

# **BAI-Webinar** **Inflation, low growth, and volatility: Why it is imperative to consider your exposure in Secured Finance**

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24.05

### BAI Webinar

- Cat Bonds as a Valuable Source of Return and Diversification in Times of Geopolitical Uncertainty
- 24.05.2022
- 11:00-12:00 Uhr

23.06

### BAI anniversary celebration

- Anniversary celebration of the BAI on the occasion of its 25th anniversary
- 23.06.2022



**Xavier Lassau, CFA**

Senior Portfolio Manager  
Structured Finance  
10+ years' industry experience



# BAI Webinar

## Inflation, low growth, and volatility: Why it is imperative to consider your exposure in Secured Finance

18<sup>th</sup> May 2022

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## Your speaker today



### **XAVIER LASSAU, CFA**

Senior Portfolio Manager,  
Structured Finance

10+ years' industry experience

Joined AXA 2018

Information regarding the background and experience of the personnel of AXA IM are provided for information purposes only. Such persons may not necessarily continue to be employed by AXA IM and may not perform or continue to perform services for AXA IM.

# Agenda

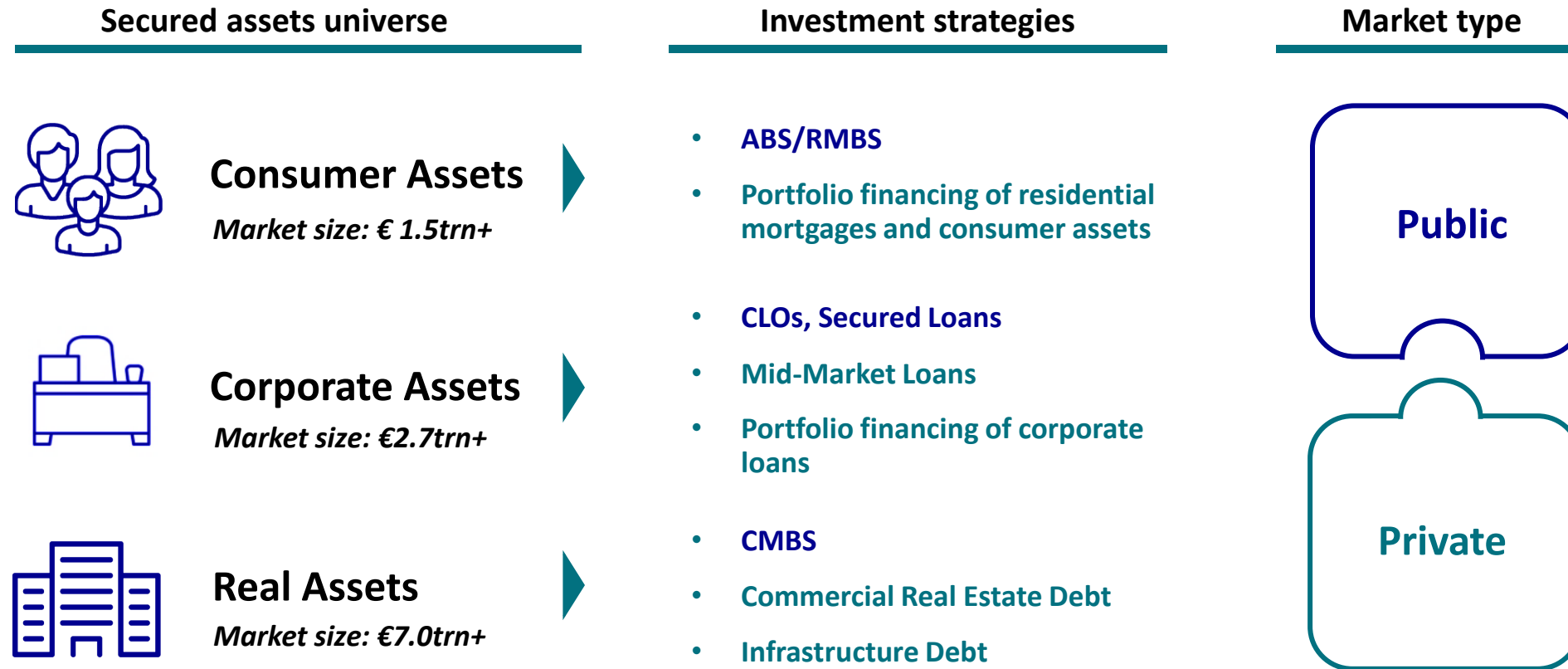
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# Secured Finance Opportunity

## Secured Finance: a sound and diversified universe



Source: AXA IM.

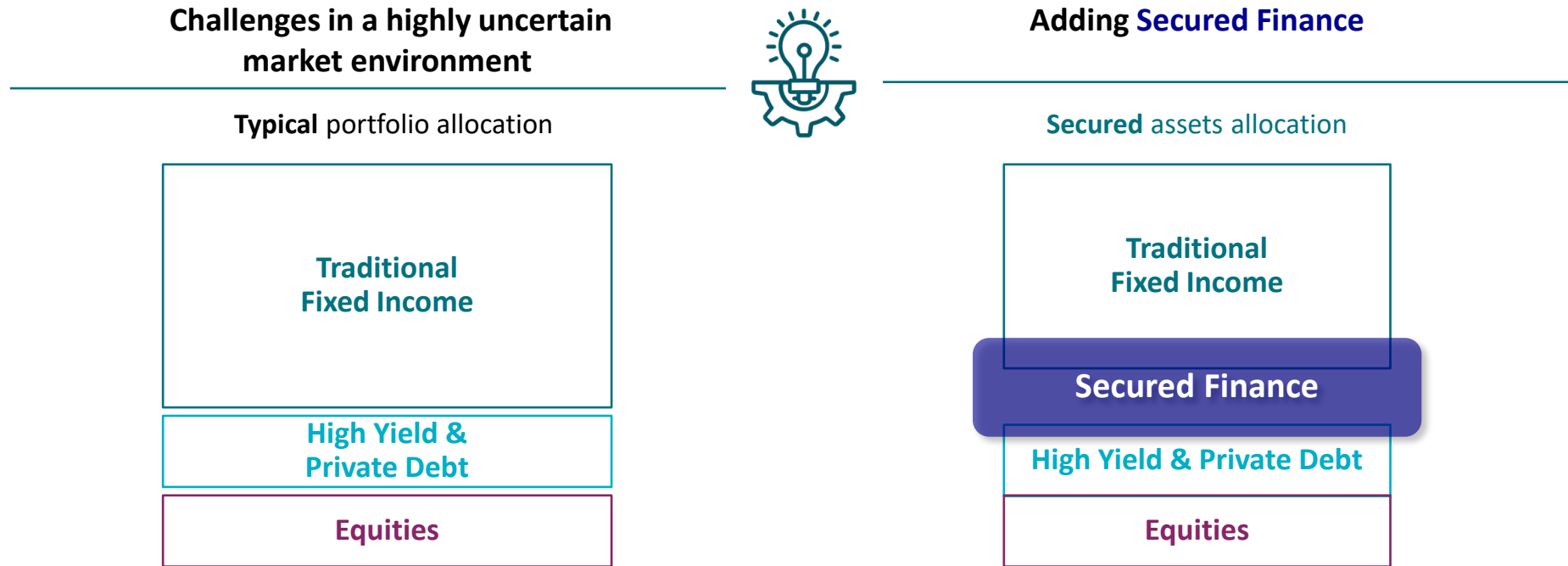
CLO: Collateralised Loan Obligations, ABS: Asset Backed Securities, CMBS: Commercial Mortgage Backed Securities.

RMBS: Residential Mortgage Backed Securities.



# What can Secured Finance offer?

Offering credit protection, diversification & yield enhancement through quality assets



## Benefits

- ✓ **Structural protection** of secured finance
- ✓ **Yield pick-up** over traditional fixed income
- ✓ **Diversification**
- ✓ **Predictable cash flows**

Source: AXA IM for illustrative purposes only.

# Additional yield capture over traditional credit

Broadening the investment universe can offer investors improved risk/return features



Secured finance assets can offer **attractive risk/return** compared to traditional fixed income credit instruments:



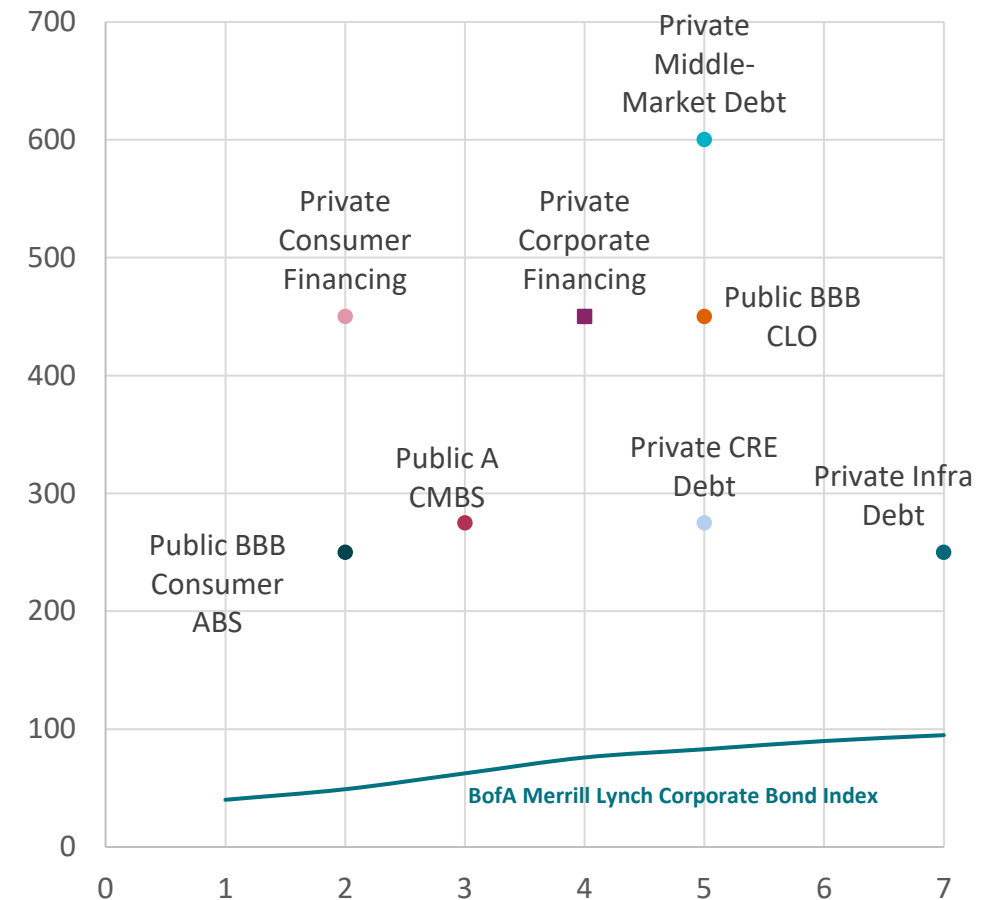
The yield pickup reflects the **structural premium** of secured finance assets:

- **Specific Premium**  
Associated with sourcing and high barriers to entry
- **Illiquidity Premium**  
Of private debt opportunities
- **Scarcity of Capital**  
Due to bank lending retreat following the changes in bank regulations since the Great Financial Crisis



**Robust structural protection** through secured quality assets offer investors additional security

## Yield premium over traditional credit



Source: AXA IM, Bloomberg: Figures are an average of observable prices seen in the market for each sub-asset class as at 29 April 2022. . BofA Merrill Lynch Corporate Bond Index. CLO: Collateralised Loan Obligations, ABS: Asset Backed Securities, CMBS: Commercial Mortgage Backed Securities. The figures provided relate to previous months or years and past performance is not a reliable indicator as to future performance.

## Macroeconomic environment

Our views: volatile and inflationary environment with geopolitical risks a concern



### Areas of concern are stacking up...

- Geopolitical conflicts
- Persistently higher levels of inflation
- Downward revision of global GDP
- New lockdown in China



### ...But fundamentals remain robust

- Benign outlook for loans default rates
- Unemployment rates to hold steady
- Improving Real Estate fundamentals

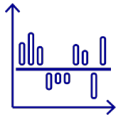
**High quality, floating rate, high-income assets could help successfully navigate difficult macroeconomic periods**

Source: AXA IM as at May 2022. This estimate is indicative only and involve significant elements of subjective judgement, assumptions and analysis. Actual results may vary and the variations may be material. These terms and conditions are indicative as of the time of this presentation and subject to change.



# How we are looking to navigate this volatile and inflationary macroeconomic environment

Emphasis is on high quality assets with strong income protection in an uncertain economic environment



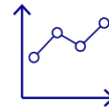
## Defensive positioning

High allocation to quality short dated assets with an active and flexible approach to add value amid market volatility



## Structural enhancement

Secured assets offer strong covenants and structural protection, hedging idiosyncratic risk and potential rise of defaults



## Short duration focus

Floating rate asset exposure to take advantage of a rising rate environment and mitigate volatility impacts on rates



## Diversification

Through jurisdictions, asset classes and different underlying risk exposures beyond traditional credit



## Look for carry

High income (on a relative basis) with the ability to capture carry in a rising rates environment



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# Secured Finance Deep Dive








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# Consumer Assets



## Consumer Assets

 <b>Collateral</b>	<ul style="list-style-type: none"><li>• Transactions secured by thousands of consumer loans such as Auto Loans, Credit Cards, Student Loans, Residential Mortgages</li><li>• Access to a diversifying asset class linked to the real economy</li></ul>
 <b>Why now?</b>	<ul style="list-style-type: none"><li>• Excellent fundamentals: low unemployment rate and high savings rate</li><li>• Good historical performance through the full credit cycle</li><li>• Attractive yield pick-up versus traditional fixed income with similar ratings</li></ul>
 <b>Target Returns</b>	<ul style="list-style-type: none"><li>• Public: E+200bp to E+350bp at investment grade level</li><li>• Private: E+300bp to E+500bp at investment grade level</li><li>• Average life between 2 to 4 years</li></ul>
 <b>Risk Drivers</b>	<ul style="list-style-type: none"><li>• Statistical approach based on macro fundamentals<ul style="list-style-type: none"><li>– Unemployment</li><li>– Consumer wealth</li></ul></li></ul>
 <b>Examples</b>	<ul style="list-style-type: none"><li>• A short-dated mezzanine tranche of German Auto ABS priced at E+250bp for 1y duration</li><li>• Investment in a private UK consumer ABS at the senior level priced at E+325bp for 1.5y duration</li></ul>

Source: AXA IM as at May 2022. Target returns are not guaranteed.

## Consumer Assets: Robust Fundamentals

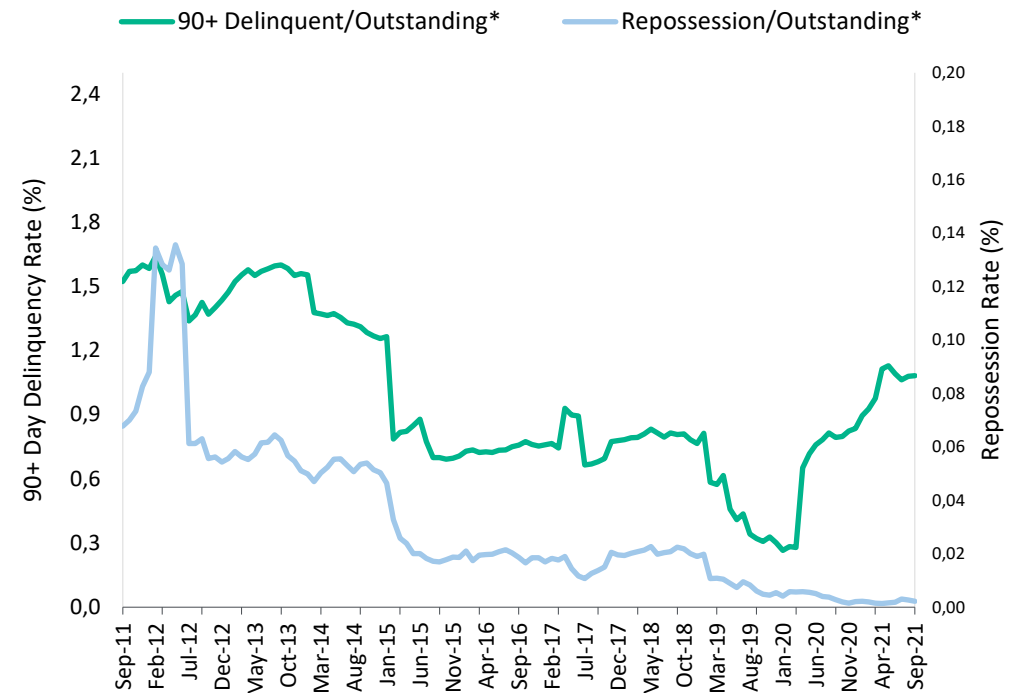
Consumer loan payment arrears and prime residential performance are examples of resilient fundamentals

- Historically low unemployment and high saving rates have led consumer assets to perform strongly
- Focusing on prime assets should help to limit inflationary and recessionary risk

**European Consumer Loan  
Payment arrears(%) < 180 days**



**Prime UK Residential Market  
Performance**



Top LF Chart source: Moody's as at 31 December 2021. Remaining charts source: AXA IM as at March 2022. \* % of outstanding balance for master trust programmes, % of original balance otherwise








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# Corporate Assets



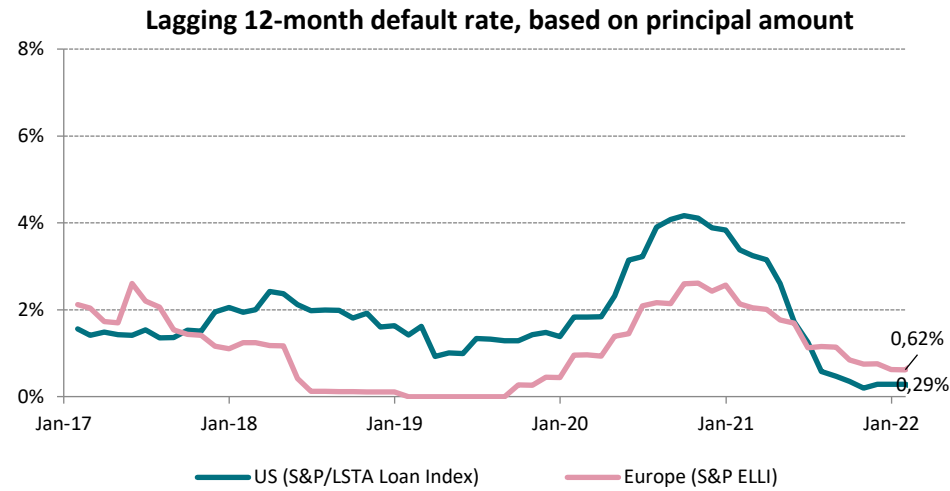
## Corporate Assets

 <b>Collateral</b>	<ul style="list-style-type: none"><li>• Transactions secured by senior secured loans</li><li>• Access to different corporate exposures focusing on the secured part of the corporate credit universe with better rates of recovery</li></ul>
 <b>Why now?</b>	<ul style="list-style-type: none"><li>• Default on Loans remain at historically low levels</li><li>• Better quality portfolio in private transactions since the Covid crisis</li><li>• Spreads on private strategies have not tightened as much as public markets</li></ul>
 <b>Target Returns</b>	<ul style="list-style-type: none"><li>• Public: E+220bp to E+450bp at investment grade level</li><li>• Private: E+400bp to E+500bp at investment grade level</li><li>• Average life between 5 to 7 years</li></ul>
 <b>Risk Drivers</b>	<ul style="list-style-type: none"><li>• Corporate default risk</li><li>• Corporate leverage</li><li>• Political risks and exposure to Covid-impacted industries</li></ul>
 <b>Examples</b>	<ul style="list-style-type: none"><li>• CLO debt tranche rated BBB at E+475bp in March 2022 during the market sell-off</li><li>• Investment in a portfolio financing global large corporates at the mezzanine level priced at E+400bp for 5y duration</li></ul>

Source: AXA IM as at May 2022. Target returns are not guaranteed.

## Attractive Relative Value

Spreads have widened while default rates remain at historical lows and recovery rates remain high



Average corporate debt recovery rates measured by trading prices\*

Priority Position	Issuer-weighted recoveries			Volume-weighted recoveries		
	2021	2020	1983-2021	2021	2020	1983-2021
1st Lien Bank Loan	68.8%	59.8%	65.5%	76.4%	61.0%	63.3%
2nd Lien Bank Loan	34.1%	26.7%	32.0%	31.8%	25.1%	28.7%
Sr. Unsecured Bank Loan	n.a.	47.5%	46.3%	n.a.	47.5%	43.9%
1st Lien Bond	58.2%	52.5%	54.6%	64.2%	50.2%	55.6%
2nd Lien Bond	98.1%	33.8%	44.3%	98.1%	26.9%	41.5%
Sr. Unsecured Bond	51.0%	34.6%	38.0%	48.6%	26.8%	34.8%
Sr. Subordinated Bond	17.0%	14.1%	31.0%	17.0%	22.7%	26.6%
Subordinated Bond	n.a.	n.a.	32.1%	n.a.	n.a.	27.9%
Jr. Subordinated Bond	n.a.	n.a.	22.3%	n.a.	n.a.	13.5%

\* We use market prices (bids) to proxy recoveries in this exhibit.  
Source: Moody's Investors Service








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# Real Assets



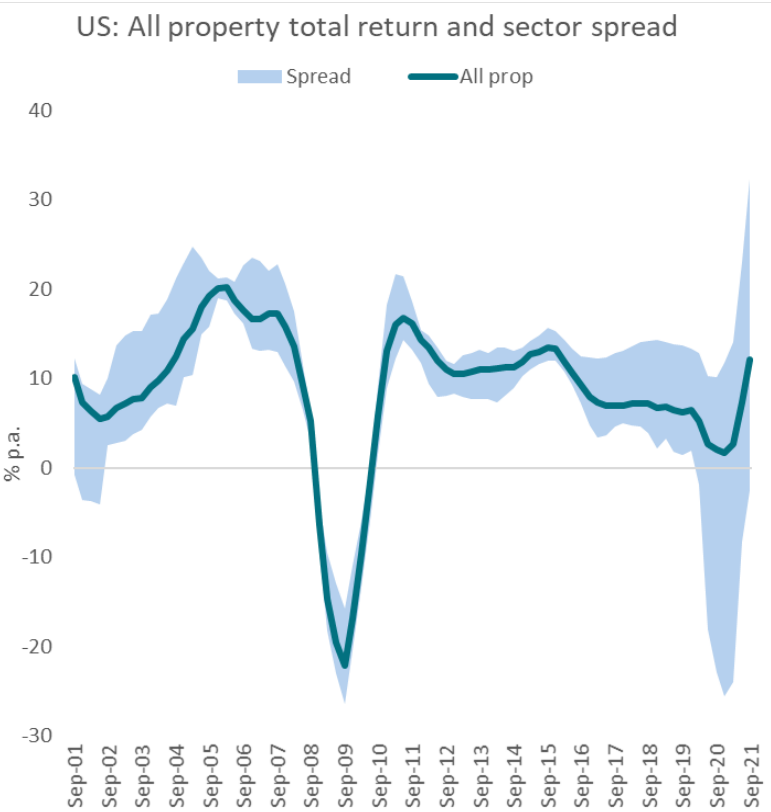
## Real Assets

 <b>Collateral</b>	<ul style="list-style-type: none"><li>• Transactions backed by commercial real estate debt</li><li>• Access to the real estate market through the debt side with high structural protection in term of LTV and covenants</li><li>• Benefit of security (mortgage) and financial covenants</li></ul>
 <b>Why now?</b>	<ul style="list-style-type: none"><li>• Market dislocation translating into flight to quality (lower LTV and more lender friendly structures) and repricing</li><li>• Acceleration of structural shift from banks (with limited capital capacities) to alternative lenders</li><li>• Premium for size and players offering track record execution capacities</li></ul>
 <b>Target Returns</b>	<ul style="list-style-type: none"><li>• Public: E+200bp to E+350bp at investment grade level</li><li>• Private: E+250bp to E+300bp at investment grade level</li><li>• Average life between 5 to 7 years</li></ul>
 <b>Risk Drivers</b>	<ul style="list-style-type: none"><li>• Vacancy rates and payment holidays</li><li>• Interest rates trend</li><li>• Macro play on economy / asset classes structural shift</li><li>• Cap rates</li></ul>
 <b>Examples</b>	<ul style="list-style-type: none"><li>• A senior mortgage secured 10 year loan to a prime multifamily Asset in New York (invested at a coupon of 4% for 60% LTV – 7% debt yield)</li><li>• A senior mortgage secured 5 year loan to a prime Italian logistic portfolio (E+325bp for 50% LTV – 10% debt yield)</li></ul>

Source: AXA IM as at May 2022. Target returns are not guaranteed.

# How to Hedge Inflation and Macro risk? Selection and Rental growth strategies

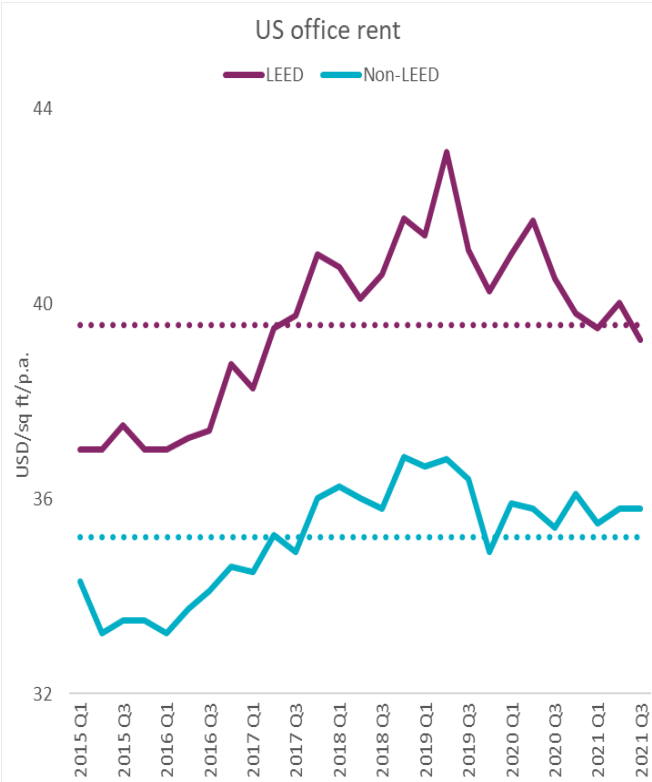
## Selection: A Tiered Market



Source: NCREIF, AXA IM - Real Assets, data as at Q3 2021

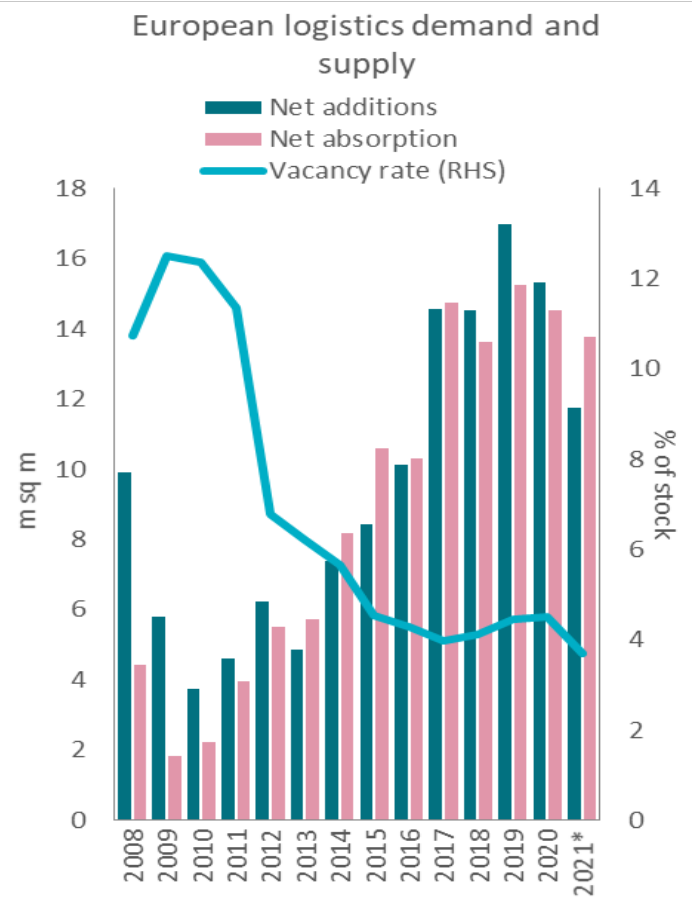
Source: AXA IM

## Rental Growth Drivers: ESG



Source: CoStar, Cushman & Wakefield, AXA IM - Real Assets, data as at Q3 2021

## Megatrends Growth



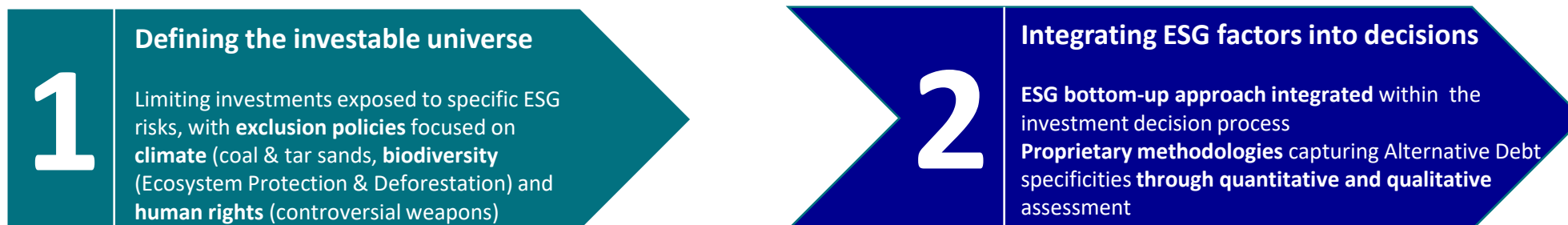


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# ESG Integration

# ESG advanced framework for private debt and alternative credit

A 2-step process, with ESG integration capturing each expertise's specificities



## Consumer lending

- For **ABS, mortgage loans and asset financing**, a variety of indicators are taken into account depending on the nature of assets:
  - CO2 emissions for auto ABS,
  - Energy efficiency measures or labels for residential or commercial assets,
  - Social risk linked to predatory lending, etc
- **Holistic ESG Due diligence** based on:
  - ESG assessment on counterparty, asset portfolio & country
  - Data provided by external providers as well as questionnaire completed by our counterparty



## Corporate lending

- **ESG Leveraged loans deep dive** based on:
  - Questionnaire completed by corporate
  - Controversial risks review and sustainability analysis
- **CLOs** framework focusing on CLO manager & portfolio to assess CLO Manager ESG selectivity
- **Reg Cap** approach based on originating banks & underlying portfolio to assess ESG on Reg Cap transaction as a whole



## Real Assets lending

- **Balanced ESG assessment factoring:**
  - Environmental impact
  - Sponsor commitments
  - Country score
- **For CRE**, assessment of the underlying portfolio, focusing on:
  - energy efficiency labels, **EPC**,
  - clean transportation,
  - environmental risks
- **Infrastructure debt** project assessment including its alignment with 7 of **UN Sustainable Development Goals**

Source: AXA IM as at March 2022 . The ESG data used in the investment process are based on ESG methodologies which rely in part on third party data, and in some cases are internally developed. They are subjective and may change over time. Scoring is not a determining factor of investment decision



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# Example of Solution

# Secured Finance: accessing public and private alternative debt markets

Ability to be agile across different market environments

## Key advantages



### Public markets:

- Ability to capture market opportunities and capitalize on market price dislocations
- Provide investors with liquidity

### Private markets:

- Capture specific market premiums
- No mark-to-market volatility

## Our solution

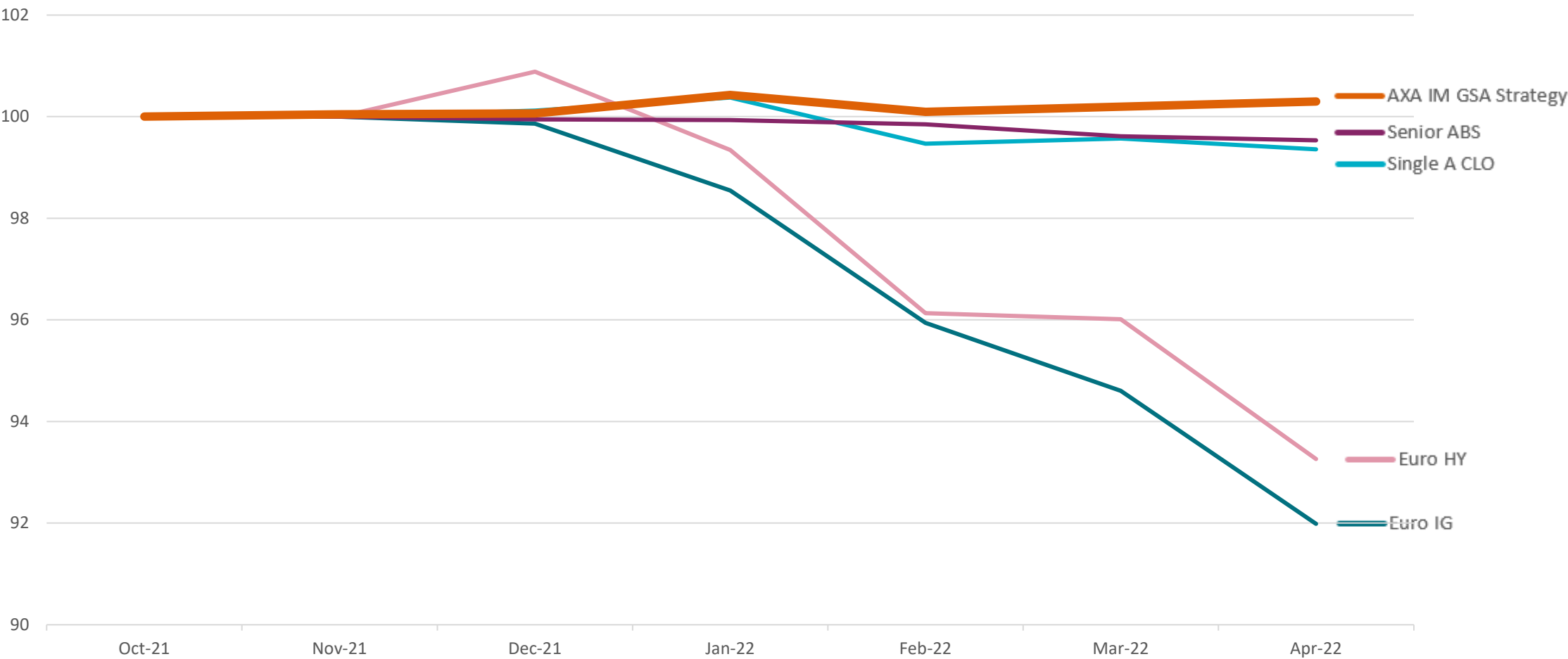


- ✓ A single solution – Secured Finance strategy
- ✓ Access to yield premiums
- ✓ Exploiting inter and intra market inefficiencies
- ✓ Ability to be patient and selective in allocating to private market opportunities
- ✓ Diversified assets addressing macroeconomic issues

**An opportunistic secured finance portfolio can help you successfully navigate uncertain macroeconomic periods**



# AXA IM GSA - Performance since Launch



**A robust and resilient track record across a volatile environment**

Source: AXA IM as at 31 March 2022. I1 shareclass performance provided above. Estimated performance for March 2022. \*SL = Since Launch



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# Questions & Answers



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