CQS Insights

Looking into 2016

Sir Michael Hintze

DECEMBER 2015

In this Q&A, Sir Michael Hintze, Chief Executive and Senior Investment Officer of CQS, presents an update on the risks and opportunities he sees in markets in 2016 and beyond.

Q How has 2015 shaped up for CQS?

A While performance has been mixed, I am very proud of the way our team has worked during 2015. Relative-value credit strategies have been challenging. Our convertibles strategies have performed well, both convertible arbitrage and long-only, especially on a relative basis. Our bespoke mandates have continued to deliver absolute returns for our clients and the long-only credit multi-strategy product has generated good returns.

There has been much comment of late about the end of the credit cycle which I believe to be incorrect. High yield credit spreads have been widening for some 18 months. Even adjusting for energy names, credit spreads are at relatively high levels. While this challenging environment has provided us with renewed opportunity, there have also been dislocations that have caused significant volatility in returns.

For example, our hedges have been affected by the basis widening. Indexes have not widened as much as the underlying single names, holding back returns in these relative-value credit portfolios. Fundamentals in ABS markets have continued to be good, but the technicals have been more challenging, although I believe this could now turn positive. The teams have continued to work hard and remain disciplined and, as a result, I believe the portfolios have significant embedded value. We have also added to the investment team over the year and in the portfolios I have direct responsibility for, we continue to actively trade both on the equity and credit sides. After a challenging 18 months, I think it is in credit markets that we are currently finding the most compelling alpha opportunities.

Q How do you see the investment environment for 2016?

A As I look into 2016, while I expect continued volatility, I am also excited about the opportunity set that is unfolding. Where there is disruption and dislocations, there is opportunity both on the long and short sides. I am also enthusiastic about the substantial investment opportunity I see resulting from bank disintermediation and market distortions more broadly. In a more volatile world one needs to be agile and, liquidity permitting, trade actively to monetise the volatility observed. Given the more technical and dislocated market environment, I believe fundamental credit and equity research will be a key element in enabling us to identify value in a market with greater dispersion.

Q What does that mean for the investment opportunity you see?

A There is a secular change and a structural opportunity due to the combined effects of regulation and central bank intervention. Bank disintermediation, particularly in Europe and the US, is a long-term theme and I believe this will continue to provide an illiquidity premium for more patient capital.

Furthermore, dislocations and distortions will provide a rich opportunity set and market participants with the skill sets to invest across the capital structure should be in a good position to find attractive relative value opportunities. More flexible and patient capital should be best able to take advantage of greater price volatility.

This, combined with a fundamentally-driven approach to investing and an understanding of the technical nature of the market, will be the key drivers of investment success in the coming year. To that end we have brought in further expertise in European distressed and US loans, and placed even greater focus on the trading of market dislocations that should enable us to extract greater value

Q What is the outlook for corporate credit investment?

A As always, opportunity follows on from dislocation. As I alluded to earlier, there has been much comment of late about the end of the credit cycle which I believe to be incorrect. High yield credit spreads have been widening since June 2014.

We are seeing differentiation both within and between credits. Figures 1 and 2 respectively, illustrate the behaviour within high yield indexes and between high yield and investment grade more recently.

Figure 1. Dispersion Within High Yield (CCC vs BB Yield Differential at 5Y Wides)[1]

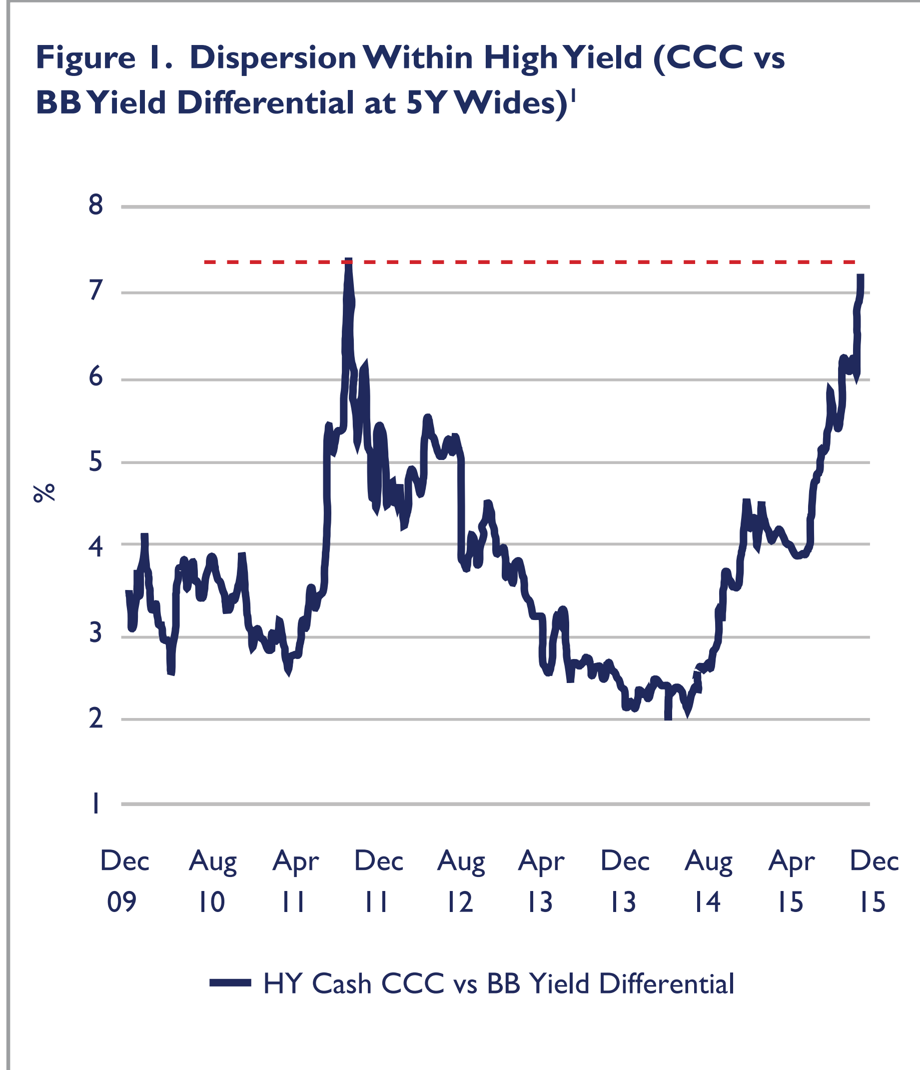
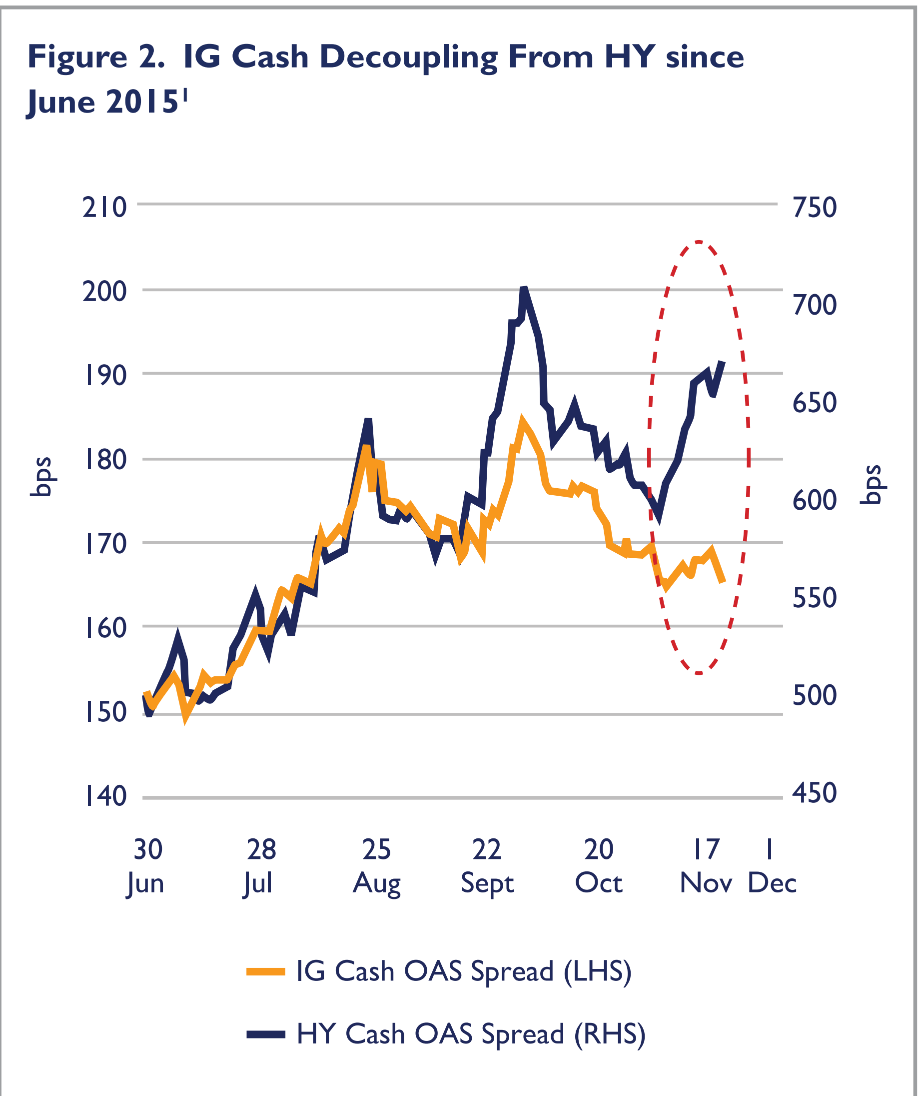


Figure 2. IG Cash Decoupling From HY since June 2015[1]



Source: [1]Credit Suisse Securities Research & Analytics: US Credit Strategy Daily Comment 23 November, 2015.

Even adjusting for energy names, credit spreads are at relatively high levels. Figures 3, 4 and 5 show what has been going on in European and US high yield credit. Figure 3 illustrates the widening of European high yield and senior secured loan spreads since the Fed announced the commencement of Taper in June 2014.

Of note is Figure 4 which shows the evolution of US (ex-energy) and European high yield indexes since the beginning of 2015. The divergence between US CCC (ex-energy) and European CCC rated credit as can be seen in Figure 5.

Figure 6 shows how the dispersion of spreads in the European high yield bond market has widened since the beginning of 2015.

To some extent the divergence of monetary policies between the US and the UK, and the EU and Asia has been driving price action and in part it has been driven by the energy complex and resources sector. I believe this is broadly reflected in pricing. The key points are that credit has been widening since June 2014 and that there is growing dispersion creating attractive opportunities.

Figure 3: European High Yield and Senior Secured Loan Spreads[2,3]

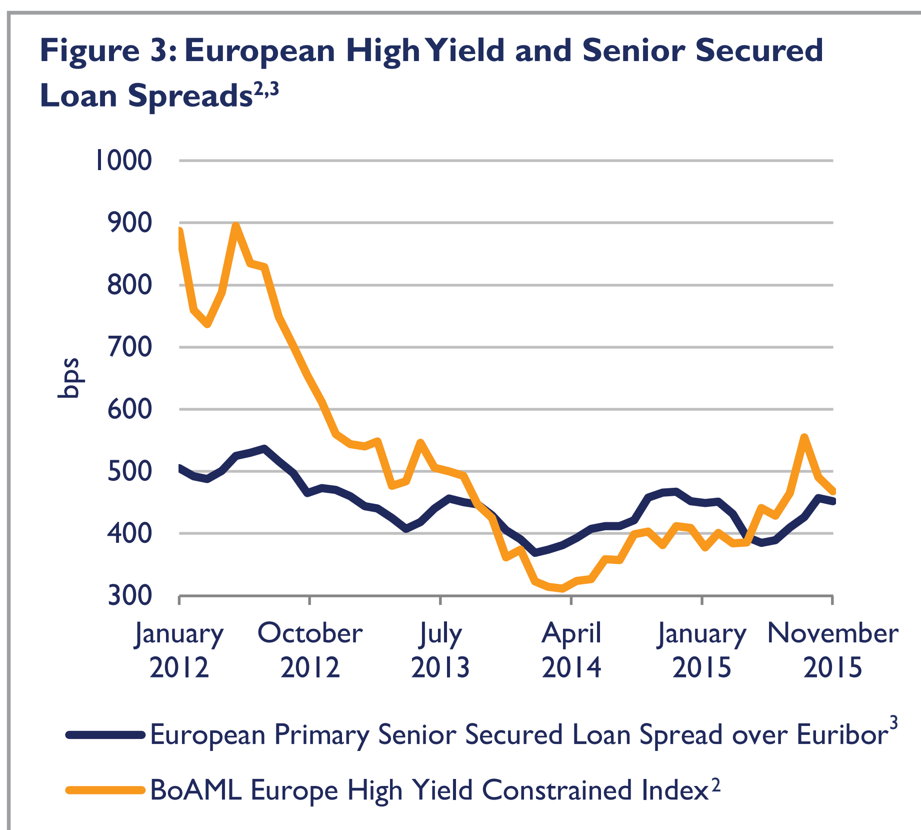


Figure 4: US High Yield (ex-energy) and European High Yield[4]

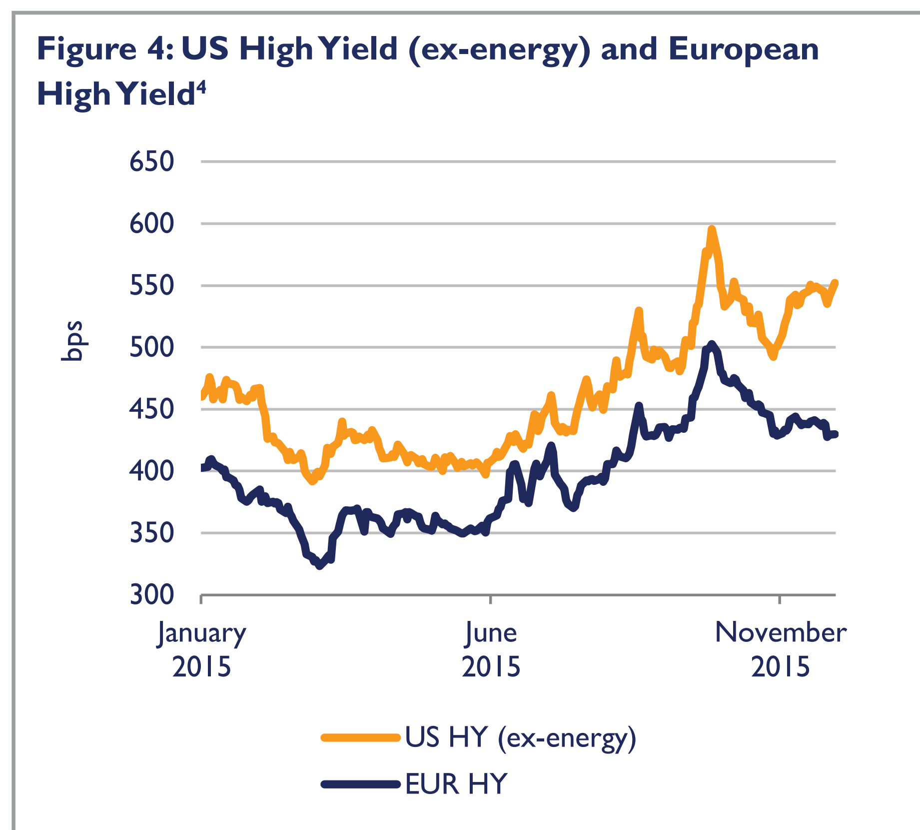


Figure 5: US CCC (ex-Energy) v European CCC Rated Bonds[5]

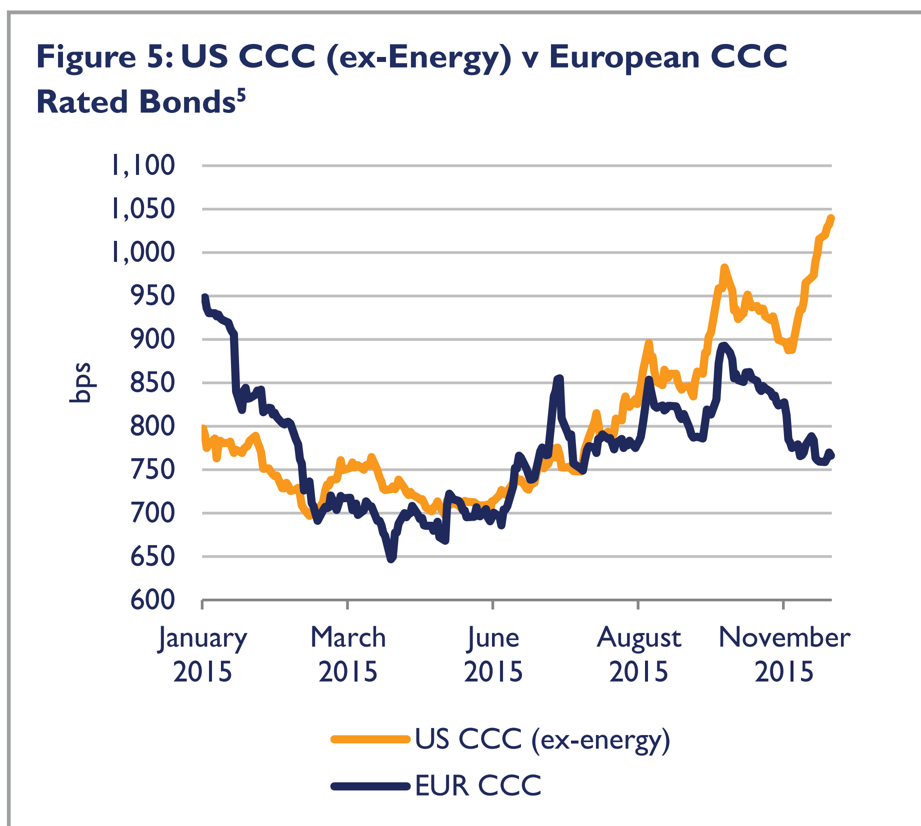
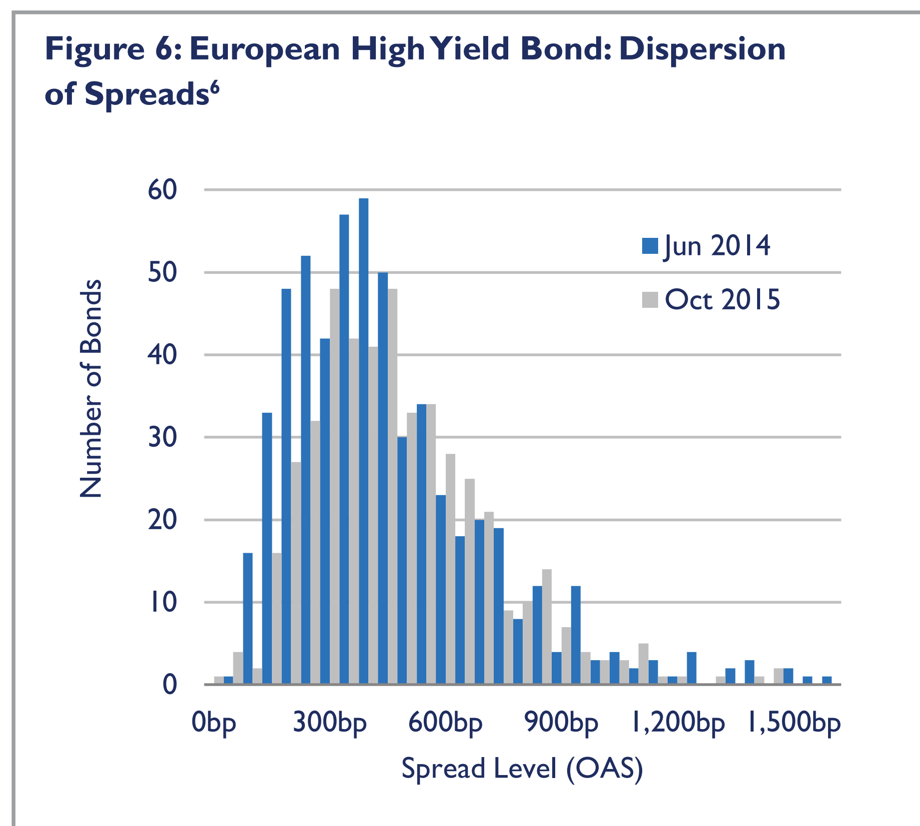


Figure 6: European High Yield Bond: Dispersion of Spreads[6]



Source: [2]Bloomberg, BoAML Euro High Yield Constrained Index (HEC0) as at 30 November 2015. The HEC0 index is designed to track the performance of euro- and British pound sterling-denominated below investment grade corporate debt publicly issued in the eurobond, sterling domestic or euro domestic markets by issuers around the world. [3]S&P LCD European Leveraged Lending Review, as at 30 November 2015. Institutional Tranches refer to loans which are syndicated to institutional / non-bank investors. For illustrative purposes only. It is not possible to invest directly in an index. [4]CQS analysis. Barclays Benchmark Index: 'US High Yield ex Energy' using the Option Adjusted Spread. Barclays Benchmark Index and 'Pan European High Yield ex Financials' using the Option Adjusted Spread as of 30 November 2015. [5]CQS analysis Barclays Benchmark Index: 'US High Yield ex Energy CCC' using Option Adjusted Spread and Barclays Benchmark Index: 'Euro High Yield Corporate CCC ex Financials' using the Option Adjusted Spread as of 30 November 2015. [6]Bloomberg, Option Adjusted Spreads as of 23 October 2015. Charts and graphs are provided for illustrative purposes only and are not recommendations to make any investment decisions.

It is worthwhile remembering that at its most basic: spread = the probability of default x the loss associated with default + a liquidity/volatility premium. In an environment where we would expect a modest rise in the default rate, growing illiquidity and rising volatility, credit spreads should widen over time. In the US, the resources sector has led the widening. Spreads widened dramatically and recovery values fell as strategic bids evaporated. With asset disposals hard to monetise and emergency lending becoming less available, some resource companies have been left with few choices but to default and restructure, further feeding the default cycle. With recoveries below average and rising probability of default, resource names have driven risky credit wider in the US.

Looking forward, BoAML estimates the US high yield default rate will rise to 4% in 2016, with the non-commodity sector's default rate forecast to be 2.3% and the commodity sector's default rate 12.1%. In CCC rated bonds the difference is especially stark at 9% and 32.5%, respectively. In other words, almost one third of names in the CCC US high yield commodity universe are anticipated to default in 2016.

By comparison, European high yield defaults are estimated to double to 1% in 2016, supported by low financing costs and relationship-driven lending. In Europe, banks have historically been more forgiving and the bankruptcy process varies materially by country which masks the 'true' default rate. Consequently, defaults in Europe are likely to be more binary with companies going into bankruptcy only once they have really 'hit the wall'. There will also be greater differentiation, especially where bank risk weighted asset regulations have an impact.

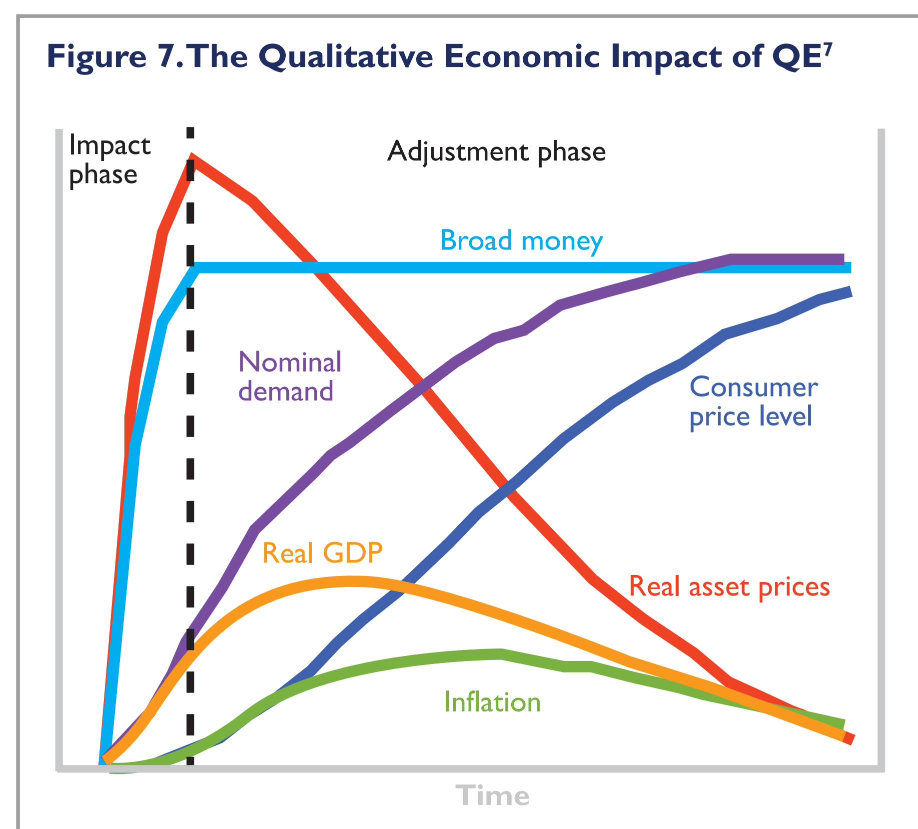
Fundamental analysis is critical to identifying value and through this process we are finding opportunities both on the long and short sides in credit and equity markets.

Q Why do you think greater caution is called for?

A Markets have been supported by QE (Quantitative Easing). There is a divergence between the US and the UK, where rates look set to rise as these economies see firm growth, and those countries that continue to prime their economies with further QE, the EU, Japan and China. The effects of QE appear to be diminishing at the margin, while supported by 'broad money' growth. The world is contending with the slowdown in China's rate of growth and there also appears to be more significant geopolitical risk than in recent times.

The combined effect of these crosscurrents makes me more cautious. To be clear, the effect of QE globally is not yet finished, but at this stage I believe real asset price appreciation may slow. Central banks are facilitators of growth rather than engines of growth. Ultimately, the real economy must be the driver. Figure 7 is a graphic from the Bank of England's Q3 2011 Quarterly Bulletin. I have referred to this chart before and it is particularly relevant today. It is interesting to me as it illustrates the theoretical qualitative economic impact of QE. Of note is the sharp rise and then fall in real asset prices. I do not subscribe to the view that asset prices will decline as QE continues, but I do believe asset prices could flatten as 'broad money' growth slows.

Figure 7. The Qualitative Economic Impact of QE[7]



Source: [7]The United Kingdom's quantitative easing policy: design, operation and impact, Bank of England Quarterly Bulletin 2011 Q3.

Q Can you expand on liquidity?

A I would guide you to read a recent CQS Strategy Perspectives on the topic of credit market liquidity and what that means for credit investment. From my perspective, it talks to the importance of patient and flexible capital as we adapt to a 'new normal' in market liquidity. Let me approach liquidity from a different angle. Sir John Cunliffe, Deputy Governor for Financial Stability at the Bank of England, has focused on the subject. Helpfully, he points to a number of differing types of liquidity - capital markets, balance sheet, and systemic liquidity. In my view, this approach frames the discussion.

Regulation since the Global Financial Crisis (GFC) has been driven largely by political imperatives. It has sometimes been hasty and has often resulted in unintended consequences. The market is a voting mechanism with the buying and selling of securities establishing a clearing price. I believe that this price discovery process is an essential part of an efficient capital formation process. Regulatory change is taking capital formation away from markets and we can see this taking place at a number of levels. The Volcker Rule has reduced market-making capacity and reduced the market's shock absorbers. Basel III is imposing increased solvency on the banking system and distorting investor preferences. One could argue that pre-GFC there was too much liquidity and not enough solvency. Now, however, I think we risk having too much solvency and insufficient liquidity. The leverage ratio and the Fed's G-SIB (Globally Systemically Important Banks) designation and balance sheet surcharge are examples. The effects of this regulation include the classification of wholesale cash deposits as 'risky' assets and contributing to the decline in the availability of repo, which lies at the heart of the financial system's plumbing, and market activity. In my view, these and several other measures are all contributing to the drain in liquidity out of the capital markets.

Q You discussed mark-to-market volatility in June. What perspectives do you have now?

A We have witnessed a great deal of market volatility since July. Mark-to-market volatility is something all market participants will have to become more accustomed to. From a trading perspective, the market has become more difficult to trade and finance. What's more, I expect pricing shocks to the system will now be greater and more common. Remember a basic rule of the capital markets: to deal with more volatility one requires a greater cushion in spread or price. It speaks to the now well-known Chinese character for crisis, 危机, which contains both danger and opportunity. I believe that it is fundamental "bottom up" credit and equity analysis that helps you distinguish real value and the appropriate sizing of positions enables you to weather any crisis. In part this is a technical situation and in part a function of regulatory risk weightings. Overall, I believe this will make assets more attractive, providing one can source and hold the assets through volatile markets. Patient and flexible capital should be best able to benefit from this volatility and we have explored the potential for this in depth in the paper.

Q Let's turn to Asia. Can you expand on the China slowdown?

A Along with others, I have expressed caution about the slowdown in China over the last couple of years. I think GDP growth in a range of 5% to 7% is more realistic and could feel 'recessionary'.[8] As the shift from manufacturing to a services-led economy continues, the industrial sector will continue to slow. As the manufacturing sector slows it will take time for the consumption and services sectors to fully replace manufacturing as an engine of growth. The People's Bank of China (PBoC's) balance sheet has expanded materially and it is unclear to me how much further it can prudently and effectively be expanded.

Source: [8]Oxford Economics Global Outlook 18 November 2015.

I think it is useful to recap what an important driver of global growth China has been. China accounts for 11% of global GDP, 10% of world trade, 11% of world oil demand and between 40% and 70% of demand for other key commodities. Despite the yuan being admitted into the SDR (Special Drawing Right) the financial system is not yet truly open, China accounts for over 20% of the world's 'broad money' (bigger than the US). What this means is that real economy developments in China are important to the global economy. As its economy slows, goods imports have slowed and fallen.[8]

I remain confident on China's future prospects and think that the leadership is both smart and well informed. However, there is a secular slowdown taking place. The transmission mechanism to the global economy is through trade channels, especially in Asia, and through commodity producers. There is also an effect on companies which have material exposures to China, such as Germany.

However, the relatively closed nature of China's capital markets should limit any potential financial fall-out from domestic defaults or deleveraging due to slower growth. By way of example, the exposures of US and European banks to Greater China is approximately US$1.1tn, broadly comparable to the exposures they had to Portugal, Greece, Spain and Ireland in 2010. While these exposures are material, I do not believe they are a systemic threat. The balance of China's economy is moving towards services, there is a strong anti-corruption drive and an internationalisation of the economy is beginning to take place.[8]

I also sense that geopolitical concerns in the South and East China seas are easing for the time being. For example, the US Navy destroyer, the USS Stethem, docked in Shanghai on November 16. I believe this and other signals suggest that there remains a positive disposition towards the United States within the Chinese administration.

Q With such a slowdown in China, does this mean you are of the view that we are in a disinflationary environment?

A It's an important and perplexing topic. There are clearly disinflationary tendencies globally. We can look at trends such as those in China which are leading to continued pressure on commodity markets, but I think there may also be secular changes at work that markets have not yet fully grasped. In traditional manufacturing economies productivity is clearly measurable, but it is more complicated in a services and virtually-driven economy. Are we now in a post-industrial society where the interface between energy and the economy has changed and where the virtual economy is a key driver? We are undoubtedly witnessing efficiencies and substitutions in energy consumption in the Western world. I wonder whether traditional measures of inflation are capturing activities in the virtual world and, for example, the productivity of apps. Given the increasingly rapid pace of technological product cycles, the inflation basket is not keeping up with consumer purchases. This might frustrate efforts to measure inflation. This is an area that we at CQS are intrigued by and continue to investigate further.

To answer the question directly, however, I cannot presently see a clear inflationary trigger. There is a tightening in labour markets especially in the US and the UK, as well as a falling unemployment rate in Europe to below 10%. There is also a view that oil prices and other commodities could see a modest rebound in 2016, but a return to anywhere near peak cycle prices is not on the cards anytime soon. Consequently, consensus forecasts for headline inflation in Developed Markets are for a rise from +0.3% to +1.5%. However, it is core inflation against central bank targets that will drive interest rates and forecasts predict a narrowing of that gap, but not an elimination of it. As a result, I continue to believe the US Federal Reserve and other central banks will be behind the curve and remain accommodative for longer.[9]

Source: [8]Oxford Economics Global Outlook 18 November 2015. [9]Goldman Sachs Global Macro Research 18 November 2015

Central banks have fostered low or zero rates to lower the cost of capital and in so doing have also pushed money into and inflated the price of risky assets. It is more difficult to generate consistently positive returns. As rates in the US rise, we are likely to see a continued pick up in volatility and dispersion. The consequence of that will be to affect the equity risk premium (ERP) and lower multiples that the market pays for growth. The question is whether earnings growth will compensate for a lower ERP. Either way, I believe more volatility and greater dispersion should be expected.

Turning to Emerging Markets (EM), last year we published a piece highlighting pressures that might emerge in China, Asia and other developing markets. Among these were Fed Taper, US dollar strength and capital outflows. EM are not homogenous and I see pockets of value, especially in Asia. However, the technical situation argues against a substantial rally in the very short term. It should not be surprising that with US tightening the stimulus is being withdrawn from developing economies therefore making it more difficult for them. This is further exacerbated by many of them also being exposed to Chinese growth. It is difficult to see this technical situation changing in the short-term. Having said that investors appear to be underweight EM which could result in sharp short-term rallies. We are certainly monitoring the situation carefully.

Q The Eurozone has been out of the headlines of late. What perspectives do you have?

A Whilst the Eurozone has achieved monetary union of sorts, it has not achieved political union. There remain impediments, evidenced by the success of the Front Nationale in France's recent local elections. The political debate is likely to become more polarised around topics such as migration, Schengen and Brexit. To be clear, a French or Italian exit would in my view lead to the end of the Eurozone, albeit that is a low probability (but with a big tail risk).

I recently heard Greece's (relatively new) Minister of Finance, Euclid Tsakalotos, speak. He has a very different style to his predecessor Yanis Varoufakis. He said there were many issues, but where there is goodwill, much can be resolved. I am constructive on the desire of all parties to find a solution. Given there are still capital controls in place in Greece and Cyprus, there are many challenges, including structural ones that remain unresolved. While Greece's size is modest in the context of the Eurozone, its importance should not be underestimated, as we witnessed during the summer of 2015. Greece's GDP is only around 1.5% of EU GDP. However, the EU is a politically levered zone and an accommodative approach, such as the one adopted by Mr Tsakalotos, can help 'stabilise' and 'deleverage' the Eurozone. The EU economy is set to continue its expansion and post a 1.7% growth rate in 2016, several large economies are recovering more strongly than expected including France and Spain. I am constructive on Greek credit risk. Furthermore, there are also interesting investment opportunities elsewhere within the Eurozone.[9]

Conclusion

The central themes of bank disintermediation, dislocation and greater dispersion are driving the investment landscape. I am confident we will find opportunity from disruption both on the long and short sides. We will continue to do our best to generate attractive risk-adjusted returns for our investors across a range of investment markets. Having continued to invest in our ability to provide solutions, I believe we have the skill sets, research capabilities and investment resources to identify and exploit relative value within corporate capital structures, between sectors and across markets globally.

Over the past year we have also worked hard to lay the foundation of a stronger business to deliver improved solutions, more consistent performance and enhanced client service. In addition, we have streamlined our product offering and strengthened our governance structure. We have invested further in broadening and deepening our investment skill sets through key hires across our global investment and operational platform.

On behalf of everyone at CQS, I would like to thank our investors for their support and our staff for their continued efforts. I would also like to wish everyone a happy, healthy and profitable 2016.

Sir Michael Hintze, AM
(Chief Executive and Senior Investment Officer)

[9] Goldman Sachs Global Macro Research 18 November 2015

About the Author

Sir Michael Hintze
Sir Michael is the founder, Chief Executive and Senior Investment Officer of CQS. He is also a Senior Portfolio Manager. Michael serves as a Director on the CQS Supervisory Board (Board of Directors) and chairs the CQS Strategy Board.

Prior to establishing CQS in 1999, Michael was a Managing Director in the Leveraged Funds Group at CSFB, having previously spent 12 years at Goldman Sachs in a variety of roles including; Executive Director and Head of UK Equity Trading. He began his career in finance in 1982 with Salomon Brothers, New York, after working as an Electrical Design Engineer for Civil and Civic Pty Ltd in Australia, where he had also served in the Australian Regular Army in the Royal Australian Electrical and Mechanical Engineers, latterly as a Captain. Michael has significant and wide-ranging philanthropic interests and to consolidate these, the Hintze Family Charitable Foundation was established in 2005 since when almost 200 charities have received funding from the Foundation.

Michael is a fluent Russian speaker. He holds a BSc in Physics and Pure Mathematics and a BEng in Electrical Engineering both from the University of Sydney. He also holds an MSc in Acoustics from the University of New South Wales, an MBA from Harvard Business School and received a Doctor of Business honoris causa from the University of New South Wales.

About CQS

Founded in 1999, CQS is an $12.6bn[1] global multi-strategy asset management firm. CQS has over 280 staff located globally, 93 of whom are specialist investment professionals. CQS is a founding member of the Hedge Fund Standards Board and is regulated by the FCA in the UK, the SFC in Hong Kong, ASIC in Australia and registered with the SEC in the US. CQS launched its first hedge fund in March 2000 and has since expanded its offering to include additional strategies and bespoke solutions in the areas of multi-strategy, convertibles, asset backed securities, credit, loans and equities.

Since inception, the firm has placed fundamental analysis at the heart of its investment process and we follow a collaborative multi-disciplinary approach seeking adjacencies across all areas in which we invest. Our robust operations and risk management platform provides all mandates with liquidity management and risk monitoring which, in our view, should enable our investment professionals to be more nimble and effective throughout all market environments.

[1]Source: CQS, estimated as at 1 December 2015.

Not for distribution to retail investors as defined in Article 4 of the European Directive 2011/61/EU and the UK FCA COBS 3.4. CQS is a founder of the Hedge Fund Standards Board ("HFSB") which was formed to act as custodian of the hedge fund best practice standards (the "Standards") published by the Hedge Fund Working Group ("HFWG") in 2008 and to promote conformity to the Standards. HFSB is also responsible for ensuring that they are updated and refined as appropriate. The Standards were drawn up by HFWG which comprised the leading hedge funds (based mainly in London) in 2007 in response to concerns about the industry, including financial stability and systematic risk. The HFWG completed its work in January 2008 and published its report outlining the Standards. By applying, managers commit to adopt the "comply or explain" approach described in the Standards. The term "CQS" may include one or more of any CQS branded entity including CQS Cayman Limited Partnership which is registered with the Cayman Islands Monetary Authority, CQS (UK) LLP and CQS Investment Management Limited which are both authorised and regulated by the UK Financial Conduct Authority, CQS (Hong Kong) Limited which is regulated by the Hong Kong Securities and Futures Commission, CQS (US), LLC which is registered with the US Securities and Exchange Commission, and CQS Investment Management (Australia) Pty Limited which is registered with the Australian Securities & Investments Commission, Australian Financial Services Licence No. 386047. This document has been prepared for general information purposes only and has not been delivered for registration in any jurisdiction nor has its content been reviewed by any regulatory authority in any jurisdiction. The information contained herein does not constitute: (i) a binding legal agreement; (ii) legal, regulatory, tax, accounting or other advice; (iii) an offer, recommendation or solicitation to buy or sell shares in any fund or any security, commodity, financial instrument or derivative linked to, or otherwise included in, a portfolio managed or advised by CQS; or (iv) an offer to enter into any other transaction whatsoever (each a "Transaction"). Any decision to enter into a Transaction should be based on your own independent investigation of the Transaction and appraisal of the risks, benefits and suitability of such Transaction in light of your individual circumstances. Where applicable, any decision to enter into any Transaction should be based on the terms described in the relevant prospectus, supplement, offering memorandum, private placement memorandum, trading strategy, constitutional document and/or any other relevant document as appropriate (each an "Offering Document"). Any Transaction will be subject to the terms set out in its Offering Document and all applicable laws and regulations. The Offering Document supersedes this document and any information contained herein. Nothing contained herein shall constitute or give rise to the relationship of partnership nor shall it constitute a joint venture or give rise to any fiduciary or equitable duties. Any information contained herein relating to any third party not affiliated with CQS is the sole responsibility of such third party and has not been independently verified by CQS or any other independent third party. The information contained herein is not warranted as to completeness or accuracy and no representations are made in such respect, nor should it be deemed exhaustive information or advice on the subjects covered; as such, the information contained herein is not intended to be used or relied upon by any counterparty, investor or any other party. The information contained herein, as well as the views expressed herein by CQS professionals made as of the date of this presentation, is subject to change at any time without notice. CQS uses information sourced from third-party vendors, such as statistical and other data, that are believed to be reliable. However, the accuracy of this data, which may also be used to calculate results or otherwise compile data that finds its way over time into CQS research data stored on its systems, is not guaranteed. If such information is not accurate, some of the conclusions reached or statements made may be adversely affected. CQS bears no responsibility for your investment research and/or investment decisions and you should consult your own lawyer, accountant, tax adviser or other professional adviser before entering into any Transaction. CQS is not liable for any decisions made or action taken by you or others based on the contents of this document and neither CQS nor any of its directors, officers, employees or representatives (including affiliates) accept any liability whatsoever for any errors and/or omissions or for any direct, indirect, special, incidental or consequential loss, damages or expenses of any kind howsoever arising from the use of, or reliance on, any information contained herein. Information contained in this document should not be viewed as indicative of future results as past performance of any Transaction is not indicative of future results. The value of investments can go down as well as up. Certain assumptions and forward looking statements may have been made either for modelling purposes, to simplify the presentation and/or the calculation of any projections or estimates contained herein and CQS does not represent that any such assumptions or statements will reflect actual future events or that all assumptions have been considered or stated. Accordingly, there can be no assurance that estimated returns or projections will be realized or that actual returns or performance results will not materially differ from those estimated herein. Some of the information contained in this document may be aggregated data of transactions executed by CQS that has been compiled so as not to identify the underlying transactions of any particular customer. Any indices included in this document are included to simply show the general market trends relative to the types of investments CQS tends to select for certain funds managed or advised by CQS ("CQS Funds") for the periods indicated within this document. The indices are not representative of CQS Funds in terms of either composition or risk (including volatility and other risk related factors). CQS Funds are not managed to a specific index. This document is not intended for distribution to, or use by, the public or any person or entity in any jurisdiction where such use is prohibited by law or regulation. In accepting receipt of this information, you represent and warrant that you have not been solicited, directly or indirectly, by CQS and are receiving this information at your own request. It is your responsibility to inform yourself of and to observe all applicable laws and regulations of any relevant jurisdiction. The information contained herein is confidential and may be legally privileged and is intended for the exclusive use of the intended recipient(s) to which the document has been provided. In accepting receipt of the information transmitted you agree that you and/or your affiliates, partners, directors, officers and employees, as applicable, will keep all information strictly confidential. Any review, retransmission, dissemination or other use of, or taking of any action in reliance upon, this information is prohibited. Any distribution or reproduction of this document is not authorized and prohibited without the express written consent of CQS, or any of its affiliates. AIFMD and Distribution in the European Economic Area: The Alternative Investment Fund Managers Directive (Directive (2011/61/EU)) ('AIFMD') is a regulatory regime which came into full effect on 22nd July 2014. CQS (UK) LLP is an Alternative Investment Fund Manager (an 'AIFM') to certain CQS Funds (each an 'AIF'). The AIFM is required to make available to investors certain prescribed information prior to investing in an AIF. The majority of the prescribed information is contained in the latest Offering Document of the AIF. The remainder of the prescribed information is contained in the relevant AIF's pre-investment disclosure document, the monthly investor report, and the fund limits document. All of this information is made available in accordance with the AIFMD. In relation to each member state of the EEA (each a "Member State") which has implemented the AIFMD (and for which transitional arrangements are not/no longer available), this document may only be distributed and shares in a CQS Fund ("Shares") may only be offered or placed in a Member State to the extent that: (1) the CQS Fund is permitted to be marketed to professional investors in the relevant Member State in accordance with AIFMD (as implemented into the local law/regulation of the relevant Member State); or (2) this document may otherwise be lawfully distributed and the Shares may otherwise be lawfully offered or placed in that Member State (including at the initiative of the investor). In relation to each Member State of the EEA which, at the date of this document, has not implemented the AIFMD, this document may only be distributed and Shares may only be offered or placed to the extent that this document may be lawfully distributed and the Shares may lawfully be offered or placed in that Member State (including at the initiative of the investor). Information Required, to the extent applicable, for Distribution of Foreign Collective Investment Schemes to Qualified Investors in Switzerland: The representative in Switzerland is ARM Swiss Representatives SA, Route de Cité-Ouest 2, 1196 Gland, Switzerland. The distribution of shares of the relevant CQS Fund in Switzerland will be exclusively made to, and directed at, qualified investors (the "Qualified Investors"), as defined in the Swiss Collective Investment Schemes Act of 23 June 2006, as amended ("CISA") and its implementing ordinance (the "Swiss Distribution Rules"). Accordingly, the relevant CQS Fund has not been and will not be registered with the Swiss Financial Market Supervisory Authority ("FINMA"). The representative in Switzerland is ARM Swiss Representatives SA, Route de Cité-Ouest 2, 1196 Gland, Switzerland. The paying agent in Switzerland is Banque Cantonale de Genève, 17, quai de l'Ile, 1204 Geneva, Switzerland. The relevant Offering Document and all other documents used for marketing purposes, including the annual and semi-annual report, if any, can be obtained free of charge from the representative in Switzerland. The place of performance and jurisdiction is the registered office of the representative in Switzerland with regards to the Shares distributed in and from Switzerland. CQS (UK) LLP (as the distributor in Switzerland) and its agents do not pay any retrocessions to third parties in relation to the distribution of the Shares of the CQS Fund in or from Switzerland. CQS (UK) LLP (as the distributor in Switzerland) and its agents do not pay any rebates aiming at reducing fees and expenses paid by the CQS Fund and incurred by the investors.

Index Descriptors: Euro High Yield Constrained Index (HEC0). Institutional Tranches refer to loans which are syndicated to institutional / non-bank investors. The HEC0 index is designed to track the performance of euro- and British pound sterling-denominated below investment grade corporate debt publicly issued in the eurobond, sterling domestic or euro domestic markets by issuers around the world. It is not possible to invest directly in an index. The HEC0 index is designed to track the performance of Euro and GBP denominated below investment grade corporate debt publicly issued in the eurobond, sterling domestic or euro domestic markets by issuers around the world. S&P Leveraged Loan Indexes are capitalization-weighted syndicated loan indexes based upon market weightings, spreads and interest payments. Specifically, the S&P/LSTA Leveraged Loan Index (LLI) covers the U.S. market back to 1997 and currently calculates on a daily basis. The S&P European Leveraged Loan Index (ELLI) covers the European market back to 2003 and currently calculates on a weekly basis.

Barclays Benchmark Index: 'US High Yield ex Energy' using the Option Adjusted Spread. The 'US High Yield ex Energy' is a subset of the Barclays US High Yield Index excluding all energy related issuers. The index is weighted by the market value of each bond issue. Barclays Benchmark Index and 'Pan European High Yield ex Financials' using the Option Adjusted Spread. The 'Pan European High Yield ex Financials' is a subset of the Barclays Pan European High Yield Index excluding all financial related issuers. The index is weighted by the market value of each bond issue. Barclays Benchmark Index: 'US High Yield ex Energy CCC' using Option Adjusted Spread. The 'US High Yield ex Energy' is a subset of the Barclays US High Yield Index but includes only those issues with a CCC rating as determined by the S&P rating methodology and then excludes those issuers that are energy related. The index is weighted by the market value of each bond issue. Barclays Benchmark Index: 'Euro High Yield Corporate CCC ex Financials' using the Option Adjusted Spread. The 'Euro High Yield Corporate CCC ex Financials' is a subset of the Barclays Pan European High Yield Index but includes only those issues with a CCC rating as determined by the S&P rating methodology and then excludes those issuers that are financial related. The index is weighted by the market value of each bond issue.

Contact Information

clientservice@cqsm.com
www.cqs.com

CQS (UK) LLP
CQS Investment Management Limited
4th Floor, One Strand
London WC2N 5HR
United Kingdom

Tel: +44 (0) 20 7201 6900
Fax: +44 (0) 20 7201 1200

CQS (Hong Kong) Limited
Unit 1207, 12th Floor
No.9 Queen's Road Central
Hong Kong
China

Tel: +852 3920 8600
Fax: +852 2521 3189

CQS (US), LLC
152 West 57th Street
40th Floor, New York
NY 10019
United States

Tel: +1 212 259 2900
Fax: +1 212 259 2699

CQS Investment Management (Australia) Pty Limited
Suite 9.02, 50 Pitt Street
Sydney
NSW, 2000
Australia

Tel: +61 2 8294 4180