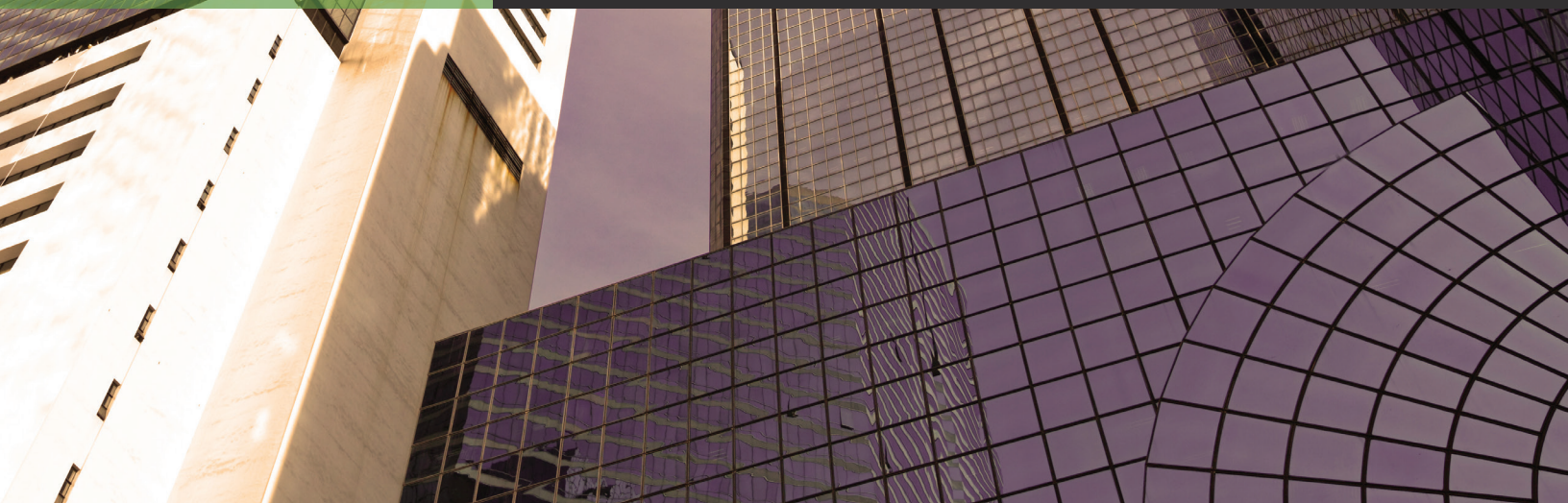
Bitterroot
CAPITAL ADVISORS

Q2 2022 Review and Current Capital Markets

July 15, 2022



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Capital Markets

Equity markets declined sharply by 15.7% in USD terms during Q2 2022 (ACWI Index), with YTD declines now at 20.5% as of July 13th (one of the worst half-year performances in history).

Initially, the declines were driven by multiple compression stemming from a) higher than expected monthly inflation figures, b) increased hawkishness from global central banks which led to rapid increases in bond yields (the US Fed raised rates by 75bps in June), and c) continued geopolitical tensions with the Russia / Ukraine conflict leading to continued elevated energy costs (crude oil, natural gas, and refined products).

Towards the latter part of the quarter economic growth clearly started to slow and recessionary fears intensified. Bond yields (especially in the US) retreated over the last few weeks, inflation expectations moderated, and several commodity prices (metals, agriculture) retreated by over 20%.

During Q2, growth stocks (-20.2%) materially underperformed value stocks (-11.5%) as defensive sectors (health care and consumer staples) outperformed as did energy.

Government and investment-grade corporate bond prices declined by the largest amounts YTD since the late 1970s.

The Barclays US Aggregate Index declined by 4.7% during Q2 and 10.4% YTD. For the first time in many years, bonds did not serve as a buffer during periods of equity market volatility (due to sharply rising interest rates driven by persistent inflationary pressures).

Corporate earnings growth has likely peaked with negative earnings revisions probable.

S&P 500 earnings grew by 11.6% YOY during Q1 2022. Analysts have increased their forecasts for full-year 2022 and 2023 since the beginning of the year (despite high inflation and weakening growth fundamentals).

Analysts are still forecasting 10.5% YOY earnings growth in 2022 and 7.6% in 2023. These views are likely optimistic as several leading economic indicators are slowing sharply. Consumer confidence is also deteriorating sharply as higher costs (especially gas prices) are affecting consumer psyches. Significant USD appreciation will also negatively impact S&P 500 earnings (while positively impacting earnings of European and Japanese companies). In prior recessions, corporate earnings have declined 12%-30%.

We are incorporating these views into portfolio positioning by:

- Increased allocations to alternative assets with less correlation to public equities and credit
- Increased allocations to private equity and other private strategies
- Selectively adding to US Treasuries at the 2-year and 3-year maturities

Strategic Asset Allocation View (7-years)

With equity valuations having declined significantly thus far in 2022, we now expect mid-to-high single digit nominal pre-tax equity returns (7.0%-8.0%) annually over a seven-year forecast period.

Returns in any individual year may vary considerably versus the 7-year annualized forecast. As we have mentioned in prior commentaries, 2022 was likely to be a difficult year for equities given elevated starting valuations and the beginning of global monetary tightening regimes.

It is increasingly likely that a recession may occur in 2023 which would lead to declining earnings (and likely further declines in equity markets).

We anticipate increasing bouts of episodic volatility over the next 9 to 15 months as investors grapple with a) central bank policy and the magnitude of rate hikes, b) whether economic slowdowns will be short-term and mild or more severe and longer-duration, and c) the outlook for corporate earnings especially in 2023.

US and Canadian government bond yields remain reasonably attractive (although 10-year US treasury yields are well off recent highs).

US and Canadian 3-year Treasury bond yields are now yielding about 300bps.

Riskier credit assets (high-yield bonds and leveraged loans) are now attractive over a mid-term time frame.

US high-yield bonds are now yielding close to 8.5% with 7-year forecasted annual returns of 7.5% (comparable to US equities). However, on a nearer-term basis (next 12 months), high yield bonds could experience 10%-15% further declines if credit spreads widen further with accumulating evidence of recessionary conditions.

Relative to public markets, we continue to forecast higher returns for risk assets across private market strategies (i.e., private equity, private credit and real estate funds).

Strategic Asset Allocation View (7-years)

Asset Class: Strategic Outlook (7-Year Timeframe)

Equities	Negative - Neutral - Positive	Average Annual Return
US Large Cap (S&P 500)		Mid/High Single-Digit
US Small Cap (Russell 2000)		Mid/High Single-Digit
MSCI Europe		Mid Single-Digit
Japan Topix		Mid Single-Digit
MSCI Emerging Markets		Mid Single-Digit
Fixed Income		
US Treasury		Low Single-Digit
US Corp Investment Grade		Low/Mid Single-Digit
US Corp High Yield		Mid/High Single-Digit
US Corp Levered Loans		Mid/High Single-Digit
Alternatives, Private Equity and Real Estate		
Real Estate (Private) / Infrastructure		Mid Single-Digit
Alternatives (Hedge Funds)		Mid Single-Digit
Private Credit		High SD / Low DD
Private Equity		Low-Teens

Shorter-Term View

Recession risks continue to increase (occurring either in H2 2022 or 2023), with most economists now assigning 40%-50% probabilities as economic growth is clearly slowing while inflation remains high.

Manufacturing PMIs are slowing considerably (although still indicating growth), US housing is slowing sharply, and German business confidence is declining. In the US, wage growth is showing signs of plateauing and jobless claimsare starting to modestly tick up.

From a shorter-term standpoint (next 9-15 months), we see three potential scenarios for equity market.

Scenario	Conditions Accompanying this Scenario	S&P Price Range within 9-15 months
No Recession (15%-25% probability)	Under this scenario- inflation moderates signficantly on a monthly basis especially for goods. Signs for moderating inflation are already emerging and include elevated goods inventories, sharply slowing US housing markets, declining commodity costs, and plateauing wage increases. Financial conditions are tightening signficantly with demand declining for new loans; We assume a cease-fire occurs in the Russia / Ukraine conflict in fall 2022. These conditions lead to lower than expected Fed interest rate increases and coupled with China's stimulus efforts leads to a low-growth (non-recession) scenario.	Forward S&P 500 estimates remain relatively flat going forward at $238 per share; Geopolitical sentiment improves; Valuation multiples modestly expand to 18x based on the 10-year Treasury yields stabilize around 250bps. S&P recovers to $4,200-$4,400, representing an 9%-13% total return from July 7, 2022 levels.
Mild Recession (50%-65% probability)	Under this scenario, recession impacts will be relatively mild given the strong household balance sheets and a strong labor market; Supply chains should normalize over the next 12-18 months and the Fed does not need to tighten more than currently anticipated. Demand slows but does not collapse which causes an increase in the unemployment rate (ticking up to 5%-5.5% from 3.6% today). A mild earnings recession ensues with forward earnings estimates declining 10%-15% (as in the 2000-2002 recession)	Forward S&P 500 estimates could decline to $200 to $215 from $238 currently. Valuation multiples likely remain in the 15x-16x range leading to an S&P target of 3,000-3,400 , representing a -10% to -18% total return.
Severe Recession (15%-25% probability)	Structural forces lead to sustained high inflationary pressures for longer than expected. The Fed raises rates more than people expect. International economies enter into recessions. The combination of these factors lead to sharp and swift decline in demand which leads to a more severe earnings decline spiral (similar to that experienced during the GFC)	Forward S&P 500 estimates could decline to $180 to $190 from $238 currently. Valuations could decline further to 14x-15x multiples which would lead to $2,600 to 2,800 S&P valuation, representing a -25% to -30% total return.

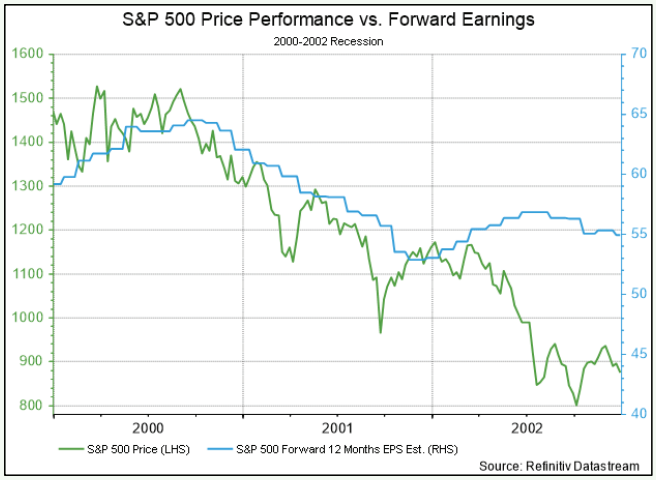
Shorter-Term View (Continued)

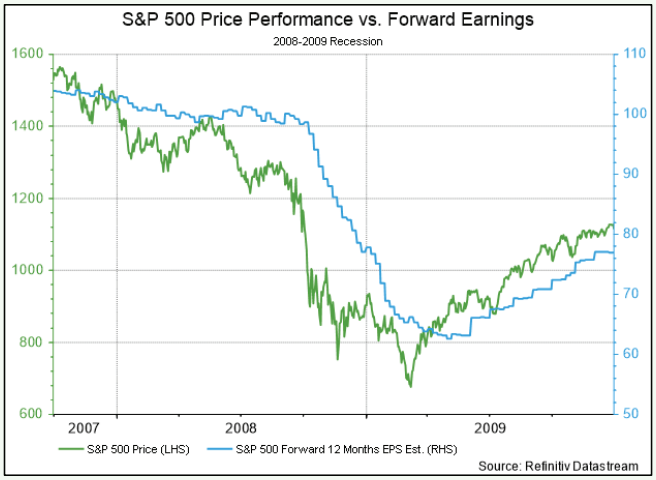
We assign higher probabilities to negative scenarios with the potential for further material equity market declines.

Presently, monetary policy is still tightening (and likely has a ways to go) and consensus sell-side forward earnings estimates have not yet begun to decline.

Given the 20%+ declines in equity markets YTD, investors are clearly factoring in higher rates (increasing discount rate assumptions) and are also ascribing some probability to forward earnings negative revisions.

However, during recent recessions (2000-2002 and 2008-2009), equity markets did not bottom until a) forward earnings estimates bottomed or negative revisions abated and b) the Fed pivoted monetary policy and began to reduce interest rates.





Macroeconomic Conditions and Inflation

The tradeoff between taming inflation (and keeping inflation expectations anchored) and facing lower economic growth is the hardest challenge facing central banks. Inflation exceeded expectations in May and June but has since shown signs of moderating.

US headline CPI unexpectedly increased 1.3% month-over-month and 9.1% YOY in June 2022 with core CPI increasing by 0.7% MOM and 5.9% YOY. The data continues to indicate broadening price pressures, especially across rental housing costs. Following high inflation reports in May, US bond yields spiked during the first two weeks of June (with both 3-year and 10-year US Treasuries reaching 3.5%). The Fed responded with an upsized 75bps hike at its June meeting and increased its forecasted magnitude of rate hikes materially.

Equity markets sold off substantially with the S&P declining to near $3,600 as of mid-June (25% down from peak).

Canada's headline inflation rate ticked up to 7.7% YOY in May and 1.4% MOM.

Canada's central bank just raised interest rates by 100bps on July 13th in response to broadening inflationary pressures and signs of an emerging wage / price spiral.

However, there are signs that inflation may be peaking and may decelerate over H2 2022 and into 2023.

Goods inventories have increased substantially which may lead to markdowns to clear excess inventory.

Commodity prices (metals and agriculture) have declined by 20%-30% from recent highs.

Wage growth seems to have plateaued and there are some early signs of labor market cooling (small decline in jobs available and layoffs or hiring slowdowns starting to emerge across certain technology companies).

US gasoline prices have retreated meaningfully through mid-July in response to falling oil prices.

US bond yields have declined across the curve with the 10-Year Treasury yielding roughly 40bps lower than mid-June peaks.

US 5-year and 10-year break-evens (inflation forecasts) have declined to 2.6% and 2.3% respectively, levels last seen in March 2021.

Macroeconomic Conditions and Inflation

Labor markets continue to remain very tight in the US and Canada.

In the US, the unemployment rate remains near historical lows at 3.6% and the job participation rate remains 1% below pre-pandemic levels.

Unfilled job vacancies remain at exceedingly high levels, especially within the service industry.

Canada's unemployment rate declined to 5.1% (lowest level over the past 50 years) in May. Unfilled job vacancies have also increased substantially over the past 18 months.

These tight labor markets will likely support consumer spending and may buffer economic slowdown effects. However, they continue to add to inflationary pressures and may lead to longer-lasting price pressures, complicating central bank efforts to reverse inflation.

US Retail sales remain strong and increased by a higher than 1% MOM in June or 0.8% when stripping out autos and gasoline sales.

Economic growth, however, is clearly slowing across most geographies.

In the US, leading indicators such as manufacturing PMIs have declined from the high 50s to the low 50s (levels above 50 correspond with positive growth expectations), with new order growth declining at faster rates.

US retail sales unexpectedly declined by 0.3% in May (flat when excluding autos and gas) as consumers pulled back on goods purchases. Consumer sentiment remains near historical low levels (yet consumers are spending on services and pent-up travel).

Consumer sentiment is also souring worldwide as sharply increasing costs for essentials (food, energy and shelter) are eating into household budgets. While consumer spending may accelerate into the summer months (pent-up demand for travel and dining out), as evidenced by a rebound in June retail sales, we expect a slowdown into the fall and winter months as pandemic savings levels begin to deplete.

German expectations of economic growth have cratered and are approaching levels seen early in the pandemic.

European energy costs (especially natural gas) have increased substantially over the last month and are approaching levels seen at the start of the Russia / Ukraine conflict. These costs could surge further as winter approaches.

China's economic trajectory remains mixed. Government monetary stimulus measures (increased infrastructure spending and loans) should help sustain economic growth. However, the country's Zero-Covid policies are leading to rolling shutdowns and disruptions in factory production and consumer spending.

Equity Markets - Performance

Equity markets declined sharply by 15.7% in USD terms during Q2 2022 (ACWI Index) and are now down 20.5% YTD through July 13th.

Global value stocks continued to sharply outperform global growth stocks as growth stocks have been hit by a combination of multiple contraction driven by rising interest rates coupled with some fundamental earnings disappoints relative to high expectations.

Consumer Staples and Healthcare sectors (-6.2% and -7.2%) performed best in Q2 along with energy (-5.2%).

Technology and Consumer Discretionary sectors had the worst performance in Q2 (-21.7% and -20.2%) along with financials (-15.9%).

Q2 corporate earnings season kicks off in earnest over the next two to three weeks. Forward looking guidance will be highly scrutinized in terms of: a) revenue growth assumptions – is demand holding up? b) margins – are inflationary cost pressures increasing?

Cyclicals such as banks and energy companies may experience short-term gains as these stocks have sold off 20%-30% since the end of May due to intensifying recession fears.

Large-cap technology companies may face near-term pressure if enterprise small-business demand weakens as valuations are still at absolute multiples ranging from 20x-25x forward EPS, even if those multiples are well lower versus beginning of the year levels.

While we believe value stocks may continue to outperform growth stocks over the next 6-9 months, we are now more constructive towards quality stocks (stocks of high-quality companies) over the shorter-term.

Valuations are much more reasonable versus earlier in the year, and these companies' earnings should prove far more resilient during a recession.

Longer-term, we continue to believe that stocks of high-quality companies will outperform given their strong business models, superior earnings growth and strong returns on capital.

Equity Markets - Performance

Equity Indices (as of 7/13/2022)

Total Returns (%) – USD

	YTD 2022	Jun-22 QTR	Annualized Returns 1Y	3Y	5Y	7Y
US Large Cap (S&P 500)	-19.8%	-16.2%	-12.1%	9.2%	10.6%	10.3%
US Small Cap (Russell 2000)	-22.6%	-17.2%	-23.4%	4.5%	5.2%	6.0%
MSCI EAFE	-20.6%	-14.5%	-19.9%	0.6%	1.7%	2.4%
MSCI Emerging Markets	-19.9%	-11.5%	-25.6%	-0.3%	1.0%	2.8%
MSCI ACWI	-20.5%	-11.5%	-16.8%	5.6%	6.6%	6.8%
Russell 1000 Growth	-27.0%	-20.9%	-19.5%	11.9%	14.2%	13.3%
Russell 1000 Value	-13.1%	-12.2%	-7.3%	6.1%	7.0%	7.5%

Equity Markets - Valuation

Equity markets are now generally undervalued relative to historical averages.

The S&P 500 is now trading modestly below historical valuations as the forward P/E multiple has compressed from 21.5x at the beginning of the year to 15.7x today. International markets are trading at 10%-15% below historical averages, which would suggest that they are relatively cheap at first glance.

However, confidence in forward earnings is much lower than normal given the backdrop of rising interest rates, inflation, geopolitical tensions and higher potential of recession.

Furthermore, earnings variability is much higher, especially so for international markets.

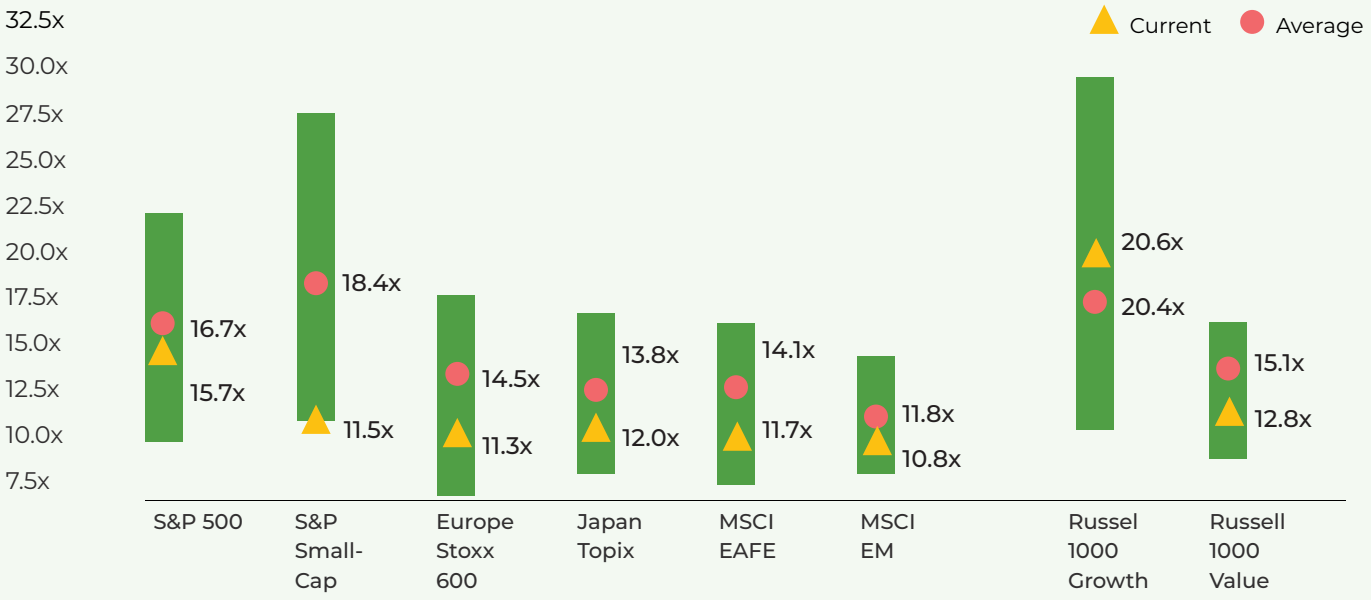
Finally, much of international markets (especially developed international markets) earnings growth in 2022 has been driven by energy and commodity sectors, which tend to trade at lower multiples.

Equity market valuations are relatively fair compared to bonds.

The S&P 500 presently trades at 15.7x consensus NTM earnings (which are likely too high).

Historically, the S&P 500 earnings yield (inverse of multiple) has averaged 250-350bps over 10-Year Treasuries. Based on that metric, a 15x-18x forward EPS multiple is "fair" for the S&P 500.

Equity Valuation –NTM P/E Multiple Ranges (10-Year History)



Fixed Income Markets - Performance

Fixed income markets declined further in Q2 due to rising interest rates and widening credit spreads.

Persistently higher levels of inflation have led to increased hawkishness by major central banks. The US and Canadian central banks are now signaling much more aggressive rate hikes for 2022 and likely into 2023.

Treasuries and safe investment grade bonds declined primarily due to interest rate increases.

High yield bonds declined by roughly 10% during Q2, with declines largely driven by spreads widening.

US high yield bond spreads widened from by 235bps from 325bps to 569bps during Q2. When combined with a rise in base interest rates, high yield bonds are now yielding close to 8.5% (historically attractive levels). Riskier credits (CCC rated) experienced the largest declines and are down 17% YTD with yields near 15%.

Leveraged loans had a difficult quarter with spread widening (associated with perceived credit risk) more than offsetting the positive impact from interest rate increases (loans are floating rate securities and benefit from rising rates).

Investors are increasingly worried about companies' ability to meet debt service obligations in the face of rising interest rates. Furthermore, in recent years, the quality of leveraged loan borrowers has declined, and financial covenants have become looser (which may adversely affect recoveries in instances of default).

Fixed Income Indices – Characteristics and Performance in USD

(as of 07/13/2022)

	% Ret YTD 2022	% Ret Jun-22 QTR	Annualized Returns 1Y	3Y	5Y	7Y	Duration (yrs)
US Treasury	-8.8%	-3.8%	-8.8%	-0.6%	0.9%	1.2%	6.5
US Corp. IG	-13.5%	-7.3%	-13.4%	-0.6%	1.5%	2.6%	7.8
US Corp. HY	-12.8%	-9.8%	-11.8%	0.7%	2.4%	3.7%	4.2
US Corp. Lev. Loans	-4.4%	-4.5%	-2.8%	2.0%	2.9%	3.3%	NA
Barclays US Aggregate	-9.8%	-4.7%	-9.9%	-0.6%	1.0%	1.6%	6.6
Barclays Canada Agg*	-11.4%	-5.4%	-10.7%	-1.8%	0.5%	0.9%	7.4

** Barclays Canada Aggregate Index returns in CAD*

Fixed Income Markets - Valuation

Government bond yields have continued to rise since the end of Q1, but have retreated from peaks seen in mid June, sharply so for longer-dated maturities (e.g. 10-year Treasury).

Bond yields are significantly higher than 10-year average levels although still below levels seen during the 2000-2006 period.

Corporate spreads (investment grade and high yield) have widened considerably but are still well below those experienced during recessions.

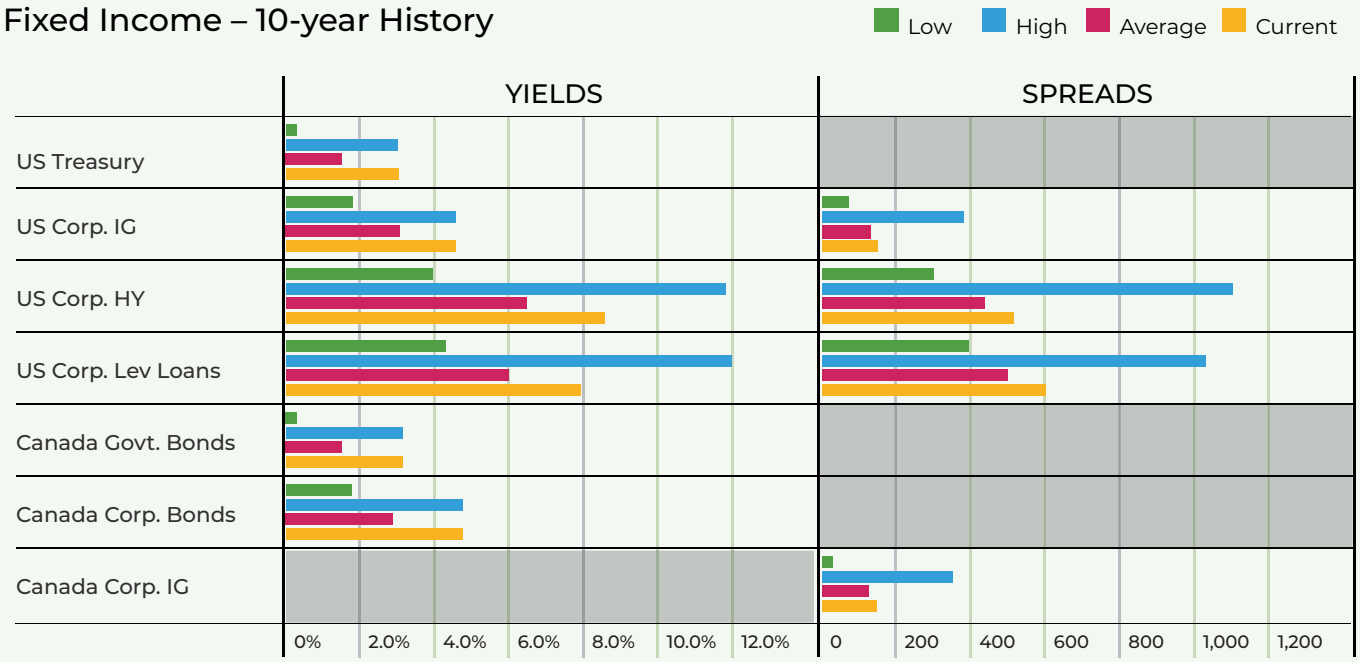
IG spreads have widened from 115bps to 151bps (levels not seen since the end of 2018).

High Yield bond spreads have widened to roughly 550bps with yields now near 8.5%.

In prior recessions, spreads generally increased to 800bps and briefly reached 1500bps during the GFC.

Credit performance remains strong with default rates well below historical levels.

However, defaults are likely to increase in 2023 and 2024 as economic growth slows, corporate earnings decline, and companies with weak balance sheets or nearer-term refinancing obligations face capital raising challenges. We expect that the default severity will be lower than that experienced during the GFC.



Alternatives and Private Investments

Hedge fund returns were down 3.7% in Q2 (far less than equity markets).

Global macro strategies performed best (+2.3%) while credit strategies and convertible arbitrage strategies performed worst (-8.0% and -9.5%, respectively).

Private real estate fundamentals continue to be strong (especially in apartment and industrial properties).

Industrial and multi-family properties are experiencing robust rental growth amidst strong demand.

Rental rates for new leases are increasing 10%-20% in many markets, and with roughly 1/3 of tenants repricing every year these subsectors have strong visibility to 5%+ rental growth rates over the next 2-3 years.

Cap-rates remain tight despite the sharp rise in Treasury yields in sectors with strong operating fundamentals. However, property transaction volumes have declined as debt funding costs have risen significantly.

Cap-rates are therefore expected to rise modestly across most sectors over the next 12 months.

Real estate continues to be an attractive hedge to inflation given the ability for rental resets.

In Q2 2022, private equity deal activity and exits slowed substantially from recent record levels.

Rising interest rates has increased funding costs for prospective buyers. Recent public equity valuation compression is leading to a mismatch between private equity buyer and seller expectations.

We expect a period of lower deal volumes and longer-hold periods for existing portfolio companies.

However, fundraising has remained robust and PE firms are sitting on large amounts of dry powder. Thus, we believe deal activity will resume after a lull period as a new equilibrium for valuations occurs.

Venture capital activity was mixed in Q2 with strong funding and deal volume offset by lower deal values and exits.

Global venture capital funding topped $120bln (6th largest quarter in history) but remained off 2021 highs.

Similarly, venture capital deal value of $62bln was the lowest since Q4 2020 (with deal values lower across all stages).

Exit volumes and values have declined significantly, especially via the traditional IPO channel which accounted for 86% of exits in 2021.

Valuations of existing venture capital portfolio companies continued to decline in Q2. Thus far, valuation compression has been highest in public companies and later-stage private rounds.

Actionable Investment Opportunities

For the first time is several years, "safe" fixed income is offering acceptable absolute yield levels.

US and Canadian Treasury bonds are now yielding north of 3% (for relatively short maturities of 2-3 years).

Investments in shorter-duration Treasury / government bonds can also serve as cash substitutes for funds held in anticipation of other higher-return investments or other needs.

Similarly, investment grade corporate bonds are now offering 4.5%-4.7% yields.

Investments in products such as Invesco Bulletshares corporate bond ETFs (maturing in 2024 or 2025) should lock in returns north of 4% if held to maturity.

Credit is becoming increasingly attractive as an investment. However, investors should have longer time horizons and be able to tolerate mark-to-market volatility.

We project 7-year annualized high-yield bond returns of 7.0-7.5% (quite attractive vs. equities on a risk-adjusted basis).

However, spreads are likely to widen further in a recession. As such, investors with a shorter-term time horizon may find more attractive entry points over the next 9-15 months.

Certain esoteric parts of the market (high-yield structured finance) are now yielding high-single digits to low-teens with very limited risk of permanent losses (the securities could certainly have mark-to-market volatility).

European credit markets (both public and private) are currently highly dislocated (See Special Topic).

Private credit strategies are also highly appealing.

Private direct lenders are increasingly taking share from traditional syndicated markets. With syndicated leveraged loan new issuance volumes declining (due to recessionary fears), private lenders should be able to increase pricing and demand better covenant protection.

Opportunistic credit funds should benefit from a wider range of higher-returning potential investments including a) dislocated publicly-traded bonds and loans, b) opportunities to provide bespoke bi-laterally negotiated credit solutions such as rescue financing or balance sheet restructuring to corporations.

The drawdown nature of these funds should enable them to pace their investments (over a 2-3 year time frame) if the economy does enter into a recession.

Actionable Investment Opportunities (Cont.)

New allocations to private equity are also becoming more interesting (especially across certain segments).

The secondary market is likely to yield attractive opportunities later this year. Several institutions are overallocated to PE and Venture Capital versus their Investment Policy Statements (as a result of the decline in public equities and fixed income). As such, these institutions are likely to sell portions of their private holdings through the secondary market.

The significant public market valuation declines for high-growth companies should filter through to private growth equity and venture markets, resulting in more attractive investment opportunities for funds currently raising capital.

Investment Case for European Credit

The combined threats of rising inflation, energy scarcity, and a potential recession are leading to significant dislocation in European credit markets.

Within public markets (high yield bonds and syndicated leveraged loans), markets have largely shut down over the past month for new issuance, and with significant price declines at the index level.

Opportunities are thus increasing for private credit solutions via direct lending to corporates and asset-backed loans to commercial real estate firms.

Commercial banks are likely to increase provision levels as the macroeconomic situation worsens in Europe.

In this environment, banks may increasingly sell non-core assets.

Private equity sponsors are likely to increasingly rely on bespoke privately negotiated direct-lending structures as the traditional syndicated leveraged market remains shut with several hung deals.

Competition within the European credit landscape is much lower than in the US, which leads to greater inefficiencies that may be exploited.

The European credit landscape is generally dominated by commercial banks.

Private credit (corporate and asset-backed) is much more nascent in Europe versus the US (both in terms of transaction values and in terms of number of competitors).

Europe's private credit market is currently $350bln compared to a roughly $1 trillion market size in the US.

Given much lower securitization volumes versus the US, European banks are overweight asset-backed credit and real assets.

BCA is actively researching European credit funds that exhibit the following attributes:

- Demonstrated success with respect to both liquid and illiquid credit investments across prior funds
- Sourcing advantages through deep relationships with motivated sellers
- Ability to develop creative financing structures and capital solutions for transitional borrowers
- Stringent underwriting prowess with heavy focus on downside protection

European Corporate Credit - Opportunities

The European corporate credit market has significantly dislocated over the past month in the face of rising recession risk, elevated geopolitical concerns, energy shortages, and rising inflation.

This backdrop is leading to interesting investment opportunities for savvy European-credit focused funds.

We believe mid-teens returns are achievable with lower risk profiles for opportunistic credit funds. The risk/ reward environment today is superior to that seen over the past 12 months.

We expect further dislocation to take place if Europe does indeed enter into a recession. As such, funds with an ability to invest across liquid and illiquid credit instruments should be well positioned to capitalize.

European Corporate Credit Markets – Potential Opportunities

Opportunity Type	Characteristics
Dislocated Secondary Loans and Bonds	• The European Leveraged Loan Index has declined from 101 to 90 over the past month. • Several loans and high yield bonds are currently trading at prices between 75-90 • Most are performing and are not distressed situations • Many are senior-secured (loans) or high-yield bonds in quality companies
Hung Syndications	• The syndicated loan market in Europe is presently frozen • Banks are looking to de-risk committed financings from Q4 2021 and Q1 2022 and move that risk off balance sheet at material discounts
Dislocated CLO Tranches	• BBB and BB CLO tranches offer attractive risk-adjusted yields relative to the underlying similar rated loan
Resuce Financing	• Performing credits may need short term liquidity to weather the storm and maintain operations. Primary markets may remain frozen and banks are likely increasingly nervous about providing financing during periods of rising economic stress

European Asset-Backed Credit - Opportunities

European banks are highly overweight commercial real estate assets (relative to US banks).

Banks are likely to face increasing pressures in terms of non-performing loans, higher capital requirements due to increased provisions and continued high levels of regulatory oversight.

Commercial real estate property developers are likely to face funding pressures as near-term maturities come due, and banks are increasingly reticent to roll over loans.

This backdrop creates interesting opportunities for savvy private credit funds focusing on asset-backed loans.

European Asset Backed Credit – Potential Opportunities

Opportunity Type	Characteristics
Non-Core Assets	• Banks need to improve capital positions and may look to sell performing assets for non-economic reasons • Assets may be non-core for banks or the banks may be looking to reduce geographic or property type concentration
Non-Performing Loans	• Properties in COVID-affected sectors may experience difficulties in meeting current financing obligations as government relief programs abate. • Opportunities may arise for purchase of NPL portfolios at material discounts for investors that can provide transitional capital and portfolio loan servicing
Capital Solutions	• Developers are likely to face increasing hurdles with respect to obtaining financing for real estate projects. • Private asset-backed credit providers can step in to fill in the gap for high-quality assets