TwentyFour
a boutique of Vontobel

Fund Commentary | 31 October 2024

TwentyFour Income Fund

This Commentary is a marketing communication for professional UK investors only

Market Commentary

October was volatile for fixed income markets as a combination of resurgent economic data and the increasing probability of a Trump presidency led to a material sell-off in government bonds. Investors adjusted their expectations to anticipate a slower and more gradual rate-cutting cycle from the US Federal Reserve (Fed), which contributed to a 50 basis points (bps) rise in 10-year Treasury yields over the month. Credit performed well as a result of further spread tightening and the continuing strong financial performance from the majority of companies.

Markets started the month strongly, with a significantly better-than-expected US labour report surprising investors and easing fears that labour demand was deteriorating at an uncontrollable pace. The combination of stronger labour data and growing inflation risks, deriving from the rise in oil prices amid the escalating conflict in the Middle East at the beginning of the month, resulted in investors gradually pricing out the probability of a 50bps interest-rate cut by the Fed at its next central bank meeting in November. As the month drew to a close, the increasing probability of a Trump presidency drove Treasury yields wider. A Trump victory is widely regarded as being inflationary and conducive to domestic growth, which suggests a higher rate environment over the medium and long term.

Being the only central bank of the 'Big Three' to host a monetary policy meeting last month, the European Central Bank (ECB) announced a 25bps rate cut, taking the level down to 3.25%, which was in line with expectations. The move represents the first back-to-back rate cut of any of them this cutting cycle as President Christine Lagarde recognised there were "probably more downside risks" on inflation, in alignment with the weak CPI data out of the eurozone in recent months. The eurozone did, however, post stronger-than-anticipated growth data as third-quarter GDP grew by 0.4% (quarter on quarter). This was above the 0.2% expected rate, with upside surprises across several countries including Germany, France and Spain. Despite this, investors still expect the ECB to cut rates by 25bps at its next meeting, and 25bps in each of the subsequent meetings heading into 2025.

The UK experienced a significant bout of volatility at the end of the month as Chancellor of the Exchequer Rachel Reeves announced the Autumn Budget. There were significant losses among UK gilts across the curve following the announcement. Gilt yields rose materially in the aftermath as investors reacted negatively to the proposals of increased investment spending that will be financed by increased borrowing and higher domestic taxes on companies and individuals. On the macroeconomic front, October's UK CPI release fell well below forecasts, which helped to reassure investors that inflationary pressures were easing. The headline number ticked down to 1.7%, versus 1.9% expected, representing the lowest annual rate since April 2021; core inflation was also its weakest in over three years. The services inflation print was particularly encouraging, falling to 4.9%, from 5.6% previously, which contributed to investors now pricing in a 25bps cut at the next Bank of England meeting in November. The labour market is still going strong, with the three-month annualised rate from June to August (released in October) falling to 4.0%.

Summary
The pace of new issuance that was set in September continued into October in both asset-backed security (ABS) and collateralised loan obligation (CLO) markets. Primary markets saw a record €17.5bn of ABS issuance and €9.5bn of CLOs, bringing the year-to-date total to over €130bn. The deluge of supply seems to have placed a floor on spread products, especially in Euro AAAs, where we have seen some fatigue. However particularly in shorter AAA CLOs and senior European consumer ABS, the team have seen good value opportunities. We expect the focus to center on secondary markets in the first weeks of November, as US elections will dominate markets. However, we can see appetite for further issuance before year-end as issuers continue to look to take advantage of persistent demand from investors.

RMBS
Residential mortgage-backed security (RMBS) markets remained active during October, with 12 new issues. Cumulative issuance now sits at €48.2bn for the year. The supply was dominated by UK issuers, with just two transactions from Continental Europe. We have persistently referenced an increase in bank issuance due to the fading of cheap central bank funding. This is evidenced again through Yorkshire Building Society introducing a debut master trust structure and Nationwide placing another tranche from their Silverstone programme. The demand remains healthy for the sector, with final AAA books 1.5-2X covered and spreads firm in 50bps over SONIA for UK prime RMBS. Another theme that has carried through to October is the frequency of debut specialist shelves from the UK, which was most prominent, surprisingly, during the week of the UK Budget. The AAA demand has remained healthy, facilitating spread tightening from initial guidance by 5-10bps, and final spreads for senior UK RMBS between 0.8-1% over SONIA. However, as collateral performance remains imperative, we have seen a significant tiering in the prints of sub-investment-grade (IG) tranches of these transactions. For example, debut shelf Citadel (Pepper-backed UK second lien mortgages) printed their BBs at 3.75% over SONIA, while LendInvest's mixed (owner occupied and BTLbuy-to-let) platform saw equally rated bonds land at a spread of 5.92% over SONIA, a gap of over 200bps. While this gap is large, we welcome investors' resistance to spread tightening where collateral performance is untested or deteriorating.

CLO
CLO markets have continued at an impressive pace during October, perhaps with a stronger focus on new issues than in September. We welcomed €9.5bn of issuance during October, €5.9bn of which was new issues. This brings the year-to-date supply to €64bn, €41bn of which is new issue. AAA levels for new issues have remained firm at 1.3% over Euribor. However, the sheer supply has meant that it is generally taking longer for CLOs to price as there seems to be a lacking attention for AA and A rated tranches, in particular. We continue to observe a very significant tightening of BB spreads, where cleaner deals have seen opportunities to print inside of 600bps, while this has been blocked for certain resets from investors who continue to demand a premium for higher beta transactions. During the month, we also saw an uptick in the CCC exposure for European pools, including downgrades in the lab space in the face of regulatory changes in Europe. European loans initially sold off during October, following heightened tensions in the Middle East; however, they ended the month moderately higher at 97.7.

Other ABS
The consumer and auto ABS market has provided consistent issuance throughout the year, continuing in October. Despite the healthy supply, these transactions continue to attract impressive demand from the market, with mezzanine tranches 5-7X covered for most issuers. We continue to observe a lack of sensitivity from investors to weakness in certain consumer collateral pools, particularly those transactions featuring higher risk borrowers, where we continue to exercise caution. We do see pockets of value in the consumer market, particularly in the periphery, where collateral performance remains healthy. At the start of the month, we welcomed WiZink to the market, with its Portuguese credit card transaction. The seniors here printed at an attractive 1.2% over Euribor, with BBBs at a spread of 2.6%, supported by strong investor demand. Notably, the market welcomed the first public ABS transaction backed by consumer loans for solar panels during October. The transaction, backed by loans originated by Enpal, was supported by the European Investment Fund and gathered healthy demand from the market, with the publicly placed senior tranche printing at 0.85% over Euribor. Although the market remains somewhat untested, the prime nature of the borrower supports the collateral performance, and we expect to see a higher degree of issuance out of the market.

Secondary
Bid wanted in competition (BWIC) activity remained elevated, in support of primary markets. We saw €1.1bn of ABS and close to €1.8bn of CLOs trading on BWICs. On the ABS side, activity continues to be driven by new issue rotation, particularly in UK prime at the start of the month, driving spreads a few bps wider and causing the pickup from prime to UK non-confirming/BTL to compress. In the CLO market, we have seen a higher share of IG mezzanine bonds on BWIC, which has caused secondary spreads there to widen by close to 10bps as investors rotate into new issues and as most bonds over a 100 price are now trading to the first call date. This rotation trade was also behind AAA supply remaining over 1.5X the average volume, as the trade from amortising AAAs to new issue remains attractive.

Portfolio Commentary

October was a busy month for the Fund, as the team deployed amortisations into an active primary market. In the CLO market, the team focused on idiosyncratic trades in B CLOs offering high income and convexity, where they have strong manager conviction at yields of around 15%. The Fund traded various other CLOs and had a number of older CLOs get called at par. Currently, the portfolio managers prefer primary issuance and older deals where they think the call optionality is undervalued and primary issuance (with BBs and single B rated bonds generally trading at Euribor +6% and +9.5% to worst). Outside of CLOs, the portfolio management team continue to allocate to shorter consumer assets in primary, where they see a strong credit story. During the month, this included B rated peripheral credit cards at 5.6% over Euribor. The team reduced the Fund's gearing to 1.4% during the month but remain agile in replacing this if opportunities arise. The team have been happy to run a higher liquidity position ahead of the US elections with the intention of remaining flexible in the face of potential volatility.

The Fund returned 1.11% for the month, with three-year volatility at 7.39%.

Market Outlook and Strategy

October has brought a diverse and buoyant supply to the market, despite the looming elections out of the US. While consumers continue to display resilience, collateral performance continues to diverge between transactions; however, the reflection of this to new issue pricing is limited from investors, particularly in consumer and auto transactions from core Europe. We expect to see a focus on secondary markets for the next few weeks, and markets digesting the pending results of the US elections. However, we see capacity for further supply before the end of the year.

Earlier in the month, the UK Chancellor's Budget caused interest rate expectations for the UK to shift higher for longer, which supports the yields for spread products. However, it will continue to pressure consumer affordability and will remain an area of focus. We have noted heightened uncertainty ahead of the US elections and have persistent concerns surrounding the escalation of conflict in the Middle East. For this reason, we value the flexibility of maintaining liquidity in the funds. We continue to display caution on issuers with weaker collateral quality using the attractive pricing to lock in funding, and the team continue to prefer established issuers with a long track record. While geopolitical risks remain, the portfolio managers remain constructive on spreads as the technical persists, also helped by lower interest rates forcing investors to look at higher spread products such as CLOs.

Cumulative Performance	1m	3m	6m	1y	Annualised			
					3y	5y	10y	Since Inception*
NAV per share inc. dividends	1.11%	2.73%	7.22%	19.11%	8.11%	7.73%	6.14%	7.87%

Discrete Performance	YTD	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
NAV per share inc. dividends	14.17%	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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