CHENAVARI INVESTMENT MANAGERS

INVESTOR LETTER – A NEW REGIME FOR GLOBAL MARKETS

FEBRUARY 14TH 2018

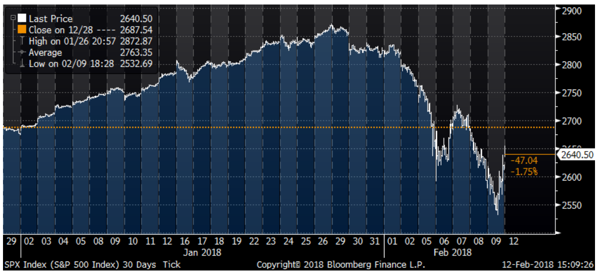
February 14th 2018

Dear Investors,

In our opinion, the past few days of market activity highlight **a significant change of regime for global markets**.

Following the recent highly-publicised meltdown of short volatility positions, as they were forced to be unwound (*evidenced by the huge spike of the VIX index last week, as shown in the chart below*) and recent discussions of funds closing down as a consequence of significant losses and margin calls, **we are convinced that markets are currently pointing toward a more significant correction** to come. With this is in mind, we have sharpened our pencils and are carefully reviewing the fundamentals of our portfolios, while keeping a watchful eye on valuations, liquidity and technicals.

S&P 500 (Source: Bloomberg)



VIX index (Source: Bloomberg)

CDX HY – US High Yield credit (Source: Bloomberg)

iTraxx Crossover – European High Yield credit (Source: Bloomberg)

Fundamentals are fine

Economic fundamentals still appear relatively strong across a wide range of metrics: after nine years of quantitative easing by the global central banks, economic data are impressive and even strengthening, with positive trends apparent in most GDP/PMI data of key countries (*Chart 1 shows strong GDP numbers in 2017, and equally supportive forecasts for 2018*), which additionally are accompanied by solid corporate earnings. Such fundamental indicators are obviously a key support for our investment decisions as credit investors.

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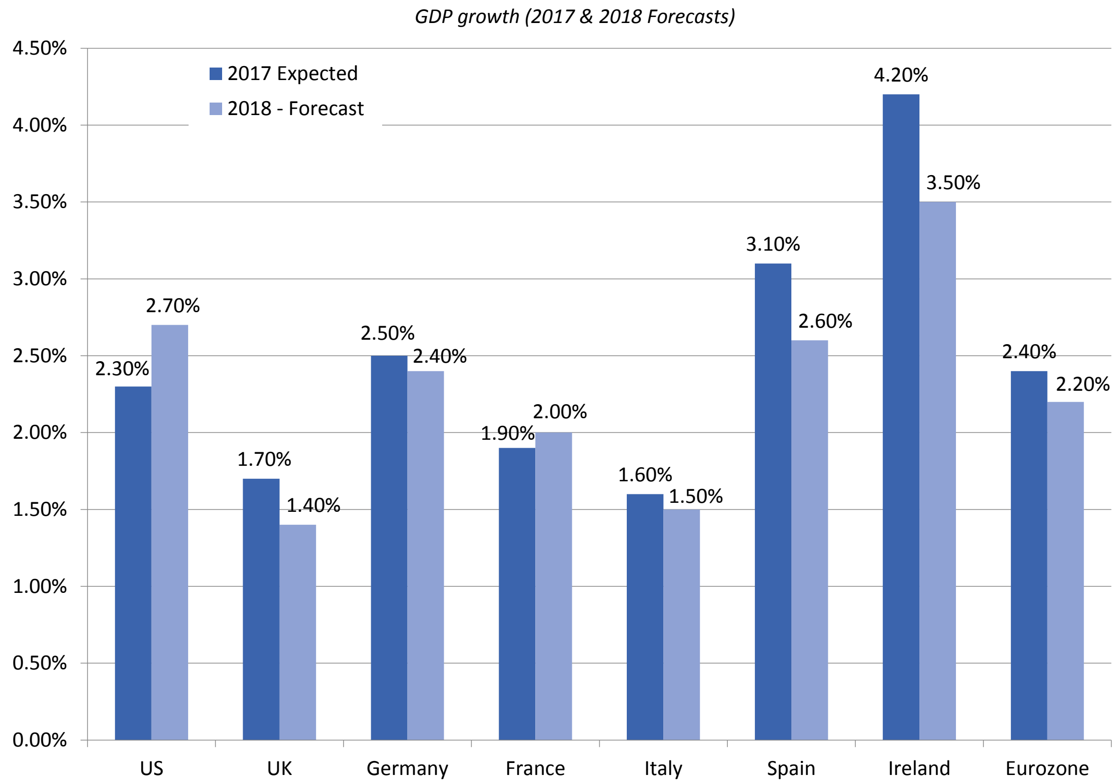
Chart 1



Source: Bloomberg

Valuations are "toppish", if not excessive

In credit and equity markets, our view is that **valuations offer limited upside**. We believe positive news, such as tax reform in the US, have been anticipated and quite significantly priced-in already. Record P/E ratios in equity markets, and extremely tight spread levels in credit markets, seem to ignore the increasing leverage of corporates, particularly in the US where average Net Debt/EBITDA in the high yield area is over 3.8x[1].

As such, we view valuations as "toppish", if not excessive. Equity markets have already seen a notable correction: despite over-performing in the past few days (compared to equity indices), credit markets undoubtedly also have the potential to see significant spread widening.

…/…

[1] Source: Bloomberg

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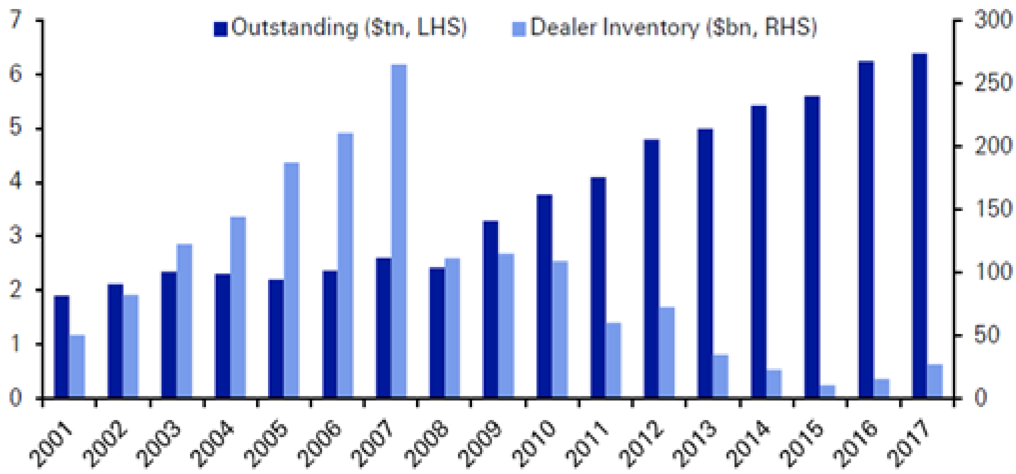
Liquidity is poor

We are becoming increasingly concerned by the lack of consideration market participants are giving to the reduced liquidity that we have observed in some markets. We have recently seen difficulty finding true prices for $5-10m bond positions from counterparties: the same bonds where large institutional asset-managers commonly hold over $100m of exposure! The poor liquidity in credit cash markets can certainly have a snowball effect, where price actions may trigger waves of redemptions from large daily or weekly liquidity funds: **we believe that the high yield market, in particular, could well experience the same price action as ABS markets witnessed during the financial crisis**, due to the acute liquidity mismatch in such funds.

US Dealer inventory versus outstanding size of IG and HY market



Source: NY Fed, Bloomberg, Deutsche Bank, "Long-Term Asset Return Study" as of 18 September 2017
Note: The inventory series changed from 2013

"Technicals have turned"

Our view is that the market will experience a "***systemic de-risking period***". The recent weakness, observed primarily in equity markets, could possibly be seen as an entry point by eternal optimists. To the contrary, we are increasingly convinced that any market relief will only be a transition before a significant market downturn. A downturn that is likely to be triggered by weak market technicals such as poor liquidity, unsuitable investment vehicles with asset/liability imbalances (e.g. ETFs), and excessive leverage being applied to fully priced assets. For example, we think **there is a possibility that we could experience a similar pattern as the 1987 crash**: following a 5-year period of equity market appreciation, first an interim period of some volatility with 5% up and down movements, followed by a 30%+ market correction.

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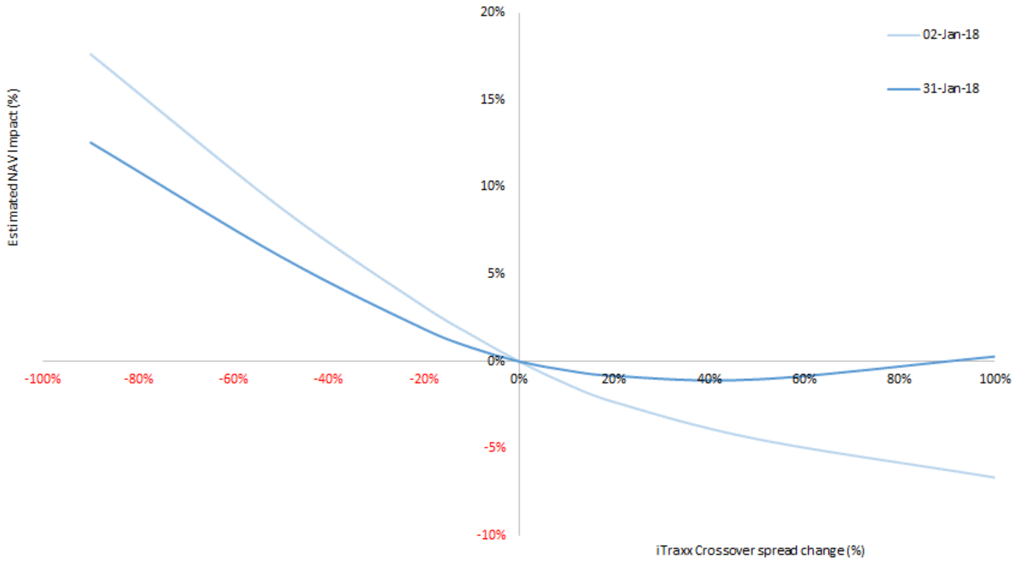
Fund Positioning

We believe that our **long/short** research and trading capabilities, combined with our experience in implementing **convex** investment strategies, puts us in a strong position ahead of this expected new market regime.

While we look to maintain a flexible approach and open minds during this fluid environment, the tradable credit investment strategies are, on the one hand, taking into consideration our perceived change of regime**, implementing an even stronger bias towards very liquid positions** and **enhancing the ability to benefit from the possible forthcoming weakness**. Chart 2 (*below*) illustrates how our market views have been implemented across the positions of our flagship Multi-Strategy fund in the past few weeks, adjusting the credit spread sensitivities and trying to maximize convexity in particular.

<u>Chart 2</u>

Chenavari Multi-Strategy Fund (MS2) risk scenario



Source: Chenavari. Risk scenario assumes that the whole portfolio underlying the Fund undergoes an instantaneous relative change of x% in portfolio spreads. Estimates are based on the market conditions at the time of modelling and are therefore subject to change. Stress Tests present a set of hypothetical scenarios that assume changes for one or more market variable in order to assess the effect on the portfolio. (Including but not limited to assumptions on Betas to Equity, Correlation, Volatility and Term Structure). The results shown represent estimated gross performance under the market conditions stated. Chenavari has made assumptions that it deems reasonable and uses the best information available to calculate the stress test estimates. If a different set of assumptions were used in this calculation, there could be a material difference in the calculated estimates.

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One last word on private credit strategies

On the other hand, **in our private credit strategies**, the **European specialty finance focus** is de-correlated from market volatility and we endeavour to structure the investments with strong embedded cash flows and structural protection. We think that **any market valuation downturn (in equity and/or credit) will be supportive to the investment opportunity in private credit markets**, through the supply/demand imbalance on financing requirements and as private credit origination yields increase. For example, in December 2017 we completed the acquisition of the €550m consumer finance performing portfolio of Banca Carige, illustrating our strong convictions in the European Specialty Finance space.

Should you wish to arrange a follow-up discussion, either to discuss how our tradable credit funds are positioned to take advantage of this perceived change of market regime, or to get more concrete examples of our speciality finance strategies in private credit, please do not hesitate to contact our Investors Relations team.

Thank you for your support and we look forward to having the opportunity to meet you soon.

With our very best regards,

Loïc Féry, CEO & Co-CIO

Fréderic Couderc, Co-CIO

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