Dear investors,

As we enter our second decade of operations at Chenavari, we are pleased to continue our tradition of providing a review of the year just gone, and an outlook on the year to come.

2018 was a tumultuous year in many respects, providing a harsh environment for financial markets. The MSCI ACWI (USD) equity index finished the year down 11% and the EURO STOXX 50 (EUR) down 14%. Italian 2-year bond yields saw a range between -0.3% and 2.7% during the year. Brent crude oil futures reached $85/bbl in October, but closed the year near $54/bbl. For European credit[1], the iTraxx Europe on-the-run 5Y index spread started the year at 45bps and ended the year at 88bps - almost a 100% widening. The iTraxx Crossover on-the-run 5Y index spread started the year at 234bps and was at 355bps at the end of the year. The volatility stemmed from many sources, but included elections (notably in Italy, the US and Brazil), popular protests (France), central bank actions, and the spectre of "trade wars" instigated by the US.

> *"In our opinion, the past few days of market activity highlight a significant change of regime for global markets."*
> ***Chenavari, 14 February 2018***

Looking ahead, there is an increasing sense that **markets are nearing the end of a cycle – whether that is the credit cycle, economic growth cycle, or debt cycle**. **A larger change in market regime may therefore be expected, although admittedly the timing remains a question mark**. Most economies continue to grow and create jobs, for example, unemployment is at historic lows in both the US and the UK, at c.4%. Around mid-2019, the US will likely hit a record for its longest-ever economic expansion and may reach 10 years of continuous growth, the longest such period since modern records began. However, economic growth is expected to slow, as indicated by lower PMIs in Europe and as the effects of US tax cuts wear off; Chinese activity has also been declining more recently. US markets, from interest rates to credit to equities, are currently pricing more than 50% probability of a recession in the US in the next twelve months.

The interest rate environment will continue to affect the dynamics for financial markets. While the US Fed hiked rates four times in 2018, the markets believe there may be a further two increases in 2019. In Europe, the prospect of a rise in the ECB interest rate has been pushed to the end of 2019, or even to the beginning of 2020. Anyway, we are still convinced that the abundance of central bank liquidity that supported excessive valuations and extremely tight credit spreads will slowly disappear.

More broadly, the **continued rise of populism** around the globe is concerning. Brazil and Italy elected populist leaders in 2018 and others may follow in 2019, as nearly one-third of the world population will be asked to vote (including in India, Indonesia and Nigeria). Connected with this theme, the US trade disputes with China

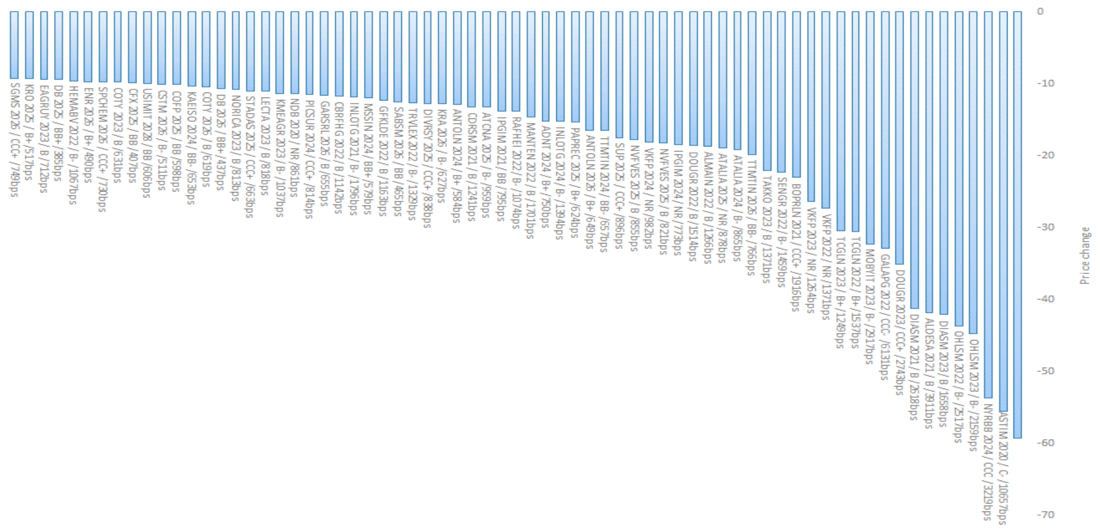
[1] Source: Markit

and the EU are also likely to result in ongoing tensions and uncertainty. In the UK, the first months of 2019 will require the country to deal with the consequences of the Brexit referendum: a bad deal, no deal at all, or a new referendum? Also of consequence for Europe this year, on top of European elections in Q2, will be decisions on replacing Mario Draghi at the ECB and Jean-Claude Juncker at the European Commission.

Tradable credit

In tradable credit markets, investors have grappled with volatility, widening credit spreads and a notable increase in dispersion. As a result, some cash bonds recorded large price moves in response to corporate events and idiosyncratic developments.

Chart 1: Selected European HY bond price moves from highest level in 2018



Source: Chenavari, Bloomberg

The seeds of this environment were sown in February, as volatility struck most markets after a strong start to the year. In response, Chenavari anticipated[2] precisely the volatility and wider credit spreads that subsequently materialised. Profiting from such conditions was more challenging however, given the technical nature of the market movements, the costs of running short positions over an extended period, and the importance of timing.

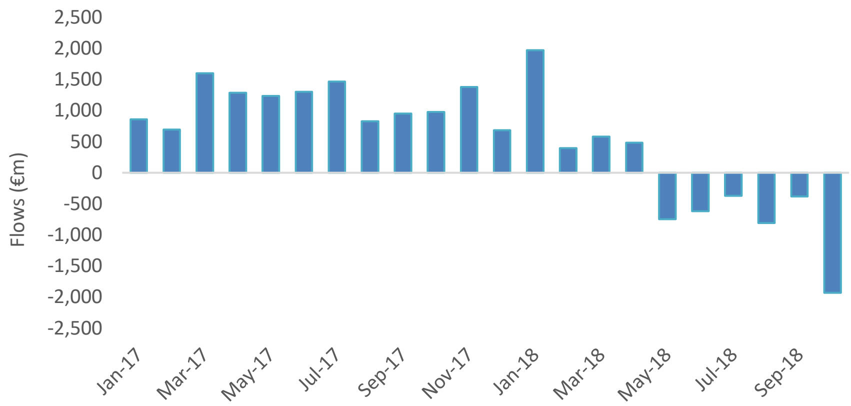
While these conditions proved difficult for most investors, ourselves included, **a positive consequence of that market environment was the uncovering of some attractive opportunities**. **Valuations are now more appealing in Europe**: the yield of the iBoxx EUR Liquid High Yield index[1] increased from 2.7% to 4.9% during

[2] Chenavari, "Investor letter – a new regime for global markets", 14 February 2018
Chenavari, "Investor letter – a new regime for global markets (part II)", 31 May 2018
Bloomberg Surveillance, Bloomberg TV Interview, 26 February 2018

2018. **The increased cost of currency hedging USD also made European credit more appealing in comparison to US credit, for non-US investors comparing the two**. For specific sectors, Financials (bank and insurance bonds) also demonstrated value – the effective yield of the BoAML CoCo index increased from 4.7% to 6.5% last year.

Combined with the improved fundamental condition of banks in Europe (average CET1 ratios now exceed 14%[3]), we believe this reveals **potential fundamental opportunities in the Financials sector**. However, as always it is important to consider technical influences here as well. We anticipate relatively heavy supply of NPS (non-preferred senior) bonds by banks in 2019, which will need to be absorbed. At the right spread, we believe that those bonds will present an attractive investment opportunity. **Since Q2 2018, heavy asset outflows have afflicted managed funds investing in this area** (cf. chart 4)**; if these outflows were to continue in 2019, it could further impact the technical picture for this market.** While we believe this warrants a more cautious stance, there is the potential for increased allocations at some point.

Chart 4: Asset flows from identified universe of European Financials credit funds

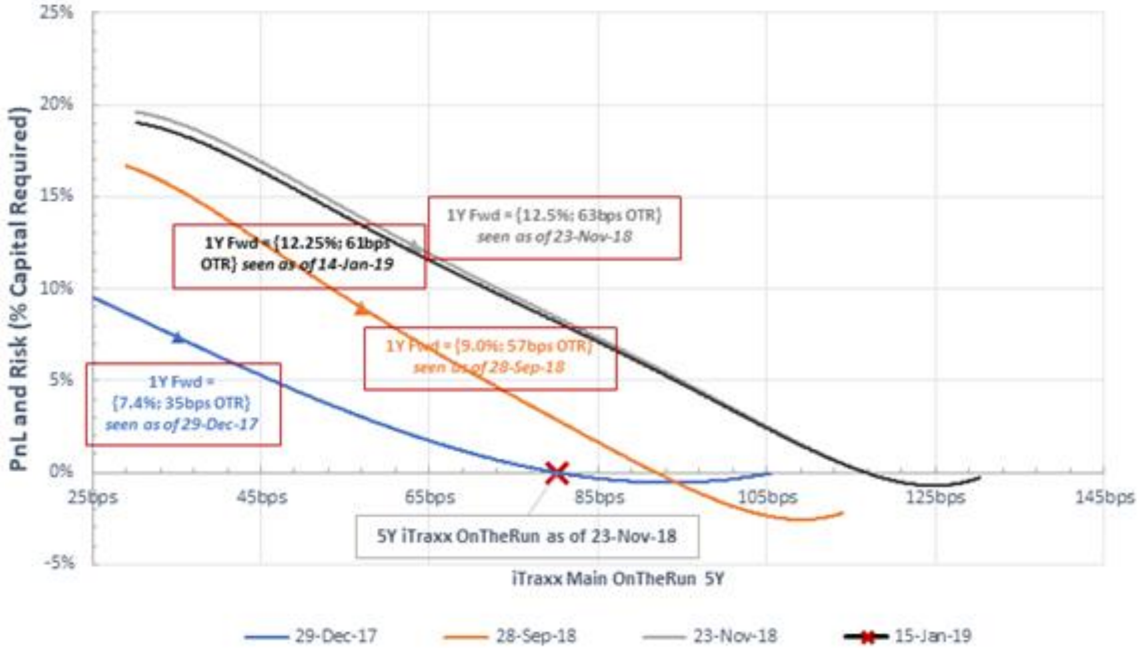


Source: Chenavari, Bloomberg

At a more granular level, we believe more specific opportunities are also available in tradable credit markets currently, driven by some of the recent technical drivers of markets. **Positions with positive convexity are generally desirable, particularly when markets may be moving into a phase of negative convexity**. For example, potentially cheap sources of convexity are identifiable in credit index derivatives, after implied correlation declined sharply at the end of 2018 as idiosyncratic risks in individual companies outweighed the risk of more systematic issues for Europe.

[3] Source: European Banking Authority, 2018 – EU Wide Transparency Exercise, June 2018

Chart 2: 1Y forward risk profile of 2Y equity tranche on iTraxx Europe

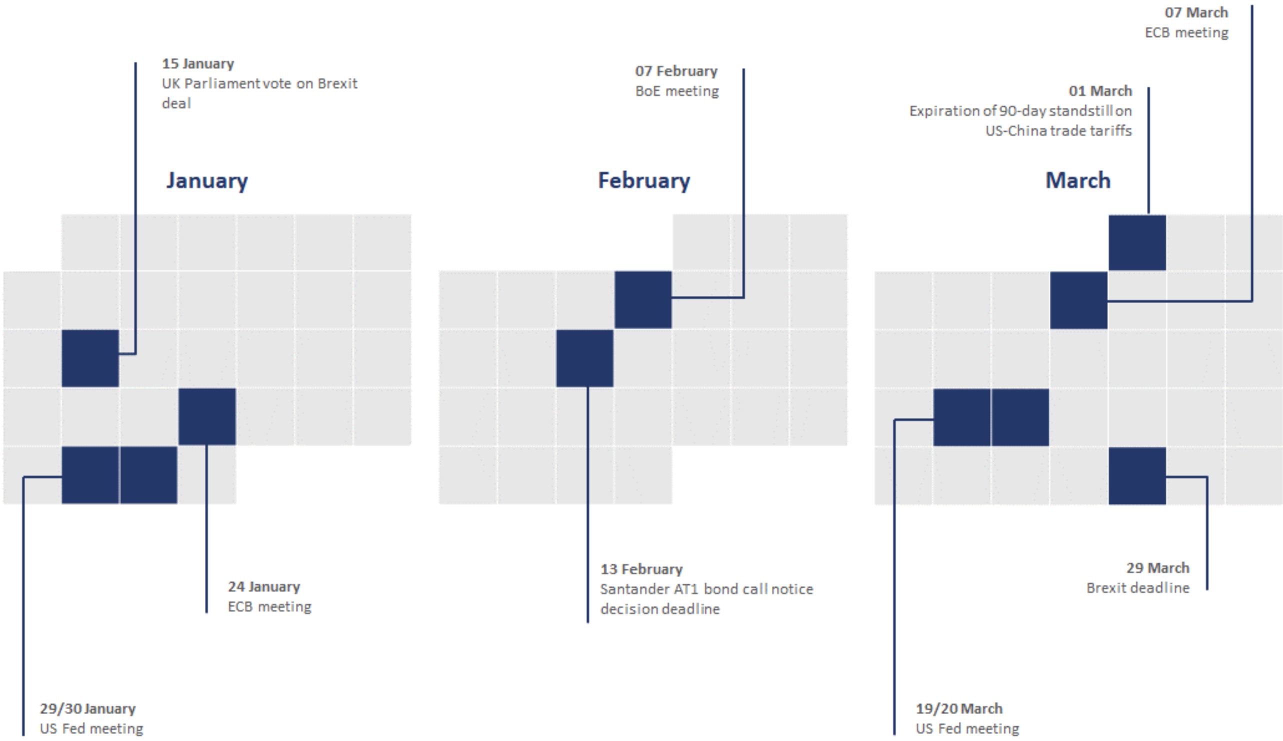


Source: Chenavari, based on JP Morgan and Bloomberg data

The opportunity in index derivatives reflects rising idiosyncratic risks for certain European companies. Greater dispersion has occurred as the credit instruments of these companies uncoupled from broader market moves. At the same time, **this has increased opportunities for long/short trading of corporate credit, with increased volatility and changing fundamental factors providing a rich opportunity set for active investors.** Deteriorating performance at French retail group Casino and Italian construction firm Atlantia provided just some of the examples of this in 2018, and we believe plenty more are likely in 2019.

While approaching these attractive opportunities in 2019, a humble attitude and laser focus on liquidity will be even more important than usual. A number of geopolitical issues are brewing, and the first quarter, in particular, has the potential for springing surprises on investors.

Chart 5: Key market events of Q1 2019



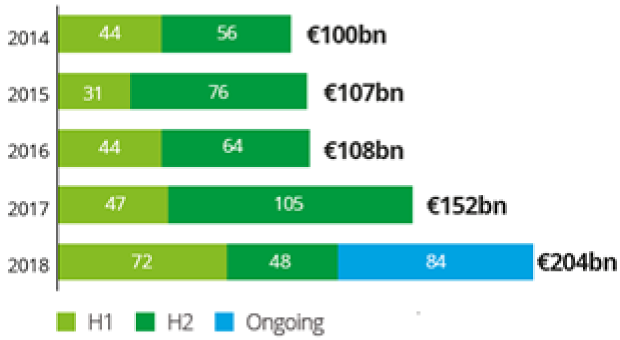
Source: Chenavari

Private Credit

In our opinion, European markets continue to provide some of the best opportunities for Private Credit. The private credit investment possibilities are driven by multiple long-term factors including **regulatory changes, structural reforms, fragmented provision of financing and deleveraging by local banks**. In the shorter-term, positive influences include default rates that are expected to remain low in Europe[4], while the supply of potential opportunities also remains robust – sales of both performing and non-performing loan portfolios are anticipated to continue at high levels in 2019.

[4] Fitch Ratings: "Default rates to Stay Low in EMEA Leveraged Credit in 2019", 4 December 2018

Chart 6: European loan portfolio market activity, by year



Source: Deloitte, Deleveraging report 2018 Q3

Our investment team continues to identify such opportunities to **acquire performing bank loan portfolios**, leveraging on the team's extensive relationships and local operating partners. Our ability to add value to these attractive portfolios was further demonstrated during November, with the pricing of a c.€300m RMBS transaction structured by Chenavari from the aggregation of three portfolios of Irish residential mortgage loans, acquired during a period from 2016 to 2018. Despite the challenging market environment of the time, the transaction was priced and all rated notes from Class A to Class F were sold.

Further attractive investments can be found in areas such as **Specialty Finance**, including real-assets finance, consumer finance and collateralized corporate financing, such as receivable finance, trade finance and more generally corporate financing secured by assets (and not just corporate EV). **We would contrast these attractive opportunities with the over-popular area of direct SME lending**, where we believe fundamentals are deteriorating even as investors continue to allocate. Corporate leverage has increased and, in our opinion, insufficient premium is being offered to compensate for the potential risks; EV and EBITDA are not collateral and **traditional direct lending may yet be a bubble waiting to burst**. Indeed, the comparable European Leveraged Loan market can provide similar risk exposures as direct corporate lending, but with better liquidity and lower default rates.

Value can also be identified in other specific areas. Chenavari has already experienced significant success in Ireland and Spain, as we managed to roll out investments in these countries benefiting from the recovery from financial and housing crises. Now, **we believe Greece may be at the beginning of a similar trajectory** as unemployment, labour costs and government bond yields have fallen, while the fiscal primary balance is positive and international debt relief efforts provide a positive impact. **Chenavari has been investing in Greece for four years already, and we see value in loans backed by conservative collateral valuations and structured investments in companies positioned to benefit from a Greek recovery**. Please contact our investor relations team if you would like to know more about this opportunity.

Other new areas of opportunity are emerging in Europe, in response to the same long-term factors as described above. Regulatory change is one such constant factor – new regulations affecting securitisation[5] came into effect on 1 January 2019 for example. The changing regulatory treatment of revolver facilities may also provide scope for attractive investments in 2019. Regulations also typically have secondary impacts, particularly on banks and the provision of finance, thus we also anticipate further opportunities deriving from direct origination of credit in Europe, as well as origination with platform providers. This builds on **Chenavari's lengthy experience with specialty finance originators in Europe since 2013**.

Overall, we believe Chenavari specialises in areas that currently offer numerous attractive risk-reward opportunities. Our focus is on niche, specialised lending in sectors that are under-supplied with credit due to identifiable, long-term factors. As stated, these include Specialty Corporate (with collateral) and Consumer Finance, where the benefits of lending with collateral and/or with granularity can be contrasted with the deteriorating environment for classic EBITDA-based direct lending to corporates.

In conclusion, niche investment opportunities exist in both private and tradable credit markets. We regard Europe as an attractive region as a source of both value (for example in Financials, consumer finance and Greece) and opportunity (driven by long-term impacts such as regulatory changes, as well as short-term drivers such as dispersion, providing a rich environment for long/short trading). However, the importance of fundamental credit selection remains key. Geopolitics will continue to be important, perhaps even more so this year as some major issues such as Brexit and "trade wars" approach conclusion. Being a specialist European credit firm with on-the-ground knowledge and resources will remain a key advantage for us. Indeed, there is a trend for investors seeking alternative asset management platforms which can provide them with scale and diversity – **we believe Chenavari's decade of experience and breadth of knowledge across European credit makes us a compelling choice for such investors**.

Once again we wish you a healthy, happy and successful New Year. We look forward to the opportunity to work with you and, last but not least, we thank you for your continued trust in Chenavari.

With our very best regards,

Loïc Féry, CEO & Co-CIO

Fréderic Couderc, Co-CIO

Should you wish to arrange a follow-up discussion, please do not hesitate to contact us:

+44 207 259 3600 ir@chenavari.com

[5] Regulation (EU) 2017/2402 (the Securitisation Regulation) and Regulation (EU) 2017/2401 (CRR Amendments)

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Chenavari Investment Managers
80 Victoria Street
London SW1E 5JL
www.chenavari.com