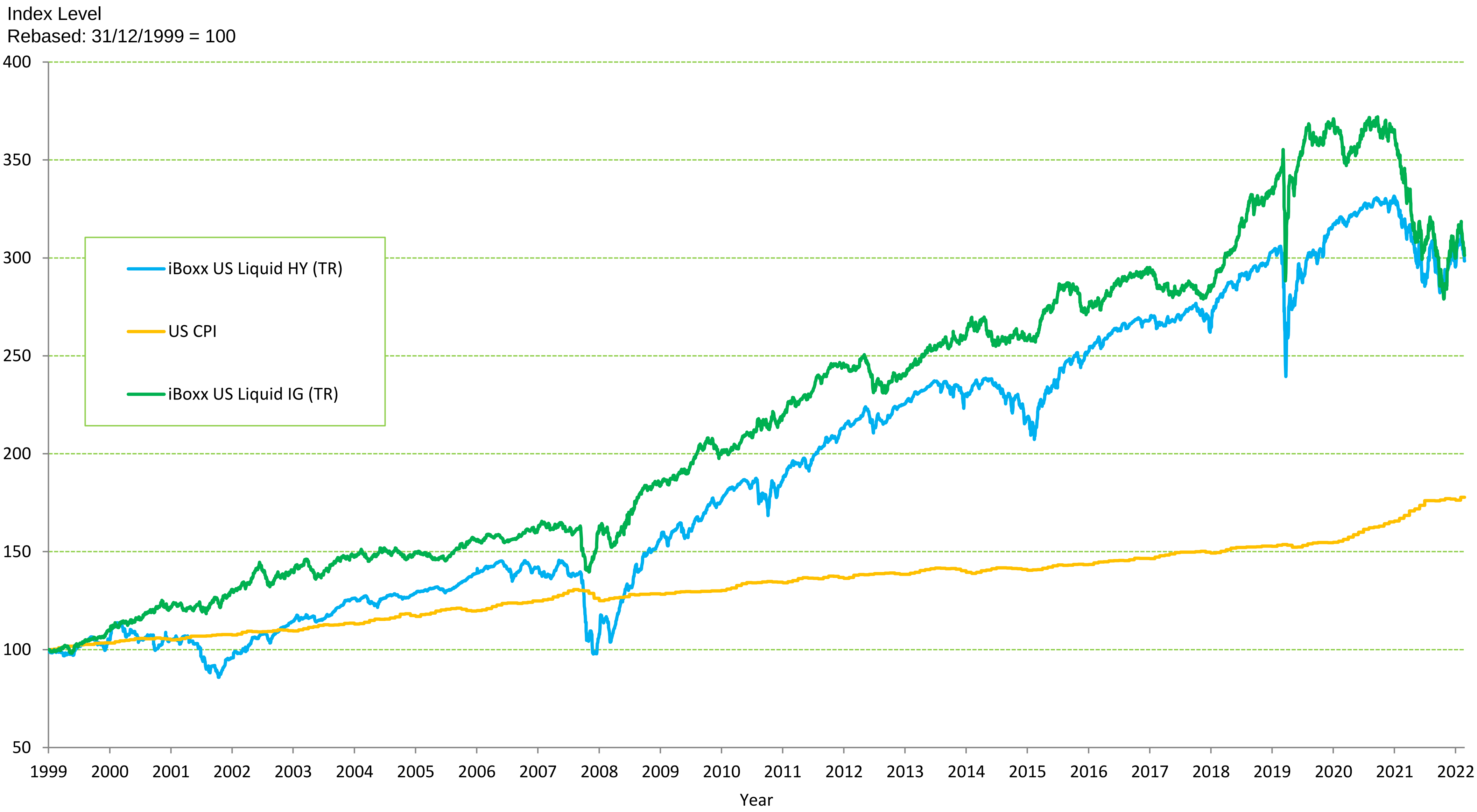
2022 was the worst year for bonds in living memory

IG had twice the losses of HY, burning through the entire century's outperformance



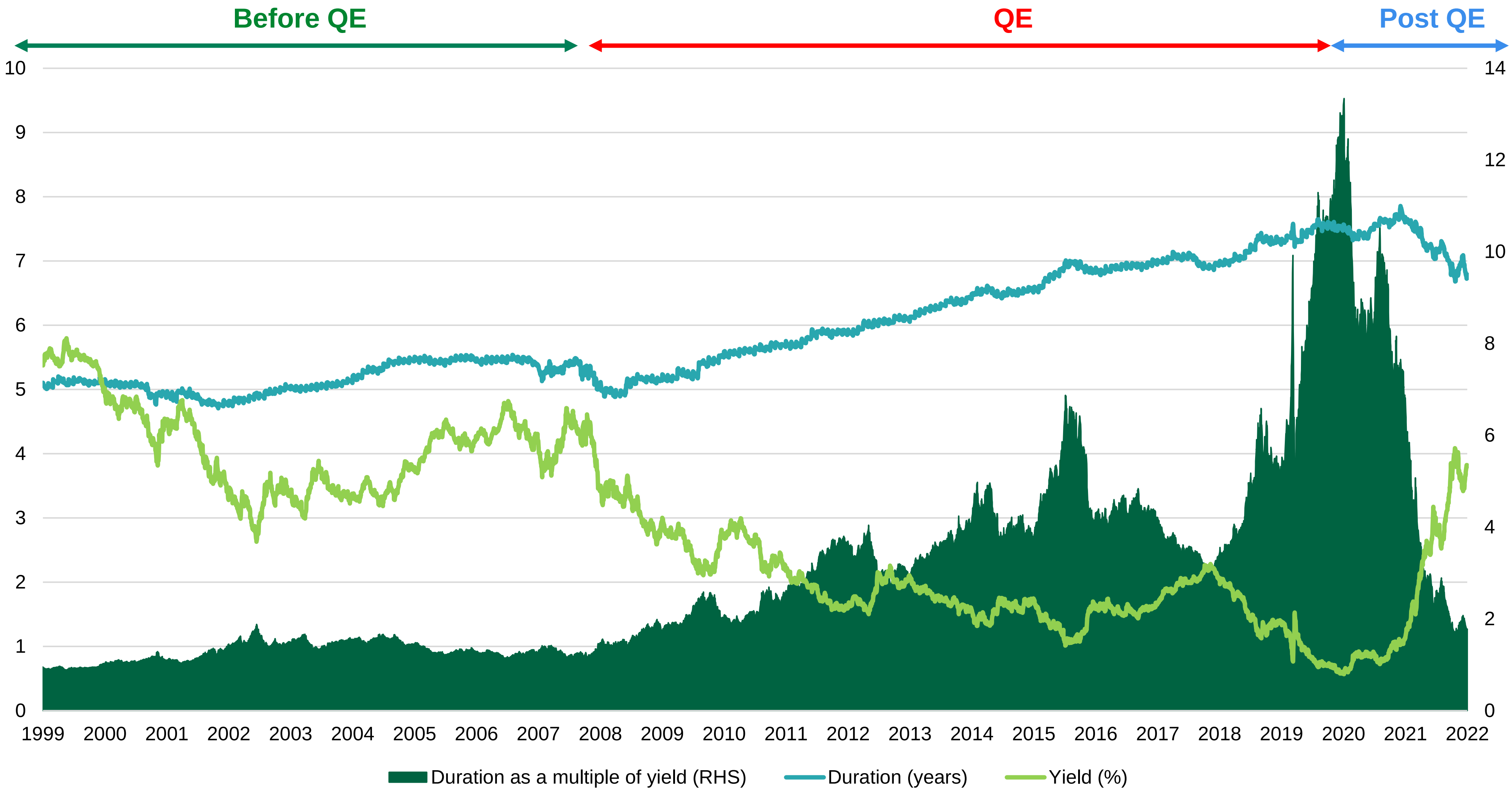
Past performance is not a reliable indicator of current or future performance. The value of an investment and the income from it can fall as well as rise as a result of market and currency fluctuations and you may get back the amount originally invested. It is not possible to invest directly into an index and they will not be actively managed.

Source: TwentyFour, Bloomberg, iBoxx, ICE indices. 21 February 2023

The yield rise in 2022 reversed all 13 years of Q.E.

(where Q.E. had previously distorted the risk/reward relationship of the bond market)

Ratio of Duration (risk) vs. Yield (reward)



Past performance is not a reliable indicator of current or future performance. 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 get back the amount originally invested. Underlying data BAML Global Broad Market Index. It is not possible to invest directly into an index and they will not be actively managed.

Source: TwentyFour, ICE indices. 31 December 2022

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The terminal rate debate has not finished yet…

Inflation remains more than transitory, keeping pressure on central banks

	US	Germany	UK
CPI	6.50% ↓	8.70% ↑	10.10% ↓
Core CPI	5.70% ↓	5.20% ↑	5.80% ↓
PPI	6.20% ↔	21.6% ↓	13.2% ↓
Unemployment	3.40% ↓	5.70% ↑	3.70% ↔
Hikes so far	3 x 25bp, 2 x 50bp, 4 x 75bp	3 x 50bp, 2 x 75bp	5 x 25bp, 4 x 50bp, 1 x 75bp
Hikes expected by end 2023	~+50bp	~+75bp	~+50bp
Official Rate	4.75%	3.00%	4.00%
Terminal rate market expectation	5.35% (Jul 23)	3.63% (Oct 23)	4.58% (Aug 23)
Mandate	Output + Inflation	Inflation	Inflation
Risk of policy error?	Lowest	Highest	Medium
Deposit Rate (3m LIBOR/SONIA)	4.85%	2.60%	4.16%

Central banks have to walk a dangerous tightrope – hike rates to retain inflation credibility and generate a recession? Or prioritise growth – but at what cost?

These views represent the opinions of TwentyFour as at February 2023, they may change and may have already been acted upon, they may also not be shared by other entities within the Vontobel Group.
Source: TwentyFour, Bloomberg. Data as at 23 February 2023

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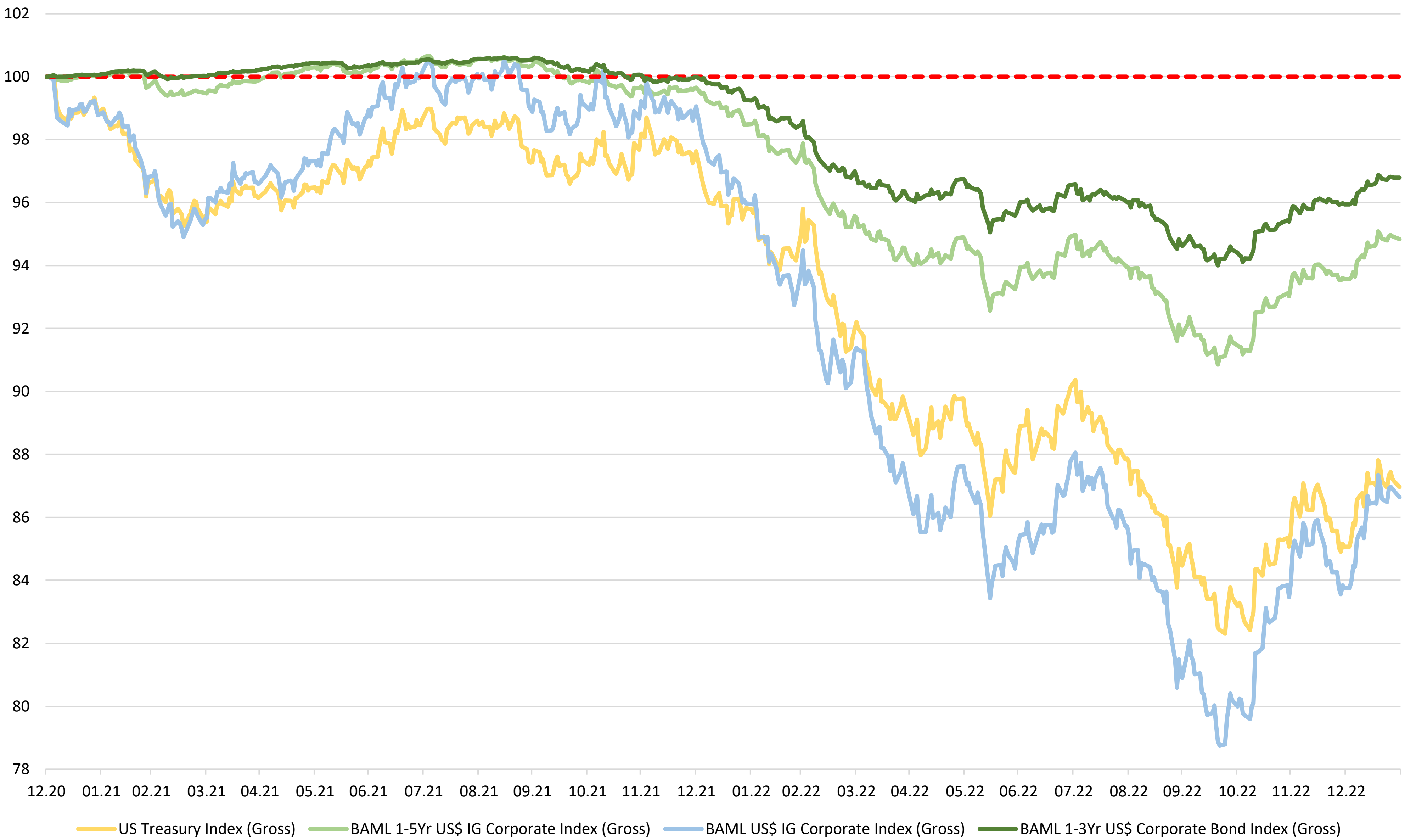
Did anywhere in fixed income avoid losses last year?
No – but short dated IG avoided the worst of the losses

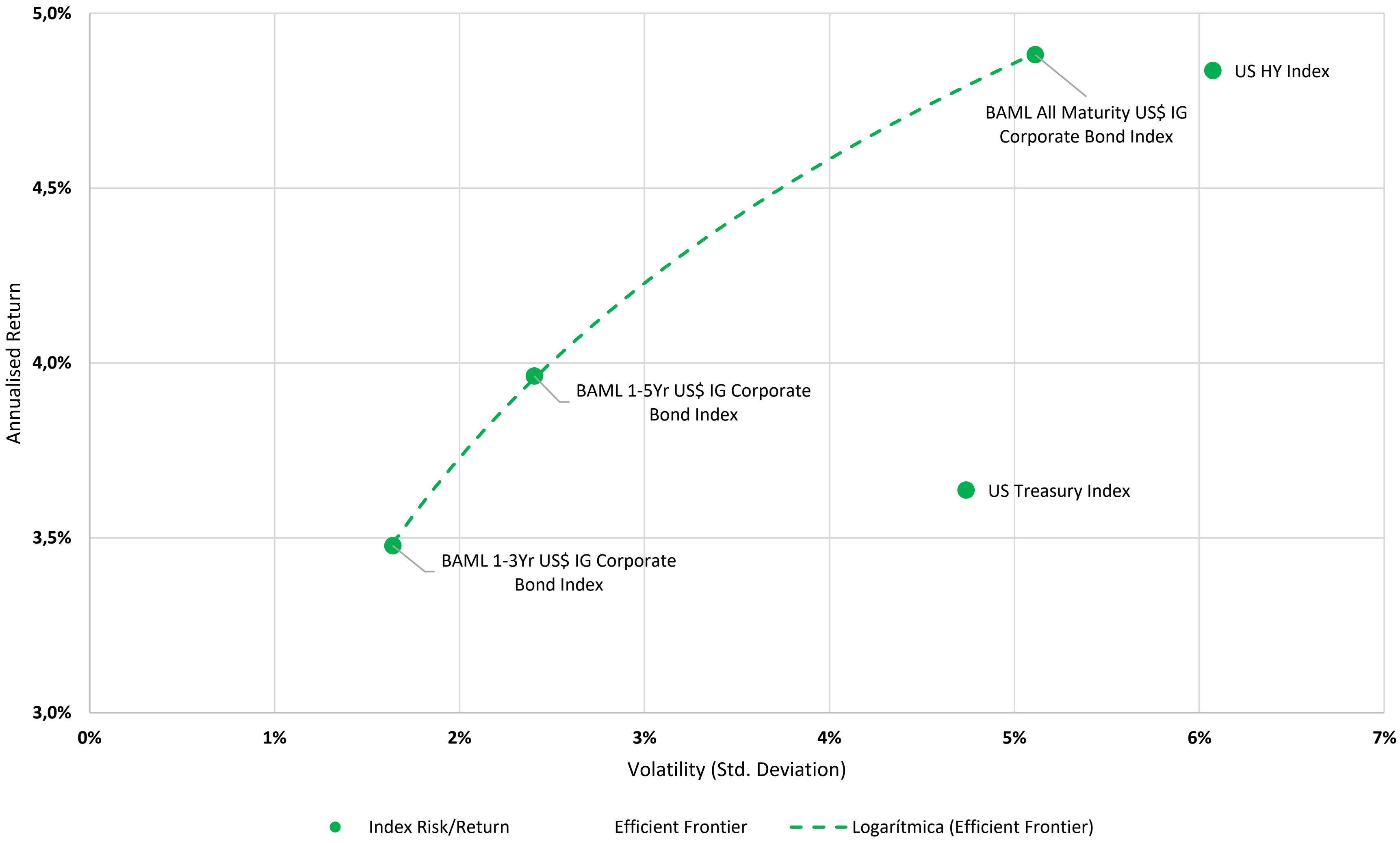


Past performance is not a reliable indicator of future performance.
Source: TwentyFour, Bloomberg
Data as at 23 February 2023

So where are the best opportunities in Fixed Income?

IG is where risk-adjusted returns are maximised
Short dated especially so

Long term risk-adjusted returns for US$ Fixed Income
31/12/99 to 22/02/23



Past performance is not a reliable indicator of future performance.
Source: TwentyFour, Bloomberg, iBoxx
Data as at 22 February 2023

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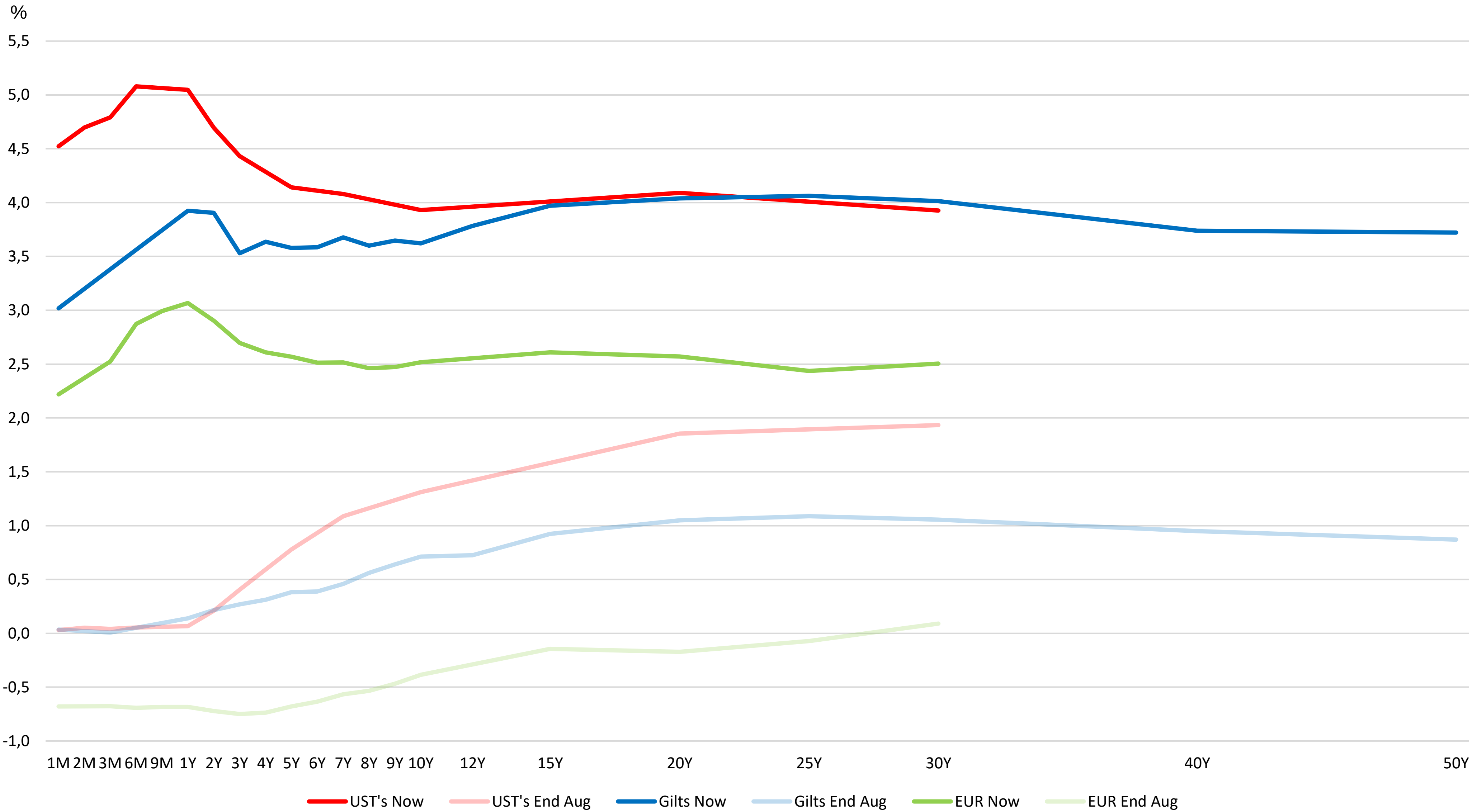
So where on the curve are the best opportunities right now?
Beyond 5yrs of maturity there is no additional yield!



Past performance is not a reliable indicator of future performance.
Source: TwentyFour, Bloomberg
Data as at 31 August 2021 & 23 February 2023

Meaning credit yields between short and long dated IG are the same…
Are capital risks the same?

ICE/BAML IG Corporate Indices	1-3Yr	1-5Yr	All Maturity
Yield to worst	5.5%	5.5%	5.5%
Duration	1.79	2.57	6.74
Yield ÷ Duration (breakeven)	+307bp	+214bp	+81bp
Identical yield?	✓	✓	✓
Protection against losses?	✓✓	✓	✘

Maximise your breakeven (protection against losses) by staying at the front end of the curve, where you get paid exactly the same yield, but have a fraction of the capital risks

Past performance is not a reliable indicator of future performance.
Source: TwentyFour, ICE/BAML
Data as at 23 February 2023

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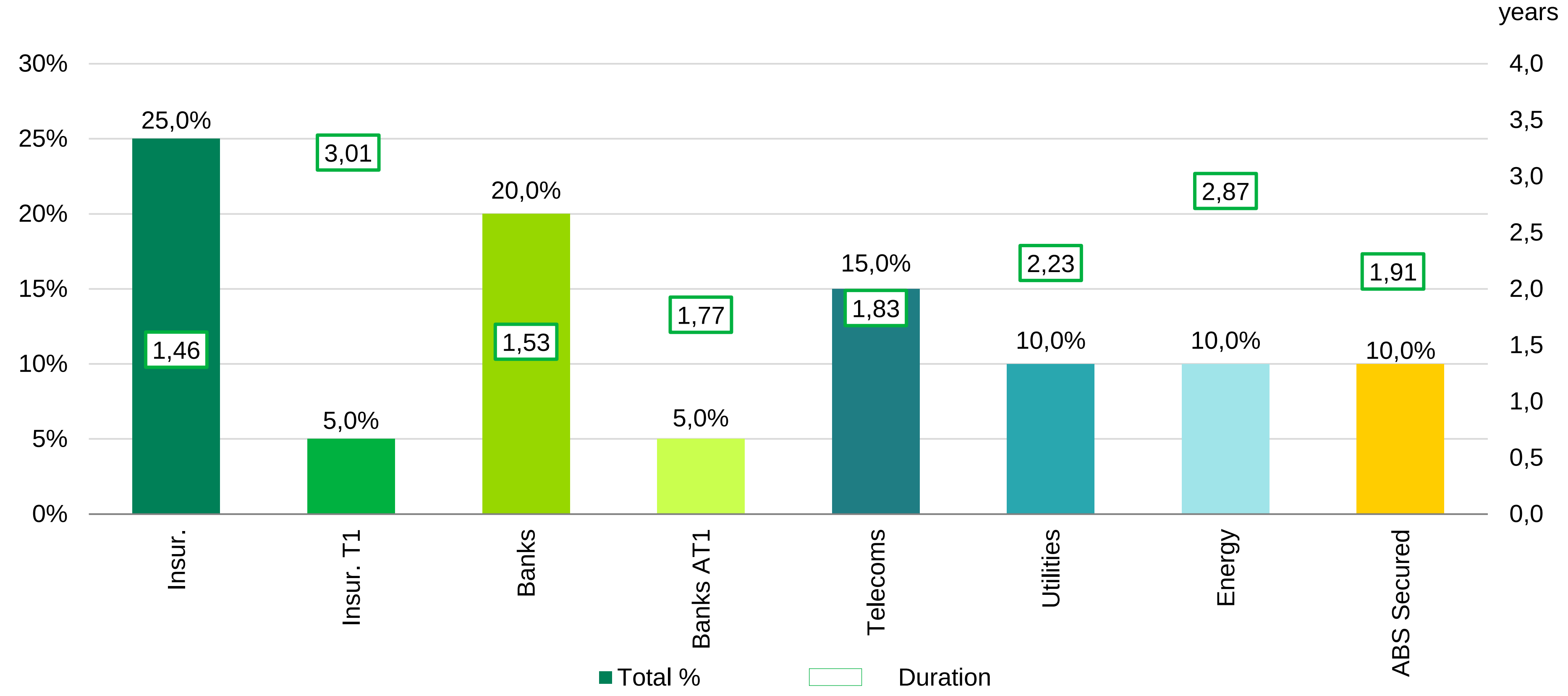
Focusing on specific index sectors allows you to improve the yield

BAML 1-5Yr Sector Yields/Durations

Sector breakdown



Yield $ (%)	6.83	12.60	6.16	9.00	7.36	6.83	7.08	7.03

USD yield 7.22%, IR duration 1.89yrs

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Risk vs. Reward including focussed index sectors example

ICE/BAML IG Corporate Indices	Focussed Example	1-3Yr	1-5Yr	All Maturity
Yield to worst	7.22%	5.5%	5.5%	5.5%
Duration	1.89	1.79	2.57	6.74
Yield ÷ Duration (breakeven)	+382bp	+307bp	+214bp	+81bp
Identical yield?	higher	✓	✓	✓
Protection against losses?	✓✓✓	✓✓	✓	✗

You can improve on the relationship between risk and reward by being selective

Past performance is not a reliable indicator of future performance.
For illustrative purposes only.
Source: TwentyFour, ICE/BAML Data as at 23 February 2023

Summary – why short dated IG is the "best game in town in 2023"

- 2022 was the worst year for bonds in living memory
- Risks still remain to all asset classes, as we move from:
  - > global inflation as a narrative…
  - > to higher terminal rates and global recession fears…
- Short dated IG consistently produces some of the best risk-adjusted returns in Fixed Income
- Right now, the yield on short dated credit is *exactly the same* as long dated credit
  - > But capital risks are far lower in short dated – so why take longer dated risk?
- By actively investing in short dated IG, you can:
  - > improve the yield
  - > keep duration even lower

You can park capital in short dated IG for the remainder of 2023, clipping a very attractive yield of >7% whilst other assets potentially reset to a challenging recession environment

Past performance are not reliable indicators of actual current or future performance. Yields shown is Yield to Maturity which is the total return anticipated on a bond if the bond is held until the end of its lifetime. Yield to Maturity is considered a long-term bond yield, but is expressed as an annual rate. Yield shown is at hedged portfolio level and gross of expenses (model). There is no guarantee that investment objectives will be achieved.
Source: TwentyFour; 30 December 2022

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ICE BofA US Corporate Index - tracks the performance of US dollar denominated investment grade rated corporate debt publicly issued in the US domestic market. To qualify for inclusion in the index, securities must have an investment grade rating (based on an average of Moody's, S&P, and Fitch) and an investment grade rated country of risk (based on an average of Moody's, S&P, and Fitch foreign currency long term sovereign debt ratings). Each security must have greater than 1 year of remaining maturity, a fixed coupon schedule, and a minimum amount outstanding of $250 million.

ICE BofA 1-3 Year US Corporate Index - a subset of the ICE BofA US Corporate Master Index tracking the performance of US dollar denominated investment grade rated corporate debt publicly issued in the US domestic market. This subset includes all securities with a remaining term to maturity of less than 3 years.

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