

Jack Deegan, Fund Manager
Polar Capital Financial Credit Fund

Q: Gary Corcoran (GC), Head of Content & Corporate Communications: The Middle East conflict is driving yields higher and forcing markets to reprice. How does that environment impact you as a credit investor?

A: Jack Deegan (JD), Manager of the Polar Capital Financial Credit Fund:

It's an incredibly interesting period of time because of the situation, and specifically what's happening in the Strait with its closure, and what that means for a commodity prices, inflation, the path of monetary policy and, in turn, growth is obviously leading to the markets to reprice and to reconsider where rates and yields need to be.

How does that impact us? Well, we manage our portfolio looking at two specific risks: credit and interest rate risk. Our whole investment process is to try and deliver high yield-like returns, but with lower volatility and significantly less downside risk. As a result, we're concentrated in lower-risk positions – 80% of the Fund is in senior and Tier 2 debt.

These are more protected in a period of volatility or stress than instruments lower down the capital stack, such as CoCos or, in itself, equity. In fact, during March when the conflict initially kicked off, the underperformance or the selloff in equities, we saw in the S&P 500 and Euro Stoxx down 9% and 11%, respectively. You saw global bonds down about 3.5% but you saw financials – seniors and Tier 2 debt – down 1.8%. Our Fund was down just 1.2% and that's because of positioning. It's a benefit of how we manage that interest rate and credit risk.

So, with credit risk you can take the outright positions and where we want to be positioned in terms of which instrument and which issuer, but we also have the ability to use credit hedges. At the start of the conflict coming into March, we had a 10% credit hedge in place. As markets deteriorated during the month, we took that credit hedge off but then, as resolution hopes manifested on the back of various tweets that were being put out, markets tightened and we've now put the credit hedge back on to position ourselves for as and when something might deteriorate again.

From an interest rate perspective, coming into the conflict we had a duration of 2.9 years, including cash. However, the situation and what that means for inflation and then the path of monetary policy has led us to reassess our desire to have a longer duration. We've actually brought that down; we're now 2.5 years and we've done that through bond sales and through the purchase of a put option on a long gilt future.

We have a concentration in lower risk positions – 80% of our Fund is senior in Tier 2 debt. That, coupled with a preference to rent as opposed to own AT1s/CoCos, has allowed us to have lower volatility and help drive returns.

I think it's important to say here a core element of our Fund is a 20% cap on CoCos which makes us very different to our peers. In fact, since inception back in 2023, we've had an average of 10% in AT1s. Our selective approach to those instruments which are more at risk during periods of volatility, i.e. they are drawn down or their underperformance is more significant, has

allowed us to navigate these periods of volatility.

It's worth saying that our positioning in lower-risk names or lower-risk positions hasn't meant that we've given up performance during periods of 'risk on'. In fact, since inception, we've managed to deliver 23.2% cumulative returns versus the Global Financials Index – the ICE BofA Global Financial Index, our benchmark – which has returned 12.1% and the CoCo index at 23.4% so we're very happy with that.

Q: GC: Historically, geopolitical shocks have had a temporary impact on credit. What risks are you looking at right now and how do you manage that risk?

A: JD: That's a really interesting question and actually we put out a piece recently called [*If the guns have gone quiet what next for bonds?*](#) In it we highlight that the opportunity cost right now with geopolitical stress and tension for owning cash and bonds is actually very low. When we're looking at a situation with regards geopolitical tension, research put out by, I think, Bank of America in February/March when the conflict kicked off, suggested that you get through the first couple of months and if a solution is found then the pickup in the bond yield over the risk-free rate can actually tighten to a pre-war level. We've actually seen that, as resolution talk has been spoken about through tweets and news articles.

How we look at the risk though is fundamentally from a credit and an interest rate perspective. What does a closure of the Strait mean for commodity prices, mean for inflation, and therefore the path

of monetary policy? That has a real impact on where you want to be from a duration perspective, i.e. that sensitivity of a bond's price to a change in interest rates.

We have looked to reduce our duration since the conflict kicked off. We now have a situation where the Fund's duration is 2.5 years, including cash, which we're comfortable with. From a credit perspective, what you can learn from previous shocks - not necessarily geopolitical shocks, but back in 2023 there was a stress at US banks and Credit Suisse - is you do not want to be exposed to the weakest institution in the pack.

During periods of geopolitical stress, while it can be completely unrelated to anything that's going on from a financials perspective, it's a case of being really comfortable owning those lower risk positions and in strong names, or names that we know have strong credit fundamentals. So, we will be positioning ourselves, as we have been, with a concentration to senior and Tier 2 debt.

Q: GC: We've seen some interesting regulatory developments, particularly perhaps a divergence between the US and Europe. What does that mean for bank credit investors?

A: JD: It's one of the things that's a crux of our analysis and our thought process when it comes to analysing which instruments to invest in and which banks to invest in. You're increasingly seeing deregulation in the US while the European Union has, back in December 2025, come out with a simplification process and aimed to try and tidy up some of the regulation that had been brought in post-global financial crisis which, let's be honest, is incredibly complicated and an alphabet soup of acronyms.

A critical aspect of that, which the regulators have come out and said, is they do not want to water down requirements. They do not want this to mean that there's a reduction in the capital that banks have to hold. So, we already have right now a preference towards European and UK names because of the stringent regulatory requirements which, as credit investors, provides us great protection. That

divergence keeps us more favoured into European names.

The Bank of England is the same. It has recently been looking at trying to simplify the regulatory regime but not weaken it, which is critical.

In the US, I think we're in a different situation, but our exposure to the US is concentrated in senior bonds, so we're a long way from the lower parts of the capital stack, and with some of the stronger names like JP Morgan. From our perspective, if we take a step back, in Trump's first term, there was a watering down of regulation in the US regarding how certain banks had to deal with interest rate risk.

That always takes time to manifest itself and then in the Biden administration in 2023, we saw what happened with Silicon Valley Bank and a number of other institutions over there having issues with dealing with interest rate risk. There's always a delay, I think, sometimes with deregulation so for us as credit investors, it's about analysing and understanding where/when that's coming and then being comfortable where we sit in the creditor hierarchy, but also being comfortable where we sit from a jurisdictional perspective. And as I said, we have a concentration at the moment towards Europe and the UK, where the regulatory environment is a bit more stringent and therefore really protective of us as credit investors.



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