December 2021

INVESTCORP

INVESTCORP CREDIT MANAGEMENT

GLOBAL CREDIT HOUSE VIEW

ROBUST PERFORMANCE WITH POSITIVE TRENDS FORECAST TO CONTINUE

Dear Investors and Friends,

Welcome to the Investcorp Credit Management House View. In this quarterly note (December 2021) we will discuss the current and future impact of inflation on global leveraged loan markets as well as reflecting on the latest trends across US and European markets.

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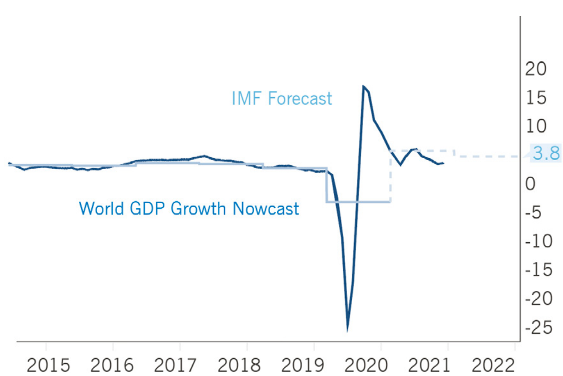
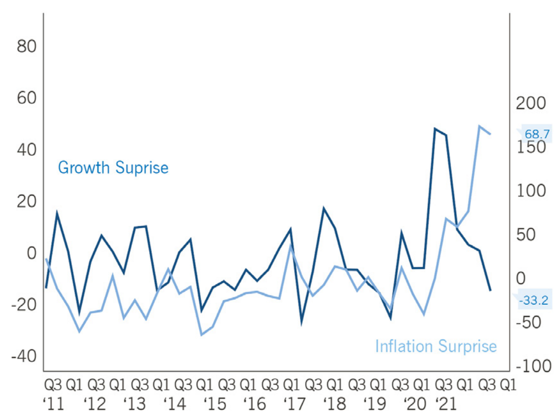
GLOBAL OVERVIEW

Global growth moderated over the third quarter due to continued supply chain bottlenecks and a limited economic drag from the spread of the Delta variant. Fundamental conditions on the demand side of the economy remain strong, with higher personal incomes, significant wealth creation in recent quarters and large excess savings across developed countries. Rising productivity and profits also bode well for the health of the corporate sector which should translate into greater capital expenditure spending in the coming quarters. Still, in a complex economy, the production ramp-up required to keep up with extraordinary demand is facing many challenges, from capacity issues in transport & logistics to a much weaker return to work dynamic. This persistent mismatch between demand and supply is fuelling a stickier and higher than expected rise in price inflation.

GLOBAL GROWTH NOWCAST & IMF FORECAST

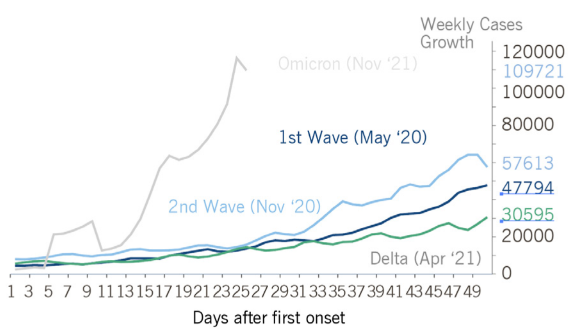


DEVELOPED COUNTRIES GROWTH & INFLATION SURPRISE

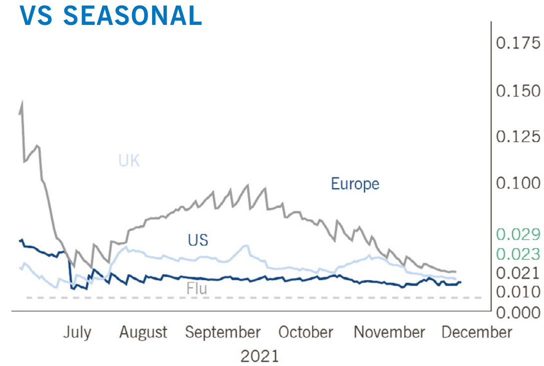


The macro-economic backdrop remains supportive with depth and breadth of momentum across sectors and geographies. But again, a full economic re-opening, looks challenged by the new Omicron variant which presents, according to early reports, a significantly higher degree of transmissibility relative to Delta. Certainly, developed countries are today much better equipped to respond to the threat, with a higher degree of population immunity and a larger toolkit of antiviral drugs. Still, this suggests another delay in the ongoing re-opening, with zero-case policies pursued in South-East Asia likely to cause new supply delays amid a slower return-to-work trend in developed countries.

SOUTH AFRICA COVID WAVES



COVID-19 HOSPITALIZATION RATES VS SEASONAL



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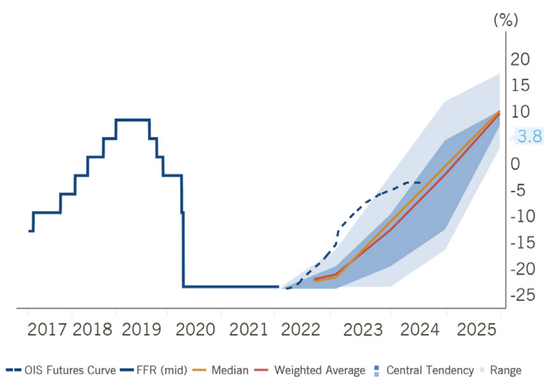
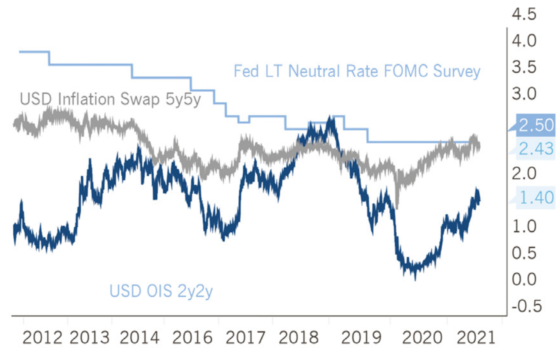
Turning to policy, monetary and fiscal support are set to diminish over the coming months, although monetary policy remains widely accommodative given current economic trends. The Federal Reserve is accelerating its tapering plans to gain greater optionality next year should inflation surprise to the upside. Other G10 central banks are further along in their hiking cycle while the European Central Bank is likely to lag as secular deflationary pressures in the currency bloc subsist. In China, the PBoC is changing gears and embarking on a new easing cycle after tightening credit conditions for the better part of this year. This policy combined with a turn higher in the fiscal impulse is designed to stabilize growth as the country faces severe, largely self-imposed, challenges in its real estate sector. The tail risks associated with the Chinese controlled de-leveraging experiment in real estate bear close watching. In the United States, investors remain positioned, maybe complacently, for a limited hiking cycle in speed and extent with a much lower neutral rate expectation compared to FOMC projections. This divergence leaves room for greater volatility and policy surprises over the coming quarters.





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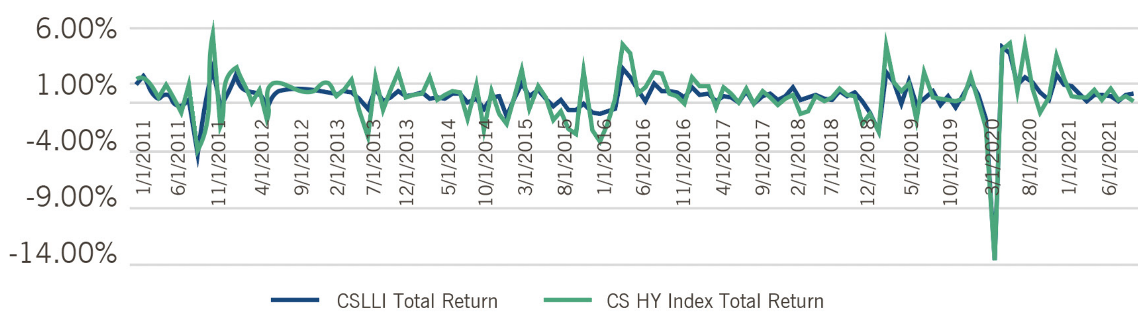
GLOBAL CREDIT MARKET

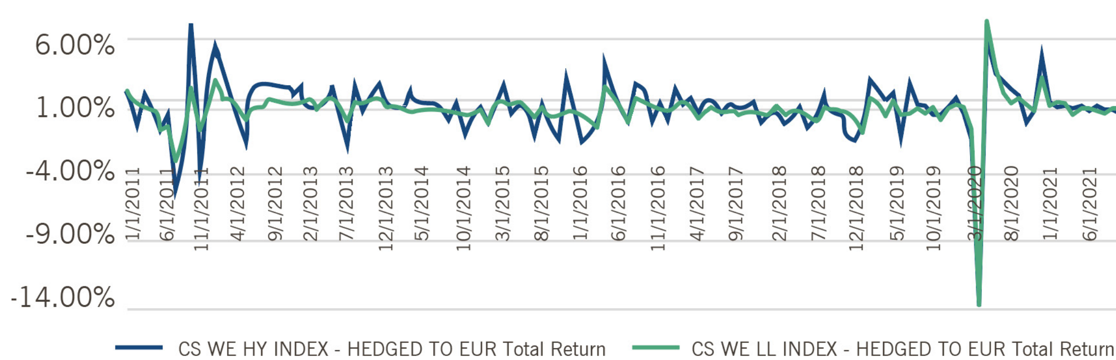
- Inflation is generally seen as a positive for leveraged loan markets given the floating rate nature of the market
- Current global inflows and demand in leveraged loan markets support the expected outperformance of the asset class
- However, current raw material and wage inflation, longer-term potential structural inflation and rate rises present potential credit risk headwinds
- Active management of portfolios away from higher risk sectors and issuers and a focus on more resilient large-cap issuers are expected to present strong mitigants to these credit risks
- We remain wary of potential wider credit market volatility from rate rises

Historically, periods of inflation have proved positive for leveraged loan relative returns. Inflation risks have traditionally been addressed through rate rises by central banks, which benefits leveraged loan returns given their floating rate nature and conversely is detrimental to fixed rate asset returns.

US LEVERAGED LOAN VS HY RETURNS



EUR LEVERAGED LOAN VS HY RETURNS



Given the benefits of rate rises on leveraged loans, the market is already seeing increases in demand for the asset class with the US market seeing $26 billion of retail and mutual funds inflows in the 9 months ended 30 September 2021 (conversely High Yield has seen $14.3 billion of outflows in the same period from retail funds[1]). Additionally, both US and European CLO new issuance markets are heading towards relative record issuance in bot markets, with the $130 billion of US CLO issuance YTD already exceeding the previous record of $129 billion in 2018 and the €26 billion of European CLO issuance YTD date expected to result in 2021 total issuance being greater than the €29.8 billion seen in 2019[2].

However, rising inflation has potential downsides to credit performance given increase in raw material input prices, energy costs and wages, potential inability or delays in passing on that inflation and longer terms impacts on demand.

We are currently of the view that the significant spike in raw material and energy inflation that we are seeing globally is driven by the short-term significant increases in demand due the COVID crisis recovery alongside structural issues caused by the pandemic. While there have clearly been some structural changes in the global employment base in certain territories following the pandemic, with older workers taking earlier retirement, some of the current wage inflation may subside as the ending of furlough schemes eventually normalize the wider employment market. Clearly, in certain specific markets, some of these impacts have been further exacerbated by wider pre-COVID issues such as Brexit for the UK. Furthermore, as the current inflationary conditions bite into consumer disposable income, we can expect that wage inflation may increase further.

In addition, current results, although showing the impact of significant raw material inflation, remain positive in most cases due to issuers lapping COVID impacted quarters. As such, we expect that the full impact of recent inflation may not be seen until Q4 2021 results are seen.

Although we believe that the current inflation may be a shorter-term phenomenon, and Central Banks seem to be taking a similar view given their current behavior, increased inflation even at a lower level than currently being seen seems to be a market expectation. As such, we should be expecting longer term rate increases as well as longer term continued inflation.

From an asset perspective, global large-cap leveraged loan markets are generally well positioned to continue to perform well in inflationary conditions. Assets across the market are generally sizeable with the ability to ride through the lag in pass through of inflation to customers and the benefit from professional Private Equity ownership.

Furthermore, global leveraged loan exposures to those markets where pass through is most difficult (Packaging/Forest Products and Containers, Retail, Food/Tobacco and Food and Drug) are relatively limited, making up 9.4% of US loan market and 14.5% of European market[3].

We believe that the most exposed issuers across all markets will be smaller issuers that are unable to pass through inflationary increases or where automatic pass through does not exist and the full risk of inflation sits with the issuer.

Rate increases, despite being beneficial for returns, also create additional risk from increased borrowing costs over the medium term which may lead to additional credit risk across markets. This would also tend to favor large-cap issuers over smaller cap issuers.

[1] Source: S&P LCD News, September 30, 2021
[2] Source: S&P LCD, as of September 30, 2021
[3] Source: Credit Suisse Leveraged Loan Index and Credit Suisse Western European Leveraged Loan Index as of September 30, 2021. Index weightings are combined for Packaging/Forest Products and Containers, Retail, Food and Drug and Food and Tobacco)

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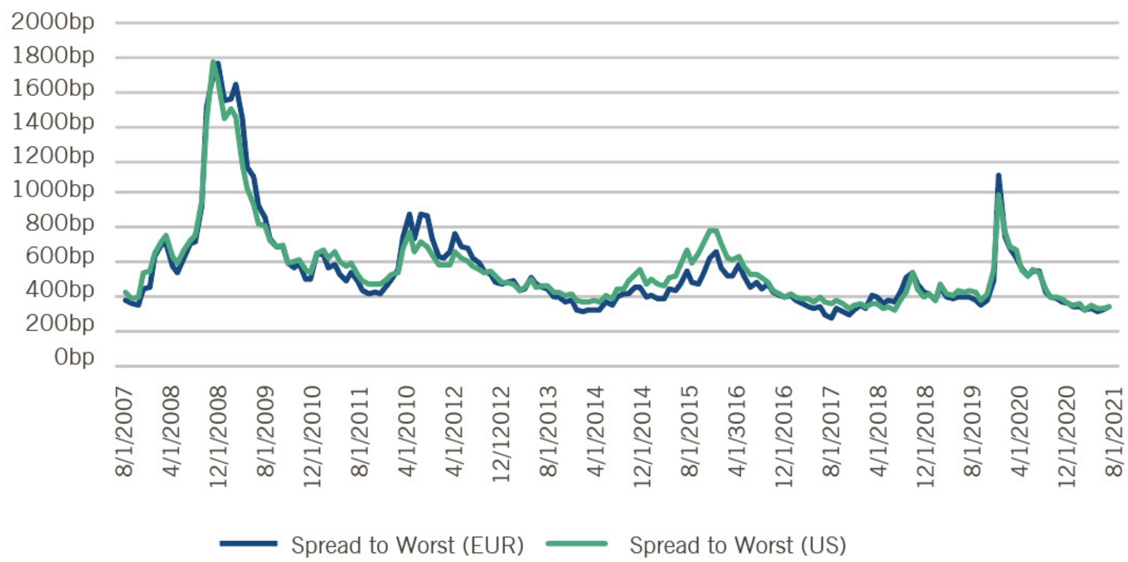
Finally, from a risk perspective, we are wary of the potential implications on wider credit markets from inflation and potential rate increases. Both US and European High Yield markets saw volatility in the quarter from a widening of longer-term rates. We expect short term volatility around rates to continue and additionally a longer-term risk to fixed income markets from a normalization of rates given the relative historical level of high yield spreads.

HISTORICAL HIGH YIELD SPREADS[4]



Whilst leveraged loans may be insulated from some of the volatility, we can expect some potential volatility in loans as a result of cross-asset investors looking to take advantage of relative return across asset classes.

Whilst we cannot fully mitigate the impact of inflation in our markets, we strongly believe that through careful portfolio construction, in particular, a focus on larger-cap issuers and avoidance of high inflation risk sectors, along with active portfolio management, we can position our leveraged loan portfolios to cope with inflationary impacts while benefitting from potential rate rises and the increase in demand for floating rate leveraged loans.

4 Credit Suisse High Yield Index and Credit Suisse Western European High Yield Index, as of September 30, 2021

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US MARKET - Q3 2021

KEY THEMES

- Credit fundamentals continue to improve
- Muted default backdrop expected for 2022
- Loan market technical remains robust
- Libor/SOFR transition remains in focus
- ESG is becoming more integrated into the market

Leveraged loans outperformed during Q3, returning 1.13% over the period[5], amid record breaking CLO issuance and weekly retail inflows into the asset class. Notably, Q3 saw $8 billion pour into loan funds versus $4 billion of outflows in the same period last year[6]. New CLO issuance in the quarter totalled $47 billion, including $19.2 billion issued in August, the highest monthly issuance on record[7]. Given the backdrop of persistently high inflation and interest rate volatility, loans continued to provide steady returns relative to other asset classes. Loans provided a +4.65% return YTD versus 4.83% for high yield bonds as of the end of Q3[8]. Since Treasury yields began to climb in mid-September, loans are outperforming high yield bonds by 119bps.[9]

Strength in credit markets has been resilient in the face of macro risks including tapering, Covid variants, labor and raw materials inflation pressure and Covid-induced supply chain disruptions. This reflects credit fundamentals that continue to improve as the post-Covid recovery has accelerated. Revenue and earnings are increasing, profit margins are near highs, leverage has declined and liquidity is strong.

In fact, this year's default volume is on pace to be the lightest since 2007 with US high yield and loan default rates YTD both under 1%. The universe of distressed loans (trading at or below $80) is ~1.5% of loans outstanding[10]. This is a low since 2014, which historically implies a twelve-month forward default rate well below average. Given the improvement in fundamentals, healthy balance sheets and low default backdrop, there has been a significant increase in the pace of corporate family ratings upgrades.

Capital markets remained readily accessible to borrowers in Q3 which gave them the ability to capitalize on historically low rates to reduce borrowing costs, increase liquidity and extend near term maturities. Issuance is at record levels with $157 billion of issuance in Q3, compared to $74 billion during the same period last year, bringing the 2021 YTD issuance to $488 billion[11]. Growth in loan market demand is keeping pace with the primary issuance calendar as CLO issuance volumes reached record levels. $130 billion of CLO new issuance YTD is already ahead of 2018's full year record of $129 billion[12]. Additionally, there has been 42 out of 43 consecutive weeks of retail inflows into bank debt funds[13], highlighting the strong demand for loans in a rising rate environment.

[5] Source: Credit Suisse Leveraged Loan Index, as of September 30, 2021
[6] Source: JP Morgan High-Yield and Leveraged Loan Morning Intelligence, October 6, 2021
[7] Source: S&P LCD, as of September 30, 2021
[8] Source: Credit Suisse Leveraged Loan Index and Credit Suisse High Yield Index, as of September 30, 2021
[9] Source: JP Morgan High-Yield and Leveraged Loan Morning Intelligence, November 2, 2021
[10] Source: S&P LCD, as of September 30, 2021
[11] Source: S&P LCD, as of September 30, 2021
[12] Source: S&P LCD, as of September 30, 2021
[13] Source: JP Morgan High-Yield and Leveraged Loan Morning Intelligence, November 5, 2021

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US MARKET OUTLOOK

On the heels of this year's record issuance, we expect another year of robust leveraged credit issuance in 2022 driven by M&A activity and borrowers managing the transition to SOFR. Credit spreads are near decade lows reflecting strong fundamentals, the benign outlook for defaults and strong demand for leveraged loans from CLO origination and retail bank loan funds. Given tight current valuations, we see risk skewed more towards modest widening in spreads, but we don't expect a significant pickup in default activity over the next 12-18 months despite looser credit conditions.

We believe the broader macro-economic risks, namely around inflation, supply chain disruption, Fed policy, interest rates, variants and Covid re-openings are well acknowledged by the market. While we are cognizant of the negative impact margin pressure could have on earnings, we believe the strong credit fundamentals discussed previously will insulate against broad based defaults. Therefore, we expect volatility to be created more by idiosyncratic credit risks. We expect 2022 will see more dispersion, making credit selection and sector positioning more critical for performance. We are focused on industries and individual credits with less degree of vulnerability to wage and input cost inflation, supply chain disruption, margin pressures and higher interest rates. We also are focused on credits that enjoy strong secular growth tailwinds and exhibit pricing power that can offset inflation pressures. As a result, some of the sectors that we currently favor include technology, life sciences, pharmaceutical services and government services. Opportunities to drive outperformance will be driven by a "front-footed" active trading and portfolio management approach focused on conserving principal while also finding opportunities for capturing total return and convexity.

2022 will be marked by the significant transition to the new SOFR benchmark for the leveraged loan and CLO markets. After year-end, banks are prohibited from issuing new Libor-linked loans. There have been a handful of SOFR-linked leveraged loans issued in Q4, and we expect this to pick up materially in Q1.

Finally, we expect ESG considerations to become more integrated into the credit markets in 2022. We believe investors will increasingly price in risks associated with clear ESG factors such as carbon emissions, controversial weapons, human rights and employee health and safety. In many cases, loan managers will be prohibited from making investments in such excluded issuers which will impact their access to liquidity and ability to address upcoming maturities.

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EUROPEAN MARKET - Q3 2021

KEY THEMES

- Credit fundamentals continue to improve
- Muted default backdrop expected for 2022
- Loan market technical remains robust
- New issue spreads remain strong despite high demand

Q3 2021 saw strong primary issuance in July 2021 which then faded into the traditional slowdown in primary issuance in both loans and high yield bonds over the summer period and a slower than expected pick up in new issuance in September (albeit the pace of issuance picked up significantly toward the end of the quarter and into Q4 2021). The quarter saw €25 billion of loan issuance and €20 billion of high yield issuance with loan volumes +50% and high yield volumes -9% on the equivalent period in 2020 but -40% and -50% down on Q2 2021 issuance respectively.[14]

While the relative level of issuance reduced, the level of demand for assets remained strong, with CLO issuance in the quarter totalling €10.5 billion.[15] Total issuance for 2021 is now forecasted to be circa €35-40 billion and will likely represent the record annual issuance (the record currently being €35 billion in 2006).

As a result, secondary markets firmed through the quarter, with the average price of the Credit Suisse Western European Leveraged Loan index ending the quarter at 98.89%, +15 bps up on the end of Q2 2021 (98.74%).[16]

Positively, despite the reduced level of issuance, the known pipeline of new deals for Q4 2021 helped maintain the favorable pricing seen in the market in Q2 2021. New issue term loan B spreads averaged 4.10% in the quarter, against 3.99% in Q2 2021 and 4.02% for the year to date.[17]

Credit risk in Europe continues to reduce, with the trailing twelve-month default rate for ending the quarter at 0.85%, having been 1.13% at the end of Q2 2021.[18]

Overall, European leveraged loans and high yield bonds posted positive returns in the quarter. European leveraged loans generated a return of +1.14% while European high yield bonds were similarly positive, generating a return of +0.99%.[19]

[14] Source: S&P LCD, as of September 30, 2021
[15] Source: S&P LCD, as of September 30, 2021
[16] Source: Credit Suisse Western European Leveraged Loan Index, as of September 30, 2021
[17] Source: Credit Suisse Western European Leveraged Loan Index, as of September 30, 2021
[18] Source: S&P European Leveraged Loan Index, as of September 30, 2021
[19] Credit Suisse Western European Leveraged Loan Index and Credit Suisse Western European High Yield Bond Index, as of September 30, 2021

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EUROPEAN MARKET OUTLOOK

As we look forward towards the end of 2021 and into 2022, European credit markets are set for a positive 2021 driven by increasing spreads and ultra-low default levels. Q4 primary issuance has been strong through the start of the quarter which has resulted in relatively high spreads continuing to be maintained. We expect that continued high CLO issuance alongside a reduction in primary issuance towards the end of the year will result in the secondary market firming into the end of the year and January 2022 until primary issuance picks up again in the new year.

From a credit risk perspective, our focus remains on the potential impact of inflation across the market. However, we expect the issuers we target within the European market to remain resilient in the face of inflationary headwinds given their relative size.

Overall, we expect 2022 to provide strong investment opportunities for our Funds. Given our strong market position, we are well placed to continue to benefit from the strong, well-priced primary issuance we have seen recently and to use this to rotate portfolios to increase yields.

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SUMMARY

Given the wider global inflationary outlook and expectations of short to medium term rate increases in the US, the UK and eventually the wider European area, we expect that, as we move into 2022, the demand for leveraged loans globally will remain high and the floating rate nature of our assets may provide a benefit to returns from any increase in rates. Clearly, the inflationary environment increases risks across credit markets but the size and resilience of the issuers in the Fund's core markets (Issuers with $100m+ EBITDA) should provide some mitigation to increased credit stress. In fact, notwithstanding the current level of global inflation, current default rates and projections point to a continuation of the current ultra-benign default conditions.

We currently expect that 2022 will provide a strong market environment for leveraged loans globally, with strong new primary issuance driven by global private equity sponsor dry powder, high investor demand for leveraged loan assets and a benign default environment.

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