



Opalesque: Big Alpha Webinar

Questions & Answers

Thank you for joining us on the Opalesque: Big Alpha webinar on March 26, 2024.

You can access the replay video [here](#).

If you are interested in setting up a call, please reach out to ir@ironshieldcapital.com.

Sectors

1 Are there any sectors you find particularly interesting?

The real estate sector provides a broad array of opportunities. Traditional capital structures, often featuring loan-to-value ratios of 60% to 70% and financed at historically low rates, have become impossible to refinance since interest rates have increased. This is on the back of the impact of COVID-19 which had already transformed the demand for offices.

The thin trading volume in the underlying property assets suggests that the underlying asset prices, particularly office properties, have yet to undergo the significant repricing necessary to stimulate transaction volumes closer to pre-COVID levels.

The historical relationship between interest rates and cash flow returns from properties imply that property prices could substantially decrease in certain segments. This would affect the book values of property assets on property company balance sheets which in many cases seem unsustainable with the potential for large write-downs.

Europe has witnessed high profile instances of distress within the real estate sector and there are numerous lower profile companies grappling with bond or loan trades.

In addition to real estate, telecoms and healthcare sectors also loom large in terms of potential distress opportunities. Once deemed stable, these sectors experienced a surge in lending at high loan-to-value ratios during periods of low interest rates. Upon refinancing, the cost of debt will become much more onerous leading to issues with capital structures.

Europe versus US

2 How would you describe the differences and different opportunity sets between Europe and the US for investing in credit?

The divergence between the growth rates of the US and European economies, with European growth rates lower, presents a significant opportunity. In Europe, there is lower scope for over-levered companies to expand earnings from robust economic growth, which means translates to a more interesting investment spectrum.

Another notable distinction between the US and Europe lies in their respective restructuring frameworks, Chapter 11 in the US and the equivalent in various European jurisdictions. While Chapter 11 proceedings tend to reward activist creditors who hold the highest proportions of the debt, European jurisdictions have a lower or no differential in recovery based on the proportion of debt held or the activism of the creditor. Therefore investment in European situations tend to reward meticulous analysis, irrespective of the size of position held. In the light of this and our concentration on Europe, we focus on time on analysis and we make use of our nuanced understanding of the intricacies inherent in each European jurisdiction. This enables us to navigate these complexities adeptly.

Exciting market opportunities

3 I love your point about “having worked for one (your) hedge fund only”. What excites you about today’s credit markets?

For the first time in three decades there has been a rise in interest rates, marking a departure from the customary trend of rates decreasing. Thirty years ago the 10-year Bund stood at 9%, over time it has transitioned to negative territory but now is above the 2% threshold. This shift signifies a substantial alteration in the credit landscape, particularly at lower credit ratings. The days of ultra-low borrowing costs are over and this change presents a rare opportunity distinct from prior cycles such as the ones triggered by Covid, the Eurozone crisis, or the collapse of Lehman Brothers.

Because of the rise in general levels of inflation, unlike recent past economic crises where central banks have provided solutions by creating money, central banks may find themselves constrained in their ability to infuse liquidity into the financial system in response to economic headwinds. Therefore this cycle is probably poised to unfold differently which is a distinction worth noting. We think that this cycle is going to be elongated in nature, characterised by the absence of readily available capital market solutions for struggling balances sheets which all adds an intriguing dimension to the present landscape.

Performance Metrics

4 What makes your fund sensitive to the choice of performance metric (e.g. Sortino vs. Sharpe)?

In reality, investors care about and are trying to determine volatility with respect to downside risk. The Sortino Ratio stands out as a superior performance metric for event-driven and distressed credit trading due to its focus on downside risk. The metric acknowledges the effectiveness of risk management techniques in preserving capital during adverse market conditions, and therefore serves as a more accurate assessment of performance for such strategies. The Sharpe Ratio penalizes both upside and downside volatility equally, instead by exclusively penalizing downside volatility the Sortino ratio aligns with investor preferences and strategy-specific risk management techniques common in distressed credit trading.

Our strategies have a low correlation to traditional asset classes, delivering equity like returns, whilst limiting drawdowns. Its also worth noting, more prosaically, that we have never had a complaint from investors when we have exhibited upside volatility. Therefore, Sortino is much more reflective, as a performance metric, of what we can deliver to investors.



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