PENTAGON
High Conviction Bond Fund

MANAGED BY ICM

January 2024 – Share Class B (USD)

MORNINGSTAR ★★★★

Morningstar Category % Rank
5 Year
2
Best=1
Worst=100

Overall rating out of 901 Global High Yield Bond funds as of 31 January 2024.

THE FUND:
The Pentagon High Conviction Bond Fund is a subfund of Merrion Capital Investment Funds Plc., an open-ended investment company with variable capital incorporated in Ireland with registered number 427248 established as an umbrella fund with segregated liability between sub-funds.

OBJECTIVE:
The Pentagon High Conviction Bond Fund's objective is to target attractive risk adjusted returns through a combination of income and capital appreciation by investing in a concentrated portfolio of higher yielding global corporate bonds.

INVESTMENT APPROACH:
The Pentagon High Conviction Bond Fund looks to gain a meaningful exposure to 'higher alpha' global credit opportunities through an investment approach that focuses on value investing, bottom-up credit selection and delivering absolute investment returns.

INVESTMENT MANAGER
ICM Investment Management Limited is the sub-investment manager to the Pentagon High Conviction Bond Fund.
www.icmim.limited

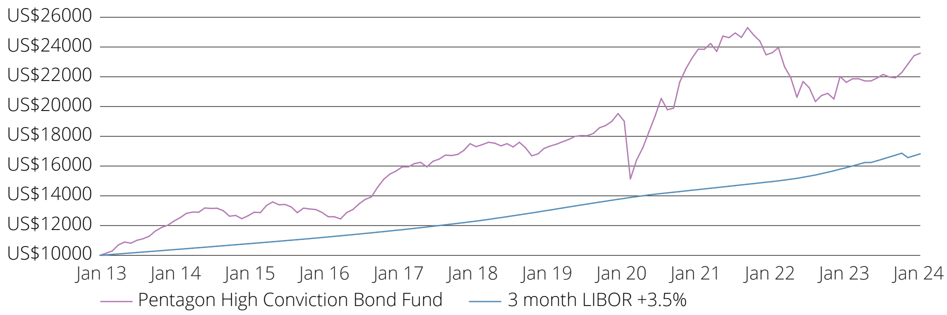
FUND INFORMATION

Total Net Assets	€11.17m
NAV per Share (Class USD)	$134.02
NAV at Launch (1 May 2018)	$100.00
Underlying Running Yield	5.64%
Effective Duration	4.06
Number of Positions	31

Domiciled	Ireland
Share Classes	Euro/USD
Minimum Subscription	€10,000
Sub Investment Manager	ICM Investment Management Ltd
Liquidity	Daily
Total Expense Ratio	1.50%
Investment Advisor	ICM Limited
Custodian	Northern Trust
Fund Administrator	Northern Trust
Investment Management Company	Merrion Capital Investment Funds PLC

PERFORMANCE

GROWTH OF US$10,000 SINCE INCEPTION



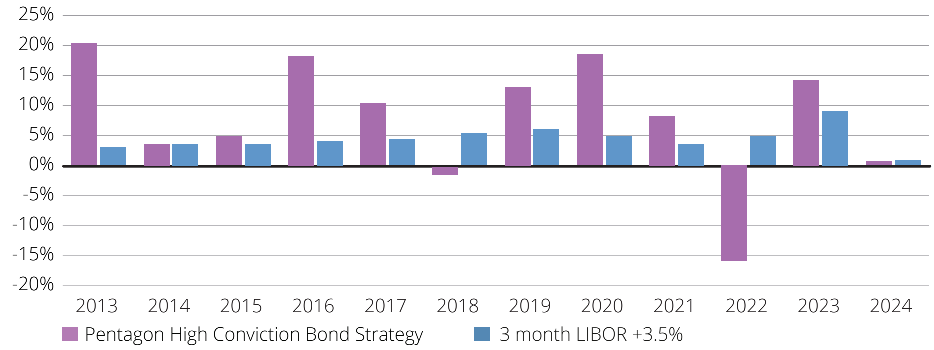
STRATEGY PERFORMANCE (USD)

	1 month	3 month	1-year	3-years	5-years	Annualised Return since Inception
Absolute Return	0.7%	5.8%	7.1%	0.5%	6.5%	8.1%

	YTD*	2023	2022	2021	2020	2019
Absolute Return	0.7%	14.2%	-16.0%	8.2%	18.6%	13.1%

* Calendar year to date

PENTAGON HIGH CONVICTION BOND STRATEGY – ANNUAL PERFORMANCE (USD)



FUND DETAILS

SHARE CLASSES & MONTH-END NAV

Share Class	ISIN	Bloomberg	Month End NAV
Share Class A (EUR)	IE00BF1F4X98	BBG00KG5NFM3	€119.77
Share Class B (USD)	IE00BF1F4Y06	BBG00KG5NFS7	$134.02
Share Class E (GBP)	IE00BHR48L00	BBG00NDP1YN8	£91.12
Share Class G (USD)	IE000HLGDJJ3	BBG0141HCP84	$100.79
Share Class P (USD)	IE000P52VV31	BBG015HY7961	$98.31

TEAM
- Gavin Blessing, Portfolio Manager
- Conor Spencer, Portfolio Manager

The value of investments and the income therefrom may fall or rise. Past performance is not indicative of future performance. For the full Performance disclosure statement, please see the final page of this document.

FUND LETTER JANUARY 2024

The Magnificent Seven (Big Tech) continue to dominate the equity indices. The Magnificent Seven refers to Microsoft, Apple, Alphabet, Amazon, Nvidia, Meta and Tesla. The Magnificent Seven makes up one-third of the market cap of the S&P 500.

In 2023, the Magnificent Seven effectively delivered all S&P 500 returns[1], i.e. the S&P 500 would have been flat rather than up 24% had they not been included.

In January, Meta and Amazon reported stellar results. Meta's market capitalisation increased by USD 200 billion to USD 1.2 trillion from USD 1 trillion based on its results after announcing plans to buy back an additional USD 50 billion shares and issue its first-ever quarterly dividend. The S&P 500 was up 1.6%[2], with 45% of the gain coming from the Magnificent Seven. The S&P 500 reached an all-time high during the month of 4,927.

The US equity market continues to benefit from significant economic growth, with the US economy growing at an annualised rate of 3.3% in Q4 2023, beating estimates by 1.3%. Jobs growth, too, has been robust, with the US economy creating 353k jobs in January 2024 and an upwardly revised 333k jobs in December 2023. Other indicators, such as the ISM Purchasing Managers Indice ("PMI"), are also showing strength. In January, the ISM PMI Manufacturing index read 49.1, its highest reading in over a year, while the ISM PMI Services Index read 53.4.

Considering that inflation is falling, the market continues to price in a Goldilocks scenario, with strong economic growth coupled with low or declining inflation. Core Personal Consumption Expenditure ("PCE"), the US Federal Reserve's preferred measure of inflation, decreased every month in 2023 and now stands at 2.9% over the past twelve months. Over the past six months, Core PCE has been running below the Federal Reserves target of 2.0%.

In Europe, too, equities rallied, with the Eurostoxx 50 increasing by 2.8%[3] during the month. European equities were buoyed by the European Central Bank's ("ECB") decision to keep rates on hold at its January meeting. Eurozone Manufacturing PMI rose to 46.6 in January from 44 in December and 43 in October 2023. Like in the US, European equities are benefitting from what investors see as an apparent Goldilocks scenario of more robust economic growth and more accommodative monetary policy.

However, January was not the everything rally that we saw in 2023. The FTSE 100, which had been sluggish for much of 2023 but rallied late in the year, was down 1.3% in the month. Emerging markets struggled, too, falling by 4.5%. China continues to be a massive drag on performance, falling by 9.2% during the month, for a return of negative 26.2% over the previous twelve months.

Chinese equities continued to be weighed down by the property market slowdown, weak consumer demand and a slowdown in global manufacturing. In January, Chinese consumer prices fell by 0.8% year-on-year, the fastest annual decline in fifteen years. The fall in producer prices was even more stark, falling by 2.5% year-on-year.

In the US, rates were flat along most of the yield curve but for a 14bps increase in US 30-year treasuries. US Treasury bonds, measured by the Barclays US Aggregate Government Index, fell by 0.3%.

All longer-term US rates, longer than two years, have fallen by 100bps over the past three months. The US yield curve still has some ways to go to reflect a normal upward-sloping yield curve. US three-year treasuries currently yield 100bps more than the US 30-year treasuries, with other parts of the yield curve still more inverted. The hope, and likely the current expectation, is that the yield curve normalises with a gradual reduction in rates at the Fed-controlled short end of the curve.

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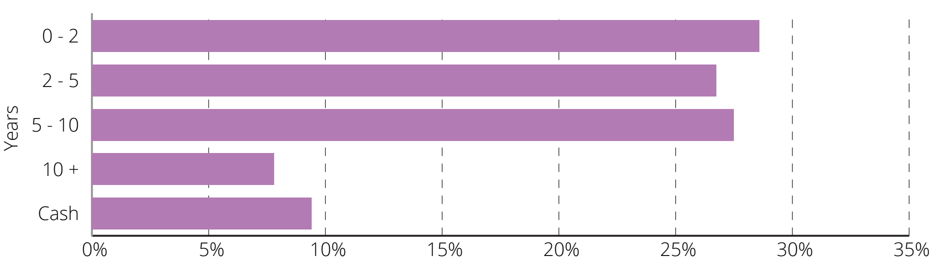
DURATION SPLIT OF INVESTMENTS



PORTFOLIO SUMMARY

TOP TEN HOLDINGS[1]		% of gross assets
1	Aris Gold 7.5% 2027	6.38
2	DNO 7.875% 2026 (Sep 2024)	5.83
3	Cosan O/seas. 8.25% Perp (Discrete 30 days notice)	5.37
4	Bath and Body Works 7.6% 2037	4.85
5	Arcelor Mittal 6.75% 2041	4.33
6	L&G 5.5% 2064	4.07
7	Just Group 5% Perp (Mar 31)	3.79
8	Nordstrom 5% 2044	3.70
9	T 3.25% June 2029	3.59
10	Block 0.125% 2025	3.58
TOTAL		**45.50**

INDUSTRY GROUP SPLIT OF INVESTMENTS	
Oil&Gas	17.87%
Insurance	12.94%
Sovereign	12.65%
Retail	10.29%
Cash	9.41%
Diversified Finan Serv	8.05%
Banks	6.79%
Mining	6.38%
Iron/Steel	4.33%
Commercial Services	3.58%
Pipelines	2.45%
Internet	1.97%
Healthcare-Services	1.64%
Transportation	1.39%
Auto Manufacturers	0.24%
Other	0.03%

GEOGRAPHICAL SPLIT OF INVESTMENTS	
United States	39.58%
Great Britain	16.47%
Cash	9.41%
Norway	8.28%
Brazil	6.76%
Canada	6.38%
Luxembourg	4.33%
Switzerland	3.04%
France	2.12%
Singapore	1.97%
Italy	1.64%
Other	0.03%

HIGH CONVICTION STRATEGY ANALYTICS[1]	
Average Credit Quality	BBB
Sharpe Ratio (Risk Free Ref: US 3mth T-Bill)	0.65
Annualised Standard Deviation	10.59%
Correlation to Treasuries	-0.14
% Periods Up:	66
% Periods Down:	34

[1] Source: ICMIM

WARNING: Past performance is not a reliable guide to future performance. The value of your investment may go down as well as up. If you invest in this fund you may lose some or all the money you invest. This fund may be affected by changes in currency exchange rates.

In Europe, rates increased across the yield curve by an average of c. 10bps. European government bonds, as measured by the Barclays Euro Aggregate Government Index, fell by 0.5%. The shape of the European yield curve remains similar to the US yield curve, albeit that rates in the US are 150-200bps higher.

In the US high-yield market, as measured by the ICE Bank of America High-Yield Index, spreads widened by 20bps from 3.39% to 3.59% but remain fairly tight by historical measures. While increasing spreads would have resulted in a capital loss for the month, this was offset by coupon income to leave the index flat for January.

In the US investment grade market, as measured by the ICE Bank of America US Corporate Index, spreads remained flat at c. 1.0%. Spreads in investment-grade credit have seldom remained at these levels for long and have tended to be higher. Investment Grade credit increased by 0.1% during the month.

PERFORMANCE

In January, the Pentagon High Conviction Bond Fund (the "Fund") increased by 0.7%, versus 0.1% and 0.0% for the U.S. investment-grade and high-yield indices, respectively.

Over the past five years, the Fund has returned 6.5% per annum versus 2.2% and 4.3% for the U.S. investment-grade and high-yield indices, respectively.

Since its inception, the Fund has returned over 135.8% in total or 8.1% annually.

Per Morningstar, the Pentagon High Conviction Bond Fund is in the 2nd percentile of top-performing Global High Yield Bond Fund out of 667 funds over the past five years.

MARKET OUTLOOK

The U.S. economy is expanding at a solid pace. So says Chairman Jerome Powell, the U.S. Federal Reserve Bank President, in the Federal Reserve Bank's January letter.

Recent U.S. economic data is undeniably positive. Job creation has quickened in recent months, well ahead of the consensus forecast, albeit slower than January 2023. U.S. unemployment remains at multi-decade lows, and consumer spending remains decent.

Thanks to this robust economic data, the U.S. Federal Reserve maintained its policy rate in the range of 5.25 to 5.50 percent at its meeting in January 2024, as expected, its fourth consecutive meeting at the 5.5% upper bound since July 2023.

The most noteworthy aspect of the Federal Reserve's January meeting was its abandonment of its tightening bias. January's Federal Reserve statement did not include its usual sentence of the previous statements, which said, "In determining the extent of any additional policy firming that may be appropriate to return inflation to 2 per cent over time, the Committee will take into account the cumulative tightening of monetary policy, the lags with which monetary policy affects economic activity and inflation, and economic and financial developments." [4]

Instead, the Federal Reserve's statement said, "In considering any adjustments to the target range for the federal funds rate, the Committee will carefully assess incoming data, the evolving outlook, and the balance of risks." [4]

The change in language suggests to us that the Federal Reserve believes it is winning the war on inflation.

Notwithstanding the softening of rhetoric, from firming to adjustment, the Federal Reserve's tone remains slightly hawkish. Its statement emphasised: "The economic outlook is uncertain, and the Committee remains highly attentive to inflation risks." And in his accompanying press conference, Chairman Powell said, "The Committee does not expect it will be appropriate to reduce the target range until it has gained greater confidence that inflation is moving sustainably toward 2 per cent." [5] Chairman Powell also said that a rate hike in March was not their central case scenario based on the current economic data. Future hikes will be contingent on incoming data.

Since that press conference, economic data has remained robust. As the market review section mentioned, U.S. nonfarm payrolls were well ahead of consensus in January, with strong revisions for previous months. The ISM Services and Manufacturing indices were higher than expected, implying a healthier economy and sound consumer appetite. In January, new orders and prices rose more than expected in the U.S., suggesting that these components are not contracting and that some inflationary pressures might still be present. The proportion of businesses complaining about rising prices was the highest in nine months.

On the one hand, Chairman Powell acknowledged that the base rate was probably at its peak for the current cycle and that the Federal Reserve will likely cut rates in 2024. But on the other hand (like every good two-handed economist), Chairman Powell emphasised the uncertain outlook for the economy.

The Federal Reserve felt it would be inappropriate to cut rates before seeing additional evidence that inflation was "moving sustainably back to two per cent." The US CPI data on the 13th of February will be an important component of the Federal Reserve's future decision-making process.

We believe it is now improbable that the Federal Reserve will cut rates in March 2024 based on existing data points and their comments that "the policy stance that represents neutral has increased in this post-pandemic recovery period." The market expects the Federal Reserve will cut rates in June 2024.

Chairman Powell reiterated that restoring price stability is the essential goal of the Federal Reserve and believes the federal funds rate "is in restrictive territory.[5]" Chairman Powell commented that inflation could be sticky at a pace exceeding two per cent. We are not convinced inflation will be sticky. We remind our readers that the personal consumption expenditures index ("PCE") minus food and energy prices - the Federal Reserve's preferred gauge of underlying inflation - slowed to a nearly three-year low of 2.9% in December 2023 on an annual basis. On a six-month annualised basis, the metric was 1.9%. On a three-month annualised basis, the metric was 1.5%, way below the Fed's 2% target.

We believe the Federal Reserve may need to move faster than 25 basis point cuts in June if the annualised core PCE inflation falls significantly below 2%.

Now, turning to Chairman Powell's comments about the 'uncertain outlook.' We believe this refers to the labour market and the U.S. commercial real estate sector, either of which could result in the Federal Reserve cutting rates sooner or more aggressively than predicted.

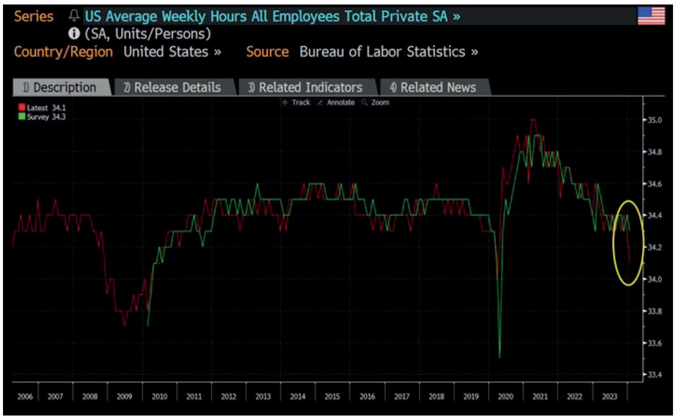
Labour market dynamics

There is no question that we are encouraged by the strong labour market in the U.S. However, we are mindful that the labour market may not be as strong as the consensus belief, and we believe the U.S. Federal Reserve Bank is wary, too. We think the U.S. Federal Reserve is telling investors as much by re-emphasising its dual mandate of inflation and employment. Let us assume inflation is conquered based on the trend in PCE that we detailed earlier.

The Federal Reserve is now equally focused on the labour market. Sure, headline payrolls added 353k jobs, increasing the three-month average to 289k, the unemployment rate remains at 3.7%, and average hourly earnings increased. However, we caution against too much optimism, given that we must discount these numbers by the drop in average weekly hours worked, 0.3 hours in January 2024 versus December 2023.

Chart 1 (below) shows employers are cutting back employee hours. Per research by First Trust, the drop in hours in January is the equivalent of losing 465,000 jobs. Average weekly hours have not been this low since March 2020, the onset of COVID. The risk is that businesses are over-staffed with less work to go around. On top of this, staff are now demanding a higher hourly wage. Higher-paid staff working fewer hours will reduce operating leverage and result in redundancies later this year. We believe this scenario concerns the Federal Reserve Bank, which is mindful of these risks hitting the job market as we go through 2024.

Chart 1: U.S. Average Weekly House All Employees Total Private



Source: Bloomberg

U.S. Employment Growth continues to trend down, as does the JOLTS quit rate, as illustrated in Chart 2 below.

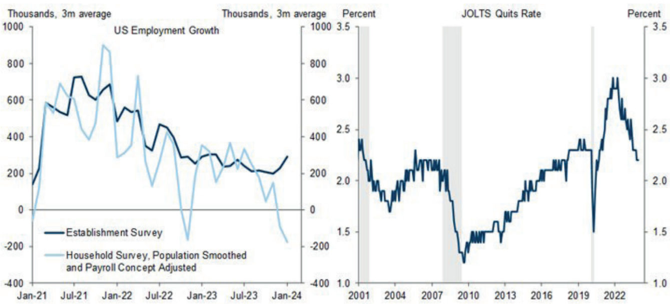
We believe the first signs of labour-force weakness will appear in the Household Survey, as opposed to the nonfarm payroll report. The Household Survey is a monthly sample survey of households that gathers data on the labour force, employment, unemployment, persons not in the labour force, hours of work, earnings, and other demographic and labour force characteristics. Crucially, the Household Survey does not duplicate individuals who double-job or triple-job. The Household Survey counts the person, not the job, and includes unskilled labour.

The nonfarm payroll report is based on the Establishment Survey, a monthly sample survey of approximately 122,000 nonfarm businesses and government agencies from 666,000 work sites, covering about one-third of all payroll workers. The Establishment Survey covers establishments (enterprises) rather than households and gathers employment data, including wages by occupation, labour costs, productivity, and employee benefits. Anyone on the payroll on the 12th of the month, including part-time workers and those on paid leave, is included in the count, contributing to estimating the total U.S. nonfarm payrolls. Such information is critical across government, business, communities, and, of course, investors in making informed decisions.

The Establishment Survey and the Household Survey differ in many ways, which result in important distinctions in the employment estimates. For example, the Household Survey includes agricultural workers, the self-employed, unpaid family workers, and private household workers among the employed. These groups are excluded from the Establishment Survey. The Household Survey is limited to workers 16 years of age and older. The Establishment Survey has no age limit and captures more short-term seasonal workers. The Establishment Survey also includes people double-jobbing, potentially portraying a stronger economy than reality.

The following chart of the U.S. Employment Growth shows that the Household Survey has trended significantly downwards in the past few months versus the Employment Survey.

Chart 2 U.S. Employment Growth and Jolts Quits Rate.



Source: Goldman Sachs, Bloomberg

Furthermore, in the past few months, the quality of the jobs created is from less productive sectors of the economy. In January, health services added 70,000, professional and business services added 74,000, retail added 45,000, government added 36,000, social assistance rose by 30,000, and manufacturing added 23,000. We would prefer to see higher manufacturing numbers. We also noted the decline in oil and gas jobs.[6]

We believe the Federal Reserve Bank will cut rates to stimulate employment if it feels the labour market is weakening too much. Rising unemployment would cause too much disinflation, possibly even deflation, which is why we believe the Federal Reserve Bank Chairman re-emphasised his mandate for price stability.

U.S Regional Banking/Commercial Real Estate

In January, New York Community Bank brought the commercial real estate (CRE) sector into sharp focus when it shocked the market by increasing its loan loss provisions by USD 550 million for loans linked to CRE.

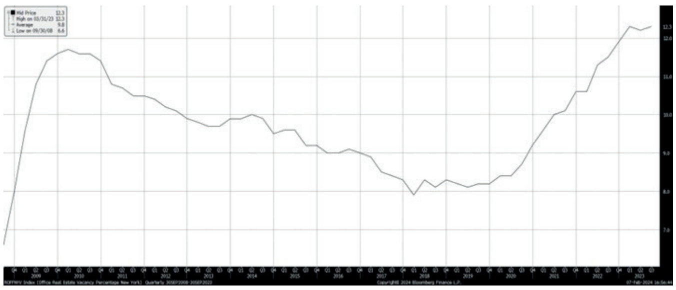
U.S. regional banks have underperformed in the market since March 2023 when Silicon Valley Bank failed, and other banks admitted problems with loans linked to real estate loans, as illustrated in Chart 2: The KBW Regional Banking Index.

Chart 3: KBW Regional Banking Index

Source: Bloomberg

Investors have had concerns about office property exposures in regional banks for at least a year. Some investors have had problems since the start of COVID because they believe the office market has structurally changed due to remote working, which we agree with. Chart 3 below shows a steady rise in vacant New York offices, which is currently higher than in 2009 and 2010, just after the Great Financial Crisis.

Chart 4: New York Office Real Estate Vacancy Percentage



Source: Bloomberg

By way of example, in January, Boston Properties bought a 29% interest in 360 Park Avenue South, an office block in a prestigious midtown Manhattan location, for $1 (one dollar) from its previous joint venture partner, the Canadian Public Pension Investment Board. The Canadian pension fund paid USD 71 million for its share of the office block. Crystalising a USD 71 million loss is palatable if you have half a trillion assets under management. It's not so easy for smaller banks and investors. Aside from New York Community Bank, some European banks have also come under pressure due to their U.S. CRE portfolios.

Any problem for banks may cause the Federal Reserve to provide liquidity to the market, which usually boosts bond prices. Bad news for banks is often good news for Government bond investors, as we saw U.S. Treasury bonds rallying strongly after New York Community Bank's results.

Interestingly, in its January statement, the Federal Reserve removed the sentence from its December statement that said the banking system remained "sound and resilient." [7]

ICM does not believe the commercial real estate market will derail the economy. Improved regulations and capital instruments allow regulators to manage failing banks in an orderly fashion. For example, in 2023, SVB and Credit Suisse ran aground but were resolved without any lasting impact on the economy, albeit after initial nervousness and volatility. However, any possible growing problems in regional banks will inevitably lead to more Federal Reserve support and more injections of liquidity into the banking sector. At ICM, we see this as simply more money printing, leading to more currency debasement and, therefore, as being positive for asset prices.

Market implications

We started last month's market implication section by saying, "We are now ready to say that 2024 will be the year that this bull market grows up." Given the rally we have seen in equities already, we have not been disappointed. At the time of writing the S&P 500 is up 4%, year to date, having been up 7% just before the latest CPI report showed inflation at 3.1% versus 2.9% expected.

We are happy to buy the dip in this instance, given we remain confident that U.S. financial markets will continue to perform strongly this year, thanks to growing corporate profits, continuing disinflation, and easing monetary conditions in the second half of the year. Equity markets are not priced to reflect any material probability of a recession. Any meaningful economic slowdown would weigh on corporate profits, but we believe the Federal Reserve has the levers to re-stimulate growth if unemployment or deflation become problems.

Like equity markets, credit markets do not price any recession or credit stress. At the end of January, credit spreads in the high-yield market were c. 380bps and have ground tighter since. We believe there are still more gains to be made from tightening credit spreads, and high-yield bonds offer an attractive all-in yield. We also like the downside protection for high-yield bonds from falling underlying yields if the U.S. economy should slow.

Similarly, Government bond yields continue to look attractive. While ten-year yields have fallen in recent months, they still offer attractive yields to investors. For example, today, the U.S. 10-year treasury yields c. 4.28%. In the long term, 10-year treasury yields are likely closer to 3.0%.

Emerging markets look cheap relative to historical valuations. Economic uncertainty in China has muddied the waters for investors in Emerging markets, as China makes up one-third of the Emerging Market Index. However, we believe compelling Chinese valuations coupled with Government support provide a positive backdrop for commodity-producing economies such as Brazil, giving us a positive outlook for 2024.

We maintain that the key risk to the macroeconomy is a misstep by the Federal Reserve Bank. Will the Federal Reserve Bank suffocate the CRE market by waiting too long to cut rates and cause an unnecessary conflagration? That might be a good reason to expedite the Federal Reserve's first policy rate cut and bring forward the tapering of quantitative tightening. Nonetheless, we remain constructive for the year ahead as we only see tailwinds.

Fund Positioning

In January, ICM increased the fund's duration to 4.1 versus 3.4 for the high-yield index. We believe it is an excellent time to add longer maturity bonds at attractive yields, given our expectation that yields will fall in the coming years. Bond prices rise when yields fall.

To add duration and increase the yield, the fund rotated into longer-maturity UK insurers by selling 2024-maturity bank investments. We believe these insurers will exercise their option to call their subordinated bonds in 2026 when the bonds lose capital efficacy and become expensive senior funding. In such a scenario, ICM's expected return will be c. 10%. ICM believes these subordinated bonds offer compelling risk-adjusted yields.

The fund remains overweight oil & gas and retail companies, sectors that we believe are oversold and will rally in 2024.

Gavin Blessing, February 16th, 2024

Source Data: ICM, Bloomberg as of January 31st, 2024

[1] https://www.redmayne.co.uk/news/january-2024/the-magnificent-seven
[2] The total return was 1.7% inclusive of dividends
[3] The total return was 3.0% inclusive of dividends
[4] Federal Reserve issues FOMC statement
[5] Transcript of Chair Powell's Press Conference January 31, 2024 (federalreserve.gov)
[6] www.bls.gov/news.release/empsit.nr0.htm
[7] Federal Reserve issues FOMC statement - December 13, 2023