# TwentyFour Income Fund

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## Market Commentary

The Russian invasion of Ukraine and central banks' attempts to address the high inflation levels brought about by COVID-stimulus packages, supply-chain disruptions and the emanating commodity-price shocks dominated market headlines in March. Equity markets posted mixed performance, with the S&P-500 closing up 3.6% for the month while the EuroStoxx-50 finished marginally down.

Fixed income was volatile as risk-free rates moved higher on the back of an expected pick-up in monetary policy as disruption to commodity markets increased inflation concerns, helping the 10-year German Bund yield rise by 41bp and the 10-year US Treasury by 52bp. Meanwhile, broader risk markets endured some days of volatility but overall, credit spreads partially regained some lost ground towards the end of the month with the Xover index closing 7bp tighter.

Central banks met in March after some historically high inflation prints. With US CPI at 7.9% year-on-year, the Fed began its hiking cycle, pointing to seven rate hikes in 2022 and Fed Funds Rate reaching 2.75% in 2023. However, these projections represented the 'median member', and significant variation existed between voting members of the FOMC. Moreover, the projections were much more hawkish than market expectations, and as a result, the US Treasury curve shifted up, especially in the short end, resulting in the curve flattening and the 2-10 yield curve briefly inverting by the end of the month.

Meanwhile, the ECB adopted a surprisingly hawkish stance, reducing the size of its Asset Purchase Programme and signalling the programme might end in Q3 – a move that possibly increases the likelihood of rate hikes this year. Finally, the Bank of England made its third successive hike in March, taking rates to 0.75%. Nonetheless, it could be described as a 'dovish hike' as the MPC warned of a cost of living crisis in the UK and alluded to the market getting carried away with the expected number of hikes.

Primary ABS market activity was a little subdued at the beginning of March. Still, the second week of the month proved to be the busiest since the start of the conflict and activity in both primary and secondary rose strongly into the end of the first quarter. As a result, the overall supply for the quarter stands at €32bn (including €10bn of new issue CLOs), a fairly similar level to that reached in Q1 2021.

The abrupt suspension of issuance at the end of February and early March led to a build up in the issuance pipeline. Eventually, this supply came to the market once the window reopened, helped by the rally in wider fixed income markets. As a result, strong levels of investor appetite met all the new deals, resulting in multiple oversubscription levels across the capital stack at, albeit at wider spreads, particularly in mezzanine bonds.

These deals were relatively diverse by asset class and geography and included UK, Dutch and Spanish Non-Conforming RMBS, Dutch & Italian CMBS, consumer deals from UK & Italy, and auto deals from the UK and France. In RMBS, deals from France and Spain offered some welcome diversification in the senior space. Spreads widened at the start of the conflict as broader markets sold off, reaching their widest point by mid-March, but a econdary selling in RMBS and ABS remained fairly contained, which suggests very little in fund redemptions or changes in strategy. Those bonds offered via BWICs were limited mainly to AAA UK BTL and NC and saw very strong demand, albeit at wider levels. As we approached the end of Q1, the market saw improved sentiment and an increase in secondary risk appetite in from trading desks which saw the beginning of a retracement, albeit this still lags the corporate market. At a senior level, RMBS spreads are 10-15bp wider YTD and 30-50bp wider in mezzanine bonds despite the strong technical backdrop in primary markets.

CLO issuance declined over March, with issuance activity of €5bn representing a fall of 40% month on month and a YTD total of €10bn in primary and €5bn of re-financings as deals came out of their non-call periods. To recap, the market got off to a very slow start in 2022 and then saw a very busy late January and February, resulting in overall volume in Q1 2022 at similar levels to the strong start seen in 2021.

Despite the market turmoil caused by inflation and more hawkish central bank policy, the funding gap remained relatively stable at 240bp. Still, the start of the conflict resulted in CLO spreads widening significantly, with AAA spreads, which had been in the 92-95dm area, moving out to 125-135dm and the lower mezzanine and sub-investment grade widening by more than 100bp; levels comparable to early summer 2020. Initially, primary issuance still worked as the liability spreads moved in tandem with underlying leveraged loan spreads. However, as the month progressed and loan market prices rallied in line with wider markets, the arbitrage became less favourable for primary issuance resulting in a slowdown. In secondary CLOs, activity was busiest in AAAs, with a large amount issued on BWICs but comfortably absorbed by the market. As the wider market rallied, the selling dissipated, and as the end of Q1 approached, spreads gathered some momentum and saw the start of a retracement. Accordingly, AAAs tightened by 8-10bp and sub-investment grade by 25bp. While the macro situation continues to evolve, the bias now suggests a tightening in spreads on expectations of strong ongoing demand for the asset class due to its floating rate nature, attractive carry and yield.

## Portfolio Commentary

In March, TFIF completed the successful acquisition £144.6m of assets originated by UKML following the positive result of the proposal and subsequent UKML shareholder vote. The portfolio was a mix of UK BTL and Non-Conforming bonds (both rated and non-rated) and cash. The team acquired these bonds at a discount to their fair value, resulting in a large NAV uplift late in March as the Fund now owns these at mark-to-market prices. TFIF's assets under management increased significantly to around £720m, including a cash element to be deployed in line with current ABS asset allocation. Consequently, the team had a busy month, made several accretive investments and took advantage of elevated volatility and wider spread levels, particularly in the sub-investment grade sector of the market. These actions included refinancing a private mezzanine facility from a seasoned Non-Conforming specialist lender in BBB and BB bonds. The Fund also added an attractive low levered Italian last mile logistic deal in BBB bonds, which offered a diversity play and was financed from the rotation of some BB UK consumer and Auto ABS bonds. In CLOs, the Fund added several BB positions, two of which were refinancing positions from existing holdings at yields above 8%. Performance fundamentals in the underlying portfolios continue to remain strong, with positive rating actions observed over the month by rating agencies.

The Fund returned 0.61% for the month with 3yr annualised monthly volatility at 11.32%.

## Market Outlook and Strategy

Stable primary issuance with solid investor demand and limited secondary volumes have steadied spread levels, and the market has started to see some retracement across all sectors, including CLOs. The new issue pipeline is expected to be reasonably healthy in the near term, with a wide diversity of asset classes throughout European issuers. Despite the overall outlook remaining rather uncertain due to Russia's invasion of Ukraine, and weaker sentiment due to tighter fiscal policy, elevated inflation and slower GDP growth, European ABS will continue to benefit from the expected increases in interest rates generating progressively higher income streams as the year evolves. We expect this search for floating rate income will continue to result in a strong technical backdrop in our market, with the possible results that spreads retrace more of the recent widening. Still, the portfolio managers remain focused on liquidity, given the uncertainties in Ukraine.

| Rolling Performance | 31/03/2021 - 31/03/2022 | 31/03/2020 - 31/03/2021 | 29/03/2019 - 31/03/2020 | 29/03/2018 - 29/03/2019 | 31/03/2017 - 29/03/2018 |
|---|---|---|---|---|---|
| NAV per share inc. dividends | 5.55% | 27.54% | -12.03% | 1.57% | 10.33% |

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.

## 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.

## Fund Managers

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

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

**Elena Rinaldi**
Portfolio Management, industry experience since 2014.

**John Lawler**
Portfolio Management, industry experience since 1987.

**Marko Feiertag**
Portfolio Management, industry experience since 2005.

**Robert Ford**
Partner, Portfolio Management, industry experience since 1986.

## Further Information

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**Further information on fund charges and costs are included on our website at www.twentyfouram.com**