TwentyFour ASSET MANAGEMENT

31 December 2018

TwentyFour

Select Monthly Income Fund

Market Commentary

Following in the same theme for the past few months, market activity in December was dominated by the Federal Reserve. As expected the FOMC raised rates on the 19th Dec, to 2.25-2.5%, the fourth hike of 2018, but it was the following statement and press conference that was the focus of attention. Chairman Powel delivered a combination of both hawkish and dovish rhetoric during the Q&A session; although market consensus generally viewed the decision as a somewhat "dovish hike". Painting a relatively positive tone, the Fed expects GDP to grow by 2.3% in 2019 (albeit down from the 2.5% in September), with inflation seen as being under control and job creation healthy. However, risks were seen as being balanced and future hikes would be data dependant, with the Fed emphasising they could be patient, with Powell stating that there was "significant uncertainty about the ultimate destination of any further rate increases". For anyone worried about the Feds balance sheet being lowered too aggressive, Powell emphasised that this was "on auto pilot". As regards specific forward guidance, the Dot Plots were also revised lower, with two hikes being forecast for 2019 (down from three at the September meeting). Treasuries yields fluctuated following the announcement, but the rally quickly gained momentum again and the 10yr maturity rallied to just below 2.7% at year-end, as risk assets were shunned by professional investment books.

President Trump remained very much in the headlines as he expressed his displeasure with the Feds decision to raise rates and he openly questioned his own appointment of Powell as chairman, which did little to improve market sentiment. Rumours that the President was exploring his options and considering firing Powell, resulted in a decline for risk assets, despite a quick denial by White House officials. There was better news in the ongoing drama of trade tariffs as the US and China reached an agreement to suspend any new tit-for-tat tariffs for 90 days, and arrange a new round of talks in early January. As year-end approached, an impasse between the Republicans and Democrats caused the federal government to be shutdown, after the President tied the funding bill to include funding for the Mexican "Wall", which the Democrats refused to support. Rates were left on hold at -0.4% by the ECB and also as expected Mr Draghi confirmed they were ending their asset purchase programme, and that any cash from maturing bonds would be reinvested. The ECB stated that growth was slowing that the balance of risks was moving to the downside, with the inflation forecast cut from 1.7% to 1.6%. Meanwhile, in Italy, a more constructive tone from the ruling coalition government, and a revised deficit budget of 2.04% being passed through parliament, took away the risk of sanctions from the EU Commission. In the UK, Brexit negotiations continued to weight on confidence as Prime Minister May was forced to delay a vote on her Brexit deal, due to significant Parliamentary opposition across all parties. December proved a challenging month for the UK PM as she was forced to face a leadership challenge, following a motion of no-confidence was tabled, which she ultimately won but only after a third of the Conservative party voted against her. Negotiations continue on an improved Brexit deal, although confidence is not high that any meaningful concessions will be made by the EU before the next vote, which is scheduled for the week of the 14th January.

With an increasingly negative sentiment holding sway, US equities which, despite suffering an increase in volatility, had weathered a lot of bad news in 2018, but finally gave way in December, with the S&P 500 and Dow Jones falling by 9% and the tech-heavy Nasdaq declined over 11%; with 2018 unfortunately going into the record books as the largest Christmas Eve decline ever for the S&P 500 (-2.7%). It took a perfectly timed Santa Clause rally of almost 5% on the 26th, followed by a huge intraday move on the 27th, which turned an almost 3% decline, into a 0.90% gain again to bring a little respectably to the December monthly performance. Europe and Asia also suffered some big moves, with the DJ Stoxx 600 down 5.4%, the DAX down 6.2% and the Nikkei down 10.3% in December. For the full year, the S&P 500 and Nasdaq ended down 4.4% and 2.8% respectively, only thanks to strong performance earlier in the year – these indices declined 13.5% and 17.5% respectively in Q4! In Europe, the DJ Stoxx 600 declined 11.5% in Q4 and 10.3% full year, with the DJ Stoxx 600 Bank index declining 25% for the year, while in the UK, the FTSE 100 declined 10% in Q4 and 9% for the year. In Asia, the Hang Seng declined 7% in Q4 and almost 11% for the year, while the Nikkei lost 17% in Q4 and 10.4% for the year.

Likewise, the moves in credit were severe, particularly in the US where high yield assets had their worst month since the energy-impacted 2015 sell off. The US HY index lost 2.2% for the month, capping an incredibly poor final quarter which returned -4.67%; it's worth remembering that as recently as the 3rd October, when incidentally, Powell made his "we're a long way from neutral" speech, US HY was up 2.8% for the year, which was then rapidly turned into a 2.26% decline for the full year. Those invested in the US leveraged loan markets did not fare any better, with a loss of 2.5% posted for December, the worst month since Aug 2011, although the index still held onto a positive return of 0.44% for the year, this was the 3rd worst performance in 20 years. Credit markets in Europe and the UK fared a little better in December, with Euro HY returning -0.38% and £ HY returning -0.92%, giving yearly returns of -3.6% and -1.6% for the Euro and £ markets respectively, as both suffered from political contagion for most of the year, and the expectations for the end of ECB QE. Technical weakness was another headwind facing investors as we approached the year-end, with negative fund flows reported. IG mutual fund outflows in the US were $9.4bn in December with total Q4 outflows, including ETFs, around $30bn. FY 2018 net flows still remained positive at $73.6bn but were down significantly on the $347bn of inflows recorded in 2017. HY suffered outflows of $8.1bn in December, taking the FY total outflows to $59.3bn, which was approximately 3x the size recorded in 2017. In Europe, IG saw FY-2018 outflows of $38.8bn (reversing similar size inflows in 2017), while Euro HY recorded outflows of almost $13bn for the year.

Portfolio Commentary

As risk-off sentiment and technical headwinds increased the portfolio managers continued to focus any credit purchases and switches on short dated opportunities, given the more attractive yields brought about by some forced selling from those funds seeing outflows. The portfolio managers view the current market situation as an opportunity, preparing to take short-term volatility in return for purchasing bonds that mature within 1-2 years, where a positive total return can be more certain. With investors turning incredibly bearish in a short period of time, most asset classes experienced a very negative month, capping a poor quarter and negative year for the majority of financial assets. This was highlighted in a Deutsche Bank report which tracks 70 global asset classes covering cash, credit, government bonds, equities and commodities, and reported that 2018 was the worst year on record, in USD terms, since 1901, with 90% of assets suffering a negative total return for the year. Unsurprisingly, the Fund was not immune to the negative mark-to-market moves, and the total return for the month was -0.48% (NAV per Share inc dividends), taking the full-year 2018 return to a disappointing –1.40%. However, the yield has been enhanced and any concerns of re-invest risk have been alleviated by the moves in 2018.

Further Information and Literature:
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Market Outlook and Strategy

The outlook for 2019 is very different to anything faced over the last few years, with concerns of possible Fed policy mistake and recessionary fears for the wider economy. In addition President Trump and associated geo political risks are also expected to continue to be a source of volatility, although planned talks between the US and China could be constructive. Away from the US, the growth of "populist" parties in the EU will likely continue, with political events in Italy and Germany a potential source of volatility. Meanwhile, in the UK, "Brexit" will have a huge impact although it's difficult to say whether an agreement will be reached or a no-deal Brexit will be triggered, while another referendum is also a possibility. In addition, the possibility of a general election and policies from a Labour led government also needs to be considered. However, while 2018 has been volatile, the mark-to-market moves has resulted in a far more attractive starting point for 2019, with the fund's yield significantly enhanced as we look forward to the new year. In addition, the Fed has stated at the further hikes will be data dependant and they are also looking at markets globally, therefore pressure from the FOMC is likely to be more balanced in the months ahead. The US economy is also still relatively strong, with GDP expected to grow by 2.6% in 2019 (according to 80 Bloomberg contributors) and unemployment lower than any time since the late 1960s, so while a recession in 2020 is beginning to be priced in, it is by no means a certain. The strategy from the portfolio managers has been to focus on relative value, increase yield where possible while improving the credit-metrics of the portfolio, and this will continue in 2019.

Fund Managers

Gary Kirk
Partner, Portfolio Manager, industry experience since 1988 .

Eoin Walsh
Partner, Portfolio Manager, industry experience since 1997.

Mark Holman
CEO, Portfolio Manager, industry experience since 1989.

David Norris
Head of US Credit, industry experience since 1988.

Felipe Villarroel
Portfolio Manager, industry experience since 2009.

Pierre Beniguel
Portfolio Manager, industry experience since 2010.

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.
- Fixed income carries two main risks, interest rate risk and credit risk: (1) Where long term interest rates rise, there is a corresponding decline in the market value of bonds and vice versa; (2) Credit risk refers to the possibility that the issuer of the bond will not be able to repay the principal and make interest payments.
- 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.
- The Fund can invest 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 performance 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.
- Investments in emerging markets may be affected by political developments, currency fluctuations, illiquidity and volatility.

Further Information

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