TwentyFour
a boutique of Vontobel

Fund Commentary | 31 December 2024

TwentyFour Sustainable Enhanced Income ABS Fund

This Commentary is a marketing communication for professional UK investors only

Market Commentary

Hawkish central bank meetings and the renewed risk of inflation in the US economy drove a significant sell-off in fixed income markets in December. Increasing caution over the pace of rate-cutting cycles across major economies pushed the 10-year Treasury yield up by 38 basis points (bps) during the month. The rise came as investors lowered their expectations for extensive interest rate cuts by the Federal Reserve (Fed) and other central banks in 2025. Equity markets also reacted negatively, with the 'higher-for-longer' interest rate narrative gaining traction.

Following November's somewhat unreliable US labour report, the market paid particularly close attention to December's numbers. The mixed jobs report saw the headline non-farm payroll figure rise by 227,000 month-on-month, However, the unemployment rate ticked up to 4.2%, which represented a significant upside surprise relative to the 4.1% expected by economists. The most significant of these data releases was for US inflation. The monthly headline and core Consumer Price Index (CPI) readings both came in at 0.3%. Although these figures were broadly in line with expectations, longer-term inflation trends were of concern to investors as the three-month annualised pace of core CPI ticked up again to 3.7%. The Fed's meeting in the middle of the month compounded the growing narrative that it would pursue a more hawkish approach next year than previously anticipated. An expected 25bps cut (which took the Fed funds rate down to 4.25-4.50%) was accompanied by an updated set of 'dot-plot' projections showing just 50bps of cuts for 2025, down from 100bps previously.

Similarly to the Fed, the European Central Bank (ECB) adopted a more hawkish approach than many had expected at its meeting, despite delivering its own 25bps rate cut to take the deposit rate down to 3.0%. Updated forecasts saw both economic growth and inflation projections downgraded over the years ahead, with GDP growth at just 1.1% (down by 0.2 percentage points from the previous quarter) and headline CPI at 2.1% (down from 2.2%) by the end of 2025. Many of the same economic data trends persisted in the eurozone, with weaker growth and slowing inflation continuing. There was political turmoil in France, however, as Marine Le Pen's party, backed by left-wing parties, announced that it would support a no-confidence motion in the government of Prime Minister Michel Barnier. Barnier went on to lose the vote, with the National Assembly choosing to oust his government. The result was somewhat expected and markets did not move much.

The Bank of England (BoE) bucked the trend in its meeting, striking a more dovish tone than anticipated. The decision to hold rates at 4.75% was widely expected, but this outcome was only made by a 6-3 vote, with the minority opting for a 25bps cut. Tracking US Treasury moves, UK gilts remained under pressure throughout the month, however. The CPI print did little to help matters, with December's reading showing that headline inflation accelerated to an eight-month high of 2.6% and that core inflation ticked up again to 3.5%. The final number for third-quarter GDP came in a tenth below expectations at 0%, which, when combined with the aforementioned inflation picture, led to growing concerns that the country was potentially heading towards a stagflationary environment.

Summary

Although the festive period drove lower activity in asset-backed security (ABS) and collateralised loan obligation (CLO) markets, issuance was healthy, particularly in CLOs. In December, €6.2bn of ABS and €7.3bn of CLOs were issued in the European market, which brought the year-to-date total to over €144bn. Secondary activity fell moderately in both markets, but remained healthy and supportive of spreads, as investors looked for opportunities to deploy cash. The European ABS market showed little correlation to equity and credit softness into the second half of December.

RMBS

The European residential mortgage-backed security (RMBS) market was active and diverse in December, with €4.4bn of supply, although many deals were not publicly placed. In the UK, there were three transaction prints, spanning UK prime 'stock and drop' from Nationwide, SMI 2024-1, to a refinancing of pre-global financial crisis Landmark mortgages, under the TPMF shelf. The three-year tranche from Nationwide printed at 45 basis points (bps) above SONIA, while the TPMF AAA tranche priced at a spread of 85bps. The differential between UK prime and non-conforming transactions tightened significantly through the year, which increased the relative value of the prime collateral, in our opinion. Away from performing UK RMBS, we saw two rare UK and Spanish reperforming mortgage transactions, with collateral from Lloyds Banking (Halifax brand) and Unicaja Banco. The Lloyds deal was privately placed, but the €300m Spanish deal was well covered in a range of 2-4 times, with AAA levels at a spread of 1.5%, in line with initial price talk in the mid-100s.

CLO

The CLO market was particularly busy in December, with a continued focus on reset and refinancing of older transactions. During the month, €7.3bn was issued, €2.1bn of which was new and €5.2bn was refinancing, which brought the year-to-date supply to €81bn. In the US market, there has also been a substantial level of supply. During December, the US market issued $42bn of CLOs ($11bn was new and $31bn was refinancing and reset), which brought year-to-date new issue supply to an impressive $496bn. In Europe, AAA levels have remained firm at 1.3% over Euribor, along with investment-grade mezzanine tranches. Market spreads for BB and B tranches tightened moderately during December, although this was supported by continued tiering between managers. Primary CLOs have seen the BB spread range tighten to 5.70-6.65%, as investors have continued to demand a premium for higher beta transactions. The European leveraged loan index initially fell, after an escalation in geopolitical rhetoric, before recovering partially to end the month at 98.

Other ABS

The ABS market remained vacant during December, after a record level of €40.5bn year-to-date issuance. Collateral performance remained robust across most transactions, as expected interest rate cuts across Europe continued to support borrower affordability. Pockets of weakness remained, and the team value established lenders that are well-equipped to support borrowers.

Secondary

Bid-wanted-in-competition (BWIC) activity fell moderately in both the ABS and CLO markets. There were €400m of ABS and €500m of CLOs traded on BWICs. On the ABS side, activity was focused on AAA bonds, particularly European automotives, where investors looked for pockets to deploy inflows into the end of the year. ABS spreads were generally flat through December. In the CLO market, although total volumes fell, supply remained diverse, with BBs and AAs holding a larger share than the year-to-date averages. Activity here was supportive across the capital structure, with equity demand particularly strong. The portfolio managers saw an increased number of trade posts from banks late in the month, which indicated that investor demand was unusually strong at this time of the year.

Portfolio Commentary

December was a relatively busy month for the Fund, as the portfolio management team deployed steady inflows. The team continued to allocate to CLOs in the primary market, particularly BBBs and BBs, where spreads of 3.4% and 5.9% over Euribor, respectively, continued to look attractive against corporate bonds. Outside of CLOs, the team looked at European automotive transactions to maintain the Fund's liquidity position, adding German automotive loans at 4.2% over Euribor. Generally, the Fund remains in a flexible position and armed to act opportunistically in the expected dynamic ABS market in January.

The Fund returned 0.75% for the month (Class A Inc), with three-year volatility at 3.81%.

Market Outlook and Strategy

Despite the wider sell-off in markets, following central bank dialogue, there was a positive tone in the ABS market during December. While consumers continue to display resilience, inflationary sentiment from the UK Budget and proposed policy of the incoming US administration of Donald Trump will likely point to more stringent conditions for consumers, and for longer. We expect the pickup in arrears of the most vulnerable borrowers to continue. In this environment, we therefore reiterate the importance of larger established lenders and avoiding products like sub-prime automotive loans and credit cards. In European CLOs, we expect corporates to benefit from the rapidly decreasing cost of funding, which should have a positive impact on defaults. We expect issuance across ABS and CLOs to remain strong in 2025, with a particular push from UK banks and CLO resets in Europe. While geopolitical risks persist the portfolio managers remain constructive on spreads as the technical condition persists. This is also helped with lower interest rates forcing investors to look at higher-spread products such as CLOs, with the late December activity indicating that the current strong demand technical is likely to persist.

					Annualised			
Cumulative Performance	1m	3m	6m	1y	3y	5y	10y	Since Inception*
Class A GBP	0.75%	2.27%	4.53%	11.53%	7.65%	N/A	N/A	6.62%
SONIA	0.40%	1.22%	2.51%	5.20%	3.76%	N/A	N/A	2.58%

Discrete Performance	2024	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Class A GBP	11.53%	14.27%	-2.11%	3.59%	N/A	N/A	N/A	N/A	N/A	N/A	N/A
SONIA	5.20%	4.71%	1.41%	0.05%	N/A	N/A	N/A	N/A	N/A	N/A	N/A

Based on the A Inc GBP share class from inception on 20 August 2020 before switching to A Acc GBP share class following its inception on 2 November 2020. Switch in reporting share class was made for ease of reporting. 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 20/08/2020. SONIA used as a proxy for cash as a performance reference for illustration purposes only, there is no specific return objective or benchmark for the fund.

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
- 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 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
- 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 **www.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 relevant offering documents available at www.twentyfouram.com/document-library