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# Aegon European ABS 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 to distract temporarily from geopolitics but volatility remains as a result of constant changing and diverging expectations on central banks actions. Similarly, the macroeconomic environment is diverging globally, feeding into the volatility we're seeing in the markets. While there was positive labour market news from both 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 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 as the weakness in its car industry dominated  headlines in September. Euro area final PMIs surprised on the upside compared to the flash print, with the composite moving to 49.6 from 48.9 but remains 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 cuts 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 labour demand now is carrying considerably more strength. The latest release reinforces the conviction that the US economy remains  resilient and the fear of recession seemed to be premature. After the 50 bps rate cut by the Fed, markets are pricing in a more gradual Fed cutting cycle. This 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

| B (EUR) | I (EUR) | I (GBP) | I (USD) | I (CHF) | I (AUD) |
|---|---|---|---|---|---|
| 0.55 | 0.55 | 0.64 | 0.68 | 0.34 | 0.59 |

### Net return September 2024

| B (EUR) | I (EUR) | I (GBP) | I (USD) | I (CHF) | I (AUD) |
|---|---|---|---|---|---|
| 0.53 | 0.53 | 0.62 | 0.65 | 0.32 | 0.56 |

### Gross returns (%)

| | YTD | 1 year | 3 year | 5 year |
|---|---|---|---|---|
| B-Share (EUR) | 5.93 | 7.87 | 3.50 | 2.51 |
| I-Share (EUR) | 5.93 | 7.88 | 3.51 | 2.52 |
| I-Share (GBP)[1] | 6.96 | 9.25 | 4.94 | 3.67 |
| I-Share (USD)[1] | 7.16 | 9.57 | 5.30 | 4.12 |
| I-Share (CHF)[1] | 3.93 | 5.22 | 2.04 | 1.52 |
| I-Share (AUD)[1] | 6.30 | 8.31 | 4.36 | 0.00 |
| Benchmark [2] | 3.53 | 4.86 | 2.18 | 1.41 |

### Net returns (%)

| | YTD | 1 year | 3 year | 5 year |
|---|---|---|---|---|
| B-Share (EUR) | 5.73 | 7.60 | 3.24 | 2.25 |
| I-Share (EUR) | 5.73 | 7.61 | 3.25 | 2.26 |
| I-Share (GBP)[1] | 6.73 | 8.94 | 4.65 | 3.38 |
| I-Share (USD)[1] | 6.93 | 9.26 | 5.00 | 3.83 |
| I-Share (CHF)[1] | 3.71 | 4.93 | 1.75 | 1.24 |
| I-Share (AUD)[1] | 6.07 | 8.01 | 4.07 | 0.00 |
| Benchmark [2] | 3.53 | 4.86 | 2.18 | 1.41 |

[1] Share class hedges the currency exposure in the pool to GBP/USD/CHF/AUD
[2] Bloomberg Barclays Capital Euro ABS Fixed and Floating Index (EUR)

### Yield to maturity (%)1

| EUR | GBP | USD | CHF | AUD |
|---|---|---|---|---|
| 4.05 | 5.89 | 5.49 | 2.06 | 5.78 |

### Spreads (bps)[2]

| EUR | GBP | USD | CHF | AUD |
|---|---|---|---|---|
| 145 | 160 | 163 | 148 | 153 |

[1] Estimated yield to maturity as per 30 September 2024 using most conservative assumptions
[2] Discount margins of the assets over the relevant swap rate per currency as of 30 September 2024
[3] The GBP Spread is compared to SONIA (Sterling Overnight Interbank Average Rate) as of 30 September 2024. Previously this was compared to the GBP LIBOR(London Interbank Offered Rate).

## 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, particularly 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 were 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 against markets' expectation of rate cuts, the yield-to-maturity could increase once more, while receiving higher carry. 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 dispersion in parts of the European ABS market, but spreads remain broadly around the tights of the past 36 months . For the remainder of the year, the way spreads would move will be influenced by idiosyncratic events and expectations on fundamentals. However, 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 has been slightly positive so far, and we expect the trend to continue 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 provides downside protection in case volatility flares 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, although 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.

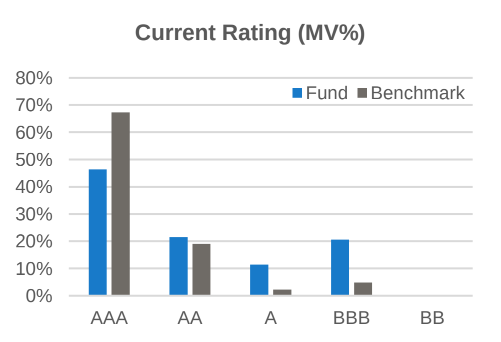
Altogether, income (coupon) tends to drive longer-term total returns more than spread movements. The current macro backdrop has also set the stage for the European ABS market to deliver attractive total returns from this point onwards. We believe that ABS is set to outperform in an environment where 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 attractive valuations from both a relative and an historical perspective, remains for the rest of 2024.

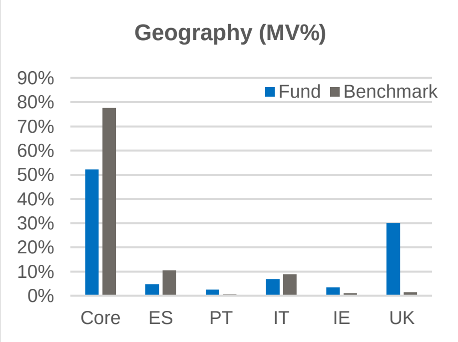
## Strategy and positioning

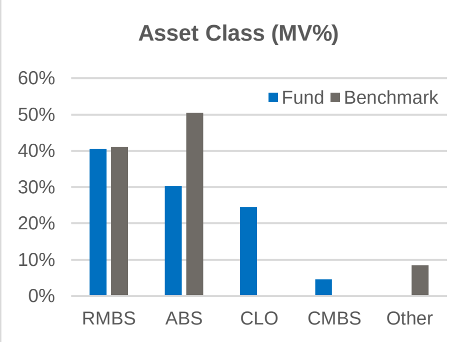
With the anticipation of heavy (and attractive) supply in September, we have invested the remaining cash of August. Overall, we have increased our ABS and CLO exposure and decreased our CMBS and RMBS positioning. In terms of countries, we have decreased our German and Irish allocations, while increasing our Spanish, Italian, UK and Mixed exposure. Our positioning senior/non-senior stayed roughly the same at around 61/39. The weighted average rating is at A+, and spread duration decreased slightly to 2.8 years. The yield-to-maturity of the fund decreased to 3.69% mainly due to the decrease in rates.

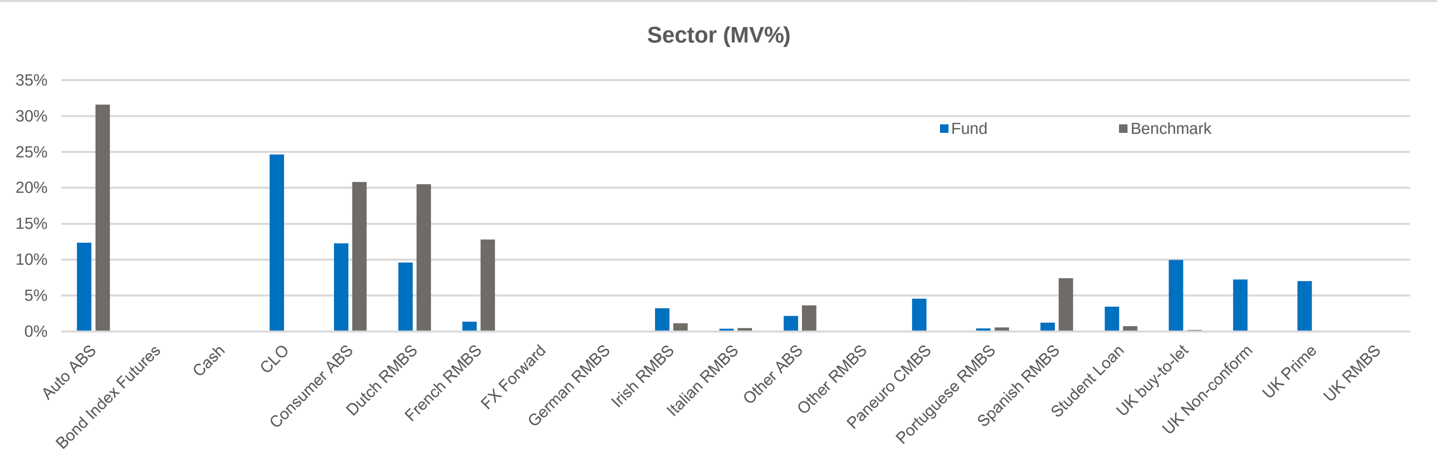
## Fund positioning versus the benchmark

Please find the positioning of the fund versus the benchmark below.




Source: Aegon Asset Management

## Calendar year performance

Source: Aegon Asset Management as of 31 December 2023. Fund launch date 11 November 2016, launch date for I EUR Acc shareclass is 25

| | 2023 | 2022 | 2021 | 2020 | 2019 | 2018 | 2017 |
|---|---|---|---|---|---|---|---|
| Fund Gross return (%) | 8.13 | -3.19 | 1.51 | 0.52 | 1.62 | 0.44 | 4.26 |
| Fund Net return (%) | 7.86 | -3.43 | 1.25 | 0.27 | 1.37 | 0.18 | 4.00 |
| Benchmark (%) | 4.53 | -1.31 | 0.46 | 0.09 | 1.10 | -0.22 | 1.44 |
| Tracking error ex post (%) | 1.17 | 2.36 | 0.34 | 2.49 | 0.22 | 0.48 | 0.69 |

November 2016. Benchmark: Bloomberg Barclays Capital Euro ABS Fixed and Floating Index

## Important information

### Investment Policy

This fund is actively managed. The Fund will seek to achieve its investment objective by investing at least 70% of its net assets in asset-backed securities. Asset-backed securities are a type of debt securities such as bonds or notes whose value and income payments are derived from an underlying pool of assets held by the issuer. The underlying pool of assets is referred to as 'collateral'. 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, such bonds will not embed any leverage.

The Fund will invest at least 70% of its net assets in bonds with a credit rating which is deemed to be 'investment grade', defined as meeting one or more of the following rating criteria: Baa3 or higher by Moody's Investor Services (Moody's); BBB- or higher by Standard & Poor's Rating Services (S&P) or Fitch Ratings Inc (Fitch).

The Fund will invest predominantly in bonds or notes issued by issuers located within Europe, but may also invest in bonds or notes issued by issuers located outside Europe.

The Fund will invest in assets denominated both in Euros and in other currencies. Where non-Euro denominated assets are held, the Investment Manager will seek to hedge the associated currency risk back to Euros.

The benchmark of this fund are Bloomberg Barclays Capital Euro Asset Backed Securities Floating Rate Note Composite Index and the Bloomberg Barclays Capital Euro Asset Backed Securities Fixed Coupon Composite Index.

The Fund's (cash) benchmark is used as a reference to measure the Fund's performance.

### Risks

The main risks are:

Credit Risk: The Fund is subject to credit risk in respect to its investments and with regard to its contractual counterparties (such as hedge providers).

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;

IV. the speed at which loans which form the collateral are repaid.

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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