

# TwentyFour Income Fund

This Commentary is a marketing communication for professional UK investors only

## Market Commentary

October was a highly volatile month for all fixed income assets, both government and credit bonds. Broadly the early part of the month saw significant weakness, especially in the UK as the now well documented LDI fund sell-off was in full swing, though this slowed by mid-month and with Gilts recovering, this initially steadied markets and then prompted a rally in broader credit. ABS bonds lagged behind a little but began to recover closer to the end of the month. New UK prime minister Rishi Sunak appears to be generally regarded as a safer pair of hands than predecessor Liz Truss, and this has reassured markets. US CPI inflation also took centre stage and once again it came in above expectations, but unlike similar relative prints earlier this year, there was no sharp sell-off in risk assets and instead equities and credit rallied – perhaps a sign of just how much bad news was priced into markets.

Following the sharp deterioration in market conditions in the last week of September, it was no surprise to see a limited amount of primary deals coming to the ABS market in October, though conditions did improve later in the month. The highlight was a new issue in UK Prime RMBS, Lanark 2022-2, from Virgin Money's Clydesdale Bank. The deal was initially syndicated as a private book build before it was announced publicly as a fully covered £300m deal. It was subsequently increased to £400m, with the tranche ultimately 2x covered from a good number of accounts. The deal priced at Sonia+82bp, tighter than initial guidance of 85bp area, which was seen as positive for both the issuer and the market. Away from that it was more of a mixed bag. The UK saw a Prime and BTL RMBS deal both retained by the issuers in full, and another established BTL deal fully place the mezzanine tranches but issue the senior AAAs in loan note format to the arranger bank.

In Ireland two reasonably sized RMBS deals, one non-conforming, were largely placed into a receptive client base, though there was not a lot of pricing transparency on the NC deal other than the AAA tranche priced at Euribor+250bp, around 110bp wider than their previous print in March 2022. Volkswagen saw plenty of demand for its AAA STS Auto deal, pricing around €1bn of ECB eligible bonds at a spread of 55bp, versus the issuer's last offering in May at 37bp. Elsewhere in Europe, a Dutch BTL issuer retained all its AAA bonds and pre-placed the mezzanine tranches.

The CLO market also saw the first rumblings of primary issuance in October after a very quiet period. A handful of deals priced with several more being announced into a marketing phase. In general, deals are smaller and not as ramped when priced due to the ongoing low amount of leveraged loans on offer, and some managers have commented that the quality of product has been on the weaker side over the last few weeks. The challenges remain around the arbitrage; the weighted average cost of capital has risen to as high as 350bp this year, considerably higher than the average 160-180bp average range in 2021. This is due to the cost of the liabilities, mainly the AAA tranches still clearing at a discount margin of around 220bp, however there have been windows where the underlying loan prices have sold off enabling managers to add collateral. Year-to-date, European ABS primary issuance is around €71bn, including €21bn of CLOs, which is 27% lower than the end of October 2021, but on pace with 2020.

Secondary markets dominated ABS and CLO trading flows during October. This was triggered by the now well-publicised pension fund LDI sell-off triggered by the UK mini-Budget at the end of September. The volume of RMBS/ABS and CLOs sold on publicly offered BWICs was unprecedented over a three-week period in October, comfortably in the region of around €6bn, and that does not include volumes which were reported to have traded bilaterally. The vast majority of the selling was in the AAA and AA tranches and after the heavy initial waves, selling began to subside towards the latter part of the month as markets became more orderly, though some selling moved on to mezzanine lists.

Interestingly, there was not a large amount of sub-investment grade offered for sale, and this endorses the fact that the sell-off was purely a drive for liquidity from a relative small group of investors and nothing at all to do with any credit performance concerns. However, the simple weight of money quickly led to spreads going wider, particularly in investment grade bonds, and this naturally filtered down into mezzanine tranches too. Selling was met by strong client demand, and levels began to retrace a little and stabilised somewhat into month-end. Any concerns that market participants may have had around liquidity in the ABS market were completely dispelled by the level of trading that took place. Spreads of course were wider, but the volume of selling was fully absorbed. It could even be argued that the level of liquidity available prompted greater selling than might have been expected, given suggestions that when liquidity was sought in other fixed income markets such as corporate bonds, it wasn't available.

## Portfolio Commentary

The Fund successfully completed the three-yearly realisation in October, which resulted in a net new placing of 35.7m shares to satisfy investor demand. The timing for this was optimal, with the Fund being able to benefit from performing assets trading at discounted prices and therefore yields not seen for multiple years. The portfolio managers were able to add a mixture of assets in mainly single-A and BBB bonds in a variety of names. Sector wise, additions were made in mezzanine Prime UK RMBS and non-conforming bonds at yields of 8-10% for relatively short maturities. The Fund also added a BBB CLO position from a preferred manager with a euro yield of 13%. Fundamental bond performance remains good with rating upgrades seen over the month, though the managers will continue to maintain high levels of due diligence on the underlying portfolio.

The Fund returned 0.35% for the month with 3yr volatility at 12.59%.

## Market Outlook and Strategy

By the end of October the relentless selling of assets had slowed down considerably, as the market reacted positively to messaging from the newly installed UK government around fiscal prudence going forward, which also led to a very strong rally in the Gilt market. It was believed that by this stage the vast majority of LDI related liquidity selling was largely completed, though secondary market trading is likely to be busy for the next few weeks as clients rebalance portfolios.

The liquidity provided by the ABS and CLO market was extremely strong and clearly appetite remains for performing assets trading at dislocated prices. It's likely that some of this volume was absorbed by dealer balance sheets, which may mean a healthy supply of secondary assets being available into year-end.

Primary issuance in the last few weeks of the year is likely to be muted, though we are likely to see issuers encouraged by the strong demand seen for deals priced in October. However, issuers will be going through a rebalancing of where liability spreads are currently versus the underlying portfolio yield, together with hedging costs in swap markets.

Rolling Performance	29/10/2021 - 31/10/2022	30/10/2020 - 29/10/2021	31/10/2019 - 30/10/2020	31/10/2018 - 31/10/2019	31/10/2017 - 31/10/2018
NAV per share inc. dividends	-10.72%	11.80%	2.74%	2.30%	4.96%

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



**TwentyFour AM**  
John Magrath  
Tel. 020 7015 8912  
john.magrath@twentyfouram.com



**Numis Securities**  
Sam Murphy  
Tel. 0207 260 1232  
s.murphy@numis.com

### Further Information and Literature: TwentyFour Asset Management LLP

T. 020 7015 8900  
E. sales@twentyfouram.com  
W. twentyfouram.com

Further information on fund charges and costs are included on our website at [www.twentyfouram.com](http://www.twentyfouram.com)

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