TwentyFour
a boutique of Vontobel

Fund Commentary | 29 November 2024

Vontobel Fund – TwentyFour Monument European Asset Backed Securities

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Market Commentary

October's elevated volatility spilled into November as the outcome of the US election and escalating tensions in Eastern Europe drove meaningful government bond moves. The significance of Trump's election for financial markets was matched by news that conflict between Ukraine and Russia escalated, with both sides launching attacks.

Earlier in the month the unemployment rate in the US remained flat at 4.1%, in line with market forecasts, although on an unrounded basis, the figure increased by almost a tenth, from 4.05% to 4.15%. The market's attention quickly switched to the US presidential election. The eventual result of a 'red sweep', whereby the Republican Party will take control of the executive branch and both legislative houses, has made it more likely that Trump will be able to pass some of the policies highlighted in his manifesto. The Federal Reserve (Fed) 's decision to cut rates by 25 basis points (bps) at its meeting the following day was largely priced in by the market. The Fed funds rate target range now sits at 4.50-4.75%, but Fed Chairman Jerome Powell did not give any indication on how the cutting cycle would proceed in the December meeting. US core Consumer Price Index (CPI) printed at 0.3% month on month for the third consecutive month, which suggested that inflationary pressures have started to resurface and has left the Fed in a precarious position on how to proceed with its easing cycle.

Similarly to the Fed, the Bank of England (BoE) delivered a quarter-point rate cut in November, taking base rates to 4.75%. The latest GDP release showed that, despite economists expecting growth of 0.2% for September, UK GDP fell by 0.1% over the month. This followed growth of just 0.2% in the previous month and brought third-quarter UK GDP to 0.1%, below both the anticipated 0.2% figure and second-quarter expansion of 0.5%. The UK's dominant services sector grew by just 0.1% on the quarter, while the construction component rose by 0.8%. Headline CPI surprised to the upside, with the figure rising by more than expected to 2.3% in October from 1.7% in the previous month, largely due to the jump in energy bills. Services inflation remained elevated at 5%, in line with the BoE's forecast, although market reaction was relatively muted as investors continued to price in two fewer cuts in 2025 than the five that the BoE has indicated.

European government bonds outperformed US Treasuries and UK gilts in November as eurozone data continued to support the narrative that the European Central Bank (ECB) would continue to cut interest rates at a faster pace than the Fed. Markets received positive news on inflation as releases across the continent were lower than forecasts, with the highlights being Germany at 2.4% and France at 1.7%, which were 0.2% and 0.1% lower than expectations, respectively. Eurozone aggregated numbers came to 2.3% and 2.7% for headline and core inflation. The ECB's inflation expectations survey showed 2.1% for three years ahead, which is the lowest since the first quarter of 2022 and suggests that the battle against inflation in the eurozone is in its final stages.

Summary

Coming into the month, investors were wary of event risk surrounding the US election. This paved way for a slower pace of new issuance from the asset-backed security (ABS) and collateralised loan obligation (CLO) markets, with €7.6bn of ABS issuance and €4.8bn of new issue CLOs, which brought the year-to-date total to over €138bn. Across ABS products, the relative slowdown in supply has halted the 'senior fatigue' witnessed in October. We expect ABS issuance to continue to grind to a close for the holidays, while CLOs are likely to remain active well into the last few weeks of the year, supported by reinvestment demand.

RMBS

Residential mortgage-backed security (RMBS) activity during November was muted against the usual levels for 2024. There was just one transaction print in the last week of the month: the Morgan Stanley-sponsored Shamrock transaction, collateralised by Irish reperforming mortgages. The €280m transaction publicly placed a full capital stack, with AAAs at a spread of 1.2% over Euribor and BBs at a spread of 5% over Euribor, close to the tightest levels for the sector in three years. As the market digests the UK Budget, announced in October, the focus has been on proposed reforms to the buy-to-let market, driven by the Renters (Reform) Bill. Currently under discussion in the House of Lords, the bill could drive changes to 'no-fault evictions' and the bidding process for rental properties, and is an area of focus into the end of the year. Outside of the UK and Europe, it is worth highlighting the impressive year-to-date issuance from the Australian RMBS market, where there has been A$52bn of public issuance, 1.3 times the post-global financial crisis record.

CLO

CLO issuance continued at an impressive pace during November, with the pendulum swinging back to a focus on reset and refinancing. Issuance totalled €9.75bn, €4.84bn of which was new issuance, which brought the year-to-date supply to €74bn. There has also been a substantial level of supply in the US. During November, $58bn of CLOs were issued in the country, $23.7bn of which was new issuance, which brought the year-to-date supply to an impressive $145bn. In Europe, AAA levels have remained firm at 1.3% over Euribor, although there were levels inside of 1% for KKR's static CLO and levels out to 1.47% for Barings' middle market CLO. Although AAA levels have seen little effect from the deluge of supply, we saw mezzanine tranches broaden in November, with more significant tiering evident between managers. Broadly syndicated loan CLOs have seen a BB spread range of 5.70-6.75%, as investors have continued to demand a premium for higher beta transactions. It is worth highlighting the first middle market private credit transaction from the European CLO market, an expected catalyst from further issuance from the sector, which is already an established market in the US. The European leveraged loan index enjoyed a significant rally during the month, strengthening by 0.5 points following the US election to end at 98.1.

Other ABS

The pace of ABS issuance slowed in line with that of RMBS, with just two transactions during the month. Stellantis returned to the market with its second Italian automotive transaction of the year. The €800m transaction saw the €710m AAA tranche pre-placed at a spread of 83bps over Euribor. The €100m of mezzanine bonds on offer gathered a large (and expected) level of interest from investors, with final coverage more than 10 times the BBB tranche, which tightened significantly from talk of high 200s to a final level of 215bps over base rates. Later in the month, investors digested a commercial mortgage-backed security (CMBS) transaction from Blackstone, a pool backed by UK logistics. Investors received the €370m transaction well, with a final AAA level of 1.35% over SONIA and coverage of 2-4 times across the capital structure. The result was a good one for the issuer and the CMBS market, potentially paving the way for increased logistic issuance into 2025. It is worth noting idiosyncratic events during the month, namely the Financial Conduct Authority (FCA) investigation into automotive commissions in the UK. While the impact on most UK automotive transactions will be negligible, the potential redress costs have resulted in heightened bids-wanted-in-competition (BWIC) activity for the UK automotive market, particularly for smaller lenders.

Secondary

BWIC activity fell moderately in both the ABS and CLO markets. About €750m of ABS and almost €1bn of CLOs traded on BWICs. On the ABS side, activity was less focused on new issue rotation, as the respite in issuance made room for relative value trades. As already mentioned, there has been a skew to the selling of UK automotives following the FCA probe, and mezzanine execution weakened during the month. Volumes in the primary CLO market drove spreads wider in the investment-grade part of the stack, especially in shorter AAAs, which were 5-10bps wider. There was also an elevated level of equity activity in the CLO market, as investors rotated from higher beta names ahead of the end of the year.

Portfolio Commentary

November was relatively quiet for the Fund, as the portfolio managers (PMs) focused on relative value trades. The team reduced exposure to Spanish automotive transactions that contain a moderate exposure to the Valencia region, where severe flooding increased tail risk. The team also sold senior European consumer paper at a spread of 0.75% over Euribor. The proceeds were used to rotate into BBB CLOs at a spread of 3.5% over Euribor, given that they have continued to look attractive against corporate bonds. The team has been happy to run a higher liquidity position and values flexibility into the end of the year.

The Fund returned 0.40% for the month (Class I Euro Acc), with three-year volatility at 2.86%.

Market Outlook and Strategy

November was generally positive for credit, although the encouraging sentiment continues to be dulled by an escalation in geopolitical risks, particularly in the conflict between Russia and Ukraine. While consumers continue to display resilience, inflationary sentiment from the UK Budget and the proposed policy of the incoming US administration of Donald Trump will likely point to more stringent conditions for consumers, and for longer. Therefore, we continue to reiterate the importance of established lenders in the environment and prioritise the monitoring of collateral performance underlying transactions. We expect CLO supply to continue into the end of the year, while ABS issuance is likely to flatten, which will allow a focus on secondary markets during the next few weeks. The path for interest-rate cuts continues to diverge between the UK and Europe, as the 'higher-for-longer' sentiment persists in the UK. While geopolitical risks continue, the PMs remain constructive on spreads as the technical persists, 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*
I EUR Acc	0.40%	1.26%	2.49%	7.30%	3.21%	2.28%	N/A	1.87%
3 month Euribor	0.25%	0.80%	1.74%	3.75%	2.38%	1.23%	N/A	0.71%

Discrete Performance	YTD	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
I EUR Acc	6.25%	8.43%	-4.54%	1.73%	-0.14%	2.05%	-1.14%	N/A	N/A	N/A	N/A
3 month Euribor	3.40%	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. Euribor 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
- 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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