Press Release

Credit Market Outlook: Inflation Pushes the Cycle Back to Dislocation

David Allen, Managing Partner and Chief Investment Officer, AlbaCore Capital Group

London 12 July 2022: – Compared to the COVID-influenced dislocation in 2020, current market conditions more closely resemble a traditional economic cycle, driven by overheating elements of the economy, which must now be cooled off with higher interest rates to restrain growth and tame inflation. Over the last few months, we've gone from questioning whether developed economies are heading for a recession, to asking how long it will last, and to what extent.

In the second quarter, risk markets have continued to swoon, with few markets spared the pain. Traditional safe havens like investment grade and sovereign credit have generated some of the worst returns across asset classes in 2021 and 2022, a painful reminder of how duration dictates the relationship between interest rates, time and a fixed level of upside (par) for credit assets. Even leveraged loans have started to trend downward in recent months, despite the protections their seniority and floating rate structures provide relative to traditional fixed rate bonds.

Inflation Outlook

We believe that – despite actions from central banks – that inflation will remain elevated well into 2023. Driven primarily by higher energy prices due to the war in Ukraine, but also by lingering supply chain issues globally, it is hard to see relief on the horizon. Lapping higher numbers from 2022 may provide some short-term relief in the US (where inflation cracked 5% in May last year), but the UK and Europe likely have tougher sledding for the rest of the year.

Unfortunately, sustained inflation and higher rates will likely prove to be a painful combination in the short-term for policy makers and citizens alike. For investors, navigating these times requires experience with higher rates and higher defaults.

The signals across spread, yield and price

In periods of rising or steady positive rates, spreads typically absorb a meaningful percentage of yield increases, as yields for certain risk assets have a somewhat natural ceiling over time. It is important to remember that for long stretches of time during a rising rates environment, yields in US high yield averaged 8%, but spreads averaged below 400bps. In a world with positive rates, spreads are one indicator of the relative attractiveness of credit, but price is also a useful guide for whether it is an attractive point to add risk.

Size and selectivity

AlbaCore take a somewhat different approach in Europe than our peers, as we wear many different hats in capital markets. Across deals, our size, speed and ability to be selective serves as a differentiator. During this period, we're focusing on our areas of expertise and experience, rather than trying new things.

The first half of 2022 has kept us busy, and we continue to grow and add team members across our firm. We have dozens of project work streams in development and are excited that these initiatives will continue to improve our firm and position us for the next five years of opportunity.

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

Mr. Allen has nearly 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 specialist credit investors focusing on public and private corporate credit markets. The senior investment team have been investing with this hybrid strategy for over a decade. Founded in 2016, AlbaCore has invested over $22bn[1] for global pension funds, sovereign wealth funds, consultants, insurance companies, family offices and endowments.

AlbaCore is focused on consistently outperforming the market in the long term while aiming to protect investor capital. The credit selection process is based on fundamental research with a focus on capital preservation, ESG factors and risk-adjusted returns.

Headquartered in London with offices in New York and Dublin, AlbaCore has a partnership approach with values at the centre of the AlbaCore community.

www.AlbaCoreCapitalGroup.com

[1] Invested capital is the sum of all 'buy' trades for all AlbaCore mandates since inception to 30 June 2022, and includes recycled capital and co-investment.