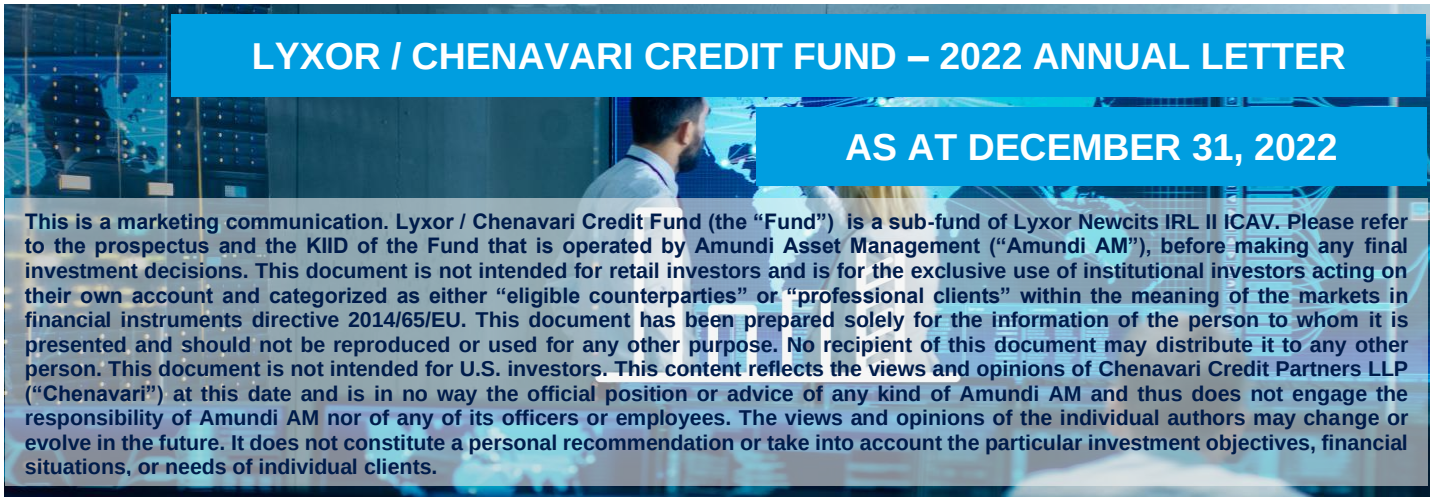

LYXOR / CHENAVARI CREDIT FUND – 2022 ANNUAL LETTER

AS AT DECEMBER 31, 2022

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In Brief

Back to basics in 2022: after a couple of years building expertise on pandemics and the efficacy of mRNA vaccines, the brutal surge of inflation brought us back to Econ 101 - with a bang.

The ensuing increase in rates by Central Banks and significant market correction have led to the return of yield for European credit investors, a sight which had all but disappeared over the past decade.

This makes for an exciting 2023, and the carry component implies intrinsic positive return in the long leg of Credit portfolios. It might make sense to not try too hard, select a few names and sit on them for the year.

However, the effects of the macro background will really start to unfold in 2023. 2022 was a year of robust growth for European economies, and only now is recession beginning to bite. Inflation has reached double digits. It is incredibly hard to assess whether it will return to its optimal level of 2-3% rapidly (as planned by the ECB) or whether it will prove sticky and stay around 5-7% for a longer period. We enter 2023 with "known unknowns" whose credible potential outcomes range across several standard deviations, and which will ultimately define market direction this year. The situation in Ukraine is highly unpredictable and can run the gamut from appeasement to nuclear strike. China is another factor, with the reopening potentially yielding some inflationary pressure in Europe on the energy side. At the end of the day, it is hard to pinpoint a narrow range for growth in Europe in 2023: it most certainly ranges from "moderately bad" to "very bad".

Corporates will be deeply impacted by this new context, and 2023 EPS growth expectations are now in negative territory for European Corporates ex Financials[1].

In addition, and whilst the cost of debt increases significantly, Corporates will need to come and tap the market ahead of the maturity wall of 2024-25, making for an abundant supply of new credit. There is no doubt that the market will be demanding on yields (more so as QT will create a liquidity drain and require fresh money to replace the ECB's).

Altogether, the downturn phase of the cycle is only beginning, with its share of credit downgrades, defaults, and rising dispersion – and significant ranges around central scenarios.

We believe that this uncertain backdrop plays to the strength of the Lyxor / Chenavari Credit Fund (the "Fund"), given its capacity to embrace beta and collect carry during upwards movements, and its focus to protect the book should the macro turn sour. Our expertise on Financials should be a powerful differentiator in 2023, as the sector should benefit from the increase in rates (as long as the recession remains shallow enough) and offers very cheap valuation at the moment.

We thank you for your trust and hope that this letter will give you further insight into our management of the Fund.

Main Fund Risk Factors: *Risk of losses, risk of non-achievement of investment objectives, risk of illiquidity, credit risk. For a complete list of risk factors (please refer to page 22 for further details on the risk factors of the Fund). Please refer to the Fund's legal documentation for complete terms and conditions.*

[1] Source: Morgan Stanley, predicting -1.8% for MSCI Europe excl. Financials (Strategy data Gallery, 4 November 2022, page 30).

EXECUTIVE SUMMARY

Section 1 – The 2022 story.

2022 turned out to be a trend-breaking year, with Central Banks losing control of inflation, and most asset classes including credit suffering significant drawdowns. EUR High Yield (HY) and Euro AT1s were down 10 and 12% respectively (as of 30/12, see Figure 3). This means that after a bruising year, the market can finally look forward to significant carry in European Credit, only mitigated by the stickiness of Inflation and the upcoming recession.

Section 2 – How we performed in 2022.

The Lyxor / Chenavari Credit Fund performance in 2022 was -0.36% (class SI USD) and -2.26% (class SSI EUR). The team was true to its management style, with its key principles at play: low correlation, low volatility, agility. Performance was achieved through an active work on the Fund's overall positioning, and a relentless focus on rate hedging.

Section 3 – The 2023 conundrum.

Looking at 2023, the environment is much more unpredictable than it has been for the past decade. High inflation is a new, hard to predict phenomenon. Given its vicious nature, it remains to be seen whether it is tamed as swiftly as Central Banks anticipate. The development of the Ukrainian war and its impact on Russian politics will be key for European energy, with a wide range of plausible outcomes. China is another factor, as the reopening is not just a source of optimism – it raises potential issues for European energy and constitutes a massive health challenge in the country and potentially globally.

Looking at Corporates, the recession has started to bite in Europe, impacting prospects for growth. This comes at a time when many companies will start refinancing ahead of the maturity wall of 2024/25 – at a much higher level of overall rates than in the last round. Central Banks pulling out of QE will add liquidity strain to the process. The credit cycle is therefore moving to a new stage, requiring enhanced attention to the health of balance sheets and growth prospects.

Section 4 – Our Gameplan.

Such uncertainty plays to the strength of the Fund, which has shown its capacity to be nimble and adjust rapidly to changing market phases. Our key focus on the long side of the book is on quality companies. Financials could be a crucial differentiator this year, given their reasonable valuation, sound financial structure, and because they are one of the few sectors to benefit from the increase in rates. Our game plan is summarised on Figure 19, page 18 below.

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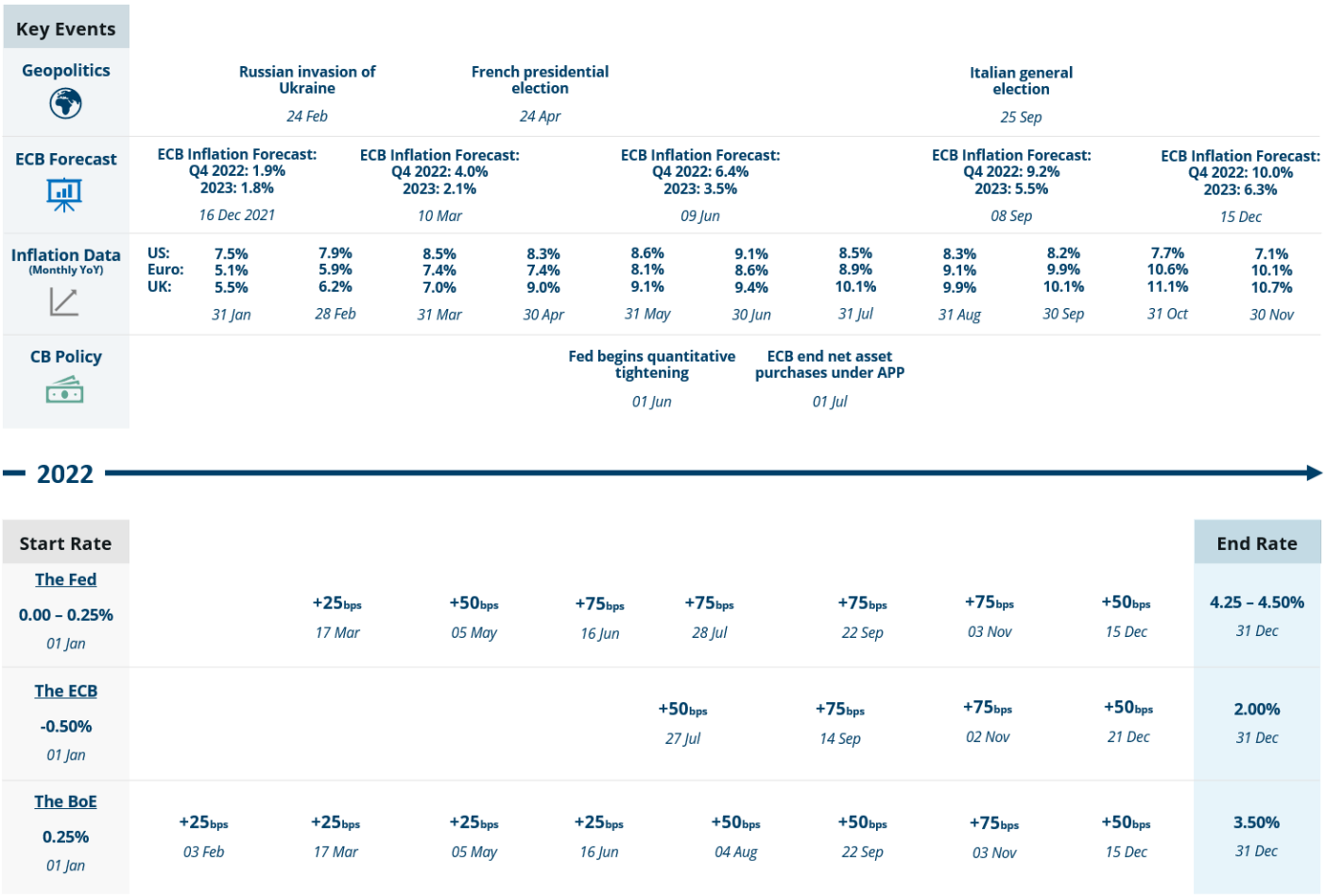
Past performance does not predict future returns. This also applies to historical market data.

1. MARKETS IN 2022: A TREND-BREAKING YEAR

After a decade's long bull market characterised by expanding monetary policies, low rates, and low inflation, 2022 proved a "trend-breaking" year.

The brutal return of inflation in developed countries (aggravated in Europe by the Russian-led energy crisis) precipitated a U-turn in monetary policies, a resounding surge in rates, and an ongoing bear market environment. Figure 1 is a brief reminder of the key events of the year.

Figure 1: 2022 key events



Source: Chenavari.

Some patterns which had become engrained in market participants' "rulebook" were aggressively tested.

- Macroeconomic data suddenly became much harder to predict (as ever in times of non-linear movements), with Central Banks struggling to appreciate the depth and stickiness of inflation.
- The unstable environment increased the risk of policy errors, which had remained contained since 2008. The "Liz Truss chapter" plunged the UK Gilt market down a perilous slope, expanding to the LDI episode (which we believe could have deteriorated into a much deeper crisis if a change of leadership and ensuing radical changes had not been implemented).

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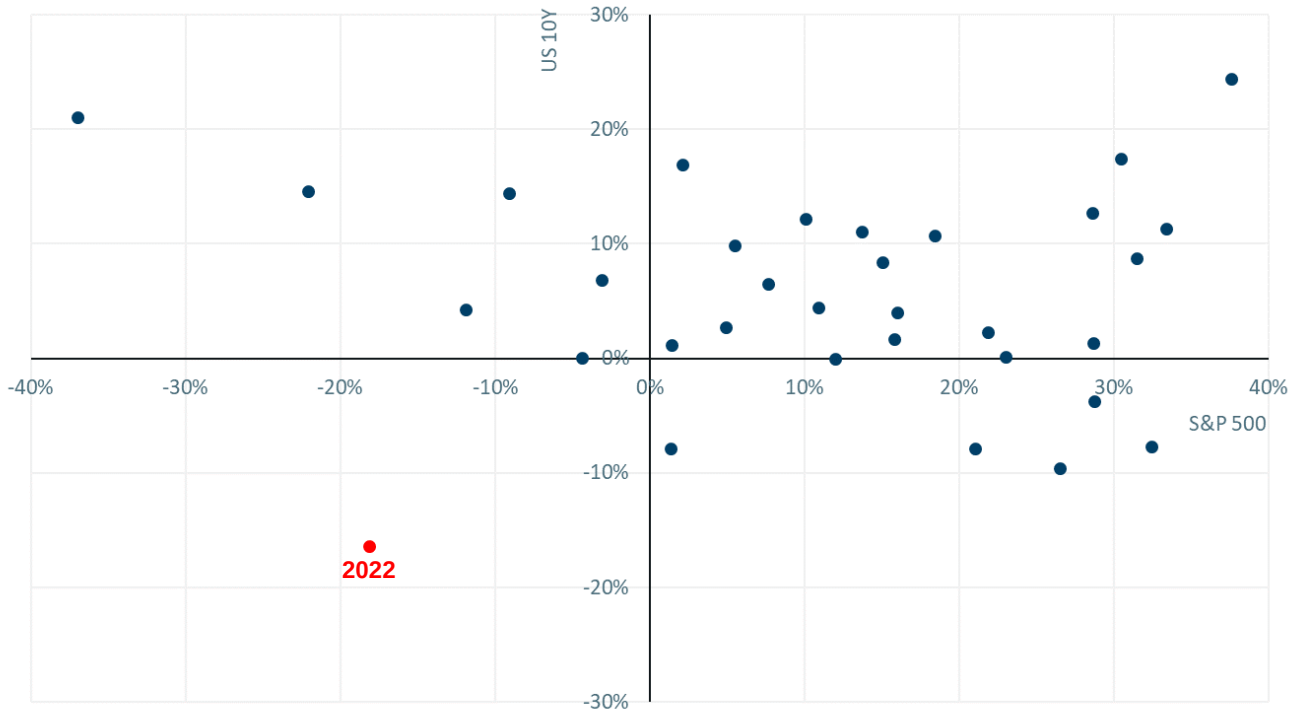
- The classic 60/40 portfolio came under significant strain: bonds did not play their traditional role of a buffer against the market collapse. The S&P 500[2] was down 19.4% over the year whilst an investment in the US 10Y Treasury[3] returned -16.5%. This is quite an extraordinary rupture from the past decades where Treasuries would usually show positive return on years of negative equity returns (as Figure 2 highlights).

Figure 2: The 60/40 wisdom came to an end in 2022 as US 10Y Treasury bills moved in line with the S&P 500 (data 1990 to 2022)



Source: Bloomberg and Chenavari, as at 30 December 2022.

- After a decade of strong performance, passive long only funds came under significant pressure as indices across the world tumbled, bringing the spotlight back to focus on active long / short strategies.
- Whilst the era of cheap money faded out, its "moral hazard aftermath" (speculation going awry and fraud being uncovered) accelerated through the year, epitomised by high-profile Crypto explosions, and alongside higher rates, calling for a general return to safer investment.

In the world of credit, the year could be best summarised by the "Pain & Hope" sequence: pain as credit indices were hit their hardest since 2008 (see Figure 3, right-hand side), and hope that better days are coming given the return of sustained yield across the whole listed credit universe. Hope is only mitigated by the fact that yields are here for a reason: the economic backdrop is no longer benign, as the debate in Europe is all about the stickiness of inflation and the depth of the recession.

[2] Please refer to page 22 for the definitions of the indices used.
[3] Please refer to page 22 for the definitions of the indices used. The Benchmark Indexes disclosed herein are used only for performance comparison purposes. The Management Company is not in any way constrained by the Benchmark Indexes in its portfolio positioning. The deviation from the Benchmark Indexes may be significant.

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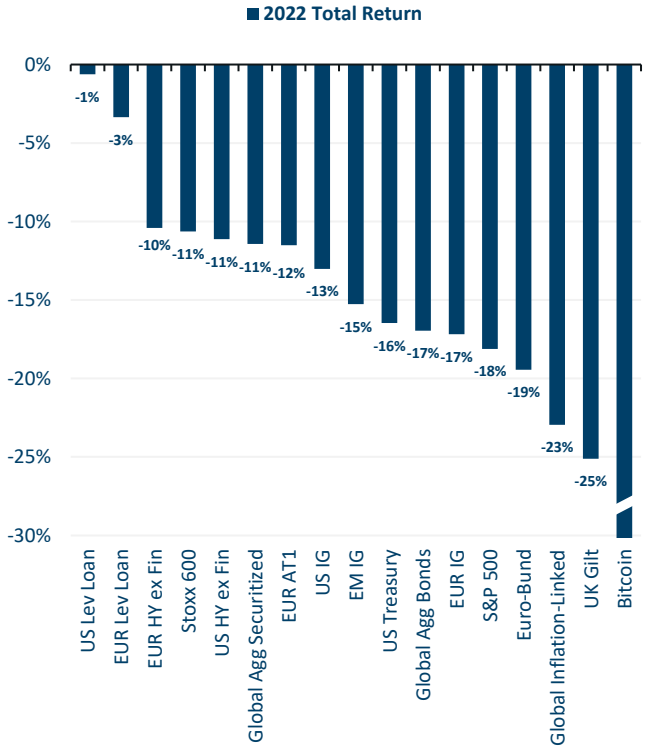
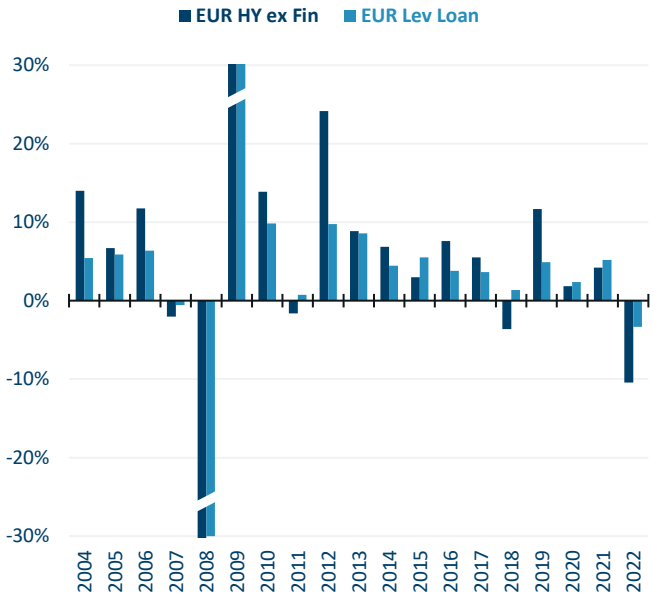
Figure 3: 2022 Returns – decline for most asset classes

2022 has been awful for returns …



… the worst for HY and loans since 2008



Source: Barclays Research and Bloomberg, updated by Chenavari as at 30 December 2022. 2022 Bitcoin total return = -65%. 2008 HY and LL returns = -33% and -30%, respectively. 2009 HY and LL returns = +60% and +43%, respectively.

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Past performance does not predict future returns. This also applies to historical market data.

2. HOW WE PERFORMED: A CLOSE LOOK AT 2022

In 2022 the Lyxor / Chenavari Credit Fund was down 0.36% (SI USD share class). The SSI EUR share class was down 2.26%[4].

Figure 4: Monthly performance of the Fund in 2022 (SI USD share class)

Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	FY
-0.45%	-1.56%	0.64%	0.08%	-0.61%	-1.71%	1.52%	1.00%	-0.47%	-1.49%	1.56%	1.22%	**-0.36%**

Source: Bloomberg and Chenavari, as at 30 December 2022. Returns and performance are representative of Class SI USD. Past performance does not predict future returns. This also applies to historical market data. For a complete disclosure of the Fund performance (Class SI USD, net of fees) please refer to the Appendix section at the end of the document.

In our view, the behaviour of the Fund during the year highlights some essential features of the Fund, namely low correlation, low volatility, and agility. We will examine each of those characteristics.

We will also reflect on what we could have done better through the year, and finally look at our key trades.

2.1 LOW CORRELATION

In 2022 again, the Fund largely decorrelated from key indices across all asset classes.

As Figure 5 shows, all correlation results are between -0.1 and 0.4, i.e., ranging from absent to non-significant.

Figure 5: Correlation between the Fund (SI USD share class) and key indices

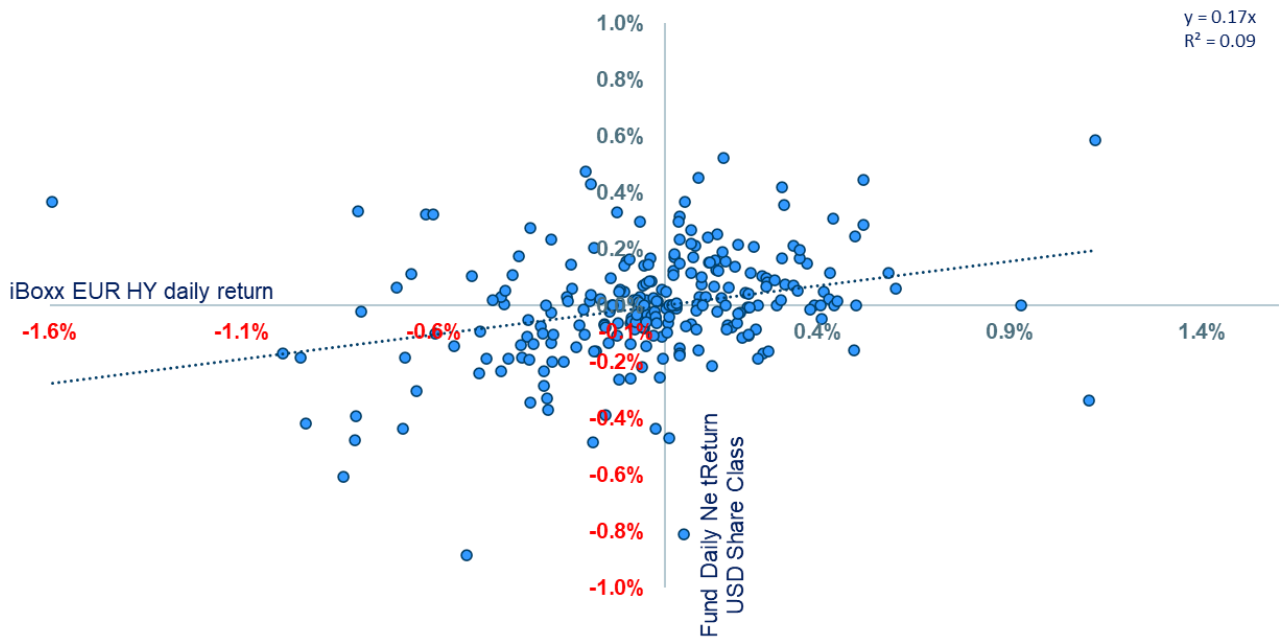
	EuroStoxx 50	EuroStoxx Banks	iBoxx € Corp.	iBoxx € Liq HY	iBoxx € AT1	Euro Bund	US 10Y Treasury
Lyxor / Chenavari Credit Fund	0.01	0.06	-0.08	0.32	0.37	-0.27	-0.30

Source: Bloomberg, Chenavari Risk, as at 30 December 2022.

The low level of correlation between the Fund and the iBoxx EUR HY index[5] is made visually intuitive on Figure 6, where we compare the daily returns of the Fund with those of the index. There is no clear pattern, with points in all four quadrants of the graph, and the R2 of the dataset coming up at 0.09.

[4] Net of fees, source Bloomberg as at 30 December 2022.
[5] The iBoxx EUR HY index (the "Benchmark Index") disclosed herein is used only for performance comparison purposes. The Management Company is not in any way constrained by the Benchmark Index in its portfolio positioning. The deviation from the Benchmark Index may be significant. Please refer to page 22 for the definitions of the indices used.

Figure 6: Insignificant correlation between the Fund and iBoxx EUR HY index in 2022 (SI USD share class)



Source: Chenavari Risk, as at 20 December 2022. Returns are representative of Class SI USD (net of fees).

The lack of correlation stems not only from the long / short nature of the Fund, but also from the implementation of macro hedges across the year, most notably rate hedges, as outlined in Figure 7.

Figure 7: Breakdown of 2022 net P&L per trade group (SI USD Share Class)

TOTAL	Bonds	Bond TRS	CDS	CDS Index	iBoxx Hedges	Equity	Rate Hedges	Other
-0.36%	-7.45%	+2.12%	-0.46%	-0.38%	+1.49%	-0.31%	+4.55%	+0.07%

Source: Chenavari Risk, as at 30 December 2022.

Indeed, action on Sovereign rates was the defining theme of 2022. The US 10Y Treasury note which was yielding as low as 0.6% post Covid, and 1.5% at the start of the year, climbed up above 4% in October. These movements rippled across all other asset classes, including High Yield Credit given the fears (i) that Central Banks would tighten very aggressively and lead to economic recession, and (ii) as a consequence, that refinancing upcoming debt maturities would be made much more expensive.

Our rate hedging, which is discretionary, was an essential part of our toolbox in 2022. Figure 8 epitomises the contribution of rate hedges to Fund performance through the year.

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Past performance does not predict future returns. This also applies to historical market data.

Figure 8: How the interest rate hedge strategies (including iBoxx IG) built up and protected the portfolio in 2022 (gross contribution to AuM, USD)

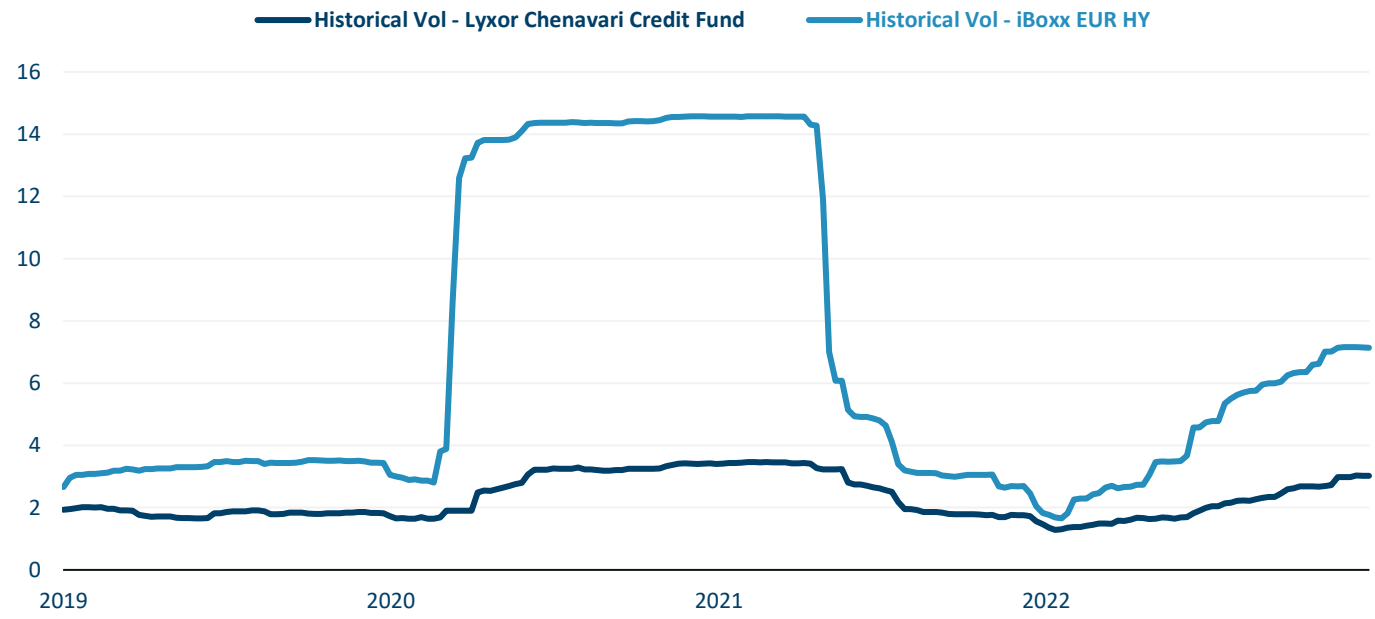
Source: Chenavari Risk, as at 20 December 2022 (includes rates trades and IG iBoxx trades).

2.2 LOW VOLATILITY

The Fund's volatility remained very subdued in 2022.

This is well illustrated by a comparison between the Fund's weekly volatility and that of the iBoxx EUR HY index on Figure 9 (60 days rolling).

Figure 9: Fund weekly volatility versus iBoxx EUR HY index – 2019 to date (60 day rolling)



Source: Bloomberg, as at 30 December 2022.

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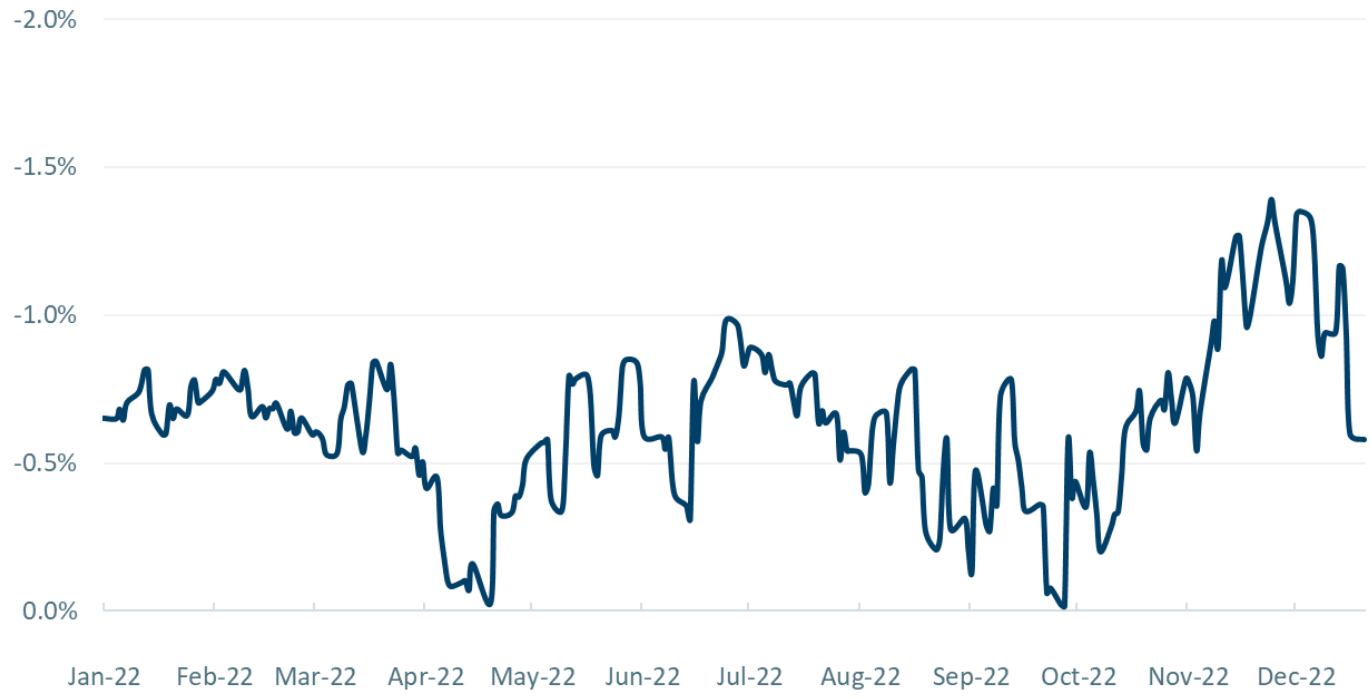
2.3. AGILITY

Whilst the PMs work closely with the team of analysts to identify long and short ideas and build a robust credit book bottom-up, they also take a very active role in defining the overall positioning / directionality of the Fund, and in reshuffling it based on macro news and market movements.

This was particularly noticeable in 2022, a "macro year" where geopolitical news, inflation data and Central Bank announcements led the markets - driving the PMs to work on the Fund's positioning in a very dynamic way.

Figure 10 illustrates the velocity of change of the Fund's positioning (expressed in PV10[6]), oscillating actively in a range between market neutral and quite firmly long.

Figure 10: Evolution of the Fund's PV10 through 2022



Source: Chenavari Risk, as at 20 December 2022.

Another illustration of the agile style of trading of the PMs is the work they did on rates hedging through the year (which led to the P&L discussed above and shown on Figure 8).

In 2022 we started formally tracking the positioning of our rate hedges in our portfolio reviews. We introduced Figure 11 in our portfolio reviews to track the theoretical reaction of the Fund (dark blue line) in case of a drop of sovereign rates. Whilst the portfolio sensitivity was naturally quite stable (grey dashes), the management of rate hedges was extremely dynamic (sky blue dashes), with the team making adjustments based on CPI news and Central Bank announcements.

[6] The PV10 is a measure of our theoretical drawdown in case of a homogeneous widening of all 5-year on-the-run credit indices by 10%. When the PV10 is zero, the Fund is market neutral. When the PV10 is negative, the Fund has a net long exposure to the market, and finally when the PV10 is positive the Fund is net short. The Fund limit on PV10 is +/- 2%.

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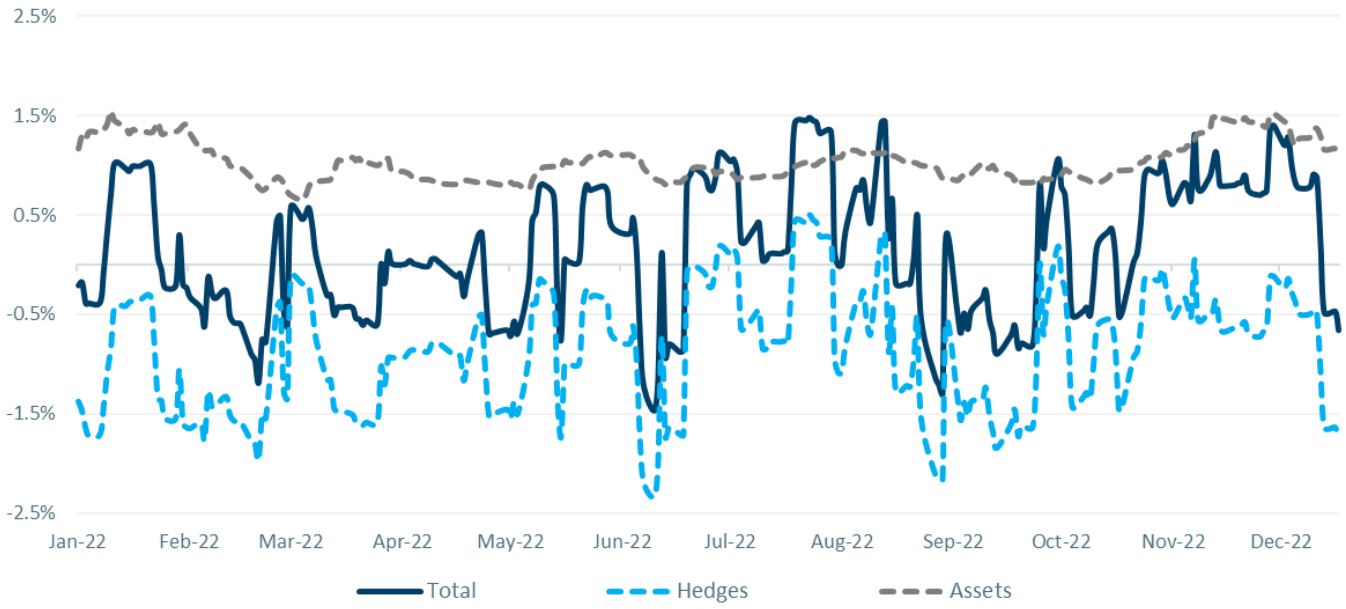
Figure 11: Tracking of the reaction of the Fund in case sovereign rates drop by 65 bps (EUR), 75 bps (USD), and 50 bps (GBP)



Source: Chenavari Risk, as at 20 December 2022 (drop assumed to be homogeneous across all maturities). Note that "Hedges" category includes trades on rate instruments and iBoxx IG.

2.4 WHAT COULD WE HAVE DONE BETTER?

Given the heightened volatility and market U-turns, 2022 was never going to be a smooth ride. We will focus on two sequences in particular: Financials at the beginning of the year, and the October market rally, upon which we did not capitalise.

2.4.1 Financials underperformance in Q1 2022

Q: Why did Financials significantly contribute to the Fund's drawdown at the start of the year?

A: We had the right cautious vision, but execution was hindered by the brutal movements on rates.

In September 2021, we started adopting a cautious view on Financials. As a consequence, the capital consumption of the Financials book was very much reduced as we entered 2022, as shown on Figure 12.

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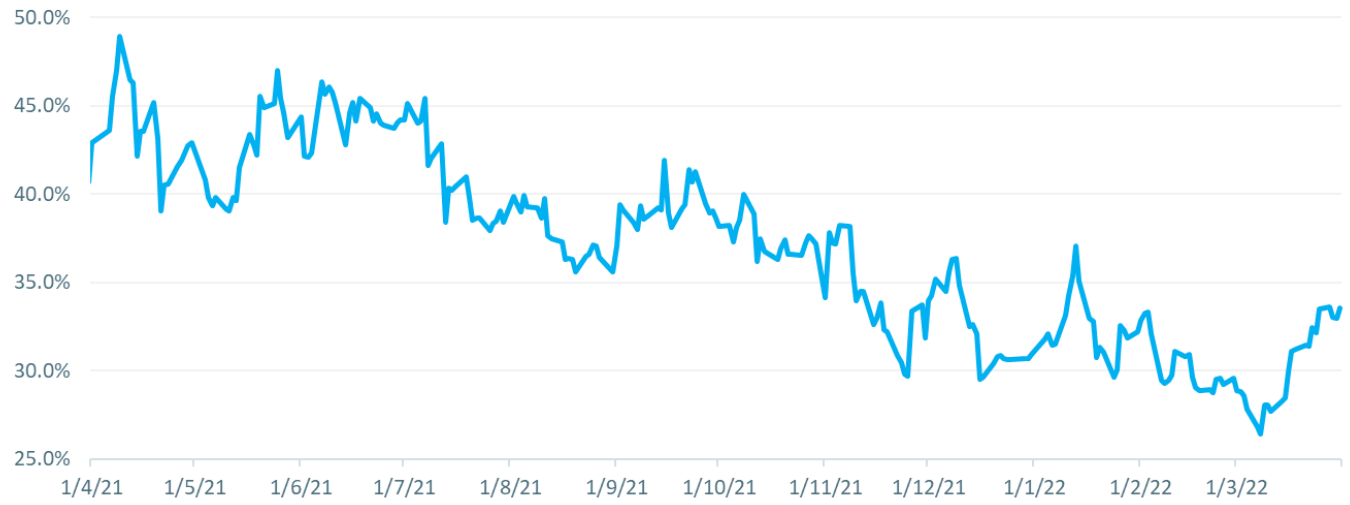
Figure 12: Capital Consumption of the Financials Book, 1/4/21 to 31/3/22

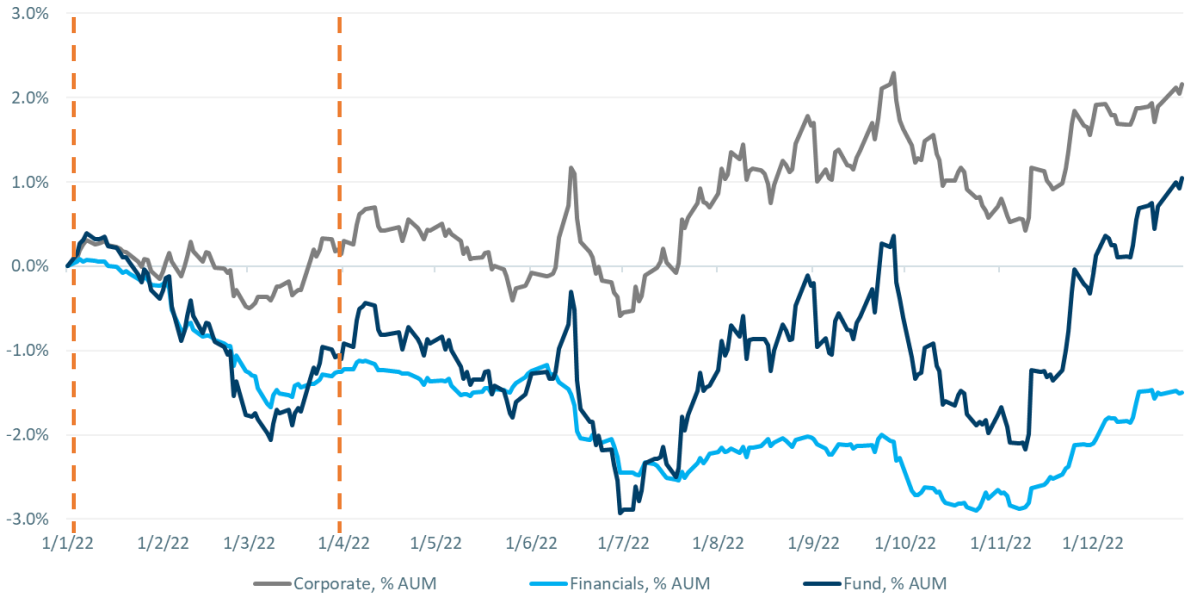


Source: Chenavari Risk.

This appeared to be the right approach as Financials underperformed Corporates[7] quite a bit in the period, and notably at the start of 2022.

And yet, over the first quarter of 2022, the Financials Book contributed -1.25% to the Gross Fund performance[8], whilst the Corporate Book was up c. 15 bps in the period. The Financials book did not recover from there, ending the year with a contribution to the fund of -1.5%, whilst the Corporate Strategy contributed +2.2%, as highlighted on Figure 13.

Figure 13: Contribution of Gross Fund performance by Strategy, 2022 to date



Source: Chenavari Risk, as at 20 December 2022.

[7] Please note that the mentioned strategies are sub-strategies which are not detailed in the constitutive documents of the Fund and conform to the overall strategy of the Fund mentioned in the documents.
[8] The net performance of the Fund may differ, the costs are detailed on the legal documentation of the Fund.

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What happened?

The sharp sell-off of sovereign rates (and credit spreads) at the start of 2022 pushed AT1s to rapidly reprice to perpetuity, as the probability that the bonds would be called at the first call date was fading away. This weakness was exacerbated by heavy supply during the period.

Even though the Financials book has de-risked, it still had too much duration stemming from AT1s (both credit and rates), without sufficient hedges to compensate the negative convexity as a consequence of the repricing to perpetuity.

2.4.2 Negative performance in October

Q: Why did the Fund post a negative performance in the first weeks of the September / October rally?

A: The fear that the LDI situation could turn into a full-blown crisis made us take a very cautious stance, and our cash longs lagged the rally whilst synthetic hedges squeezed accordingly.

From the end of September onwards, the market experienced a strong rally, with the Crossover tightening massively from its peak of 673 on 27 September, down to 460 on 30 November.

The Fund failed to capture the first leg of this rally, as the performance of the Fund was -1.49% in October (before posting +1.56% in November).

The reason for this stems from the very defensive positioning of the Fund. September had been marked by the UK mini budget announced by Liz Truss and Kwasi Kwarteng. This led to a severe market dislocation in September, with LDI leverage arising as a new “unknown unknown” for the market. The issue had become quite thorny with Gilts rising steeply and potentially triggering significant redemptions across liquid assets. The risk of a nasty spill-over could not be ruled out, and the low level of information on the segment did not reassure. Given this tail risk, we reduced our market exposure to neutral, and put in place hedges on indices in front of our long cash positions.

The tail risk did not materialise, and the publication of the CPI on 13 October was a pivotal moment for the market, as data that “did not look obviously stunning” translated into a market drop, only followed by a brutal short squeeze, from which a robust rally developed.

Our conservative portfolio construction suffered from this squeeze. As the cash market lagged most liquid instruments (such as indices), the long leg of the Fund remained quite atonic. This contrasted with the dramatic reaction of our hedges – making the Fund behave as if it was net short and generating the negative performance in October.

As it became clearer that the LDI tail risk was fading away (notably given the mounting pressure on Kwasi Kwarteng and Liz Truss, ultimately leading to their departure), we turned the portfolio back to longer positioning, reduced index hedges, cut select shorts, and built long positions on perceived “safer” companies (including in the European IG space as spreads looked attractive).

The movement of the Fund cutting its market exposure followed by a more constructive approach is very apparent on Figure 14, replicated below (cutting the exposure in the brown circle, going long in the blue circle).

Figure 14: Evolution of the Fund's PV10 through 2022

Source: Chenavari Risk.

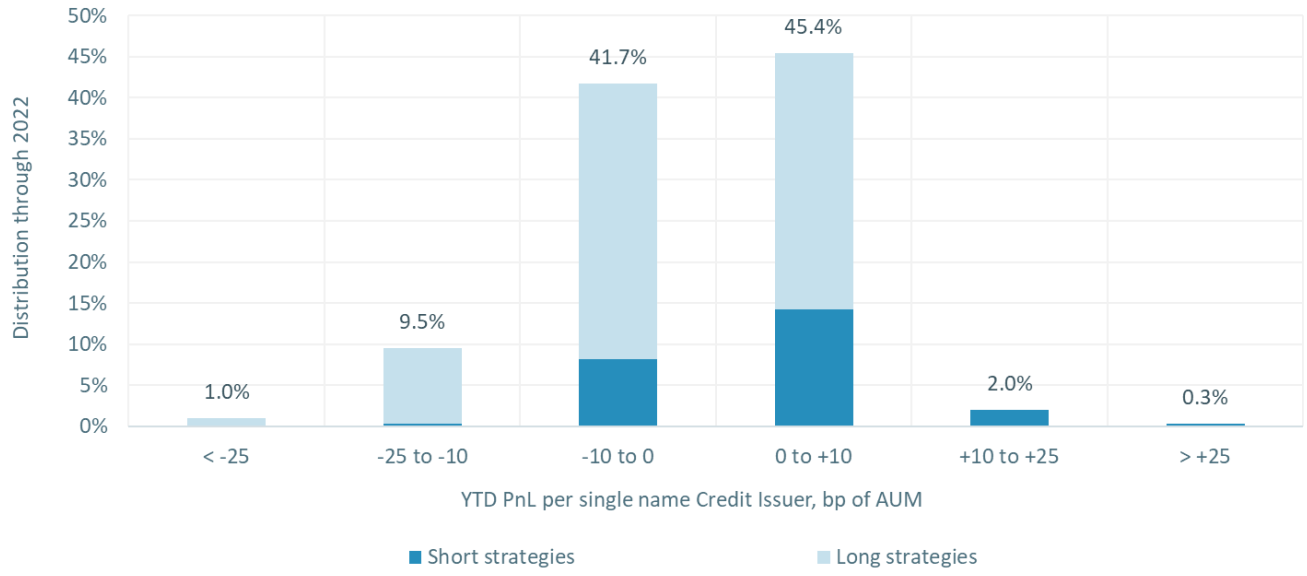
2.5 ANALYSIS OF SINGLE NAME CONTRIBUTIONS

By all metrics, 2022 was a macro year and the importance of bottom-up work was somewhat subdued by the strength of movements on rates and inflation.

That said, the team was as active as ever evaluating names on the long and short side, ending the year with a balanced contribution on the positive and negative side, in spite of the prevalence of long over short single names, and the market dislocation. It is also worth noting that the selection was cautious enough to avoid any significant accident, as only 1% of trades had a drawdown contribution of more than 25 bps for the Fund.

Figure 15 highlights this point.

Figure 15: Breakdown of long and short strategies by contribution to Fund performance (bps of AuM)



Source: Chenavari Risk, as at 8 December 2022.

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Unsurprisingly, the best performers in the book as at 8 December 2022 were mostly short positions, such as Lanxess, Michelin or HSBC which all contributed over 20 bps to the Fund.

At the other end, the worst performing positions were United Group in Corporates (c.-40 bps) and Credit Suisse in Financials (c.- 50 bps).

Credit Suisse was a case of risk management as we had some exposure to the AT1 and decided to rebalance it toward the more senior part of the capital structure on the back of the “twitter storm” of the end of September. Our analysis was clear that the bank had ample liquidity and the noise was unjustified, however banks are driven by psychological factors which can derail from hard facts and we made the choice to pull out of this risk.

Besides United Group and Credit Suisse, the worst negative contributors contributed less than -30 bps of AuM.

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3. OUR VIEWS ON 2023: DON'T BE CARRIED AWAY BY THE CARRY

The investment landscape was completely reshuffled in 2022. The "yield drought" finally ended. European HY is currently yielding around 7.4%[9], US HY around 8.6%[10] and European Cocos about 9.1%[11].

However, the Goldilocks days are firmly behind us. Gone are QE, easy financing, and rock bottom defaults. Europe is entering recession, and the key question now is whether this recession will be mild enough and short enough to avoid a painful reckoning for European Credit. Carry offers a welcome buffer to total return, but it also reflects a brand-new landscape.

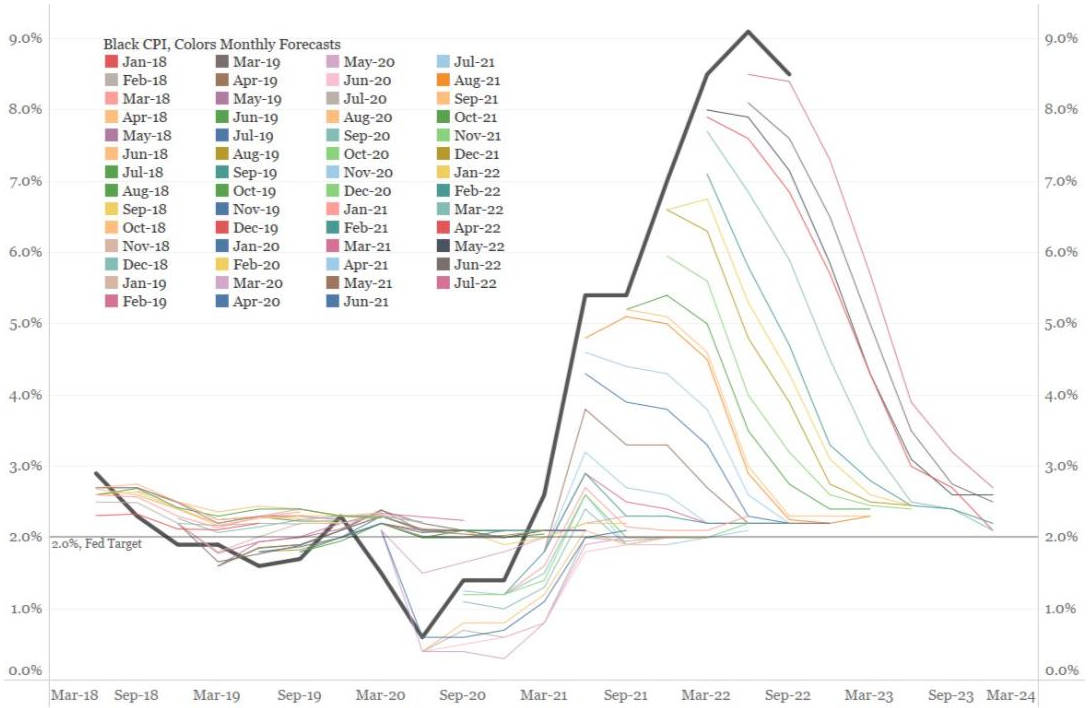
2023 key market drivers are particularly hard to forecast

One lesson of 2022 is that not all macroeconomic forecasts are equally simple to perform. The margin for error on predictions is especially high when the data are swinging by multiple standard deviations, whilst there is no recent history of such movements.

At the dawn of this new cycle, forecasts are much more tentative.

This has been epitomised by inflation forecasting throughout 2022. After years of loose fiscal policy, the difficulty for market participants to predict inflation data (including Central Banks) has been epitomised by many charts, such as Figure 16, predicting a swift return to 2% that stubbornly fails to materialise... Are inflation models broken?

Figure 16: Wall Street Inflation Forecasts (versus actual in black)



Source: Bianco Research.

In addition, the invasion of Ukraine by Russia (which itself took market participants by surprise) has opened an era of high geopolitical uncertainty.

[9] Approximated via the yield of the iShare EUR HY Corp ETF (IHYG LN), Source: Bloomberg, as at 4 January 2023.
[10] Approximated via the yield of the iShare iboxx HY Corp ETF (HYG US), Source: Bloomberg, as at 4 January 2023.
[11] Source: Bloomberg, Yield to Worst of I30904EU Index, as at 4 January 2023.

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At the end of the day, we believe that 2023 markets will be driven by a number of key topics, for whom the range of outcomes is widely distributed.

1- Inflation: Whilst most market commentators expect European inflation to get back below 3%, there are questions whether it could remain stuck above there for an extensive period. Factors such as the energy crisis, the employment markets, and the very nature of inflation itself (a vicious, self-feeding process) are hard to properly appreciate, as the ECB forecasts showed over the course of 2022.

2- Russia: The strategy to shut down Ukrainian power plants and indiscriminately leave a large portion of the Ukrainian population without heating and hot water through the freezing winter is ruthless. From there, it seems plausible that Putin would launch a massive attack as soon as weather conditions permit, potentially dragging Belarus into the conflict. On the other hand, the setbacks experienced by the Russian army and the growing discontent in Russia could lead to significant reconsideration of Russian leadership in 2023. The tail event of a nuclear attack is mentioned quite a bit these days. Depending on this, the European energy situation could change materially during the year.

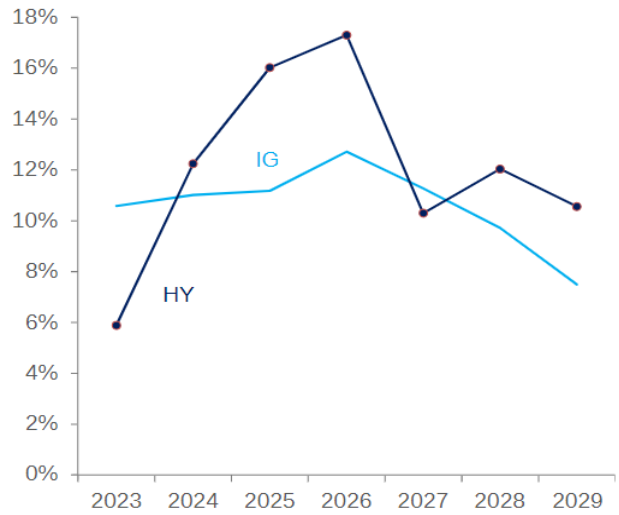
3- China: This is another "hard to predict" situation with a large range of possible outcomes.
Obviously, there is a lingering geopolitical risk related to Taiwan.
However, the key source of uncertainty relates to the reopening of the Chinese economy, and its potential impact on energy demand (LNG in particular). In 2022, Europe did benefit from the redirection of gas from Asia. The impact of a Chinese reopening on energy demand could have significant inflationary reverberations in Europe.
On the other hand, the Chinese reopening is a wild test which could prove a significant health challenge, and ultimately lead to further restrictions. The low rate of Covid vaccination in the country has triggered a new outbreak (with 1 to 1.5m deaths projected in the coming few months). The risk of a resistant new variant is an area of scrutiny from health agencies across the world.

These factors underpin our conviction that the level of uncertainty around the base case has increased dramatically for market participants, making it difficult to adopt a simple "buy and hold" positioning through the year. In that context, the capacity to dynamically adjust positioning is critical. We believe this environment suits our active approach well.

Secondly, the recession has direct, real-life implications for Corporates and their credit status. Many will get some pressure on their free cash flow generation, especially the most cyclical companies and those with a high fixed cost base.

This comes at a time when Corporates come near a refinancing wall (in 2024-25 in particular). Around one third of European HY debt is due for refinancing between 2023 and 2025 (see Figure 17). Many Corporates will seek to refinance in advance out of caution and good management. This bodes well for significant supply in the market during the year (and for increased pressure from rating agencies). Obviously, these refinancings will not come cheap and will exert further burden on levered capital structures.

Figure 17: Maturing EUR Corporate Bond Debt, as a share of total outstanding



Source: Citi Research, Bloomberg. IG=Investment grade. HY = High Yield.

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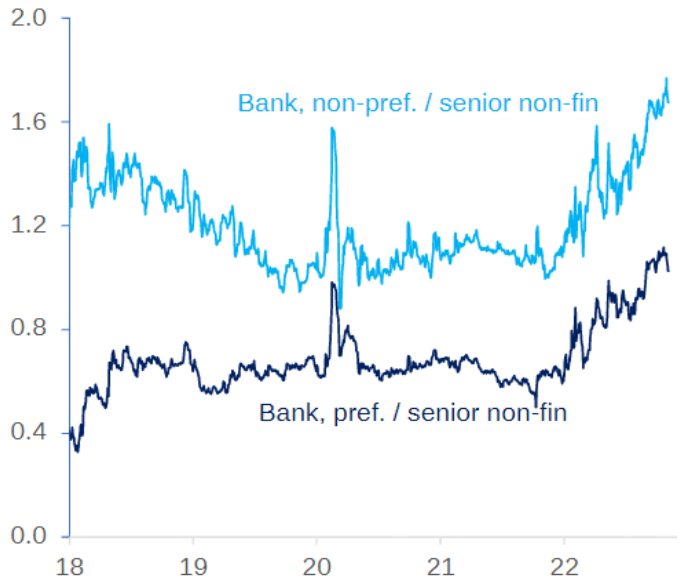
In parallel to this, the ECB balance sheet will continue to shrink. The end of the QE programme and upcoming beginning of QT dry up liquidity in the market, altering credit demand. This will create additional tension for corporate bonds to find refinancing at a reasonable price.

Bottom line, there will be some alterations of P&L dynamics, rating downgrades, and the cycle of defaults will resume (although it should remain benign to start with). In spite of the appealing carry, this is not a beta play or buy the index. Not all credits are safe to invest.

All this points to focusing on quality (including Investment Grade opportunistically), keeping dry powder for primary business, and being active on the short side, where some tricky situations are likely to emerge over the course of the year.

Banks are part of this Quality theme (specifically for Senior and Tier 2). In addition, they are one of the rare winners of the increase in rates (at least as long as the recession is shallow). Given their current appealing valuation when compared to non-financials (Figure 18), they constitute a strategic part of our allocation for the new year.

Figure 18: Bank senior spread ratios vs senior non-financials



Source: Citi Research, Markit, “Conflicting Signals”, 13 December 2022.

Figure 19 endeavours to summarise our thinking process and current game plan for 2023.

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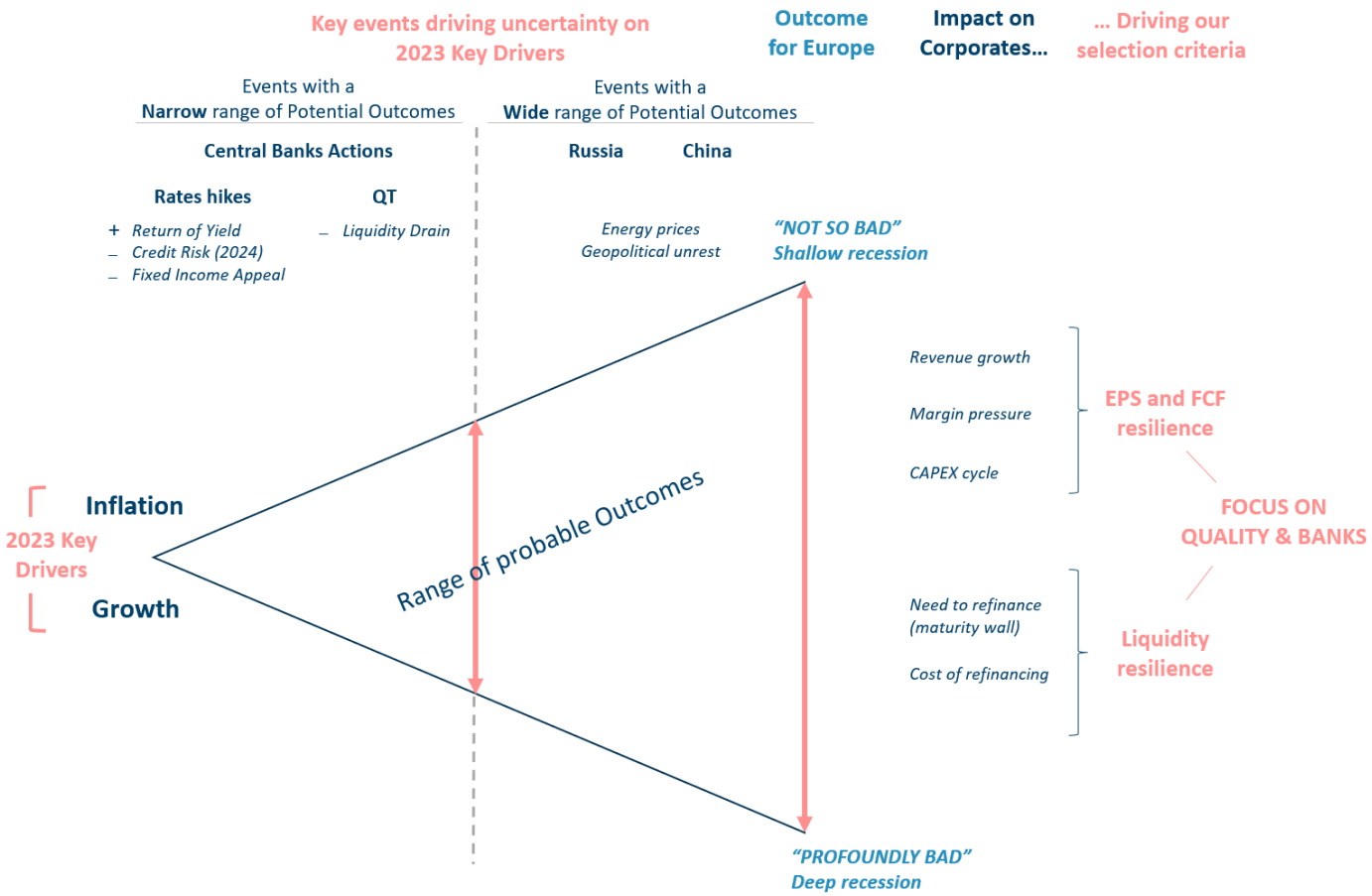
Figure 19: A visual summary of our 2023 Game Plan



Source: Chenavari.

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4. INITIAL THOUGHTS ON BOOK POSITIONING FOR 2023

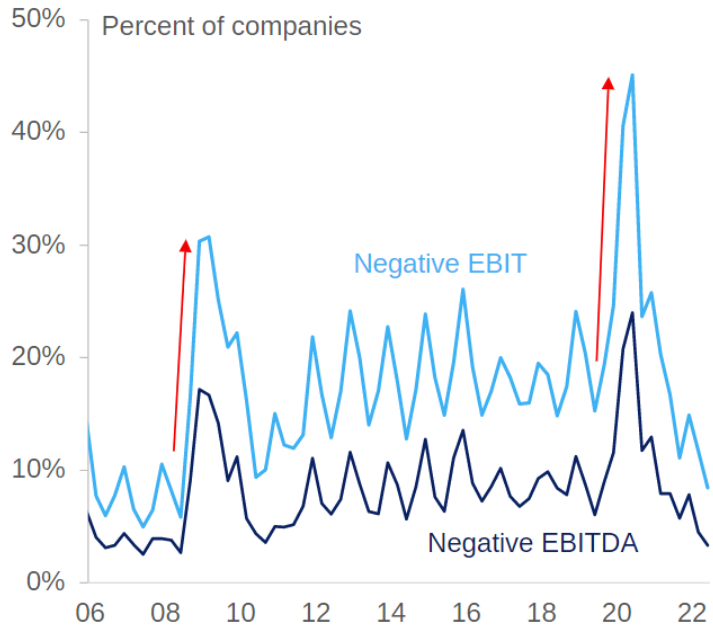
4.1 CORPORATE BOOK

The environment described above lends itself very well to a long / short strategy on Corporates.

On one hand, the return of carry is a great opportunity to build a solid long book built on quality names and facilitate a decent return through the year.

On the other hand, recession periods create significant dispersion. Stakes get higher as Figure 20 illustrates, which combined with the "maturity wall" can create quite a bit of stress on certain names. Even though most listed European Corporates currently enjoy a healthy cash position, this opens a derating cycle (and subsequently a default cycle), creating opportunities on the short side of the book.

Figure 20: Share of European companies with negative earnings



Source: Citi Research, Markit, "Conflicting Signals", 13 December 2022.

In line with this analysis, we have adopted a rather conservative positioning, building long exposure with companies offering high visibility on their operations, and attractive yields in terms of bond prices. This has prompted us to look at beaten up BBs and Hybrids: large cap, high-grade companies that have been severely affected by risk-off sentiment, but still have solid liquidity and balance sheets, such as Abertis. We are also looking at companies with defensive earnings and a significant capacity to withstand their debt refinancing, such as telcos (SFR, Iliad, Virgin Media).

On the short side, we are looking at cyclical names with sensitivity to energy prices, such as Thyssenkrupp, or ArcelorMittal.

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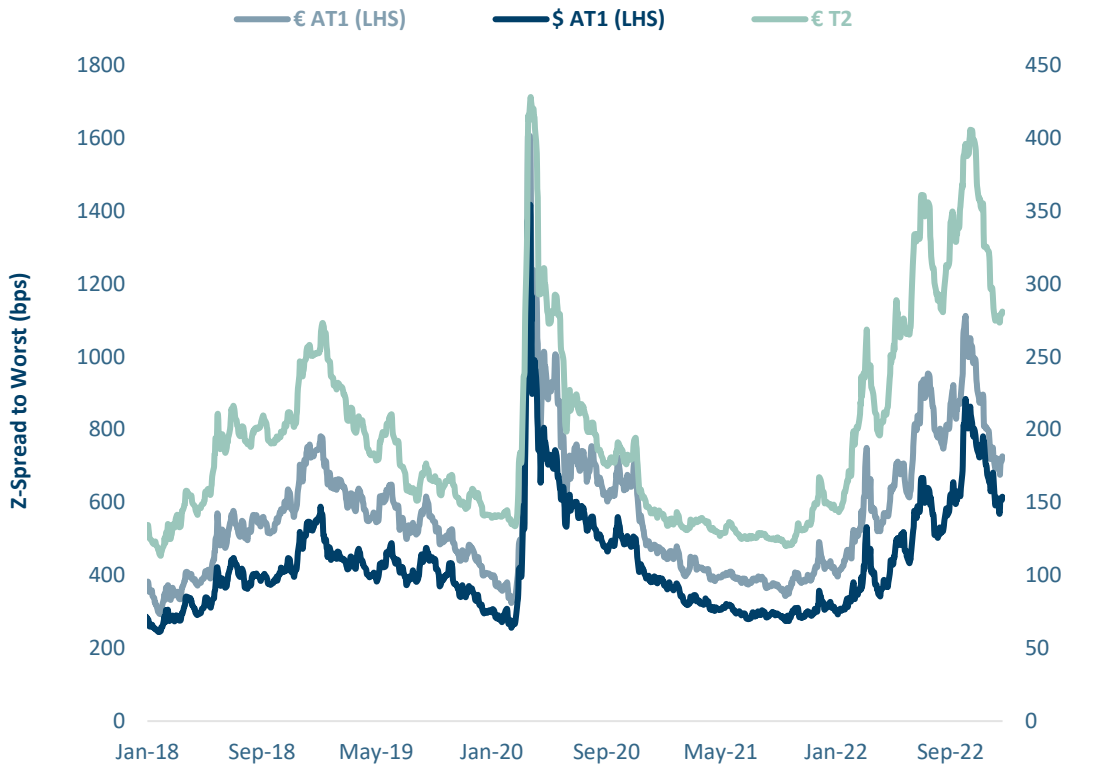
4.2 FINANCIALS BOOK

When it comes to Financials, a high rates environment (translating into higher revenue) with a shallow recession (i.e. not much default) seems ideal for the asset class.

This environment is currently the consensus' base case, and yet Financials have come under significant pressure in 2022 and appear quite cheap: AT1s are currently trading at 727 bps (Z-spread to worst), about twice their level of early 2020 (see Figure 21).

Figure 21: Yield of EUR AT1 and USD AT1 (expressed as Z-spread to worst)



Index ZtW (bps)	Current	Pre-Pandemic (Feb-20 average)	Pre Nov US CPI (8 Nov 2022)
€ AT1	727	363	893
$ AT1	616	293	764
€ T2	281	142	354

Source: Chenavari, Bloomberg, as at 20 December 2022.

We are therefore starting the year with a strong conviction on Financials, which we express via a barbel portfolio, focusing on AT1s with first call dates between 2024 and 2027. As the rates curve is quite flat in Europe, and credit spreads are also very flat, we feel well remunerated looking at the belly of the credit curve, where one benefits from the maximum positive convexity should the bonds reprice to their call date (as most bonds have repriced to perpetuity in 2022). This leaves us with many liquid bonds from top quality issuers, such as UBS, Barclays, ING among our top convictions.

On top of these AT1s which are trading between 70 and 90, we will look at Senior Financial Bonds via the new supply, to benefit from the new issue premium. Banks had to print a lot which was very negative from a technical point of view. 2023 should show less supply (lower amount coming in). Quite interesting to look for 4-5% carry in the senior part of the financial sector.

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We also maintain our conviction on Deutsche Bank Tier 2 as the bond was upgraded to IG, and where we feel there still is significant room for the name to outperform in the new year.

On the short side, we aim to look at bonds that are already fully priced to call, like CNP and Credit Agricole, where the yield to perpetuity and the yield to call are now similar. That means they have negative convexity in case of market weakness.

* * *

We hope the above helps explain the Fund's approach.

Despite the appealing carry, 2023 may well prove a rocky year with several macro events at play and inflation yet to be tamed, whilst recession is only starting to bite in Europe, imposing a close monitoring of the credit cycle.

We will endeavour to navigate this new environment with discipline and consistency, keeping a nimble approach to top-down positioning and hedging, whilst using fundamental, bottom-up research to generate alpha.

We thank you for your continued trust and hope to pursue a fruitful partnership with you in the years to come.

With our best wishes for 2023,

Vincent Laurencin

Deputy CEO and Chair of the Fund's portfolio review, Chenavari Investment Managers

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- ***Risk of non-achievement of investment objectives:*** *There is no assurance that the Fund will achieve its investment objective.*
- ***Risk of illiquidity:*** *Certain exceptional market conditions may have an unfavorable impact on the product's liquidity, or even make the product totally illiquid. This leads to a risk to the possibility of valuing the product, a risk of loss, and may make it impossible to resell the product. Some products are by nature less liquid than others and carry a high liquidity risk.*
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S&P500 Total Return Index (SPXT Index): *S&P 500 Total Return Index. Calculated intraday by S&P based on the price changes and reinvested dividends of SPX <INDEX> with a starting date of Jan 4, 1988.* ***Source:*** *Bloomberg*

US 10Y Treasury (SPBDU1BT Index): *S&P U.S. Treasury Bond Current 10-Year Total Return Index.* ***Source:*** *Bloomberg.*

Euro Stoxx 50 (SX5E Index): *The EURO STOXX 50 Index, Europe's leading blue-chip index for the Eurozone, provides a blue-chip representation of supersector leaders in the region. The index covers 50 stocks from 11 Eurozone countries. The index is licensed to financial institutions to serve as an underlying for a wide range of investment products such as exchange-traded funds (ETFs), futures, options and structured products.* ***Source:*** *Bloomberg.*

Euro Stoxx Banks (SX7E Index): *The EURO STOXX Banks (Price) Index is a capitalization-weighted index which includes countries that are participating in the EMU that are involved in the banking sector. The parent index is SXXE. The index was developed with a base value of 100 as of December 31, 1991.* ***Source:*** *Bloomberg.*

iBoxx € Corp. (QW5A Index): *iBoxx Euro Corporates Overall Total Return Index measures the Euro denominated, corporate, investment and investment grade bond market. The index includes bonds with minimum 1 years to maturity. Bond type includes fixed and zero coupon, step-ups, event-driven bonds, dated and undated callable subordinated corporate bonds, soft bullets. See IBOX<go> for further information.* ***Source:*** *Bloomberg.*

Euro Bund (RXA Comdty): *Euro – Bund Futures. RXA comdty. Long-term notional debt securities issued by the German Federal Govt with a term of 8.5-10.5 yrs.* ***Source:*** *Bloomberg.*

iTraxx Europe (ITRX EUR CDSI GEN 5Y Corp): *The Markit iTraxx Europe index comprises 125 equally weighted credit default swaps on investment grade European corporate entities, distributed among 4 sub-indices: Financials (Senior & Subordinated), Non-Financials and HiVol. The composition of each Markit iTraxx index is determined by the Index Rules. Markit iTraxx indices roll every 6 months in March & September.* ***Source:*** *Bloomberg.*

Markit iBoxx EUR Liquid High Yield Index (IBOXXMJA Index): *The Markit iBoxx EUR Liquid High Yield Index is designed to reflect the performance of EUR denominated sub-investment grade, liquid corporate debt. The index rules have been designed to offer a broad coverage of the market with emphasis on liquidity to be suitable for OTC and exchange-traded derivatives, and Exchange Traded Funds (ETFs). The index is an integral part of the global Markit iBoxx Liquid Indices which provide the marketplace with liquid and investable versions of the broader Markit iBoxx benchmark index families.* ***Source:*** *IHS Market*

iShare iboxx HY Corp ETF (HYG US)*: iShares iBoxx High Yield Corporate Bond ETF is an exchange-traded fund incorporated in the USA. The ETF seeks to track the investment results of an index composed of U.S. dollar-denominated, high yield corporate bonds.* ***Source:*** *Bloomberg.*
iShare EUR HY Corp ETF (IHYG LN): *iShare EUR HY Corp ETF (IHYG LN): iNAV iShares EUR High Yield Corp Bond ESG UCITS ETF EUR Acc EUR iNAV iShares € High Yield Corp Bond ESG UCITS ETF EUR (Acc) EUR.* ***Source:*** *Bloomberg.*

Contingent Capital EUR. Bloomberg Contingent Capital EUR Total Return Index Value Unhedged EUR (I30904EU Index): Source: *Bloomberg.*

APPENDIX – *Fund net performance – SI USD (net of fees):*

Fund	2022	2021	2020	2019	2018	2017	Annualised return since inception*
SI USD	-0.36%	3.27%	8.25%	6.72%	0.64%	7.32%	3.15%

*Source: Lyxor / Chenavari Credit Fund SI USD, net of fees, Bloomberg. *Since inception: 19 June 2015. Past performance does not predict future returns. This also applies to historical market data.*

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ii. Any such offer would deal with securities that are not registered in the Securities Registry nor in the Foreign Securities Registry kept by the CMF, and that are, therefore, not subject to the supervision of the CMF;
iii. Given that the securities would not be registered, there would be no obligation for the issuer to disclose in Chile public information about said securities; and
iv. The securities may not be publicly offered as long as they are not registered in the corresponding Securities Registry.

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