TwentyFour ASSET MANAGEMENT

TwentyFour Income Fund

Monthly Commentary | 29 October 2021

Market Commentary

October was a challenging month for credit, as volatility in rates weakened investor sentiment. Central bank rhetoric and the subsequent move in rate yields were the key focus, with the BoE and the gilts market stealing the limelight as the market moved forward its expectations of a rate hike by the end of this year. The new BoE chief economist stated that inflation could rise close to, or above, 5% in early 2022, considerably higher than the central bank's 2% target and implied that the November committee meeting was "live" regarding a move in monetary policy. This followed comments from Governor Bailey that he expected inflation to last for longer, and the bank would have to act accordingly. In response, the market is now pricing in a rate hike at the BoE's next meeting on November 4th, followed by another hike at their December meeting. As a result, the five-year gilt yield widened by nearly 20bp over the month, finishing at 0.83%.

Inflation remained the key focus for fixed income participants as evidence of it durability mounts. Rising energy prices, supply chain disruptions, shortage of labour, infrastructure and transport problems and record lead times on raw materials are all exacerbating high inflation prints from the summer, along with a steady increase in average hourly earnings. In addition, US CPI beat expectations, coming in at +5.4% YoY and +0.4% MoM, which added weight to the discussion that the Fed would have to hike rates earlier than expected.

October tends to be a busy month for ABS primary markets and this one was no exception. Around €15bn of issuance during the month including €5bn of new CLO issuance brought the overall YTD supply to around €90bn including €31bn in CLOs , which is a record in itself for the 2.0 post GFC era, surpassing the €29.8bn issued for the full year in 2019. In the UK RMBS market one of the highlights was the refinancing of the mezzanine notes from a large UK legacy deal, as these tranches hit their first early call option date and which the sponsor duly exercised. The AAA notes will remain outstanding in line with expectations but it was encouraging that these mezzanine notes were publicly distributed as opposed to being privately placed, which has been an unhelpful trend in some larger, pre-sounded, transactions of late.

Consumer ABS deals once again saw elevated issuance over the month from a diversified group of sponsors across Europe. The highlight was a €1.5bn repeat issue, highly granular German consumer loan deal from a large mainstream European bank offering bonds across the whole capital stack in this very popular shelf. The deal saw very high levels of subscription across the board, leading it to be increased, with the sponsor achieving good execution on pricing.

Also successfully launched were Auto deals from a range of issuers from Germany, Finland, France, Italy and the UK. The UK CMBS market priced an interesting deal in the form of a UK Student housing accommodation deal from a very large global CRE sponsor, which was the first deal in this asset class since late 2019. The CLO market had another very strong pipeline of deals, with investment-grade tranches attracting new investors. AAA coupons have ranged between 0.97% and 1.02%, narrowing from the wides of 1.08% witnessed earlier this summer.

In secondary markets the month got off to a slightly more challenging start. After a prolonged period of positive and stable spread performance in 2021, it was inevitable that this broader volatility might start seeping through into structured finance markets. However, spreads stabilised by mid-month with some retracement across some sectors in the last two weeks of the month. With strong primary issuance at tighter pricing terms over the month the market witnessed a pick up in the amount of relatively shorter-dated RMBS and ABS secondary supply as investors rotated into primary markets. This in turn led to dealers wishing to move supply on and resulted in some widening of bid-offer spreads in order to place bonds. For context, spreads were unchanged in UK Prime seniors but around 10-25bps wider in secondary BTL and NC RMBS mezzanine notes on very little observable size trading. The CLO market proved to be fairly resilient to wider market weakness in October although the rates sell-off put further pressure on the Euribor floor which is now in the region of 10bps. Shorter dated BB/B proved to be well supported with any weakness seen mainly in longer duration bonds and underlying leveraged loan performance has outperformed High Yield on a total return basis.

Portfolio Commentary

The portfolio managers were active in primary markets during October. The refinancing of a Prime UK RMBS deal in the mezzanine tranches enabled the fund to maintain and increase exposure to a very liquid shelf and reset the duration in these bonds a little longer. The managers made further RMBS additions via a Prime Irish deal which added some diversification. Slightly busier secondary markets also allowed investments in some add on positions in UK and Dutch BTL mezzanine bonds at slightly wider spreads. In addition, the managers made some smaller investments in legacy 1.0 deals which offer attractive yields comparable to some of the recent 2.0 deals for the same type of collateral. In CLOs, the managers purchased single B new issue deals from top tier preferred managers at attractive spreads. B CLO yields continue to offer a yield of Euribor + Low 9%. The portfolio also added mezzanine bonds in a highly granular consumer loan deal in an established shelf from a mainstream European bank. Inflows and rotations from higher cash premium shorted dated bonds funded purchases. Secondary market pricing was a little weaker over the month but stabilised and retraced in some sectors by month-end. Performance fundamentals in the underlying portfolios remain strong, with positive rating actions from agencies observed over the month. The portfolio managers will continue to maintain high levels of due diligence on the underlying portfolio through the recovery stage of the cycle.

The fund returned 0.41% for the month with 11.35% volatility since inception.

Market Outlook and Strategy

The technicals in the ABS market are more balanced as we move into Q4, and we expect issuance levels for the year to come close to the YOY highs seen over the last five years, almost €100bn. This sustained but manageable supply coupled with periods of macro risk-off moves is expected to preserve a spread premium into year-end. Whilst inflation and slowing growth remains a broad concern for fixed income investors globally, closer to home, the OBR now expects UK unemployment to peak at 5.2% in 2022, a far cry from the OECD's 9.7% tier 2 stress test outlined in 2020. This expectation largely reflects how we expect other European labour markets will fare as they also are seeing the tapering of their respective COVID support schemes. These policies have assisted the fundamental performance of ABS pools, so a move to a more normal level of support for consumers and corporates as economies reopen will likely see some deterioration in loan performance on a longer-term view, but within our base case scenarios.

The market expects the Bank of England to be the first G7 central bank to raise policy rates, with futures pricing in one hike by the end of 2021 and four by the end of 2022.

Central to our view for the rest of the year is to take advantage of a more balanced market to rotate using the secondary market and use pockets of value in the primary to build longer-term income exposures. That said, we view bank trading desks as having had a steady year and expect liquidity to fade in a typical year-end fashion. Management of liquidity in the short term is a focus as we expect continued yield hunting and shelter seeking from rate volatility to drive a positive start to 2022 for European ABS.

Rolling Performance	30/10/2020 - 29/10/2021	31/10/2019 - 30/10/2020	31/10/2018 - 31/10/2019	31/10/2017 - 31/10/2018	31/10/2016 - 31/10/2017
NAV per share inc. dividends	11.80%	2.74%	2.30%	4.96%	13.09%

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