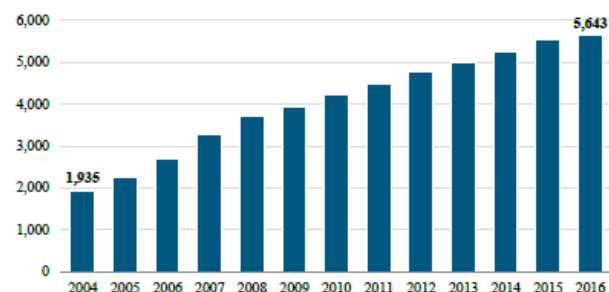


DIRECT LENDING – A GROWING ASSET CLASS

Investment Insight | Series II

In a series of articles we discuss and present investment opportunities we actively use in our building blocks to form our absolute return portfolios. We have started the series with structured credit in September and continue with “Series II” about direct lending, which we believe will take an even more important role for institutional investors going forward. As long as interest rate levels in developed countries remain at historical depressed levels the asset class offers an outstanding risk/reward ratio as compared to traditional “safe haven” assets. **Direct or private loans give access to attractive and stable yield income at the expense to lock up the capital for in average 5-8 years.**

Chart 1: Middle market companies owned by PE firms



Source: S&P / Angelo Gordon

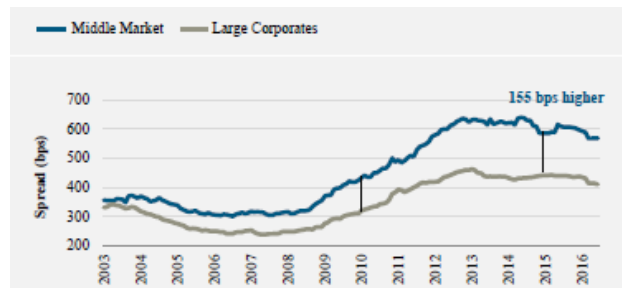
Direct lending – An attractive alternative

In a world of historical low interest rates and (very) high debt burdens combined with an economic outlook that foresees only moderate global GDP growth, it is a fair assumption that structural inflation pressure should remain tame – at the minimum for the next few years to come. Moreover, central banks responded to the lackluster economic growth with the introduction of new creative measures and actions to push key rates in some cases to the lowest levels ever. Even when we anticipate that the FED will soon start to normalize its interest rate policy and lift the yield curve, the income generation

from “safe” bonds such as high quality investment grade or US Treasuries bonds will remain meagre. The situation gets even worse when we turn to European or Japanese bonds, earning in many instances negative yields. In this environment, private debt appears like a “yield island” offering an average yield of 7-8% p.a. for senior secured loans of well backed small and medium sized companies (middle market). This alternative investment opportunity gained popularity and has attracted an increasing number of institutional investors.

Chart 1 on the left hand gives an example to demonstrate the rapidly growing number of small and medium sized companies (SME’s) tapping the private market for their borrowing needs. **Non-bank lenders are increasingly an alternative to the traditional bank lending as the regulatory burden for commercial banks has steadily increased since the financial crisis.** Chart 2 below illustrates well that investors can ask for an incremental yield for smaller loans as compared to the large syndicated loan market. The additional loan spread between SME’s and large corporate loans from 2010 to 2015 was 155 bps higher.

Chart 2: Average yield for middle market loans



Source: S&P Capital IQ LCD / Angelo Gordon

Positive supply demand dynamics

Banks are incentivized to reduce their balance sheets because of the new regulatory environment

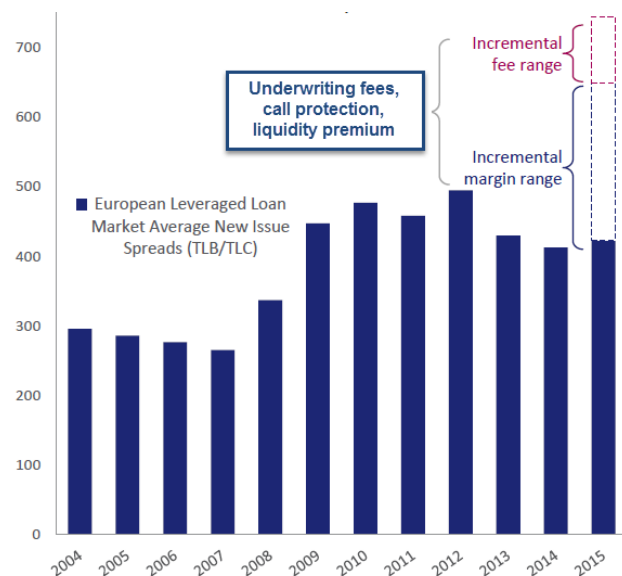
post the financial crisis. It is in many instances not any more efficient for them to hold exposure to SME's as the required capital costs by the regulator are too high. This leaves increasingly room for alternative lenders to step in and provide the lending.

While the private lending market is already established in the U.S. it is a relatively new market in Europe, which got a boost over the last 24 months. While some SME's are too small to tap the syndicated market and feel forced to enter the private lending market, the larger middle market companies like the speed, sophistication and flexibility of alternative lenders and are therefore willing to pay a premium versus the traditional market.

Attractive yields

The nature of deals structured has led in the past to high absolute and relative returns. Importantly, not only are the private lenders able to ask for a higher yield compensation (see chart 2), but they are also able to negotiate for "upfront fees" and call protection, what helps to increase the total target return for an investor as it is documented in chart 3.

Chart 3: Incremental fees enhance the target return



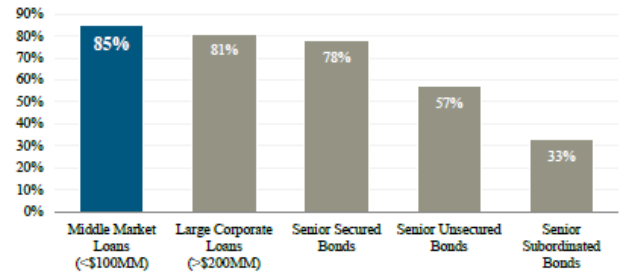
Source: S&P Capital IQ LCD / Bluebay / Alpinum Investment Management

Lower loss rates lead to lower risk profile

Historical analysis shows that experienced private debt lenders suffer lower default- & loss rates as compared to the "public" syndicated market. On average, **directly originated middle market senior**

secured debt offers not only a higher yield, but has on average also a lower leverage employed than large corporate syndicated loans, what leads to higher recovery rates (see chart 4 below).

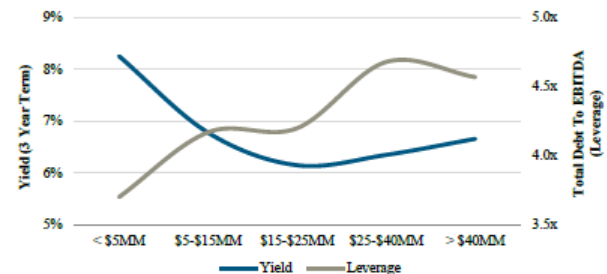
Chart 4: Average historical Recovery Rates



Source: S&P / Angelo Gordon

Chart 5 below illustrates well the fact that smaller credits are on average more conservatively financed. More equity within the capital structure does not only lead to **lower leverage ratios**, but also to **lower loss rates** (combination of low default rates & high recovery rates).

Chart 5: Middle market loans are more conservative



Source: Thomson Reuters / Angelo Gordont

Diversification and experience matters

Private debt as an asset class is growing rapidly and accounts today for **more than 2'000 funds** with an aggregate value of more than USD 140 bn. We have already been successfully investing in illiquid credit for many years and have also exposure in direct lending funds. Besides experience and superior selection skills of the funds' management teams, **portfolio diversification** is an absolute necessity in running a successful long term private loan portfolio. A **diligent underwriting process** with **strong covenants** in the documentation and an **effective loan monitoring process** are other key success factors.



Disclaimer

This document does not constitute an offer to anyone, or a solicitation by anyone, to make any investments in securities. Such offer will only be made by means of a personal, confidential memorandum. This document is for the intended recipient only and may not be transmitted or distributed to third parties

Past performance is not a guide to future performance and may not be repeated. You should remember that the value of investments can go down as well as up and is not guaranteed. The actual performance realized by any given investor depends on, amongst other things, the currency fluctuations, the investment strategy invested into and the classes of interests subscribed for the period during which such interests are held. Emerging markets refer to the markets in countries that possess one or more characteristics such as certain degrees of political instability, relative unpredictability in financial markets and economic growth patterns, a financial market that is still at the development stage, or a weak economy. Respective investments may carry enhanced risks and should only be considered by sophisticated investors.

Nothing contained in this document constitutes financial, legal, tax, investment or other advice, nor should any investment or any other decisions be made solely based on this document. Although all information and opinions expressed in this document were obtained from sources believed to be reliable and in good faith, no representation or warranty, express or implied, is made as to its accuracy or completeness and no liability is accepted for any direct or indirect damages resulting from or arising out of the use of this information. All information as well as any prices indicated is subject to change without notice. Any information on asset classes, asset allocations and investment instruments is only indicative. Before entering into any transaction, investors should consider the suitability of the transaction to their own individual circumstances and objectives. We strongly suggest that you consult your independent advisors in relation to any legal,

tax, accounting and regulatory issues before making any investments.

This publication may contain information obtained from third parties, including but not limited to rating agencies such as Standard & Poor's, Moody's and Fitch. Reproduction and distribution of third-party content in any form is prohibited except with the prior written permission of the related third party. Alpinum Investment Management AG and the third-party providers do not guarantee the accuracy, completeness, timeliness or availability of any information, including ratings, and will not be responsible for any errors or omissions (negligent or otherwise), or for the results obtained from the use of such content. Third-party data are owned by the applicable third parties and are provided for your internal use only. Such data may not be reproduced or re-disseminated and may not be used to create any financial instruments or products, or any indices. Such data are provided without any warranties of any kind.

If you have any enquiries concerning the document please contact your Alpinum Investment Management AG contact for further information. The document is not directed to any person in any jurisdiction which is prohibited by law to access such information. All information is subject to copyright with all rights reserved. Any communication with Alpinum Investment Management AG may be recorded.

Alpinum Investment Management AG is incorporated in Switzerland and is FINMA licensed and regulated.

Contact Information:

Alpinum Investment Management AG
Talstrasse 82
CH-8001 Zurich
Tel: +41 43 888 79 30
Fax: +41 43 888 79 31
alpinumim.com