TwentyFour
a boutique of Vontobel

Fund Commentary | 31 January 2023

TwentyFour Income Fund

This Commentary is a marketing communication for professional UK investors only

Market Commentary

Markets got off to their strongest start to a year since 2019 in January, after a number of issues that had driven sentiment in 2022 started to ease. European gas prices continued their significant decline from the highs thanks to the combination of a warmer winter and effective supply management by European economies. With this came better growth forecasts, hopes of avoiding a recession and better inflation news, with the headline rate dropping to 8.5% year-on-year in January from 9.2% in December, though core inflation remains at record highs (5.2%). In the US, the recent turn in sentiment continued its positive momentum in January with YoY headline inflation now 260bp below its June peak. The market has battled hard against the Federal Reserve's insistence that rates need to exceed 5% and stay there for a meaningful period of time. Interest rate swaps are now pricing in a peak US base rate of just below 5%, and probably more importantly pricing in a significant number of cuts in 2023 and 2024.

As the primary ABS market slowly emerged from the seasonal break with a handful of deals, predominantly from the UK RMBS sector, the main theme during the month was very strong spread performance across all asset classes (with the understandable exception of CMBS) and a lot of demand for bonds across nearly all rating bands. Yorkshire Building Society remarketed a previously retained Prime AAA RMBS and Coventry Building Society brought a new Prime AAA offering, sized at £525m and £350m and priced at Sonia+63bp and Sonia+56bp respectively within a week of one another. Both deals saw very high levels of demand from investors with oversubscription levels of approximately three times. The pricing represents a tightening of 11bp versus the Nationwide deal that printed at the end of 2022 which in the AAA Prime sector is a strong rally in spread terms.

Away from that the market saw a UK BTL RMBS and a legacy portfolio non-conforming RMBS deal priced, both of which saw good demand and also offered mezzanine tranche, providing useful pricing points for market participants. Placed European issuance was light by comparison as most issuers remained on the side lines, with just one Dutch BTL RMBS from RNHB under its seasoned platform. This too saw good levels of demand with the mezzanine tranches seeing multiple levels of oversubscription. The CLO market saw two new issues with an overall volume of around €1bn and reasonable levels of appetite, though the main challenge for issuers remains around arbitrage as investors demand a premium to secondary market bonds. Thankfully, the situation on the supply side has improved with more leveraged loan product becoming available and therefore managers have been able to ramp their portfolios more effectively. To put the premium into context the AAA new issue levels were a blended 195bp vs. Euribor compared to secondary bonds trading at a spread of 160bp by month-end in top tier issuers.

Secondary ABS markets spreads began the month on a stable footing but as the wider credit market compression theme filtered through, sentiment quickly changed driving a risk rally across securitised products. This was also helped by the supply-demand technical, driven by lowish and orderly primary issuance together with an atypical month of supply in BWIC volume of around €1bn, all of which saw healthy demand. UK Prime RMBS paper saw tightening of around 20bp over the month, retracing to pre-Budget levels thanks to strong demand particularly from UK bank treasury investors. Senior BTL and non-conforming senior bonds rallied around 75bp and there remains strong investor demand for mezzanine bonds where spreads contracted 75-125bp down the capital stack. CLO spreads also saw strong performance with steady tightening throughout the month. AAAs are around 30bp tighter from year-end, BBBs better by around 100bp and sub-investment grade BB and B bonds are around 125bp tighter. CLO demand remains predominantly in the senior, BBB and BB space, though we note there remains a wide pricing dispersion on manager tiering.

Portfolio Commentary

The Fund saw good performance in January as ABS and CLO prices rallied strongly over the course of the month, supported by a positive tone and favourable wider market conditions. The portfolio managers were active in the primary market, adding two new UK building society Prime RMBS deals in AAA, which following the Bank of England rate rises now yield around 4.5% for three-year maturities. The managers also made an asset allocation decision to add liquidity assets from this highly liquid sector. Following the sharp rally in CLO markets the managers trimmed some AAA and B exposure to the sector in the latter part of the month to bring holdings in line with asset allocation targets. Fund leverage remained steady at 8% after the team reduced it in December, and this will likely reduce further next month as spreads continue on a tightening trajectory together with further share capital issuance. Fundamental bond performance remains good with rating upgrades seen over the month, and the portfolio managers will continue to maintain high levels of due diligence on the underlying portfolio.

Market Outlook and Strategy

After a challenging 2022 the positive start to the year in the European ABS market has been encouraging, as a combination of risk-on appetite and a steady but limited amount of primary supply initiated a strong rally across the sector which continued to gain momentum throughout the month. Whereas the cumulative spread tightening in January is retracing spreads towards late-summer levels, there is a long way to go before the market recoups the sell-off in 2022. The likely volume of primary supply over the course of the next month would appear to be steady, and this ongoing technical is likely to be supportive for further spread performance in the near term.

February starts with central bank week, and despite market participants attempting to read between the rhetoric and second guess where the pivot unfolds, expectations are that interest rates will continue to rise in the short term and this continues to be beneficial for floating rate asset classes such as ABS and CLOs. In a relatively short period of time available yields have risen to around 8% for balanced investment grade ABS strategies and double digits for non-investment grade ABS.

Cumulative Performance					Annualised			
	1m	3m	6m	1y	3y	5yr	10y	Since Inception*
NAV per share inc. dividends	2.78%	5.80%	1.16%	-6.73%	1.64%	2.55%	N/A	6.13%

Discrete Performance	YTD	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
NAV per share inc. dividends	2.78%	-8.84%	7.85%	5.97%	5.04%	2.39%	13.51%	4.28%	-0.12%	13.39%	N/A

Past performance is not a reliable indicator of future performance. The performance figures shown are in GBP on a mid-to-mid basis inclusive of net reinvested income and net of all fund expenses. Performance data does not take into account any commissions and costs charged when shares of the fund are issued and redeemed. The value of an investment and the income from it can fall as well as rise as a result of market and currency fluctuations and you may not get back the amount originally invested. *Inception date: 06/03/2013.

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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