PRYTANIA INVESTMENT ADVISORS LLP

Market Update

May 2017

Athena

An actively managed global credit opportunities fund, exploiting exceptional value across the structured credit universe, targeting future returns of 10% p.a. over 3 years.

April 2017	+ 1.95%
2017 YTD	+14.76%
2016	+ 5.71%
2015	- 6.46%
2014	+ 3.01%
2013	+ 18.64%
2012	+ 32.34%
Latest 12 months Distribution	+ 3.06%
Inception Date: May 2008	Currency: USD

Galene

An actively managed global fund focusing on investment-grade structured credit assets, targeting returns in excess of 1M LIBOR+400 bps p.a.

GBP Share Class

April 2017	+0.48%
2017 YTD	+3.57%
2016	+ 12.37%
2015	- 1.02%
2014	+ 7.26%
2013	+ 5.32%
2012 (June launch)	+ 5.55%

USD Share Class

April 2017	+0.39%
2017 YTD	+4.47%
2016	- 5.27%
2015	- 6.17%
2014	+ 2.20%
2013 (April launch)	+ 7.15%

EUR Share Class

April 2017	+ 0.57%
2017 YTD	+2.01%
2016	- 1.08%
2015	+ 5.18%
2014 (April launch)	+ 7.04%

Metreta

Senior structured credit assets, seeking stable returns of 7-Day LIBOR+125bps p.a.

April 2017	+ 0.39%
2017 YTD	+ 1.70%
2016	+ 1.43%
2015	- 0.03%
2014	+ 1.69%
2013	+ 0.95%
2012, from April launch	+ 4.63%

Currency: GBP

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UK election surprise but no concern - yet - in the markets

In the UK, the shock General Election announcement on 18th April has changed conventional thinking about the interaction of the Brexit negotiations with the EU with a political calendar that had long thought a poll could not occur until Spring 2020. For all the inevitable comment about the early vote being to ensure endorsement for the Prime Minister's approach to a so-called 'hard Brexit', we believe the more pertinent point is that this strategy is to enable Mrs May to pursue her own agenda, which is well to the left of most Conservatives. Accordingly, she is hoping for a sufficiently large majority on 8th June to be able to ignore those in her party who would be happy with no deal in the EU talks. This would permit UK politicians and bureaucrats to agree compromises with the EU on such key issues as access to markets, contributions to EU budgets and citizens' rights. As we commented after the tremendous results for the ruling Conservative Party in the local elections on 4th May, the main danager to investors was the complacency around the General Election result, which we have thought could be less clear cut. Any politically-inspired caution in UK assets and Sterling, however, could present a buying opportunity for well-secured ABS bonds with solid underlying fundamentals.

French election uncertainty clears to underpin the rally in European ABS and CLOs

Asset prices rose strongly straight after the results of the first round of elections placing centre-left candidate Mr. Macron ahead of the National Front's Mrs. Le Pen, in a powerful relief rally pricing the election of the former as a quasi-certainty. French assets obviously tightened, but unloved peripheral assets that had been somewhat held back by 'tail risk' Euro concerns were actually the outperformers. For example - as regular readers of this newsletter will know - one of our favourite trades over the past year was to buy higher yielding Portuguese senior RMBS bonds and these assets broadly doubled their YTD gains from +5% to +10% (+20% since our largest purchase early last year).

The next political step is the parliamentary election on 11th June but the base case is for a split parliament with only extremely limited prospects of a far-right (or far-left) majority that would be a cause for concern. Looking further ahead, the market is likely to concentrate its attention on monetary policy decisions, along with UK and even Italian elections later on. The combination of an overall positive macroeconomic momentum, higher rates and limited political risk should provide a broad fundamental support through 2017 for the floating-rate secured credit universe we invest in. Within that group, the most senior assets targeted for purchase by the ECB should continue to underperform as the programme nears its end.

Investors with double digit return targets favor Prytania's niche European themes

Recently we have had numerous conversations with investors who seek double-digit return targets and like the risk / reward proposition offered by off-the-run European structured credit. In many cases these are US investors that have been harvesting gains on US non-agency RMBS and CLO equity and are seeking diversifiers for their portfolio that have a potential 10-15% return. Most discussions to date have been regarding separate account vehicles dedicated to off-the-run European structured credit. However, given the significant and growing numbers of investors who expressed interest we are working to see if a commingled fund rather than separate accounts might be both optimal and feasible.

We have long sought to identify and exploit mis-priced risk and mis-priced upside optionality in these less established or less well followed sectors in our funds. Examples of off-the-run European structured credit include UK reverse mortgage ABS, Portuguese RMBS, SME (Small Medium Enterprise) ABS, and UK consumer lending ABS. In the case of UK SME ABS and UK consumer lending ABS, the underlying collateral may involve peer-to-peer lending. The underwriting standards tend to be higher in UK peer to peer lending than in the US and deals are structured very conservatively.

Looking ahead in times of market uncertainties

As April progressed, the consensus decided that political risks across Europe were receding and forward-looking returns on assets accordingly contracted as prices rose. We, therefore remain focused on sensible reinvestment, avoiding the rush to acquire assets seemingly at any price and often preferring shorter WAL deals or those where extension risk seemed low.

CLO refinancing/resets continued apace in April with $26bn across 57 global CLOs either refinanced or reset. Compare that with the $33bn (61 CLOs) of actual new issuance in the whole of 2017 and it is clear that it is refinancing/resets that are dominating investors' time and not actual new issuance. A refinancing involves the reduction of liability spreads whilst the structure and terms (including WAL) remain consistent whilst a reset involves that same reduction in liability spreads, but also sees the extension of reinvestment/non-call periods, with potential changes to the capital structure which can include a flushing of excess collateral to equity and a re-gearing of the debt stack. Prytania's focus remains on the quality of the investment, typically rolling into refinancings where we continue to enjoy a lower WAL and carefully navigating the resets that still make sense i.e. avoiding significant extensions where capital structures have been re-levered and debt protection reduced even though passing on some of these has meant the return of cash back into the funds. On the ABS side, a relatively active new issue calendar into the end of the month resulted in a reported circa €33 billion of distributed European ABS in the year-to-date, up almost €6 billion on the same period on 2016. This pipeline has certainly helped the senior fund, Metreta, source good quality paper. In addition, the implementation of an active hedging strategy earlier in the year has benefited our more senior funds, allowing them to participate in recent new issues which increase diversity and return potential without adding FX volatility or reducing liquidity.

Looking ahead, the supportive macro environment for credit markets are underpinning values this quarter despite a growing awareness that an end to accommodative central bank policy draws ever closer.

Corporate Demerger Update

Prytania Investment Advisors is delighted to report the corporate demerger of its sister company, which offers valuation services, is close to completion. The progressive segregation of our businesses in the last two years will be finalised in June.

Given the firm's long-standing focus as an independent structured credit fund manager, Prytania Investment Advisors will be renamed Prytania Asset Management. This retains the strong market recognition Prytania has developed with investors, issuers and market counterparties over the last 14 years.

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The investment and marketing teams will be present at the Global ABS Barcelona Conference 2017 on 6th-8th June.

Prytania will also be in Chicago on 20th- 21st June, Boston 22nd -23rd June and Germany 28th-30th June.

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