Santander Asset Management

Santander Financial Credit

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Fund commentary

February was characterized by heightened geopolitical uncertainty, renewed equity volatility, and a continued recalibration of monetary policy expectations. Trade tensions in the US and debate around global tariff structures contributed to a more cautious tone early in the month, while the final week saw an escalation of tensions in the Middle East. The immediate market reaction was orderly but clearly risk-off in nature: oil prices moved higher, core government bond yields declined, and credit spreads widened modestly.

In the US, macro data remained mixed. Fourth-quarter GDP was 1.4%, while inflation indicators, including the PCE deflator, continued to signal persistent price pressures. Federal Reserve communication maintained a cautious and data-dependent stance, with policymakers emphasizing the need for additional clarity before adjusting rates. Market expectations for near-term easing were further moderated, contributing to intermittent volatility in rates markets. In Europe, the ECB left policy unchanged, describing current conditions as appropriately calibrated. While inflation showed signs of moderation earlier in the month, the Governing Council reiterated that decisions would remain data driven. Government bond markets performed positively overall, with yields declining across core and peripheral curves, particularly in medium and long maturities. This provided some offset to the widening in credit spreads from a total return perspective.

Against this backdrop, European financials credit widened modestly over the month, broadly tracking the move in euro investment grade spreads, which increased by 10bps to 82bps versus government bonds. The widening was gradual and primarily driven by macroeconomic factors rather than any deterioration in underlying credit fundamentals. Senior financial instruments demonstrated relative resilience, while subordinated debt—particularly AT1—saw greater intra-month volatility, reflecting their higher beta. Euro-denominated AT1 spreads widened by 10bps, compared with 18bps for USD issues and 21bps for GBP issues. For context, global high yield spreads widened by around 20bps.

Primary market activity remained strong despite the more fragile risk tone. February was particularly active in subordinated issuance, with several notable AT1 transactions. Intesa Sanpaolo came with two issues – a call 2032 with a reset of +303bps and a call 2036 with a reset of +314bps – while BNP Paribas issued a call 2033 AT1 resetting at +305bps. National Bank of Greece printed a call 2031 AT1 at +332bps, Nykredit issued a call 2031 AT1 at +286bps, and ING accessed the USD market with a call 2033 AT1 resetting at +285bps. Order books were generally strong, confirming that investor appetite for yield and carry remains intact even in a more volatile macro environment. Reset levels reflected a modest concession compared to January's tighter conditions, but overall execution was constructive and secondary performance broadly stable post-pricing.

Earnings season continued to reinforce the sector's underlying strength. Large European banks delivered solid profitability, supported by structural hedge benefits and still-resilient net interest income. Asset quality metrics remain benign, with cost of risk broadly at or below through-the-cycle averages and non-performing loan ratios stable or declining in most jurisdictions. Capital positions remain comfortable relative to regulatory requirements, even as banks continue to optimize balance sheets through dividends and buybacks.

Insurance reporting was also broadly supportive, with strong solvency ratios and disciplined underwriting performance. However, insurance spreads widened modestly in sympathy with broader credit markets and rates volatility, rather than due to any material deterioration in operating metrics.

Overall, February's spread widening reflects a repricing of macro and geopolitical risk rather than a shift in credit fundamentals. European financials continue to exhibit robust balance sheets, solid capital buffers, and resilient earnings capacity.

The Fund experienced positive performance over the month and although it experienced some widening of spreads, the downward rate movement and carry from coupons more than compensated. The Fund continues to benefit from inflows, with almost $50mln in inflows ending the period with a NAV close NAV to 160Mln. Given the volatility towards the end of the month, we paused investments closing with cash position of 6%, ready to be deployed if we see opportunities. Throughout the month the fund was active in primary markets, adding some of the new issues mentioned above, and we continued to add on the LT2 issues in secondary (12% of the fund), more defensive while securing yields close to 5%. In terms of sectors, the Fund end the month invested 83% in Banks, 10% in Insurance. By Geography UK, France and Spain continue to be the main regions accounting for 48.6% and in Latam the fund as 5.4% exposure distributed via 3 issuers (Bancomer, Banorte and BCI). The top 3 issuers are Barclays, Societe General and Deutsch Bank. The Fund ended the month with a YTM of 6.35 %, YTW of 5.03% and duration to 3.25 years, with 6% in cash, BB+ average rating and invested across 140 (+9) securities.

The Fund delivered positive performance throughout the month. While there was some widening of credit spreads, this was more than offset by downward movements in rates and steady coupon income, resulting in a net gain for investors.

In response to heightened volatility towards the end of the month, the investment team paused new allocations, closing with a 6% cash position. This reserve is strategically held, ready to be deployed should attractive investment opportunities arise.

Throughout the month, the Fund was active in the primary market, participating in several of the new issues highlighted previously. Additionally, exposures to long-term Tier 2 (LT2) instruments were increased in the secondary market, now accounting for 12% of the portfolio. These positions are considered more defensive and were secured at yields close to 5%.

At month end, sector allocation was dominated by Banks, representing 83% of the portfolio, with Insurance making up a further 10%. UK, France, and Spain remain key geographic exposures, collectively accounting for 48.6% of the portfolio. In Latin America, the Fund holds a 5.4% allocation spread across three issuers: Bancomer, Banorte, and BCI.

The Fund's largest holdings are Barclays, Societe Generale, and Deutsche Bank. The portfolio closed the month with a yield to maturity (YTM) of 6.35% and a yield to worst (YTW) of 5.03%. Duration stands at 3.25 years, with a 6% cash allocation. The average credit rating is BB+, and the Fund is diversified across 140 securities, up by nine from the previous month.