April 2021

INVESTCORP

INVESTCORP CREDIT MANAGEMENT

GLOBAL CREDIT HOUSE VIEW

Dear Investors and Friends,

Welcome to the Investcorp Credit Management House View. This quarterly note discusses the events over the past quarter and based on our insight into both the US and European credit markets offers our views as to the market dynamics we expect to see in Q2 2021.

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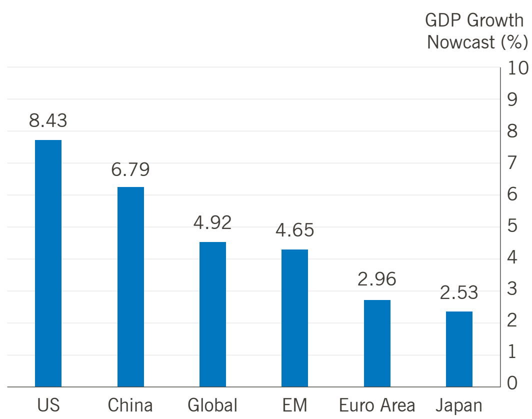
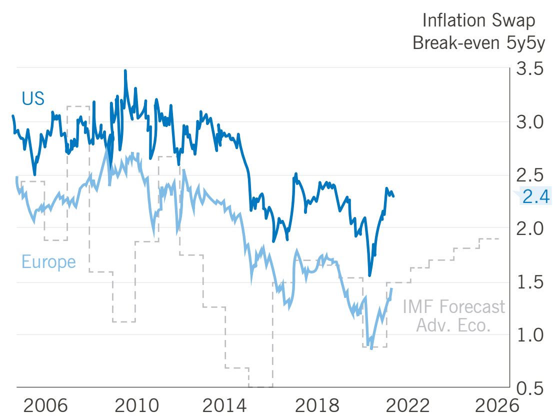
GLOBAL OVERVIEW

Global growth re-accelerated modestly over the first quarter. But economic fortunes varied widely, with the United States recovering much faster thanks to continued extraordinary policy support. The new Democratic administration wasted little time in passing a $1.9 trillion support package, beating expectations for a more modest stimulus. And President Biden recently presented yet another fiscal plan with his infrastructure and tax reform bill that would likely add another trillion dollars of spending in the next few years. Meanwhile, the United States and United Kingdom reaped the benefits of well-organized immunization campaigns, allowing them to gradually reopen their economies while Europe continued to struggle with another wave of COVID-19 contaminations.

GDP GROWTH NOWCASTS BY REGION



INFLATION BREAK-EVEN RATES & IMF FORECAST



Unleashed fiscal power supported by loose monetary policy can be a potent growth cocktail. But it also naturally brought forward questions over the inflation outlook. Near-term, a surge in demand fuelled by excess savings and robust income growth will meet a supply side still scarred by the effects of the pandemic. This imbalance will be compounded by base effects that will likely push the inflation rate in the United States above 3%, if only for a brief period. Longer-term, a Bayesian prior would strongly suggest that price pressures will remain muted, held down by successfully anchored expectations, demographic trends, or technology. But our confidence level should certainly be revised downward. In Europe, a larger output gap and tighter policy mix point to a more timid reflationary impulse.

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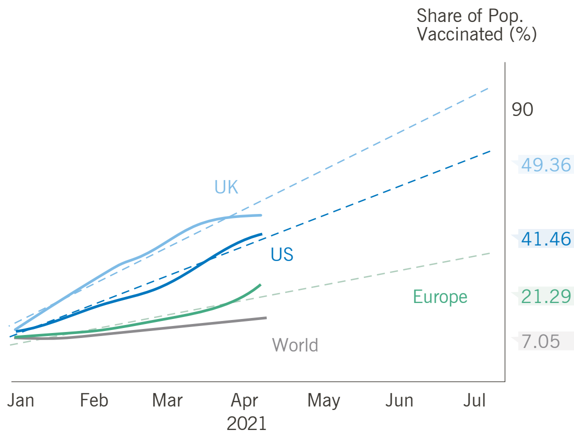
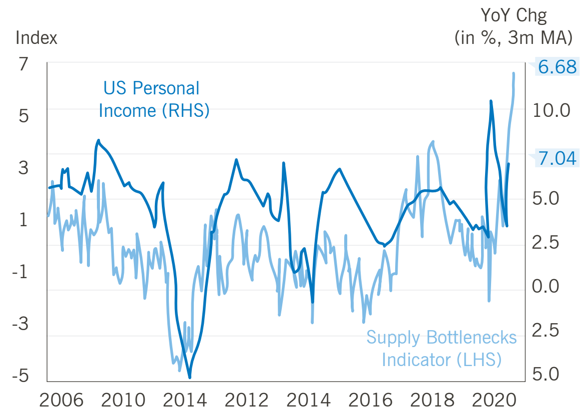
IMMUNIZATION CAMPAIGNS PROGRESS

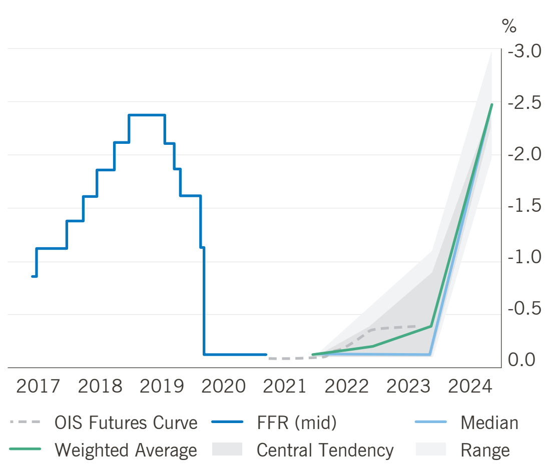


US Supply & Demand Dynamics

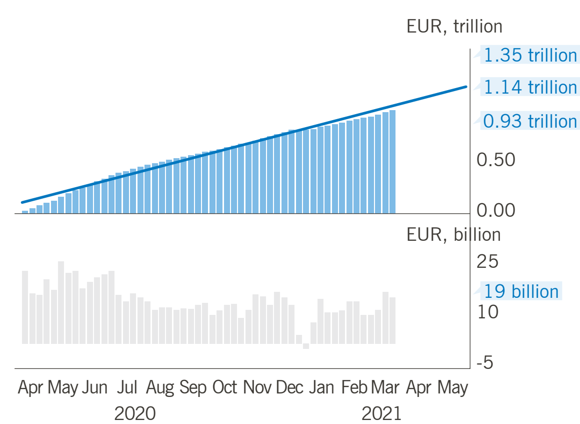


Diverging economic conditions in recent months are creating greater dispersion in monetary policy too. In China, policy is likely to turn less accommodative as signalled by the NPC's deliberations. Financial stability concerns and the leadership's long-term objective to rebalance economic growth away from debt-financed fixed asset investments and towards domestic consumption will take priority again. In Europe, the ECB is leading the response by pushing back against steeper yield curves through their communication and more rapid purchases under the PEPP. The fiscal outlook beyond the European Recovery Fund remains uncertain however as old habits die hard, and institutional constraints limit individual government's spending ability. All eyes will really be on the Federal Reserve for the coming months as pressure is building from investors to clarify their exit plans. Jerome Powell and the FOMC have pushed back against expectations of an earlier tightening with their outcome-based forward guidance but market participants remain unconvinced – pricing in initial rate hikes in 2023, one year ahead of the median path communicated in the FOMC's Summary of Economic Projections. The coming quarters will bring an opportunity to test the Fed's response function and how their recent Average Inflation Targeting framework will drive policy actions.

FOMC SEP VS. MARKET EXPECTATIONS



ECB PANDEMIC EMERGENCY PURCHASE PROGRAM (PEPP)



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GLOBAL CREDIT MARKET

LEVERAGED LOANS IN RISING RATE ENVIRONMENTS

Key Themes:

- Loan prices and flows are positively correlated to moves in UST 10y rates
- Loans should outperform in a rising rate environment
- Investors increasing allocations to loans as a short-duration, floating rate alternative to bonds

In the current period of rising rates and inflation, senior loans are an attractive asset class given their low duration and floating rate nature. Loan prices and flows are positively correlated to moves in UST 10y rates. As shown in the table below, loans have historically outperformed bonds in periods of rising rates.

HISTORICAL PERIODS OF RISING RATE ENVIRONMENTS[1]

	Range from Beginning to End of Period		Index Return from Beginning to End of Period		
Time Period	**10yr Treasury Yield**	**Fed Funds Effective Rate**	**C S High Yield**	**C S Leveraged Loan**	**BofA ML IG Corp Master**
Sep 93 - Nov 94	5.4% - 7.9% ▲	3.1% - 5.3% ▲	1.80%	13.40%	-4.30%
Dec 95 - Aug 96	5.6% - 6.9% ▲	5.6% - 5.2% ▼	6.30%	5.40%	-2.20%
Sep 98 - Jan 00	4.4% - 6.7% ▲	5.5% - 5.5% ◀▶	6.30%	6.60%	-1.3%
Oct 01 - Mar 02	4.2% - 5.4% ▲	2.5% - 1.7% ▼	5.90%	4.00%	-2.00%
Feb 03 - May 04	3.7% - 4.6% ▲	1.3% - 1.0% ▼	23.80%	11.70%	5.10%
Jun 05 - Jun 06	3.9% - 5.1% ▲	3.0% - 5.0% ▲	5.00%	6.70%	-2.00%
Dev 08 - Mar 10	2.2% - 3.8% ▲	0.2% - 0.2% ◀▶	61.10%	51.2%	23.00%
Aug 10 - Mar 11	2.5% - 3.5% ▲	0.2% - 0.1% ▼	9.90%	7.40%	0.00%
Apr 13 - Dec 13	1.7% - 3.0% ▲	0.2% - 0.1% ▼	2.60%	2.90%	-3.20%
Feb 15 - Jun 15	1.7% - 2.5% ▲	0.1% - 0.1% ◀▶	2.96%	2.71%	-3.75%
Jul 16 - Dec 16	1.4% - 2.6% ▲	0.4% - 0.7% ▲	7.06%	4.93%	-3.52%
Sep 17 - Nov 18	2.1% - 2.3% ▲	1.2% - 2.2% ▲	2.83%	6.00%	-2.97%
Aug 20 - Current	0.5%- 1.7% ▲	0.1% - 0.1% ▲	8.56%	8.29%	-2.44%

[1] Source: Bloomberg, Credit Suisse Leveraged Loan Index, Credit Suisse High Yield Index, ICE BofA US High Yield Index, ICE BofA US Corporate Index

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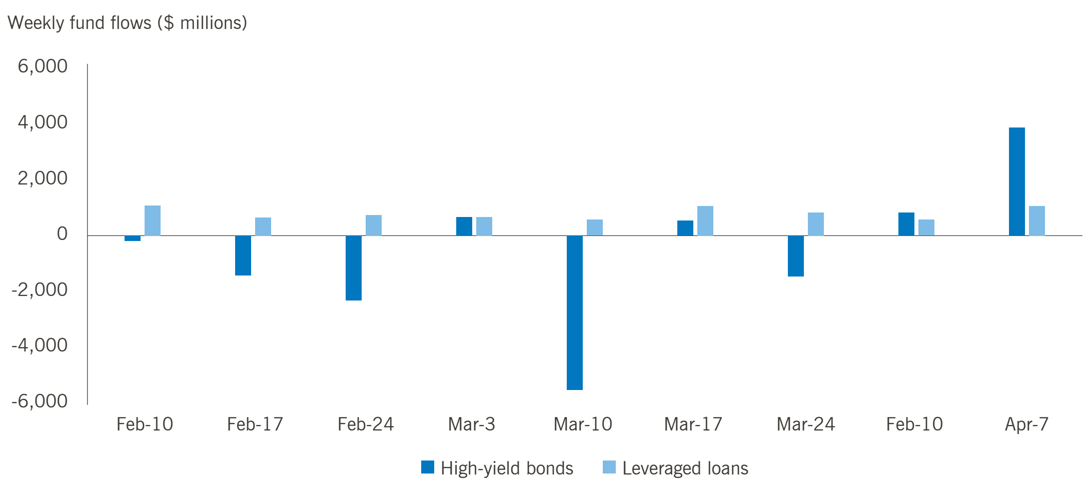
We expect this pattern to repeat as UST 10y rates are expected to continue their upward trajectory and the Fed begins to raise rates over the next 12-18 months. Many Wall Street strategists are calling for yields to be between 1.8% and 2% by year end.

In the face of this, investors have been seeking short duration or floating rate alternatives to corporate bonds. The leveraged loan market rivals the size of the high yield market and currently offers yields ~4.92% that are roughly on par with ~4.87% on high yield bonds[2]. However, given their floating rate nature, loans provide investors the option to earn similar yield without rate and duration risk that is inherent in HY and IG. Loans also provide the potential for increased yields as short term interest rates rise. As secured debt at the top of the capital structures, loans provide steady income with downside protection and less volatility in prices even during slower economic periods.

Investors, recognizing these benefits, have been increasing their allocation to loans in Q1 2021. In addition to the robust CLO formation mentioned above, inflows into loan mutual fund and ETFs totalled over $13bn in Q1[3]. More recently, we've also seen increased buying from high yield crossover accounts. We can continue to expect significantly increased demand for leveraged loan assets through 2021 should the current rate outlook persist.

US FUND FLOWS[4]



US MARKET – Q1 2021

Key Themes:

- Macro tailwinds fuelling strong growth expectations
- Rates and inflation concerns creating pockets of volatility
- Loans outperforming HY and IG
- "Risk-On"; COVID-recovery and discounted credits continue to rally
- Investors increasing allocations to loans as a short-duration, floating rate alternative to bonds

[2] Source: JP Morgan Research, as of April 1st, 2021
[3] Source: S&P/LSTA Leveraged Loan Index, as of March 31, 2021
[4] Source: JP Morgan High-Yield and Leveraged Loan Strategy, Lipper, as of April 7, 2021

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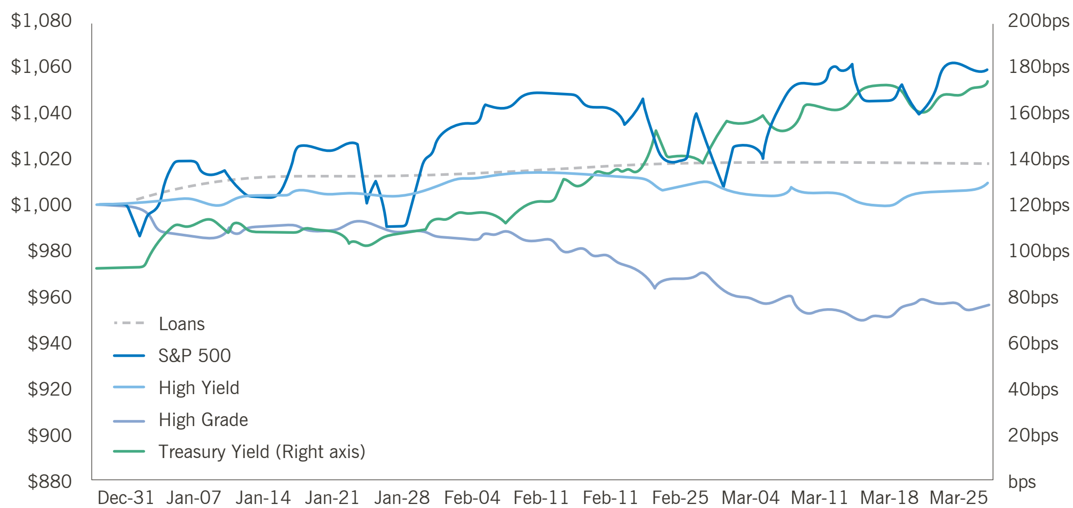
In Q1 2021, US credit markets have embraced expectations for a strong economic rebound. This "V-shaped" recovery is being fuelled by unprecedented US fiscal stimulus, significant progress getting COVID-19 "shots in arms" and expectations for substantial pent-up demand as we reach a "return to normalcy" by summer 2021. Many Wall Street economists are now calling for US GDP growth of between 5.5% - 6.5% for 2021, which is much faster than pre-pandemic growth. These reopening tailwinds have driven a dramatic move in US 10-year Treasury (UST 10y) yields from ~.90% at year end to ~1.74% more recently. The move in rates created some volatility in equities and tempered the rally in high yield and leveraged loans which pulled back from the February highs.

Rising rates have benefited the loan market over high yield and investment grade credit. Leveraged loans, given their floating rate structure, provide investors an option to maintain yield while reducing rate and duration risks. Loans have significantly outperformed high yield bonds YTD and have attracted large inflows into retail mutual funds and ETFs. YTD loans are generating a 2.01% return while high yield has returned 1.35% in the comparable period[5].

COMPARISON OF ASSET CLASSES[6]
(Growth of $1,000 in 2021)



The rally in higher-beta, cyclical and COVID-19 recovery names continued in the quarter, with CCC loans continuing to outperform, returning +7.49%, while Single-B's gained +1.54% and BB loans returned +0.71%[7].

From a technical perspective, the loan market has, as predicted in our last House View, remained strong through Q1 2021 driven by strong CLO demand, retail inflows and the improved economic outlook. During Q1, gross CLO issuance was over $106bn, which was the highest quarterly amount on record. Meanwhile, a near record $300.5bn of leveraged loans were issued in Q1[8].

[5] Source: Credit Suisse Leveraged Loan Index as of March 31, 2021
[6] Source: S&P LCD, as of March 31, 2021, Bank of America Merrill Lynch, Bloomberg
[7] Credit Suisse Leveraged Loan Index as at 31 March 2021
[8] Source: JP Morgan Research, as of April 1st, 2021

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US MARKET OUTLOOK

Key Themes:

- Massive stimulus, accelerating economic growth and vaccination progress are supportive for credit quality
- Loans should continue to outperform
- Outperformance of higher-beta and recovery exposed credit
- The “reopening” trade is “not one size fits all”

With economic recovery and reopening underway, supported by nearly -$3 trillion- in stimulus since December and progress towards ending the pandemic, we expect improving credit fundamentals and declining default rates. Instead US credit investors are focused on the rise in UST 10y yields, risks of inflation, vaccination rates and the impact of variants on the reopening of world economies. There is also the expectation for rate hikes as the recovery leads policy makers to temper COVID induced accommodation over the next 12-18 months. As discussed in the previous section, we believe loans are well-positioned to outperform in this environment.

In addition to these concerns, we continue to monitor how the progressive policies of the new administration might be burdensome for certain areas of the economy. We are also investing with an eye toward ESG policies which we expect to gain momentum in the US over the next 1-2 years.

Stimulus and economic re-opening remain supportive for higher-beta and recovery exposed credit (CCC, energy, etc). In general, we expect this segment to continue to outperform the rest of the market as investors play for any remaining upside from a re-opening trade. However, we anticipate more dispersion in performance as credit fundamentals and trajectory of recovery differs by industry and individual credits. We are expressing this through a more active, “front-footed” trading approach. We are frequently adjusting our portfolio to position into sectors and individual credits that should continue to benefit from cyclical momentum versus those that may be closer to exiting the COVID-recovery phase. Active portfolio management is required to identify credits that will normalize during a cyclical recovery while recognizing which sectors may have experienced permanent structural changes to their business models and customer behavior (e.g., airlines, real-estate, cruise lines, theatres).

As always, we are focused on credits that offer high margin of safety, positive catalysts and attractive risk-adjusted spread particularly in a low rate environment. We expect this combination of front footed trading and active management to drive outperformance.

EUROPEAN MARKET – Q1 2021

Key Themes:

- European Leveraged loans have outperformed high yield
- A significant amount of this issuance
- Signs of renewed market discipline as price pressure eases

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European markets have remained “risk-on” in Q1 2021 albeit March 2021 has also seen some volatility especially in higher duration fixed rate assets driven by the similar rate hike fears to the US. As a result, European Leveraged loans have outperformed high yield in the quarter, with leveraged loans returning +1.73%[9] in the quarter ended 31 March 2021, against a +1.60%[10] in the quarter for European High Yield.

Interestingly, the quarter has seen senior secured high yield bonds pricing inside of pari-passu senior secured loans for the same issuers. A situation that is normally reversed given the duration risk on bonds.

SIMULTANEOUSLY ISSUED LOANS/FRNS AND SECURED BONDS IN EUROPE WHERE BONDS PRICED TIGHTER

Launch Date	Issuer	Sector	Purpose	Loan/FRN Amount €M	Loan/FRN YTM & Tenor	HY Amount €M	HY YTM & tenor	Yield differential
Jul 2020	Verisure AB	Services & Leasing	Refinancing	800	4.16% / 6	800	3.875% / 6	0.29%
Oct 2020	Adevinta ASA	Computers & Electronics	Acquisition	900	3.72% / 7	400	3% / 7	0.72%
Oct 2020	Ineos Group Ltd	Chemicals	Recapitalisation	375	3.72% / 7	325	3.38% / 5	0.34%
Nov 2020	Infopro Digital SAS	Printing & Publishing	Refinancing	*200	*5.987% / 7	500	5.5% / 5	0.49%
Dec 2020	IMA	Machinery	Acquisition	*450	*4.11% / 7	830	3.75% / 7	0.36%
Jan 2021	Verisure AB	Services & Leasing	Recapitalisation	20000	3.59% / 7	1150	3.25% / 6	0.34%
Jan 2021	Ineos Quattro	Chemicals	Acquisition	1500	2.89% / 5	800	2.5% / 5	0.39%
Jan 2021	BioGroup-LCD	Healthcare	Refinancing	1650	3.59% / 7	800	3.375% / 7	0.22%
Jan 2021	TeamSystem SpA	Computers & Electronics	LBO	*850	*3.81% / 7	300	3.5% / 7	0.31%
Jan 2021	Kloeckner Pentaplast Eur	Chemicals	Refinancing	600	4.96% / 5	400	4.25% / 5	0.71%
Jan 2021	THOM Europe	Textile & Apparel	LBO	*250	*5.615% / 5	370	5.375% / 5	0.24%

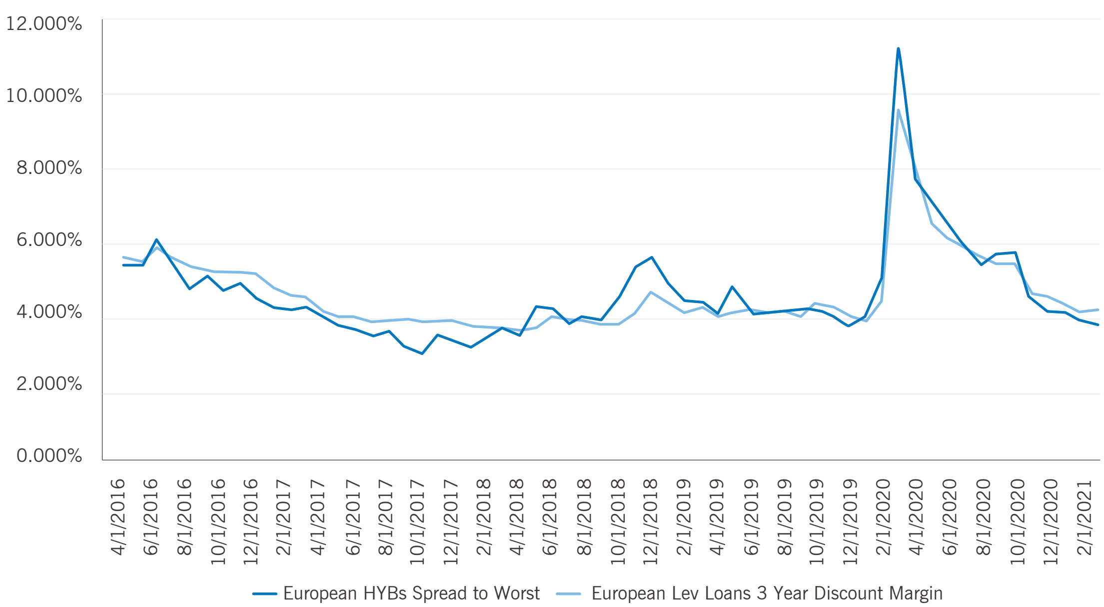
*FRN issuance
(Includes all loans and bonds regardless of tenor)
Data through Feb 28, 2021
Source: LCD, an offering of S&P Global Market Intelligence

[9] Credit Suisse Western European Leveraged Loan Index as at 31 March 2021
[10] Credit Suisse Western European High Yield Index as at 31 March 2021

This is a clear indication of the current strength of the European bond market despite rate hike fears towards the end of the quarter. This strength is further demonstrated by the continued decrease in yields in the high yield market over the quarter, with average yields at 3.48%, close to 50bps below the 3.95% level seen at the end of January 2020 (before the crisis) and significantly down on the 3.79% at the end of December 2020 . In fact, European high yield bond yields closed the quarter at their lowest point since October 2017 when they touched 3.15% (the lowest yield posted by the Credit Suisse Western European High Yield Index over its life).

The differential between the European High Yield spread to worst and the 3-year discount margin on European Leveraged Loan indices ended the quarter at 40bps in the favour of loans.

EUROPEAN HIGH YIELD SPREAD TO WORST AND LEVERAGED LOAN 3-YEARS DISCOUNT MARGINS



Source: Credit Suisse Western European Leveraged Loan and High Yield indices

Given the continued dovish ECB stimulus stance we currently expect that the differential in high yield spreads versus loan discount margins will be maintained.

Looking at European leveraged loans in detail, the market has benefited through most of the quarter from significant technical tailwinds. Although headline primary issuance has been strong, at €36.1billion for the quarter, a significant amount of this issuance has related to the repricing or refinancing of existing deals. As a result, market prices grinded higher over January and February, with the average price of the index finishing February at 98.61% (versus 97.35% at the end of December 2020) before a combination of the impact of the repricing activity and wider market softness saw prices regress back to 98.29% at the quarter end . The significant repricing activity alongside the new issuance in the quarter saw average new issue loan spreads averaging 3.78% in the quarter against 4.12% in the quarter ended December 2020 .

Similar to the US, higher risk assets and COVID exposed assets continued to significantly outperform in the quarter, with CCC loans returning +7.06% in the quarter while Single-B's gained +1.39% and BB loans returned +0.71%.

EUROPEAN MARKET OUTLOOK

Key Themes:

- Market fundamentals remain problematic
- Default rates expectations continue to reduce
- European loans appear to have hit a margin floor of 3.5%
- Primary loan activity remains buoyant

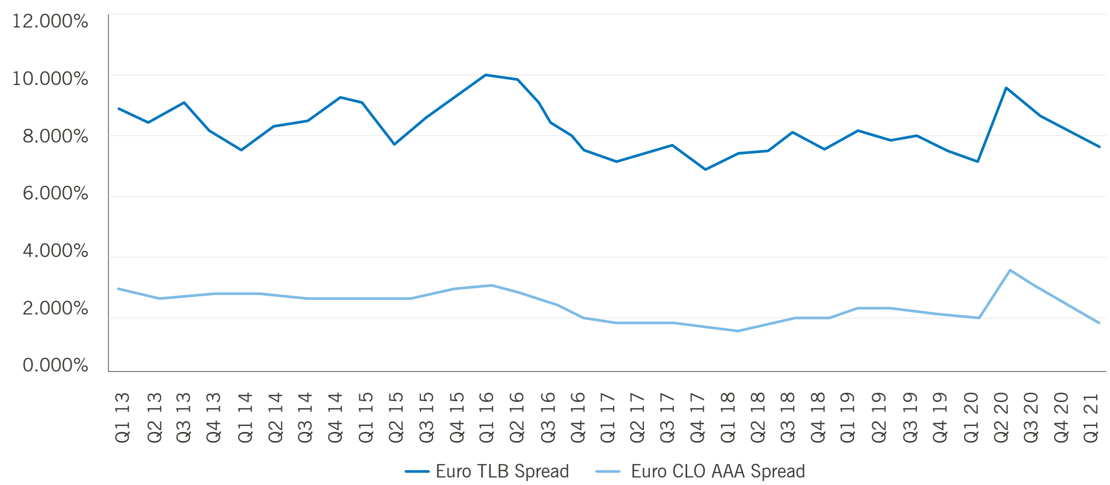
Looking forward into the remainder of 2021, underlying European market fundamentals remain problematic especially when compared to the US. Clearly, the EU's COVID vaccination program is not operating as planned which in turn has resulted in significant third wave infections and an increase in lockdowns and restrictions across the continent, just as both the US and the UK are starting to ease restrictions as a result of their more advanced vaccination programs.

Positively, this is not feeding into increases in defaults, even in those credits most exposed to COVID risks, with the European default rate continuing to fall and now standing at 2.01% . Although, we believe that significant risks still attach to those issuers whose balance sheets were weaker coming into the crisis or who are materially exposed to the long-term structural impacts of the crisis and who do not have significant liquidity buffers. In the short to medium term, we expect that the increased economic risk in Europe will result in a maintenance or extension of current ECB stimulus, which will support markets and which should also mean that the risk of medium term rate rises are limited in Europe, the opposite of the US.

However, the continued over reliance of European markets on Central Bank stimulus is an increasingly significant longer-term risk for fixed income markets. The market impacts of the removal or reduction of this stimulus is likely to be significant. Positively, loans should be relatively insulated when this happens given their floating rate nature.

Turning to the outlook for loan pricing, the relative March softness along with the normal rebalancing of demand from CLOs in the European markets, with demand reducing for new assets when spreads overly tighten and put pressure on CLO equity arbitrages, has resulted in the market starting to push back on recent spread tightening. This is evidenced by the chart below which shows that European loan spreads tend to be relatively stable, in a range of 3.5% to 4.5%, driven by AAA CLO spreads which also tend to be range bound between 75 and 150 bps. As a result of this self-balancing mechanism, we would expect a stabilisation of spreads in Q2 2021 given that CLO AAA spreads have started to widen in March and April 2021 and that the pipeline for new transactions is expected to remain strong through 2021 driven by the high level of unutilised Private Equity Sponsor capital.

EUROPEAN LEVERAGED LOAN NEW ISSUE SPREADS VERSUS NEW ISSUE CLO AAA SPREADS



Source: S&P/LCD News 31 March 2021

Given the above dynamics, we continue to conservatively position our European portfolios alongside, where sensible, taking advantage of short-term trading opportunities provided by market volatility. On the positive side, we expect that as new primary transactions continue to launch in the remainder of 2021, we will be provided with opportunities to rotate portfolios to increase yields.

SUMMARY

Across both the US and Europe markets we have seen positive trends in both issuance and underlying asset performance with the expectation these will continue into the forthcoming quarter. Technical factors had dominated Q1 and although these remain the impact (primarily due to an excess of demand for loan assets) on pricing has given way to a more disciplined approach, with market push back clearly evident in the US and Europe.

The relative attraction of loans vs bonds is well covered herein as is the potential in the US for loans to benefit from increasing US rates. The global outlook for loan defaults continues to improve reflecting increasing confidence that the pandemic is finally being brought under control, however, as noted we anticipate further periods of volatility but draw comfort from the resilience of the asset class as clearly demonstrated over the last 12 months.

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