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# Aperture Credit Opportunities Fund
# Q1 2021 Commentary

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**Quarter in Review**

The Aperture Credit Opportunities Fund (Ticker: AICOIUC LX, Institutional USD Acc) returned 1.75% (net of frees) for Q1 2021, versus the Fund's benchmark return of 0.50%, for a total outperformance of 1.25%.[1]

The recovery in markets from the March 2020 lows through to the end of the year was broad-based and quite remarkable. For example, both investment grade (IG) and high yield (HY) spreads, which had ballooned wider, recovered around 90% of the move by year-end along with yields having also fallen to record lows with the US HY market at just over 4%.[2]

Consequently, when we surveyed the credit landscape in early January we concluded that, although inflows to the asset class remained strong, stretched valuations meant that the upside to most credits was limited. We felt that the market was unlikely to sell off too far and that spread dispersion was likely to continue to decline as markets priced in an eventual recovery from COVID.

From an asset allocation perspective, we believed that the core long portfolio would continue to generate the majority of returns (albeit at a slower rate) and that the relative value (RV) and primary trading buckets would also be net contributors. Some steady carry could also be contemplated from a market most likely to be range-bound. When looking at things from a regional perspective, we felt we saw relatively similar degrees of opportunity in the US versus Europe and kept balance sheet allocation and leverage balanced across the two.

We focused the long opportunities around those names that we felt continued to demonstrate positive convexity: beaten-up credits with the potential to surprise to the upside and those likely to benefit from positive event risk and some of the better quality "stable carry" names.

In mid-March we added some duration to our core long book, buying names that had been hit hardest by the move higher in treasury yields. These performed well as government bonds rallied into year end.

*1) Fund benchmark: United States Secured Overnight Financing Rate (SOFR) + 2%*
*2) ICE BofA US High Yield Index (H0A0) yield-to-worst of 4.24% as of December 31, 2020*
*The Credit Opportunities Fund charges a management fee of 0.39% and a performance fee that is equal to 30% of the over performance of the Net Asset Value of the Class of Share over the applicable performance fee benchmark.*

**Quarter in Review (cont'd)**

Unsurprisingly, against a backdrop of strong liquidity and expectations of rebounding economies, the short side of the book fared less well. We believe in such markets often the value of single name shorts, when they lose money in absolute terms, can be overlooked. The key question in our opinion is whether they can create alpha in simple terms by rising in value less quickly than the longs. Added to this is the fact that many credits should have an asymmetric risk to the downside while also allowing the portfolio to run with less index-type hedging, thus reducing basis risk.

In Europe, the main thematic short theme was REITs which worked reasonably well, largely as a result of the entry levels being particularly high / tight. In the US, the focus was more broadly on struggling names that seemed overpriced in sectors such as retail, healthcare and consumer cyclicals.

As the market begins to consolidate and factor in the COVID damage, we anticipate increasing spread dispersion and more bifurcation of investment decisions broadly across credit markets. If we are correct, the short side of the balance sheet will have an important part to play through the middle of the year.

Relative value trades provided some additional, non-correlated performance where opportunities tended to be a mixture of negative basis trades (buying CDS protection and buying bonds in the same capital structure) and senior/sub trades both targeted at credits where our fundamental view was negative. We anticipate adding to the RV bucket during the second and third quarters as we expect increased dispersion in range-bound, choppy market conditions.

We also saw a high likelihood of equity outperformance relative to credit, and as a result we increased equity-linked exposure through the addition of some convertible bonds trading close to their bond floors, as we believe this provides us with cheap equity optionality.

The primary bucket once again produced a steady flow of opportunities both in terms of trading the new issue premium as well as adding new longs to our core portfolio. At the time of writing, there remains an extremely healthy pipeline of deals coming to the markets as corporate and financial treasurers anticipate rising yields and cost of capital later in the year.

**Outlook**

Looking forward, how do we see markets behaving through the middle of the year and where will we likely find the best risk-adjusted opportunities for the strategy?

Our 30,000ft overview is that credit markets are likely to fall, and therefore we anticipate some spread-widening from here if growth turns out to be either much stronger than is currently expected (higher yields, less stimulus) or if it turns out to be much weaker than expected (rising default risk, lower profitability).

Only if we experience a Goldilocks-like global economy do we think that we'll see current market levels holding or being exceeded. Investors are likely to oscillate between optimism and pessimism until a clearer picture of the "new normal" emerges.

To protect against some of these extreme outcomes (rising yields, falling equity markets and / or widening credit spreads) we will continue to buy cheap insurance such as out-of-the-money payers and puts on credit and equity indices, whilst hedging duration risk with government bond hedges.

**Outlook (cont'd)**

Assuming that the most likely outcome is a range-bound market, we think that the best positively convex longs will still be found amongst names that currently trade stressed but that demonstrate an ability to surprise to the upside and those positive event risk names benefiting from IPOs, M&A and refinancings.

We anticipate that the best shorts are likely to be thematic-based and demonstrate negative convexity. This should include sectors that are overbought and face headwinds, names where positive event risk appears to be fully priced in, and in weaker credits which we feel will be hit heavily in any protracted downturn.

We will continue to search and screen for RV trades that appear to offer attractive upside vs. downside. With markets at elevated levels, it is likely that a key focus for RV will remain on names where our fundamental thesis is negative but where the timing of the price fall / spread-widening is uncertain. In these circumstances, the long leg should help to cover the cost of the short, while also providing optionality to sell out of such positions if negative news begins to unfold, or to transition the position to an outright short.

To summarise, on balance we see rising volatility and increased spread dispersion going forward. We remain hopeful that the opportunity set for the Fund increases in line with these developments and therefore aim to efficiently and effectively hedge out the tail risks mentioned earlier. Whilst the next twelve months are unlikely to produce the same degree of surprise and volatility seen in 2020, it seems likely that the numerous macro factors coalescing (COVID-related, geo-political and macroeconomic) will produce thrills and spills before year end.

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The Secured Overnight Financing Rate (SOFR) is a broad measure of the cost of borrowing cash overnight collateralized by Treasury securities.

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