Press Release

Credit Market Update: Ongoing Uncertainty is the Early Theme for 2024

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London 5 February 2024 – Despite heading into February with a tailwind of positive macroeconomic data that makes a soft landing seem increasingly possible, a number of risks remain on the horizon.

The political landscape presents a key area of uncertainty for markets in 2024. With more than 40 percent of the global population heading to the polls this year, there is a high potential for policy paradigm shifts. We're also currently experiencing heightened geopolitical risks, with conflict continuing in Ukraine and tensions increasingly rising in the Middle East.

The impact of this uncertainty upon markets is underscored by the broad range of forecasted returns for European high yield bonds in banks' 2024 outlooks. These projections range from as low as 2.8% from Deutsche Bank to 9.3% from Goldman Sachs. **This level of uncertainty has the potential to create opportunity**; volatility can present scenarios to deploy capital into high quality issuers trading at a discount. As public credit markets close to primary issuance, lenders like AlbaCore can step into the breach, be it investing via hung syndication or through bespoke private credit solutions. **In a market environment with a wide range of outcomes, a broad toolkit is needed** to navigate across the breadth of European leveraged finance markets, both public and private credit.

Interest rates to dominate markets once again in 2024

While expectations for a near term interest rate cut have fallen in early 2024, multiple rate cuts are still expected through the course of the year. However, rates are unlikely to return to their post- Global Financial Crisis (GFC) lows anytime soon.

Given higher funding costs, new transactions are likely to continue to be structured with lower leverage, creating several interesting opportunities for lenders. As highlighted previously, we believe that the opportunity in senior first lien debt for large cap issuers is an attractive and growing opportunity, with the higher interest rate environment and illiquidity premium meaning these transactions offer compelling total returns.

With lenders requiring lower leverage for senior debt, there may be a greater need for broader capital solutions that also combine junior and/or Payment-in-Kind (PIK) debt in transactions that may have historically been financed on a senior only basis. Junior debt can be used by sponsors to fund new bolt-on acquisitions or as part of a full refinancing solution, with borrowers able to place facilities behind various senior debt levels. As the elevated interest rate environment has increased funding costs, this has impacted liquidity for some borrowers. Junior debt may include “pay-if-you-can” clauses which allow borrowers to opt to PIK debt, reducing their ongoing cash burden, and affording them greater financial flexibility in an elevated rate environment. **We have recently seen a rebound in interest for junior solutions**, which supports this thesis. However, given the continued economic uncertainty and the attractiveness of yields on senior debt, selectivity is key.

Can European loans continue to defy expectations?

In 2023, the Morningstar European Leveraged Loan Index, saw its second highest annual return at 13.6%[1], only trailing the 2009 rebound following the GFC. This was largely due to defaults remaining moderate at 1.6%[2], while the rising interest rate environment boosted coupon income. **While it is unlikely that European leveraged loans will replicate their 2023 returns, their high running income (average yield of 9.05%[3] as of year-end) should continue to drive returns this year**. Despite the expectation of interest rate cuts as the year progresses, there is a strong likelihood that rates remain higher than the post-GFC norms, boosting the ongoing return potential of the asset class.

High yield bonds: watch out for maturities

The European high yield bond market, which was substantially less proactive in addressing near term maturities than the loan market in 2023, has its backs against a maturity wall that could potentially be challenging to address.

For many borrowers, the reluctance to address these maturities is perfectly rational. Most of these bonds were issued prior to recent interest rate increases, and as a result, pay relatively low coupons. Borrowers therefore had little incentive to refinance at today’s higher rates and instead have allowed maturities to creep closer. Many of these upcoming maturities are from borrowers rated Single B or higher. We do not believe they currently pose a fundamental risk for the market, as they should face minimal issues refinancing if markets remain constructive. However, **if market conditions change, borrowers who have been complacent may need to pay a premium, creating interesting opportunities for private lenders.**

David Allen is the Managing Partner and Chief Investment Officer at AlbaCore Capital Group.

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[1] Source: Morningstar European Leveraged Loan Index as of 31 December 2023
[2,] Source: Morningstar European Leveraged Loan Index LTM Par Weighted Default Rate as of 31 December 2023
[3] Source: Morningstar European Leveraged Loan Index LTM Par Weighted Default Rate as of 31 December 2023

Mr. Allen has more than 30 years of financial services and investment experience, with a focus on the High Yield and Leveraged Finance Markets.

Prior to founding AlbaCore Capital Group, Mr. Allen managed Canada Pension Plan Investment Board's European Principal Credit Fund and was a member of the Investment Committee. Mr. Allen was also a Partner, Investment Committee member and Senior Portfolio Manager at GoldenTree Asset Management, where he established and ran the firm's European presence. Mr. Allen spent a decade with Morgan Stanley in New York and Hong Kong, working across M&A and investment banking before specializing as a High Yield media analyst.

Mr. Allen graduated from the University of California, Berkeley, where he earned a Bachelor of Arts in Economics and was an all-conference rower.

About AlbaCore Capital Group

AlbaCore Capital Group is one of Europe's leading alternative credit specialists, investing in private capital solutions, opportunistic and dislocated credit, CLOs, and structured products. Founded in 2016, AlbaCore is part of the First Sentier Investors Group. AlbaCore's investment philosophy is focused on capital preservation and generating attractive risk adjusted returns through the cycle for its investors. AlbaCore manages **US$ 9.6 billion in AuM[4] as of 30 December 2023** on behalf of global pension funds, sovereign wealth funds, consultants, insurance companies, family offices and endowments around the world.

For more information, visit www.AlbaCoreCapitalGroup.com

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[4] AuM is calculated as the sum of the Net Asset Value, undrawn capital commitments, available debt finance and assets of all vehicles managed by AlbaCore.