Asset Class Investment Strategies

Liquid Credit

This is a financial promotion. Your capital is at risk, the value of investments may fall and rise and you may not get back the full amount you invested. Past performance is not indicative of future returns.

Major Trends

Rising rates sparking spread widening: As of the time of writing, spreads of the Barclays US Corporate High Yield Index are more than 60bps wider since the start of the year, with the index now yielding 5.3%. This spread widening has been partially driven by rising interest rate expectations, and persistent inflationary pressures may lead to further widening. The Credit Suisse Leveraged Loan Index is offering a slightly higher yield of 5.6%, which we view more favorably in the context of a rising rate environment.

Structured Credit opportunities persist in niches: Certain niche segments of structured credit markets have yet to fully recover from the stresses of the COVID crisis and offer attractive opportunities, albeit often with more complexity and less liquidity.

Golden Rules

- Partner with specialists with deep knowledge of a sub-sector's credit fundamentals, market technicals and legal documentation
- Focus on niche, capacity constrained sub-sectors marked by complexity to uncover additional value
- Use custom vehicles where appropriate to maximise flexibility and allow for precise control of sub-sector exposure

Sub-Strategy Attractiveness

Structured Credit: Favorable view. While yields have narrowed to an average of 4.0% within the non-agency index, there remain ample opportunities to generate alpha from mispriced RMBS securities and participate in the gradual recovery in CMBS. Fundamental trends are promising for the underlying assets, particularly in residential housing due to robust home price appreciation.

Aviation Debt: Favorable view. Aircraft-backed securities sold off sharply in March 2020 amid forced selling as flights were grounded around the world. While prices have recovered partially, the yield-to-maturity on mezzanine debt ranges from 5-12% depending on the tranche and structure, and we believe these securities remain well insulated even if travel restrictions remain in place longer than expected.

Corporate Credit: Neutral view. Despite a benign outlook for defaults and moderate spreads, we expect rising rates to create a volatile trading environment with bouts of market illiquidity.

Event Driven Credit: Neutral view. The dearth of corporate defaults limits distressed opportunities, but some opportunities remain for cross-capital structure and event-driven trading in stressed credits.

Emerging Market Debt: Neutral view. We are monitoring the recent developments in emerging markets and China's property sector, in particular. Yields in broad EM Debt have climbed to 6.0%, with Chinese high yield property debt yielding more than 20%. However, there is much uncertainty regarding the resolution process in China and balance sheet transparency is inconsistent.

2022 Strategic Priorities

- **Continue to utilise bespoke "funds-of-one" structures:** After launching two customised fund-of-ones in 2020 in structured credit and CLO/loans, we added a third in 2021 to target short-dated primary lending strategies. Going forward we will continue to develop customised vehicles where appropriate.
- **Expand Partnerships with Emerging Managers:** We actively seek out early-stage managers where we can negotiate terms and access niche or capacity-constrained strategies. In 2021, we made investments in an emerging market debt launch and an opportunistic credit fund, and our pipeline will continue to focus on emerging managers going forward.
- **Add Niche Lending Strategies:** We continue to seek out niche strategies that have high-single digit (or better) net returns with short duration (three years or less) and limited sensitivity to a market downturn. This includes real estate bridge lending, tax credit financing, and non-performing loans.

Expected 12-Month Returns

Exhibit 1

Expected returns by scenario

	Recovery Falters (10%)	Stagflation (10%)	Gradual Normalisation (60%)	Reflation 2.0 (20%)	Expected Value
Liquid Credit	-1.6%	-3.5%	3.0%	4.5%	**2.2%**
Notes	These return assumptions reflect 0.5x credit beta + 1.5% alpha. In our base case, the yield-to-worst on the Global High Yield index rises from 6% on 31 Jan 2022 to 7% over the next 12-months, a spread of 4.75% over US Treasuries. The return forecasts above are conservative assumptions. Our credit vehicle is expected to generate over 500 bps of alpha relative to a beta benchmark by investing in more attractive, higher yielding strategies.				

Return assumptions are for the 12 months from 31 January 2022.

Hypothetical return expectations are based on simulations with forward looking assumptions, which have inherent limitations. Such forecasts are not reliable indicator of future performance.

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