

Press Release**AlbaCore Credit Market Update: 'A Fundamental Shift in Global Trade'****David Allen, Managing Partner and Chief Investment Officer, AlbaCore Capital Group**

London, 24 April 2025 - The themes in credit markets have been constant over the past year: strong technical demand, improving but still limited M&A volumes, and ever tightening spreads as markets seemed impervious to headlines. However, President Trump's April 2nd announcement of broad tariffs turned markets on their heads, spurring broad risk-off moves. Equity markets have borne the brunt of these moves, seeing their worst days since the height of the pandemic.

The tariff announcement triggered a fundamental shift in global trade, causing the markets to whipsaw as investors responded to a rapidly evolving news cycle vacillating between the potential for trade deals and escalating and retaliatory moves from China.

Credit markets have felt the market volatility, with European high yield bonds spreads widening from 357 to 468 basis points during the first week of April¹. While the sell-off has been broad based, autos and pro-cyclicals have found themselves the centre of short activity. Spreads in the European high yield bond and loan markets are currently still off their historical peaks of 700 – 1,000 bps during periods of recession, with the Global Financial Crisis as a notable exception which saw spreads reach over 2,000 bps². This uncertainty has caused outflows in European high yield bond funds and put a stop to the high levels of repricing activity in the loan market seen in Q1, and has the potential to slow more opportunistic issuance.

This has translated into significant moves in the European structured credit market. Earlier this year, CLO equity arbitrage looked its most attractive since 2018, as spreads on CLO debt tranches hit the 10th percentile. In the six weeks since, spreads across the debt tranches have moved out to the 70th percentile. Despite these developments, the market has seen liquidity remaining robust. **While there may be additional volatility on the horizon, at these levels CLO tranches begin to look attractive in our view.**

New issue Q1 2025 vintages of CLO equity are well placed to take advantage of the current volatility. Having locked in liabilities at tight spreads, these CLOs are able to ramp their portfolios into high quality loans trading at discount to par. **CLOs issued just prior to periods of market dislocation have historically seen some of the highest returns for CLO equity holders**, with 2020 and 2022 vintages serving as recent examples.

Should prolonged uncertainty prevail, negative returns may lead to broader outflows across European credit markets, with forced selling leading to falling asset prices which trigger further outflows. This may be further exacerbated by interest rates. While rates typically tighten during crisis periods driven by a flight to quality, this has not been the case this month as US Treasuries role as a historical safe haven has been called into question by the Trump administration's policy shifts.

¹ Source: Bloomberg Pan-European High Yield Index as of 8th April 2025.

² Source: Bloomberg Pan-European High Yield Index as of 8th April 2025.

Positioning to capitalise on a potential dislocation

While we are not yet experiencing a broad dislocation in European credit, the current uncertainty begs reflection upon lessons learned during previous periods of market volatility. The past few decades have seen multiple periods of dislocation, from the Global Financial Crisis through to the inflationary spike following Russia's invasion of Ukraine. In moments of uncertainty, liquid credit markets tend to overreact, with spreads implying defaults far in excess of what has played out. While it is impossible to perfectly time the market, having the structures, processes and tool kit established in advance allows the opportunity to capitalise on volatility. To do so effectively requires an understanding of how the market has historically behaved:

Phase 1: The immediate sell-off

When the risk-off sentiment takes hold, investors often sell high-quality assets en masse to raise liquidity. These credits benefit from higher cash prices in periods of uncertainty and offer the greatest liquidity, whereas moving on from higher risk assets can be challenging. This means that the relative spread moves can be greater on the best quality names versus higher risk instruments – which is what is playing out in today's CLO market. While all tranches have traded wider, AAA notes have seen the largest relative move and appear to be the cheapest part of the capital structure. In contrast, sub-investment grade tranches have seen relatively smaller moves despite being more exposed to underlying European corporate credit risk.

The period when high quality assets are disproportionately inexpensive is often short lived and requires the ability to act quickly. As an established CLO manager, with coverage across European issuers, we have the infrastructure to quickly identify high quality names most resilient to macroeconomic uncertainty and deploy capital at scale accordingly. **Having an appropriate fund structure with pre-committed or locked up capital allows well positioned managers to step into the void** while others must spend time raising liquidity and selling assets to meet redemptions.

Phase 2: Rationalisation

Following the initial sell off, markets then begin to rationalise. The high-quality assets that were initially disproportionately sold-off begin to normalise. At this time relative value can shift frequently with technical dynamics differing radically across the market. Active management allows investors to effectively recycle capital into positions offering better relative value, but it requires discipline. Experience investing across the differing segments of the market is particularly helpful, affording options from rotating down through the various rating tranches of CLO debt to exploiting relative value between the high yield bond and loan market.

Phase 3: Bifurcation

In any dislocation, some sectors will experience more fundamental challenges, with winners and losers emerging. The capital structure, liquidity profile and level of sponsor support that an issuer benefits from will also influence the degree of flexibility they have to manage through challenging trading conditions. Identifying these more resilient issuers requires deep fundamental analysis and appreciation of a company's operations. We believe having a dedicated team of sector specialist credit analysts dedicated to covering European corporates allows us to better select the issuers who are set to outperform and avoid lenders most at risk of default.

Phase 4: Bank Derisking

Underwriting and syndicating a position in the public credit markets typically involves a longer lead time, which can expose banks to risk if market volatility arises during this period. In these situations, banks seek to de-risk their trading book and positions they underwrote prior to the challenging market conditions that have yet to syndicate. **Investors who have strong relationships with syndicating banks and an established capital solutions platform may be afforded opportunities to invest in these hung syndications.** These situations allow investors to invest in high quality issuers at attractive discounts to par. Selectivity is crucial though, as it is important to determine if a failed syndication is the byproduct of unfortunate timing for the borrower or of fundamental issues with the credit.

Direct lending presents opportunities in times of uncertainty

In a market defined by uncertainty, we believe senior direct lending, if executed carefully, may serve as a safe haven for investors offering downside protections, contractual income and defensive exposures. Being senior and secured places lenders at the top of the capital structure. Coupled with strong documentary protections, this provides strong downside protections in the event of weaker company performance. With returns driven primarily by contractual coupon income, investors need not rely upon capital appreciation to generate returns.

While the impact of tariffs will likely be broad reaching, the sectors which comprise the majority of the European direct lending market, including software, businesses services and healthcare, appear relatively protected due to the service-oriented nature of their businesses. **We also see opportunities from companies benefiting from long term structural growth, while we look to avoid pro-cyclical businesses which are more directly reliant on economic growth.**

In addition to its more defensive positioning, direct lending stands to benefit from rising volatility in the public credit markets. Although the current uncertainty may weigh on overall M&A activity volumes, for transactions that do proceed, the value of private credit's certainty of execution is a significant advantage private lenders can offer. **During periods of volatility, European public credit markets often remain accessible only to the strongest issuers, while direct lending has consistently proven to be a dependable source of capital for both sponsors and businesses.** We believe it will continue to be a natural financing solution for both new M&A and refinancing activity, presenting a strong pipeline of opportunities to deploy capital into well-positioned businesses at attractive spreads in the months ahead.

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



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, direct lending, 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 \$10.0 billion in AuM³ as of 31 March 2025 on behalf of global pension funds, sovereign wealth funds, endowments, insurance companies, family offices and high net worths around the world.

For more information, visit www.AlbaCoreCapitalGroup.com

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³ 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.