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Insight INVESTMENT

APRIL 2023

INSIGHT'S LEVERAGED LOANS STRATEGY
A CREDIT OPPORTUNITY

LEVERAGED LOANS HAVE PLENTY OF FEATURES THAT INVESTORS MAY CONSIDER TO BE ATTRACTIVE, INCLUDING THE HIGHER YIELD LEVELS THAT PREVAIL AND THE CURRENT POTENTIAL FOR CAPITAL APPRECIATION. INSIGHT'S LONG-STANDING CAPABILITY IN MANAGING LOANS AND ITS STRATEGY TRACK RECORD MAY ALLOW INVESTORS A WAY TO CAPTURE BENEFITS THAT WE BELIEVE THE LOANS MARKET CURRENTLY OFFERS.

WHY CONSIDER LOANS NOW?

Loans have certain features that we believe investors may find appealing:

Security: Leveraged loans are classified as secured First Lien instruments. This means that a loan investor has first claim on the company's assets and cashflows in the event of a default, which can help lower the risk of principal loss versus other asset classes. The assets may be individual, discrete, and specifically defined (such as a building or piece of plant and machinery) or they may be loosely defined, such as a revenue stream from a particular part of the business.

Structural seniority: Loans sit higher up the seniority profile for a corporate borrower than other borrowing such as standard issue bonds. This may be able to offer some lenders improved protection in the event the borrower begins to have trouble in servicing its debt.

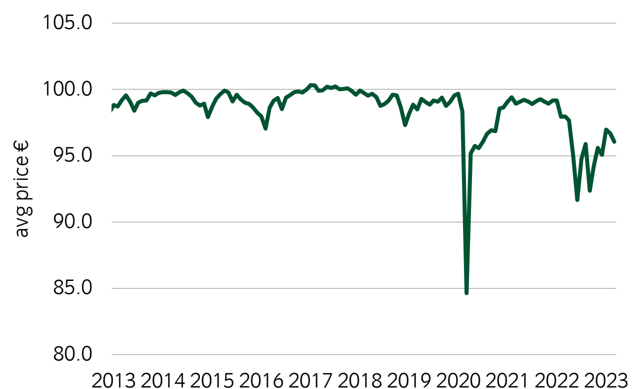
Yield: After an extended period during which yields were at historically low levels, loan yields, in common with other parts of the debt markets, have increased to levels that investors may regard as more attractive and capable of delivering the income or returns they may be targeting.

Figure 1: Yield levels have moved sharply higher

Source: Bloomberg. Credit Suisse Western European Institutional Leveraged Loan Index. As at 31 March 2023.

Improved potential for capital appreciation: The increase in yield levels has broadly been reflected in the lower capital values, though the effect tends to be muted due to the floating rate nature of loans which reduces their interest rate sensitivity. At the end of December 2022, the average price of the Credit Suisse Western European Leveraged Loan Index was just above €95, having recovered from periods of volatility due to the Russian invasion of Ukraine and the UK gilts crisis. That is below the historical average, since 1998 of €97.9, which included both the global financial crisis (GFC) in 2008 and the short-lived dip in early 2020 as COVID-19 took hold. This highlights the potential that improved market conditions may permit yields to decline once more, and average loan prices could increase, thus introducing the potential for some modest capital appreciation.

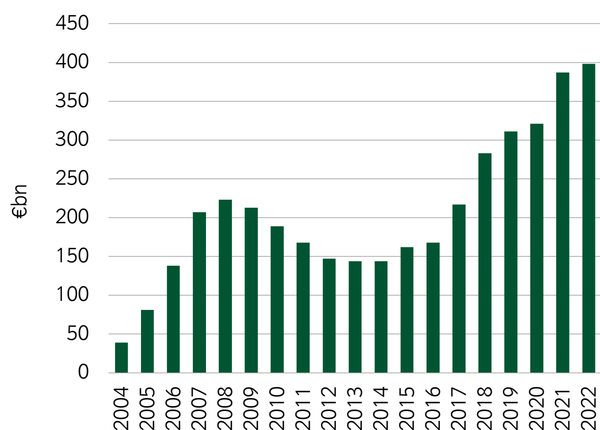
Figure 2: Average price of loans offers scope for potential capital appreciation on top of higher yield and income



Source: Bloomberg. Credit Suisse Western European Institutional Leveraged Loan Index. As at 31 March 2023.

Growing asset class: The European leveraged loan market has grown significantly in recent years. It has evolved into a highly liquid and tradeable market. With more than 500 issues in over 20 countries, we believe the European leveraged loan market offers an attractive opportunity set, which may provide diversification benefits within defensive sectors. There may be a misconception is that it is a small market, but the evidence shows otherwise.

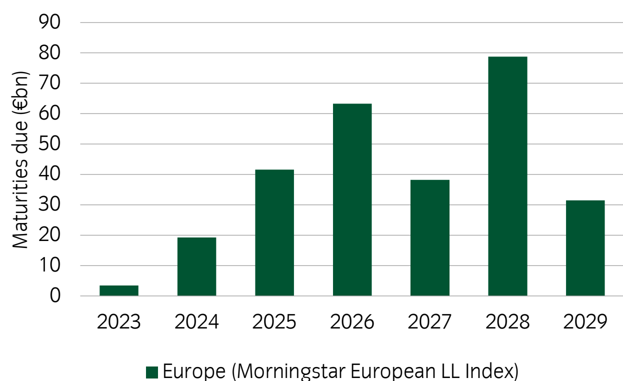
Figure 3: European leveraged loan market size (€bn)



Source: Credit Suisse. As at 31 December 2022. Note: includes US$-denominated loans of European issuers.

Absence of an imminent debt wall: Lenders may be comforted and encouraged by the knowledge that borrowers have been active in recent years, extending and spreading the maturity of their debt. The consequence is that maturities in 2023 and 2024 are relatively modest (as shown in Figure 4), which we believe will be manageable against a challenging economic backdrop.

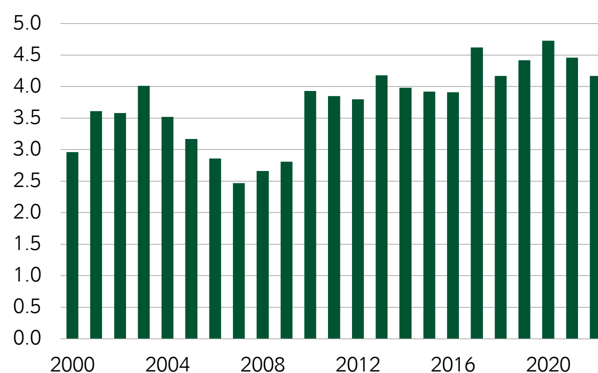
Figure 4: Maturity profile of European leveraged loans outstanding



Source: Morningstar. As at 31 December 2022

Higher levels of interest coverage: The number of times interest payments are covered by earnings before interest and taxes (EBIT), has risen. There have been variations in the interest coverage level in the European market as Figure 5 shows, notably in the run up to and in the wake of the GFC in 2008. However, the coverage level has increased from around 3x EBIT in 2000, to above 4x EBIT in the last six years.

Figure 5: Interest coverage (EBIT/interest payments) – Europe



Source: Pitchbook LCD. As at 31 December 2022.

Manageable expected default rates: The experience of defaults in the European leveraged loan market has declined since the GFC. We expect defaults to rise only gradually in the years ahead but remain low by historical standards.

The representative portfolio for Insight's leveraged loan strategy has not experienced a default since its inception in 2008. During that period, the default rate experienced each year by the S&P European Leveraged Loan Index has typically been between 1% - 4%, based on principal amounts. However, during the GFC in 2009, the default rate exceeded 10%.[1]

Attractive risk/reward characteristics: Further, the risk/reward that can be achieved from investing in loans relative to other asset classes can be attractive. The level of yield they typically provide compares favourably with, and frequently exceeds, that of high yield markets, while their floating rate nature can help to keep the volatility of those returns lower than for fixed rate instruments.

INSIGHT'S STRATEGY

As part of a conservative investment approach, we seek to accompany generating attractive returns with achieving a low volatility of those returns. As we are not attempting to outperform a benchmark index, we are free to selectively invest where we see value and where we believe the business fundamentals of the issuer are solid, to best ensure repayment of the funds we invest.

In managing the leveraged loan strategy, we typically aim to focus on selecting issuers which have defensive properties and visible cashflows.

EXPERIENCE AND CAPABILITIES

Insight's European leveraged loan capability was established in 2007. A dedicated pooled fund, the IIFIG Loan Fund, was launched in March 2008. It is a Qualified Investor Alternative Investment Fund (QIAIF), domiciled in Ireland. The Fund and overall strategy is managed by the European high yield and loan team, part of Insight's Global Fixed Income Group. Lorraine Specketer joined Insight in 2007 to help establish and manage

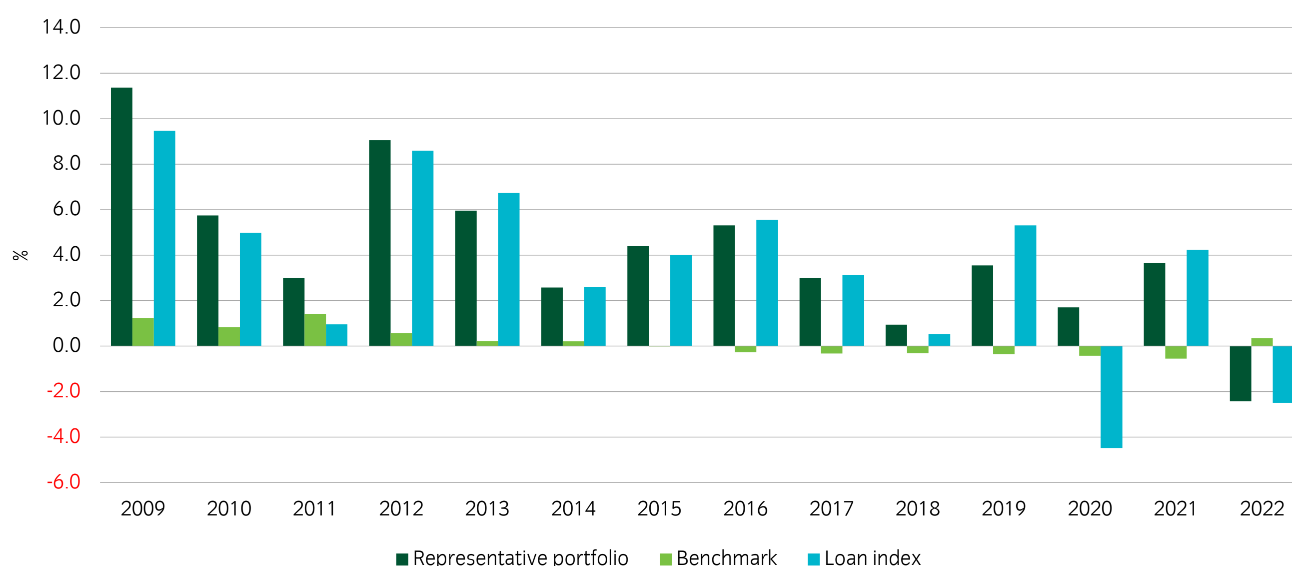
[1] Source: Insight, Standard & Poor's. As at 31 December 2021. S&P lagging 12-month loan default rate, based on principal amount.

the loan platform and has been the lead portfolio manager since 2019. She is a member of the Corporate Lending Committee and is currently the co-Chair of the European Leveraged Finance Association's (ELFA) Loan Investor Committee. Lorraine is assisted by Catherine Braganza, portfolio manager – high yield and leveraged loans and Ulrich Gerhard, portfolio manager – high yield. They are supported by an experienced team of 10 analysts who are sector specialists within leveraged finance.

Since its inception in 2008, the IIFIG Loan Fund has achieved its objective of producing an interest-based return through investment in loans in all years with the exception of 2022. Rising inflation and interest rates, alongside increased volatility driven by the war in Ukraine, made 2022 a torrid year for many fixed income markets, with widespread negative returns. The representative portfolio has successfully achieved its target return of 2.5% per annum above the 3-month Euribor benchmark before tax, fees and expenses in nine of the 14 full calendar years since its inception (see Figure 6).

STRATEGY PERFORMANCE

Figure 6: Calendar year performance of the representative portfolio for the strategy against the benchmark index, 3-month Euribor and a comparator index, the Credit Suisse Institutional Western European Leveraged Loan Index



Source: Insight, Bloomberg, Credit Suisse. As at 31 December 2022. Representative portfolio: Insight Loan Fund (EURLO1UP). Returns are shown gross of fees and in EUR. All returns are annualised. Benchmark: 3-month Euribor. Index: Credit Suisse Institutional Western European Leveraged Loans Index (hedged into EUR). Inception 31 March 2008.

IMPORTANT INFORMATION

TEN-YEAR PERFORMANCE RECORD TO 31 DECEMBER 2022

	Calendar year returns									
	2022	2021	2020	2019	2018	2017	2016	2015	2014	2013
Representative portfolio (gross)	-2.43	3.65	1.70	3.55	0.94	3.00	5.30	4.39	2.57	5.95
Representative portfolio (net)	-2.82	3.24	1.29	3.14	0.54	2.59	4.88	3.97	2.16	5.52
3-Month EURIBOR	0.35	-0.56	-0.43	-0.36	-0.32	-0.33	-0.27	-0.02	0.21	0.22

	12-month rolling returns									
	2022-2023	2021-2022	2020-2021	2019-2020	2018-2019	2017-2018	2016-2017	2015-2016	2014-2015	2013-2014
Representative portfolio (gross)	-2.43	3.65	1.70	3.55	0.94	3.00	5.30	4.39	2.57	5.95
Representative portfolio (net)	-2.82	3.24	1.29	3.14	0.54	2.59	4.88	3.97	2.16	5.52
3-Month EURIBOR	0.35	-0.56	-0.43	-0.36	-0.32	-0.33	-0.27	-0.02	0.21	0.22

Please refer to the following risk disclosures. Returns are shown gross and net of fees. Representative portfolio: Insight Loan Fund (EURLO1UP) is in EUR. Inception date: 31 March 2008.

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 certain charges, such as currency conversion charges may depend on the individual situation of each investor and are subject to change in future.

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 materialize 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

Fixed income

- Where the portfolio holds over 35% of its net asset value in securities of one governmental issuer, the value of the portfolio may be profoundly affected if one or more of these issuers fails to meet its obligations or suffers a ratings downgrade.
- 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.
- The issuer of a debt security may not pay income or repay capital to the bondholder when due.
- 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 emerging markets can be less liquid and riskier than more developed markets and difficulties in accounting, dealing, settlement and custody may arise.
- Investments in bonds are affected by interest rates and inflation trends which may affect the value of the portfolio.
- Where high yield instruments are held, their low credit rating indicates a greater risk of default, which would affect the value of the portfolio.
- The investment manager may invest in instruments which can be difficult to sell when markets are stressed.
- Exposure to international markets means exposure to changes in currency rates which could affect the value of the portfolio.
- Where leverage is used as part of the management of the portfolio through the use of swaps and other derivative instruments, this can increase the overall volatility. While leverage presents opportunities for increasing total returns, it has the effect of potentially increasing losses as well. Any event that adversely affects the value of an investment would be magnified to the extent that leverage is employed by the portfolio. Any losses would therefore be greater than if leverage were not employed.
- While efforts will be made to eliminate potential inequalities between shareholders in a pooled fund through the performance fee calculation methodology, there may be occasions where a shareholder may pay a performance fee for which they have not received a commensurate benefit.

VOLCKER DISCLOSURES

The fund described in this document meets the definition of a covered fund under Volcker regulations, that is, a domestic or foreign hedge fund, private equity fund, venture capital fund, commodity pool or alternative investment fund (AIF) that is sold in a private, restricted or unregistered offering to investors who must meet certain net worth, income or sophistication standards or is sold to a restricted number of investors. Generally, any such fund is not registered with a securities/commodity regulator and therefore cannot be offered to the general or retail public unless the investor meets some type of qualification to demonstrate the investor doesn't need the protection of the securities or commodities regulations.

- **Any losses in the fund will be borne solely by investors in the fund and not by BNY Mellon (including its affiliates); therefore BNY Mellon's losses in the fund will be limited to losses attributable to the ownership interests in the fund held by BNY Mellon and any affiliate in its capacity as an investor in the fund or as beneficiary of a restricted profit interest held by BNY Mellon or any affiliate.**
- **Ownership interests in the fund are not insured by the FDIC, are not deposits, obligations of, or endorsed or guaranteed in any way, by BNY Mellon. Neither BNY Mellon nor any of its controlled affiliates (which includes the fund's general manager/ managing partner/ investment adviser), may directly or indirectly, guarantee, assume, or otherwise insure the obligations or performance of the fund or of any other covered fund in which the fund invests.**
- **Investors should read the fund's offering documents before investing in the fund. Information about the role of BNY Mellon, its controlled affiliates, and their employees in sponsoring or providing services to the fund are described in the Volcker Rule section of the offering documents.**

Institutional Business Development
businessdevelopment@insightinvestment.com
+44 20 7321 1552

European Business Development
europe@insightinvestment.com
+49 69 12014 2650
+44 20 7321 1928

Consultant Relationship Management
consultantrelations@insightinvestment.com
+44 20 7321 1023

@InsightInvestIM

company/insight-investment

www.insightinvestment.com

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