TwentyFour
a boutique of Vontobel

Fund Commentary | 31 July 2024

Vontobel Fund – TwentyFour Monument European Asset Backed Securities

This Commentary is a marketing communication for professional UK investors only

Market Commentary

July was a very strong month for fixed-income markets as cooling inflation and weakening labour market data led to a growing narrative that the cutting cycle is edging closer for the US Federal Reserve (Fed). Government bonds rallied sharply as investors moved to price in the probability of a greater number of interest-rate cuts by year-end, while heightened geopolitical tensions and political instability contributed to marginal credit spread widening. Equity markets had a more mixed month after a strong run over the year to date, with some evidence of sectoral weakness – particularly consumer discretionary.

US Treasuries experienced a steady and consistent rally throughout July as economic data pointed towards signs of weakening in both the US labour market and the consumer. The US jobs report at the beginning of the month delivered something for everyone; the non-farm payroll number came in higher than expected at +206k. The unemployment rate unexpectedly ticked up by another 10 basis points (bps) to 4.1%, fuelling fears that an upward unemployment rate trend is beginning to form given the increases in previous months. A stronger-than-anticipated second-quarter US GDP print later in the month partly pushed back on a growing narrative that the US economy was showing the first real signs of struggle. At the end of the month, the Fed acted in line with market expectations, keeping rates unchanged at its July meeting. However, Fed Chair Jerome Powell mentioned that the Federal Open Market Committee had started to discuss potential rate cuts and announced that "a reduction in the policy rate could be on the table at the September meeting".

US politics continued to dominate headlines during July as Joe Biden announced his withdrawal from the 2024 US Presidential race following weeks of pressure from members of the Democratic party. In Europe, the second round of French elections brought an electoral shock, with the far-left New Popular Front (NPF) winning 188 seats and consequently securing the surprise outcome of being the largest single bloc. The far-right Rassemblement National (RN) party claimed 142 seats, significantly below the 190 expected before voting began, while Macron's bloc secured 161 seats – up from the 135 expected prior to the election. Since no bloc came close to an absolute majority (289 seats required), a hung parliament is the most likely scenario. The UK held its own national elections in July and will have a Labour Majority government (412 seats) in charge for the first time since 2010. Since the result was largely expected, the most noteworthy event from the election was the collapse in the Conservative vote, which went primarily to the right-wing Reform UK Party.

Eurozone consumer price index (CPI) inflation in July was marginally stronger than expected, with headline and core inflation rising a tenth above expectations, to 2.6% and 2.9%, respectively, on a year-over-year basis. The slight reacceleration in inflation and lack of significant weakness throughout European economies meant the European Central Bank left base rates unchanged at its July meeting, but continued to insinuate that there will be further easing in the near future. This contrasts the narrative building in the UK, whereby investors moved to price in a 25bp rate cut ahead of the Bank of England's meeting on August 1 given that headline CPI remained at the targeted 2% for a second consecutive month. The UK economy also returned to growth in May as GDP rose by +0.4% on a month-over-month basis, double the +0.2% anticipated figure. Over the three months to the end of May, the economy grew by +0.9%, representing the fastest rate for over two years. Equity markets had a mixed month following a series of revenue misses and profit warnings from several big companies, particularly those in the airline, fashion, and automotive industry.

Summary

The positive direction that we have seen in the asset-backed securities (ABS) market over the year to date (YTD) has continued during July. Although markets are moving towards a summer recess, they welcomed a diverse set of issuance during the month, and there has been a particular focus on debut issuers for this time of the year. The support of the macroeconomic environment has also meant that collateral deal performance has stayed healthy and deterioration has remained limited to risk pockets such as pre-Global Financial Crisis (GFC) mortgage collateral and commercial mortgage-backed securities (CMBS), backed by office assets and a handful of retail assets. Primary issuance YTD sits at €90bn, with July welcoming €11.5bn issuance of ABS and €9bn of collateralised loan obligations (CLO). The pipeline for post-summer activity looks healthy and should provide ample opportunities for growth and value.

RMBS

Residential mortgage-backed security markets were more muted during July, with just four new issues. Cumulative issuance now sits at €36.4bn for 2024, already ahead of the €27bn seen throughout 2023. Perhaps unusual for July, half of the new issues were from first time issuers Quantum and Edenbrook. Both issuers printed full capital structure UK buy-to-let transactions, with AAAs settling at 87 basis points (bps) over SONIA, with healthy coverage of 2-3X facilitating tightening from 90a IPTs. Despite support for seniors and going against a defined trend for the year however, this coverage fell as we moved down the capital structure. Edenbrook printed BBBs at 2.55% over SONIA while, a few weeks later, the Quantum deal printed 15bps tighter. Both tranches ended with sub 2X coverage, which is somewhat unusual for 2024 ABS markets, and an indicator of possible market fatigue as the summer approaches. July also welcomed an issuance from Coventry Building Society, printing a £500m AAA tranche at a spread of 47bps over SONIA. Coverage was healthy at 1.8X.

CLO

Collateralised loan obligation markets were particularly active during July, welcoming €9.1bn of new issuance across 12 deals (split €5.2bn for new issue and €3.9bn for resets). This brings the YTD supply to a record €42.1bn, helped by lower funding costs, active loan markets and stronger investor demand. European leveraged loans have reached €126.5bn YTD, already ahead of 2023 issuance, driven by repricing. Since the lows at the start of the month (driven by the French election uncertainty), loans have been pushed higher and are now trading close to an average price of 98. AAA spreads have tightened 8 basis points (bps) during July, with new issues pricing at a spread of 130bps over Euribor on average (the tightest print was achieved by Avoca XXXI at 125bps). The resistance mentioned last month has continued (perhaps driven by the time of year), and BB primary spreads have yet to break 600bps. We continue to see manager tiering here with a range of 600-700bps. With a number of redemption notices coming out during the month, we maintain our caution on reinvestment risk in the second half of the year and favour retaining shorter seasoned deals, which we expect to gradually have call options exercised.

Other ABS

ABS markets remained active during July, with prints from the UK and Germany in the consumer space, along with two auto transactions from Germany. The consumer market saw a return of BNP's consumer shelf NORIA, with a full capital structure transaction. The €800m transaction was met with impressive demand, which allowed tightening significantly from IPTs and puts spreads close to post-GFC tights for investment-grade mezzanine tranches. However, the AAA printed at 59 basis points (bps) over Euribor and was 1.6X covered, while BBBs ended at 165bps over Euribor, supported by close to 7X coverage (mezzanine coverage ended 4-10X subscribed). From the UK, we saw a successful debut non-prime consumer transaction from Asimi funding. The AAAs here printed at 100bps over SONIA, with BBBs at 460bps, showing a clear new issuer premium to recent consumer prints out of the UK. This is something we feel has been absent for most of the year but is welcomed. In the auto space, we saw Global Drive (Ford) and Auto1 come to market. Unlike the consumer prints, we saw less of a premium between the Ford issue and debut issuer Auto1; Ford printed AAAs at 43bps over Euribor while Auto1 managed to print just 27bps behind that. This, however, did not seem to deter investors, and final coverage for both deals were healthy in the 2-3X range on the seniors. It is also worth noting that supportive savings and employment data in the UK and Europe will continue to support the performance of European consumer collateral, as has been the case for the past 12 months.

Secondary

Bid wanted in competition activity for July inevitably slowed during the month, with ABS markets seeing a greater volume compression than with CLOs. We ended the month with €362m of trading in ABS and €950m of CLOs. Almost 1/3 of all CLO trading was in AAA paper, particularly in shorter profiles and drawing spreads 5-10 basis points tighter. In ABS markets, primary markets have driven rotation trades and we have seen YTD tights in senior RMBS and ABS markets. UK prime spreads are firm in 30-40s, while senior UK RMBS has tightened by 1-2 basis points on the month, in the 70a. The Australian secondary market has felt more open in Europe this month, with multiple bid wanted in competition requests and strong participation.

Portfolio Commentary

July was a relatively quiet month for the Fund as the market moved towards a summer recess. The portfolio management team (PMs) used inflows during the month to add to mezzanine consumer ABS in the primary market, picking up AA rated bonds at 95bps over Euribor. The PMs are happy with current positioning ahead of the summer holidays.

The Fund returned 0.49% for the month (Class I Euro Acc), with three-year volatility at 2.86%.

Market Outlook and Strategy

The market will be focused on data releases in August to guide the narrative for central banks and September activity. The continuing strong fundamental performance in the UK and Europe has meant collateral performance has held up well. Spread products continue to provide an attractive running income, and a lack of material declines in macroeconomic data remains evident in risk sentiment. Although caution on geopolitical escalation is warranted, we expect this to support demand into the third quarter, albeit met with strong supply. We also notice that the issuer tiering has contracted significantly during July, with only a couple of new issuers having to pay a premium to investors. As a result, the rewards for moving down in quality remain scant and dictate our more defensive stance. In the longer term, we continue to see geopolitical risk as the key risk for market volatility and, while the PMs do not see a catalyst for short-term volatility, they value flexibility and continue to see the attractiveness of AAAs (particularly in UK prime and CLOs) as well as shorter mezzanine investments.

Cumulative Performance	1m	3m	6m	1y	Annualised 3y	5y	10y	Since Inception*
I EUR Acc	0.49%	1.48%	3.40%	7.93%	2.79%	2.01%	N/A	1.74%
3 month Euribor	0.31%	0.95%	1.93%	3.95%	1.94%	0.98%	N/A	0.59%

Discrete Performance	YTD	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
I EUR Acc	4.69%	8.43%	-4.54%	1.73%	-0.14%	2.05%	-1.14%	N/A	N/A	N/A	N/A
3 month Euribor	2.27%	3.49%	0.34%	-0.55%	-0.42%	-0.36%	-0.32%	N/A	N/A	N/A	N/A

Past performance is not a reliable indicator of future performance. The performance figures shown are on a mid-to-mid basis inclusive of net reinvested income and net 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 27/06/2017.

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
- Derivatives entail risks relating to liquidity, leverage and credit fluctuations, illiquidity and volatility
- Interest rates may vary, bonds suffer price declines on rising interest rates
- The structure of ABS/MBS and the pools backing them might not be transparent which exposes the sub-fund to additional credit and prepayment risks (extension or contraction risks) depending on which tranche of ABS/MBS is purchased by the sub-fund
- The sub-fund's investments may be subject to sustainability risks. The sustainability risks that the sub-fund may be subject to are likely to have an immaterial impact on the value of the sub-fund's investments in the medium to long term due to the mitigating nature of the sub-fund's ESG approach
- The sub-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 sub-fund may be obtained from **Vontobel.com/SFDR**

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

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