TwentyFour
a boutique of Vontobel

Fund Commentary | 31 March 2023

TwentyFour Income Fund

This Commentary is a marketing communication for professional UK investors only

Market Commentary

March kicked off with 10-year Treasury yields reaching new year-to-date highs, but it was the regional banking crisis in the US and the forced acquisition of Credit Suisse (CS) that captured investor attention. Although there was very little read-across to European banks, they nevertheless suffered contagion, and spreads began to widen across the capital structure as CS was caught by the negative sentiment. However, the most controversial decision taken was that CHF 3bn would be paid to CS shareholders but the Additional Tier 1 (AT1) bonds would be written down to zero. This decision, which put equity holders in front of subordinated debt holders, led to a sharp move lower in European bank debt the following morning, until statements from the European Central Bank (ECB) and the Bank of England (BoE) confirmed that the hierarchy of payments would be respected. These statements led to a sharp rebound in Euro and UK bank debt, with Swiss banks unsurprisingly lagging. On the data front, inflation remained high in the eurozone, with the CPI release for February coming in above expectations which led the ECB to maintain its hiking pace as previously communicated, despite the banking crisis, and increase the deposit rate by 50 basis points (bps) to a post-2008 high of 3.0%. In the US, inflation remained high and the US Federal Reserve (Fed) followed the ECB and hiked interest rates by a further 25bps to put the policy rate in a target range of 4.75%-5.0%. The environment was similar in the UK. Inflation surprised to the upside and the BoE raised its base rate by 25bps as expected, taking it to 4.25% – also a post 2008 high. The investor sentiment led to a comeback of the volatility in rates for March, best characterised by the moves along the US yield curve, with the US 2-year Treasury yield declining by 0.79% to 4.03% and the yield on the US 10-year declining by 0.45% to 3.47%. This move led to further divergence between the Fed and the market regarding the likelihood of rate cuts in the latter part of this year. The positive environment for ABS markets continued at the start of March with several deals pricing during the first two weeks. The main highlight was a €500mm prime Dutch RMBS deal from Obvion's STORM platform, probably the most liquid shelf in the European ABS market, which unsurprisingly saw very strong demand from investors since it has been a while since their last outing. Similar to their previous deals, this was also a green bond and featured only loans to properties with an EPC rating of A or better. A large auto prime deal from Germany also saw strong demand for the AAA notes as the theme for European auto issuance continues. A smaller, more esoteric non-conforming Spanish RMBS deal also printed early on and offered a full capital stack of rated tranches; despite being slightly more specialist in terms of collateral, it achieved attractive execution from the issuer's perspective. In the UK a large £1.3bn non-standard full capital stack RMBS deal was pre-placed to investors. This deal was originated by Kensington and the vast majority of the collateral was previously securitised in seven older Kensington deals that had matured. As the US and European banking crisis struck financial markets mid-month, another repeat UK non-conforming lender deftly managed to price bonds mid-month at very respectable levels, having successfully had their AAA tranche underwritten by a bank treasury account. The unravelling banking situation put paid to any further issuance until the last week of the month as spreads widened in quick order and borrowers waited to observe market developments. The ABS market bounced back reasonably quickly to the extent that BMW was able to place a £400m deal into the UK together with another prime auto deal in Germany. In Spain, a green RMBS deal was all placed by month-end as ABS spreads, in general, retraced nearly all of their intra-month widening. On the CLO side, issuance remained fairly muted for another month, with the sector now having seen just below €7bn of issuance year-to-date. This has led some market analysts to reduce their issuance expectations to around €20bn for the whole year. This is due to ongoing low levels of loan supply which continues to make deal-ramping a challenge, together with an unfavourable arbitrage as liability spreads on the CLO tranches remain elevated, leading to unattractive returns for third-party equity investors. Cumulative primary issuance for the quarter including CLOs, totalled just under €20bn. Secondary markets were reasonably active at the start of the month. Spreads initially tracked sideways having seen a little bit of widening into February month-end but, as the banking failure fed into the ABS space, spreads quickly gapped wider, as did bid-offers, and market participants paused to observe how the situation would develop. Unlike other periods of market volatility, there was no reach for liquidity by investors so there was a sharp drop in the number of bonds being offered via BWIC for the rest of the month. RMBS and ABS widening outperformed relative to CLOS; Senior UK BTL gapped out and were bid S+150 before retracing almost all of that by month end. AAA CLO widened initially but recovered to around 175-200 when sellers failed to materialise, and it was a similar story further down the capital stack where BBB and BB spreads were roughly 50bps wider than their February highs as buying interest picked up across asset classes quite quickly. There continues to be quite wide dispersion between manager and deal performance. The only real laggard in the market continues to be the CRE sector where concerns remain around refinancing, valuations and occupancy levels. CMBS mezzanine bonds continue to be dripped into the market, not in material size, but there is little demand overall and pricing weakness is expected to prevail.

Portfolio Commentary

The Fund has seen strong performance over the first quarter of 2023. Being relatively fully invested and positioned in line with asset allocation decisions, trading was muted for the most part across the month, but the portfolio managers were able to add several positions with accretive value. The opportunity to add some rare investment grade single A bonds from Lloyds Bank's prime RMBS shelf was taken at an attractive GBP yield of 11%. In CLOs, the Fund added BB assets from three Tier 1 managers in strongly performing deals at attractive yields and good convexity. Gearing was further reduced to 5.4%, as the portfolio managers continued to build up future flexibility in the Fund. Liquidity observed in the month provided by bank trading desks remained good. 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. The Fund returned 0.57% for the month with 3yr volatility at 8.41%.

Market Outlook and Strategy

The first quarter finished on a relatively positive note for European ABS markets. Apart from a short period of volatility in March, overall spread performance has been good and there is clearly strong demand for high quality floating rate ABS, judging by the ongoing high levels of oversubscription. Issuance has been a diverse mixture of RMBS, auto and consumer ABS. CLO issuance has underwhelmed, as discussed above. While fundamental performance of the collateral has remained strong, we do expect to see a gradual deterioration as elevated inflation and higher rates start to impact the economy towards the summer, starting in unsecured credit. Absent further esoteric surprises, the market currently expects the BoE and ECB to increase rates by another 0.25% and 0.50% respectively through the summer, and these levels are then likely to be maintained for the remainder of 2023, further increasing future coupon income for investors. The primary market is likely to see further issuance after the Easter break, and relatively light levels of trading in the secondary market together with lower inventory levels should continue to support spreads in the near term. Without a significant pick-up in LBO and M&A activity, leverage loan issuance will likely remain muted and that should further supress CLO issuance in the next quarter, leaving room for CLO spreads to tighten. They are currently still 25-50bps wide in IG and 75-100bps in HY versus levels seen in January this year.

					Annualised			
Cumulative Performance	1m	3m	6m	1y	3y	5y	10y	Since Inception*
NAV per share inc. dividends	0.57%	5.88%	9.37%	-3.62%	9.07%	3.00%	6.37%	6.35%

Discrete Performance	YTD	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
NAV per share inc. dividends	5.88%	-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 et 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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