Cape Fixed Income Monthly

Cape Capital

MONTHLY COMMENT – FEBRUARY 2022

Michael Lienhard: michael.lienhard@capecapital.com
Sarah Zhu: sarah.zhu@capecapital.com

Temporary Correction or Bear Market?

- Turbulent month due to Russian-Ukraine war, however, still a lower magnitude vs. March 2020
- Stagflation fear is looming, leaving the ECB with limited tools available
- Fund outperformed relatively vs. the generic universe; Fund beta risk sits at record low with elevated liquidity on hand – to be deployed slowly but surely No direct exposure to Russia within the Portfolio. Some limited indirect exposure through Western European companies acting in Russia (<4%) exists and we further reduced it as a good risk management practice
- Energy security may turn the current correction in a longer-term bear market and Europe is worse off than the US under this circumstance; ECB is left with limited tools, bringing stagflation fear to the centerstage
- Energy price and fragile supply chain may threaten corporate margin, though current consumer demand is strong enough to absorb rising prices

Markets

The Russian-Ukraine war has led to an overly turbulent month. Macro uncertainty escalated to the peak level since COVID-19. Western sanctions on Russia who plays a major role in commodity export especially to European nations have substantial implications to the bloc's future of energy security as well as homeland security.

Within the broad credit compact, EM credit (which is outside of our mandate) has suffered the most given the sizable weight of Russian exposure within the universe. Outside of EM, both IG and HY traded similar to Equity where the macro sentiment has completely dominated both the fund flow and asset valuations.

The correction is broad-based, nevertheless, comparing to the price actions seen in COVID, jump moves / "gappy" trading has not yet been seen in most part of the market and drawdown is so far much more contained vs. March-2020.

In the meantime, the inflation concerns will accelerate as the sanctions address a commodity powerhouse (Russia) and energy prices are bound to fuel the already mounting pricing pressures. This leaves the market worrying about the scenario of stagflation in Europe due to dampened growth trajectory in conjunction with rapid surging prices.

This also leaves the ECB in a dilemma with limited tools available as the starting point is low. In short, the current market regime is anything but predictable.

Fund performance

The Fund has lost around -1.9% in the month of Feb, bringing YTD performance to -2.8%. This compares to the average European IG benchmarked mandate of -4.3% and HY -4.2% respectively. In terms of topline risk (in Duration-times-Spread terms), the portfolio is now close to its all-time low and cash / liquidity level is maintained at an elevated level due to the heightened uncertainties. Additionally, the tail hedges (which we systemically implement within our portfolio) worked well during the market sell-off, therefore we have taken profit and rolled to new levels.

Within the portfolio, all sub-strategies' performances were negative led by higher beta assets like Bank AT1s and Corporate Hybrids. Broad market de-risking due to elevated volatility has also pushed up asset correlation. Since a substantial part of the portfolio's current positioning are concentrated on the front-end of the credit curve (current fund credit duration is close to 3yr and rates duration at 1.5yr), the fluctuation should recover given pull to par.

Fund exposure

Regarding the geographic exposure, the Fund is Developed Market centric, therefore, it does not contain any direct exposure to Russia or Ukraine. The limited revenue exposure stems mainly from the banking sector and the energy sector given the nature of these businesses. While the loss of revenue stream will certainly impact the near-term earnings and the sentiment around these issuers, it doesn't materially alter the issuer's credit or capital profile given their contained exposure to the local Russian business (where subsidiaries are typically self-financed and any cross-border financing and potential provision should be absorbed by the liquidity on balance sheet).

Therefore, as credit investors, while we see a fatter tail now, we are not concerned on any default events any time soon. Nevertheless, as a good risk management practice amid overwhelming headwinds, we further reduced our marginal exposure to these issuers.

Looking forward

We now observe this fast-changing situation and respond cautiously. Whether the current correction would turn into a more persistent bear market depends on how long the geopolitical aggression lasts and how the world tackles the energy security issue. Europe is in a much more challenging position than the US as the latter has a self-sufficient energy market and a more robust and dynamic economy.

As a result, when it comes to monetary policy, Powell reinstated the stand of raising rates in March as previously planned during his House hearing - while in Europe, the ECB may have to diverge from its previous calibration in order to support the economy during stress times. The market has now pushed back the 1st rate hike in the Euro zone to 2023 from Dec-22, bringing the fear of stagflation to the centerstage, which also means that rates vol is here to stay due to the uncertainty of the Central Banks' reaction function.

Impact of energy prices

Further on the impact of surging energy prices to European corporates: Though at first glance, the hit to the corporate profitability from direct Russian exposure is rather well contained (according to corporate reported data on their sales exposure and energy costs), the indirect costs from raw material to logistics will exacerbate the already fragile supply chain.

This is true especially for sectors that are energy intensive but with low pricing power. While continuously robust consumer demand and low inventory level will likely allow most corporates to pass on their costs and maintain their margin, we remain very cautious on the future evolvement of credit metrics.

Cape Capital

DISCLAIMER

The Fund is a sub-fund of Cape Capital SICAV-UCITS, an umbrella fund regulated pursuant to part I of the Luxembourg law of 17 December 2010 on undertakings for collective investments ("Law of 17 December 2010") transposing Directive 2009/65/EC of the Capital European Parliament and the Capital Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferrable securities and authorized by the Luxembourg Supervisory Commission of the Financial Sector (Commission de Surveillance du Secteur Financier – CSSF). This is an advertising document. Cape Capital SICAV-UCITS (the "Fund") is domiciled in Luxembourg. In Switzerland, the representative of the Fund is ACOLIN Fund Services AG, Leutschenbachstrasse 50, CH-8050 Zurich, whilst the paying agent is Credit Suisse (Switzerland) Ltd., Paradeplatz 8, CH-8001 Zurich. The prospectus, the key information documents or the key investor information documents, the articles of association as well as the annual and semi-annual reports of the Fund may be obtained free of charge from the Swiss representative ACOLIN Fund Services AG. Please note that past performance is no indication of current or future performance. The performance data do not take account of the commissions and costs incurred on the issue and redemption of units of the Fund.

Cape Capital AG is an independent asset management firm based in Zurich, Switzerland, and is regulated by FINMA (www.capecapital.com). For eligible investors only. This fact sheet is no legally mandatory document but for information and promotional purposes only.

IMPORTANT NOTICE AND DISCLAIMER
This confidential presentation and the information set out herein (the «Presentation») is summary in nature only and is qualified in its entirety by the information set out in the offering document or other formal disclosure document (the "Disclosure Document") relating to the potential opportunity described herein. The prospectus, annual financial statements, KIIDs, and legal documents can be obtained from the representative in Switzerland. FOR INVESTORS IN GERMANY: The information agent in Germany is ACOLIN Europe GmbH, with registered office at Reichenaustraße 11a-c, 78467 Konstanz. The basic documents of the Fund, including the prospectus (in English) and the KIID (in German) may be obtained free of charge at the registered office of the German Information Agent. FOR INVESTORS IN THE UNITED KINGDOM: The Fund and certain of its Sub-Funds are recognised in accordance with Section 264 of the Financial Services and Markets Act 2000. UK investors should read the Appendix for UK investors in conjunction with the Fund's Prospectus which are available from the Facilities Agent. The Prospectus of the Fund and the KIIDs can be obtained on www.fundinfo.com. FOR INVESTORS IN SPAIN: The Prospectus of the Fund and the KIIDs can be obtained on www.fundinfo.com.

The information provided is not intended to be used by any person or entity in any country or jurisdiction where the provision of information and subsequent potential commercialisation would be illegal. The Presentation does not constitute an offer for sale in the United States of America. The information provided by this Presentation is not intended for U.S. persons. The fund shares described in this Presentation may not be offered or sold in the United States or to U.S. persons or for the account for the benefit of a U.S. person.

This Presentation has been provided to the recipient by Cape Capital AG as portfolio manager (the "Portfolio Manager") of Cape Capital SICAV-UCITS for informational purposes for the personal use and is only intended to assist eligible investors in deciding whether they wish to consider reviewing the Disclosure Document. This Presentation is meant for use in one-on-one presentations with eligible investors. However, the contents of this Presentation are not to be construed as investment, legal or tax advice or recommendation and do not consider the particular circumstances specific to any individual recipient to whom this presentation has been delivered. The recipient should make its own appraisal and should obtain advice from appropriate qualified experts. This Presentation is furnished on a strictly confidential basis to eligible investors. None of the information contained herein may be reproduced or passed to any person or used for any purpose other than the purpose of considering the potential opportunity described in the Presentation.

Any opinions, forecasts, projects or other statements, other than statements of historical facts that are made in this Presentation are forward-looking statements. Although the Portfolio Manager believes that expectations reflected in such forward-looking statements are reasonable, they do involve a number of assumptions, risks and uncertainties. Accordingly, the Portfolio Manager does not make any express or implied representation or warranty, and no responsibility is accepted with respect to the adequacy, accuracy, completeness or reasonableness of the facts, opinions, estimates, forecasts or other information set out in this Presentation or any further information, written or oral notice, or other document at any time supplied in connection with this Presentation, and nothing contained herein or in the Disclosure Document shall be relied upon as a promise or representation regarding any future events or performance. Past returns are no guarantee for future returns.

The recipient's attention is specifically drawn to the risk factors identified by Cape Capital SICAV-UCITS's investment fund manager and Portfolio Manager as set out in the Disclosure Document. The Portfolio Manager also advises that the potential investments described herein are speculative, involve a degree of risk and there is no guarantee of performance or a return of any capital with respect to any investment. By accepting delivery of this Presentation, the recipient accepts the terms of this notice and agrees, upon request, to return all materials received by the recipient from the Portfolio Manager, including this Presentation without retaining any copies thereof. This Presentation, layout, copyright materials and trademarks featured in the Presentation may not be used or copied or otherwise reproduced by any unauthorized third party.