TwentyFour ASSET MANAGEMENT

TwentyFour Income Fund

Monthly Commentary | 28 August 2020

Market Commentary

There was a firm tone in risk markets throughout August as strong technical support remained, resulting in credit spreads grinding tighter. The S&P 500 reached a record high, the EuroStoxx 50 rallied 3.09% and the iTraxx Xover index tightened 53bp. Ten-year US Treasury bonds traded across a 22bp range, closing close to their recent wide of 0.71%.

Tensions between China and the US remained elevated as President Trump cancelled trade talks and claimed the Chinese were a "threat to peace" following a military exercise where the Red Army launched missiles into the South China Sea. Elsewhere the number of COVID-19 cases continued to increase, seemingly spurred on by holidaymakers, increasing the re-introduction of travel restrictions and localised lockdowns. However, markets largely shrugged off both issues as technical strength dominated investor sentiment, driven by continued central bank and government stimulus. In the US, Congress broke for its August recess without any agreement on a new stimulus package, although Speaker of the House, Nancy Pelosi, did comment that the Democrats may be willing to reduce the size of their proposal; this still leaves a $1tr difference between the two parties. President Trump did however sign four executive orders, including authorising the continuation of the unemployment benefit package. In the presidential race Joe Biden continued to enjoy a lead in the polls and selected Californian Senator Kamala Harris as his running mate.

In monetary policy, minutes from the Fed's July meeting showed officials remained cautious on the economic recovery with limited appetite for yield curve control. More importantly, Fed chair Jerome Powell gave a much-anticipated speech on the first day of the 'virtual' Jackson Hole symposium (which allowed public viewing for the first time in its history). The market had expected details on the strategic review and were not disappointed as Powell announced that going forward the central bank would seek an "average" inflation target of 2% (i.e. allowing the economy to run hot in order to make up for periods of economic softness). While this was not a surprise to the market, it was coupled with a larger-than-expected US CPI print earlier in the month, which led the long end of the US Treasury curve to sell off and curves to steepen. The long end had already been under pressure earlier in August after disappointing demand at the latest 30-year auction, where the yield was 0.02% higher than expected and the bid-to-cover ratio was the lowest since July 2019, at 2.14x. Closer to home, the Bank of England's meeting yielded no changes to policy but in the subsequent press conference Governor Bailey struck a slightly hawkish tone and announced upwardly revised growth forecasts, albeit still negative at -9.5%. He also said that negative rates were not something the committee was currently considering. Meanwhile, the UK and European Union resumed Brexit talks but seemingly remain no closer to a deal as the EU's chief negotiator, Michel Barnier, reported that discussions were "going backwards."

The European ABS market was typically very quiet in August, with very little publicly distributed primary issuance, though we did see a small Auto deal from Greece, an inaugural French Consumer deal and a UK Non-conforming deal from multiple originators all placed, while a sizeable French RMBS deal and a smaller Italian RMBS transaction were retained. Similarly in CLOs just two deals were placed; one a debut short-dated static portfolio with a one year non-call period, and the other from an established multi-deal manager. Appetite was strong on both and led to the size of the deal from the seasoned manager being increased, and the static nature of the debut issue aided tight prints on the investment grade classes.

Secondary markets were equally slow and steady for the time of year with a corresponding drop in BWIC auctions. Where bonds were offered, the market saw decent amounts of liquidity offered by trading desks together with good participation from investors who continue to be in risk-on mode. This was particularly the case for Prime UK STS RMBS deals, where bids are now comfortably inside pre-COVID levels. This in turn led spreads in BTL and Non-Conforming deals to continue to grind tighter across the capital stack over the course of the month. Legacy 1.0 deals from names such as Paragon attracted demand too, with some very strong trading levels seen towards the end of the month as there has been a pick-up in interest in this sector. Being generally longer dated, they have very seasoned pools, offer interesting convexity and have the added attraction of uncertain call dates in an environment where there has been a notable increase in the level of issuer calls where often assets are trading at lower cash prices.

Portfolio Commentary

In the absence of any meaningful primary issuance compared to July, the market was able to consolidate the recent issuance volumes and the focus for the portfolio managers was in the secondary market. The Fund added positions in a mixture of senior and mezzanine UK RMBS, together with a CLO position from a preferred manager, bringing the weighting into line with asset allocation targets. Some short dated positions were also rotated into longer dated bonds together with a couple of legacy 1.0 issuers, adding some convexity and a little credit duration to the Fund with the portfolio managers optimising yield as opportunities presented themselves. Purchases were also funded using redemptions from called bonds during the month, or rotated out of short dated bonds. Despite generally lower trading volumes, liquidity offered by trading desks remained good and the portfolio managers will maintain appropriate levels of liquidity and balanced positioning across rating and sector in the Fund. Fundamentals in the ABS market remain robust, with investment grade ABS continuing to benefit from strong subordination levels and the team will continue to maintain high levels of due diligence on the underlying portfolio as the effects of COVID-19 become visible. The fund returned 1.06% (NAV Per Share) for the month with 3yr monthly volatility 11.17%.

Market Outlook and Strategy

The primary ABS pipeline was building quite quickly into the end of August, with several issuers likely to announce deals in the early September from sectors such as Spanish consumer ABS, Dutch and UK RMBS. Several full cap stack Auto deals are also rumoured to be likely to surface, together with a build-up of potential regulatory capital deals from European banks. There is also a steady pipeline of CLOs building as we see syndicate desks at investment banks start to refine their full year issuance volumes higher again. CLO performance has improved over the last month or so as we have observed deal metrics, such as market valuations for underlying loan pricing, improve recently. All this is positive for the sector, which is enjoying a strong supply demand technical at the moment and should be well received. However, once this initial wave of issuance has worked its way through the market there is a possibility that issuance levels will start to tail off in certain sectors of the market. Prime UK RMBS is unlikely to see an increase in issuance despite bonds trading at a compelling spread vs. Sonia in the mid-30s, for highly liquid assets, and this is due to the ongoing funding support programmes offered by government schemes, such as the Bank of England's TFSME. As well as mortgages, this scheme also extends to a variety of consumer assets and SME loans and so far around £20bn has been drawn down. Furthermore, issuance from non-bank lenders, who have been the main issuers since the market reopened, will also likely diminish somewhat into year-end given mortgage origination will have dropped significantly, or in some cases ceased entirely, during the lockdown and it will take some time to build up volumes again. Given this backdrop we expect the strong supply/demand technical to continue for the near future and to be supportive of ongoing spread performance barring periods of wider macro volatility.

Rolling Performance	28/08/2020 - 30/08/2019	30/08/2019 - 31/08/2018	31/08/2018 - 31/08/2017	31/08/2017 - 31/08/2016	31/08/2016 - 31/08/2015
NAV per share inc. dividends	0.21%	2.73%	6.37%	13.02%	-0.10%

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
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Douglas Charleston
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John Lawler
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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