

Alternative Credit



The diversification benefits of bank originated assets.



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The investment landscape has transformed dramatically over the past decade, and the role of private credit in institutional investor portfolios has moved from a satellite investment to a core portfolio allocation, playing an important role within a new, uncertain macro environment. Not only have institutional investors continued to increase allocations to private credit, they are also actively looking to diversify within this asset class - seeking solutions which address specific portfolio goals, in addition to providing access to idiosyncratic factors and potential for robust risk return profiles.

Pension funds and insurers are the largest investors in private credit funds globally and their allocations have increased more than six-fold in the last decade. Many initial private credit allocations have resulted in a somewhat concentrated exposure with overlapping underlying credit risk, borrower profile, interest rate correlation and duration, even with different investment managers.

In this context, it has become increasingly clear that private credit could potentially play a much bigger role, addressing investor

allocation needs that can no longer be met solely by traditional strategies, both public and private. Institutional investors continue to seek yield-generating private credit investment opportunities with shorter maturities, lower risk, or lower interest rate correlation or simply, a different return generation profile. This has resulted in significant increase in interest in several asset classes in this space, traditionally originated and retained by banks.

One of the challenges facing investors has been securing access to the origination flows and establishing adequate asset selection and portfolio management to gain that exposure efficiently. As a result, private credit managers have increasingly looked to banks and their origination platforms, aiming to secure bank origination partnerships that provide access to deal flow. Bank-owned asset managers have naturally found themselves in prime position to execute these partnerships.

From a broader perspective, the combination of modest economic growth, coupled with increased macro and interest rate volatility may continue to put pressure on assets in the near term, leading to increased investor focus on asset classes which have proven to be resilient over the economic cycle. Many institutional investors can consider adding complementary strategies to their existing allocation, providing diversification, stronger historic credit resilience and robust downside protection whilst still generating potentially attractive illiquidity premium.

Revolving Credit Facility (RCF) Strategies

A good example of how bank-originated assets can complement existing allocations to private credit are Revolving Credit Facilities (“RCFs”), a critical operational liquidity tool.

RCF strategies provide significant diversification benefits without sacrificing yield. RCFs can generate double digit returns and diversified borrower profile by investing in large, multinational corporate borrowers with diversified operations. RCFs have proved highly resilient during economic downturns, with a much lower historic default rate, shorter duration and less interest rate sensitivity than traditional private credit strategies, a clear benefit in a volatile interest rate environment. Finally, RCFs can also provide regulatory benefits for specific pools of capital, such as insurance capital.

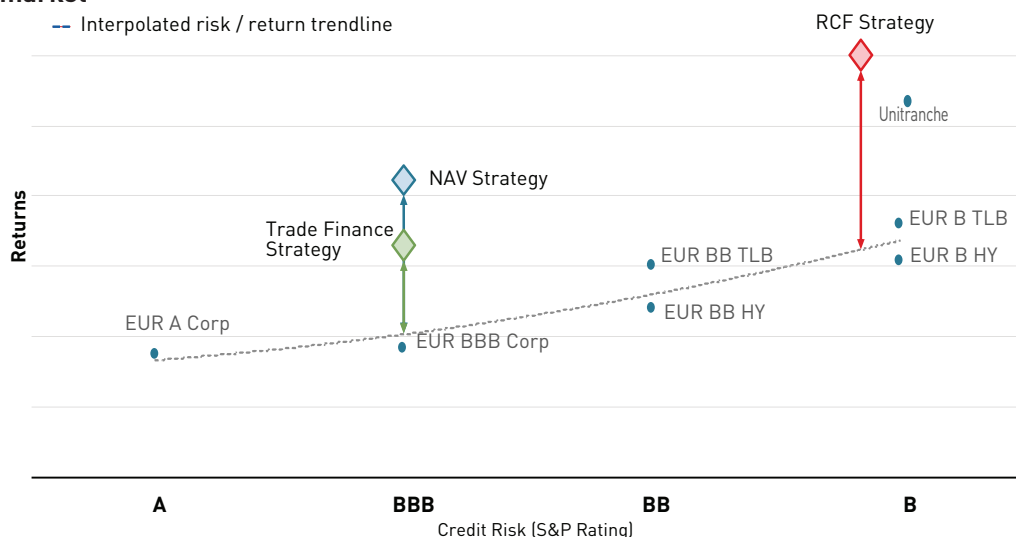
NAV Finance Strategies

Further collaboration opportunities are opening up in the expanding asset-backed finance space. A second partnership example is NAV Finance Strategies which invest in senior secured, investment grade-rated loans. Senior Secured fund financing has historically been provided by banks but is increasingly becoming available to institutional investors. Investment grade-rated NAV loans can provide spreads in excess of 400-500 bps, similar to many sub-IG strategies, but with a shorter maturity and an IG credit rating profile. This makes NAV Finance strategies particularly attractive for investors requiring a sizeable IG-rated allocation, whilst capturing the illiquidity premium in an efficient format and without extending duration. In the case of NAV strategies, partnering with a Bank allows investment managers to tap into a wider and deeper deployment opportunity, as most banks retain large origination platforms and often a position of incumbency with many borrowers.

Trade Finance Strategies

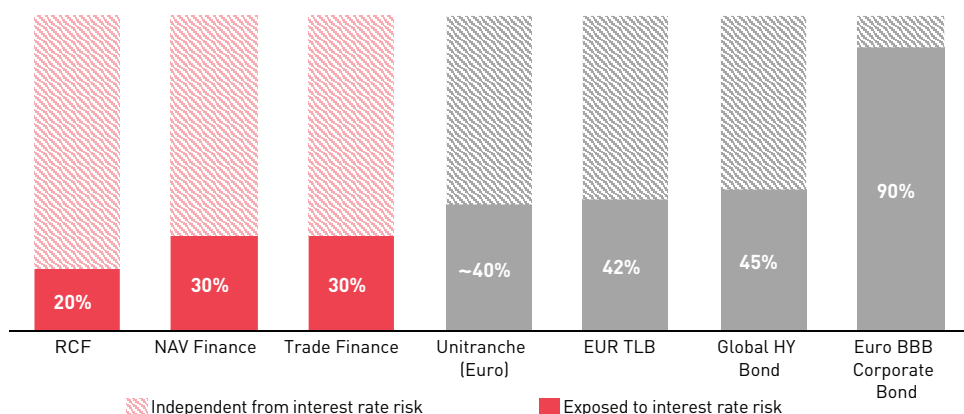
A third example of asset-backed bank-originated assets which provide risk-adjusted diversification benefits in shorter duration allocations are Trade Finance Strategies. Trade Finance strategies offer access to high quality, short-dated, asset backed, working capital assets ranging from investment grade programs to sub-IG deal flow. Trade Finance assets generate spreads similar or higher to benchmark liquid BBBs, with a much shorter maturity (typically self-liquidating within 3-6 months) and uncorrelated to the broader

Exhibit 1: Portfolio mapping vs risk/return investment opportunities in the credit market



For illustrative purposes Any forecast, projection or target when provided is indicative only and is not guaranteed in any way. There is no guarantee that portfolio characteristics or target returns will be achieved. Diversification does not ensure a profit or protect against loss. only. Euribor base rate of 2.81% as of Jan-25. Source: Bloomberg and LCD as of Jan-25

Exhibit 2: % exposure to interest rate risk by asset class (%)



Source: HSBC Asset Management as of Jan-25. Net IRR for comparable credit investments as per Bloomberg indexes and LCD ELLI index as of Jan-25. Euribor base rate of 2.81% as of Jan-25. EUR BBB Corporate Bond, Global HY Bond and EUR TLB % split based on current yield as of Jan-25 and Euribor base rate of 2.81%

market. Through a partnership with a credible and experienced Trade Finance Bank, investors can gain access to a curated, high quality deal flow with a diversified selection of underlying assets, packaged in an efficient format.

Exhibit 1 illustrates the risk - returns diversification benefits offered by some of these bank-originated strategies, which complement traditional public and private credit strategies.

Bank-originated assets also allow institutional investors to enhance yield even in a declining rate environment, without compromising credit quality. As rates decline, traditional private credit allocation returns could be affected, driving investors to seek alternative types of private credit strategies which are less interest rate-dependent (see exhibit 2). As illustrated in exhibit 3, bank-originated assets also have shorter duration than comparable traditional allocations, an important diversification point in an increasingly uncertain macro-outlook.

Bank origination partnerships

This evolving investment landscape and the demand for different type of private credit assets, which historically have only been provided and held by banks, has created a suitable environment for asset managers and bank partnerships to thrive and develop beyond traditional corporate lending.

The increasing demand for diversification has pushed bank partnerships to innovate and offer investors access to distinctive investment opportunities, targeting specific

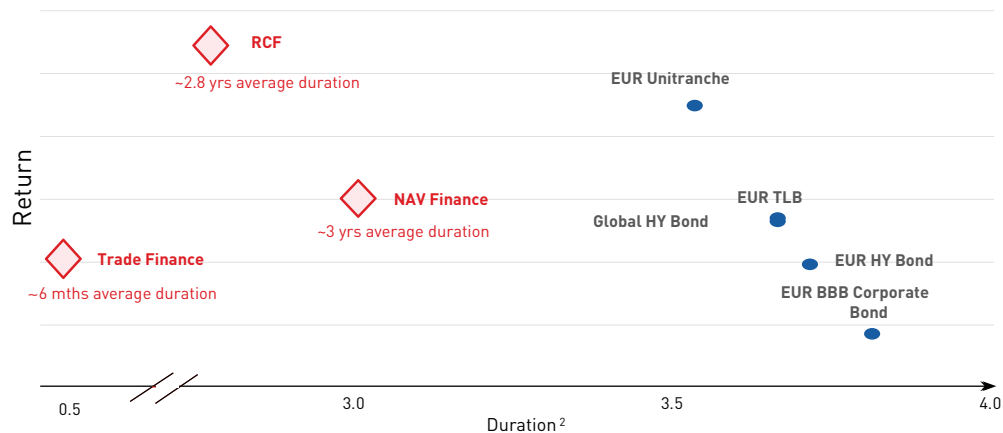
investor outcomes, leveraging the strengths of their origination and distribution networks. These strategies tap into the strong and well-established bank pipelines while providing critical, additional asset manager investment selection and governance. Furthermore, investment managers must provide an integrated portfolio, liquidity management and structuring solution to ensure an efficient access for investors. In this new environment, bank-owned asset managers and other managers who have a deep understanding of bank deal flow, credit selection and structuring are in a strong position to provide investors with an efficient, complementary investment proposition. Partnerships are a cornerstone to bank

origination and when executed well, there is demonstrable evidence that they can deliver positive outcomes for both parties: banks continue to work with their clients while investment managers continue to develop new solutions for investors' portfolio needs, providing attractive risk-return and diversification benefits.

Looking ahead, we expect business demand for credit to continue and adapt to new forms of activity. In parallel, we expect several key trends to continue re-shaping the bank origination landscape, resulting in new opportunities to partner with asset managers and institutional capital, generating new and attractive ways to provide a differentiated source of returns for investors.

HSBC Asset Management's ("HSBC AM") Alternative Credit platform provides such strategies for investors, leveraging on its proven bank partnership model. The combination of the origination agreement with HSBC Bank and HSBC AM's independent fiduciary and governance framework, provide our highly experienced teams with an informed and balanced view of the market to identify attractive investment opportunities. Our experience underwriting risk, our understanding of how the assets behave throughout long cycles, including downturns, and our ability to construct complementary portfolios with attractive risk reward features makes our Bank Originated Credit strategies a valuable addition to Institutional investors allocations.

Exhibit 3: Return /duration per credit strategy



Source: HSBC Asset Management as of Jan-25. Net IRR for comparable credit investments as per Bloomberg indexes and LCD ELLI index as of Jan-25. Euribor base rate of 2.81% as of Jan-25. Illustrative duration calculated based on 4 years to maturity for all investments and calculated as weighted average of non-discounted cash flows

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