FEBRUARY 2025

SECURED FINANCE
ACHIEVING LIQUIDITY FROM ILLIQUID ASSETS

Achieving the cashflows and the certainty of those cashflows required by investors does not mean avoiding illiquid assets. Invested properly, secured finance can naturally provide investors the cashflows they need, when they need them.

SUMMARY

- Secured finance assets have some key attractive characteristics that any investor can make work to their advantage. Too often secured finance is dismissed as a viable investment, being regarded as illiquid, but illiquidity, if managed correctly can actually benefit investors looking for cashflows.
- By managing secured finance assets properly, investors can use them to meet return or cashflow needs and can play a valuable role in any broad investment portfolio.

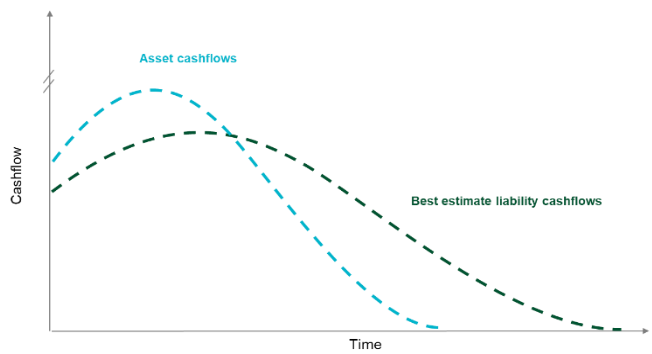
ILLIQUID ASSETS CAN PROVIDE LIQUIDITY NATURALLY

Citing illiquidity for not holding secured finance may mean missing some critical and attractive features of the asset class, as they may still be completely capable of meeting an investors cashflow needs. If secured finance investments can provide the cashflows an investor needs (through coupons or maturities) before an investor would otherwise sell liquid assets to raise cash - what we call 'natural liquidity', concerns about not being readily saleable in the open market may be overstated. Consequently, illiquid assets can play an important part of a maturing asset base – particularly secured finance assets that have a relatively short maturity profile.

For our UK pension scheme clients, we typically use secured finance assets with up to approximately three to four years to maturity. This means they can play a role so long as the total amount held is less than the expected liability cashflow over this time (below the green line in Figure 1).

Investors can therefore receive more cash for their investment due to the "illiquidity premia" in the asset; essentially sacrificing liquidity that they don't need.

Figure 1: In early years, excess asset cashflows over liabilities could help to improve resilience[1]

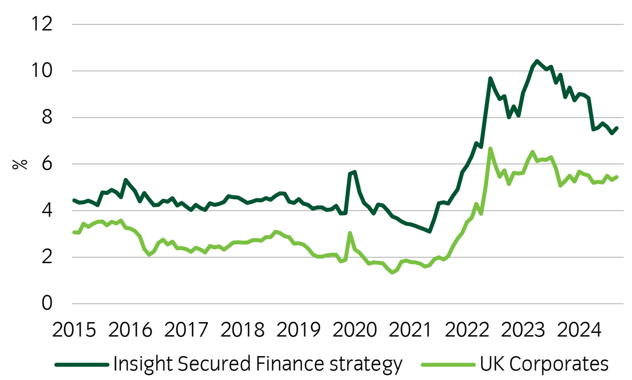


YIELD APPEAL

For schemes with suitable time horizons, switching from public assets into private markets as they come closer to maturity may also provide a yield enhancement. The credit spread on public market assets typically tightens for short maturities, so there is potential for a yield pick-up by moving into private assets.

The last time yields on the broad investment grade (IG) UK corporate market exceeded 6% was before the 2008 global financial crisis. Similarly, it has been a long time since IG secured finance had yields available around current levels (see Figure 2).

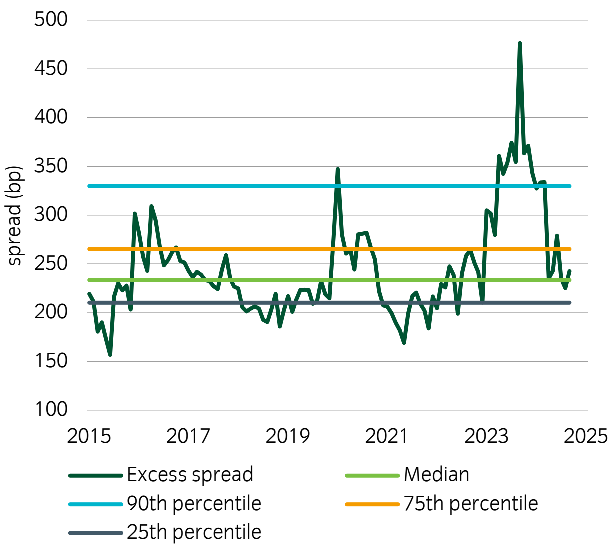
Figure 2: Yields remain above the long-standing range when short-term rates were held low[2]



[1] Source: Insight. For illustrative purposes only.
[2] Source: Insight, Bloomberg. As at 31 December 2024. Insight Secured Finance strategy yield is the discount margin on the representative portfolio plus the generic 3-year GBP swap rate. UK Corporates represented by Yield to Worst on Bloomberg Sterling Corporate Bond Index (LC61YW).

In addition to the attractive absolute levels of yields, defined benefit (DB) pension schemes may find the amount of additional yield that a secured finance strategy currently offers over comparable corporate bonds appealing. The excess spread level of Insight's Secured Finance strategy over an equivalent sterling corporate market index is currently almost 250 basis points (bp), as illustrated in Figure 3, close to the average available since the strategy's representative portfolio began in 2015.

Figure 3: Secured finance – excess spread over sterling corporate bonds



Source: Insight, Bloomberg. As at 31 December 2024. Discount margin on Insight Secured Finance strategy representative portfolio versus Bloomberg Sterling Corporate Bond Index option adjusted spread (LC61OAS).

NOT ALL ILLIQUID ASSETS ARE THE SAME

While secured finance may be viewed as illiquid, it has materially different characteristics to perpetual assets such as private equity or long dated infrastructure projects.

The degree of liquidity available is unlikely to be uniform across all illiquid asset classes. That means different categories of assets with limited liquidity are likely to have different characteristics and different appeal in the broader portfolio construction decision process.

Table 1: Illiquid asset characteristics

Type of illiquid asset	Principal and interest paid	Investment grade quality	Typical average maturity
Private secured finance (e.g. asset backed)	Yes	Yes	1-2 years
Private debt (e.g. middle market corporates)	Yes	Not generally	5-7 years
Private equity	No	No	7-10 years

Source: Insight. For illustrative purposes only

TRANSFORMING SECURED ASSETS INTO NATURAL LIQUIDITY

Secured finance may benefit materially from natural liquidity if designed appropriately, even if they may face difficulty in being sold prior to maturity.

Insight is a market leader in providing risk management solutions[3]. Pension schemes with an excess of maturing assets do not have to be forced sellers to meet liquidity needs.

An added benefit for pension schemes is that, if the portfolio is structured as such, the collateral adequacy of the scheme could steadily be topped up over time, as more than 100% of outflows could be met from maturing assets.

SECURED FINANCE ASSETS – A REFRESHER

What is secured finance?

The secured finance market, which includes asset-backed securities (ABS), is a credit market in which the coupons and principal payments are backed by, and frequently derived from underlying pools of loans that act as the collateral.

The key difference between secured finance and more mainstream corporate bonds is that the latter are typically unsecured (particularly in the investment grade market) and also offer comparatively little in the way of structural protection.

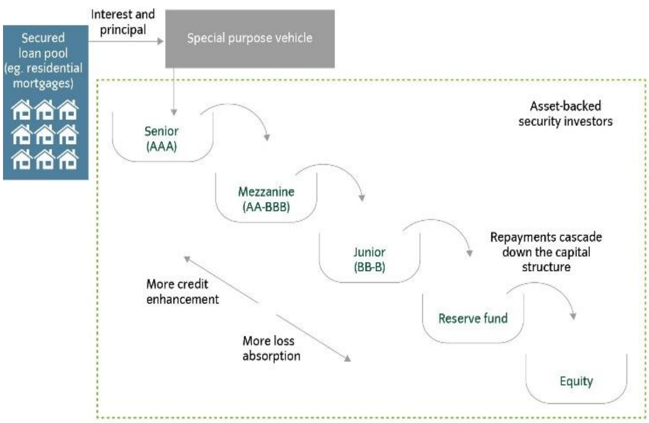
How ABS are structured

Banks create ABS structures by taking loans from their books (such as mortgages previously written to customers) into a separate legal structure known as a special purpose vehicle (SPV). The loans are then repackaged into bond structures that investors can buy.

How ABS can enhance credit quality

ABS are structured into different classes of bonds with different credit ratings.

Figure 4: Secured finance "waterfall"[4]



As Figure 4 illustrates, the principal and interest payments from the underlying loan pools flow through to the SPV which then

[3] Insight was named sole UK Quality Leader for Investment Management Service in 2024 based on citations by UK clients in Coalition Greenwich's 'Voice of Client' – 2024 UK Institutional Investors Survey
[4] Source: Insight. For illustrative purposes only.

distributes the payments to holders of the highest-rated bonds (senior bondholders) first.

Only once these bondholders have been paid in full are proceeds distributed to the holders of lower-rated bonds (mezzanine or junior). This cascading pattern continues all the way down the capital structure and is known as a '**waterfall**' structure.

Effectively, the bonds higher up the capital structure have a higher credit quality than the underlying loan pool in aggregate because they will generally still be repaid even if a portion of the underlying loans default. We call this process '**credit enhancement**'. However, those at the bottom of capital structure would suffer losses immediately should loans in the pool begin to go bad, hence they are called 'loss absorbing'.

IMPORTANT INFORMATION

TEN-YEAR PERFORMANCE RECORD TO 31 DECEMBER 2024

	Calendar year returns									
	2024	2023	2022	2021	2020	2019	2018	2017	2016	2015
Insight secured finance strategy	11.80	9.17	0.52	5.83	0.37	5.20	2.59	7.59	6.82	-
SONIA	5.28	4.77	1.42	0.06	0.29	0.80	0.72	0.35	0.50	-

	12-month rolling returns									
	2024	2023	2022	2021	2020	2019	2018	2017	2016	2015
Insight secured finance strategy	11.80	9.17	0.52	5.83	0.37	5.20	2.59	7.59	6.82	-
SONIA	5.28	4.77	1.42	0.06	0.29	0.80	0.72	0.35	0.50	-

Please refer to the following risk disclosures. Returns are shown gross of fees. The Insight secured finance strategy (C0937) is in GBP. Inception date: 27 November 2015.

RISK DISCLOSURES

Past performance is not indicative of future results. Investment in any strategy involves a risk of loss which may partly be due to exchange rate fluctuations.

The performance results shown, whether net or gross of investment management fees, reflect the reinvestment of dividends and/or income and other earnings. Any gross of fees performance does not include fees, taxes and charges and these can have a material detrimental effect on the performance of an investment. Taxes and costs incurred when purchasing, holding, converting or selling any investment, will impact returns. Costs may increase or decrease as a result of certain currency conversions, such as currency hedging, investment exposure to international markets, and exchange rate fluctuations.

Any target performance aims are not a guarantee, may not be achieved and a capital loss may occur. The scenarios presented are an estimate of future performance based on evidence from the past on how the value of this investment varies over time, and/or prevailing market conditions and are not an exact indicator. They are speculative in nature and are only an estimate. What you will get will vary depending on how the market performs and how long you keep the investment/product. Strategies which have a higher performance aim generally take more risk to achieve this and so have a greater potential for the returns to be significantly different than expected.

Any projections or forecasts contained herein are based upon certain assumptions considered reasonable. Projections are speculative in nature and some or all of the assumptions underlying the projections may not materialise or vary significantly from the actual results. Accordingly, the projections are only an estimate.

Portfolio holdings are subject to change, for information only and are not investment recommendations.

ASSOCIATED INVESTMENT RISKS

Secured Finance Fund

- A credit default swap (CDS) provides a measure of protection against defaults of debt issuers but there is no assurance their use will be effective or will have the desired result.
- Derivatives may be used to generate returns as well as to reduce costs and/or the overall risk of the portfolio. Using derivatives can involve a higher level of risk. A small movement in the price of an underlying investment may result in a disproportionately large movement in the price of the derivative investment.
- Investments in bonds are affected by interest rates and inflation trends which may affect the value of the portfolio.
- The investment manager may invest in instruments which can be difficult to sell when markets are stressed.
- Leveraged funds: as a result of market conditions, the value of the assets held by a Fund may fall and result in a higher degree of leverage than is deemed appropriate by the Investment Manager. In order to reduce the degree of leverage, the Investment

Manager may seek to reduce a Funds' total asset exposure. Investors would need to subscribe for additional Shares in order to maintain the level of sensitivity to market movements. Where such an event is unanticipated, this may result in the investors having less sensitivity to market movements than they might consider appropriate to their individual requirements until they have subscribed for additional Shares.

- The specific collateral used to secure a loan may decline in value or become illiquid, which would adversely affect the loan's value. Also, many loans are not actively traded, which may impair the ability of the portfolio to realise full value in the event of the need to liquidate such assets.
- Property assets are inherently less liquid and more difficult to sell than other assets. The valuation of physical property is a matter of the valuer's judgement rather than fact.

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