TwentyFour ASSET MANAGEMENT

TwentyFour Income Fund

Monthly Commentary | 31 October 2019

Market Commentary

Geopolitical tensions led to an uncertain start to the month but gradually sentiment improved and October finished with a positive tone. As a result risk assets performed well with credit spreads generally tighter.

The key catalyst was a sign of genuine improvement in trade relations between the US and China, as both sides suggested a 'phase one' trade deal was likely and could possibly be signed at the APEC Summit in Chile in November. Unfortunately Chile cancelled the conference due to extensive civil protests in the country, but both the US and China reiterated their intention for a deal to be signed 'soon'. While trade tensions were easing on one side, they were heating up on another as President Trump imposed $7.5bn of tariffs on the EU following a WTO ruling that state subsidies had been unfairly given to Airbus Industries.

A slew of poor data from the US, including ISM manufacturing hitting a 10-year low and the IMF cutting global growth forecasts, contributed to the Fed's decision to cut the Fed Funds rate by 25bp, taking the range down to 1.5%-1.75%. However, the central bank also signaled a pause in further action unless further data clearly pointed to weaker growth. Separately, the Fed tried to calm markets by announcing it would consider a resumption of asset purchases to help alleviate the uncertainty surrounding recent surges in overnight borrowing rates.

Brexit once again dominated UK news and following considerable debate and political impasse in parliament, a UK general election was agreed for December 12 to try and break the 'deadlock'. Though the outcome remains uncertain, the chance of a no-deal Brexit has decreased from a month earlier, leading to a sharp sell-off in Gilts with the key 10-year yield moving from 0.47% to close the month at 0.63%.

Against this backdrop the tone of the European ABS market was broadly constructive throughout October. Steady primary market issuance took the YTD volume to around €88bn, moving ahead of the 2018 issuance level at the same point. Supply has continued to be from a broad range of issuers by both geography and asset type, with RMBS and CLOs accounting for the largest sectors. Early in the month the market saw the largest UK Prime RMBS deal of the year, coming from a UK clearing bank and with the STS banner, where very high investor demand saw the deal upsized. The positive technical continued as the market absorbed all the ABS and RMBS supply with good levels of oversubscription, particularly in mezzanine tranches, and deals pricing at the tighter end of initial price guidance. The positive sentiment filtered through into secondary performance where both senior and mezzanine spreads were around 5bp tighter over the month.

The CLO market also continued to see steady issuance over the month, and while spreads held up relatively well at the senior and investment grade part of the capital structure, performance in the non-investment grade sector deteriorated as the month progressed and spreads widened by around 75bp month-on-month. Higher up the capital structure, a combination of lower risk appetite and a fall in the intrinsic value of the Euribor floor has also seen spreads soften. At present, demand for AAA paper appears to be strong with primary issues being placed with spreads in the low 90bp area.

The factors contributing to underperformance in CLO mezzanine bonds include issuer fatigue after a year of heavy supply, US-based clients selling and reinvesting in the domestic US market at wider levels, less liquidity available from investment banks as we approach year-end, and Europe looking over its shoulder at the weaker credit dynamic in the US market. Overall it is probably a combination of all these factors which have led to recent underperformance in this sector, and it is worth reiterating that we have been steadily reducing our exposure in the sector throughout the year.

Portfolio Commentary

The portfolio managers had a busy October. The fund added primary UK Prime RMBS at the senior level together with a repeat issuer in the UK non-conforming space in the senior and mezzanine sectors adding some liquidity. Also added in primary was the mezzanine tranche of an Italian consumer loan transaction adding a little diversification. In the secondary market, additions were made to existing holdings in UK RMBS across the ratings spectrum down to single A bonds and also in Dutch RMBS and CMBS. The portfolio managers also sold holdings in senior Italian CMBS and UK Prime RMBS which are trading at high cash premiums. Further reductions were made in non-investment grade mezzanine CLO bonds which were partially rotated into a mixture of higher and lower rated non-investment grade CLOs with cleaner profiles and from preferred mangers. Good levels of liquidity were offered through the month in ABS markets and fundamental performance remains strong. The portfolio managers continue to maintain a focus on shorter dated assets maintaining appropriate levels of liquidity and balanced positioning across rating and sector. The fund returned -0.27% (NAV per share) for the month with 3yr volatility at 2.28%.

Market Outlook and Strategy

The backdrop to the ABS market remains fairly positive overall, given the ongoing geopolitical and macro backdrop. In the UK we have seen a strong pipeline of issuance over the month which in part has been driven by issuers wanting to get deals their priced ahead of the October 31 Brexit deadline. With that now pushed into January and the year-end approaching, it's likely that we will see a slowdown in primary issuance. Clearly there remains good investor appetite for the asset class which we have seen throughout the year and this should be positive for spreads.

The CLO market will continue to be a focus for market participants during the run into year-end. Though the number of deals in the pipeline optically seems quite healthy, the number actually expected to be priced is anticipated to fall as some deals are likely to be postponed. Furthermore, it is possible we will see some structural features developing such as amortizing deep mezzanine tranches and managers retaining Single B tranches on new issues rather than placing them, as at current spreads it is becoming an expensive form of leverage for the equity. Market conditions in the non-investment grade part of the CLO market are likely to be challenging in the near future. Although some of the underperformance is due to weaker conditions in the US market, it is worth reiterating that while structurally US and European CLOs are similar, there are differences between the markets that can impact a number of the key risk metrics that we evaluate as portfolio managers. The portfolio managers will remain measured on risk and will maintain appropriate levels of liquidity in the portfolios.

Rolling Performance	31/10/2019 - 31/10/2018	31/10/2018 - 31/10/2017	31/10/2017- 31/10/2016	31/10/2016- 30/10/2015	30/10/2015- 31/10/2014
NAV per share inc. dividends	2.30%	4.96%	13.09%	4.00%	-0.96%

The performance figures shown are in GBP on a mid-to-mid basis inclusive of net reinvested income and, with the exception of share price performance figures, net of all fund expenses. Past performance is not a reliable indicator of future performance. Performance data does not take into account any commissions and costs charged when shares of the portfolio are purchased and disposed of.

Fund Managers

Robert Ford
Partner, Portfolio Manager, industry experience since 1986.

Ben Hayward
Partner, Portfolio Manager, industry experience since 1998.

Aza Teeuwen
Partner, Portfolio Manager, industry experience since 2007.

Douglas Charleston
Partner, Portfolio Manager, industry experience since 2006.

John Lawler
Portfolio Manager, industry experience since 1987.

Marko Feiertag
Portfolio Manager, industry experience since 2005.

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.
- The Fund invests 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 value 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.
- 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.

Further Information

Further Information and Literature: TwentyFour Asset Management LLP

T. 020 7015 8900 E. sales@twentyfouram.com W. www.twentyfouram.com

TwentyFour AM
John Magrath
Tel. 020 7015 8912
john.magrath@twentyfouram.com

Numis Securities
Chris Gook
Tel. 020 7260 1378
c.gook@numis.com

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