TwentyFour
a boutique of Vontobel

Fund Commentary | 30 December 2022

TwentyFour Income Fund

This Commentary is a marketing communication for professional UK investors only

Market Commentary

December was a weaker month for broader markets after a very strong November, with non-ABS credit spreads widening and government bond yields again drifting higher on hawkish rhetoric from central banks.

Despite softer US inflation data, the Fed's December meeting saw FOMC participants project a Fed Funds rate still above 5% by end-2023, contradicted by rates markets which continued to price in rate cuts for the second half of the year. The ECB also took a hawkish stance at its December meeting, raising rates by 50bp to leave the deposit rate at 2%, the highest since 2009. The ECB also pointed to significant rises to come and outlined its quantitative tightening (QT) programme, with holdings set to decline by €15bn per month from March. The reason for this hawkish stance stemmed from ECB official inflation projections rising across the board, with 6.3% expected for 2023 and 3.4% for 2024 (up from 5.5% and 2.3% respectively three months earlier). Finally, the Bank of England also hiked rates by 50bp as expected to a policy rate of 3.5%, though interestingly two voters wanted no change at all in the policy rate.

European ABS issuance remained, as expected, quite light into year-end 2022 with just three deals pricing in December. A UK Prime and a BTL RMBS deal were partially placed with the originator retaining several tranches, and in Europe a Spanish Non-Conforming RMBS deal closed out the year. CLO primary supply was also on the low side with just €1bn of issuance. This brought the overall volume of placed issuance for the year to around €80bn including €26bn in CLOs. RMBS accounted for €32bn of issuance with the rest split between Autos and Consumer at €18bn. The year also saw a drop in CMBS primary to just €0.9bn. While this overall number was the second lowest annual total in the post-2008 period, it could be suggested that given the macro backdrop over the course of 2022, it was actually a reasonably strong outcome, as evidenced by the strong levels of investor interest in deals that came during the windows of opportunity, other than during the LDI-driven selling seen in late Q3 and the start of Q4.

Activity in the secondary market also tailed off into year-end. Spread performance in general over the month was positive with a noticeable investor bias to add risk in both CLOs and ABS. BWIC volumes returned to a degree of normality and execution prices remained strong throughout the month. In general spreads in senior RMBS tightened 5-10bp and mezzanine bond spreads rallied around 15-20bp over the month. Following on from similar generic moves seen in November, this puts the market on a reasonably positive footing going into 2023.

Portfolio Commentary

Despite broader market weakness, ABS market conditions remained constructive in December. BWIC volume was unsurprisingly lower in December compared to levels seen in previous months as the market slowed down into the festive break. With there being little or no primary issuance to engage with, the portfolio managers continued to add assets at accretive yields across several sectors funded by share issuance over the course of the month. The Fund added senior AAA CLOs, where yields are now above 4.5%, and balanced out some liquidity asset allocation. The Fund also added some mezzanine UK RMBS together with some Dutch BTL bonds and a rare sub-investment grade prime Auto ABS position from a UK clearing bank. The Fund also trimmed some exposure to a short dated UK non-conforming mezzanine bond from a legacy issuer. The inflows enabled the managers to reduce the level of gearing to 9%. Liquidity observed in the market remained good as investors and dealers looked to add assets in preferred sectors. Fundamental bond performance remains good with rating upgrades seen over the month, and the managers will continue to maintain high levels of due diligence on the underlying portfolio.

The Fund returned 1.65% for the month with 3yr volatility at 12.62%.

Market Outlook and Strategy

With the ABS market having finished the year on a relatively constructive note, given the enhanced levels of volatility in pricing and secondary supply volume seen over the year, this provides the market with a positive platform for the start of 2023. Fundamentals have so far held up well, though as expected we are starting to see some increases in arrears materialize in certain shelfs. It should however be noted that these are coming from a very low starting point, and increases were inevitable given the slowdown in the economy and rising interest rates. However, securitizations are robustly structured and continue to benefit from subordination and other mechanisms to protect bondholders, as has always been the case, and these structural protections are typically increased during weaker economic periods as the rating agencies demand higher levels of credit enhancement. In fact, positive rating actions have consistently been applied to ABS bonds throughout 2022 and the widening in spreads in the market has been driven mainly by macro factors rather than underlying asset performance, which overall remains good.

Market participants expect the level of European ABS issuance to be higher in 2023, driven mainly by an increase in RMBS in both the UK and Europe, as banks continue their move back towards a wholesale market funded balance sheet as cheap central bank QE programmes are withdrawn. Increased appetite for this sector should be positive for spread momentum in the earlier part of the year and the level of demand seen in recent deals should dissipate any concerns around ECB QT as that eventually kicks in at the end of Q2 2023. In the meantime lower levels of primary at the end of 2022 and the start of 2023 should provide a positive technical for spreads in the interim.

Cumulative Performance					Annualised			
	1m	3m	6m	1y	3y	5yr	10y	Since Inception*
NAV per share inc. dividends	1.65%	3.30%	-2.17%	-8.84%	1.37%	2.30%	N/A	5.89%

Discrete Performance	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013	2012
NAV per share inc. dividends	-8.84%	7.85%	5.97%	5.04%	2.39%	13.51%	4.28%	-0.12%	13.39%	N/A	N/A

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

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