TwentyFour ASSET MANAGEMENT

Vontobel Fund – TwentyFour Monument European Asset Backed Securities

Monthly Commentary | 29 October 2021

Market Commentary

October was a challenging month for credit, as volatility in rates weakened investor sentiment. Central bank rhetoric and the subsequent move in rate yields were the key focus, with the BoE and the gilts market stealing the limelight as the market moved forward its expectations of a rate hike by the end of this year. The new BoE chief economist stated that inflation could rise close to, or above, 5% in early 2022, considerably higher than the central bank's 2% target and implied that the November committee meeting was "live" regarding a move in monetary policy. This followed comments from Governor Bailey that he expected inflation to last for longer, and the bank would have to act accordingly. In response, the market is now pricing in a rate hike at the BoE's next meeting on November 4th, followed by another hike at their December meeting. As a result, the five-year gilt yield widened by nearly 20bp over the month, finishing at 0.83%.

Inflation continued as the key focus for fixed income participants, given mounting evidence that it may not be merely transitory as maintained by some central bankers. Rising energy prices, supply chain disruptions, shortage of labour, infrastructure and transport problems and record lead times on raw materials are all compounding to lead to a continuation of high inflation prints from the summer, which in turn is fuelling a steady increase in average hourly earnings. In addition, US CPI beat expectations, coming in at +5.4% YoY and +0.4% MoM, which added weight to the discussion that the Fed would have to hike rates earlier than expected. October tends to be a busy month for ABS primary markets, and 2021 was no exception. Around €15bn of issuance during the month, including €5bn of new CLO issuance, brought the overall year-to-date supply to around €90bn including €31bn in CLOs. These supply volumes represent a record for the post-GFC era, surpassing the €29.8bn issued for the full year in 2019. One of the highlights in the UK RMBS market was the refinancing of mezzanine notes from a large UK legacy deal, as these tranches hit their first early call option date, which the sponsor duly exercised. In line with expectations, the AAA notes will remain outstanding. Still, the public distribution of the mezzanine notes was encouraging as opposed to being privately placed, which has been an unhelpful trend in some larger, pre-sounded transactions of late. Elsewhere in the UK RMBS market, a UK digital challenger bank issued a AAA only tranche of Prime STS mortgages which was well received. In Europe, the mortgage sector saw deals from a Non-conforming lender in Ireland and STS deals from slightly rarer Dutch and Spanish issuers, allowing investors to diversify.

Once again, Consumer ABS deals experienced elevated issuance over the month from a diversified group of sponsors across Europe. The highlight was a €1.5bn repeat issue, highly granular German consumer loan deal from a large mainstream European bank offering bonds across the whole capital stack. The deal saw very high subscription levels, with the sponsor achieving good execution on pricing. Other deals in this space included an inaugural consumer loan deal in the UK, which was slightly more esoteric and structurally enterprising, but nevertheless saw strong demand. Also successfully launched and priced were Auto deals from a range of issuers from Germany, Finland, France, Italy and the UK. The UK CMBS market priced an interesting deal in the form of a UK Student housing accommodation deal from a global CRE sponsor, the first deal in this asset class since late 2019 and COVID-19. The deal was comfortably placed, albeit at slightly wider spreads in the AAA class than initially indicated. The CLO market had another robust pipeline of deals, with investment-grade tranches attracting new investors. AAA coupons have ranged between 0.97% and 1.02%, narrowing from the wides of 1.08% witnessed earlier this summer, benefitting from the return of large anchor investors from the US and Asia persuaded by the asset class' lack of duration and in the search for floating-rate assets. In secondary markets, the month got off to a slightly more challenging start. After a prolonged period of positive and stable spread performance in 2021, including resilience over the previous few weeks despite macroeconomic news and rates movements, it was inevitable that volatility might start seeping into structured finance markets. However, this was not meaningful and spreads stabilised by mid-month. Some retracement was evident across some sectors during the final two weeks of the month. With strong primary issuance at tighter pricing terms over the month, the market did see a pick up in the amount of relatively shorter-dated RMBS and ABS secondary supply as investors rotated into the primary market. This increase came in the form of a large number of small line items and generally absorbed by trading desks. This led to dealers wishing to discharge some supply, resulting in some widening of bid-offer spreads to place bonds. For context, spreads were unchanged in UK Prime seniors but around 10-25bps wider in secondary BTL and NC RMBS mezzanine notes on minimally observable size trading. The CLO market proved to be reasonably resilient to broader market weakness in October, although the rates sell-off put further pressure on the Euribor floor, which is now in the region of 10bps. Shorter dated BB/B proved well supported with any weakness seen mainly in longer-duration bonds, and underlying leveraged loan performance has outperformed High Yield on a total return basis.

Portfolio Commentary

The portfolio managers had busy month managing inflows in October. The refinancing of a Prime UK RMBS deal in the mezzanine tranches enabled the fund to maintain and increase exposure to a very liquid shelf and reset the duration in these bonds a little longer. Additionally, the managers allocated a proportion of inflows into core AAA UK Prime RMBS liquidity assets. The managers made further RMBS additions via a Prime Irish deal which added some diversi-fication. Slightly busier secondary markets also allowed investments in some add-on positions in UK and Dutch BTL mezzanine bonds at marginally wider spreads. In addition, the managers made some smaller investments in legacy 1.0 deals which offer attractive yields comparable to some of the re-cent 2.0 deals for the same type of collateral. In CLOs, purchases were made in AAA and BBB new issue deals from top tier preferred managers. BBB CLO yields continue to offer an attractive yield of Euribor + Low 3%. The portfolio also added mezzanine bonds in a highly granular consumer loan deal in an established shelf from a mainstream European bank. Inflows and rotations from higher cash premium shorted dated bonds funded purchases. Secondary market pricing was a little weaker over the month but stabilised and retraced in some sectors by month-end. Performance fundamen-tals in the underlying portfolios remain strong, with positive rating actions from agencies observed over the month. The portfolio managers will continue to maintain high levels of due diligence on the underlying portfolio through the recovery stage of the cycle. The fund returned 0.00% (Class I EUR) for the month with volatility since inception at 4.60%.

Market Outlook and Strategy

Technical factors of the ABS market are more balanced as we move into Q4, and we expect issu-ance levels for the year to come close to the YOY highs seen over the last five years, almost €100bn. This sustained but manageable supply coupled with periods of macro risk-off moves is ex-pected to preserve a spread premium into year-end. Whilst inflation and slowing growth remains a broad concern for fixed income investors globally, closer to home, the OBR now expects UK unem-ployment to peak at 5.2% in 2022, a far cry from the OECD's 9.7% tier 2 stress test outlined in 2020. This expectation largely reflects how we expect other European labour markets will fare as they also are seeing the tapering of their respective COVID support schemes. These policies have assisted the fundamental performance of ABS pools, so a move to a more normal level of support for consumers and corporates as economies reopen will likely see some deterioration in loan per-formance on a longer-term view, but within our base case scenarios. The market expects the Bank of England to be the first G7 central bank to raise policy rates, with futures pricing in one hike by the end of 2021 and four by the end of 2022. Central to our view for the rest of the year is to take advantage of a more balanced market to ro-tate using the secondary market and use pockets of value in the primary to build longer-term in-come exposures. That said, we view bank trading desks as having had a steady year and expect li-quidity to fade in a typical year-end fashion. Management of liquidity in the short term is a focus as we expect continued yield hunting and shelter seeking from rate volatility to drive a positive start to 2022 for European ABS.

Rolling Performance	30/10/2020 - 29/10/2021	31/10/2019 - 30/10/2020	31/10/2018 - 31/10/2019	31/10/2017 - 31/10/2018	31/10/2016 - 31/10/2017
I EUR Acc	2.64%	-0.75%	0.48%	0.59%	N/A

The performance figures shown are in EUR on a mid-to-mid basis inclusive of net reinvested income and 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 issued and redeemed. *Inception date 27/06/2017.

Fund Managers

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

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

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

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

John Lawler
Portfolio Management, industry experience since 1987.

Marko Feiertag
Portfolio Management, industry experience since 2005.

Electronic Trading available by Calastone and EMX

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- **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.**
- The issuer of ABS 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.
- Past performance is not a reliable indicator of future performance, and the Fund may not achieve its investment objective.
- 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.

Further Information and Literature: TwentyFour Asset Management LLP

T. 020 7015 8900 E. sales@twentyfouram.com W. www.twentyfouram.com

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

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