Smart Lenders AM presents its 2021 review and its outlook for 2022

January 2022

Dear investors and partners,

After an almost normal end to the year, at least when compared to the previous one, we are pleased to publish some thoughts on the economic situation in the United States.

Covid-19 was not a classic crisis. In many ways, it differs from previous crises. As such, to ensure continuity in our analysis, we have repeated a series of economic aggregates that we presented to you last year. In a sustained economic context, weighted by a sharp rise in inflation, online lending activity has grown strongly in recent years and despite the crisis, its future looks promising.

We would like to sincerely thank our investors who have trusted and supported us since the launch of the fund. We would also like to thank the investors who are currently analysing our product to see how to include it in their investment strategy.

We remain at your disposal for any questions this communication may raise and look forward to continuing to provide you with the best service and even more value.

Yours sincerely

Your Smart Lenders Asset Management team

Impressive fall and recovery of the US economy in less than 24 months

Source : BlackRock

2020 and 2021 will have been the years of all the superlatives in the US. After a record fall in GDP in Q2 2020, the US economy could, on a real basis, appreciate by almost 10% in Q4 2021.

Thus, the US economy has added nearly $4 trillion in value since the 2020 trough, a recovery of more than 20%.

Expectations for 2022 are varied but remain high, including BlackRock's expectation of nearly 4% real growth, noting that the average for the previous 7 years is 1.5%.

On the business side, confidence has returned

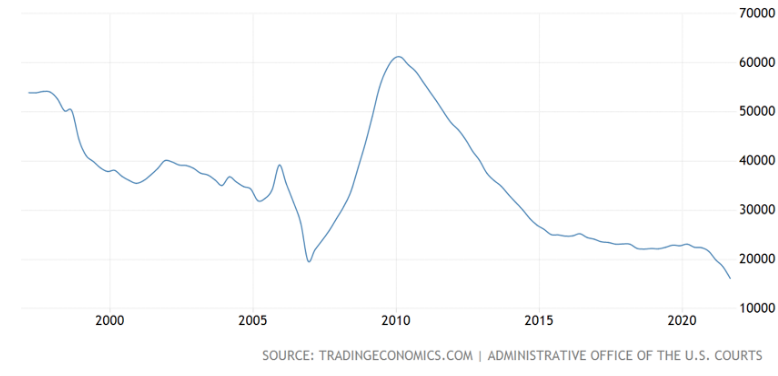
ISM Confidence Index

Source : Trading Economics

Despite the pandemic, business support plans, notably the "Paycheck Protection Program", have helped to mitigate its effects.

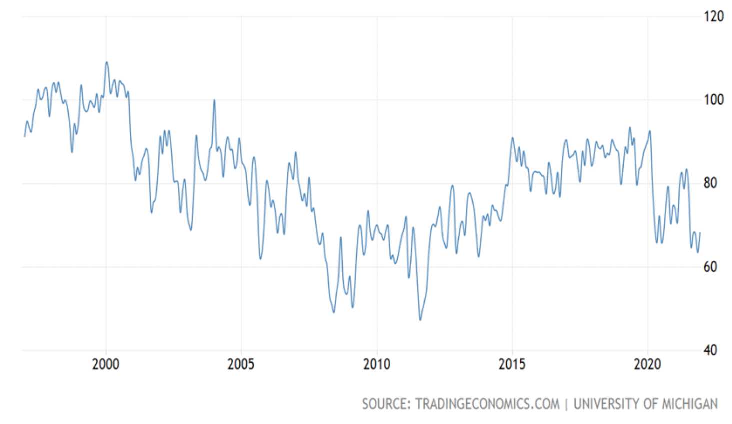
As a result, the ISM confidence index reflects a level close to the records of the previous quarter century.

Bankruptcy Rate



Similarly, the bankruptcy rate is particularly low. You must go back to before the subprime crisis to find such a level.

Consumer Confidence Index



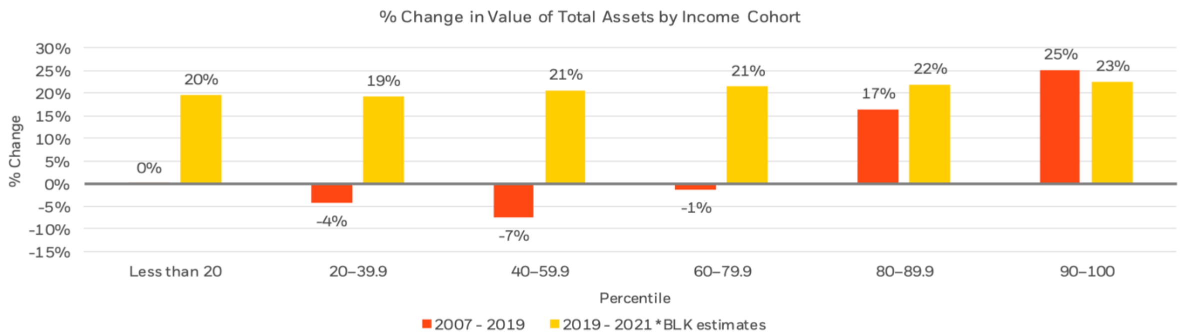
Nevertheless, these good indicators must be tempered by the consumer confidence index, which does not reflect such optimism.

It is even at historically low levels.

Household balance sheets strengthened, and not just for the wealthy

Unlike the previous crisis, the subprime crisis, the effects of the Covid-19 crisis are sometimes surprising. This is due to the proactive and coordinated responses of governments and central banks, at least in developed countries.

Between 2007 and 2019, 80% of households, the less wealthy, were negatively impacted in terms of asset values and felt a lost decade. As a result of the very generous support programs immediately put in place in 2020 and continued in 2021, all income groups experienced an almost identical increase in asset values of around 20%. This distributed increase across the balance sheets of each of the income groups has also had knock-on effects such as the "great resignation", where an unprecedented number of workers have left the labour market.



Source : BlackRock

Households have many years of liquidity ahead of them

Cash holdings for all US households have reached USD 2.5 trillion, or about 10% of GNP. The wealth effect should not be underestimated: property prices in the US have risen by more than 20% in less than two years.

Household debt has risen by $1.1 trillion, while net wealth has increased by $31.1 trillion. With household consumption accounting for two-thirds of US GDP, it is likely that, in the absence of significant asset prices corrections, US growth will remain strong.

Balance Sheet Metric	Feb-20	Nov-21	Change since pre-pandemic
Cash [Excess Savings above pre-pandemic run rate ($T)]	0.0	2.5	**2.5**
House ($k)	306	373	**21.9%**
Equities, S&P 500 ($T)	28.0	40.4	**12.4**
HH Debt ($T)	16.2	17.3	**1.1**
HH Net Worth	110.6	141.7	**31.1**

Source : BlackRock

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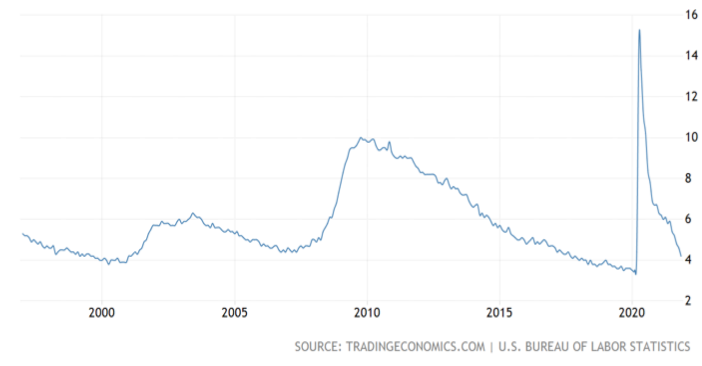
Unemployment has fallen significantly and the labour market remains buoyant

United States Unemployment Rate



Having peaked at over 15% at the height of the pandemic, unemployment has fallen sharply and rapidly to near historic lows. The 4%-mark, a trigger for the withdrawal of extraordinarily accommodating monetary and fiscal policies, is thus clearly in sight.

Job vacancies

The number of job vacancies has jumped to an unprecedented 11 million.

While this is clearly inflationary, it reflects shortages in certain sectors of the economy, such as hospitality, catering, or training, where wages are generally low.

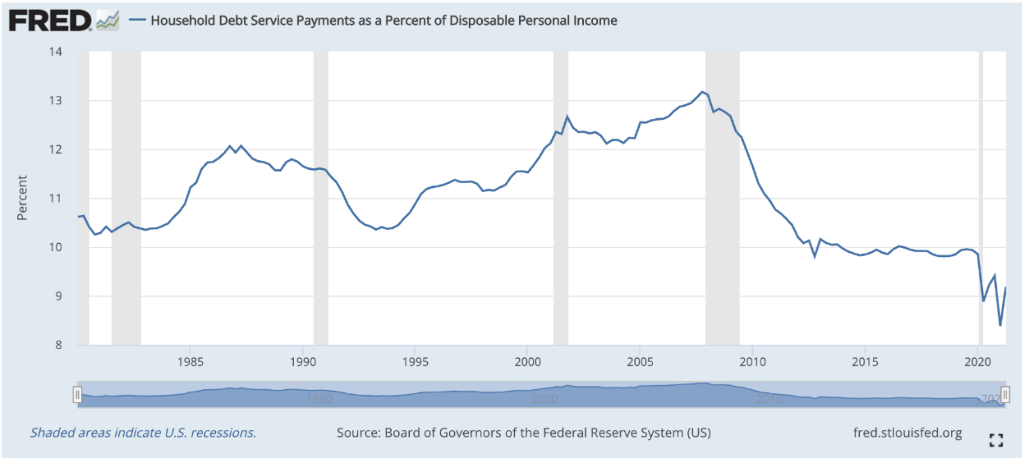
United States Wages Growth

These tensions in the labour market led to very sharp increases in wages after a sharp decline in the first wave.

Once this element of catching up has taken place, a normalisation is expected. This increase in wages and the growth in their savings rate, supports the ability of the US consumer to service its debt.

Household debt service costs remain at record lows

Despite some bumps in the road, the cost of servicing debt has not changed much. At around 9% of household disposable income, it remains at historically low levels and even lower than in the pre-Covid period, when it was around 10%.

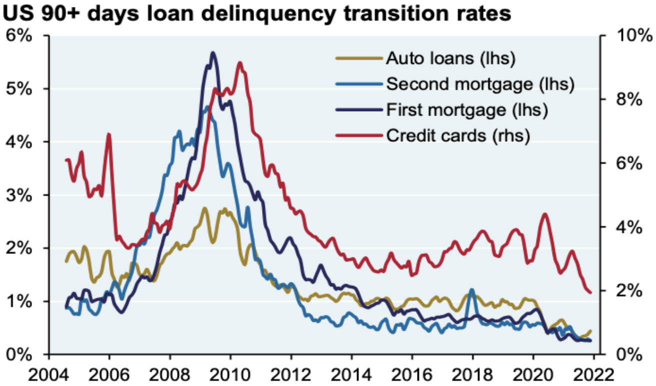


Default rates all at record lows

In such an environment, it is hardly surprising that default rates on credit cards (a proxy for consumer loans) are also approaching historic lows.

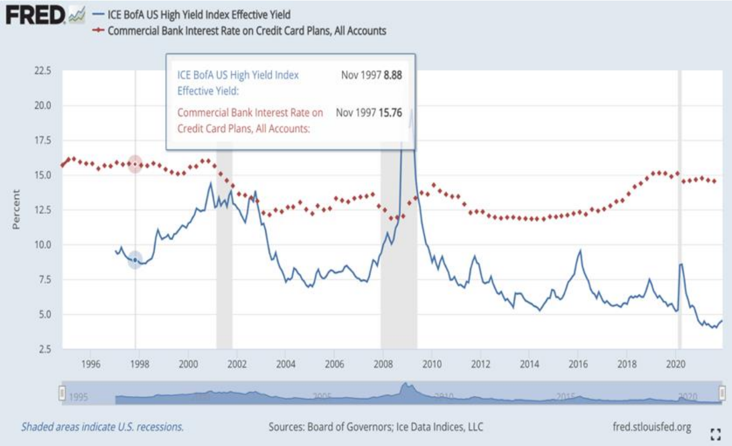
Credit card loans defaults have broken through their previous lows and are now slightly below 2%. This is also the case for vehicle loans and mortgages.

US 90+ days loan delinquency transition rates



Source: S&P Dow Jones Indices, Experian. November 2021.

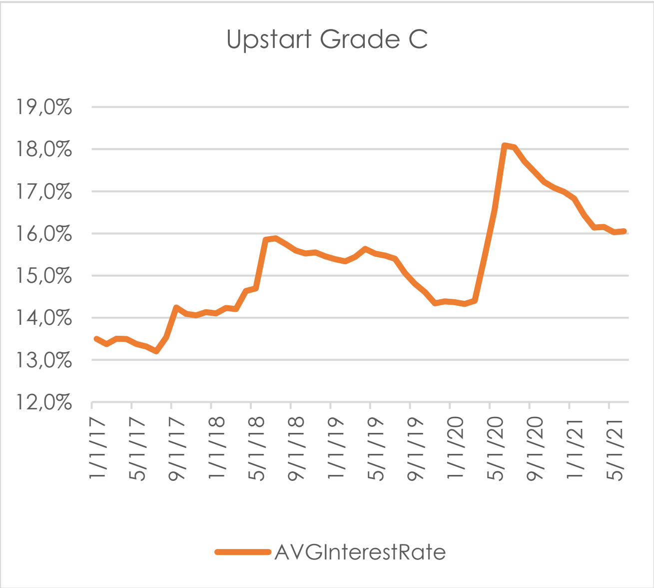
Gap between consumer credit and high yield bonds



While high yield bonds continue to appreciate and therefore generate lower yields, consumer credit has been able to increase its lending rates slightly before and maintain them during the Covid crisis.

Thus, the latter has risen from around 12.5% between 2012 and 2018 to around 15% since then.

Evolution of interest rates for a constant borrower risk



Source : Upstart

As seen on the platform Upstart, interest rates for the average borrower have fluctuated significantly over the past two years.

After bottoming out at 14.3% in November 2019, they peaked at 18.1% in June 2020.

Since then, they have returned to the mid-range of 16.1%, the highest levels reached between 2018 and 2019.

As much as the Covid crisis had a significant impact on the cost of credit, this has now largely faded, and rates are slowly normalising.

Conclusion

While the previous two years were a source of worry, shocks, and anxiety, at the beginning of 2022, the financial situation of American consumers and small businesses is in good shape. Reserves have been accumulated, often reluctantly, debts paid off or at least only slightly increased, and finally, despite the crisis context, assets have performed as strongly as ever. However, inflation, which has continued to surprise in 2021, continues to be a source of uncertainty for most players.

We are monitoring all these elements very carefully. The duration of our portfolio is low (around 13 months) and the net asset value of Moonstone Lending SICAV would therefore be less impacted by a reversal of the trend in interest rates, especially if their rise is gradual and limited, as it was between 2016 and 2019. Positioned for a continuation of a favourable scenario, we nevertheless remain attentive and maintain a qualitative approach regarding the selection of our platforms as well as that of our borrowers.

2021 was therefore an exceptional performance (9,95% in USD, 9,26% in EUR and 8.96% in CHF), benefiting from a dual positive effect: on one hand, monetary support for US consumers by the federal government, which pushed their default rate to historic lows, and on the other hand, the rise in lending rates, a response by platforms to the rise in the unemployment rate, a leading indicator of the rise in future default rates (which did not happen).

For 2022, we can expect a slow normalisation of the situation, i.e., a gradual rise in default rates towards their historical trend and the continuation of the measured decline in the platforms' lending rate towards their pre-covid level. The Fund could therefore benefit from a positive transition year, still profiting from the favourable conditions of 2021 before returning to the historical returns of this asset class in 2023, all other things being equal.

About Smart Lenders AM

Smart Lenders AM is an asset management company specialised in managing portfolios of loans issued through established marketplace lenders, online-lending platforms and Crowdlending platforms. In January 2018, the company relocated from London to Paris where it is regulated by the AMF and is accredited with the AIFM full-scope status.

Our primary activity is to select loans and construct portfolios with a quantitative and algorithmic approach focusing specifically on consumer and SMB loans in the US and Europe. Since its launch, Smart Lenders AM has invested in over $1bn of loans on behalf of European institutional and professional investors.

A leading player in online credit investing for European investors.

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