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ASSET MANAGEMENT

# TwentyFour Select Monthly Income Fund

## Update

December 2020

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# Where are we today in rates?

- **Fed funds rate were slashed to 0 to 0.25% on 15 March 2020**
- The last time this happened was December 2008
- They stayed there for 7 years before the first hike in December 2015
- By December 2018 cash briefly became an asset class as Fed funds rate hit 2.5%
- 10yr UST's started 2020 yielding 1.91% and by 9 March they hit 0.54%

- **Base rates were axed from 5% in September 2008 to just 0.5% by March 2009**
- They were not hiked again until the end of 2017 and only managed to hit 0.75% at the cycle peak thanks to Brexit uncertainty
- Two cuts followed in March 2020 taking rates to their lowest ever at 0.1%
- 10 year gilts started 2020 at 80bp collapsing to 16bp on 9 March

- **ECB's deposit rate slashed to 0.25% in September 2009**
- Apart from a brief hike under Trichet's Presidency in 2011, which was widely considered a mistake, the deposit rate only has gone lower since, going negative in March 2014 and to Minus 50 in September 2019
- 10 year bunds went negative for the first time in March 2019
- They started 2020 at a lofty negative 22bp before collapsing to negative 86bp on 9 March 2020


Source: Bloomberg, ICE Indices
4 December 2020

# Where are we today in credit?

- Credit spreads hit their lows in October 2018, when US HY was 326bp over risk free
- Took almost 10 years to reach this point from the time rates were slashed in December 2008
- YTD lows were in January 2020 at 351bp before ballooning out to 1,082bp on 23 March 2020
- **By the beginning of December 2020, spreads were still at 407bps**

- £ credit spreads missed out on the late cycle rally largely due to Brexit uncertainty, so the cycle lows were much earlier in June 2014 when HY spreads were at 298bp
- Brexit pushed them out to 600bp in July 2016
- YTD lows were 430bp in January 2020, before hitting a new cycle peak of 1032bp on 23 March 2020
- **By the beginning of December 2020, spreads were 456bp**

- European HY spreads hit their cycle lows in October 2017 at just 235bp over risk free
- YTD lows were in January 2020 at 307bp before hitting new cycle highs of 865bp again on 23 March 2020
- **By the beginning of December 2020, spreads were at 354bp**



Source: Bloomberg, ICE Indices

4 December 2020

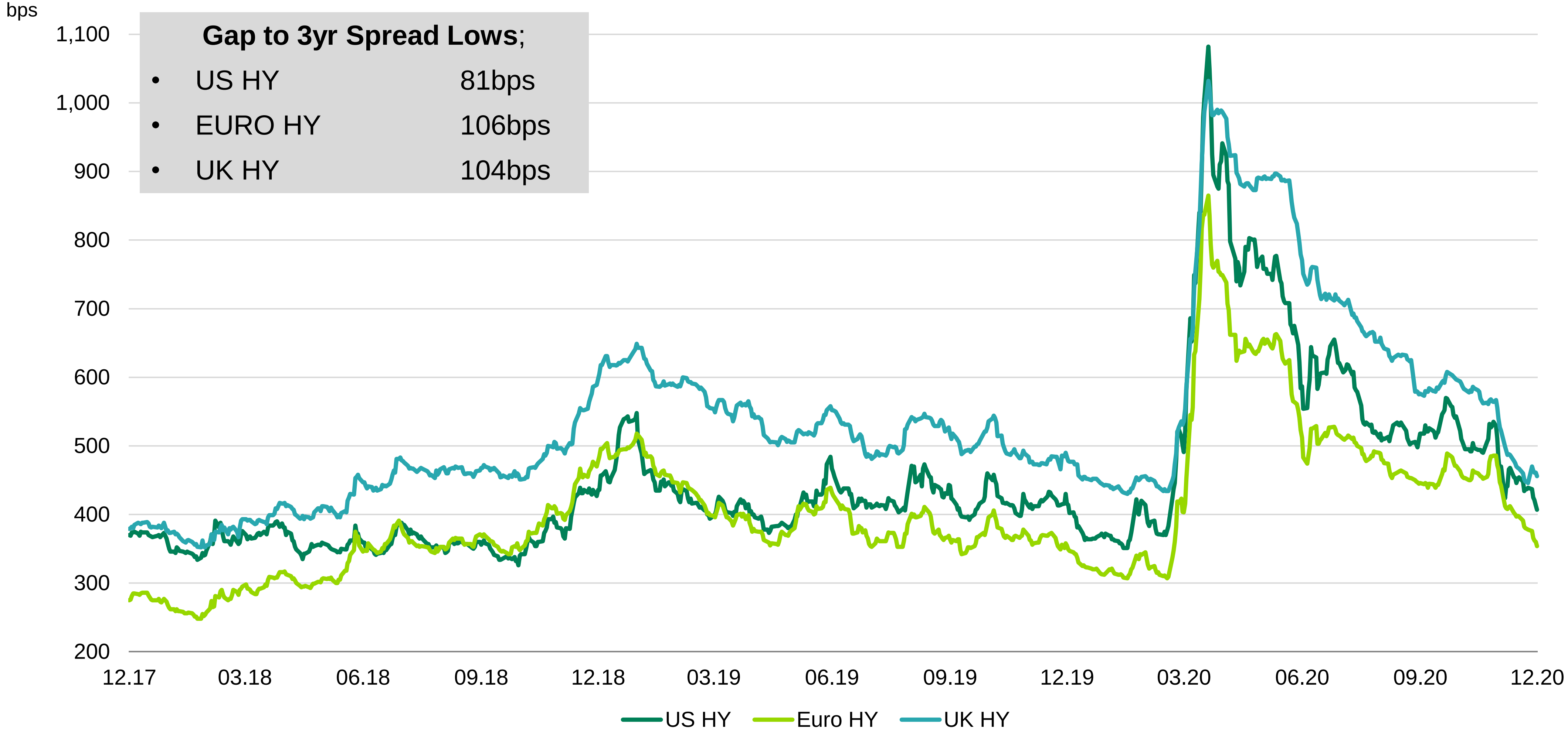
# Drivers likely to impact spreads in 2021

- **Global central banks** are expected to **keep rates at, or lower than, current levels** as countries recover from the global pandemic
  - > ECB likely to increase and extend its PEPP, while BoE flirting with Negative Rates (with a TLTRO programme also a possibility)
- **Government bond yields expected to remain anchored** near record lows, with investors relatively sanguine to higher inflation risks
- **Governments likely to keep their support schemes in place**, particularly given the supportive vaccine developments, which means an end is in sight for the widespread lockdowns
- **Default rates**, which were expected to reach into the low teens in early 2020, are now **expected to be much lower**, with Euro HY default rates now expected to peak at approx. 4%
- The speed with which viable **vaccines** have been developed, and already administered in the UK, supports the **continuation, and acceleration, of the economic recovery**
- **Strong technical factors remain in place**; rotation out of government bonds into credit, strong flows continuing into mutual funds and net issuance of credit likely to fall in 2021

**Credit spreads are expected to continue to grind tighter and some sectors may reach new lows as early at 2021**

# HY spreads

## Spread to worst vs. government bonds




**Past performance is not a reliable indicator of future performance.** It is not possible to invest directly into an index and they will not be actively managed.
Source: Bloomberg, ICE Indices
4 December 2020

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# CoCo bond spreads

## Spread to worst vs. government bonds

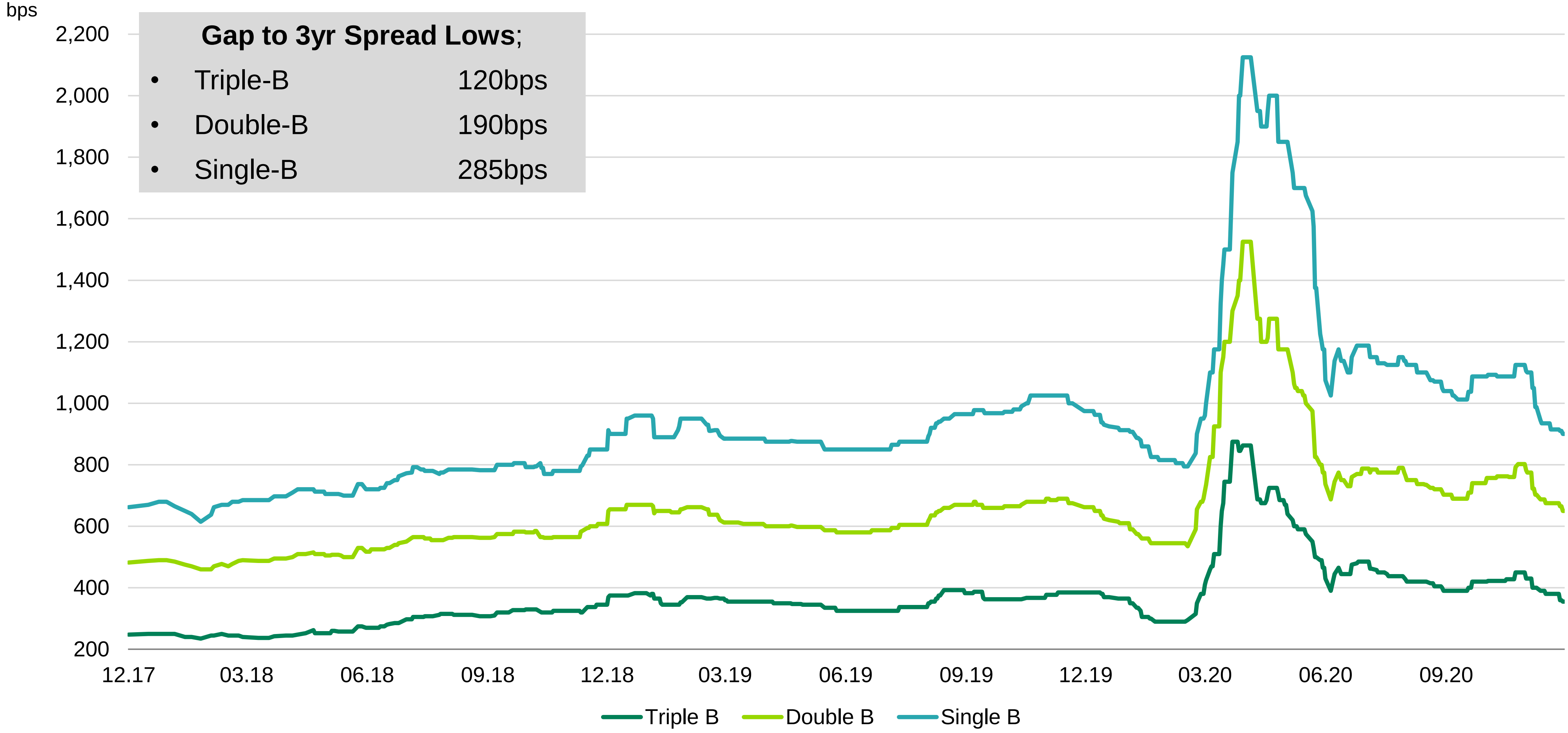

**Past performance is not a reliable indicator of future performance.** It is not possible to invest directly into an index and they will not be actively managed.

Source: Bloomberg, ICE Indices

4 December 2020

# Euro CLO spreads

## Spread to benchmark

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Source: Bloomberg, ICE Indices

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# Outlook for defaults

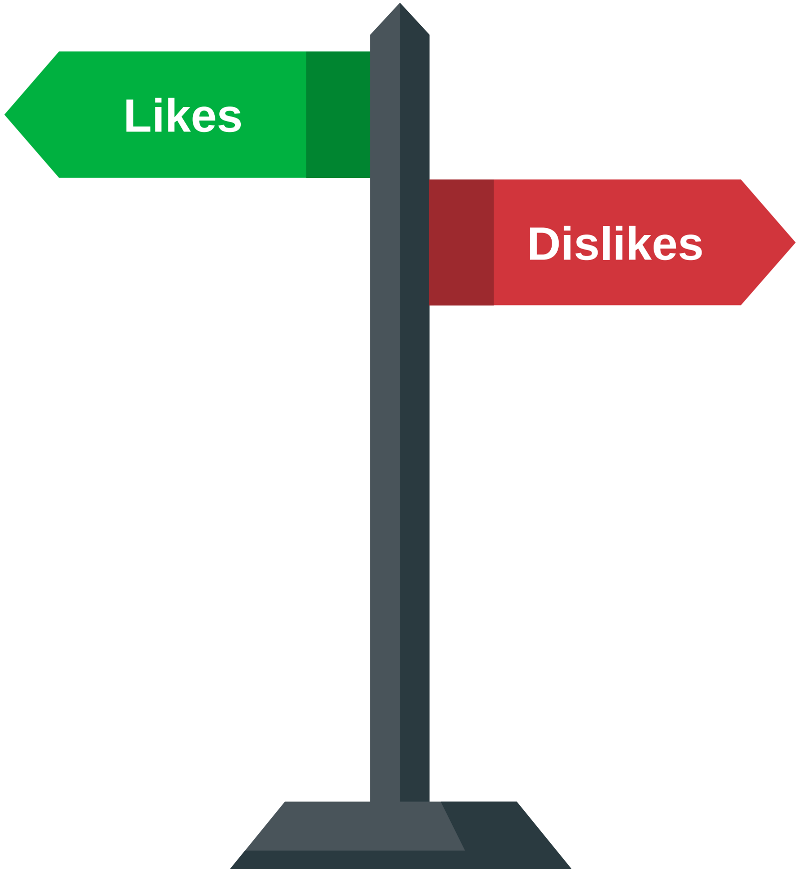
- In our opinion, **policy makers' intervention** undoubtedly avoided an uncontrollable default cycle
- Furthermore the **measures undertaken** have helped serve to supress expected defaults to a level expected during a much shallower recession
- As is always the case historically, almost all **defaults are expected to come from CCC** rated entities
- **Sectors to watch out for** in particular: metals, mining, commodities, transport, leisure, gaming, retail, automotive
- **US far more exposed** than Europe to these sectors
- **Defaults likely to peak** at c4%, in mid 2021 – much lower than initially expected
- **Negative ratings migration** is improving
- Bonds trading at **distressed levels (above 1,000bp) only 3% of the market**, half the number at the start of 2020

# Current likes and dislikes

- Credit spreads generally attractive
- Longer duration in credit where possible: BB sweet-spot
- Brexit premium
- New issue premium
- Cautious approach to pro cyclicality

**Sectors:**

- Insurance
- Banking
- Selective HY corps
- European CLO (mezz)




- CCC & single-B unsec
- Industries undergoing structural changes
- Sin industries

**Sectors**

- Energy, metals, mining, commodities
- Automotive
- Retail
- Commercial property
- Gaming

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# TwentyFour Select Monthly Income Fund Summary

| | COCO $ Index | BAML € High Yield Index | BAML £ High Yield Index | TwentyFour Select Monthly Income Fund |
|---|---|---|---|---|
| **Size** | $273.24 | €425.24bn | £38.38bn | £200.77mn |
| **Spread duration** | 5.72yrs | 3.88yrs | 3.86yrs | 3.94yrs |
| **Mark to market yield*** | 3.60%(£) | 3.54%(£) | 4.73% | 6.61% |
| **Average rating** | BB+ | BB- | BB- | BB- |
| **Diversified portfolio (no. of bonds)** | 233 | 698 | 101 | 112 |

**Past performance is not a reliable indicator of future performance.** *Mark to Market Yield is calculated to the bond's expected maturity. It is the discount rate that makes the current bond price equal to the present value of all cash flows due. Yield shown for the TwentyFour Select Monthly Income Fund is at hedged portfolio level and gross of fund expenses. See Important Information slides for TwentyFour's average credit rating methodology. Performance data does not take into account any commissions and costs charged when shares of the fund are purchased and disposed of. It is not possible to invest directly into an index and they will not be actively managed. The value of an investment and the income from it can fall as well as rise as a result of market and currency fluctuations and you may not get back the amount originally invested. Source: TwentyFour, ICE Indices; 4 December 2020

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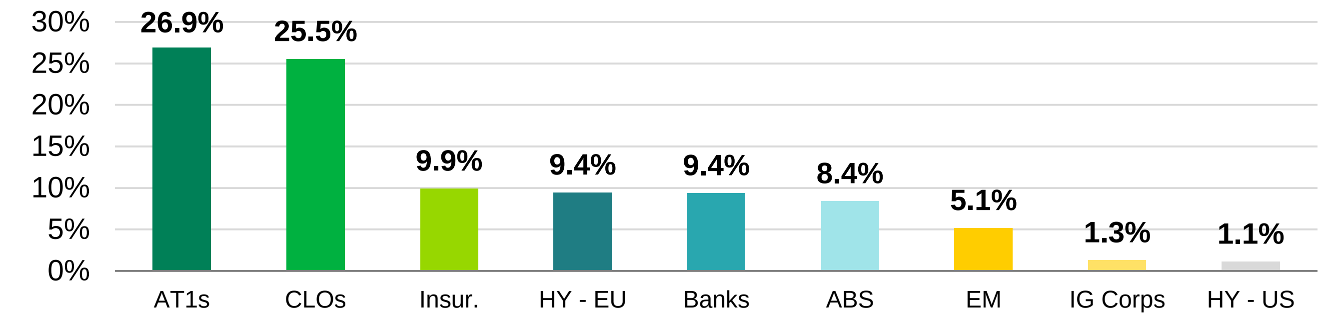
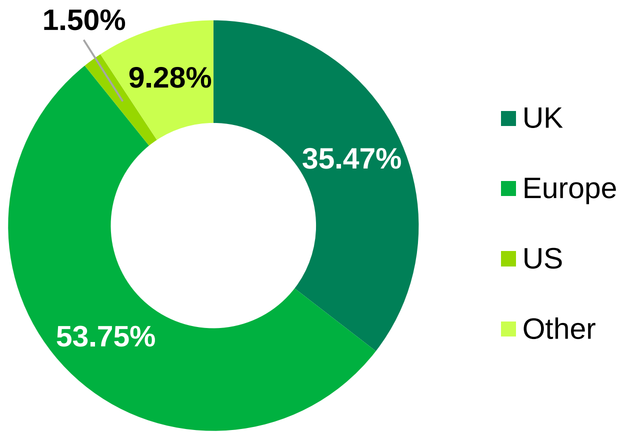
# TwentyFour Select Monthly Income Fund portfolio positioning

## Sector breakdown

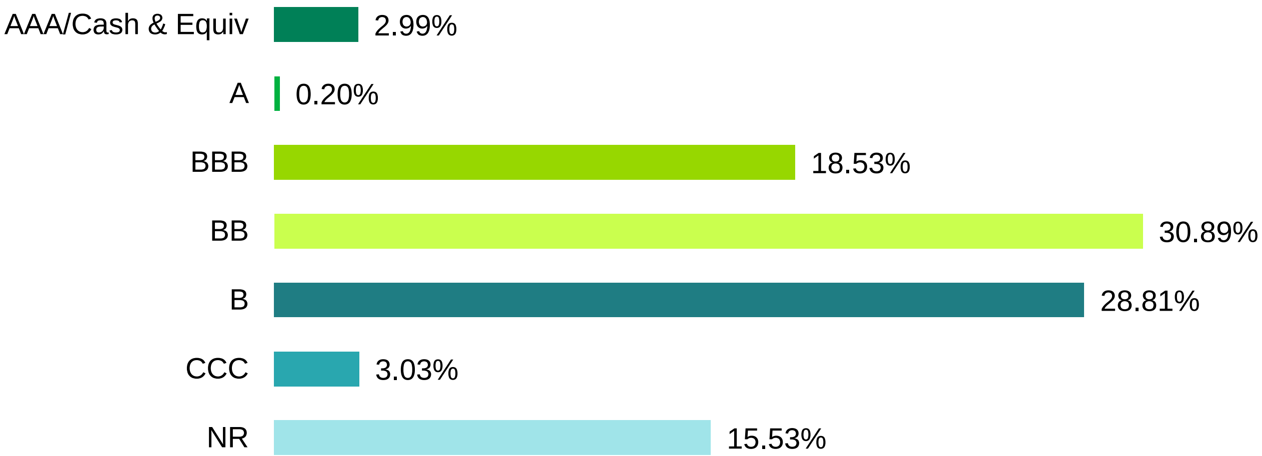



| | AT1s | CLOs | Insur. | HY - EU | Banks | ABS | EM | IG Corps | HY - US |
|---|---|---|---|---|---|---|---|---|---|
| Yield, £ (%) | 5.71 | 9.26 | 5.02 | 6.93 | 5.70 | 7.87 | 6.00 | 4.37 | 6.07 |
| Duration (yrs)* | 2.86 | 4.01 | 5.75 | 2.24 | 9.39 | 3.04 | 3.81 | 3.66 | 2.76 |

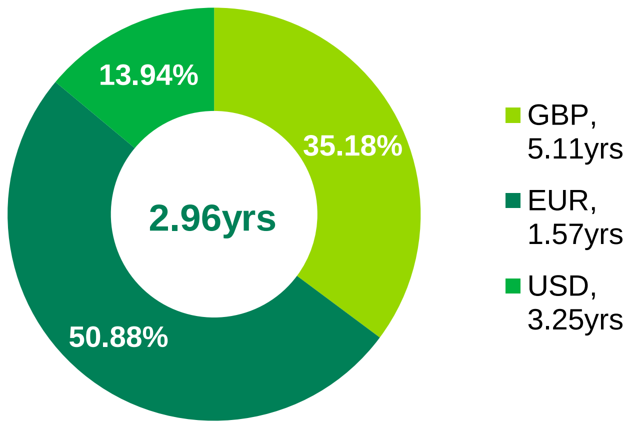
## Geographic breakdown




## Rating breakdown




## Interest rate duration by yield curve




*Duration is Credit Spread for all sectors excluding Government Rates which is Interest Rate Duration. Geography for ABS calculated on a direct exposure basis. See Important Information slides for credit rating methodology.

Source: TwentyFour

30 November 2020

# Why we still see relative value in AT1s

- Still room to tighten by over 100bps just to reach recent lows
- Compares favourably to BB rated corporates that are now printing below 3%
- Banks have proved their ability to weather a very aggressive downturn, whilst continuing to grow their capital ratios
- 2020 dividend payments deferred – adds 40bps+ to CET1 ratio
- Highly regulated with an average rating of BB-
- Pillar 3 disclosures help considerably in due diligence & relative value analysis

**In our opinion investors are being adequately compensated for the underlying risk in a world where yield is becoming an ever more scarce commodity**



Source: (1) Bloomberg / (2) BoE FSB Report

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# Key reasons we believe in European ABS

ABS typically **finances the better quality bank assets** such as residential mortgages. Low exposure to some of the sectors most in danger of structural decline post COVID

European issuers have quickly adapted to the needs of investors for **higher quality ESG reporting** and transparency

**Strong performance history** through previous periods of material economic stress, **transparent reporting** of loan, **deal and asset class performance**

**Loan origination quality and structural strength** both materially higher over the past decade

**Yield pick-up** from investing in floating rate bonds in comparison to fixed rate bonds and **low mainstream yields**

Lack of recent central bank support has **stopped spreads from tightening** as aggressively as **US ABS** and other fixed income sectors, therefore there are still attractive opportunities

**New issuance expected to dry up** materially on a forward looking basis due to lower loan origination, lower bank funding requirements and higher cost of deal launch. Reduced supply is a good technical for ABS

## High quality credit – High quality income*

**Past performance is not a reliable indicator of future performance.** These views represent the opinions of TwentyFour as at 30 November 2020, they may change and may have already been acted upon, and do not constitute investment advice or a personal recommendation. Observations are based on TwentyFour's trading experience and market observations which may not be reflective of those experienced by others. *Views and expectations on liquidity and quality are also based on normal market conditions, they may change in abnormal conditions.

# TwentyFour Select Monthly Income Fund Performance

| Cumulative performance | 1 month | 3 months | 6 months | 1 year | 3 years | 5 years |
|---|---|---|---|---|---|---|
| NAV per share inc. dividends | 4.90% | 6.54% | 16.28% | 5.76% | 15.10% | 39.80% |

| Discrete performance | YTD | 2019 | 2018 | 2017 | 2016 | 2015 | Since Inception* |
|---|---|---|---|---|---|---|---|
| NAV per share inc. dividends | 3.94% | 11.94% | -1.41% | 14.56% | 8.20% | 2.81% | 46.14% |

| Rolling performance | 11.19-11.20 | 11.18-11.19 | 11.17-11.18 | 11.16-11.17 | 11.15-11.16 |
|---|---|---|---|---|---|
| NAV per share inc. dividends | 5.76% | 9.48% | -0.59% | 16.48% | 4.27% |

**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 fund are purchased and disposed of The value of an investment and the income from it can fall as well as rise as a result of market and currency fluctuations and you may not get back the amount originally invested. *Inception date: 12 March 2014
Source: TwentyFour
30 November 2020

# TwentyFour Select Monthly Income Fund Performance Contribution

| Sector | 2020 YTD | Average Holding | 2019 | Average Holding |
|---|---|---|---|---|
| ABS – CLOs | 0.48% | 24.78% | 1.83% | 24.93% |
| ABS – Non CLOs | 0.21% | 8.45% | 0.13% | 5.92% |
| Banks – AT1s | 1.85% | 27.12% | 4.05% | 25.82% |
| Banks – Non AT1s | 0.52% | 10.98% | 1.45% | 10.46% |
| Insurance | 1.34% | 12.48% | 2.32% | 12.48% |
| High Yield – EU | 0.19% | 7.14% | 0.95% | 10.18% |
| High Yield – US | 0.12% | 0.68% | 0.02% | 1.55% |
| IG Corps | 0.08% | 0.87% | 0.11% | 0.59% |
| Emerging Markets | 1.29% | 4.74% | 0.66% | 4.68% |
| Cash & equivalent | | 2.77% | | |
| **Total net return** | **3.94%** | | **11.94%** | |

**Past performance is not a reliable indicator of future performance.** Contribution per sector: each individual sector's contribution to the overall performance in the TwentyFour Select Monthly Income Fund. The net return contribution per sector is calculated by adjusting the realised gross contribution per sector by portfolio fees apportioned on the basis of average sector portfolio weighting. Performance data does not take into account any commissions and costs charged when shares of the fund are purchased and disposed of. The value of an investment and the income from it can fall as well as rise as a result of market and currency fluctuations and you may not get back the amount originally invested.

Source: TwentyFour; 30 November 2020

# TwentyFour Select Monthly Income Fund

## 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.
- Fixed income carries two main risks, interest rate risk and credit risk: (1) Where long term interest rates rise, there is a corresponding decline in the market value of bonds and vice versa; (2) Credit risk refers to the possibility that the issuer of the bond will not be able to repay the principal and make interest payments.
- 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.
- Investing in emerging markets may be affected by political developments, currency fluctuations, illiquidity and volatility.
- The fund can invest 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 purposes only (EPM). This may magnify gains or losses.

The listed risks concern the current investment strategy of the fund and not necessarily the current portfolio. Please see offering documents for the full list of risks.

# Appendix

# Introduction: TwentyFour Select Monthly Income Fund (SMIF)

- Closed-ended investment company, Guernsey domiciled, London-listed
- Income-focused bond fund
- Focus is on less liquid securities that can offer potential for a significant yield pick up
- Dividend of 0.5p per month, plus any excess income paid at year end*
- 6.53p paid in full-year 2015, 6.85p paid in full-year 2016, 6.56p paid in full-year 2017, 6.55p paid in full-year 2018, 6.32p paid in full-year 2019, 6.14p paid in full-year 2020
- Managed with interest rate duration as a key consideration
- All securities hedged back to sterling

*This is a target only and does not represent a forecast of SMIF's profits.

**Past performance is not a reliable indicator of future performance.** The value of an investment and the income from it can fall as well as rise as a result of market and currency fluctuations and you may not get back the amount originally invested.

Source: TwentyFour

December 2019

# TwentyFour Select Monthly Income Fund Overview

| | |
|---|---|
| **Goal** | Aims to generate **attractive risk-adjusted returns**, principally through income distributions and targets a dividend of at least 6% per annum* |
| **Concept** | **Closed-ended investment company focused on income and less liquid securities** |
| **How** | Management of **interest rate duration** is a key consideration |
| | Invests in a diversified portfolio of **fixed income credit products** |
| | **Seeks to enhance liquidity** through availability of the **placing programme and quarterly buyback facility** |
| | **Focuses on less liquid securities** that can offer a potentially significant yield pick up |
| | Quarterly exit mechanism for shareholders |
| **Consequence** | **A closed-ended vehicle designed to take advantage of the liquidity premium** |

A liquid market is considered to be one that has plenty of buyers and sellers, and transactions do not have a significant effect on the asset price. Less liquid securities are typically less frequently traded and/or have wider spreads than more frequently traded securities which can result in a premium from the perception these are riskier than conventionally more liquid securities. Past performance is not an indication of future performance. The value of an investment and the income from it can fall as well as rise as a result of market and currency fluctuations and you may not get back the amount originally invested. *This is a target only and does not represent a forecast of SMIF's profits.

# Rationale behind SMIF

- There are bonds in the market that we believe offer compelling long-term investment opportunities, but which are not typically liquid enough or scalable to be suitable for daily liquidity funds

- As a relatively small closed-ended vehicle, SMIF is designed to take advantage of this liquidity premium

- The bonds in SMIF are historically less suitable to be actively traded. The principle behind SMIF is to carry out extensive due diligence at the point of investment and then let bonds generate their returns through timely interest payments and the natural pull to par at redemption

# Portfolio managers

**Mark Holman**

**Partner, Portfolio Manager, CEO**

Mark is one of the founding partners of TwentyFour, and serves as the firm's Chief Executive Officer.

He sits on the firm's Executive Committee, which has the overall responsibility for the day to day running of the firm, as well as the Board of Directors which sets the overall strategy and direction of the business.

Day to day, Mark is also a key member of the firm's Multi-Sector Bond team which manages portfolios including the TwentyFour Select Monthly Income Fund. He is a member of the firm's Investment Committee.

Mark has 30 years of experience in fixed income markets gained across a variety of senior roles in asset management and investment banking, including positions at Barclays Capital, Lehman Brothers and Morgan Stanley.

**Eoin Walsh**

**Partner, Portfolio Manager**

Eoin is one of the founding partners of TwentyFour, and a Portfolio Manager.

Eoin's main responsibility is managing the firm's Multi-Sector Bond team which manages portfolios including the TwentyFour Select Monthly Income Fund. He also sits on the firm's Investment Committee.

Eoin has over 21 years of experience in fixed income markets and prior to joining TwentyFour was a portfolio manager at Citigroup Alternative Investments, managing over $75bn of fixed income assets.

**Gary Kirk**

**Partner, Portfolio Manager**

Gary is one of the founding partners of TwentyFour, and a Portfolio Manager.

He sits on the firm's Investment Committee, which sets the overall risk bias for the portfolios managed by the firm. Gary's main responsibility is managing the firm's Multi-Sector Bond team which manages portfolios including the TwentyFour Select Monthly Income Fund.

Gary has over 31 years of experience in fixed income markets gained across a variety of senior roles in asset management and investment banking, including leadership positions at Daiwa Capital, Royal Bank of Canada, CDC and Wachovia Bank.

**Felipe Villarroel**

**Partner, Portfolio Manager**

Felipe joined TwentyFour in 2011 and is a partner and Portfolio Manager in the Multi-Sector Bond team which manages portfolios including the TwentyFour Select Monthly Income Fund. He is also a member of the Investment Committee.

Prior to joining TwentyFour, Felipe worked as an Asset Allocation and Strategy Analyst at Celfin Capital in Chile, now part of the BTG Pactual Group. There, Felipe took an active role in developing the team's strategic view of the global macro economy and asset classes.

Felipe graduated from Pontificia Universidad Catolica de Chile with a Bachelor's degree in Economics and Business Administration before obtaining a Master's in Finance from London Business School. Felipe is also a CFA charterholder.

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