Asset Class Investment Strategies

Private Debt

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

Pandemic resilience supports continued growth. The performance of Private Debt strategies was resilient through the pandemic. The flexibility of direct lending structures allowed borrowers to negotiate directly with their lenders, allowing them to navigate short-term business disruption. After slowing in 2020, inflows resumed in 2021 with AUM in private lending strategies now in excess of $1.21T[1].

A broader opportunity set as the asset class matures, expanding into new strategies, structures and borrowers. Opportunities to lend into new sectors such as renewable energy, agriculture, emerging healthcare segments and technologies, as well as into innovative financing solutions.

The growth of capital solutions. This refers to flexible financing solutions offered to businesses that are in transition or are in need of restructuring. These structures are supplanting those offered by special situations and mezzanine lenders due to a lower cost of capital and an ability to avoid raising dilutive equity capital to fund growth.

Continued demand for income-generating investments. Asset-based lending offers an illiquidity premium of 200-500bps over liquid credit markets and is increasingly replacing traditional liquid credit as a source of yield in portfolios where investors are less liquidity-sensitive.

Golden Rules

- Target specialists in niche strategies: specialist providers of capital providing certainty of execution can command a premium due to lower levels of competition and higher degrees of complexity.
- Focus on downside protection: identify and partner with disciplined investors who i) take senior positions in the capital structure, ii) lend at low LTVs and iii) maintain discipline on covenants and documentation. Underwrite investors that can protect capital and have the necessary skillset to directly manage assets in the event of a restructuring.
- Generate alpha through customisation and direct investment: seek structures which offer enhanced discretion, tax benefits, fee savings and customised risk exposures. Partner with who we believe to be best-in-class managers on co-investments to benefit from more immediate deployment and greater transparency.
- Allocate selectively to uncorrelated strategies: uncorrelated strategies can offer attractive diversification benefits and resilience in a market downturn. These strategies pose a unique diligence challenge and it is critical to be aligned with best-in-class managers.

1. Preqin: Alternatives in 2022

Sub-Strategy Attractiveness

Capital Solutions and Corporate Special Situations: Favourable view of lenders with the ability to provide flexible capital to complex situations, restructurings, and businesses in transition.

Specialist Lending: Favourable view of sector specialists in collateral that requires expert underwriting (e.g., healthcare, emerging technology, portfolio financing).

Real Estate Lending: Attractive opportunities with senior and mezzanine lending specialists with proven sourcing advantages and the ability to manage assets where necessary. Short duration bridge lending and mortgage-backed securities are attractive opportunistically.

Middle Market Direct Lending: Neutral view. Avoid commoditised strategies with relatively limited credit protections and higher leverage. Favour selective allocations to idiosyncratic co-investments.

Asset-Based Lending: Neutral view. Asset based lending can provide an attractive yield base to a Private Debt portfolio. Avoid complex platforms and significant allocation to consumer strategies.

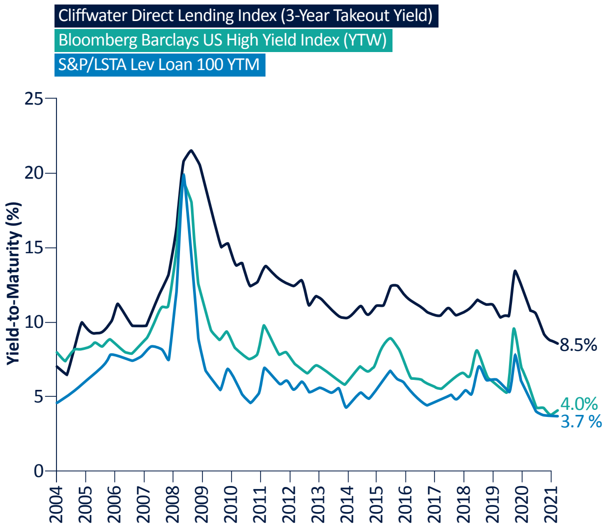
Distressed for Control: Negative view of long and legally intensive bankruptcy and recovery processes which culminate in full equity ownership.

2022 Strategic Priorities

- Add to long-term partnerships with managers with lower cyclical exposures: deepen relationship in life sciences, SAAS, telecom and technology infrastructure.
- Strike partnerships with managers who have the capacity to exploit short-term market anomalies as an enhancement to their core strategy.
- Build capacity for the long-term with a new generation of specialists: identify the next generation of emerging managers in sectors of interest. Be wary of generalist lenders underwriting specialist collateral and be alert to scope creep.
- Identify opportunities for positive societal impact in private lending: collaborate with managers to support their ESG initiatives and identify opportunities to invest alongside managers who invest with an ESG or impact mandate. Increase the number and range of women and minority owned investment managers in our pipeline.
- Drive co-investment deal flow to benefit from the increased cash efficiency of rapid deployment, greater control of underlying exposures and enhanced fee terms.

Private Debt
continued

Exhibit 1
Private lending has offered a consistent premium to liquid credit



Source: *Middle Market Direct Lending: Cliffwater Direct Lending Index (3-year Takeout Yield) at Q2 2021; US High Yield: Bloomberg Barclays US HY Index (YTW), Leveraged Loans: S&P/LSTA Leveraged Loan 100 YTM (Sourced from Bloomberg) as at Q3 2021*

Expected 12-Month Returns

Exhibit 2
Expected returns by scenario

	Recovery Falters (10%)	Stagflation (10%)	Gradual Normalisation (60%)	Reflation 2.0 (20%)	Expected Value
Private Debt	-1.2%	-5.0%	6.8%	9.6%	**5.4%**
Notes	Assumes a 4% illiquidity premium and 1% manager alpha over 0.9x high yield credit beta.				

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

Uncorrelated Strategies

Major Trends

Search for yield driving return compression. Low interest rates have attracted investors into strategies that offer yield-like returns. Music royalties and retrocessional reinsurance are examples of asset classes where capital flows have compressed yields to unattractive levels.

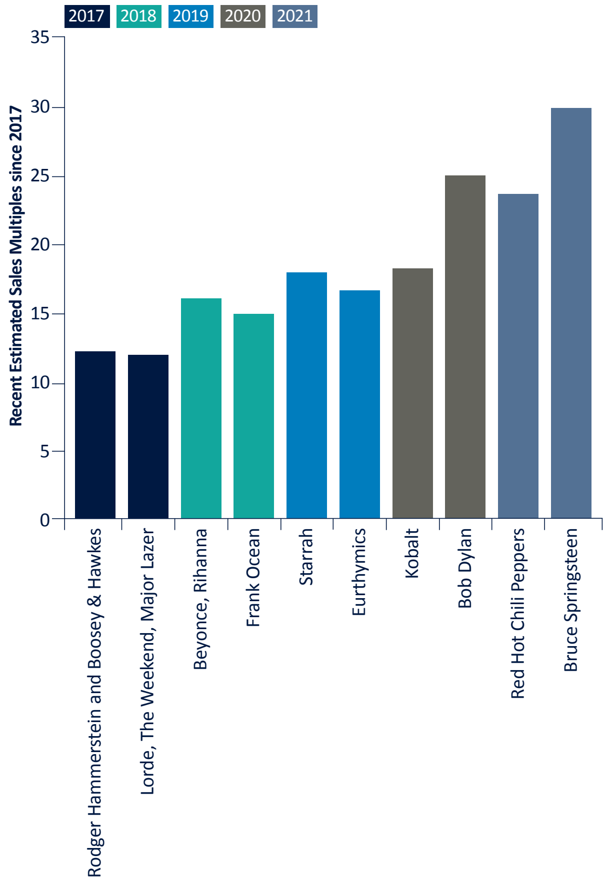
Institutionalisation of esoteric investments. The corollary of increased institutional investment into esoteric assets is that there are increasingly standardised ways to access these investments. We expect the next step to be increased structuring and stratification of risk, enabling investors to explicitly target more precise risk-return exposures.

Positive societal impact through uncorrelated strategies. New investment areas that are considered to offer positive societal impact are increasingly accessible through institutional investment structures, for example 'access to justice' funding in litigation finance or phase 3 drug trial financing in clinical co-development.

Model risk may be under-priced. Many esoteric strategies rely on modelled valuations. Changes in assumptions can materially shift investment outcomes, as we have seen in life settlements and reinsurance strategies.

Exhibit 3

Estimated music catalogue sales multiples have nearly doubled in 5 years



Source: *Ares Alternative Credit Newsletter: In The Gaps 4Q 2021*

Sub-Strategy Attractiveness

Drug Trial Financing: Favourable view. Clinical co-development offers the opportunity to finance phase 3 drug trials in partnership with pharmaceutical companies, in exchange for a royalty stream or fixed cash payments. Given the specialism required to assess trial outcomes, drug trial finance remains an under-exploited opportunity with few participants.

Litigation Finance and IP: Neutral view. The global market for legal services is projected to grow by ~20% to nearly $1T by 2025. Financing portfolios of corporate litigation is an area that remains relatively underexploited and is attractive in our view, as are new opportunities in patent and IP litigation.

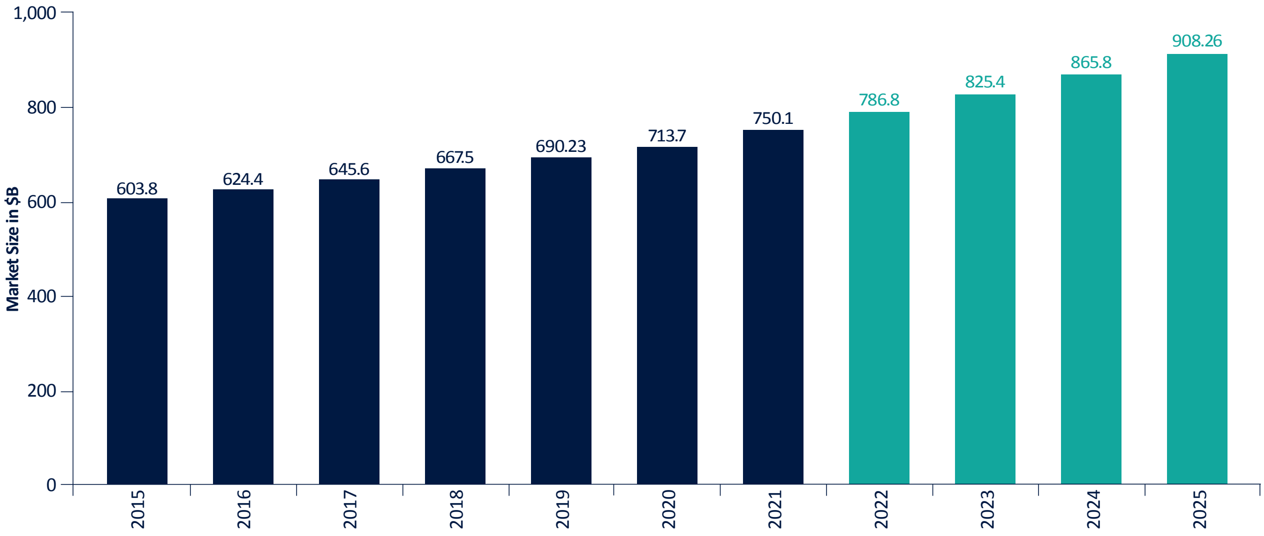
Insurance strategies (Life, Insurtech): Neutral view. Continued consolidation and disruption in life and health strategies offer potentially interesting opportunities. Insurtech is a growing area which may offer opportunities to provide senior financing.

Royalties: Neutral view. Pharmaceutical royalties are complementary to our healthcare lending and drug trial financing investments. However we believe some royalty assets such as music royalties have become too expensive.

Insurance strategies (Property and Natural Catastrophe): Negative view. We have deprioritised retrocessionary reinsurance strategies as they no longer offer attractive risk-adjusted returns due to significant capital inflows and the potential risks of climate change which may not be accurately reflected in underwriting models.

Private Debt
continued

Exhibit 4
The legal services market is projected to reach nearly $1T by 2025



Source: *Statista 2022*

2022 Strategic Priorities

- **Focus on contractual returns:** strike new partnerships with managers that focus on assets generating contractual cash flows rather than back-ended equity pay-offs. e.g., royalties, litigation lending.
- **Expand the range of uncorrelated strategies** with a view to diversifying exposures and avoiding unintentional factor concentration. Concentrate capital in managers with clear and quantifiable competitive advantages through scale, specialism, or sourcing.
- **Partner with emerging managers** to establish early exposure to novel and innovative strategies. e.g., clinical co-development.
- **Identify and partner with managers seeking to have positive societal and environmental impact.** Engage with Impact and ESG managers in uncorrelated strategies. Encourage better ESG engagement in our existing managers.

Expected 12-Month Returns

Our required return for uncorrelated strategies is in line with our expectations for Private Debt strategies assuming an equivalent risk profile. For more esoteric or longer tenor strategies we require an additional illiquidity premium to reflect the increased risk or longer duration[1].

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

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