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Aegon ABS Opportunity Fund

Monthly September 2024

Market review

General financial markets

After being rattled by an escalation of Middle East tensions following Iran's military strikes on Israel, financial markets remain very nervous as we enter the final quarter of 2024. The US and Europe jobs reports helped temporarily distract from geopolitics but volatility remains due to the constant changing and diverging expectations on central banks actions. Similarly, the macroeconomic environment is diverging globally, feeding into the volatility in the markets. While there was positive labor market news both out of Europe and the US and inflation is easing, the growth outlook seems to be moving to the forefront of central banks' policy decisions.

In the euro area, inflation risks have diminished and the focus is broadening, with the ECB is getting more concerned about the growth outlook and the increased probability of stagnation with Lagarde stating that the recovery is "facing headwinds". Within the euro area, Germany stands out with weaker data than elsewhere as the weakness in its car industry dominating the headlines in September. Euro area final PMIs surprised to the upside compared to the flash print, with the composite moving to 49.6 from 48.9 but still in contractionary territory. While the ECB has been worried about wage pressures and the stickiness of services inflation, the recent inflation decline has increased the ECB's confidence. An October rate cut seems to be a done deal and a third and fourth rate cut by the ECB at the next two meetings in October and December are fully priced in.

US economic strength contrasts with weakness in Europe. The weakness of US nonfarm payrolls during the summer seems something of the distant past, as labor demand now is carrying considerably more strength. The most recent release reinforces the conviction that the US economy remains very resilient and the fear of a recession seemed to be premature. After the 50 bps rate cut by the Fed, markets are pricing in a more gradual Fed cutting cycle which seems to be in line with recent communications, where Fed chair Powell repeatedly made the case that the FOMC is in no hurry to cut rates. US terminal rates are now expected to get closer to 3.45% versus 2.8% in the midst of September.

However, not everything is carved in stone as geopolitical tensions are intensifying. The market is looking for more stimulus measures from China, boosting demand. If a negative supply shock occurs due to a further escalation of the tensions in the Middle East, higher (import) tariffs, and other import restrictions, these would disrupt the disinflation trend, resulting in central banks not delivering on the significant easing priced in by markets.

Gross return September 2024

	I (EUR)	I (GBP)
	1.17	1.16

Gross returns (%)

	YTD	1 year	3 year	5 year
I-Share (EUR)	10.73	15.48	7.01	0.00
I-Share (GBP) ¹	11.65	16.79	8.45	0.00

¹ Share class hedges the currency exposure in the pool to GBP

Characteristics	EUR	GBP
Yield to maturity ¹	7.1	8.7
Spread ¹	468	488
Spread Duration	5.05	
Modified Duration	0.215	

¹ Estimated spread and yield to maturity as per 30 September 2024 using most conservative assumptions

ABS Market

Primary market issuance geared up and the flurry of supply was met with healthy demand especially down the capital structure. Overall, spreads moved slightly wider, especially on the senior part, given the heavy supply in the primary but deeper down the capital structure, spreads were tighter. Overall, European ABS markets performed strongly, with carry providing most of the performance, despite the rate cuts. Secondary supply has also been elevated as ABS investors seem to be rotating into new issuance, causing a mixed technical (generally seniors wider, non-seniors tighter). Primary issuance in September marked the month with the second highest issuance of 2024, amounting to €15.3 billion. ECB eligible sectors have widened about 8-10 bps over the 3rd quarter, while spreads in higher beta sectors like UK Buy-to-Let and CLOs are broadly similar.

Issuance year-to-date is €111 billion, a 65% increase compared to the same period last year. The bulk of issuance comes from CLOs (32%), followed closely by the UK (30% YTD) and is geared towards RMBS. Within RMBS, issuance from the UK makes up 70%. With spreads tightening significantly over the past year, CLO issuance continues to be buoyant and is expected to continue. Furthermore, we have seen CLOs being called and reissued, or using refinancing or resets which add to the supply. Auto ABS, the sector with record issuance last year increased to 20% and consumer ABS to 11% year-to-date. Overall, RMBS makes up 33% of issuance, followed by CLOs (32%) and consumer ABS (31%).

Outlook

European ABS showed a positive performance in September. Carry again contributed the most (~80%) as spreads moved sideways to slightly wider and non-seniors outperforming seniors due to higher carry. The front end of the interest rate curve at the 1-year point is currently around 0.4% higher than the 3-year point. As such, the current yield of European ABS is 0.4% higher than the yield-to-maturity. If interest rates move opposite the markets expectation of rate cuts, the yield-to-maturity would increase once more, while receiving higher carry now. Considering the broader macro backdrop i.e., geopolitics, recession risk, continuous repricing of central bank expectations, and idiosyncratic corporate downgrade events, there are many uncertainties that will affect short-term returns.

There has been a slight bit of dispersion in parts of the European ABS market, but spreads broadly remain around the tightness of the past 36 months (about three years). Looking ahead to the remainder of the year, the way spreads would move will be influenced by idiosyncratic events and the expectations regarding fundamentals, but we do not expect spreads to move tighter from here. On the technical side, while we have seen an increase in supply from primary markets, there is also (re)new(ed) interest from certain investor groups.

There is plenty of cash to put to work and early redemptions and amortizations of ABS structures provide additional technical support.

Net supply so far has been slightly positive, and we expect the trend to remain in place over the remainder of the year. With valuations tighter (although the relative value versus other parts of the fixed income market is clearly visible), there is limited upside for spreads to go tighter on a standalone basis. Therefore, carry will be the most important driver of returns and is meanwhile providing downside protection in case of volatility flaring up.

While market pricing of interest rates is currently quite aggressive (similar to December 2023), central banks have reiterated that they are very much data-dependent and data could involve surprises, as we have seen many times before. Surprises will come from incoming data, the flaccid geopolitical environment, or the US elections. The timing of any rate cuts and how quickly they are priced in by the markets presents a great deal of uncertainty and markets may quickly reverse their initial expectations. With this uncertainty, predictable current, attractive, and stable income is certainly welcome, which is something that European ABS can provide.

From a fundamental perspective, the pickup in arrears is much lower than most would have predicted given where rates are. So far, the main drivers of European ABS performance are interest rates and the possible interest rate shock that consumers could face but unemployment numbers continue to be low. Performance, however, has held up quite well and deterioration is only seen in certain parts of the market where loans could not refinance. With borrowing costs moving towards a more neutral rate in Europe, credit availability should improve. We have seen arrears increasing in some sectors, especially those that mostly have exposure to floating-rate collateral. Idiosyncratic issues are also creating more bifurcation across the market, leading to an uptick in distressed situations and defaults. Even though weaker consumers and companies will continue to face pressures, we expect defaults to remain below their long-term averages. As credits become more stressed and idiosyncratic factors drive dispersion, selection will be increasingly important, and we believe it is prudent to be modestly defensive. Potential losses, however, can be absorbed by structural features such as excess spread and reserve funds.

Altogether, income (coupon) tends to drive longer-term total returns more than spread movements. The current macro backdrop has also set the stage for the European ABS market to deliver attractive total returns from this point forward. We believe that ABS is set to outperform in an environment where there are many uncertainties. The relatively high carry value (partially due to the inversion of the interest rate curve) of ABS coupled with limited concerns from a fundamental perspective and valuations that are attractive from both a relative and an historical perspective remains for the rest of 2024.

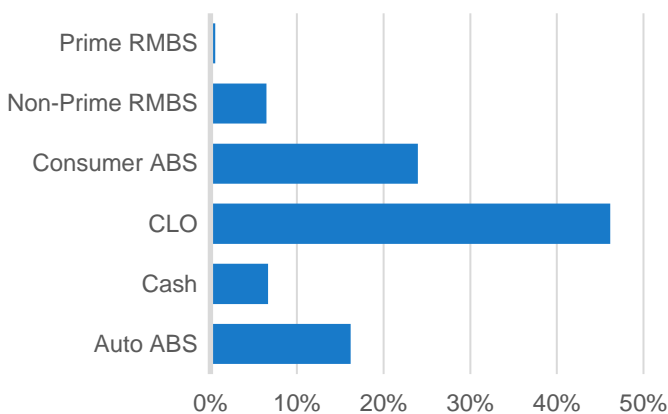
Strategy and positioning

With an active primary market and attractive opportunities deeper down the capital structure, we have added several positions. Furthermore, we sold some shorter duration bonds and added bonds with a longer spread duration. We added 6 BB-rated CLO positions and 7 BB-rated ABS/RMBS bonds. The spread of the portfolio increased to approximately 480 (over Euribor) and 510 (over SONIA) bringing the current yield to 8.2% and 9.8% in EUR and GBP respectively.

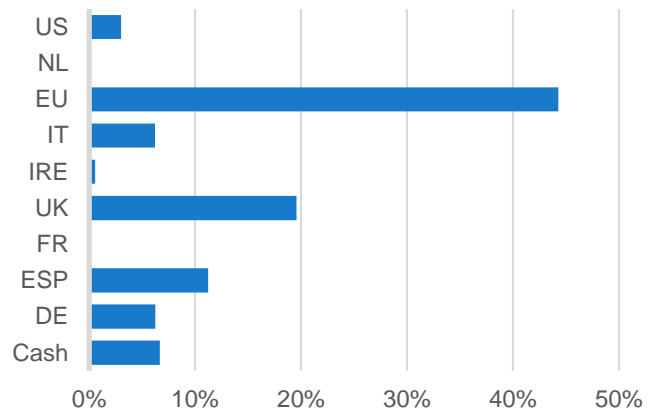
Fund positioning

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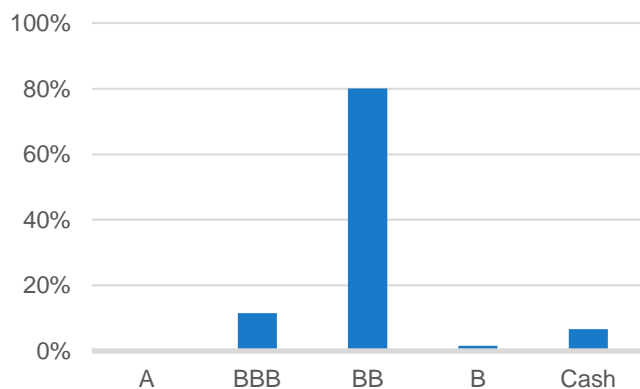
Sector Breakdown



Geographical Breakdown



Rating Breakdown



Source: Aegon Asset Management

Calendar year performance

	2023	2022	2021	2020	2019	2018	2017
Fund Gross return (%)	13.68	-3.52	6.08	-	-	-	-
Fund Net return (%)	13.11	-4.00	5.55	-	-	-	-

Source: Aegon Asset Management as at 31 December 2023. Fund launch date 9 September 2020, launch date for I EUR Acc shareclass is 6 October 2020.

Important information

Investment Policy

This The Fund aims to achieve its objective by investing substantially in asset-backed securities (including CLO's for max 50%). The Fund will have a focus on asset backed securities with a credit rating which is deemed to be 'non-investment grade'. Non-investment grade is defined as meeting one or more of the following rating criteria: Ba1 or lower by Moody's Investor Services (Moody's); BB+ or lower by Standard & Poor's Rating Services (S&P) or Fitch Ratings Inc (Fitch).

The Fund may hold bonds and notes with various types of collateral, but some examples include residential mortgages, commercial mortgages, consumer loans, car loans, credit card loans, student loans and corporate loans. The Fund will invest the majority of its assets in the portfolio in bonds or notes issued by issuers located within Europe but may also invest in bonds or notes issues by issuers located in other OECD countries. The Fund will invest in assets denominated both in Euro and in other currencies. Where non-Euro denominated assets are held, the Investment Manager will seek to hedge the associated currency risk back to Euro.

Risks

The main risks are:

Objective Risk: There can be no assurance that the Fund will achieve its investment objective. An investor should consider his personal tolerance for an investment based upon fixed income securities before investing in the Fund. The investments of the Fund will be subject to market fluctuations, currency fluctuations, custody and settlement risks, registration risk and foreign exposure risk.

Liquidity Risk: The secondary market for sub-investment grade bonds is typically much less liquid than the market for investment grade bonds, frequently with significantly more volatile prices and larger spreads between bid and asked price in trading.

Asset Backed Securities Risk: The value of an asset-backed security can be affected by various factors, including: (i) changes in the market's perception of the pool of underlying assets (or collateral) backing the security; (ii) economic and political factors such as interest rates and levels of unemployment and taxation, which can have an impact on repayments and default rates on the collateral; (iii) changes in the market's view of the creditworthiness of the issuer; and (iv) the speed at which loans which form the collateral are repaid.

Asset-backed securities that are not backed by mortgages present certain risks that are not presented by mortgage-backed securities. Primarily, these securities may not have the benefit of the same security interest in the underlying collateral. Credit card receivables, for example, are generally unsecured. Therefore, there is a possibility that recoveries on defaulted collateral may not, in some cases, be available to support payments on these securities. The investment characteristics of asset-backed securities differ from traditional debt securities. Among the major differences are that interest and principal payments are made more frequently, very often monthly or quarterly, and that principal may be prepaid at any time because the underlying loans may often be prepaid at any time. Investments in subordinated asset-backed securities involve greater credit risk of default than the more senior class(es) of the issue or series.

For more details on the risks for this fund please see the KIID or Prospectus at www.aegonam.com/documents.

Disclaimer

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Past performance does not predict future returns. Outcomes, including the payment of income, are not guaranteed.

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AdTrax: 4953283.61. | Exp Date: 31 October 2025