TwentyFour ASSET MANAGEMENT

TwentyFour Income Fund

Monthly Commentary | 29 May 2020

Market Commentary

The strong technical support continued unabated in May, with credit spreads tightening across all sectors. In Europe the market was buoyed by the ECB, which announced a Targeted Long-Term Repo Operation (TLTRO-III) effectively guaranteeing three-year liquidity to the banks at between -0.5% and -1.0%, which was akin to a stealth rate cut. In addition the ECB announced a Pandemic Emergency Long-Term Repo (PELTRO) programme, offering 16-month loans at an interest rate 0.25% below its main refinancing rate, starting in May and consisting of seven staggered operations up to September 2021. Needless to say these liquidity backstops to the financial system had an immediate effect, with a short squeeze being felt across the euro market. The German Constitutional Court poured some cold water on the euphoria by ruling that the ECB's public sector purchase programme went beyond its legal authority (due to it not being proportionate to the capital key), which resulted in a slight pullback in Italian BTPs and domestic credits. However, this was quickly upstaged by the announcement that France and Germany agreed to support a EU Recovery Fund, jointly funded by EU debt and paid from future budget contributions; the first time there has been concrete talk of pseudo-joint and several bond issuance from the EU. Away from that there there was a deterioration in US-China relations, following the enactment of a Chinese national security law in Hong Kong, which heightened concerns of renewed sanction threats between the two economic heavyweights.

Positive sentiment continued in European ABS throughout May as the first publicly syndicated deal reopened the market. Long-standing issuer BMW priced a 1.6yr AAA German Auto ABS transaction at 3mE+40bp, which saw very strong demand from a broad range of investors resulting in the deal size being increased to€700m and a final order book oversubscribed by 1.7x. For context, Volkswagen priced its last comparable deal in late February at 3mE+16bp, so the BMW deal represented a very modest retrenchment in pricing for very high quality liquid bonds. This deal was quickly followed by a transaction from Mercedes Benz Bank, which priced at the same level and again saw strong demand from investors resulting in an oversubscribed order book. While it is normal to see higher quality liquid deals reopen the market after a period of volatility, we will likely see more price tiering between issuers in the near term as investors demand more conservative structural features such as higher coupons, step-ups and more restrictive covenants in favour of bondholders. As an example of this, we also saw the issue of an Irish RMBS deal backed by seasoned loans, some of which have negative historical performance, with its AAA bonds priced at 3mE+150bp when a comparable deal in 2018 was priced at 3mE+65bp.

The CLO market also saw a further four primary deals priced during the month from seasoned managers, and these are generally being pre-placed with small groups of investors. Common features among these new deals are that they are smaller in size and shorter maturity, with 6-12 month non-call periods and a shorter reinvestment period of 1-3 years compared to the more typical 4.5 years.

The secondary market also saw steady positive momentum throughout the month. UK Prime RMBS is virtually back to pre-virus levels at Sonia + low-60bp area, with very little supply available either via BWIC or bilaterally. UK non-conforming senior bonds tightened to finish the month around 130bp discount margin. Equally, mezzanine bonds in the RMBS sector saw similar performance as spreads contracted steadily and any bonds offered in the market saw competitive bidding from multiple investors and bank trading desks. Secondary CLOs, following broader credit tighter, performed well over the month, particularly in the mezzanine sector as underlying loan prices rallied. The rally was characterised initially by stronger profile managers and portfolios testing new highs each week but by month-end most profiles benefited from the overall rally as the supply of low cash bonds diminished. Relative value is still attractive as the loan market is lagging the latest move tighter in high yield and there is a calmer backdrop with rating downgrades slowing in May. AAA CLOs month-on-month were 10bp tighter, AAs and As 80-100bp tighter, BBB 5-10 points and BB and B 10-15 points.

Portfolio Commentary

The portfolio managers continued to be active in May, and in the absence of any suitable primary market issuance focus remained in the secondary market, which still offers good relative value. The Fund added several mezzanine sub-investment grade high conviction CLO positions from 'tier 1' preferred managers with strong underlying pool portfolio characteristics. These positions were bought at the beginning of the month and benefitted from the very strong performance seen in the CLO market throughout May, particularly in the mezzanine sector. These purchases were funded by the sale of short dated senior liquidity assets. The supply-demand technical remains very much in place and spreads continued to grind tighter steadily across all asset classes throughout the month in the face of diminishing supply. Liquidity provided by investment banks remained strong over the course of the month. The portfolio managers will continue to maintain appropriate levels of liquidity in the Fund. Fundamentals in ABS remain robust, with deals continuing to benefit from strong subordination levels and the team will continue to maintain high levels of due diligence on the underlying portfolio.

The Fund returned 7.52% (NAV Per share) for the month with monthly volatility since inception at 10.59%.

Market Outlook and Strategy

The welcome return of primary issuance during the month will have given the market a much needed gauge of investor appetite, and to a certain extent a pricing point for high quality liquid ABS. However, despite the breakthrough, the disruption still leads us to expect lower issuance volumes for the year, particularly because the bank lenders and issuers have alternative access to attractive central bank funding options such as the Bank of England's revamped Term Funding Scheme.

Spreads are expected to continue to grind tighter in the near future as the technical supply-demand imbalance remains in play, compounded by the low level of BWIC activity in the secondary market.

The market also saw rating agencies begin to take action in May by placing certain issuers on review for potential downgrade. These are limited to the mezzanine tranches of specific issues at the moment, and in their view reflects the increased likelihood of deteriorating performance due to the economic disruption caused by COVID-19. These mainly involve deals where there is higher exposure to interest-only mortgages or loan pools with a larger self-employed borrower component, for example, but it does mean that the portfolio managers will continue to be vigilant around adding incremental risk in mezzanine bonds with appetite for high conviction deals. Additionally, issuer platforms have started to report on the level of payment holiday requests they have received, and how many have been granted. This will vary by type of lender and is something we are actively monitoring to determine what the impact could be on our expectations for longer term arrears performance.

Rolling Performance	29/05/2020 - 31/05/2019	31/05/2019 - 31/05/2018	31/05/2018 - 31/05/2017	31/05/2017 - 31/05/2016	31/05/2016 - 29/05/2015
NAV per share inc. dividends	-7.87%	2.13%	8.88%	12.83%	-3.83%

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.

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

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

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

John Lawler
Portfolio Management, industry experience since 1987.

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

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