TwentyFour ASSET MANAGEMENT

TwentyFour Income Fund

Monthly Commentary | 31 January 2020

Market Commentary

It was an eventful and busy start to the new year, which saw equity indices breaching new highs before finishing the month lower than where they started. The benchmark 10-year US Treasury traded in a very wide 36bp range, ending January close to 1.50% (a level not seen since early September). 2020 began with tensions flaring between the US and Iran following a US drone strike in Baghdad that killed Qasem Soleimani, the head of Iran's Revolutionary Guards' Quds Force, though fears of a full military confrontation between the two countries ultimately eased. The US and China signed their long-awaited 'phase one' trade deal during the month. While this should have been supportive for markets, it was quickly overshadowed by the rapid spread of a new mutation of the coronavirus. As the infection spread across China and beyond its borders from its epicenter in the Hubei region, the World Health Organization declared a global health emergency towards the end of January. With China enforcing travel restrictions within parts of the country coinciding with the Lunar New Year holiday, and companies announcing they will be shutting offices and factories for extended periods, concerns grew about the impact on the Chinese economy and the knock-on effect for supply chains and global growth. Closer to home, the UK left the European Union on the January 31, resulting in a collective sigh of relief from the markets, given three and a half years of uncertainty following the 2016 referendum. With the transition period ending on December 31, 2020, the focus now shifts to the negotiation of a bilateral trade agreement and whether this can be completed by the transition deadline. Staying with the UK, the market was split on its expectations for the Bank of England interest rate decision at the January meeting. Half of market participants expected a cut in base rates following dovish comments from monetary policy committee (MPC) members Saunders, Haskel and the governor himself, Mark Carney. However, while economic data in November and December had been weak, the remaining market participants thought this was due to uncertainty heading into the December general election and that a rebound would ensue in the wake of the Conservative party's comfortable win. The actual MPC meeting – Mark Carney's last as governor – took place on January 30, where the committee voted 7-2 to keep interest rates unchanged. Markets after the decision were largely unchanged with the 10-year Gilt closing the month at 0.52%, having been as high as 0.82% in the early part of the month. The European Central Bank and the Federal Reserve also had their first meetings of 2020, which in terms of policy changes were equally uneventful. In Europe, Italian politics returned to the limelight as Luigi Di Maio, leader of the Five Star Movement party and co-leader of the ruling coalition government, resigned as head of Five Star having lost more than 20 MPs since the coalition was formed last September and with his party now polling around 16% nationally. His resignation coincided with a key regional election in the Emilia-Romagna region, where the centre-left Democratic Party, the other ruling coalition party, secured an overwhelming 50% vote. Di Maio will remain as Italy's foreign minister. Elsewhere, there was better news in France where a truce with the US was agreed in the recent dispute surrounding the tax levy on US tech groups. The European ABS market got off to a very strong start with both primary and secondary markets experiencing very high demand following the UK election and a fairly benign December. The primary market saw issuance of around €7bn, all of which saw healthy levels of oversubscription across asset classes with mezzanine bonds seeing the most demand. In the UK there were two bellwether Prime RMBS deals from Nationwide Building Society and Clydesdale Bank, which both set the tightest prints in AAA pricing on a relative Sonia basis since the first half of 2018. Additionally, the Nationwide deal was increased from an initial £500m to £1bn due to excess demand. There were also UK deals from established buy-to-let and non-conforming lending platforms, which also gave investors the opportunity to buy mezzanine bonds. The market also saw three Dutch RMBS transactions, an Auto ABS deal from Spain and a Paris-based single asset CMBS transaction, the first Green CMBS to be issued in that market. The primary CLO market was slower getting off the mark, with just one deal priced by a tier one manager. The deal also saw a good level of oversubscription across the whole capital stack, achieving tight pricing compared to what would have been possible at the end of last year. The strong technical was also reflected in the secondary market. Spreads contracted steadily throughout the month across all asset classes, modestly in senior bonds but particularly in mezzanine and non-IG rated tranches, with the biggest move in spread contraction being in BB and B CLOs. We highlighted the underperformance of this particular sector in the last few weeks of last year from a spread perspective, and the market moved quite quickly in January which saw high levels of demand in BBB and non-IG rated bonds. Single B tranches saw spread tightening of around 150bp, while there was around 100bp of tightening on BB tranches depending on the manager. The market did see some profit taking on these tranches as the month progressed, evidenced by an increasing amount of CLO bid auctions, but the sheer weight of demand absorbed the bonds on offer, along with a lot of available dealer inventory which maintained the trajectory on spreads. On the regulatory side, the Bank of England and FCA also released a set of documents outlining priorities and milestones for 2020 on the transition of GBP Libor, including the requirement that the market ceases to issue sterling debt linked to Libor by the end of Q3 2020. Virtually all UK ABS now uses Sonia as the reference index, but there remains a reasonable amount of bonds outstanding with non-call dates beyond 2021, when the requirement for contributing banks to quote GBP Libor rates ceases. Furthermore, there are significant pools of underlying assets such as mortgages which reference Libor and extend way beyond the cut-off date. That said, there will be a significant decrease in these legacy issues in the next two years due to natural amortisation, clean-up calls and some Master Trust issuers making amendments in deals that will mitigate this.

Portfolio Commentary

The portfolio managers were busy in January in both primary and secondary markets. While the focus has been mainly in slightly shorter duration bonds, the Fund selectively added a little duration and risk to existing mezzanine CLO positions from preferred mangers, together with a new issue, all at attractive yields. These purchases were funded by the sale of some short dated Prime RMBS liquidity assets trading at a healthy premium, a legacy UK CMBS mezzanine position, and some shorter dated mezzanine CLOs trading at a premium, to leave the net exposure position neutral. Good levels of secondary market liquidity were seen in the market via strong execution on BWIC lists, as investors bid for paper and bank trading desks looked to replenish depleted trading inventory. Fundamental performance across all sectors remains robust and the portfolio managers will maintain appropriate levels of liquidity. The fund returned 1.97% (NAV per share) for the month with 3yr volatility at 2.24%.

Market Outlook and Strategy

The near term outlook looks broadly supportive for the European ABS market. There is an ongoing healthy pipeline of new transactions and re-financings, which will rebalance the technical and in all likelihood lead to a more tempered movement in spreads. From an issuer perspective, more optimal pricing will potentially be a driver for a pick-up in call notifications for pre-crisis legacy transactions, together with more recent deals which will become callable as the year progresses. The benefit here will be the ability to issue new transactions as STS compliant in certain cases, thereby reaching a wider investor base, together with a move away from Libor pricing to Sonia in the case of UK deals. There is also around £15bn in TFS funding due to be repaid in the latter part of 2020 by UK banks, so it is likely that we will see ongoing issuance if pricing looks competitive. In CLOs, the pipeline for the next few months is potentially healthy but while on one side the contraction in spreads in mezzanine bonds helps the arbitrage, the ongoing contraction in spreads in the loan market will make issuance challenging and potentially mean the pace is more measured.

The portfolio managers will continue to monitor the coronavirus situation, particularly how this potentially impacts the wider market. While February is limited with regards to key meetings at present, economic data releases will be important, especially after the World Bank cut its global growth forecast for the fourth time in a row. Q4 earnings releases will continue with European banks and big US tech due to report early on in the month.

Rolling Performance	31/01/2020 - 31/01/2019	31/01/2019 - 31/01/2018	31/01/2018- 31/01/2017	31/01/2017- 29/01/2016	29/01/2016- 30/01/2015
NAV per share inc. dividends	7.44%	0.52%	12.85%	7.90%	-1.95%

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 Management, industry experience since 1986.

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Aza Teeuwen
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Douglas Charleston
Partner, Portfolio Management, industry experience since 2006.

John Lawler
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Marko Feiertag
Portfolio Management, 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

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Further information on fund charges and costs are included on our website at 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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