Why does Private Credit Remain a Compelling Investment Opportunity vs High Yield Bonds in the Current Economic Environment?

November 2022

Introduction

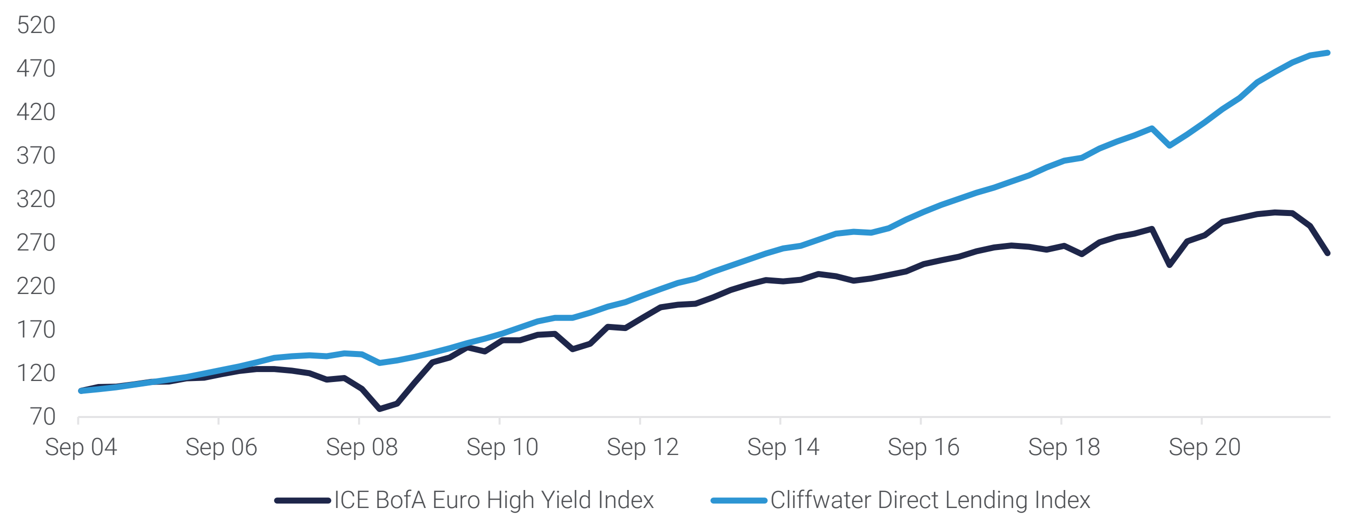
As the U.S and Europe transition into a new era of tighter monetary policy, higher interest rates have had dramatic consequences across virtually all asset classes. Bonds were amongst the hardest hit given the interest rate risk inherent with any fixed payment security. Bond prices have fallen to their lowest levels since the Great Financial Crisis ("GFC"), and as a result today's yields ("YTM") present opportunities for institutional investors. Some such investors now see High Yield Bonds ("HY") as directly comparable with Senior Private Credit ("PC") from a returns' perspective.

This short paper will examine the nuanced differences between these two asset classes from the perspectives of: return, risk, and geography/industry exposures; and present a case for why senior private credit remains an extremely attractive investment proposition. The ICE BofA Euro High Yield Index[1] has been used to represent the HY universe in the analysis below. PC is represented by both the S&P ELLI[2] and the Cliffwater Direct Lending Index[3] as appropriate (based on data availability).

Return Considerations – Short Term vs Long Term Returns Expectations

The graph below shows that PC (as measured by the Cliffwater Direct Lending Index) outperforms HY by a significant margin on a non-risk-adjusted basis (**total return of 389% vs 158%**). Further analysis shows outperformance on a risk-adjusted basis too (**Sharpe ratio of 2.51 vs 0.47**).

1) Quarterly Index Returns (Sept '04 = 100)



Past performance is not a reliable indicator of future results.

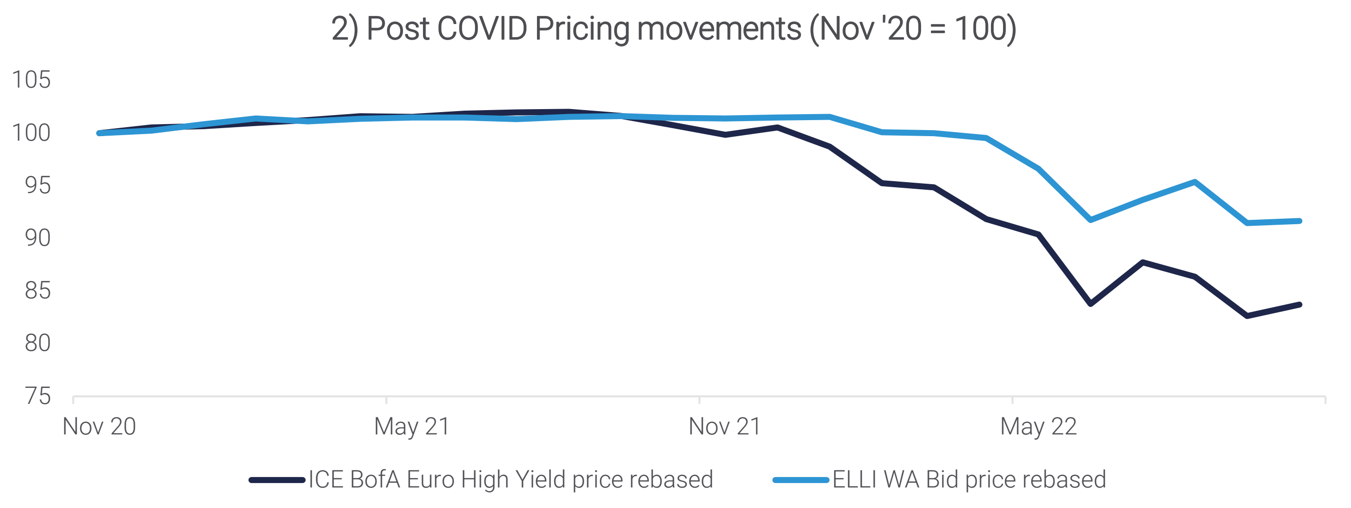
Although HY YTMs spike during some periods due to the inherent volatility of the asset class, PC displays consistent performance within the c.8%-10% range of annualised returns. Over the period shown, **PC delivers 9.3% annualised return vs 5.5% for HY**.

[1] Source: ICE BofA database: Nov 2022
[2] Source: https://www.lcdcomps.com/lcd/idx/index.html?rid=20 : Nov 2022
[3] Source: https://www.cliffwaterdirectlendingindex.com/ : Nov 2022

PC is an asset class that is proven to deliver consistent returns over long term time horizons, regardless of short-term market movements (as is made clear in graph 1). HY is an opportunistic prospect available exclusively in the short term where investors will have to hold for an undefined period to realise current yields. HY has underperformed significantly through the past 12 months, where PC has continued to deliver stable returns in the high single digits.

Return Considerations – Price

The graph below[4] shows the isolated price component of returns for the ICE BofA HY Index vs the S&P ELLI. The current interest rate environment has impacted HY with greater severity given the fixed rate nature of this asset class (please see "interest rate risk" section below). Current HY pricing presents an opportunity for new investors, but also serves as a warning that pricing can be volatile and is a significant contributor towards the long-run return underperformance vs PC demonstrated in graph 1) above.



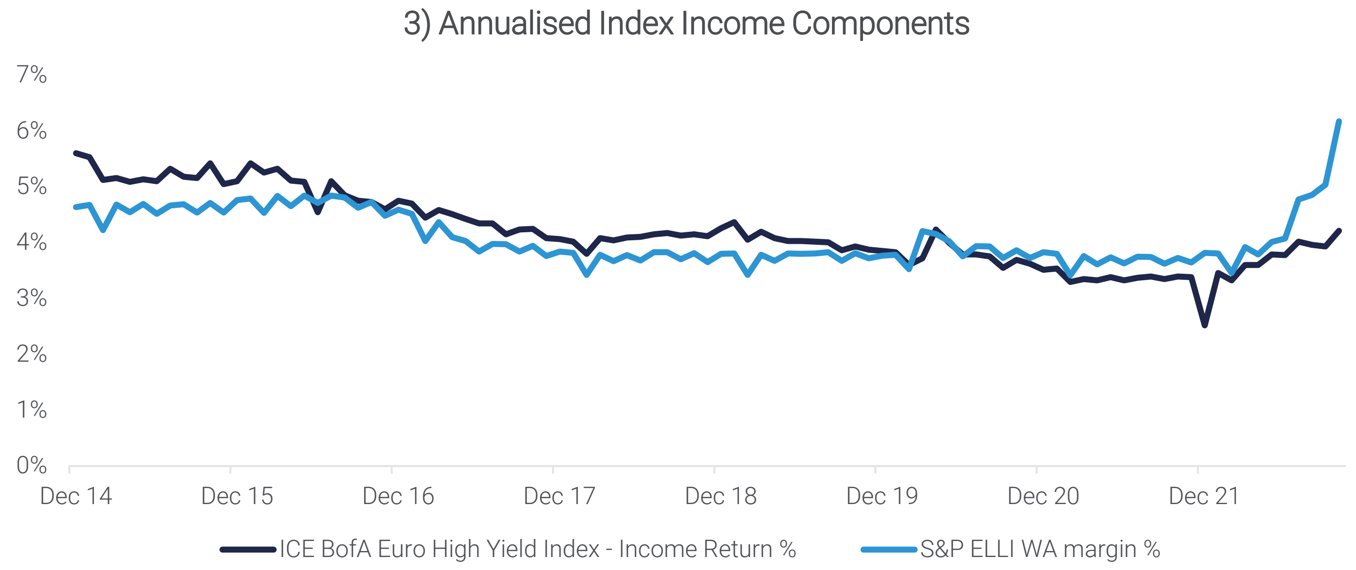
Past performance is not a reliable indicator of future results

The price decline through 2022 shows that this HY opportunity is only temporary. Before the shift in global interest rates, HY could not offer high single digit yields. The current yield is largely in place to compensate investors for increased interest rate risk (see below).

Return Considerations – Income

Contractual income returns (coupons/margin) are the second key component to consider when comparing the return profiles of HY and PC. The graph below[5] shows how the interest return component of the S&P ELLI compares with the income return component of the ICE BoA Euro HY index.

[4] Source: ICE BofA database: Nov 2022 and https://www.lcdcomps.com/lcd/idx/index.html?rid=20 : Nov 2022
[5] Source: ICE BofA database: Nov 2022 and https://www.lcdcomps.com/lcd/idx/index.html?rid=20 : Nov 2022



Past performance is not a reliable indicator of future results

Income based returns across both HY and PC have responded positively to the macro-economic headwinds that have emerged through 2022 – PC margins to a far greater extent, reaching 6.2% vs 4.2% in Oct '22 as shown in graph 3).

PC margin increases since mid-2022 can be explained by a fall in the supply of loans to sponsor backed companies, with demand for these loans holding more steadily. Banks have stepped away from the market, becoming more hesitant to use their balance sheets for the arrangement and/or syndication of new deals. Hence, private equity sponsors are increasingly reliant on relationships with direct lenders and have been forced to accept wider pricing and more lender friendly terms.

Risk Considerations - Interest Rate Risk

Although both HY and PC asset classes display comparable return and credit risk profiles, the two investment opportunities are very different in the sense of their interest rate risk. Bonds are fixed rate instruments and hence are subject to price movements determined by the interest rate environment.

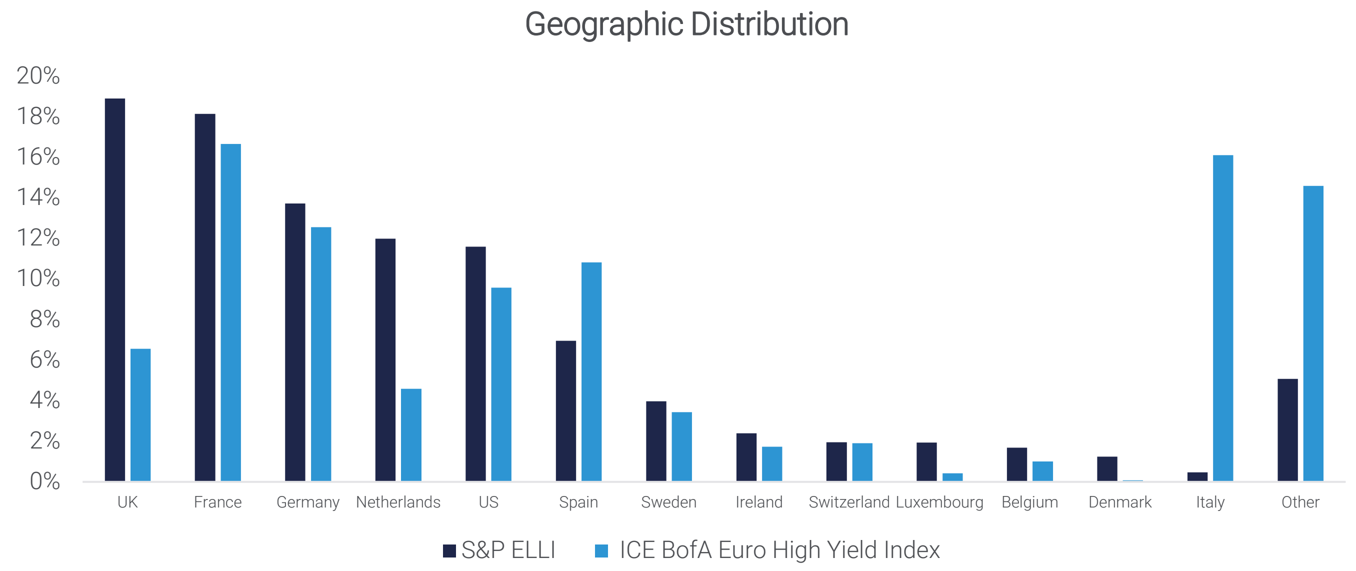
MV Credit invests in 100% floating rate instruments that have minimal duration, hence low interest rate risk. Any comparison between PC and HY should require HY bonds to include a premium to compensate investors for interest rate risk. Throughout the low and stable rate environment in Europe between 2013 and 2021, this risk was minimal. Today's ever-changing interest rate environment commands a higher premium. HY bonds currently do not offer investors a significant return premium above that of PCs, that come with a similar expected return and far lower interest rate risk.

Risk Considerations – Opportunity Set

Any investor wishing to make return comparisons between the PC and HY asset classes must also take the respective risks into consideration. Macroeconomic conditions across European countries can vary significantly, and there are substantially different risk profiles for businesses headquartered in developed Western European/Nordic countries vs Central/Eastern/Southern Europe. MV Credit invests predominantly in sponsor backed Western European businesses.

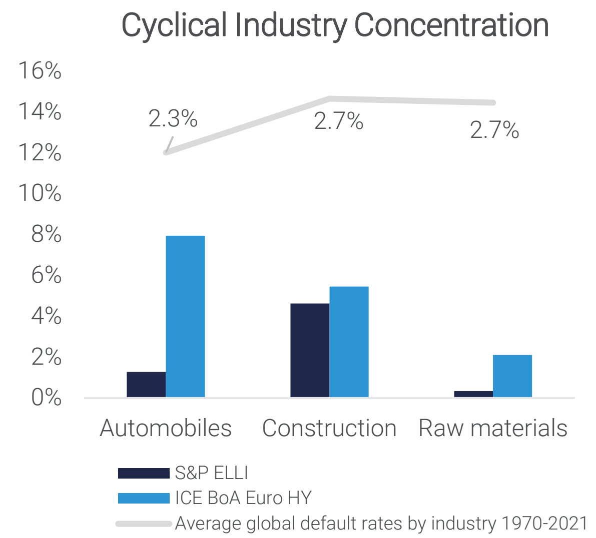
The graph below[6] demonstrates that the PC universe is concentrated more towards regions of lower geographic risk – UK, France, Germany, the Netherlands, US, Sweden, Ireland, Switzerland, Luxembourg, Belgium, and Denmark. The HY universe has a markedly large bias towards Italy (16%), with a larger allocation to "Other" European countries such as Bulgaria, Cyprus, Czechia, Estonia, Greece, Hungary, Lithuania, Poland, Romania, Slovenia, Turkey, and Ukraine.

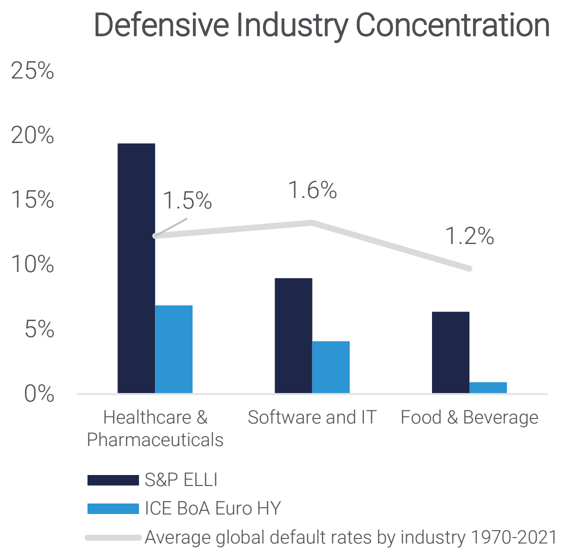
MV Credit believes that the macro risks facing the less developed economies (which are more prevalent within the HY universe) are material and should command a return premium. Investors should be aware that these geographic risks are more pronounced within the HY universe relative to PC.



Past performance is not a reliable indicator of future results

This narrative is even more pronounced when one looks at industry exposure. The two asset classes are skewed very differently regarding concentrations in cyclical industries (such as automobiles, construction, and raw materials[7]) vs more defensive sectors (such as healthcare/pharmaceutical, software/IT and food/beverage[7]).





[6] Source: ICE BofA database: Nov 2022 and https://www.lcdcomps.com/lcd/idx/index.html?rid=20 : Nov 2022
[7] Industry buckets contain sub-industries across Moody's, S&P and ICE Bof A databases. Please see Disclaimer Appendix table below for a summary of these industry buckets

Past performance is not a reliable indicator of future results

The graphs above illustrate the extent to which the HY universe is skewed more towards cyclical industries at the expense of the defensive industry allocation. These cyclical industries have significantly higher default rates[8] over a long-time horizon (1970-2021).

Risk Considerations – Recovery Rates

Downside risk is another area that potential PC and HY investors must consider when comparing the two asset classes. Loss (and hence return) expectations must be adjusted according to the recovery rates of past defaulting borrowers.

According to the 2021 Annual Default Study (Moody's): the volume-weighted average recovery rate for defaulted 1st Lien loans (secured) between 1983-2021 is **63.3% vs 45.2%** for 1st Lien Bonds (secured and unsecured). Over the course of 2021, there were **13** 1st Lien Loan defaults and the average recovery across these defaults was **68.8%**. There were **38** Senior Bond defaults over the same period and the average recovery was lower at **52.9%**.

Conclusion

Popular belief is that the HY asset class currently presents a compelling opportunity for investors seeking returns in the high single-digits.

A deep dive into several risk/return considerations reveals that - in MV Credit's opinion – **the PC asset class continues to be a more compelling opportunity for investors over both the long and short term, even as bond prices remain depressed.**

[8] Source: Moody's annual default study 2021

Contact Details

MV Credit Partners LLP
45 Old Bond Street, London W1S 4QT
Tel: +44 (0) 20 3961 8820
Email: investorrelations@MVCREDIT.COM

Disclaimer

This Document ("Document") is being provided by MV Credit Partners LLP ("MVCP") and MV Credit S.à r.l. ("AIFM") together referred to as MV Credit ("MV Credit"). MVCP is a firm authorised and regulated by the UK Financial Conduct Authority (the "FCA") with firm registration number: 67717. MVCP is also an Exempt Reporting Advisor (ERA) with the SEC. For additional information please see: https://adviserinfo.sec.gov/firm/summary/28825

The AIFM is a Luxembourg private limited liability company, authorized and regulated by the Commission de Surveillance du Secteur Financier ("CSSF") with a registered number A00002885. The AIFM has delegated portfolio management to MVCP for the MV Credit funds it controls. This Document is being issued on a strictly confidential basis to selected financial institutions and other parties considering entering into business relationships with MV Credit and may not be reproduced, distributed or published by any recipient for any purpose without the prior written consent of MV Credit.

- This Document is not intended to create any right of a legally binding or enforceable nature between MV Credit and the recipient in respect of the provision of services or products. This Document is being made available on a strictly non-reliance, no representations, no warranty and hold harmless basis only and will not be updated. The content of this Document does not constitute professional advice, including but not limited to; legal, tax or investment advice and any recipient should consult with their own professional advisor before making any decisions relating to this Document.
- No liability whatsoever (for negligence or otherwise) is accepted by MV Credit nor any of the MV Credit affiliates for any loss howsoever arising, directly or indirectly, from any use of this Document or otherwise arising in connection therewith.
- By receiving this Document, you agree that you will, and will cause your respective directors, officers, employees, advisers, agents and representatives (together "Recipient Affiliates") to, (i) use such information only to evaluate the various funds and other products managed by MV Credit (the "Funds") and for no other purpose whatsoever, and (ii) keep confidential all information contained herein, and not disclose any information contained herein or derived here from to any person without the prior written consent of MV Credit (provided that you may disclose this Document on a strictly confidential basis to the Recipient Affiliates for the purposes of obtaining advice relating to the Funds). You further agree to promptly return this Document, together with any copies thereof (except as may be required for regulatory purposes), to MV Credit upon request.
- No regulatory body has reviewed or approved or passed opinion upon this Document or the merits of any investment discussed herein.
- This Document does not constitute a part of any fund document; nor is it a sales advertising document or a solicitation of offer.
- The past performance of the Funds is not indicative of, nor a guarantee of the Funds' future results.
- This Document contains information about the performance of investments previously made by funds advised/managed by MV Credit. It does not purport to be a comprehensive or accurate view of future performance, targets or projections and whilst forward looking language may be used, this is only for illustrative purposes and not to be relied upon. Prospective investors must be aware that all investments in debt funds are speculative and involve substantial risk of loss. Please ask your professional advisor for advice regarding the specific risks.
- Any statement as to risks herein is not an exhaustive list.
- This material has not been audited but is communicated in accordance with Article 14 (Investment Professionals), Article 21 (Certified high net worth individuals) and Article 22 (High net worth companies) of the Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001, or pursuant to the permitted exemptions made available by the FCA in section 4.12 of its Conduct of Business Sourcebook and is not intended for retail clients (as defined in the FCA Rules) who should not, and cannot, rely on information here.
- This Document is issued to professional investors only such as financial institutions and other parties considering entering into business relationships with MV Credit and is not intended for distribution to or use by any person or entity in any jurisdiction or country where such distribution or use would be contrary to local laws or regulations. As such, the distribution of this Document in other jurisdictions may be restricted by law, and persons into whose possession this Document comes should inform themselves about, and observe, any such restrictions.

Additional notes

This material has been provided for information purposes only to investment service providers or other Professional Clients, Qualified or Institutional Investors and, when required by local regulation, only at their written request. This material must not be used with Retail Investors.

To obtain a summary of investor rights in the official language of your jurisdiction, please consult the legal documentation section of the website (im.natixis.com/intl/intl-fund-documents)

In the E.U.: Provided by Natixis Investment Managers International or one of its branch offices listed below. Natixis Investment Managers International is a portfolio management company authorized by the Autorité des Marchés Financiers (French Financial Markets Authority - AMF) under no. GP 90-009, and a public limited company (société anonyme) registered in the Paris Trade and Companies Register under no. 329 450 738. Registered office: 43 avenue Pierre Mendès France, 75013 Paris. Italy: Natixis Investment Managers International Succursale Italiana, Registered office: Via San Clemente 1, 20122 Milan, Italy. Netherlands: Natixis Investment Managers International, Nederlands (Registration number 000050438298). Registered office: Stadsplateau 7, 3521AZ Utrecht, the Netherlands. Spain: Natixis Investment Managers International S.A., Sucursal en España, Serrano n°90, 6th Floor, 28006 Madrid, Spain. Sweden: Natixis Investment Managers International, Nordics Filial (Registration number 516412-8372- Swedish Companies Registration Office). Registered office: Covendrum Stockholm City AB, Kungsgatan 9, 111 43 Stockholm, Box 2376, 103 18 Stockholm, Sweden. Or,

Provided by Natixis Investment Managers S.A. or one of its branch offices listed below. Natixis Investment Managers S.A. is a Luxembourg management company that is authorized by the Commission de Surveillance du Secteur Financier and is incorporated under Luxembourg laws and registered under n. B 115843. Registered office of Natixis Investment Managers S.A.: 2, rue Jean Monnet, L-2180 Luxembourg, Grand Duchy of Luxembourg. Germany: Natixis Investment Managers S.A., Zweigniederlassung Deutschland (Registration number: HRB 88541). Registered office: Senckenberganlage 21, 60325 Frankfurt am Main. Belgium: Natixis Investment Managers S.A., Belgian Branch, Gare Maritime, Rue Picard 7, Bte 100, 1000 Bruxelles, Belgium.

In Switzerland: Provided for information purposes only by Natixis Investment Managers, Switzerland Sàrl, Rue du Vieux Collège 10, 1204 Geneva, Switzerland or its representative office in Zurich, Schweizergasse 6, 8001 Zürich.

In the British Isles: Provided by Natixis Investment Managers UK Limited which is authorised and regulated by the UK Financial Conduct Authority (register no. 190258) - registered office: Natixis Investment Managers UK Limited, One Carter Lane, London, EC4V 5ER. When permitted, the distribution of this material is intended to be made to persons as described as follows: in the United Kingdom: this material is intended to be communicated to and/or directed at investment professionals and professional investors only; in Ireland: this material is intended to be communicated to and/or directed at professional investors only; in Guernsey: this material is intended to be communicated to and/or directed at only financial services providers which hold a license from the Guernsey Financial Services Commission; in Jersey: this material is intended to be communicated to and/or directed at professional investors only; in the Isle of Man: this material is intended to be communicated to and/or directed at only financial services providers which hold a license from the Isle of Man Financial Services Authority or insurers authorised under section 8 of the Insurance Act 2008.

In the DIFC: Provided in and from the DIFC financial district by Natixis Investment Managers Middle East (DIFC Branch) which is regulated by the DFSA. Related financial products or services are only available to persons who have sufficient financial experience and understanding to participate in financial markets within the DIFC, and qualify as Professional Clients or Market Counterparties as defined by the DFSA. No other Person should act upon this material. Registered office: Unit L10-02, Level 10 ,ICD Brookfield Place, DIFC, PO Box 506752, Dubai, United Arab Emirates

In Japan: Provided by Natixis Investment Managers Japan Co., Ltd. Registration No.: Director-General of the Kanto Local Financial Bureau (kinsho) No.425. Content of Business: The Company conducts investment management business, investment advisory and agency business and Type II Financial Instruments Business as a Financial Instruments Business Operator.

In Taiwan: Provided by Natixis Investment Managers Securities Investment Consulting (Taipei) Co., Ltd., a Securities Investment Consulting Enterprise regulated by the Financial Supervisory Commission of the R.O.C. Registered address: 34F., No. 68, Sec. 5, Zhongxiao East Road, Xinyi Dist., Taipei City 11065, Taiwan (R.O.C.), license number 2020 FSC SICE No. 025, Tel. +886 2 8789 2788.

In Singapore: Provided by Natixis Investment Managers Singapore Limited (NIM Singapore) having office at 5 Shenton Way, #22-05/06, UIC Building, Singapore 068808 (Company Registration No. 199801044D) to distributors and qualified investors for information purpose only. NIM Singapore is regulated by the Monetary Authority of Singapore under a Capital Markets Services Licence to conduct fund management activities and is an exempt financial adviser. Mirova Division is part of NIM Singapore and is not a separate legal entity. Business Name Registration No. of Mirova: 53431077W.This advertisement or publication has not been reviewed by the Monetary Authority of Singapore.

In Hong Kong: Provided by Natixis Investment Managers Hong Kong Limited to professional investors for information purpose only.

In Australia: Provided by Natixis Investment Managers Australia Pty Limited (ABN 60 088 786 289) (AFSL No. 246830) and is intended for the general information of financial advisers and wholesale clients only .

In New Zealand: This document is intended for the general information of New Zealand wholesale investors only and does not constitute financial advice. This is not a regulated offer for the purposes of the Financial Markets Conduct Act 2013 (FMCA) and is only available to New Zealand investors who have certified that they meet the requirements in the FMCA for wholesale investors. Natixis Investment Managers Australia Pty Limited is not a registered financial service provider in New Zealand.

In Colombia: Provided by Natixis Investment Managers International Oficina de Representación (Colombia) to professional clients for informational purposes only as permitted under Decree 2555 of 2010. Any products, services or investments referred to herein are rendered exclusively outside of Colombia. This material does not constitute a public offering in Colombia and is addressed to less than 100 specifically identified investors.

In Latin America: Provided by Natixis Investment Managers International.

In Uruguay: Provided by Natixis Investment Managers Uruguay S.A., a duly registered investment advisor, authorised and supervised by the Central Bank of Uruguay. Office: San Lucar 1491, Montevideo, Uruguay, CP 11500. The sale or offer of any units of a fund qualifies as a private placement pursuant to section 2 of Uruguayan law 18,627.

In Mexico: Provided by Natixis IM Mexico, S. de R.L. de C.V., which is not a regulated financial entity, securities intermediary, or an investment manager in terms of the Mexican Securities Market Law (Ley del Mercado de Valores) and is not registered with the Comisión Nacional Bancaria y de Valores (CNBV) or any other Mexican authority. Any products, services or investments referred to herein that require authorization or license are rendered exclusively outside of Mexico. While shares of certain ETFs may be listed in the Sistema Internacional de Cotizaciones (SIC), such listing does not represent a public offering of securities in Mexico, and therefore the accuracy of this information has not been confirmed by the CNBV. Natixis Investment Managers is an entity organized under the laws of France and is not authorized by or registered with the CNBV or any other Mexican authority. Any reference contained herein to "Investment Managers" is made to Natixis Investment Managers and/or any of its investment management subsidiaries, which are also not authorized by or registered with the CNBV or any other Mexican authority.

In Brazil: Provided to a specific identified investment professional for information purposes only by Natixis Investment Managers International. This communication cannot be distributed other than to the identified addressee. Further, this communication should not be construed as a public offer of any securities or any related financial instruments. Natixis Investment Managers International is a portfolio management company authorized by the Autorité des Marchés Financiers (French Financial Markets Authority - AMF) under no. GP 90-009, and a public limited company (société anonyme) registered in the Paris Trade and Companies Register under no. 329 450 738. Registered office: 43 avenue Pierre Mendès France, 75013 Paris.

The above referenced entities are business development units of Natixis Investment Managers, the holding company of a diverse line-up of specialised investment management and distribution entities worldwide. The investment management subsidiaries of Natixis Investment Managers conduct any regulated activities only in and from the jurisdictions in which they are licensed or authorized. Their services and the products they manage are not available to all investors in all jurisdictions. It is the responsibility of each investment service provider to ensure that the offering or sale of fund shares or third party investment services to its clients complies with the relevant national law.

The provision of this material and/or reference to specific securities, sectors, or markets within this material does not constitute investment advice, or a recommendation or an offer to buy or to sell any security, or an offer of any regulated financial activity. Investors should consider the investment objectives, risks and expenses of any investment carefully before investing. The analyses, opinions, and certain of the investment themes and processes referenced herein represent the views of the portfolio manager(s) as of the date indicated. These, as well as the portfolio holdings and characteristics shown, are subject to change. There can be no assurance that developments will transpire as may be forecasted in this material. The analyses and opinions expressed by external third parties are independent and does not necessarily reflect those of Natixis Investment Managers. Past performance information presented is not indicative of future performance.

Although Natixis Investment Managers believes the information provided in this material to be reliable, including that from third party sources, it does not guarantee the accuracy, adequacy, or completeness of such information. This material may not be distributed, published, or reproduced, in whole or in part.

All amounts shown are expressed in USD unless otherwise indicated.

Natixis Investment Managers may decide to terminate its marketing arrangements for this product in accordance with the relevant legislation

Disclaimer Appendix

Broad industry bucket label	Moody's (default rates)	S&P	ICA BofA
Automobiles	Automotive	Auto Components ; Automobiles	Auto Parts & Equipment ; Automakers
Construction	Construction & Building	Building Products ; Construction & Engineering ; Construction Materials	Building & Construction ; Building Materials ; RealEstate Dev & Mgt
Raw Materials	Energy: Oil & Gas ; Forest Products & Paper ; Metals & Mining	Oil, Gas & Consumable Fuels ; Paper & Forest Products ; Metals & Mining	Oil Field Equipment & Services ; Oil Refining & Marketing ; Forestry/Paper ; Metals/Mining Excluding Steel ; Steel Producers/Products
Healthcare & Pharmaceuticals	Healthcare & Pharmaceuticals	Health Care Equipment & Supplies ; Health Care Providers & Services ; Health Care Technology ; Life Sciences Tools & Services ; Pharmaceuticals	Health Services ; Medical Products ; Pharmaceuticals
Software & IT	High Tech Industries	IT Services ; Software	Software/Services ; Tech Hardware & Equipment
Food & Beverage	Beverage, Food, & Tobacco	Food & Staples Retailing ; Food Products	Restaurants ; Beverage ; Food - Wholesale