



Monthly Commentary | 31 December 2019

## Market Commentary

December was generally a positive month for risk sentiment, with two of the big geopolitical risks that dominated headlines for much of 2019 showing significant improvement. The uncertainty surrounding whether China and the US could agree a 'phase one' trade deal remained for the first half of December, but ultimately ended on a high note with President Trump saying he would look to sign a deal on January 15. The deal meant the US cancelled tariffs that were due to be imposed on December 15, and after the deal is signed, there will also be some reduction in the existing tariffs. China has agreed to cancel the retaliatory tariffs it had planned and has also committed to increase purchases of US goods and services. In addition, and in another positive move for sentiment, Trump signaled he would head to China in the New Year to begin 'phase two' discussions. This rhetoric was supportive for risk markets and saw safe haven assets sell off, with the bellwether 10-year US Treasury yield spiking higher on the news.

As expected, there were no changes from the last central bank meetings of the year for the Bank of England, the US Federal Reserve and the European Central Bank. We did though get the first glimpse of the new ECB president, Christine Lagarde, in action as she chaired her first press conference, where she very much stuck to recent scripts without providing anything new for the markets. The euro strengthened during the conference but was unable to hold onto its gains. Although 2019 saw reasonable bouts of volatility, the year produced good returns not only for risk-on assets, which benefitted from fading geopolitical risks in the final months of the year, but also for risk-off assets, which benefitted from further central bank rate cuts. In the US, the S&P 500 returned over 30%, the US HY index returned 14.4%, while the US Treasury index returned just under 7% after giving back 0.6% in December on the better risk sentiment. In Europe, the Euro HY index returned 11.3% for the year and the Government Bond index returned 6.3%. In the UK, markets benefitted as fears of a hard Brexit abated and the HY index finished with a return of 13.4% for the year. One of the best performing sectors in fixed income was once again subordinated financials, with the Coko index returning an impressive 17.5% for 2019.

The European ABS market remained stable into year-end, with low levels of volatility. Although new issue supply tapered off by the middle of the month, the primary market signed off the year with another record amount of issuance post-2010 at around €98bn. This was despite a very slow start during the first quarter of 2019, which was due to the introduction of the new regulatory framework that we have highlighted previously. The market embraced the main development of STS labelled deals, which saw steady supply through the year and the transition to Sonia-referenced deals from the Libor reference rate has been seamless. The two largest sectors by issuance were RMBS and CLOs, followed by Auto ABS, while from a geographical perspective the UK accounted for the majority of issuance followed by Germany. Despite the ongoing geopolitical factors of Brexit, trade wars, tension in the Middle East and the European economy cooling down over the year, credit fundamentals in the ABS market remained positive; interest rates remained low and unemployment rates, particularly in the UK, remained at multi-year lows. This was very constructive for the market with all asset classes seeing ongoing strong performance in their underlying loan pools, with very low levels of arrears experienced across the board.

In terms of spread performance, the ABS market started 2019 on a weaker footing following global markets' risk-off sentiment and spreads were close to 2016 wides. However, the dovish stance seen from the ECB and the reversal in the trajectory from the Fed saw the ABS market join the rally in wider fixed markets, though at a slower pace. Although there were one or two instances of imported volatility into the ABS market, the general theme over the second half of the year was of spreads grinding tighter which continued into year-end. Specifically, ECB-eligible euro denominated bond spreads are trading around their post-crisis tight levels, but other

sectors such as UK RMBS and Consumer ABS deals are still trading wider than the 2018 post-crisis tight. In CLOs, spreads generally traded sideways through 2019 in the investment grade space, hindered by abundant supply, but non-investment grade spreads materially widened at the end of Q3 and at the beginning of Q4, before retracing most of that as the sector saw a very strong rally in spreads into the year-end.

## Portfolio Commentary

Primary and secondary market volumes tailed off mid-month in December, which is often the case into year-end, but the portfolio managers added several positions funded from a mixture of maturities and rotation out of secondary bonds. The Fund added a new issuer in Spanish consumer ABS at the mezzanine level, along with an inaugural consumer ABS deal from the Dutch subsidiary of a French bank sponsor. These additions added diversification at attractive yields on a relative value basis. The portfolio managers also added some liquidity assets in Prime UK RMBS, together with the senior tranches of several existing holdings. In CLOs mezzanine bonds were added to existing holdings from preferred managers, adding incremental yield. In CMBS the Fund invested in a primary Finnish transaction at the AAA level from a strong sponsor, priced at an attractive yield given the timing of the deal. Several disposals were concluded from a mixture of CMBS and RMBS on shorter dated bonds trading at a premium. Good levels of liquidity were offered in the secondary market. Fundamental performance across all asset classes remains robust and the portfolio managers will maintain appropriate levels of liquidity and balanced positioning across ratings and sectors. The fund returned 1.25% NAV Per share for the month with 3yr volatility at 2.28%.

## Market Outlook and Strategy

The broad consensus from the ABS community suggests more of the same for 2020, with a similar projected issuance volume of around €90-100bn overall. However, in terms of sector there is an expectation that the market will see an increase in RMBS issuance, since the first drawdowns under the UK's Term Funding Scheme scheme are due to start being repaid towards the end of 2020 and drawings by some European banks under TLTRO II come due in June. While some issuers have returned to the market for the first time in many years, it is also worth considering that UK banks have been more inclined to use the covered bond market over the last few years, so cost will come into play. It is also expected that Consumer ABS issuance will be higher and we have seen that in H2 2019, as many European banks took advantage of regulatory changes to issue full capital stack risk transfer deals. It is expected that these increases in supply will be offset by a decline in Auto ABS (due to supply side pressures) and CLO new issuance, due to ongoing low leverage loan supply and fewer debut managers entering the market. CMBS has been more of a niche sector in the market for the last two years and is likely to see similar volumes to 2019.

Overall the outlook for ABS in 2020 is relatively constructive. A more stable regulatory and technical backdrop should maintain the market's current momentum. Fundamentals are likely to remain supportive with economists expecting a relatively benign economic environment in 2020, with low interest rates, stable housing markets and steady levels of employment. Against this backdrop we would expect spreads to tighten modestly during the year, qualified by the likelihood that the market will see some periods of wider macro volatility which might lead to pockets of widening. However, wider market volatility might also lead to a lesser degree of contagion in ABS which would represent a good point to add risk.

Rolling Performance	31/12/2019 - 31/12/2018	31/12/2018 - 29/12/2017	29/12/2017 - 30/12/2016	30/12/2016 - 31/12/2015	31/12/2015 - 31/12/2014
NAV per share inc. dividends	5.04%	2.39%	13.51%	4.28%	-0.12%

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

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Further information on fund charges and costs are included on our website at [www.twentyfouram.com](http://www.twentyfouram.com)

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For definitions of the investment terminology used within this document please see glossary at: <https://twentyfouram.com/glossary>

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