TwentyFour ASSET MANAGEMENT

TwentyFour Income Fund

Monthly Commentary | 28 June 2019

Market Commentary

Markets rallied across the board in June, with both risk-off and risk-on assets posting positive returns, as the Federal Reserve seemed to pacify the markets' call for lower rates and the rhetoric relating to the US-China trade standoff eased during the month. As a result 10-year US Treasury yields dipped below 2% for the first time since 2016 and European government bonds hit record low yield levels, while all major equity indices were up on the month. The Fed set a very dovish tone, as interest rates remained unchanged but with the wording of its statement altered, suggesting it is prepared to move to easing measures given the downside pressures.

The ongoing US trade war and geopolitical risk events involving Iran and North Korea were also in the spotlight as comments from both China and the US raised market hopes for a re-kindling of talks at the G20 meeting in Osaka. President Trump also threatened tariffs on Mexico, resulting in a quick response from the Mexican government, which avoided any action by agreeing to the US request for stronger immigration enforcement at the US-Mexico border. President Trump was far more forceful when facing Iran, though he did leave the door open for dialogue. On a more positive note, the US president also met with North Korean leader Kim Jong-un at the G20, and became the first sitting president to ever set foot in North Korea as they also agreed to re-start talks.

The key event in Europe was the European Central Bank meeting where outgoing president Mario Draghi delivered a particularly dovish speech, stating that the ECB stand ready to act with additional stimulus if the outlook in Europe doesn't improve. This naturally led to a strong rally in both European government bonds and credit, with the 10-year Bund hitting an all-time low yield and Italian 10-year BTPs tightening 46bp over the month, despite the country's ongoing political conflict with the European Union hierarchy. The UK and EU alike now await July 22, when the new UK prime minister will be revealed, likely alongside a new Brexit negotiation plan.

The positive macro sentiment filtered through to the European ABS market throughout the month, though a combination of heavy secondary offerings and consistent primary issuance at the end of May and in early June weighed on spreads and volatility remained elevated. The secondary flow traded at respectable levels with decent liquidity provided by dealers, and once the broader macro picture recovered in wider markets we saw more balanced flows in the ABS space, with buyers returning to the secondary market as the month progressed leading to a compression in spreads.

CLO secondary market supply was also quite heavy in the first part of the month, mainly attributable to rotation into primary, profit taking from Q1, realization of CLO outperformance in May and investors taking advantage of the liquidity ahead of the Global ABS conference mid-month. Again a lot of the liquidity was provided by dealers but this still led to a dispersion in clearing levels of around 5-10bp in mezzanine bonds on tier one managers, and slightly wider for tier two. In the latter part of the month there was a better tone, with a strong pick up in two-way flows leading to a compression in spreads, particularly in mezzanine bonds.

In the meantime, primary issuance in both ABS and CLOs shrugged off wider market volatility in early June and there was steady issuance throughout the month from a wide variety of asset classes and geographies. All deals were successfully placed into strong demand, though levels of oversubscription varied from just covered to multiple times done, with particularly strong demand in the mezzanine area, and transactions continued to price at the tighter end of guidance. Issuance year-to-date is around €40bn, which is still around 25% lower than 2018 at the same point, but not especially surprising given the hiatus in Q1 while the new securitisation regulations were bedded in.

The annual Global ABS conference took place in June and the event was bigger than ever, with a post-crisis record number of attendees. The broad consensus from participants was positive for the market with confidence in the structural support across asset classes and a view that in relative value terms, ABS markets are likely to outperform other credit markets. Regulation continues to be a much discussed topic but overall there is a sense of more certainty, as more STS labelled transactions are coming to the market, which is a positive development for both issuers and investors into the future.

Portfolio Commentary

June was another busy month for the portfolio managers. Maintaining a focus on shorter dated two- and three-year maturity bonds, the Fund added positions in Prime UK RMBS, UK buy-to-let senior and mezzanine and seasoned non-conforming RMBS. The Fund also took the opportunity to add a secondary Dutch senior and mezzanine RMBS, and added a small amount of mezzanine CLO paper from preferred managers, rotating out of longer dated deals and adding incremental returns. Secondary market liquidity provided by dealers remained good, including during the period of volatility at the beginning of the month. Fundamentals remain supportive and performance across asset classes remains robust, and the portfolio managers continue to be comfortable with the balanced positioning and liquidity profile. The NAV per Share returned 0.37% for the month with 3yr volatility at 2.72%.

Market Outlook and Strategy

The last two months have seen elevated levels of issuance, particularly in UK RMBS from new and repeat issuers, but also from other European issuers, though we expect this will now start to taper off into July once the current crop of deals in the market have been placed. The market is also starting to see full capital stack deals from Auto ABS issuers (as opposed to senior AAA tranches only) as some bank sponsors look to address regulatory capital requirements, adding an opportunity for investors to diversify. We expect to see more of this issuance in the latter part of this year. Spreads in Dutch RMBS have tightened over the month as a result of very heavily oversubscribed Prime RMBS appetite from investors keen to add bonds with the STS label. UK spreads traded sideways in the main, due to heavier supply, but spreads held up well throughout the ongoing technical of supply-demand economics. The current geopolitical backdrop remains positive for spreads too, and as we approach the summer lull with decreasing supply we do not expect too much market volatility in the near future.

Fund Managers

Robert Ford
Partner, Portfolio Manager, industry experience since 1986.

Ben Hayward
Partner, Portfolio Manager, industry experience since 1998.

Aza Teeuwen
Partner, Portfolio Manager, industry experience since 2007.

Douglas Charleston
Partner, Portfolio Manager, industry experience since 2006.

John Lawler
Portfolio Manager, industry experience since 1987.

Luca Beldi
Portfolio Manager, industry experience since 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.

Further Information

Further Information and Literature: TwentyFour Asset Management LLP

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

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For definitions of the investment terminology used within this document please see glossary at: https://twentyfouram.com/glossary

Past performance is not an indication of future performance. Performance figures are shown in sterling on a mid-to-mid basis, inclusive of net reinvested income and net of the annual management charge and all other fund expenses.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.

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