Santander Asset Management

Santander Financial Credit

Marketing Communication

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Fund commentary

September was a more challenging month for credit markets as higher government bond yields, renewed concerns around inflation and fiscal sustainability, and increasing political uncertainty in France drove a broad risk-off move across spread products. Financials were not immune to this repricing, particularly in subordinated debt, where spread widening was significantly larger than in senior debt. Despite the weaker market performance, the move was driven primarily by rates volatility and broader market sentiment rather than any meaningful deterioration in sector fundamentals.

For financials, spread performance was weakest in the most subordinated parts of the capital structure. Euro Senior Financials and Euro LT2 widened by around 12bps and 11bps respectively during the month. CoCos underperformed materially, with the overall AT1 universe widening by around 38bps. Bank CoCos were the weakest segment, widening by around 43bps in EUR, 26bps in GBP and 21bps in USD, while insurance CoCos / RT1 proved more resilient, widening by around 20bps in EUR, 17bps in GBP and 9bps in USD. The repricing broadly mirrored the move seen in wider risk markets, with Euro HY widening by approximately 41bps over the same period.

Despite weaker spread performance, the fundamental backdrop for European banks remained constructive. Asset quality trends continued to improve, profitability remained strong and capital generation stayed robust across most institutions. The strongest fundamental momentum remained concentrated in Southern Europe, where Italian and Greek banks continued to benefit from improving operating performance, sovereign support and positive rating developments. Moody's and S&P actions during the month reinforced the positive outlook for several Greek and Italian issuers, with investors increasingly focused on potential upgrade opportunities and further spread compression potential over the medium term.

European banking consolidation remained a major theme throughout September. UniCredit continued to dominate headlines through its strategic ambitions around Commerzbank, while corporate activity involving Banco BPM, Monte dei Paschi, BPER and Crédit Agricole reinforced the view that consolidation remains one of the key structural drivers for the sector. Markets have generally viewed these developments positively, reflecting the strong capital positions from which these transactions are being pursued and the potential for further efficiency gains across the European banking landscape.

Primary market activity remained exceptionally strong despite the increase in volatility. September was one of the busiest months of the year for financial issuance, with approximately €6bn of AT1 issuance, €2.3bn of Tier 2 issuance and substantial volumes across senior preferred and senior non-preferred formats. Transactions from UniCredit, Crédit Agricole, Commerzbank, Deutsche Bank, Société Générale and others were generally

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met with strong investor demand and significant oversubscription, allowing issuers to price comfortably inside initial guidance. The market's ability to absorb such heavy subordinated supply highlights the continued strength of demand for financial credit despite recent spread widening.

Insurance fundamentals remained supportive, supported by strong solvency ratios, resilient earnings and ongoing capital generation. However, performance across subordinated insurance debt was mixed. RT1 spreads outperformed bank AT1s during the month, particularly in USD and GBP. While some areas of the reinsurance market continue to experience softer pricing conditions, the broader credit outlook for large European insurers remains stable.

Overall, September represented a period of spread correction rather than fundamental deterioration for financial credit. The sharp widening in subordinated debt, particularly AT1s, reflected higher rates volatility and weaker market sentiment rather than concerns around issuer credit quality. The sector continues to benefit from strong profitability, improving ratings momentum, particularly in Greece and Italy, healthy capital positions and supportive primary market technicals.

The fund suffered from the rising volatility, posting negative returns over the period. The banking sector was the main negative contributor, given its weight in the portfolio compared to insurance segment. The sell off in spreads, was mostly general but some names got more penalized than others, such as Eurobank in Greece and RBI in Austria, despite positive news over the month. The curve positioning was only favorable vs the market in greater than 5-year maturity, but not enough to offset underperformance of less than the 5-year bonds where the fund is positioned. During the period, we took advantage of primary market to add positions in names such as Mizuho in USD callable 2036, Unicredit in Euro callable 2031, Credit Agricole in Euro callable 2031, Societe General in USD callable 2033 and Deutsche Bank in Euro callable in 2033. With the market movement in the end of the month, the fund also did some switches to optimize the portfolio, in general selling some USD bonds that overperformed and buying Euro bonds that underperformed, while also raising reset levels of the new addition to better protect the fund for a higher interest rate environment.

In terms of sectors, the Fund ended the month invested 83.6% in Banks, 11.4% in Insurance. By Geography France, UK and Spain continue to be the main regions accounting for 44% vs 48% in August and in Latam the fund as 6.6% (+0.2%) exposure distributed via 3 issuers (Bancomer, Banorte and BCI). The top 3 issuers are now Deutsche Bank, Societe General and Banco Santander.

The Fund ended the month with a YTM of 7.57% vs 7.24%, YTW of 6.34% vs 5.75% and duration of 3.46 unchanged, with 4% cash, BB+ average rating and invested across 137 securities.

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