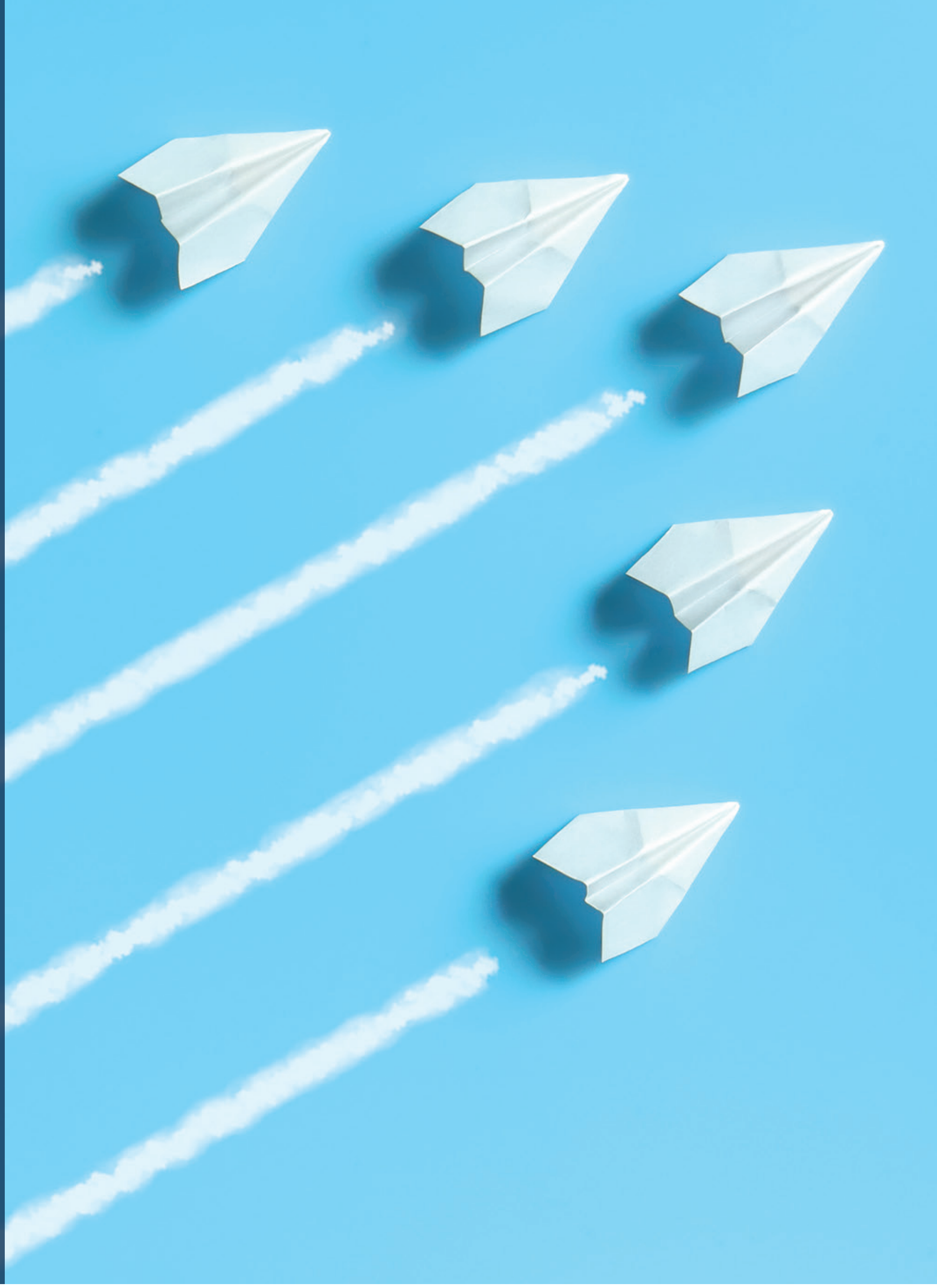


Q3
2022

Insights

Darren Toner

Senior Portfolio Manager (High Yield, Financials and Investment Grade)

Five Credit Views in Five Charts

Rising geopolitical tensions, a global energy crisis, slowing economic growth and central banks' commitment to fight stickier high inflation continue to weigh on Credit and Equity markets. Here are five trends that we are observing in financial markets.

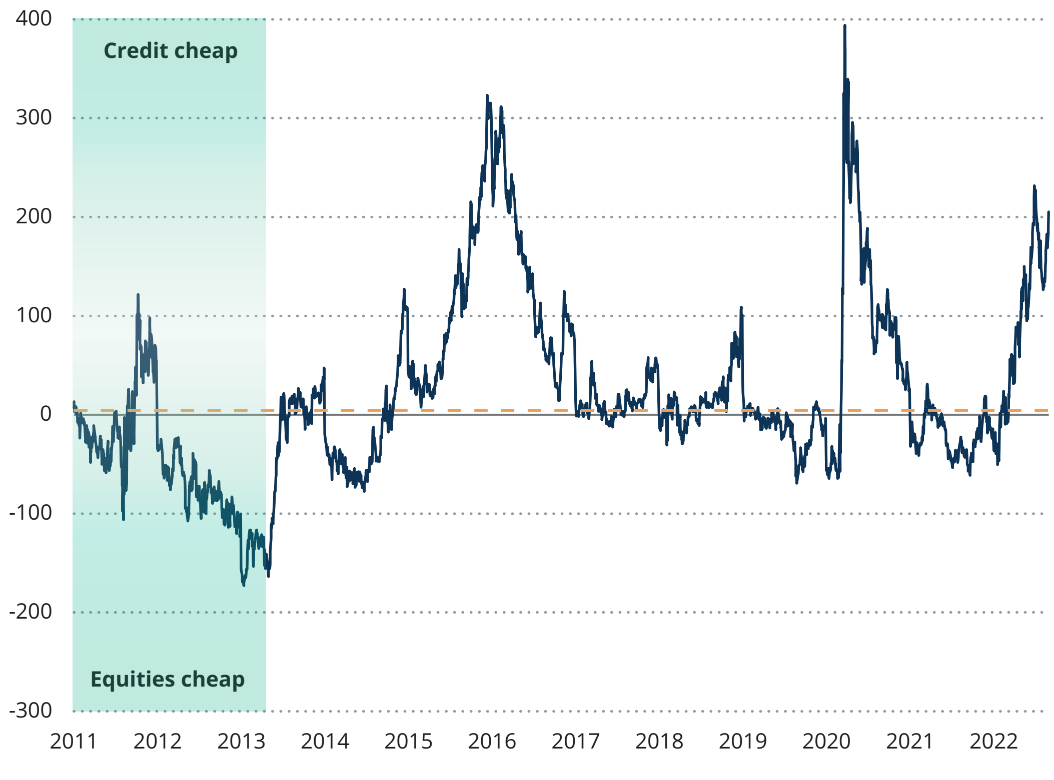
1

Credit appears cheap relative to Equities

When we compare the risk premium above the risk-free rate between Equity and Credit markets, we see a different story: US Equity risk premia is currently trading at its 1st percentile since 2011, meaning that equity investments are looking expensive. On the other hand, Credit and US High Yield (HY) are currently in the 68th percentile, making Credit look relatively attractive. The difference signals that Equity is pricing in a well-handled soft landing, whilst Credit suggests the tightening of monetary policy will lead to a recession and a material increase in defaults. Although nobody really knows whether a recession can be avoided, our analysis suggests that Credit should outperform Equities in either scenario given the valuation gap.

Chart 1: Credit says recession, Equities say soft-landing

Difference HY spread - Equities risk premium (basis points)

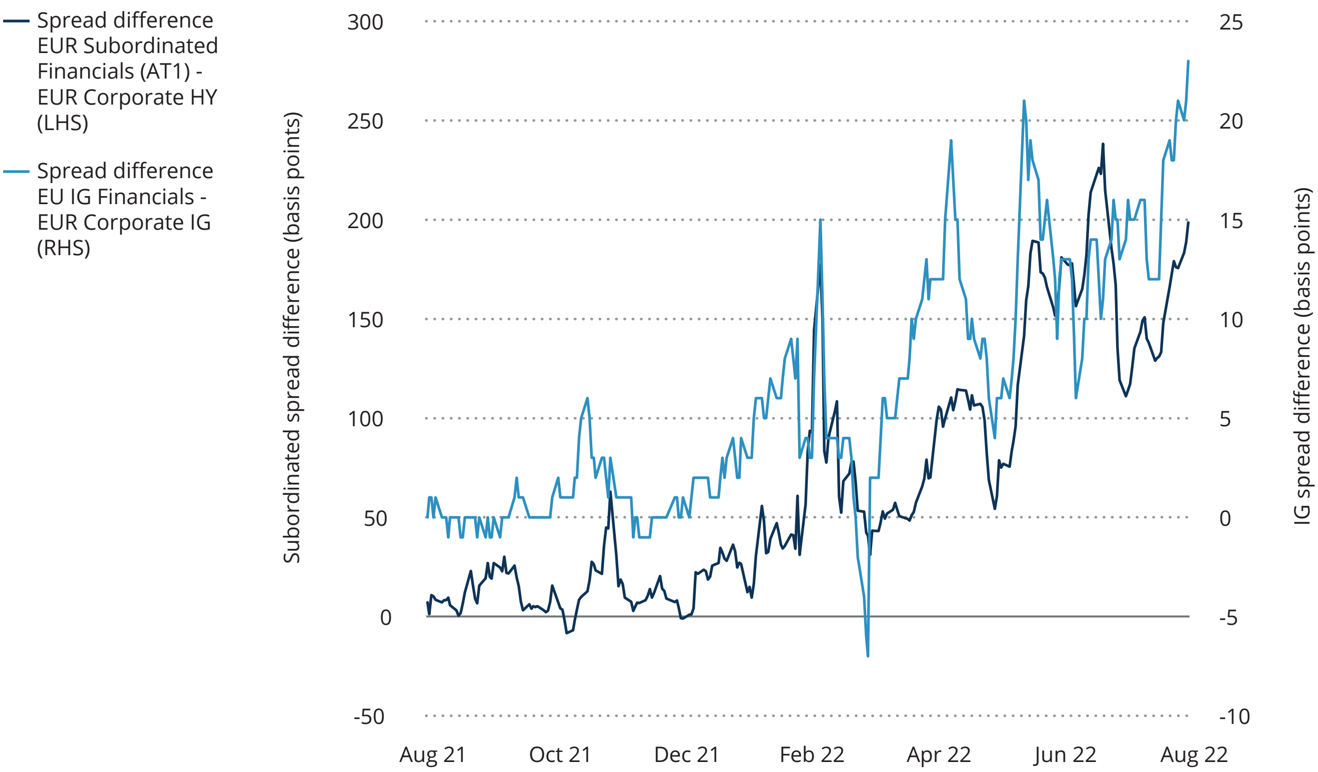


Source: Bloomberg as at 31 August 2022.

2 European Financials versus Corporates - Technicals provide opportunity

European banks have built a strong position, with robust capital levels combined with a tailwind from rising rates, which typically increase profitability. This leads us to having an overweight sector bias. Contrastingly, European corporate bonds face multiple headwinds despite also coming from a strong fundamental position, including the effects of the energy crisis, record high inflation, consumer weakness, windfall taxes and the end of the European Central Bank's (ECB) bond-buying programme. However, and due to certain technicals in Financials, such as higher supply, we have seen European banks' spreads dramatically underperform other corporates, as seen in Chart 2. For example, in European Financials we saw in August €63.5bn issued, or 2.6 times more than in August 2021 and c. €28bn higher than any other August in the last 20 years. Issuance is likely to slow significantly from here, since banks are now ahead of their issuance plans. Whilst European Financials will also face some headwinds fundamentally, they provide an excellent relative value opportunity both in Senior and Subordinated levels relative to their corporate equivalents.

Chart 2: Financial spreads have widened more than corporate spreads

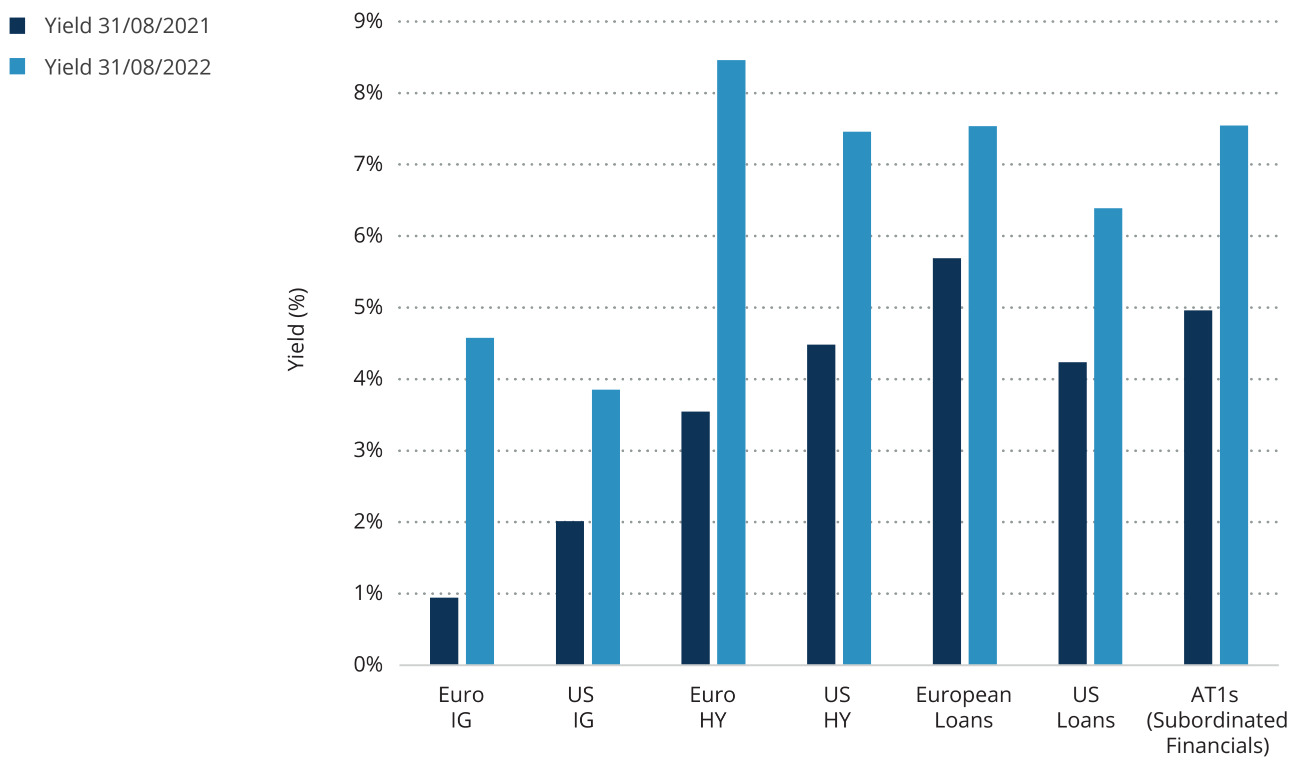


Source: Bloomberg as at 31 August 2022. IG stands for Investment Grade; AT1s are securities issued by European financial institutions that generally carry higher yields than traditional fixed income securities.

3 Credit spreads are attractive, but yields are even more so

With the evolving macro backdrop, spreads have widened over the last year, providing attractive entry points relative to historic levels. As seen in Chart 3, the yields available are substantially higher than they were last year. This has been driven by a combination of rising government bond yields globally and the aforementioned spread widening in Credit. In fact, even on a look back to 2011, the yield offered by Credit is at the 90-99th percentile across both Investment Grade (IG) and HY markets. Both IG and HY yields are now attractive relative to Equities on a risk-adjusted basis, providing a level of income that should help dampen market volatility.

Chart 3: Credit yields have risen to attractive yield and percentile levels



Percentiles

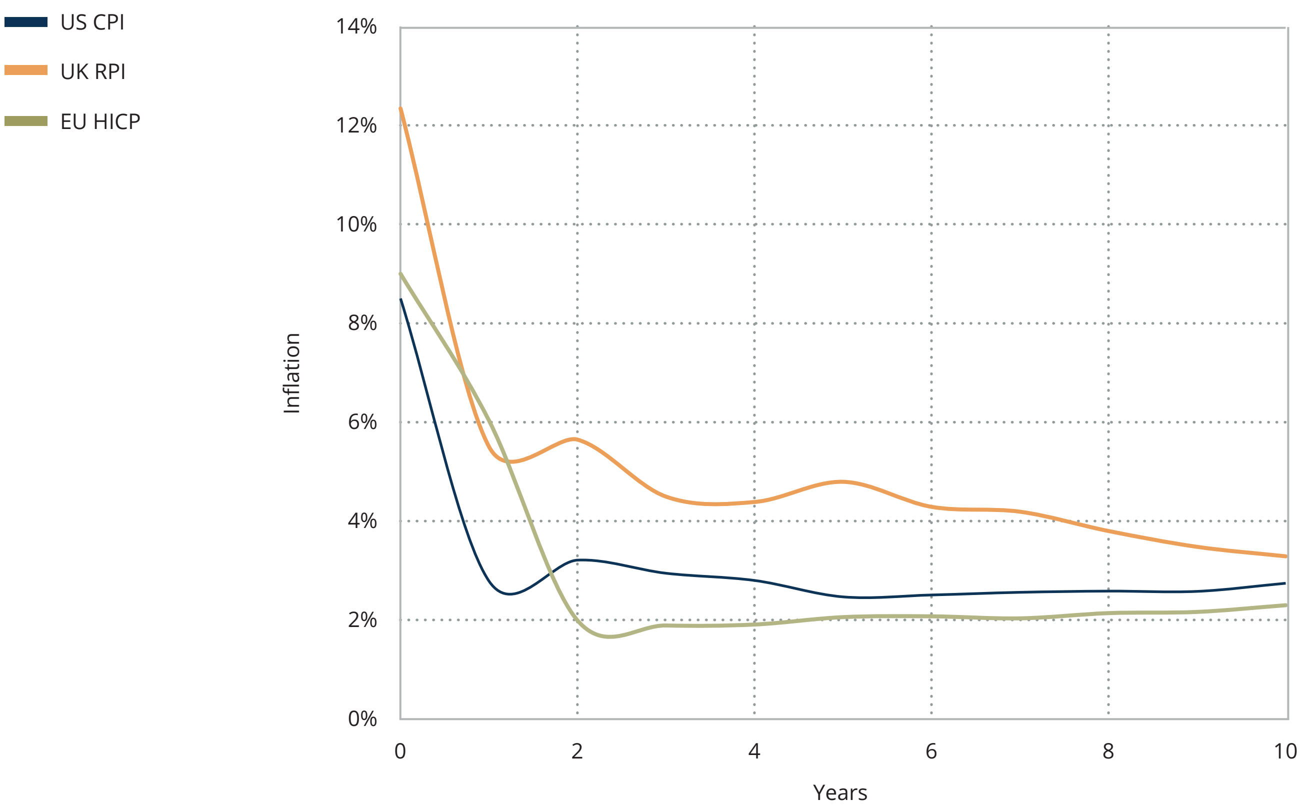
Euro IG	US IG	Euro HY	US HY	European Loans	US Loans	AT1s (Subordinated Financials)
90	99	89	95	81	98	98

Source: Bloomberg as at 31 August 2022. Percentiles all calculated from ICE data (YTW and OAS) since 2011/01/01 to 2022/08/31. YTM and Spreads from ICE and LCD data as of 31 August 2022.

4 European inflation more of an issue than in the US – market says

Inflation has been a hot topic for markets and may become even more so: markets are pricing in a sharp drop in inflation over the next 12 months, particularly in the US, where it is expected to fall close to the central bank's 2% target, whilst in the Eurozone this may take two years and substantially longer in the UK, as seen in Chart 4. Europe may see more persistent inflation than we have seen historically because of its current weak currency, which makes imports more expensive, and also because of the region's open economy and reliance on global energy sources (both issues that the US does not have). As a result, European investors are demanding an additional premium in Credit, which has taken European IG and HY spreads to trade 40 basis points (bps) and +75bps, respectively, wider than their US counterparts.

Chart 4: Forward inflation expected to return to central bank targets: markets say when

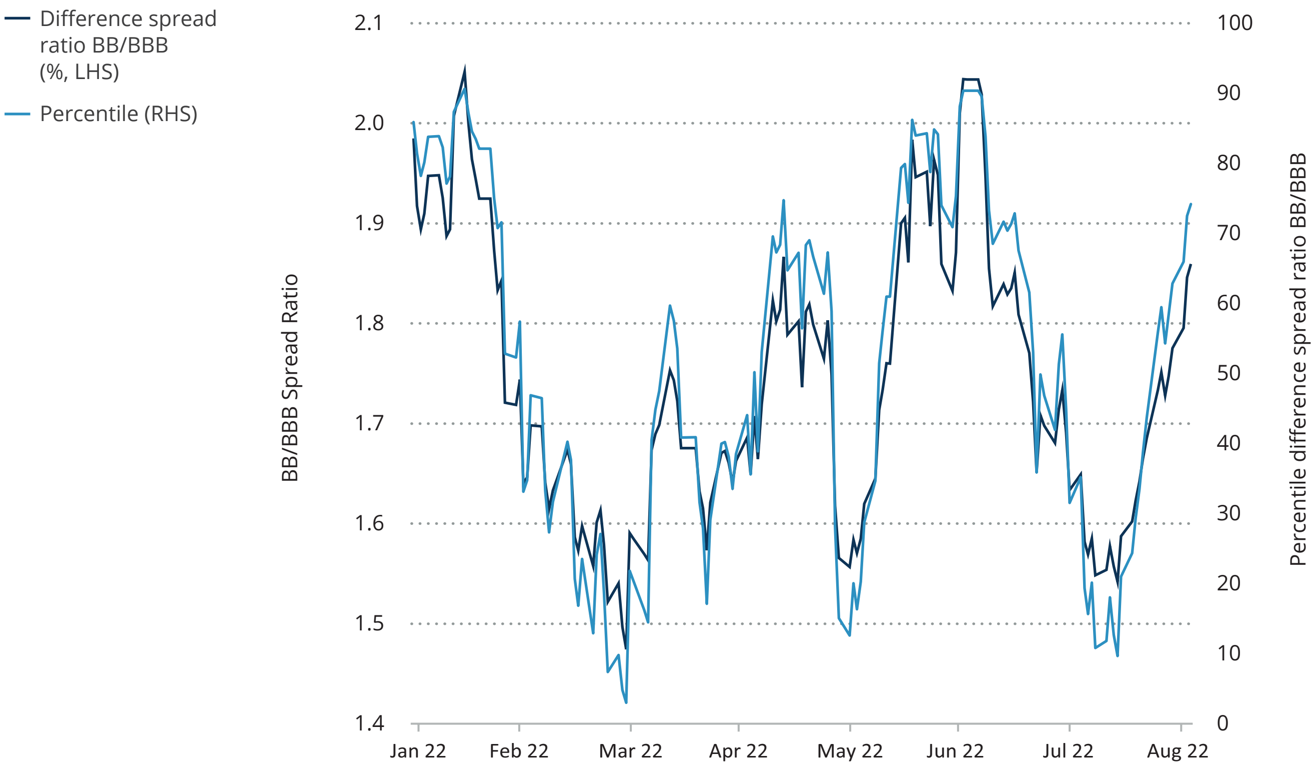


Sources: Zero Coupon Inflation Swaps BBG ()and most recent CPI BBG/Bureau of Labor Statistics, UK RPI BBG/ UK Office for National Statistics and Euro HICP BBG/Eurostat as of 2022/08/31 CPI is Consumer Price Index; RPI is Retail Price Index and HICP is Harmonised Indices of Consumer Prices.

5 Credit ratings – dispersion is rising, creating opportunity

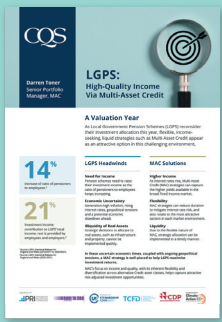
In our last edition, we highlighted increasing dispersion within sectors as a source of opportunity; now, and given the ongoing volatility, we see a similar trend impacting rating buckets. In US Credit markets, for instance, and over the past three months, the spread difference between IG and HY corporate bonds has traded from the 90th percentile to the 10th percentile, and back to the 72nd percentile of their relationship since 2011. In July and early August, much of this volatility was driven by short covering in the US High Yield ETF, which as a result traded at high premiums and in turn forced bond prices higher; at the same time, IG spreads widened on ample supply. Trading the ratios of these rating groups can provide outperformance: for example, switching from HY to IG in mid-August would have protected returns by 2.3%, as investors would have sold HY at high prices to buy IG at attractive levels.

Chart 5: IG vs HY: wider spread and percentile difference



Sources: Bloomberg as at 31 August 2022.

Don’t miss our latest thought leadership on cqs.com

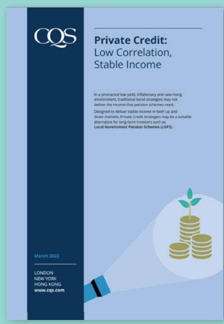


Multi-Asset Credit for LGPS

New two-pager promoting MAC in a valuation year.

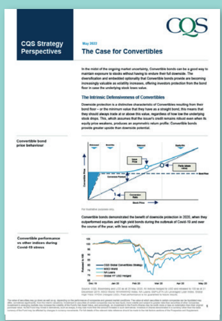
Good Times for Yield: Q&A with Craig Scordellis

The latest thoughts from the head of our MAC strategies.



Private Credit: Low Correlation, Stable Income

The benefits of this alternative asset class that offers low correlation to public markets.



The Case for Convertibles

Convertible bonds can be a good way to maintain exposure to stocks without having to endure their full downside.

Credit Matters

Our monthly Credit markets 2-page summary.

Investment Biases

Know them to tame them.

Follow us on LinkedIn and cqs.com

Important Information

This document has been issued by CQS (UK) LLP which is authorised and regulated by the UK Financial Conduct Authority, CQS (US), LLC which is a registered investment adviser with the US Securities and Exchange Commission, and/or CQS (Hong Kong) Limited, which is authorised and regulated by the Hong Kong Securities and Futures Commission. The term "CQS" as used herein may include one or more of CQS (UK) LLP, CQS (US), LLC, and CQS (Hong Kong) Limited or any other affiliated entity. The information is intended solely for sophisticated investors who are (a) professional investors as defined in Article 4 of the European Directive 2011/61/EU or (b) accredited investors (within the meaning given to such term in Regulation D under the U.S. Securities Act of 1933, as amended) and qualified purchasers (within the meaning given to such term in Section 2(a)(51) of the U.S Investment Company Act 1940, as amended). This document is not intended for distribution to, or use by, the public or any person or entity in any jurisdiction where such use is prohibited by law or regulation.

This document is a marketing communication prepared for general information purposes only and has not been delivered for registration in any jurisdiction nor has its content been reviewed by any regulatory authority in any jurisdiction. The information contained herein does not constitute: (i) a binding legal agreement; (ii) legal, regulatory, tax, accounting or other advice; (iii) an offer, recommendation or solicitation to buy or sell shares or interests in any fund or investment vehicle managed or advised by CQS (a "CQS Fund") or any other security, commodity, financial instrument, or derivative; or (iv) an offer to enter into any other transaction whatsoever (each a "Transaction"). Any decision to enter into a Transaction should be based on your own independent investigation of the Transaction and appraisal of the risks, benefits and appropriateness of such Transaction in light of your circumstances. Any decision to enter into any Transaction should be based on the terms described in the relevant offering memorandum, prospectus or similar offering document, subscription document, key investor information document (where applicable), and constitutional documents and/or any other relevant document as appropriate (together, the "Offering Documents"). Any Transaction will be subject to the terms set out in the Offering Documents and all applicable laws and regulations. The Offering Documents supersede this document and any information contained herein. The Offering Documents for CQS UCITS range of funds is available here (www.cqs.com/ucits-funds#global-convertibles) in English (US persons will not be eligible to invest in CQS managed UCITS funds save to the extent set out in the relevant Offering Document). A copy of CQS' Complaints Policy, which sets out a summary of investors' rights, is available here (www.cqs.com/site-services/regulatory-disclosures) in English. CQS may terminate the arrangements for marketing or distribution of any CQS Fund at any time.

Nothing contained herein shall give rise to a partnership, joint venture or any fiduciary or equitable duties. The information contained herein is provided on a non-reliance basis, not warranted as to completeness or accuracy, and is subject to change without notice. Any information contained herein relating to any non-affiliated third party is the sole responsibility of such third party and has not been independently verified by CQS. The accuracy of data from third party vendors is not guaranteed. If such information is not accurate, some of the conclusions reached or statements made may be adversely affected. CQS is not liable for any decisions made or action taken by you or others based on the contents of this document and neither CQS nor any of its directors, officers, employees or representatives accept any liability whatsoever for any errors or omissions or any loss howsoever arising from the use of this document.

Information contained in this document should not be viewed as indicative of future results as past performance of any Transaction is not indicative of future results. Any investment in a CQS Fund or any of its affiliates involves a high degree of risk, including the risk of loss of the entire amount invested. The value of investments can go down as well as up. Future performance is subject to taxation which depends on the personal situation of each investor and which may change in the future. Investments may lead to a financial loss if no guarantee on the capital is in place. An investment in any CQS Fund will involve a number of material risks which include, without limitation, risks associated with adverse market developments, currency and exchange rate risks, risk of counterparty or issuer default, and risk of illiquidity. Any assumptions, assessments, targets (including target returns and volatility targets), statements or other such views expressed herein (collectively "Statements") regarding future events and circumstances or that are forward looking in nature constitute CQS' subjective views or beliefs and involve inherent risk and uncertainties beyond CQS' control. Any indices included in this document are for illustrative purposes only and are not representative of CQS Funds in terms of either composition or risk (including volatility and other risk related factors). Unless stated to the contrary CQS Funds are not managed to a specific index.

The information contained herein is confidential and may be legally privileged and is intended for the exclusive use of the intended recipient(s) to which the document has been provided. In accepting receipt of the information transmitted you agree that you and/or your affiliates, partners, directors, officers and employees, as applicable, will keep all information strictly confidential. Any review, retransmission, dissemination or other use of, or taking of any action in reliance upon, this information is prohibited. Any distribution or reproduction of this document is not authorized and prohibited without the express written consent of CQS, or any of its affiliates. Unless otherwise stated to the contrary herein, CQS owns all intellectual property rights in this document.

CQS is a founder of the Standards Board for Alternative Investments ("SBAI") which was formed to act as custodian of the alternative investment managers' industry best practice standards (the "Standards"). By applying the Standards, managers commit to adopt the "comply or explain" approach described in the Standards. CQS is a signatory of the UN Principles for Responsible Investment and a supporter and participant of certain other responsible investment related industry associations.

PRI Note:
PRI is an investor initiative in partnership with UNEP Finance and the UN Global Compact. GMv10.

3192132769 / G-22-0153 / 09.22

CQS (UK) LLP
4th Floor, One Strand, London WC2N 5HR, United Kingdom
T: +44 (0) 20 7201 6900 | F: +44 (0) 20 7201 1200

CQS (US), LLC
152 West 57th Street, 40th Floor, New York, NY 10019, US
T: +1 212 259 2900 | F: +1 212 259 2699

CQS (Hong Kong) Limited
1308 One Exchange Square, 8 Connaught Place, Central, Hong Kong, China
T: +852 3920 8600 | F: +852 2521 3189

CQSClientService@cqsm.com | www.cqs.com