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EXPERT OPINION – LYXOR / WELLS CAPITAL FINANCIALS CREDIT FUND

FIXED INCOME HIGH YIELD FINANCIALS: YIELD YOU CAN 'BANK' ON

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High yield bonds issued by financial sector companies, including Contingent Convertible bonds (Cocos), have become a large asset class. Investors of the Lyxor/Wells Capital Financials Credit Fund, which recently celebrated 1 year since the Fund's inception, have been rewarded with YTD performance of **10.73%**[1].In our view, high yield financial sector bonds offer an attractive opportunity compared to corporate high yield, while benefitting from recently strengthened balance sheets and positive exposure to higher interest rates.

WHY ALLOCATE TO COCOS NOW?

1. The need for yield

a. In the current low yield environment, investors need **diversified sources of yield**. As shown in Figure 1 below, the Coco universe is large ($183bn) and the Coco index yield is comparable to corporate high yield indices (using indices with the same average rating for comparison).

Figure 1: Investors' search for yield

SECTOR	BAML INDEX	YIELD AS AT NOV 14, 2017	AVERAGE RATING	LAST 5 YEARS' LEVERAGE TREND	FACE VALUE AT NOV 14, 2017
GLOBAL COCOS	COCO	4.5%	BB2	Deleveraged	$183 bn
US HY BB	H0A1	4.5%	BB2	Levered up	$583 bn
€ HY BB	HE10	1.7%	BB2	Stable	$ 234 bn

Source: Bank of America Merrill Lynch credit indices and Bloomberg as at Nov 14, 2017

b. The yields make Cocos particularly attractive as the issuing banks have **deleveraged** significantly during the last five years, whereas US high yield issuers in particular have levered up. For these reasons, we expect that during the next recession, financial sector default rates are likely to be very low, and much lower than corporate high yield default rates.

c. Cocos offer **higher yields** as they have complex structural features. Cocos are also excluded from mainstream bond indices. As such, credit selection becomes paramount, particularly during recessions. Our view is that investors are likely to be better served by allocating to **specialist funds focused on financials**.

d. When compared to high yield corporates, **banks' credit quality** benefits from their typically larger business profile and access to equity markets. Furthermore, investors in bank credit benefit from tough post-crisis regulation and central bank liquidity support.

e. Banks and insurance companies stand to benefit substantially as the US Fed raises interest rates, and medium term bond yields rise from historically low levels. Banks' **net interest income grows with higher central bank rates, and insurance company solvency strengthens with higher bond yields**. High yield corporates, by contrast, face higher refinancing costs in such a scenario.

f. Global high yield financial bonds (in USD, EUR and GBP), including Cocos, comprise a large diversified **$500bn**[2] asset class, with more than 300 issuers from 50 countries.

[1] Lyxor Asset Management as of October 31, 2017. Performance reflected of I USD share class. The figures relating to past performances and simulated past performances refer or relate to past periods and are not a reliable indicator of future results.
[2] Based on Bank of America Merrill Lynch credit indices and Bloomberg as of 30 June 2017

SPEED READ

In our view, investors who allocate separately to the high yield financials asset class are likely to be rewarded in the future because:

- Financials high yield is a large diversified sector, with strong growth potential through new issuance
- Financials sector credit fundamentals are robust compared to pre-crisis levels, with most issuers having much higher capital ratios and lower leverage

2. Fundamental credit quality for Cocos is improving

In our view, coupon cancellation risks remains very low for most Coco issuers over the next few years. Principal write-down or equity conversion risk is even more remote. Fundamental credit quality is improving because:

a. Compared to pre-crisis levels, most banks have much **higher capital ratios** (as shown in Figure 2) and lower leverage

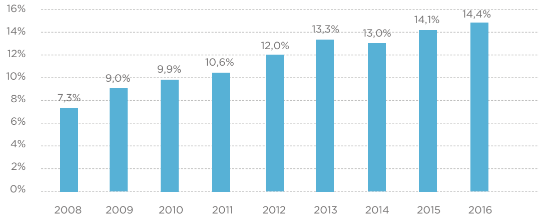
b. Most banks have **reduced risky asset portfolios** such as Collateralised Debt Obligations (CDOs), though peripheral banks still have large non-performing loan portfolios to work through

c. Eurozone banks have **access to European Central Bank liquidity lines** such as the Main Refinancing Operations (MRO) and targeted long term refinancing facilities with long repayment profiles

d. Central banks remain **vigilant to systemic risk**, as evidenced by the ECB's on-going quantitative easing (QE) programme, and the Bank of England's (BoE) liquidity programme post the Brexit referendum

e. Banks have become much **more risk averse** in their lending and trading portfolios, as evidenced by moderating new non-performing loans, and the reduction of proprietary trading business.

Figure 2: Improving capitalisation: European Bank common equity tier 1 ratios



Sources: ECM Research and Bloomberg as of 30 June 2017

f. The SREP (Supervisory Review and Evaluation Process) ratio is the Core Equity Tier 1 ratio below which the ECB requires banks to limit discretionary dividends and Coco coupons, and to submit capital strengthening plans. The 2017 SREP ratios are lower than 2016 levels, significantly improving banks' ability to pay Coco coupons. For example, as illustrated in Figure 3 below, ING's CET1 ratio is 14.5%, while the bank's SREP ratio for 2017 is 9%[3], resulting in a buffer of 5.5% (or €17.6 Bn). This means, ignoring any equity capital raise, ING can suffer a sudden loss of up to €17.6Bn before coco coupons become "at risk". We see the regulator's endorsement of bank capital strength as a significant positive driver of Coco returns in 2018-19.

Figure 3: Reported CET1 (Core Equity Tier 1) ratios and buffers

	CET1 RATIO AT SEP-17 (%)	2017 MDA* BUFFER ESTIMATE IN EUR BN**
BNP	11.9	20.4
SOCIETE GENERALE	11.6	13.6
UNICREDIT	13.9	18.1
INTESA	12.5	15.8
COMMERZBANK	14.4	12.6
BBVA	11.9	15.5
SANTANDER	12.2	18.9
ING	14.5	17.6
RABOBANK	15.0	12.4

* MDA refers to Maximum Distributable Amount.
** ECM analysis, using published 2017 SREP ratio, and CET1 ratio, RWAs as at Sep-17.
Source: ECM. As at November 14, 2017.

WHY SELECT THE LYXOR/WELLS CAPITAL FINANCIALS CREDIT FUND?

Given the above backdrop, we believe that we are well placed to add value to clients' portfolios.

a. Our dedicated financials team at Wells Capital has a **consistent record of investing in the winners** in this asset class such as Delta Lloyd, Caixa Geral, CYBG and Erste Bank. Our team has also been able to maintain performance by **avoiding defaults**, such as Banco Popular and Banco Espirito Santo, as well as weaker credits such as certain Russian banks.

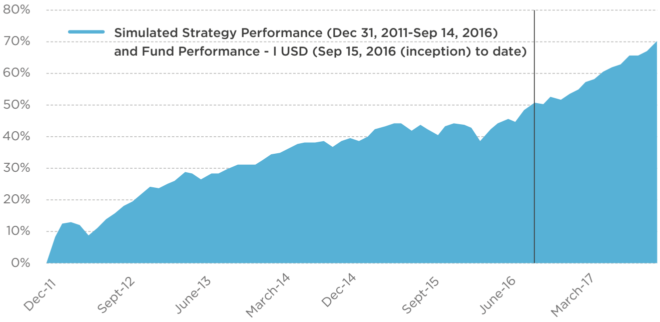
b. We expect that the default rate in the financial sector is likely to be significantly lower than the corporate high yield sector over the next five years, because banks have deleveraged significantly. This strongly argues for a standalone allocation to high yield financials, as a diversifier from corporate high yield. However, if we were to witness another recession, in our view, both corporate high yield and financials high yield are likely to post low or negative returns, despite the differences in default rates. Historically, we have observed high correlation within the financial sector during periods of stress. Hence, it is particularly important that strategies focusing on financials credit have a **track record of protecting capital in systemic risk scenarios**. Lyxor/Wells Capital's Financial Credit fund manager has demonstrated risk mitigation strategies, for example, during the 2011-12 peripheral Eurozone crisis, and the Brexit vote On both these occasions, the fund reduced higher risk exposures, increased cash holdings, and bought CDS protection (single name and index), in order to significantly reduce drawdowns.

c. Looking ahead over the next 12-24 months, we expect improving economic growth globally to lead to higher interest rates, with the US Federal Reserve leading the way. This environment, while generally supportive of bank and insurer credit quality, is also likely to generate many investment opportunities and challenges. Specifically, rotating between Europe, the US and emerging market financials is likely to be

[3] ING Press Release https://www.ing.com/Newsroom/All-news/Press-releases/ING-Groups-2016-SREP-process-completed.htm

a significant lever for return performance. The financials team at Wells Capital has a **strong focus on country rotation which can add value to client portfolios**. Currently, this is demonstrated by very low exposure to US and emerging market bonds, offset by a long exposure to Europe.

Figure 4: Cumulative Performance – including Simulated strategy and Fund performance



Source : Lyxor Asset Management, October 31, 2017

Click here for more information on the fund.

Important note: The performance shown from December 31, 2011 through September 14, 2016 reflects the performance history of a paper track record as described herein ("Simulated Strategy Performance") built on the basis of the asset class allocation of the Lyxor/Wells Capital Financial Credit Fund ("Fund") as of end of August 2016 and using as a proxy the most relevant market index for each of the asset classes: on the long side 5% of BofA Merrill Lynch Euro Tier 1 Index, 60% of The BofA Merrill Lynch Contingent Capital Index, 5% of BofA Merrill Lynch Euro Lower Tier 2 Corporate Index, 10% of BofA Merrill Lynch Euro Subordinated Insurance Index, 10% of BofA Merrill Lynch Euro Senior Banking Index and on the short side 10% notional exposure of MARKIT ITRX SNRFIN (CDS index) and 10% notional exposure of MARKIT ITRX SUBFIN (CDS index). The performance shown from September 15, 2016 represents the performance of the Fund as described herein ("Fund Performance"). Performance for September 2016 represents the linked returns of the Simulated Strategy Perfromance from September 1, 2016 to September 14, 2016 and the Fund from September 15, 2016 (inception) to September 30, 2016. Simulated Strategy Performance and Fund Performance are for illustration purposes only. Simulated Strategy Performance is not representative of the actual or expected Fund Performance due to, among other reasons, the different investment strategies, structures, fees and expenses. The key differences between the Fund Performance and the Simulated Strategy Performance include: (i) The Simulated Strategy is run using the above stable index allocation whereas the Fund is managed following a discretionary security picking which may modify exposures on a daily basis; (ii) Simulated Strategy Performance is net of management fees of 0.75% but gross of all other fees including administration fees, audit fees etc whereas the Fund Performance is net of all fees; (iii) the Simulated Strategy is using exclusively index-based securities. This removes a significant part of the liquidity constraints of the Fund. The Fund will have management fees of 0.65% to 1.50%, depending on the class of shares in the Fund. It is also important to note that there are inherent limitations with respect to the use of historical data including, without limitation, results which may not reflect the impact that material market or economic factors might have on the Fund or the impact of subscriptions and redemptions. THE FIGURES RELATING TO PAST PERFORMANCE REFER OR RELATE TO PAST PERIODS AND ARE NOT A RELIABLE INDICATOR OF FUTURE RESULTS. * The risk free rate used to calculate the Sharpe ratio is the Euribor 1M interest rate.

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-Risk of losses
-Volatility
-Leverage & Value-At-Risk - Market Risk
-Currency Risk
-Risk of investment in emerging markets
-Risk relating to Cocos: Cocos are complex instruments that may not be suitable to all investors. The performance of the fund may be negatively impacted by cocos behaviors and specifics features

We recommend you to refer to the "risk factors" section of **the prospectus** and **the supplement of the prospectus** of the fund which can be found on http://fr.lyxorfunds.com/. The risks associated with the fund are not limited to the aforementioned.

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