TwentyFour
a boutique of Vontobel

Fund Commentary | 30 August 2024

TwentyFour Income Fund

This Commentary is a marketing communication for professional UK investors only

Market Commentary

August was a highly volatile month for fixed income and equity markets alike. At the beginning of the month, the US labour report sparked recessionary fears and prompted negative market sentiment. However, these concerns were quickly offset by strong economic data showing the US economy was still performing well. Although the data resulted in a sharp rebound in government bond yields and equity indices, the repercussions of the weak jobs report were present throughout the month as investors priced a more aggressive rate-cutting cycle by the US Federal Reserve (Fed) and other major central banks.

As with every month, the first Friday of August provided investors with the monthly US jobs report. However, in contrast to previous months, the labour market showed significant signs of weakening. The unemployment rate came in at 4.3% (higher than the expected reading of 4.1% and up from 3.7% at the beginning of the year), while non-farm payrolls printed at 114k, which was well below the anticipated 175k figure. In the immediate aftermath of the release, recessionary fears gripped markets, and economists began calling for meaningful action by the Fed in the form of rate cuts. Confidence of a soft landing diminished, which resulted in sharp negative moves across global equity markets, government bonds benefiting from a flight to quality, and growing expectations of a more aggressive rate-cutting cycle, with 10-year Treasuries having rallied to a yield of as low as 3.70%.

However, as the month unfolded, economic data pointed towards a US economy that was still performing well and, as a result, market sentiment began to improve. The supportive data included a very strong retail sales print, with the headline number accelerating to +1% month-on-month in July, significantly higher than the +0.4% expected and the fastest monthly retail sales increase since the beginning of 2023. The Fed also received positive news on the inflation front in August, with headline consumer price inflation undershooting expectations on a year-on-year basis, rising 2.9% (versus an expected 3%), which represents the slowest print since March 2021. Core inflation was in line with consensus at 3.2% at the year-on-year level. The revised estimates of second-quarter US GDP helped in painting an increasingly positive story for domestic economic growth. The headline GDP number was revised upwards to an annualised growth rate of 3% from 2.8% previously, and the Atlanta Fed increased its third-quarter GDPNow estimate to 2.5%. Nevertheless, Jerome Powell's speech at Jackson Hole at the end of August saw several dovish comments that all but confirmed the Fed will be cutting rates at its upcoming central bank meeting in September. Powell said "the time has come for policy to adjust" and acknowledged that "downside risks to employment have increased", suggesting the Fed is shifting its focus away from inflation and towards the employment side of the economy. Powell noted the recent uptick in the unemployment rate has been driven not just by weakening labour demand but very strong supply. He described the cooling in labour market conditions as "unmistakable", which resulted in markets increasing the probability that the Fed would execute a 50 basis point (bps) interest-rate cut in September to 33% by the end of the month.

In the UK, the Bank of England (BoE) delivered its first interest-rate cut in four years at the beginning of the month, with the 25 bps move made on a knife-edge 5-4 vote. Similarly to the US, the UK had a soft inflation report. The headline number came in one-tenth below market expectations on both a monthly and annual basis, while core CPI also surprised on the downside, ticking down to 3.3% from 3.5% in the previous month. Services inflation fell noticeably from 5.7% in June to 5.2% in July, well below consensus expectations of 5.5%. UK unemployment also surprisingly fell to 4.2% in the second quarter, down from 4.4% in the first quarter, with the monthly reading of 3.6% for June representing the lowest reading since February 2022. Despite cutting rates at the beginning of August, the BoE struck a cautious tone at its last meeting and did not commit to further cuts in the near term, reiterating that it is now more focused on broader trends than individual data points.

In Europe, the preliminary headline CPI release for August was in line with expectations at 2.2%, as was core inflation at 2.8%. This figure represents the eurozone's lowest inflation figure for three years, opening up the opportunity for a second European Central Bank (ECB) rate cut in September, which the market is fully pricing in. There remain some doubts over the Eurozone's future economic growth prospects over the medium term. However, reassuringly, second-quarter GDP came in line with expectations at 0.6% year-on-year. Moreover, Purchasing Managers' Indices (PMI) posted a significant outperformance relative to expectations, with the composite PMI reading coming in at 51.2 (50.1 expected), supported by a strong reading from France amid the Olympics.

Summary

Despite an opening week of volatility, August saw asset-backed security (ABS) markets move in the same direction as the rest of the year. Primary markets saw more subdued activity (although busier than average for this time of the year). Primary issuance over the year to date sits at €96.5bn, with August welcoming €6.3bn of ABS issuance and €4.7bn of collateralised loan obligations (CLOs). Markets have started introducing September's supply, at a pace that we feel will set the tone for the coming weeks.

RMBS

Residential mortgage-backed security (RMBS) markets were more muted in August, with just three new issues. Cumulative year-to-date (YTD) issuance now sits at €38.5bn. Interestingly, two of these deals printed during the week of volatility at the start of the month. We first saw a UK buy-to-let transaction from the London Wall shelf of Fleet/Precise/TML, which initially planned to publicly place bonds but was disturbed due to market volatility and pre-placed the AAA bonds at a spread of 99 basis points (bps) over SONIA, retaining other tranches. The following day, Santander was able to publicly place £500m AAA Prime RMBS bonds at a spread of 50bps. While this did not see impressive coverage (and was perhaps a few bps wider than during a more benign week), it shows a strong resilience for primary markets in the face of widespread volatility. Later in the month, we saw a fully pre-placed transaction from Cornwall Home loans. We expect RMBS issuance to pick up in September, both with repeat issuers and new entrants.

CLO

CLO markets saw the busiest post-Global Financial Crisis August, welcoming €4.7bn of supply across 12 transactions, 50% of which were refinancings. This brings the YTD supply to a record €46.0bn (€33bn new issue and €13bn Refi/Reset), helped by lower funding costs, active loan markets and strong investor demand. AAA levels in primary widened a few bps in response to market volatility, with levels ending at 130bps over Euribor. As expected, BBs now sit further from YTD tights, with mid 600s seeming a new clearing level in primary. European leveraged loans were hit at the start of the month, and the index dropped 0.3 points to intra month lows of 97.7. They have since recovered close to half of the drop, but still sit below YTD highs, and will help the arbitrage in CLO transactions. Although slower to erupt post-summer, we expect very healthy gross supply into the end of the year, including a higher share of resets and refinancing.

Other ABS

We saw limited ABS issuance during August, with just two auto deals printing in the last week of the month. Both repeat issuers, we saw Bank11 and LeasePlan come to the market in late August. LeasePlan came with a senior only offering, printing €600m of AAAs at a spread of 64bps, tightening from IPTs of MH60s with a well covered 1.4X book. Bank11 offered a full capital stack, just four months after their first mezzanine offering this year. The AAAs here ended at a spread of 0.56% over Euribor, with mezzanine down to a Baa3/BB+ tranche ending at 3% over Euribor. Coverage and pricing was back in line with July, with mezzanine tranches seeing 5-7X subscription, indicating healthy ongoing demand.

Secondary

Bids Wanted in Competition (BWIC) activity remained subdued for most of August. We ended the month with just €310m of ABS and €780m of CLOs trading on BWICs. Over half of all CLO trading was in AAA paper, particularly during the first week of volatility. Initially spreads widened by around 10bps as banks reduced inventory, on very little trading, but have since recovered some of this. In mezzanine CLOs, particularly sub-investment grade tranches, we have not seen a full recovery due to limited trading and are seeing BB/Bs 20/50bps from pre-summer levels. In ABS markets, activity remains focused on seniors, where the few bps of widening at the start of the month have been recovered.

Portfolio Commentary

August was a relatively busy month for the Fund as the team reinvested amortisations. In the collateralised loan obligation (CLO) market, the team continue to allocate to BB and B CLOs, where spreads remain attractive versus corporates. The team added BB CLOs at spreads of 5-7% over Euribor, and Bs at 9-11% over Euribor in both the primary and secondary markets. While non-CLOs remained low during the month, the Fund added mezzanine tranches of a UK auto transaction, at attractive yields. The gearing of the Fund remained unchanged in August and the portfolio management team are happy with the flexibility of the Fund as we head into the wave of September new issue.

The Fund returned 0.85% for the month, with three-year volatility at 7.37%.

Market Outlook and Strategy

Despite the bout of volatility at the start of the month, ABS markets bring a positive tone into September. Although there was weaker labour data out of the US, 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. A lack of material declines in macroeconomic data remains evident in risk sentiment; however, caution on geopolitical escalation is warranted. We expect this to support demand into September, albeit met with strong supply. Although the pipeline of new transactions is very large, early prints show that there is a lot of demand for high-quality paper, and we expect this wave of supply to be taken down by the market without too many problems. The PMs are opportunistic about the ability to add good quality risk at attractive prices. Notwithstanding this, we caution on issuers with weaker collateral quality using the attractive pricing to lock in funding. The team continues to prefer established issuers with a long track record.

Cumulative Performance	1m	3m	6m	1y	Annualised 3y	5y	10y	Since Inception*
NAV per share inc. dividends	0.85%	3.03%	7.79%	18.77%	7.80%	7.41%	6.12%	7.81%

Discrete Performance	YTD	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
NAV per share inc. dividends	12.07%	20.40%	-8.84%	7.85%	5.97%	5.04%	2.39%	13.51%	4.28%	-0.12%	13.38%

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 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: 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.twentyfouram.com/view/GG00B90J5Z95/twentyfour-income-fund

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