SMART LENDERS
ASSET MANAGEMENT

Smart Lenders AM presents its 2022 review and 2023 outlook

January 2023

Dear investors and partners,

After a complicated 2022, marked by the conflict in Eastern Europe, restrictive monetary policies, and fears of rising inflation, **our Moonstone Lending fund has performed well, posting a positive performance in 2022 on the USD (+1.94%) and EUR (+0.13%) units, one of the best performances among bond funds**.

In this context, despite the rise in interest rates and defaults (in the low premium segment), **the fund's performance demonstrated the resilience of the asset class thanks to the unique combination of an ultra-short duration with high interest rates.**

The strategy therefore offers investors a very favourable asymmetry that takes advantage of the cycle (+9.26% in EUR and 9.95% in USD in 2021) and absorbs rapid rate hikes such as in 2022 while protecting capital.

In this letter, we would like to address the following three points: a review of 2022, a status report at the beginning of 2023 and, finally, some future prospects for the strategy.

We thank you warmly for your confidence in these troubled times and remain at your disposal for any questions that this communication may raise.

Yours sincerely

Your Smart Lenders Asset Management Team

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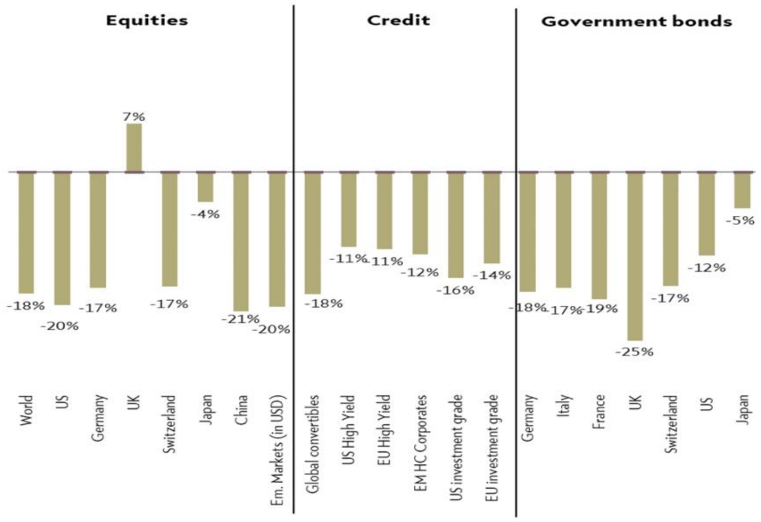
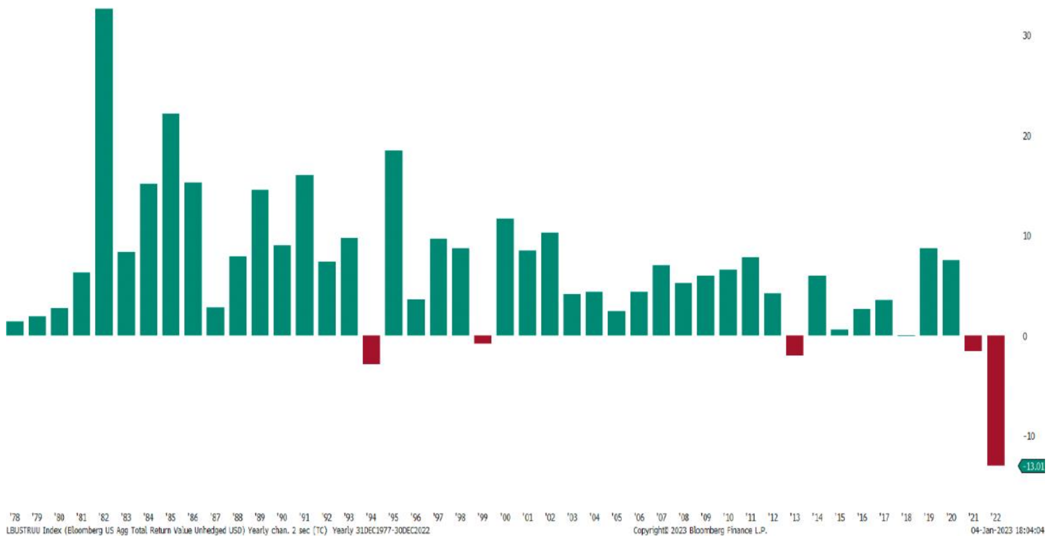
2022 : « No place to hide »

The major asset classes experienced almost unprecedented and coordinated declines in 2022. With the exception of UK equities in local currency, the main benchmarks, both equities and bonds, ended the year significantly in the red, with the large majority posting double-digit declines.



Source : Julius Baer, january 2023

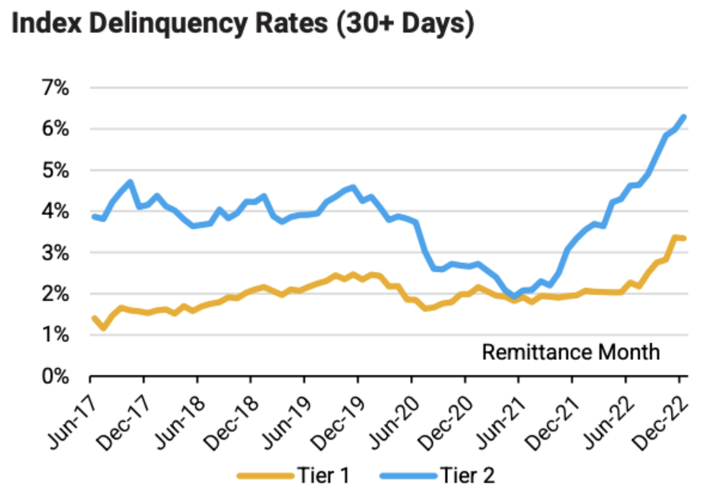
Bonds had their worst performance since the 1970s, which were notoriously characterised by "stagflation". The decline is all the more remarkable as it has affected all asset classes, including credit, emerging markets and developed country sovereign bonds.



Source : Julius Baer, january 2023

In the US consumer segment, we were confronted with rising interest rates (between 300 and 400 basis points depending on the duration) and credit deterioration in the "low prime" segment.

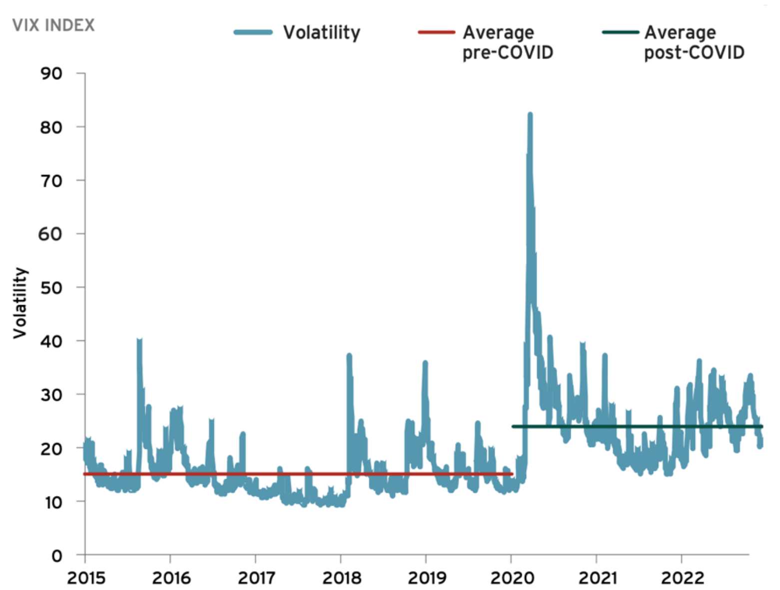
However, these adverse elements were adequately compensated by a high coupon and limited exposure to weaker borrowers.



Source : KBRA, december 2022

2023 : A year of transition

We assume that the volatility regime that was established at a higher level during the Covid-19 crisis will continue. The various crises since then have led to a more fragile environment. International tensions, supply chain issues and economic fears lead to more uncertainty, which in turn leads to more volatility. Investors should therefore be prepared to find it more difficult to generate high Sharpe ratio returns.



Source : Apollo, december 2022

In previous interest rate hike cycles, interest rates peaked well above the consumer price index. This is not the case at the beginning of 2023, as we can see on the chart below:

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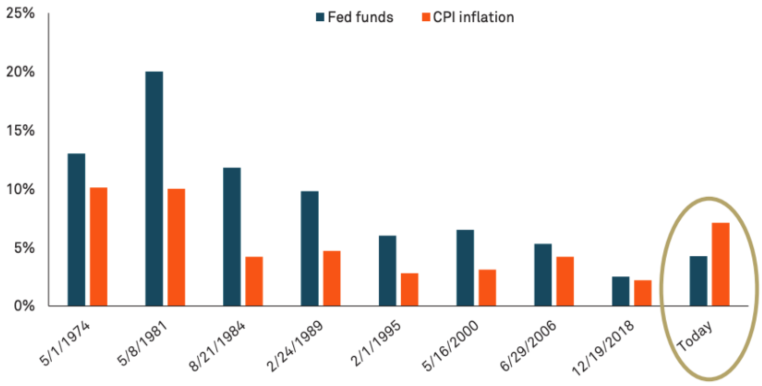
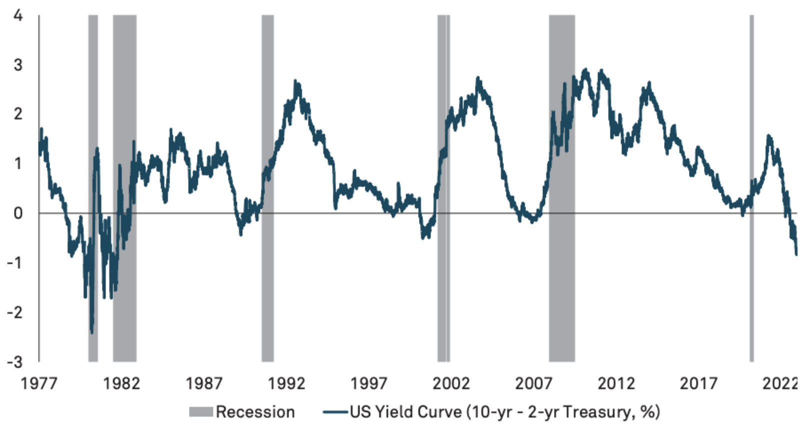


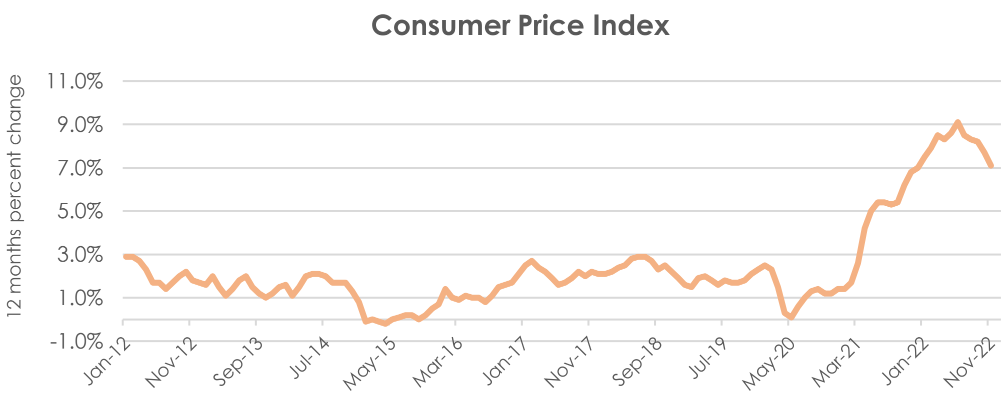
Source: Strategas. As of December 14, 2022.

Although inflation appears to be well on its way down (see below), we expect a series of further rate hikes to control it. This is an objective on which the Fed Chairman has been firm throughout 2022 and such a restrictive policy, of course, has consequences. Also, the inversion of the yield curve is a signal of recession.



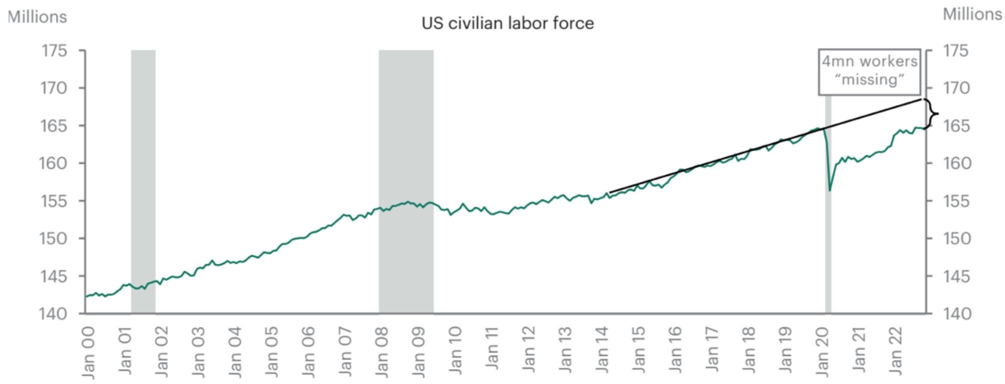
Source: Bloomberg. As of December 14, 2022.

The latest consumer price index showed that inflation slowed and was below expectations.



Source : U.S Bureau Of Labor Statistics

We do not anticipate the likelihood of a future recession but note that the impact on employment could be contained. Indeed, the labour market is still experiencing a high deficit, which emerged after the Covid crisis, and which has not been absorbed to date. Maintaining employment is a key factor in our strategy.



Source: Bureau of Labor Statistics (BLS), Haver, Apollo Chief Economist. Data as of November 30, 2022.

Furthermore, the US consumer confidence index resumes an upward trend after the Covid crisis (2020) despite the end of the federal stimulus coupled with the start of hostilities in Ukraine (2022).

*Shaded areas represent periods of recession.
Sources: The Conference Board; NBER
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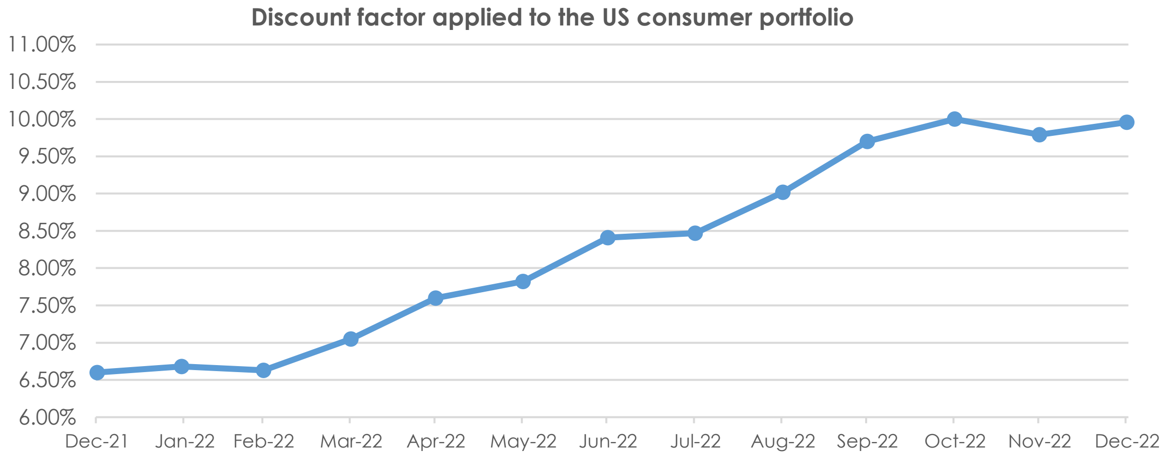
This indicator forecasts consumer spending, which plays a major role in overall economic activity. Its movement is partly linked to the performance of the labour market.

Outlook

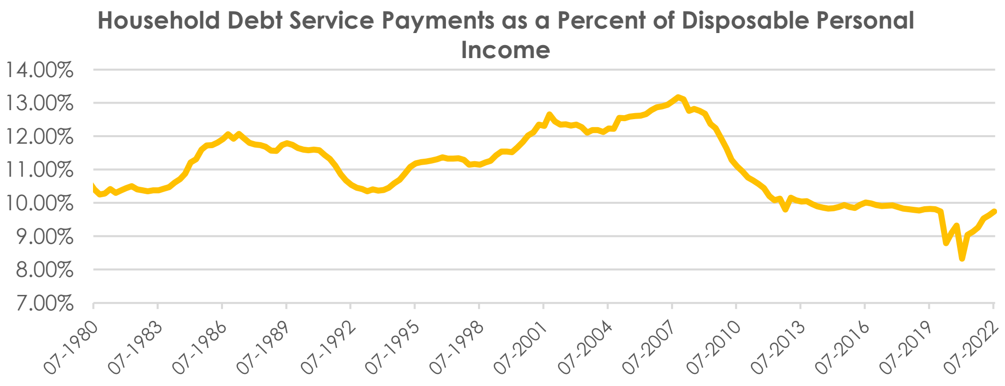
While the portfolio has been fully impacted by the Fed's rate hikes, 2023 is looking better. The new loans are much better remunerated, and the portfolio has now reached a discount rate of 10%.



Source : Smart Lenders Asset Management, january 2023

It could even benefit, probably at the end of the year, from a reversal in US monetary policy. Many economists are counting on a "pivot" by the Fed, which would have the effect of increasing the value of the entire portfolio.

Moreover, despite the very significant rate hikes in 2022, the situation of US households remains healthy. In particular, the debt service ratio in relation to disposable income has increased only slightly and remains below the historical average. This can be explained primarily by significant income growth and fixed-rate real estate debt locked in for the long term.



Source: U.S Bureau of Labor Statistics

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The real estate market is by far the most important element of the US household wealth. Here too, and by way of an international comparison, we can observe relative strength. In particular, the debt-to-income ratio as a percentage of taxable income is among the lowest of selected developed countries.

Housing-risk indicators, selected countries

(Ranking out of 17 countries*, 1=most exposed)	**Policy rates** %-point increase Jan 1st 2021-Oct 18th 2022	**Household debt as % of net disposable income** 2021†	**House prices** % increase 2019-Q2 2022
Canada (1)	3.00	186	41.7
Netherlands (2)	1.25	222	39.7
Australia (=3)	2.50	203	26.7
New Zealand (=3)	3.25	122	38.1
Norway (=3)	2.25	241	26.4
Sweden (6)	1.75	203	32.2
Luxembourg (=7)	1.25	187	34.7
United States (=7)	3.00	101	45.3
Portugal (9)	1.25	126	29.0
Britain (10)	2.15	148	23.6
Denmark (=11)	0.65	249	18.8
Finland (=11)	1.25	156	14.1
Germany (=11)	1.25	102	28.1
France (=14)	1.25	124	17.2
Ireland (=14)	1.25	119	21.8
Spain (16)	1.25	106	5.3
Italy (17)	1.25	91	9.7

*Average of three indicators †Or latest
Sources: Knight Frank Research, Macrobond; OECD; Refinitiv Datastream

The US unemployment rate fell slightly to 3.5% in December 2022, the same low point as in September 2022, suggesting a tight labour market that is likely to continue to contribute to inflationary pressures and consequently further rate increases by the FED.

Source: U.S Bureau of Labor Statistics

Job creation remains strong, and redundancies remain at a low level despite media headlines, as seen in the graph below:

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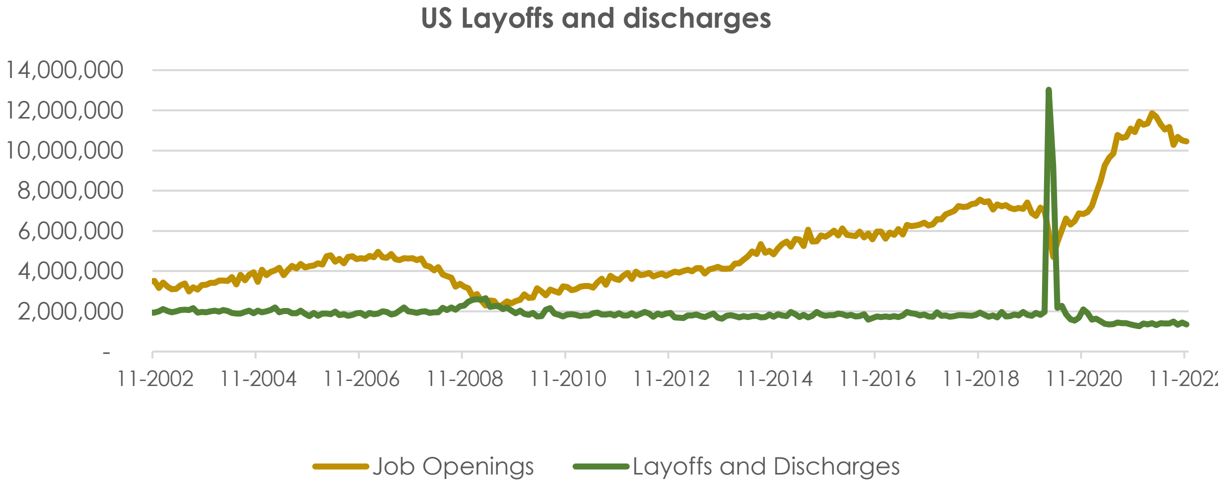

Source: U.S Bureau of Labor Statistics

This results in the number of unemployment benefit claimants being comparable to the pre-Covid level.

Source: U.S Bureau of Labor Statistics

On the wage side, growth is strong

Average hourly wage growth for all private non-farm payrolls in the US rose by 5.1% year-on-year in November 2022, well above the market forecast of 4.6%, indicating that the pressure remains.

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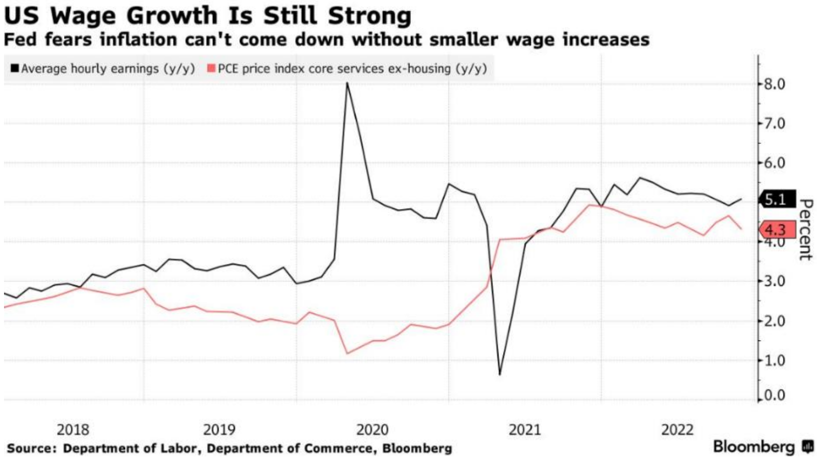
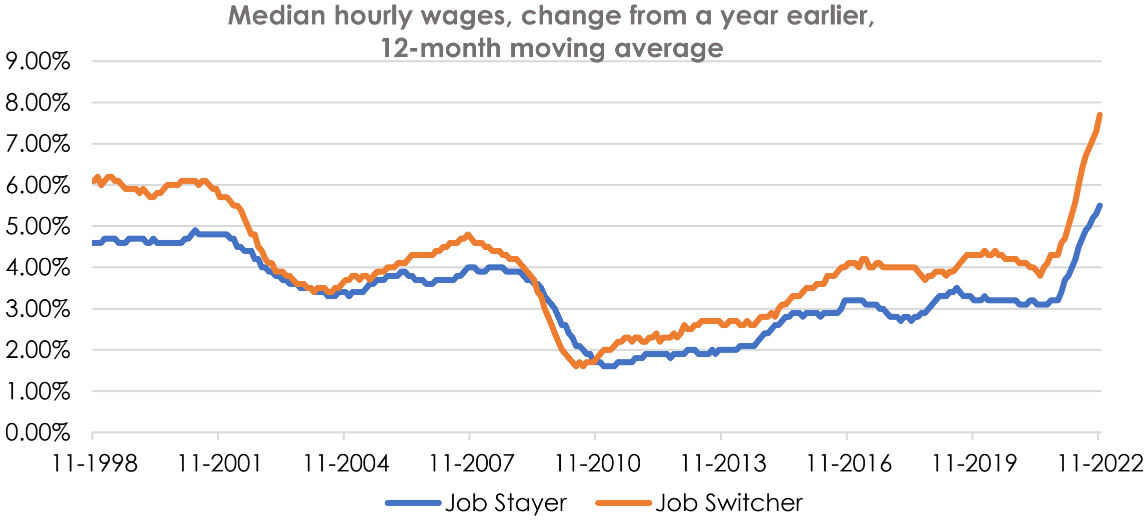


Especially for employees who change jobs

Wage increases were significant in 2022, as in 2021, and even more so for workers who changed jobs.

According to the Atlanta FED, job changers enjoyed a median annual wage increase of 7.7%, compared to 5.5% for workers who stayed in their jobs. (Data correct as of the end of November 2022).



Source: U.S Bureau of Labor Statistics

This rise in wages supports the ability of the US consumer to service its debt.

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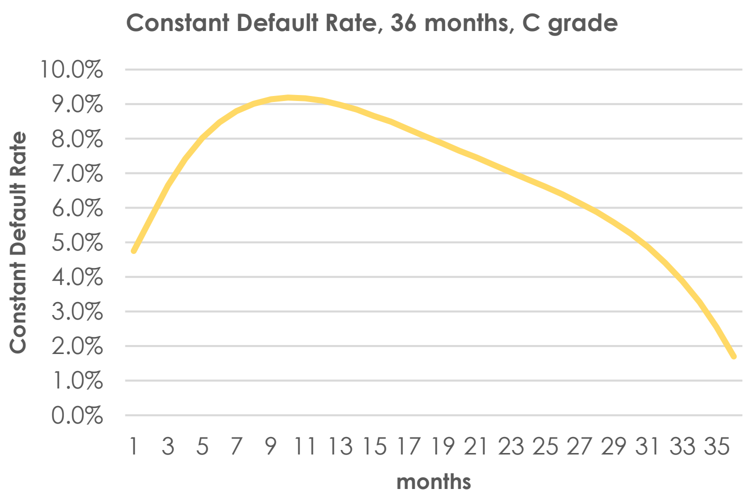
Default rates on the rise

Having reached an all-time low thanks to federal stimulus policies, default rates have returned to their pre-covid level for the "super-prime" and are higher for the "low-prime".

Originations in 2021 suffered from a relaxation of underwriting criteria in the face of a very buoyant start to the cycle after the Covid crisis. The invasion of Ukraine reversed the trend and low prime 2021 vintages have suffered since.

The bell curve of default timing for a 3-year loan below shows that the increase in defaults is between month 8 and month 18.

We now believe that we have passed the peak of these defaults and the portfolio should gradually resume performance growth.



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Conclusion

The macroeconomic situation in 2022 was influenced by the shock of the conflict in Eastern Europe, the slow recovery of the international supply chain and the start of money supply reduction policies (QT and rate hikes) whose intensity surprised the markets.

In a stabilised macroeconomic context (slowing of the pace and then end of the US rate hike), the excellent investment conditions allowed by high rates and more restrictive credit criteria should allow our Moonstone Fund to deliver excellent returns in 2023.

In addition, we would like to highlight our ESG work, which has enabled us to qualify our Moonstone Lending Fund and The Lending Smart Fund (launched in 2022, see below) for Article 8 under the SFDR. To this end, we have implemented ESG rating procedures for platforms and are helping them to improve their lending policies in the three areas of environment, governance, and social equity.

Finally, 2022 saw the launch of our second fund, The Lending Smart Fund 1, an 8-year closed-end fund (still open for subscription), with a European focus and a set-up that combines credit risk protection and participation in the capital appreciation of digital lending platforms. We would be delighted to discuss this with you to kick off the new year, which we hope is a happy and prosperous one for you.

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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