TwentyFour
a boutique of Vontobel

Fund Commentary | 31 October 2023

TwentyFour Income Fund

This Commentary is a marketing communication for professional UK investors only

Market Commentary

October saw a continuation of busy supply following on from a post-GFC record in September. A further €14bn of paper took the YTD volume to around €80bn, including €21.2bn of CLOs, despite a quieter end to the month. The weight of supply has been met with strong demand overall, although we are seeing some signs of fatigue in spread tightening when compared to September, syndicates preferring to price quickly once books open. Investors, on the other hand, are sitting comfortably with strong YTD returns and this is apparent in some deals having to start with wider price talk. We understand the US market is in a similar position, with strong supply coming in a month where the selloff in rates markets intensified before the latest round of central bank meetings. Macroeconomic data gave comfort that peak rates were here along with slowing growth and softening labour markets. With spreads being more stable over the course of the month, the tone did turn positive in the final few days in sympathy with broader fixed income strength.

RMBS/ABS

A blend of mortgage and consumer deals came to market with bank sponsors leading the way. On the mortgage side, BPCE sold an upsized €1bn funding deal with AAA at +70bps while two UK offerings from Bank of Ireland and challenger Atom Bank provided more unconventional AAA bond deals with varied success. Two consumer deals from Santander in Italy (including a first through a joint venture with Hyundai), French and Irish leasing transactions, and a German BMW deal rounded out a varied month. A second credit card ABS deal in 2023 from Tesco printed AAA +92bps. In addition, there was an Irish reperforming loan deal from Morgan Stanley and a tiny retained UK RMBS deal which comprised old and weak performing collateral. One tangible change in 2023 has been a greater level of mezzanine bonds available from bank sponsored transactions, motivated by capital relief as well as funding, something that is opening up our investable universe. It has also stimulated demand, with almost all such transactions able to attract orders multiple times the bonds available, something that did not slow down during the month of October. Our sense is that spreads have settled into a pattern now until the end of year, for example the specialist RMBS market in the UK for AAA/AA/A/BBB rated bonds would expect to see spreads of 115bps/200bps/300bps/400bps. For now, the market seems very comfortable in that issuers are motivated to print before the end of the year and investors are sufficiently rewarded to put cash to work.

CLO

The CLO market saw nine deals priced in October, with a remarkable 40 separate managers printing so far in 2023. Market issuance continues to outstrip expectations with leverage loan supply a paltry gross €26bn against €21.2bn of CLO issuance. It is not surprising then that the European loan index has been remarkably strong, despite a weakening backdrop. That said, a drawdown was experienced from late September as the weight of the credit selloff took its toll. Geopolitical tensions in the Middle East at the beginning of the month also contributed to the volatility in the CLO market, although there was a small reversal into the end of the month after central banks lifted sentiment. CLO primary spreads moved wider, and execution through October became progressively patchy, with BBB and BB prints moving to +600bps and +900bps in some instances, a full 100bps wider than in recent months. The month saw familiar names Blackstone, CVC and Ares print while GLG returned after a long period of troubled performance and personnel changes. There are also a couple of debut managers in the market currently, Sona and Arini, which will provide tests for demand as the year draws to a close. Performance has been a bright spot, with the percentage of loans rated CCC or below in the index continuing to drop, now below 3%, although we do not see this continuing in 2024.

Secondary markets

In the secondary market, spreads held up very well, with our own trading being in a defined range and one which we expect to last until the end of year. With a sense that investors are distracted with primary deals, activity dropped a little, and spreads performed well, with higher quality and shorter deals receiving the most attention. BWIC activity, while 1.3x compared with recent averages, dropped 40% to €1.6bn in October, with prime RMBS and consumer deals consistently offered. There was a sense that dealer bids had weakened somewhat and end investors were the primary buyers. Of the total, CLO BWIC activity dropped from a period of heavy profit-taking in September, finishing at €800m. This was also reflected in a divergence in strength when compared to primary markets, BBB CLOs clearing nearer +500bps with demand remaining strong. There were also tentative signs of life within the CMBS market following a second primary deal of the year from Blackstone, and several investors tested liquidity to a total of €75m. Liquidity overall remains strong, and our sales, where needed, provided predictable execution.

Portfolio Commentary

October proved to be another busy month for the Fund as the portfolio managers were able to take advantage of a strong primary pipeline of geographically diverse deals. Two transactions held in the Fund redeemed during the month, and the team managed to reinvest the proceeds into a couple of new issues at attractive yields. The team added sub-IG positions in a Dutch consumer ABS deal at 10% and 14% yield. In addition, in primary, a BB CLO bond was added from a French CLO manager at >13% yield. In secondary markets, the PMs were able to add a couple of investment grade (BBB- and A-rated) UK RMBS positions from preferred lenders at an attractive yield of over 10%. Fundamental performance in the underlying portfolio otherwise remained strong, with early arrears for consumer deals marginally increasing and leverage loan performance actually improving during October. Given the elevated level of supply during the month, spreads held in well although a little weakness was seen in the CLO market. However, liquidity observed in the market was robust. The Fund returned 0.52% (NAV incl. dividend) for the month, with three-year volatility at 6.96%.

Market Outlook and Strategy

We have been surprised at the pace of deals through October, but, with renewed credit market confidence, we now see issuance continuing well into November, which is also requiring us to pose questions of how to allocate into year end. Our conclusion is that, with spreads stable at wider levels and supply likely to anchor it there, there are opportunities to add selectively before the end of year. Liquidity remains strong, and execution on the limited number of sales we have made gives us confidence we can execute rotation effectively. This more balanced technical will be tested if the macroeconomic sentiment improves further against a backdrop where we already expect inflows into the ABS market following a very strong return performance so far in 2023. That said, the default cycle in Europe and elsewhere has not started in earnest yet, in our view, despite rates appearing to have peaked. As a result, our allocations are barbelled, such that allocations to AAA holdings into 2024 are skewed to those we consider 'tier 1' quality (a relative term when comparing AAA bonds). At the other end of the spectrum, we are seeing plenty of opportunities in mezzanine bonds, where we continue to believe risk is attractively rewarded, and we would expect to take advantage of the long-term income on offer. Our expectation is for continued growth in issuance in 2024, led by the banks who fortunately provide large liquid deals backed by high quality underlying assets and increasingly offer mezzanine bonds. In summary, we feel there is some scope to add back a limited amount of beta from very conservative levels, but without compromising on liquidity and flexibility to respond late this year or into 2024.

					Annualised			
Cumulative Performance	1m	3m	6m	1y	3y	5y	10y	Since Inception*
NAV per share inc. dividends	0.52%	3.08%	6.73%	18.80%	5.85%	4.50%	6.02%	6.85%

Discrete Performance	YTD	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
NAV per share inc. dividends	15.40%	-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

- Limited participation in the potential of single securities
- Investments in foreign currencies are subject to currency fluctuations
- Success of single security analysis and active management cannot be guaranteed
- It cannot be guaranteed that the investor will recover the capital invested
- The structure of ABS/MBS and the pools backing them might not be transparent which exposes the fund to additional credit and prepayment risks (extension or contraction risks) depending on which tranche of ABS/MBS is purchased by the Fund
- The Fund has the ability to use derivatives, including but not limited to FX forwards, for hedging and EPM purposes only. This may magnify gains or losses
- Typically, sub-investment grade securities will have a higher risk of default, and are generally considered to be more illiquid than investment grade securities
- The Fund's investments may be subject to sustainability risks. The sustainability risks that the fund may be subject to are likely to have an immaterial impact on the value of the Fund's investments in the medium to long term due to the mitigating nature of the Fund's ESG approach
- The Fund's performance may be positively or negatively affected by its sustainability strategy
- The ability to meet social or environmental objectives might be affected by incomplete or inaccurate data from third-party providers
- Information on how environmental and social objectives are achieved and how sustainability risks are managed in this fund may be obtained from **twentyfouram.com/responsible-investment**

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Further information on fund charges, costs and other important information pertaining to the fund can be found in English and free of charge on the fund pages of our website and/or in the Prospectus and the Key Information Document (KID) which are available at www.twentyfourincomefund.com

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