TwentyFour
a boutique of Vontobel

Fund Commentary | 28 April 2023

TwentyFour Income Fund

This Commentary is a marketing communication for professional UK investors only

Market Commentary

After a volatile March that saw the development of a regional banking crisis in the US and the forced takeover of a systemically important bank in Europe, April was surprisingly calm, and, by a few measures, was one of the least volatile months since the pandemic and In the absence of negative news, markets were steady, with small gains across equity and credit markets. Government bond returns were slightly positive in the US (0.5%), flat in Europe (0.0% return for Bunds), and negative in the UK (-1.9%) That said, US debt ceiling concerns did come to the fore, with a lower tax take at the end of the financial year leading analysts to bring forward the 'x-date' (the estimated date when the Treasury can no longer pay its bills) amid concerns that a divided congress will find it difficult to come to an agreement.

Inflation data across Europe and the US continued to print significantly above central bank targets, with the UK in particular seeing an upside surprise to April's data and headline inflation yet again above 10% (driving the move in UK government bonds mentioned earlier).

With wider markets sailing on calmer waters after the recent banking headlines, and a benign backdrop into the end of March, both the primary and secondary ABS markets got off to a relatively slow start in April due to holiday shortened weeks around Easter. However, as expected, activity picked up significantly in the second half of the month with just over €7.2bn of primary issuance, as market conditions proved favourable for issuers to price new transactions. This was skewed towards €4.1bn in Auto and Consumer ABS, €2bn RMBS and €1bn in CLOs taking the YTD total issuance up to €27bn, including €7.7bn in CLOs. Around a third of this came in the UK, where the market saw a large ~£1bn refinancing of a RMBS deal backed by UKAR collateral (originally from Northern Rock) which was pre-placed with investors. Two deals were also issued in the UK Auto sector, one from a specialist lender offering senior and mezzanine bonds and achieving good pricing execution with a relatively high number of participants from both bank and asset manager investors, and the other being a senior tranche only funding trade from Ford. AAA bonds for this type of borrower now yield in the region of 5% for short WALs. The UK market also saw two public book build transactions from repeat BTL issuers. Given that one of these deals offered bonds down to the subordinate CCC/B rated notes it suggests that a degree of confidence has returned to the primary market. A UK Credit Card deal from Tesco was well received, having last been in the market with a retained transaction in 2020, with this their 5th securitisation under their Delamare shelf. Finally in the UK a popular, slightly more esoteric deal, from PCLF securitizing insurance premiums made a welcome return after their deal last year. In Europe, the Auto and consumer sector, saw five deals pricing and more transactions announced for pricing in early May. In RMBS, a full capital stack, Prime STS deal from Dilosk Ireland saw good levels of demand, especially in the mezzanine tranches where investors had the opportunity to add Prime € collateral for the first time in a while. Credit Agricole reoffered a retained 2022 consumer loan deal at the AAA level to successfully tap into this ongoing demand. Two Auto deals in Germany saw Mercedes Benz Bank issue a €750mm AAA 1.5 Auto year deal under their highly liquid Silver Arrow shelf together with a rarer Prime STS Auto issuer, RevoCar via Bank 11, and both Finland and Holland also saw Auto deals from a repeat issuers.

It took until the second week of April to see the first CLO price in the market since the middle of March and the pipeline is fairly benign with just three deals in marketing for May. Despite the reported return of Asian AAA investors and no lack of other investor appetite, this reflects the ongoing challenges of sourcing primary leveraged loan supply, which is 54% lower YTD compared to 2022 (although issuance did pick up in April) along with the alignment of secondary loan pricing versus the cost of liabilities, given the average WACC of ~334bps in April which remains the highest in any month so far in 2023. The European Leveraged Loan Index finished the month in positive territory with a monthly return of 0.81% and the Euro sector returned 4.93% YTD.

Secondary markets got off to a very subdued start to April with BWIC volume well below average in both ABS (the lowest year to date) and CLOs (the lowest for the 4th straight week). Flows remained skewed towards the GBP space in RMBS and were predominantly in the senior sector. There remains very strong demand for UK Prime RMBS at AAA, where bonds were seen to change hands at the start of April in the Mid-Low 40s DM which represented quite a strong move month-on-month and compared to Covered Bonds. The general theme of spreads grinding slowly tighter prevailed for the first two weeks, driven by a lack of supply as the market waited for the new issue pipeline to kick in. Mezzanine spreads also started to be a touch better bid in the face of light street inventory and few observable pricing points. Primary issuance will often lead to a pick-up in secondary activity as investors rotate into new deals and April was no exception. The aforementioned quiet opening to the month, which provided a favourable technical backdrop for levels, was followed by a spike in activity in the latter two weeks of April, initially in CLOs which saw €300mm in BWIC volume in one week (triple the average weekly volume seen in the previous six weeks), followed by RMBS, all of which was digested readily by the market as investors took the opportunity to source risk. Generically through the month, spreads ground steadily tighter across the capital stack in RMBS & ABS and In CLOs where a lot of BWIC activity was in the belly of the stack, between BBB and BB bonds, which saw the biggest outperformance in spreads.

Portfolio Commentary

Overall, April proved to be a relatively quiet month for the fund, however the portfolio managers carried out several credit optimisation trades together with several investments as the fund saw further inflows through stock issuance. Given the spread tightening observed in the sub investment grade sector of the CLO market the opportunity was taken to taken to reduce CLO exposure in deals where performance has been lagging other managers and reinvested in better quality deals. The portfolio managers also decided to further reduce the CMBS exposure due to ongoing nervousness around CRE valuations. Further investments were made in the mezzanine bonds of a new UK RMBS transaction with yields ranging from 8.6% for BBB to ~15% for the non-rated bonds. Late in the month, 2 large non-rated investments were repaid and 1 was sold. The repayments as well as further stock issuance was invested in a mix of UK RMBS bonds and CLOs, including a rare single-A rated bond from a Lloyds Bank Prime RMBS deal at an attractive yield. As amortisations happened late in the month, the fund is showing an elevated cash level. The portfolio managers expect to be reinvesting this in the primary market, as well as reducing gearing in the short term, and the focus remains on primary supply, fundamental performance and liquidity in the medium term as the fund continues to benefit from higher interest rates.

The Fund returned 2.12% for the month with 3yr volatility at 8.33%.

Market Outlook and Strategy

The last month has seen a very positive tone in the ABS market and, having seen a very large amount of monthly issuance together with a strong bounce in BWIC volume , the positive technical remains in place with every primary deal seeing good over subscription levels pricing at the tighter end of initial pricing talk. This was seen across a very diverse range of ABS sectors and geographical jurisdictions with an observable increase in the numbers of investors in the sector despite the ECB's well flagged likely reduction in market participation going forward. Having lagged corporate bond market spread compression for a long time, ABS and CLO spreads have remained insulated regardless of the moves seen in Euro and Sterling corporates in recent weeks. Whether it is due to investors reflecting on the liquidity, robust bankruptcy remote structure and the benefits of the bonds' floating rate nature witnessed during in Q4 2022 is difficult to ascertain, but there is clearly more investor activity in the sector which also possibly suggests perhaps that the likelihood of higher terminal rates for a longer period remains an attraction.

Fundamentals too remain positive. Employment levels remain strong and the recent RICS survey in the UK suggests property surveyors for the first time in a year are anticipating an increase in sales with the outlook for prices at the strongest level since September amidst a stabilizing market, and although property prices continued to fall in March the Nationwide HP index reported a small gain at the start of May. We have alluded to the anticipation of slightly weaker performance metrics a number of times recently and concerns from investors around affordability and refinancing risk will remain. It is however worth noting that loan advances in Interest Only BTL and Non-Conforming pools have fallen significantly since 2012, with the NC sector facing a refinancing wall after 2030. However given the long seasoning and house price appreciation LTVs have fallen significantly for loans in NC pools and the proportion of IO mortgages in negative equity remains negligible. Taken together, very substantial prices falls would be required to offset this, notwithstanding the robust structural mechanisms that exist in ABS bond deals to protect investors.

					Annualised			
Cumulative Performance	1m	3m	6m	1y	3y	5y	10y	Since Inception*
NAV per share inc. dividends	2.12%	5.20%	11.30%	-1.96%	10.40%	3.37%	6.45%	6.52%

Discrete Performance	YTD	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
NAV per share inc. dividends	8.12%	-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

- **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.

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