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Alcentra

Avoid Volatile Banking Exposure with Attractive Yields in European Loans

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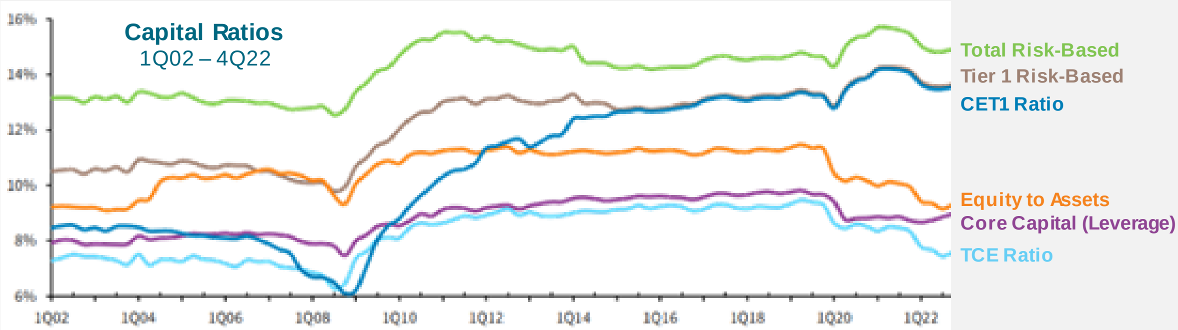
Very swiftly the market switched its focus from Central Banks tightrope walking between high inflation and slowing economic growth, to concerns over the resilience of the Banking sector. The fall of Silicon Valley Bank ("SVB") triggered scrutiny over the other weaker banks, which led to Credit Suisse's ("CS") debt and equity trading materially lower despite its issues being well publicised in recent years.

Is this the start of a contagion? Unlikely.

We believe there is less of a fundamental basis for a systemic issue with the European Banking sector. 4 reasons:

1. SVB and CS had idiosyncratic issues which the broader banking sector does not.
2. European banks are under more stringent regulation that ensures the issues that befell SVB are less likely to occur.
3. Wider Banking sector capital ratios are at near-peak health levels looking over the past 2 decades.

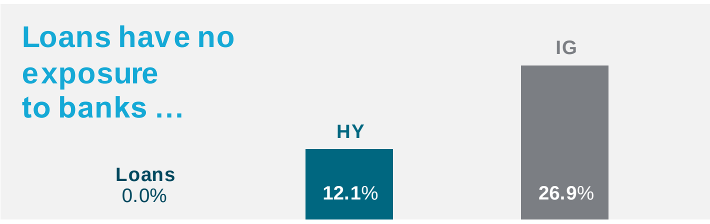


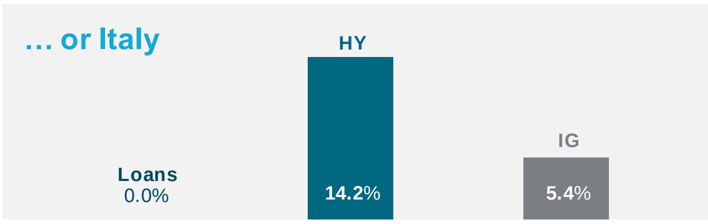
Source: Barclays Research and FDIC

4. The coordinated response from global regulators to address contagion was sufficiently reassuring and swift to inspire some market recovery. Central banks remain motivated to support and ensure the financial system's credibility.

European Loans are more insulated from direct Banking sector volatility …

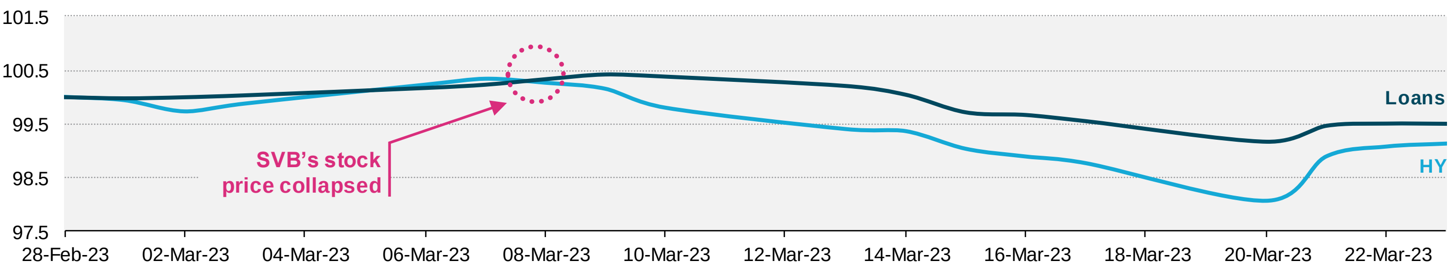
for the simple reason that there is no exposure to Banks! This contrasts significantly with European Investment Grade ("IG") with c.27% in Banks and European High Yield ("HY") which has c.12% in Banks, of which a notable exposure is from peripheral countries (Italian Banks alone make up c.6% of the index). Historically, Italian Banks triggered volatility in Italian corporates which make up a further c.8% of the HY index.





Source: Bloomberg as at 23 March 2023. Loans: Credit Suisse Western European Leveraged Loan Index ex USD; HY: ICE BofA European Currency High Yield Index; IG: ICE BofA Euro Corporate Index

Loans were more insulated, with a smaller drawdown



Data to 23 March 2023. Loans: Credit Suisse Western European Leveraged Loan Index ex USD; HY: ICE BofA European Currency High Yield Index. **Past performance is not a guide to the future.**

Structurally stable

European Loans ("Loans") provide a senior claim to assets in a default (leading to higher recovery rates), are not susceptible to volatile retail flows and have natural tilts towards defensive sectors. As a result, Loans should be more stable than other traditional fixed income assets. For example, Loans historically experienced about a third less volatility than HY.

An attractive time to switch to Loans

The credit spread (how much you are paid to take on the risk) is higher in Loans at c.650bps at the time of writing than other traditional fixed income assets. For example, they offer c.130bps more credit spread than HY. The excess yield relative to 5y historical averages is also higher for Loans than it is for HY and IG.

Adding more stability and a better yield through Loans, means an improvement on your overall portfolio efficiency by increasing risk-adjusted returns

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