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Aegon European ABS Fund

Q3 2024

Performance

The third quarter of 2024 again was very strong for European ABS markets. The quarter started with the market expecting around four rate cuts until the end of the year, of which one rate cut was announced in September. The market is pricing in two additional rate cuts for the remainder of the year. As most central banks across the globe have commenced cutting rates, it seems that concerns around high inflation have receded and that growth risks are increasingly in focus. Currently, as inflation risks subside, the sensitivity of interest rates is shifting, with growth becoming increasingly important. In Europe, recent PMIs surprised to the upside, but while the periphery continues to be an area of economic strength, German data remains lackluster. The dispersion across countries on activity, labor markets and prices, makes it hard to have strong views on the business cycle and the pace of disinflation and the growth trajectory. However, the ECB's strong focus on spot inflation developments will remain an obstacle to pricing a deeper cutting cycle. Indeed, the ECB's recent communication has been non-committal, with some members of the Governing Council increasingly confident on the extent and pace of disinflation while others remain hesitant and concerned about upside risks.

US economic strength contrasts with the weakness in Europe. The most recent labor market figures reinforce 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 cutting cycle, in line with recent communications where Fed chair Powell repeatedly made the case that the FOMC is in no hurry to cut rates.

After being rattled by an escalation of Middle East tensions following Iran's military strikes on Israel at the end of the quarter, 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. With geopolitical tensions intensifying and the US elections around the corner, there is quite some uncertainty. Also, while the market is looking for more stimulus measures from China, boosting demand, a negative supply shock due to further escalation of tensions in the Middle East, higher (import) tariffs, and other import restrictions, would disrupt the disinflation trend, resulting in central banks not delivering on the significant easing priced in by markets.

In this volatile environment, European ABS markets performed strongly as spreads continued to tighten across all European ABS sectors, further triggering conditions in which primary issuance continued to be plentiful. Primary issuance amounted to around €35 billion in the third quarter of 2024, bringing year-to-date issuance to €111 billion, an increase of 65% compared to the same period last year. While spreads initially tightened during the quarter before moving to approximately the same level as where they started.

Positioning and outlook

Over the quarter we have continued to reduce risk in the portfolio as spreads tightened and the credit curve flattened. We have repositioned the portfolio more towards the higher part of the capital structure. While credit curves have flattened, there still is value to be found in non-senior bonds. Overall, we have increased our AA allocation while our A- and BBB-rated exposure decreased. However, our weighted average rating stayed the same at AA-/A+. The spread duration is still slightly below three years, and the weighted average spread decreased due to reallocation and spread tightening. The yield-to-maturity declined, due to tightening in spreads and the decrease in interest rates. In terms of countries and collateral, we have added to our Italian, Spanish and Mixed exposure, while our UK, Irish, US, Dutch, French and Finnish exposure decreased. Furthermore, our allocation to CLO and ABS increased, while our exposure to RMBS and CMBS declined.

We expect modest collateral performance deterioration in 2024 as affordability remains challenging in a higher- rate environment. ABS performance is inherently linked to the financial health of consumers. So far, the consumer has proven to be quite resilient, given the rapid adjustment in interest rates coupled with high inflation. A combination of excess savings, healthy wage growth, a change in spending habits, and stability in unemployment rates have helped borrowers manage higher debt repayment burdens and mitigate decelerating growth. Furthermore, the full recourse nature of consumer lending prevents borrowers from defaulting voluntarily.

The key driver for ABS collateral performance is the evolution of the unemployment rate, but with the view of limited loosening of labor markets, ABS performance should continue to be robust. However, any change in the outlook for labor markets could change this view. Potential losses on bonds, on the other hand, can be absorbed by structural features such as excess spread and reserve funds, alongside asset price increases we have seen across Europe.

Although spreads tightened, European ABS still stand out from a valuation perspective especially due to the high carry value, protecting investors in case sentiment turns bearish again. Low interest rate duration provides stable returns in the current uncertain interest rate environment. Even with flatter credit curves, non-senior tranches provide compelling opportunities to earn additional income, but we have become more selective as in some deals the risk-reward ratio is limited, especially now that the curve has flattened. The uncertain outlook for the European economy and the way central banks act will likely lead to periods of weakness in the markets going forward as concerns about inflation, the growth prospect of the eurozone economy and the impact of higher interest rates remain.

Calendar year performance

	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

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

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