CANDRIAM
A NEW YORK LIFE INVESTMENTS COMPANY

Credit Long Short: a diversified alternative strategy targeting moderate volatility

60 seconds with the fund manager

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This marketing communication is intended for non-professional investors.

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60 SECONDS WITH THE FUND MANAGER

Patrick Zeenni, CFA, Head of Investment Grade & Credit Arbitrage, Guillaume Benoit, Senior Portfolio Manager / Credit Analyst and Mouine Darwich, CFA, Portfolio manager/ Quantitative credit Analyst explain why a Credit Long Short strategy could be a «must have» in a diversified portfolio.

What is a Credit Long Short strategy?

A Credit Long Short strategy aims to capitalize on inefficiencies in the credit market, while seeking to limit exposure to market risks (credit and interest rates) and/or volatility peaks.

At Candriam, our approach integrates ESG criteria[1] and aims for long-term absolute returns and low correlation with other asset classes.

Our strategy is based on a broad investment universe, in terms of geography (selection of issuers from all regions - with a preference for Europe and the USA), type of issuer (financial and non-financial companies), market segment (investment grade[2] or high yield[3]), and, last but not least, instruments involving bonds or the use of credit derivatives such as Credit Default Swaps[4] and Total Return Swaps[5] (i.e. all instruments that are directly or indirectly linked to an issuer's ability to repay its debt, thus offering a diversity of investment options for managers).

What is the favorable economic and financial context for long-short strategies?

Long-short strategies have the advantage of adapting to changing economic and financial cycles. They can adjust to a volatile market context, influenced by central bank decisions, economic indicators that don't match expectations, or geopolitical tensions. They may also be capable of performing in a relatively stable environment.

In turbulent times, investors are seeking strategies that provide performance, stability and diversification in their portfolios.

Our Credit Long Short strategy aims to be a wise choice to meet these expectations by investing in the credit market.

What are the special features of your Credit Long Short strategy and how does it stand out in the market?

Our Credit Long Short strategy boasts several key features that make it an attractive solution for investors.

Firstly, it is a low-volatility strategy, aiming to offer an optimized balance between return and risk. When markets are marked by heightened volatility, our strategy has historically stood out for its ability to keep volatility low, thanks to robust position diversification, disciplined and rigorous risk management, and the use of strict stop-loss[6] selling.

(1) Environmental, social & governance.
(2) Investment-grade issuers are those with a high credit quality (i.e. low probability of default) assigned by a rating agency. For example, an issuer with a minimum rating of BBB-.
(3) high yield " issuers have a lower credit quality than " investment grade " issuers (i.e. with a higher probability of default). For example, an issuer with a rating below BBB-.
(4) Credit Default Swaps (CDS) are derivatives used to hedge against the risk of default.
(5) Transaction in which two players exchange revenues and the risk of changes in the value of two different assets over a given period.
(6) The stop-loss can be defined as an advance order to sell an asset when it reaches a certain price level.

Another distinctive feature of our strategy lies in our investment process, which relies on two complementary performance drivers - relative value arbitrage and directional strategy[7] - and our flexible approach, which have enabled us to achieve our performance objective throughout credit cycles since its inception in 2009. Our fundamental and extra-financial (ESG) analyses, as well as our legal expertise and quantitative research, are the cornerstones of our approach.

Finally, the strategy benefits from the support of an experienced team of 11 credit analysts/managers dedicated to the analysis and identification of opportunities, and 20 ESG analysts whose analysis enables us to better understand the risks and opportunities that could impact the solvency of issuers over the long term.

How do you select your investments?

Our aim is to capture the best investment opportunities in the credit market. This selection is based on a fundamental financial and extra-financial (ESG) analysis of issuers, an in-depth legal assessment, and a quantitative analysis of issues. Our ambition is to select issuers we consider undervalued for long positions[8], and those we consider overvalued for short positions[9].

These investment opportunities are structured around two distinct pockets within the portfolio:

- Relative value arbitrage: this strategy aims to exploit observed or anticipated differences in returns between different geographical zones, business sectors, currencies or financial instruments. To identify these arbitrage opportunities, we use fundamental and/or quantitative analysis.

- Directional strategies: we implement long or short positions based on strong convictions about the outlook for issuers. This approach allows us to take advantage of market trends and price movements.

We apply dynamic global management of credit and interest-rate risks to limit volatility, with the aim of generating performance in all market conditions. This proactive risk management enables us to maintain an optimal balance between return and risk for our customers.

To what extent does a flexible approach enhance performance?

The fundamental and ESG analyses we apply to each issuer, which have been tried and tested for over 25 years, enable us to go beyond traditional boundaries and position ourselves between investment grade and high yield segments. This agility enables us to navigate through credit cycles by exploiting the «cross-over» zone between these two market segments, where the difference in market perception between the «rising stars» and the «fallen angels» can be significant. The «fallen angels» are companies whose rating is «downgraded» from investment grade to high yield, and vice versa for the «rising stars». In recent years, high-yield issuers have strengthened their balance sheets in order to reduce their cost of debt and regain investment grade status. De facto, «fallen angels» have seen their credit rating improve and are now «rising stars» likely to enter the investment grade category.

This diversification between the two segments offers attractive performance potential, reinforced by current market dispersion and volatility. We manage the overall[10] duration (credit and fixed income) in a flexible way, to adapt the portfolio to changes in the market environment.

Flexibility is the key to our Credit Long Short strategy, enabling us to seize a wide range of opportunities while seeking to maximize returns and reduce the risks associated with market fluctuations. In an uncertain geopolitical and economic context, this flexible approach can be particularly relevant and advantageous when seeking to diversify a portfolio or achieve performance.

(7) Explanation in the next question.
(8) To be long, to hold a long position, means to have anticipated an upward trend for a financial asset.
(9) A short position consists of being short because you expect the price to fall in the future.
(10) Duration measures the sensitivity of the price (principal value) of a bond investment to changes in interest rates.

The main risks of the strategy are:

• Risk of capital loss:

There is no guarantee for investors relating to the capital invested in the strategy in question, and investors may not receive back the full amount invested.

• Interest rate risk:

A change in interest rates, resulting in particular from inflation, may cause a risk of losses and reduce the performance of the strategy (especially in the event of a rate increase if the strategy has a positive rate sensitivity and in the event of a rate reduction if the strategy has a negative rate sensitivity). Long term bonds (and related derivatives) are more sensitive to interest rate variations. A change in inflation, in other words a general rise or fall in the cost of living, is one of the factors potentially affecting interest rates and consequently the NAV.

• Sustainability Risk:

The sustainability risk refers to any environmental, social or governance-related event or situation that might affect the performance and/or reputation of issuers invested in.

Sustainability risks may be subdivided into three categories:

• Environmental: environmental events may create physical risks for the companies invested in.

• Social: refers to the risk factors linked to human capital, the supply chain and the way companies manage their impact on society.

• Governance: these aspects are linked to governance structures.

The sustainability risk may be specific to the issuer, depending on its activities and practices, but may also be due to external factors. If an unforeseen event occurs in a specific issuer such as a strike or more generally an environmental disaster, the event could have a negative impact on the performance. In addition, issuers which adapt their activities and/or policies may be less exposed to the sustainability risk.

• Derivative risk:

Financial derivatives are instruments whose value depends on (or is derived from) one or more underlying financial assets (equities, interest rates, bonds, currencies, etc.). The use of derivatives therefore involves the risk associated with the underlying instruments. They may be used for purposes of exposure or hedging against the underlying assets. Depending on the strategies employed, the use of derivative financial instruments can also entail leverage risks (amplifying downward market movements). In a hedging strategy, the derivative financial instruments may, under certain market conditions, not be perfectly correlated to the assets to be hedged. With options, an unfavourable fluctuation in the price of the underlying assets could cause the strategy to lose all of the premiums paid. OTC financial derivatives also entail a counterparty risk (though this may be attenuated by the assets received as collateral) and may involve a valuation risk or a liquidity risk (difficulty selling or closing open positions).

• Credit risk:

Risk that an issuer or a counterparty will default. This risk includes the risk of changes in credit spreads and default risk. Some strategies may be exposed to the credit market and/or specific issuers in particular whose prices will change based on the expectations of the market as regards their ability to repay their debt. These strategies may also be exposed to the risk that a selected issuer will default, i.e. will be unable to honour its debt repayment, in the form of coupons and/or principal. Depending on whether the strategy is positively or negatively positioned on the credit market and/or some issuers in particular, an upward or downward movement respectively of the credit spreads, or a default, may negatively impact the performance. When evaluating the credit risk of a financial instrument, the Management Company will never rely solely on external ratings.

• Arbitrage risk:

Arbitrage is a technique which consists in benefiting from the differences in prices recorded (or anticipated) between markets and/or sectors and/or securities and/or currencies and/or instruments. If such arbitrage transactions perform unfavourably (a rise in sell transactions and/or fall in buy transactions), the performance may fall.

The risks listed are not exhaustive, and further details on risks are available in regulatory documents.