TwentyFour Income Fund

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Market Commentary

Ongoing volatility characterised risk and rates markets during May due to comments from central bankers, data prints and other market moving headlines. In fixed income, the US 10 year Treasury yield tightened by 14bp, whilst both Gilts and Bund yields finished higher. Finally, the Xover widened by 15bp during the month.

The Federal Open Market Committee met at the beginning of May and raised rates by 50bp. They also signalled that the Fed would start reducing the size of its balance sheet in June. Chairman Powell also stated Fed members were not considering 75bp rate hikes, which initially drove a rally in risk markets. However, as the market digested the potential number of upcoming hikes and the prospect of quantitative tightening, risk assets quickly sold off, accompanied by a sell-off in US Treasuries. Meanwhile, the US CPI report surprised to the upside by showing 8.3% year-on-year inflation against expectations of 8.1%, and headlines of Chinese lockdowns continuing, volatility remained.

As fears of a hard landing in the US grew, US Treasuries began to rally from intra-month wides, with investors speculating that the Fed would find it difficult to push through as many hikes as previously thought. Risk assets continued to underperform on growth concerns. The only bright spot for investors was the return of correlations, with US Treasuries finally behaving as a risk-off asset class. The release of the FOMC minutes reinforced the strength in rates, calming investors' fears over the hawkishness of the Fed. While the minutes confirmed the consensus of two 50bp hikes at the June and July meetings, they also indicated that a pause could follow later this year, helping to support the 10-year US Treasury yield.

Elsewhere, the Bank of England raised rates by 25bp as expected, but its forecast for a contraction in UK growth during 2023 caused Gilts to rally. However, this reversed towards the end of the month, coinciding with the UK Government's fiscal support package and a refocus on the high levels of UK inflation. There was no ECB meeting, but a strong consensus has now formed that net purchases from its Asset Purchase Programme will stop by July, and they will begin their hiking cycle at the July meeting. As a result, the market has priced four 25bp hikes for the Eurozone during 2022.

In May, the ongoing negative macro dynamic finally caught up with the primary European ABS market. After a heavy month of supply in April, total issuance over the month slowed to €4bn, of which €2bn was in CLOs. Year to date, supply now stands at €45 bn, including €20bn in CLOs. Overall, the month could generally be characterised by an expected healthy pipeline with several deals either in marketing or expected to be announced before a deteriorating backdrop caused their subsequent postponement until market conditions improved. The UK saw just one Non-Conforming deal from a repeat issuer at considerably wider spreads, particularly in mezzanine tranches, and a commercial real estate deal from the same issuer. Both deals were pre-placed privately but saw good demand levels across the capital stack. In Europe, issuance was limited to a German consumer deal and four Auto deals; three from Portugal, Finland and Spain, which proved challenging to get over the line, and a Prime German Auto deal from Volkswagen. Ultimately, the bank originator retained the Spanish deal and the Volkswagen deal priced AAA bonds at Euribor +30, the widest level since May 2020, but, being STS and ECB eligible, was well received.

The CLO market saw five new issues price, totalling €2bn, the same as April, and with no refinancing due to wider liability costs. Total supply year to date reached €20bn, of which €13.5bn is primary; a 55% reduction from the same point in 2021, emphasising that widening spreads led to a much lower volume of refinancing. With a muted primary leveraged loan market over the month and diminishing liquidity in secondary and unfavourable arbitrage conditions, it is not surprising to see low issuance levels.

It proved to be a challenging month for secondary markets with elevated levels of BWIC activity in RMBS, CLOS and CMBS, whilst liquidity offered by bank trading desks diminished. A lot of this activity was attributed to portfolio rebalancing in other fixed-income areas. As a result, spread widening occurred in all sectors, although some stability did return to the market in the last week of the month. UK Prime AAA spreads were around 10bp wider month on month to SONIA +50 bp, with UK BTL and NC AAA widening around 25bp to SONIA +125/130, respectively, for longer duration bonds. This sector has seen a good level of demand from Bank Treasury investors. Generically, senior spreads are now at May 2020 levels. Investment grade RMBS saw further widening and are now broadly +60, +100, and +130-150bp wider year to date for AA, A, and BBB bonds. As the month progressed and the pace of selling abated a little, it was clear that these levels represented attractive entry points for investors looking for incremental yield at discounted cash prices in secondary and, in some instances, primary.

Portfolio Commentary

As a consequence of more subdued primary markets, the portfolio managers predominantly focused on selectively rotating positions in the portfolio. In the secondary market, the managers sold a position in UK Non-Conforming BBB bonds with a very short dated WAL at close to par at a spread of SONIA +420bp. The team reinvested the proceeds into a primary UK Non-Conforming BBB bond with a mid-90 cash price and a spread of SONIA +525bp. The managers also rotated into existing sub-investment grade CLO positions from preferred managers in cleaner pools, such as BB 2.6 year bonds yielding over 12% with discounted cash prices below 90. Performance fundamentals in the underlying portfolios continue to remain strong, with positive rating actions observed over the month from rating agencies. The portfolio managers will continue to maintain high levels of due diligence on the underlying portfolio.

The Fund returned -4.26% (NAV per Share total return) for the month with three year volatility at 11.65%.

Market Outlook and Strategy

The ABS market finished May in slightly better shape than the early part of the month, which experienced the most volatile period in terms of price movement since the onset of the conflict and subsequent broader macro volatility. With the annual Global ABS Conference taking place in the second week of June, the window for primary deals is closing fast from both a timing or viability from an asset/liability cost perspective. A pause for breath here in terms of primary supply should result in near-term stability as there are some attractive re-entry points across all asset classes. There is an interesting pipeline of UK and European deals waiting in the wings, and some of these will likely test the waters in the second half of June.

Rolling Performance	31/05/2021 - 31/05/2022	29/05/2020 - 31/05/2021	31/05/2019 - 29/05/2020	31/05/2018 - 31/05/2019	31/05/2017 - 31/05/2018
NAV per share inc. dividends	-0.33%	22.63%	-7.87%	2.13%	8.88%

The performance figures shown are in GBP on a mid-to-mid basis inclusive of net reinvested income and, with the exception of share price performance figures, net of all fund expenses. Past performance is not a reliable indicator of future performance. Performance data does not take into account any commissions and costs charged when shares of the portfolio are purchased and disposed of.

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