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INVESTMENT GROUP

European credit – 2015 Outlook
5 lessons + 5 ideas + 5 questions

Fabrice Dumonteil
Founder & CEO

Emmanuel Weyd
CIO - Credit

The long transition towards disintermediated European credit markets continues. 2014 was a record year in terms of high yield new issues in Europe, surpassing 2013, which itself exceeded 2012. While European corporates are increasingly turning to non-bank financing (funds, direct lending, etc.), banks continue to deleverage and strengthen their solvency. All this against a backdrop of lower interest rates and tighter credit spreads, which add to the pain when credit accidents arise.

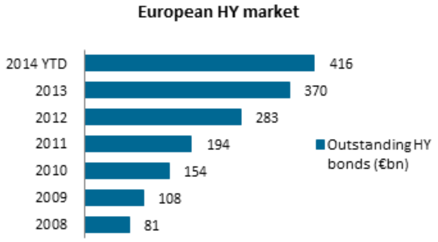
We believe that 2015 will see a continuation of many of the trends of 2014: low default rates (isolated and lumpy), powerful flows, continued deleveraging of banks and high volumes of new issuance.

But these trends shouldn't hide the questions that we face at the dawn of this new year. Where Europe stands in the credit cycle, and -even more fundamentally- the relevance of old-style credit cycles in the "new world" remain uncertain. In terms of valuations, yields are at historic low. Have they troughed? The question is all the more important as US credit has clearly underperformed vs. European credit in 2014. US IG now yields twice as much as European IG. And there is a 3% gap between US HY and European HY. Is this divergence sustainable? And finally, a key question to prepare 2015: what impact will the ECB have?

We highlight 15 snapshots for 2015 below - 5 lessons of 2014, 5 ideas for 2015, 5 questions on 2015.

We are confident that 2015 will be another exciting year, as were all post-crisis years. Agile investors will be faced with many opportunities. Absolute return and flexible strategies should be well suited to the market regime that we expect. And the ultimate rule of survival will be -as always for credit investors- name selection.

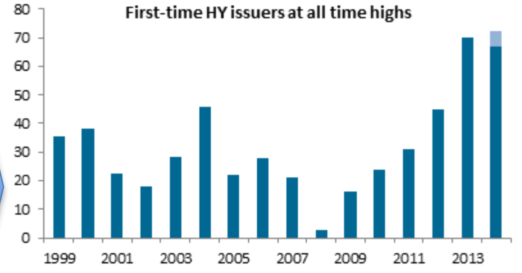
We wish you a Happy New Year 2015!



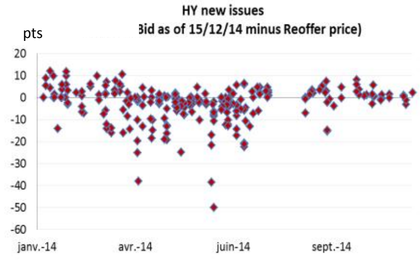
Source: Credit Suisse; EIG analysis

Lesson 2014 #1 – Outstanding European HY bonds volumes are reaching all time highs

Lesson 2014 #2 – The number of first-time issuers ("debut borrowers") continues to rise; new issuers are often under-researched



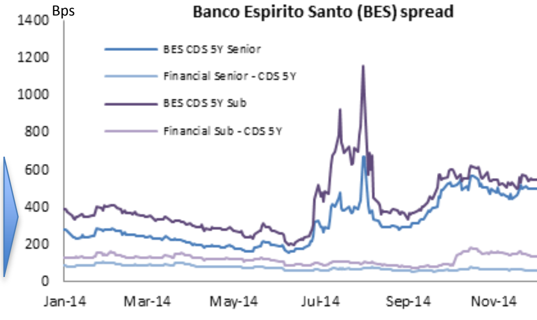
Source: Citi; EIG analysis



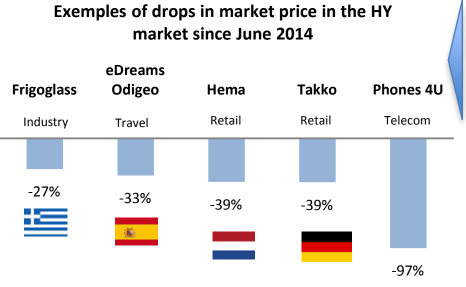
Source: Bloomberg; EIG analysis

Lesson 2014 #3 – Dispersion is significant – HY is not only beta play

Lesson 2014 #4 – Despite an increasing solvency, European banks remain a risky asset class



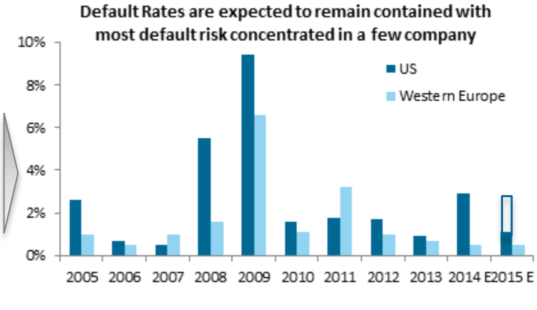
Source: Bloomberg; EIG analysis



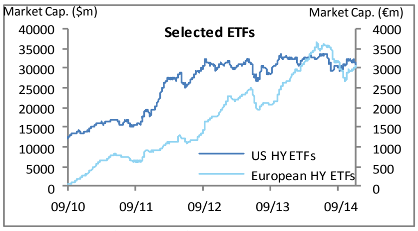
Figures as of 15/12/2014
Source: Bloomberg; EIG analysis

Lesson 2014 #5 – HY can go both ways – there is room for alpha

Idea 2015 #1 – Default rates of European corporates should stay relatively low



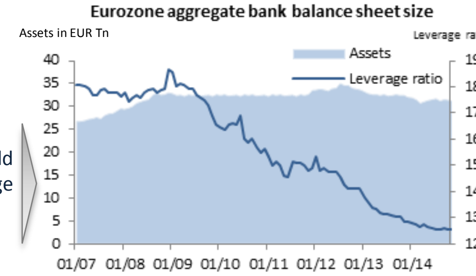
Source: Credit Suisse; analyses EIG



Source: Bloomberg; EIG analysis

Idea 2015 #2 – Inflows in the HY market should remain strong

Idea 2015 #3 – Banks should continue to deleverage



Source: JP Morgan; EIG analysis

Expected corporate issues in 2015 - Europe

€ bn	Gross	Repayment	Net
Investment Grade Non financials	280	160	**120**
High Yield Non financials	72	60	**12**

Source: Morgan Stanley; EIG analysis

Idée 2015 #4 – In a context of disintermediation, corporate issues are expected to remain strong in 2015

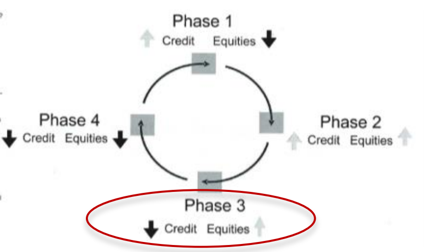
Idea 2015 #5 – Financial institutions should continue to issue hybrid bonds in line with Basel III requirements

Expected financial issues in 2015 - Europe

€ bn	Gross	Repayment	Net
Senior	255	300	**-45**
Tier 2	45	20	**25**
Alt. Tier 1	65	0	**65**

Source: Morgan Stanley; EIG analysis

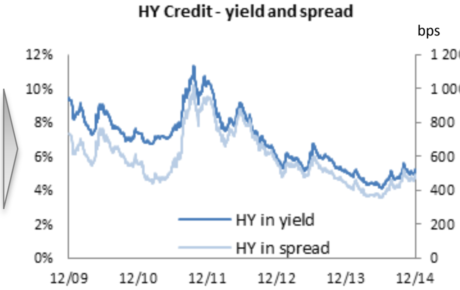
Credit Clock



Phase 3 historically has delivered 3 things: (1) more volatility, (2) big-cap outperformance, (3) bubbles

Source: Citi; EIG analysis

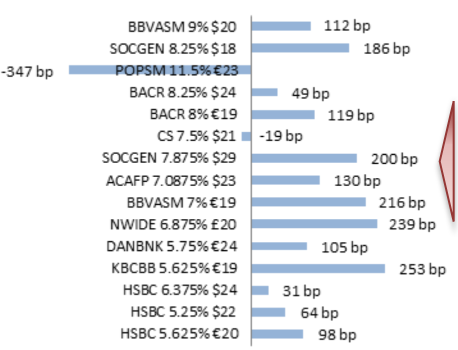
Question 2015 #1 – Where are we in the European corporate credit cycle? Is the credit clock still relevant in the "new world"?



Source: EIG analysis

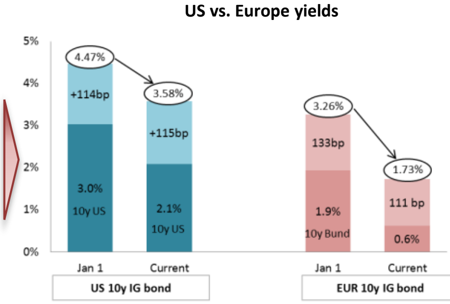
Question 2015 #2 – Have valuations peaked?

AT1 Fair Value model framework



Source: JP Morgan; EIG analysis

Question 2015 #3 – Are CoCos attractive?



US HY = 7.56% Europe HY = 4.69%
Difference = 1.26% (yield) + 1.61% (spread)

Source: Société Générale; EIG analysis

Question 2015 #4 – Is the US vs. Europe divergence sustainable?

ECB – what kind of purchase program?

€ denominated securities	Current outstanding	Eligible ECB refi	Likelihood of ECB purchase in 2015
€ Govies	ca. €6,500 bn	✓	***
€ ABS	ca. €900 bn	✓	100%
€ Covered bonds	ca. €900 bn	✓	100%
€ Financial senior	ca. €300 bn	✓	*
€ IG corporate	ca. €600 bn	x	**
€ HY	ca. €200 bn	x	n.a.
Total	**ca. €9,400 bn**		**€ 1,000 (inc.TLTRO)**

Source: EIG analysis

Question 2015 #5 – What will be the impact of the ECB's next move?

ABOUT EIFFEL INVESTMENT GROUP

Eiffel Investment Group is an alternative asset manager and investor in European credit and equity.

The firm manages close to EUR 500 million of proprietary and third party assets in a range of absolute return strategies in European credit and equity.

Eiffel Investment Group relies on a fundamental, research-intensive, investment approach to identify attractive alpha generating investment opportunities.

Eiffel Investment Group is an independent firm, owned by the team alongside former Louis Dreyfus group Chairman & CEO Jacques Veyrat (the company started end 2008 as an asset management division of the Louis Dreyfus group and spun-off mid-2011).

The firm and its principals have invested EUR 100 million in the funds managed by Eiffel Investment Group, ensuring a very strong alignment of interests with investors and a constant focus on risk management.

Guillaume Panié
gp@eiffel-ig.com
+33 1 81 69 25 84

Gilles Macaigne
gm@eiffel-ig.com
+33 1 81 69 25 85