



Monthly Commentary | 29 January 2021

Market Commentary

It was an eventful start to 2021 with riots in response to a change of president in the US, political uncertainty in Italy and the emergence of new COVID-19 variants resulting in a number of additional lockdown restrictions across many countries. It was no surprise therefore that broader risk markets took a pause from the strong rally experienced in the latter half of 2020 to take stock, despite the vaccine rollout giving hope that the peak in the pandemic would soon be behind us.

European ABS primary markets started 2021 at a steady pace which was expected by most market participants with overall placed issuance in January at just under €3bn across ABS and CLOs. Two deals from the UK BTL RMBS sector were the first to be priced, both of which saw strong demand across the capital stack; AAA tranches saw oversubscription levels of more than three times and the mezzanine tranches were multiple times that. These deals priced significantly tighter across the capital stack compared to deals printed towards the end of 2020, which continues to reflect the ongoing strong technical currently prevailing in the market. Further RMBS deals were seen from Ireland, one being a legacy mortgage portfolio comprising some restructured loans together with a newly originated deal yet to price by month-end. The former was priced at levels to reflect the quality of the collateral and saw healthy levels of interest, with the senior AAA bonds attracting a two-times oversubscription.

Elsewhere in Europe public issuance was fairly muted with one Spanish Consumer deal from a mainstream Spanish bank announced at month-end. There were also deals from a Dutch RMBS originator, a French bank consumer deal and a UK credit card issuer, but the originators chose to retain these transactions. However, with just under €2bn of placed RMBS and ABS issuance during the month the overall supply was one of the slowest starts for several years. The primary CLO market eventually got off the ground and saw three new deals priced towards the end of the month as well as a further five refinancings, all of which saw high levels of demand, and in similar fashion to the RMBS market priced at strong levels. By month-end the weighted average cost of debt was around 175bp, with the stronger structures around 150bp and the weaker around 200bp, a level not seen since the latter part of 2018.

With primary supply slow to get underway, secondary markets began the year with very positive momentum and continued to be resilient across all sectors in both ABS and CLOs, despite a wider market sell-off at the end of the month. While dealer inventory was relatively light into the new year secondary market activity was brisk, as observed by the volume of BWICs over the month. With sentiment being very much risk-on, this secondary supply was absorbed very easily by investors and dealers, with one of the driving factors being rotation out of shorter dated bonds into primary as it materialised. In the UK, the non-conforming (NC) and buy-to-let (BTL) sectors outperformed with senior bonds up to 20bp tighter, now in the S+60-80bp area, and mezzanine bonds rallying between 30bp and 50bp. Similarly in Europe, Dutch BTL seniors and mezzanine saw strong performance of 20-25bp. Prime RMBS issues already trading at tight levels treaded water over the month with very few bonds changing hands as they continue to be tightly held.

In the CLO market participants also started the year constructive on spreads. Having broadly lagged wider credit markets in H2 2020 and being highlighted in various market outlooks as offering compelling relative value, it was not surprising to see spreads continue to move tighter across the capital stack, in particular for AAA and sub-investment grade notes. Despite this, secondary spreads in sub-IG started to look more attractive in secondary vs.

primary towards the end of the month, as the latter continued to price at ever tightening levels and secondary retraced some of the gains on slightly weaker macro markets, an enhanced level of supply and diminishing convexity as this sector pulled to par. Given the rally in CLO spreads over the last few weeks, and strong demand for AAA bonds driving spreads tighter, the market has seen several managers issue re-pricing notices for slightly shorter-dated maturities, and while the AAA curve remains relatively steep, this a trend that is likely to continue as managers seek to lower their cost of funding.

Portfolio Commentary

The new issue supply enabled the portfolio managers to add several new positions. The Fund invested in the lower mezzanine tranche of a new UK BTL deal at an attractive yield for a relatively short maturity. In the secondary market the managers were able to source some rare mezzanine and sub-investment grade UK non-conforming bonds from an auction, adding to an existing holding at an attractive yield. Further additions were made in BB rated UK BTL and NC RMBS together with CLOs in BB and B rated tranches from preferred managers. Purchases were funded from more senior rated shorter maturity holdings as the portfolio managers added some duration and beta to the Fund. Secondary market liquidity remained robust through the month. 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.

The fund returned 1.31% for the month with 3yr annualised monthly volatility at 11.36%.

Market Outlook and Strategy

The ABS market started the year strongly as spreads tightened from the outset in all sectors, with the market continuing to redress some of the lag to other credit markets following the pause in December. The supply-demand technical, as evidenced by the very high levels of oversubscription for primary deals so far and the demand for secondary bonds, remains very much in play and that will be supportive for spreads in the near term.

The new issue pipeline is expected to be steady over the course of the next few weeks with RMBS and CLOs likely to account for the majority. In the case of UK RMBS it is most likely to be ongoing non-bank financial issuers who will be the most active, from a mixture of refinancings coming due in 2021 and recently originated collateral. As we have said before, the older Term Funding Scheme (TFS) and the more recent TFSME facility make it less likely that bank issuers will be coming to the market in the near future, but it is worth pointing out that due to recent spread compression in this sector, the funding cost differential between UK Prime RMBS and TFSME borrowing has narrowed to around 20bp. Furthermore, the way the aggregate allowances under the scheme are calculated could mean some institutions are pushed towards funding in capital markets, which might lead to some welcome issuance in the STS Prime RMBS sector.

Rolling Performance	31/01/2020 - 29/01/2021	31/01/2019 - 31/01/2020	31/01/2018 - 31/01/2019	31/01/2017 - 31/01/2018	29/01/2016 - 31/01/2017
NAV per share inc. dividends	5.28%	7.44%	.52%	12.85%	7.90%

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.

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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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