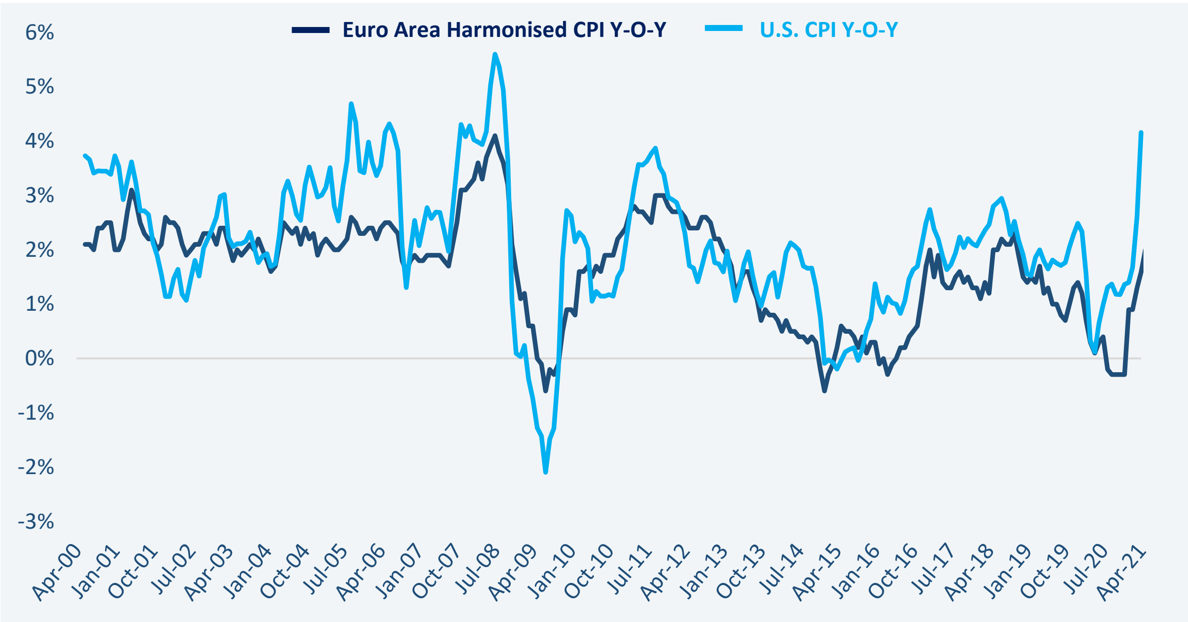
What are your expectations and timing of U.S. / EU bond yields rise?

Global markets have been fuelled by extraordinary levels of policy accommodation with the Federal Reserve and the ECB currently purchasing $120bn and €100bn of bonds per month.

Such unprecedented level of stimulus was implemented to support the economy during the pandemic but as life normalises, these “extraordinary” measures will need to be tapered eventually. Our base case is not for inflation to rise to a dangerous level but simply to reflect that, thanks to the prompt government and central bank actions, our economies are slowly returning to life. Having said that, the USA was more aggressive in its policy response with both fiscal and monetary policy combined with fewer lockdowns and a faster vaccine rollout. As a result, its economy is running much “hotter” than Europe and therefore subject to much higher price pressures (cf. Figure 1).[1]

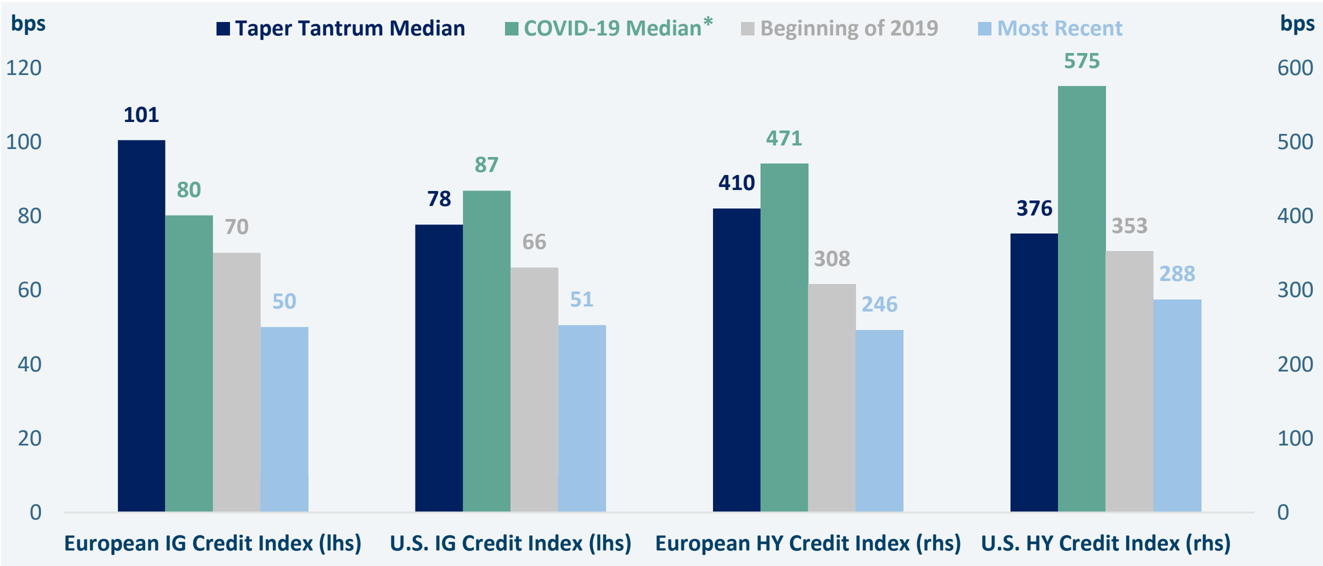
Figure 1: Consumer Price Index – U.S. vs. Europe



[1] Bloomberg, as of 30 April 2021.

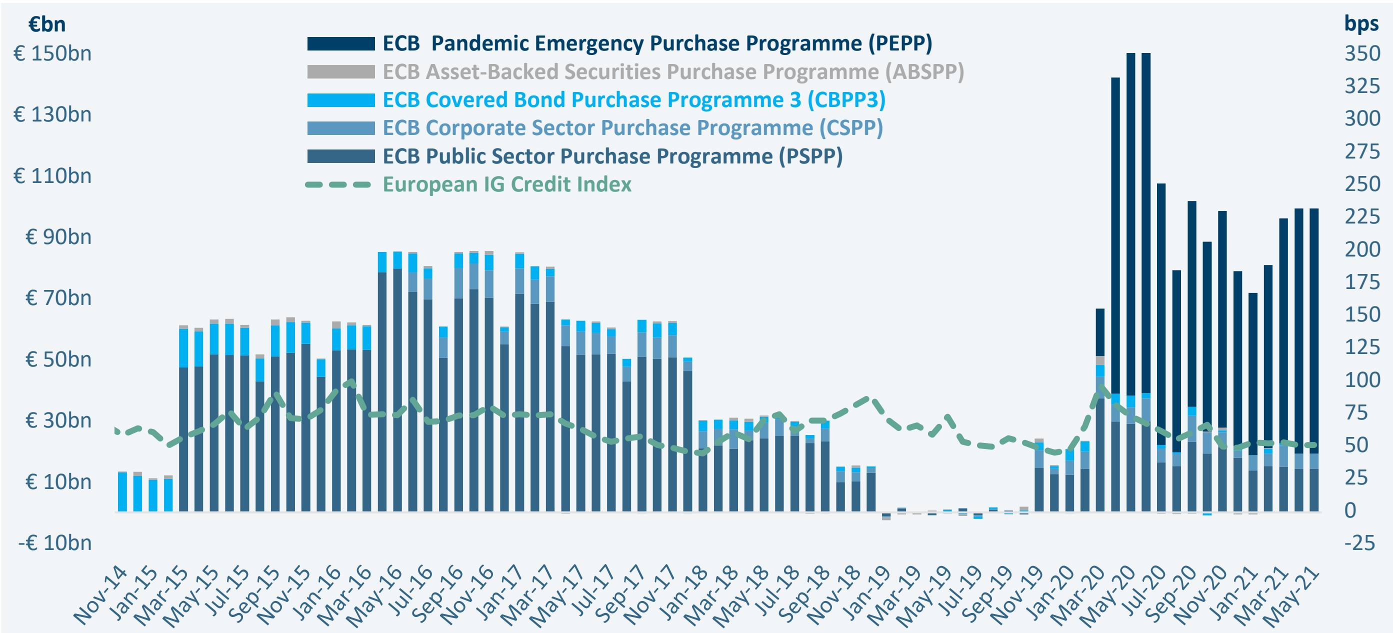
If central banks were to normalise monetary policy to reflect the strong rebound, they would have to withdraw liquidity by tapering their respective Quantitative Easing (QE) programmes and this could have a negative impact in Fixed Income. In 2013, we witnessed the first "Taper Tantrum" when the Federal Reserve surprised the market by hinting at quicker-than-expected tightening. Current spreads are overall much tighter than those observed during this period as depicted below (cf. Figure 2).[2]

Figure 2: Spread Levels – Taper Tantrum vs. Current



Aggressive QE programmes have pushed the global supply of negative yielding debt to a peak of $18tn in December 2020[3], driving credit spreads even tighter (cf. Figure 3). Historically, such periods of tightening have pushed lower quality issuer spreads to compress towards high quality ones as investors are seeking better yielding assets.

Figure 3: Growth of ECB Balance Sheet vs. Credit Spreads[4]



As monetary policies normalise, the compression process should reverse, creating a selling pressure on the riskiest part of the market including lower rated credits, longer duration trades, fundamentally weak sovereigns, etc. During this transition, we often

[2] Source: Bloomberg, as of 28 May 2021. *COVID-19 Median relates to the 1st wave period from 14 February to 30 June 2020.
[3] Source: Bloomberg, Bloomberg Barclays Global Negative Yielding Debt Index, as of 26 May 2021.
[4] Source: Bloomberg, as of 31 May 2021. European IG credit index; Markit iTraxx Europe.

find that many credits had been trading much tighter than their fundamentals would suggest. The “decompression” process is enough to create a higher volatility environment; it results in the underperformance of long only funds as beta begins to come under pressure.

If inflation were to run much higher than the central banks’ targets, this dynamic would be further accentuated as central bankers would be forced to taper more aggressively and to normalise monetary policy much quicker, potentially creating a fire sale as investors seek to de-risk.

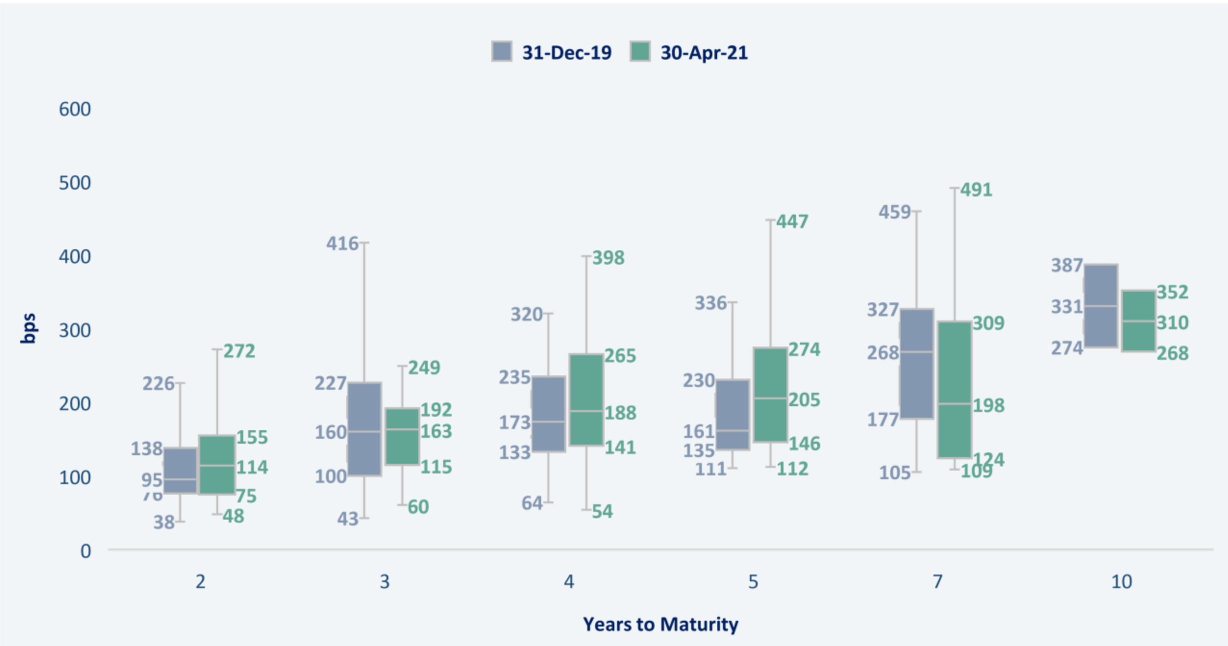
That said, higher governmental yields reflect a market view of a better economic outlook and therefore better fundamentals for companies. Barring an unwarranted inflationary environment, the underperformance of credit should be contained to the worst quality names at first. Only once the economies start to lose momentum should spread widening become more generalised across the markets.

Even though Bank debt is subject to the market Beta dynamic described above, it’s worth noting that a rise of interest rates could potentially contribute to higher profitability through the increase in net interest margin and therefore offset some of that impact. According to a recent research from Autonomous, a parallel shift of +100bps in all yield curves would lead to an estimated +20% uplift in European banks’ 2022 pre-tax profits. The return to normality should be positive for banks as demand resumes; however, we have yet to see the impact of NPLs when the COVID-driven loan moratorium and other temporary regulatory relief are lifted.

The ideal time to switch from long only to long / short is during periods of euphoric spread compression to protect the gains from the Beta rally and prepare the portfolio for the next stage of the credit cycle with wider spreads and greater dispersion. Long / short credit funds can profit from wider spreads and greater dispersion and better protect gains from a more adverse spread widening scenario.

For example, as depicted in Figure 4, within the universe of European high yield corporates with BB rating, we have observed rising dispersion compared to the pre-COVID period (e.g., BB-rated bonds with 4 years to maturity was trading at the tightest Z-Spread at 54 bps and the widest at 398 bps vs. 64bps and 320 bps in December 2019).[5]

Figure 4: Credit Spread Dispersion (High Yield € BB)*



The pandemic has also accelerated some profound changes to our way of life, some of which could have a more permanent impact on the economy. Hybrid working models could lead to less demand for office space. Diversification of supply chains could lead to price increases if “Made in China” becomes “Made in Your Country” (especially in Western Europe). Video conferencing may

[5] Source: Bloomberg, as of 30 April 2021. *The box for each maturity year is representative of the interquartile range, composed of the lower quartile, median and upper quartile.

reduce business travels permanently, changing the way the airlines and hospitality sectors operate. As the post-Covid world slowly emerges, some lockdown-induced habits may prevail whilst some other older habits will take over again, the economies will need a few more quarters for any meaningful conclusion to be made.

Moderate inflation is generally considered a good thing for the economy, but not a sharp increase, which would lead central banks to try and tame it through different policy tools, steepening the rate curve in the process. As discussed above, whilst the full price effect of "out of lockdown" may not be known for a few more quarters, periods of volatility should be unavoidable. Bumpy rides may lie ahead but could also be fruitful as they create trading opportunities, which will be best managed with a long / short approach in our view.

https://www.prometeia.it/it/financial-advisory_anteo-article/112-quali-sono-le-aspettative-e-le-tempistiche-per-laumento-dei-tassi-obbligazionari-usaue

Disclaimer

This material is not for distribution to retail clients and is directed exclusively to Chenavari Investment Managers' Professional Clients and Eligible Counterparties, as defined in the Markets in Financial Instruments Directive (2004/39/ EC) Article 4(1) (12); investors who are U.S. Persons and Accredited Investors within the meaning of Regulation D under the U.S. Securities Act of 1933, as amended, or Qualified Purchasers within the meaning of Section 3(C)(7) of the U.S. Investment Company Act of 1940, as amended. Chenavari Investment Managers is the trading name of Chenavari Credit Partners LLP ("CCP") and Chenavari Investment Managers (Luxembourg) S.à.r.l is the AIFM ("CIM Lux" and together with CCP, "Chenavari"). The information contained herein is confidential information supplied at the sole request of the recipient. By accepting this information, the recipient agrees that it will not divulge any such information to any other party. Any reproduction of this information, in whole or in part, is prohibited. The distribution of this document in certain jurisdictions may be restricted by law; therefore, people into whose possession this document comes should inform themselves about and observe any such restrictions. It does not take into account the particular investment objectives, financial situation, risk appetite, tax status or needs of individual clients. Chenavari disclaims any and all liability relating to a decision based on or for reliance on this document.

This document has been prepared for general information purposes only and has not been delivered for registration in any jurisdiction, nor has its content been reviewed by any regulatory authority in any jurisdiction. The information contained herein does not constitute: (i) a binding legal agreement; (ii) legal, regulatory, tax, accounting or other advice; (iii) an offer, recommendation or solicitation to buy or sell shares in any fund or any security, commodity, financial instrument or derivative linked to, or otherwise included in, a portfolio managed or advised by Chenavari; or (iv) an offer to enter into any other transaction whatsoever. This document does not constitute due diligence reporting and Chenavari bears no responsibility for your investment research and/or investment decisions, nor will Chenavari be liable of any decision made or actions taken by you or others based on the contents of this document and neither Chenavari nor any of its directors, officers, employees or representatives accept any liability whatsoever for any loss or damage of any kind and howsoever arising.

The information, estimates, forecasts or opinions supplied by Chenavari in this document are supplied for your private use and information, and for discussion purposes only and do not constitute and may not be used for the purposes of, an offer to sell or the solicitation of an offer to buy nor shall there be any sale of units or shares issued by a fund managed or promoted by Chenavari or its affiliates in any jurisdiction in which such offer, solicitation or sale would be unlawful. The units or shares issued by a fund managed or promoted by Chenavari are offered or otherwise made available only in accordance with available, applicable private placement or offering rules. The information supplied by Chenavari or its affiliates and contained herein shall not be deemed to constitute investment advice and should not be relied upon as the basis for a decision to enter into a transaction or as the basis for an investment in units or shares issued by a fund managed or promoted by Chenavari or its affiliates as an investment in funds units of these funds may not be suitable or lawful for all investors.

Prospective investors should: (i) consult their financial, accounting, tax and legal advisors prior to any investment in units or shares issued by a fund managed or promoted by Chenavari; and (ii) inform themselves as to (a) the appropriateness of said investment in units or shares, (b) the legal requirements within their own jurisdictions for the purchase or holding of said investment, (c) any foreign exchange restrictions which may affect them, and (d) the income and other tax consequences which may apply in their own jurisdictions relevant to the purchase, holding or disposal of units or shares of the relevant fund or investment vehicle.

Chenavari makes no representation or warranty, express or implied, as to, or assumes any liability responsibility for, the accuracy, reliability or completeness of any information, so obtained and supplied, or any information, estimates, forecasts or opinions prepared on the basis of such information. Furthermore, Chenavari shall not be under any obligation or assume any liability towards any person to update or correct any inaccuracy or incompleteness of the information, estimates, forecasts or opinions prepared on the basis of such information. Chenavari shall not be in any way responsible, or assume any liability for, any act or omission made by any person in reliance on this document or any information contained herein. This document shall not in any event be deemed to be complete and exhaustive information on the subjects covered. Chenavari makes no representations and/or warrants that contained in this document is either up to date and/or accurate and expressly disclaims all liability for errors and/or omissions. The information contained in the document is not related to any particular investment objective, financial position or specific interest of any recipient and is not intended to be relied upon or used by any counterparty, investor or other party.

Where indicated, the information sourced relating to Chenavari or its affiliates has been provided for information or illustration purpose only, and Chenavari nor its affiliates shall not be held responsible for the content of such information. Although some information has been provided by Chenavari, the information is based on information furnished by third parties, the accuracy and completeness of which has not been verified by Chenavari or any other person.

These materials may also contain historical market data; however, historical market trends are not reliable indicators of future market behaviour. Any historical investment results of any person or entity described in this material are not Indicative of the future investment results. Such results are intended only to give potential investors information concerning the general experience of the relevant person or entity is not intended as a representation or warranty by Chenavari, or any other person or entity as to the actual composition of or performance of any future investments.

This document contains information about Chenavari, certain of its respective personnel and affiliates and the historical performance information of investment vehicles whose portfolios are managed by Chenavari. Such information has been included to provide prospective investors with information as to Chenavari's general portfolio management experience. Prospective investors should not view the past performance of Chenavari as indicative of the future results. Chenavari makes no representation or warranty, express or implied, as to the fairness, accuracy or completeness of the information contained herein and nothing contained herein shall be relied upon as a promise or representation as to past or future performance of any structure managed by Chenavari or its affiliates from time to time.

Chenavari and/or its affiliates may receive or pay fees or rebates, in compliance with the Markets in Financial Instruments Directive, as implemented in each state of the European Economic Area. The offer, purchase or sale of units in any fund managed by Chenavari or its affiliates is accepted only from eligible investors on the basis of the current prospectus and subscription document for the relevant fund. The fund interests or securities referred to herein have not been, nor will they be, registered or qualified under the U.S. Securities Act of 1933, as amended (the "U.S. Securities Act") or any applicable securities laws of any state or other political sub divisions of the United States, and may not be offered, sold, transferred or delivered, directly or indirectly, in the United States or to, or for the account or benefit of, any U.S. Person, except pursuant to an exemption from, or in a transaction not subject to the requirements of, the U.S. Securities Act and any applicable U.S. state securities laws. The Fund has not registered and does not intend to register under the U.S. Investment Company Act of 1940, as amended (the "Investment Company Act") in reliance on the exemption from such registration pursuant to Section 3(c)(7) thereunder and certain interpretations of Section 7(d) of the Investment Company Act by the staff of the U.S. Securities and Exchange Commission. Accordingly, the Interests are being offered and sold only: (i) outside the United States to persons other than U.S. Persons in offshore transactions that meet the requirements of Regulation S under the U.S. Securities Act; or (ii) to U.S. Persons who are (a) "accredited investors" as defined in Rule 501 of Regulation D promulgated under the U.S. Securities Act and (b) "qualified purchasers" within the meaning of Section 2(a)(51) of the Investment Company Act. Except as otherwise disclosed in a fund's prospectus, its interests have not been registered for distribution in any other jurisdiction.

In Switzerland, the Fund is considered foreign investment schemes pursuant to Art. 119 of the Swiss Federal Collective Investment Schemes Act (CISA). No application has been submitted to the Federal Financial Market Supervisory Authority (FINMA) to obtain approval within the meaning of Art. 120 CISA to offer or distribute the investment in or from Switzerland to "Non-Qualified Investors", and no other steps have been taken in this direction. Consequently, investors do not benefit from the specific investor protection and/or FINMA supervision pursuant to the CISA and its implementing ordinances.

Any offer or sale must therefore be in strict compliance with Swiss law, and in particular with the provisions of the Collective Investment Schemes Act and its implementing ordinances, and FINMA circular 2013/9 on distribution of collective investment schemes. No person or entity is authorized to offer or sell the Shares or distribute any Fund Documentation, including the Prospectus, the Articles of Incorporation and annual reports issued by the Fund from time to time or promotional material pertaining to the Fund in or from Switzerland other than to "Qualified Investors", as defined in Article 10 of the CISA and Articles 6 and 6a of the CISO and any circulars issued by FINMA.

The investment vehicles have appointed as Swiss Representative Oligo Swiss Fund Services SA, Av. Villamont 17, 1005 Lausanne, Switzerland, Tel: +41 21 311 17 77, email: The Fund's paying agent is Banque Cantonale de Genève. Any Fund Documentation may be obtained free of charge from the Swiss Representative in Lausanne. In respect of the shares or units distributed in or from Switzerland, the place of performance and jurisdiction is at the registered office of the Swiss Representative.

This document has been prepared, issued and approved by Chenavari, registered in England and Wales Companies House No. OC337434, with its principal place of business at 80 Victoria Street, London, SW1E 5JL. Chenavari is authorised and regulated by the Financial Conduct Authority under the number 484392, the Commodities and Futures Trading Commission (No. 0426351), and registered with the Securities Exchange Commission (No. 801-72662).