# East Lodge Capital Credit Opportunities Fund

East Lodge Capital Partners LLP ("ELC") is a London based investment management firm founded by Alistair Lumsden in August 2013. The East Lodge Capital Credit Opportunities Fund ("The Fund") is focused on opportunities across the global structured finance and direct lending markets, with a particular focus on investments in the European space.

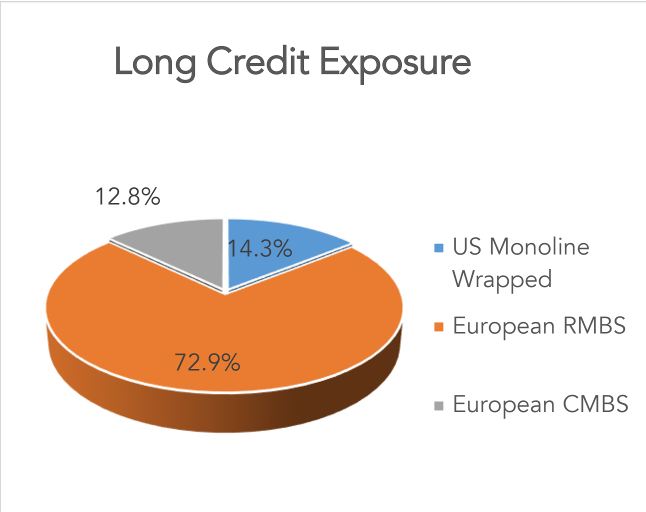
## Performance Summary[1]

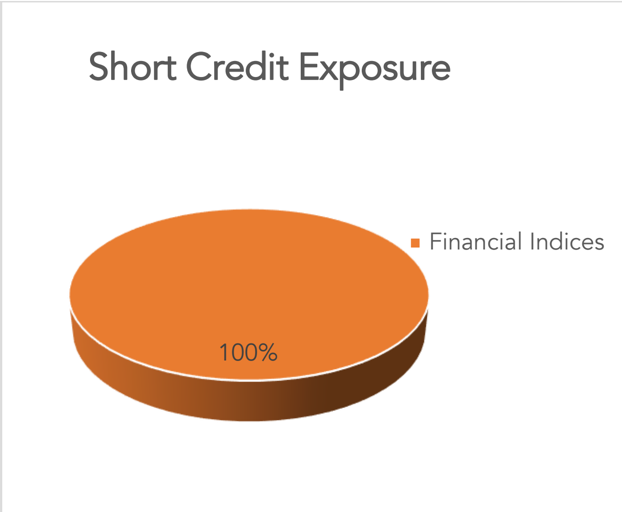
| MTD Return – April 2014 | 2014 YTD Return |
|---|---|
| 4.27% | 4.27% |

## Assets Under Management

| Fund AUM as of 1 April 2014 | Firm AUM as of 1 April 2014 |
|---|---|
| $10.55 mn | $10.55 mn |

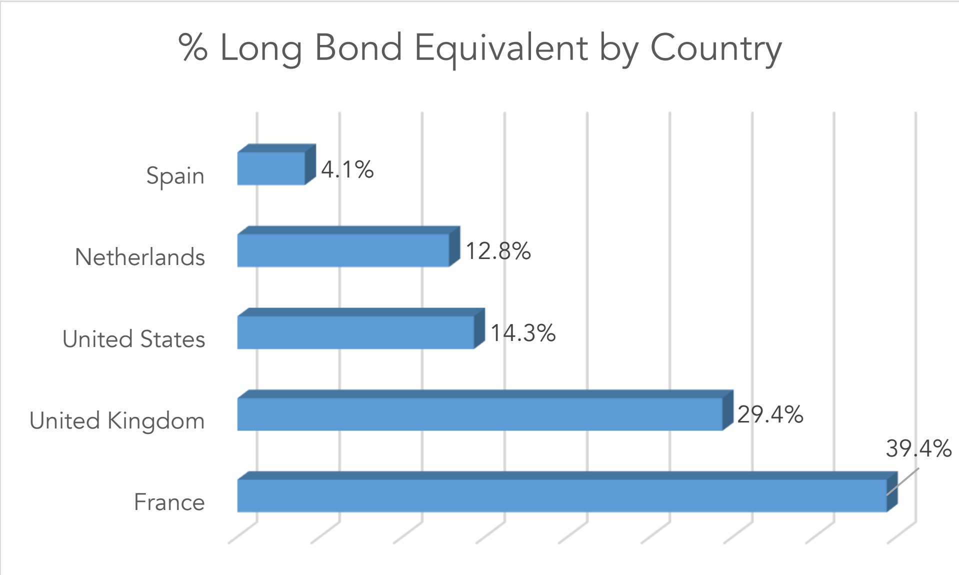
## Portfolio Summary as of 30th April 2014

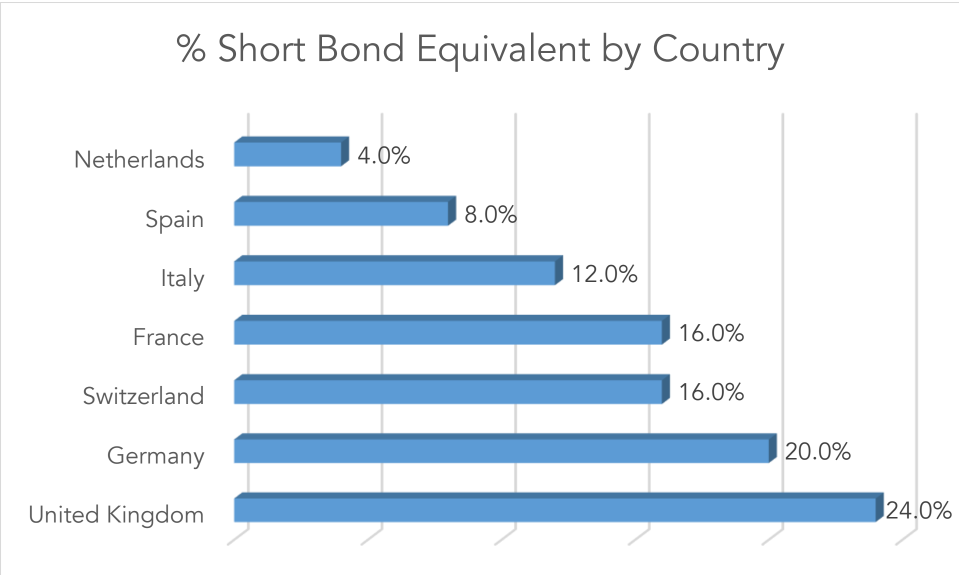



1Performance shown is that of the Offshore Fund and is unaudited and reflects the capping of certain Fund expenses by the investment manager. In addition, as only principal capital was invested in the Fund during the month of April 2014, no management or performance fees were charged (which fees, had they been charged, would have had the effect of reducing the returns shown).

## Country Analysis as of 30th April 2014



# Commentary

We are very pleased to provide you with the first East Lodge Capital Investor Letter, and we look forward to a long and healthy relationship with our investors in the years to come. We are planning to provide risk and performance data on a monthly basis, accompanied by a brief commentary highlighting what took place during the month and any additional useful information. A more detailed quarterly letter will also be produced to provide investors with a more in-depth overview of the strategy, fund investments over the quarter, and the views of ELC's investment team. For our first few months, we will be providing you with a more detailed monthly letter (in the format of the quarterly letter) to keep investors well-informed during our initial stages of capital deployment.

In April, we added Rob Riley to our Portfolio Management team. We are now at full strength, having added Rob as a fourth portfolio manager, three of whom focus specifically on the European space.

We saw several interesting opportunities during the month, in particular in the areas of Spanish SME, French non-conforming and European CMBS. This is reflected in our first month's performance of net +4.27%. Approximately 77% of this gain was realised through a careful evaluation of market dynamics and a decision to pare down some of our positions due to strong price appreciation.

We expect it will take us several months to reach our medium-term allocation targets for the portfolio, however we will aim to give guidance on the assets to which we are seeking to allocate until such time that the fund is fully invested and we have reached our targets.

During April, we identified more opportunities in the European RMBS space relative to some of our other areas of focus. We also traded into, and subsequently out of, a Spanish SME deal, the sale of which led to a higher concentration of European RMBS in the portfolio. It is likely to take more time to build the Fund's exposure to European CMBS due to the level of detail required to analyse each underlying property, and the more limited supply of investable opportunities. We continue to work on some very interesting potential investments for the side pocket. In particular, we have evaluated a UK regional office development, looking to partner with a highly respected property fund in what we believe is a very compelling metropolitan submarket. The investment team is concentrating on proactively working with a limited number of counterparties to best identify and partner up on selective real estate lending opportunities, primarily at the mezzanine level where the risk/return profile is the most attractive at this time.

### The ECB Report

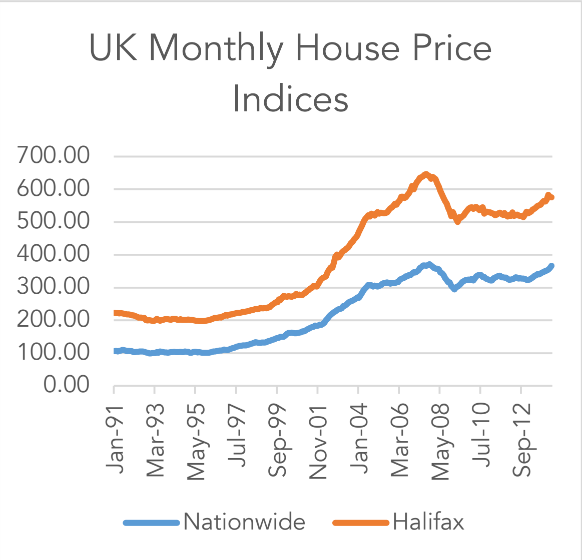
The ECB and the Bank of England released a paper on 27th March 2014 discussing the European Securitisation Market. The paper refers to an S&P report which showed that the cumulative default rate of European Securitised Product had been measured since the start of the crisis to be 1.5%, compared to an aggregate US default rate of 18.4%. The paper discusses European ABS in a very constructive way, and outlines ways to reopen the market. The full report can be found at the ECB website at: http://www.ecb.europa.eu/pub/pdf/other/ecb-boe_impaired_eu_securitisation_marketen.pdf.

## European Markets

### UK

The UK housing market has been the subject of many column inches in the press of late. It is hard to escape the news flow in the UK that house prices are on an upward path, or indeed are in bubble territory. The reality, as is often the case, is more nuanced. If you compare the two prominent house price indices from Halifax and Nationwide (based on their own mortgage lending, thus excluding parts of the market and specifically excluding any 'all cash' transactions) you will see that Halifax has prices well below peak, whilst Nationwide has prices close to flat. Unsurprisingly, both indices show London as the best performing region in Q1 2014.

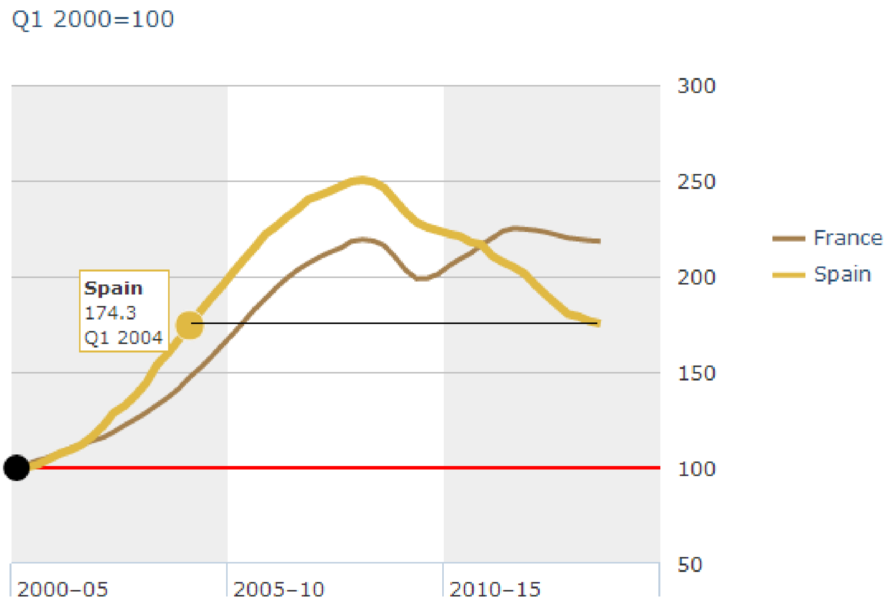
| Apr-14 | Halifax | Nationwide |
|---|---|---|
| Annual Change | 8.50% | 10.90% |
| Quarterly Change | 2.30% | 2.50% |
| Month Change | -0.20% | 1.20% |
| | | |
| Average Price | 177,648 | 183,577 |
| From Peak: | -11.00% | -1.33% |
| | | |
| Q1 2014 | | |
| Best Performing Region | London (+1.48%) | London (+5.07%) |
| Worst Performing Region | Scotland (-2.18%) | Yorkshire (-0.65%) |




The talk of pricing bubbles is supported by the recently published Office for Budget Responsibility report which expects annual price inflation to peak at more than 9% later this year with prices rising by c.30% by 2018-19. This has led to much discussion on the Help-to-Buy scheme (see https://www.gov.uk/affordable-home-ownership-schemes for a full explanation of the scheme) and whether it is helping inflate London property prices. According to the Help-to-Buy equity loan statistics through 31-Mar-14 published this month, only 6.8% of loans were to London regions whereas 87.5% were to First Time Buyers suggesting the scheme is indeed helping the market segments it is targeting rather than fuelling rises in prime London real estate that is already in great demand. Statistics on the wrapped mortgage element of Help-To-Buy scheme will be out towards the end of May.

On the rental side, LSL Property Services reports that UK Rent rises total 12.9% since January 2010 which is less than cumulative inflation of 14.5% over the same period, however in absolute terms rents stand at £741 per month vs £736 as of April 2013. The fact that Buy-to-Let finance/property is still in such demand despite rents not keeping pace with inflation suggests the consensus is firmly for further property price appreciation.

In terms of the RMBS market, there remains opportunity to pick up seasoned mortgage product with a greater propensity to be able to refinance (e.g. higher coupon, principal paying, low LTV loans) at spreads flat to pools that are much less robust (e.g. those which are predominately low coupon, IO and self-certified). Given the discounts to par available and the market implied path in UK interest rates, we believe exposure to this spread duration provides an opportunity to benefit as assumptions change.




*Source: The Economist

France

France is a market that has been quiet from an ABS perspective with only a handful of deals in the market. This comes in part from a penchant to use covered bonds to fund residential mortgages – for example, Crédit Foncier are one of the largest covered bond issuers (€7-10bn pa). However, the market is expecting at least one sizeable full capital structure deal to come to market in H1 2014 which led to some interest in the residential mortgage space. We found an unusual opportunity in RMBS from a bank disposing of a previously retained legacy issuance. This allowed us to purchase low LTV (53.3%) mortgages in a securitised format at attractive spreads with plenty of positive optionality.

In terms of housing market performance, HPA to the end of 2013 was a small negative (-1.4%) with expectation in 2014 to see a similar negative drift downwards (-1 to -3% estimated). The visibility of house prices in the French market is much more transparent given transactions have to be placed via a notary, and pricing is based on price per square metre. This, combined with the full recourse nature of these loans - that is actively pursued - and the laws in place to ensure lower Debt-to-Income multiples (must be below 35%), leads to a robust market.

## Spain

The Spanish economy grew at the fastest rate since 2008 in Q1 2014, although retail sales dropped 0.5% and unemployment ticked up to 25.9% (youth unemployment remained static at 53.9%). As seen in the chart above, house prices are back to levels last seen in Q1 2004. Mortgage credit availability remains tight, although more new products are starting to emerge. It will be a long time before transaction volumes return to their pre-crisis norms, however, April did see a 22.5% jump in Spanish house transactions on a YoY basis, albeit off a very low base.

The ABS market continued to see good demand in clean/ tight/ on-the-run names from the 'real money' community rebalancing/building their exposure to the sector which has provided an anchor to spread and has left more optically distressed seniors looking attractive here, especially where the structural support to the cashflows is strong. Outside of the RMBS space, the news flow around ECB QE and ECB support for SME markets combined to help re-price the credit risk of junior mezzanine SME bonds tighter in a short space of time.

## CMBS

April was a particularly active month within the European CMBS market with quarterly interest payment dates. Prepayments continue to be a strong theme across the sector either through sales of assets on defaulted loans or through voluntary prepayments. The number of loans failing to repay at stated maturity continues to increase, mainly due to valuation declines leading to increased leverage levels.

The commercial property markets throughout Europe continue to stabilise, and there have been several signs of a pick-up in activity. Sales of assets on loans in default are increasing and this uptick in activity is leading, in some circumstances, to revised valuations to the upside. That said, the importance of conducting detailed analysis continues to be demonstrated by headline shocks where assets have been sold at levels often well below recent valuations, or where recently undertaken valuations have come in at substantial discounts to those carried out only 12 months earlier.

During the month, we added exposure to German shopping centres and Dutch offices; investment activity within these sectors is improving. The specific German assets we analysed are experiencing strong demand from a range of institutional buyers. We are also seeing a number of lenders refocusing on this space.

The Dutch office market has gone through a period of extreme stress. Office vacancy levels have historically been high (13% in 2007, increasing to 16% in 2013) leading to a significant downward revision of valuations. Given this asset price volatility, CMBS investors have recently shied away from this jurisdiction and asset class. That said, vacancy levels have recently stabilised, and there has been limited new development activity. Despite these supportive technicals, investors have been able to buy assets at high-teen cap rates. Given the compression in yields we have seen in other European jurisdictions, it has meant that more distressed buyers have looked to this market for value. This is now resulting in greater sales activity in the Dutch office market and cap rates are beginning to move tighter, significantly supporting CMBS outcomes.

## US

We continue to see strong technical support for mortgage cashflows across the non-agency space. House prices continued to rise, albeit at a declining rate. The Corelogic year over year (YOY) index in March was 11.1% but the monthly increase was just 0.5% (partially due to seasonality). We think YOY numbers will continue to moderate as stronger numbers from mid-2013 roll off. The expectation for 2014 annualised house price appreciation (HPA) is 7%.

Several servicers have reduced their use and extent of principal modifications. Possibly from changes to its NPV valuation process, Ocwen has reduced the share of principal modifications and the average reduction has dropped. Countrywide deals, which experienced aggressive principal modifications recently, have seen a decline in the share of principal modifications. Possibly due to a shift in servicing to Nationstar, these declined in BOA/Nationstar serviced deals as well. The Servicer advance percentage continues to fall on a number of deals, but much of this is concentrated in recently transferred servicing to Nationstar and Ocwen. As a result, Nationstar serviced deals continue to experience cashflow interruptions. Default rates are continuing to trend lower, and on a deal-specific basis we are also finding prepayment speeds picking up, particularly in deals that are experiencing improving HPA metrics.

April also saw the OCI propose an increased cash payout for AMBAC on outstanding claims relating to the segregated account. The proposal to the court is that the cash element of unpaid historic and current claims should be increased from 25% to 45%. Our current monoline exposure is exclusively to AMBAC wrapped collateral, so this led to strong price movement on this position.

FHFA Director Watt said he does not "think it's the FHFA's role to contract the footprint of Fannie and Freddie" and that Congress needs to act to determine the companies' futures. He has taken steps to focus FNMA and FHLMC on helping troubled borrowers and supporting the housing market. In a change in direction from former Director DeMarco, the FHFA removed targets to reduce the footprint of the two. They also kept current limits on the size of loans. In addition, he loosened buy-back rules which forced banks to repurchase bad loans, and he wants public input before increasing guarantee fees. Watt said the objective was to "ensure that there is broad liquidity in the housing finance market and to do so in a way that is safe and sound". In order to limit the risk of the two companies, the FHFA will push for additional risk sharing transactions in order to bring more private capital into the mortgage market.

## Financials

In financials, April was focussed on clean balance sheets, asset quality and the capital required following CCAR (Comprehensive Capital Analysis and Review) and in Europe as we follow the progress of AQR (Asset Quality Review), the ECB Stress test and move slowly towards fully loaded CRD4 (Capital Requirements Directive). The European Banking Authority (EBA) published its adverse stress scenarios at the end of the month as did the Bank of England. The EBA scenario is more severe than past scenarios and went some way to allaying previous criticism with respect to the treatment of sovereign bonds, but drew some criticism for being too focussed on past issues and not future ones such as the potential for deflation. In tandem, the banks continued to issue CoCo AT1s apace, the subordinated debt of choice, which were invariably oversubscribed. These instruments are the most subordinated debt possible and feature conversion to equity or write-down at the point when a bank's capital is eroded below defined trigger levels. Whilst it is not a homogeneous market, we generally don't share investor enthusiasm at c.6% for what is effectively tax efficient equity for the banks; the bonds are perpetual, fully deferrable and can also be bailed-in whenever a regulator deems it appropriate.

Earnings season got underway in Europe and the US. Across both regions core earnings for financials generally underperformed, particularly with Fixed Income Currency and Commodities (FICC) of which much narrative has been seen along with pronouncements of restructuring and reductions. That said, non-core units continue to shrink fairly successfully, asset quality improves and impairment formation slows. We are also seeing less restructuring and disposal items than for 2013 in the income statement and cost reduction programs are maturing with mixed results. Consequently, year-on-year comparisons and headline announcements of large percentage changes give a somewhat simplistic picture. For example, in Spain there were comparisons to Q1 13 which contained the mandatory real estate developer provisioning. Another example is Caixa's bottom line profit down 54% partially as a result of a €2.2bn gain on disposal in the prior year. At first look Caixa's revenues seemed on a positive trajectory at 4.3% up on Q1 13, yet really the only income lines that were up were gains on financials due to the sale of a stake on Bolsas y Mercados and AFS securities; Caixa is not alone. The real challenge is to achieve core revenue growth particularly if target RoEs are to be met, e.g. Deutsche's stated 12% by 2015. For the investment banks this is key as they continue to be dogged by large "recurring one-off items". BNP's results contained the statement that "fines could be far in excess of provisions" in regard to the criminal investigation into payments to US sanctioned countries. Similar concerns surround others as rumblings continue on US tax evasion, FX and gold fixing and look to be ongoing features over the medium term. Net interest income in Spain and Italy were underpinned by reduced cost of funds offsetting lower interest revenues as a result of lacklustre lending volumes. All in all, the tight spreads and market direction seemed overly predicated on positive data coming to fruition and reliant on Mr Draghi's assurances of "whatever it takes". We think there is a reasonable chance of expectations being disappointed and have been positioning ourselves accordingly, to scale into short positions that will benefit from general widening in the sector. We have also been looking at names that we feel are particularly vulnerable for some of the specific reasons discussed herein as well as those that are exposed to geopolitical tensions.

## Gross Return Attribution by Strategy

| Strategy | Attribution (%) | LCE (%) |
|---|---|---|
| US Monoline Wrapped | 0.91% | 14.3% |
| Other Structured Finance | 2.77% | 0.0%[2] |
| European RMBS | 0.86% | 72.9% |
| European CMBS | 0.17% | 12.8% |
| **Total Return (%)** | **4.72%[3]** | **100.0%** |

## Stress Tests

| Stress Test | Result % NAV |
|---|---|
| Equities -10% | 0 |
| Equities +10% | 0 |
| Corporate Credit Spreads -25% | -0.5% |
| Corporate Credit Spreads +25% | 0.5% |
| Equity Volatility –5 pts | 0 |
| Equity Volatility +5 pts | 0 |
| FX -10% | -0.3% |
| FX +10% | 0.3% |

## Estimated Liquidity

| Category | % LCE |
|---|---|
| < 30 Days | 14.3% |
| 30-60 Days | 85.7% |
| >60 Days | 0.0% |

## ASC 820

| Category | LCE (%) |
|---|---|
| Level 1 | 0.0% |
| Level 2 | 100.0% |
| Level 3 | 0.0% |

2 Position sold prior to month-end

3 Gross return used for attribution purposes

## VAR

| | |
|---|---|
| VaR (1 Day 95%) (% of NAV) | 0.7% |

| Long Equity Delta | Short Equity Delta |
|---|---|
| 0 | 0 |

## Fund Terms

| | |
|---|---|
| Minimum Investment ($mn) | 1 |
| High Water Mark | Yes |
| Side Pocket | Optional (subject to 20% limit) |
| Redemptions | Quarterly |
| Redemption Notice | 90 days prior written notice (subject to a 4% penalty if made within first 12 months following initial investment) |

| | |
|---|---|
| Gate | 25% (Investor-level) |
| Prime Brokers | Bank of America Merrill Lynch<br>Barclays Bank Plc |
| Administrator | Wells Fargo Global Fund Services LLC |
| Auditor | EY |
| US/UK Legal Counsel | Schulte, Roth & Zabel International LLP |
| Cayman Legal Counsel | Mourant Ozannes |

## Contacts

| | | |
|---|---|---|
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## Fund Net Performance

Performance shown is that of the Offshore Fund and is unaudited and reflects the capping of certain Fund expenses by the investment manager. In addition, as only principal capital was invested in the Fund during the month of April 2014, no management or performance fees were charged (which fees, had they been charged, would have had the effect of reducing the returns shown). Due to the relatively small size of the Fund, the Fund had a higher concentration of positions than should otherwise be expected once the Fund fully invests third party capital.

## Portfolio Statistics

Unless otherwise noted, all portfolio statistical information shown is for the Master Fund and is calculated by ELC and is unaudited. Portfolio information is as of the date shown; the actual portfolio may vary, sometimes materially, from that shown.

- Long Credit Exposure: Calculates asset class exposure as a percentage of total long credit exposure.
- Country Analysis: Calculates country of risk for each long credit asset as a percentage of total long credit exposure; where a security has more than one country of risk, the largest country of risk for that security is used.
- Return Attribution by Strategy: Calculates an estimate of the return attribution of the various assets classes based on gross performance.
- Estimated Liquidity Profile: reflects the liquidity profile of the long credit portfolio using the following methodology:
    - < 30 days Senior tranches
    - 30-60 days Large exposures >$50m, 2nd lien senior bonds, mezzanine ABS
    - 60-90 days Residuals, CLO tranches rated below BBB
- ASC 820 classifications are unaudited and are estimates assigned solely by ELC. ELC makes no representation as to the accuracy of such classifications.
- Stress tests are calculated by ELC and reflect estimated impacts due to changes in FX rates and corporate credit spreads as specified.
- VaR is calculated by ELC using simulations based on historical portfolio price information.

## Legal Disclaimer

This document contains general information on East Lodge Capital Credit Opportunities Fund Ltd. (the "Offshore Fund") and East Lodge Capital Credit Opportunities Fund LP (the "Domestic Fund", each a "Fund", and together with the Domestic Fund, the "Funds") which are managed by East Lodge Capital Partners LLP ("ELC").

Each Fund invests substantially all of its assets in the East Lodge Capital Credit Opportunities Master Fund, Ltd. (the "Master Fund"). This document, which is being provided on a confidential basis, is not an offer to sell nor a solicitation of an offer to buy interests of either Fund. Offers and sales of interests in the Funds may only be made in those jurisdictions permitted by law and once a qualified offeree receives a Confidential Private Placement Memorandum (a "Memorandum") which describes the risks related to an investment in the Funds. This presentation is qualified in its entirety by reference to such documentation. In the case of any inconsistency between the descriptions or terms in this document and the Memorandum, the Memorandum shall control. Interests in either Fund shall not be offered or sold in any jurisdiction in which such offer, solicitation or sale would be unlawful until the requirements of the laws of such jurisdiction have been satisfied. While all the information prepared in this documentation is believed to be accurate, ELC makes no express warranty as to the completeness or accuracy of such information.

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An investment in either Fund is speculative and involves a high degree of risk and there is no guarantee that the Fund's investment objective will be achieved. Opportunities for withdrawal/redemption and transferability of interests are restricted, so investors may not have access to capital when it is needed. There is no secondary market for the interests and none is expected to develop. The Master Fund's portfolio, which is under the sole trading authority of ELC, is a credit strategy with a focus on securitised products and this lack of diversification may result in higher risk. Please see the Memorandum for a more detailed description of the risks involved with an investment in the Funds. An investor should not make an investment unless he/she is prepared to lose all or a substantial portion of its investment. The fees and expenses charged in connection with this investment may be higher than the fees and expenses of other investment alternatives and may offset profits.

Past performance of the Funds should not be construed as in indicator of future performance. Any projections, market outlooks or estimates in this documentation are forward looking statements and are based upon certain assumptions. Other events which were not taken into account may occur and may significantly affect the returns or performance of the Funds. Due to market risks and uncertainties, any projections, outlooks or assumptions should not be construed to be indicative of the actual events which will occur.