Performance Summary

The A3 Alternative Credit Fund (AAACX) had a net return of 0.05% in Q4 2020 and 4.88% in 2020. Since inception (10/1/19), the Fund has a total net return of 8.58%[1]. We continue to see tremendous opportunities in allocating capital towards high quality, high income assets. Today 78.93% of the portfolio holdings are U.S. Government Agency securities, which have an "implied AAA rating" and carry the full faith and credit guarantee of the U.S. Government[2]. The Fund distributed its 4th quarter dividend of $0.1747 per share on December 30th, representing a current distribution rate of 6.93%[3], with zero paid out capital gains in 2020.

In addition to attractive risk adjusted yield, the portfolio has exhibited appealing correlation metrics. Since inception through December month end, AAACX has exhibited very low monthly correlations to both broad credit and equity indices. Recall that correlations are measured from positive 1 to negative 1, with 0 signifying no correlation. The A3 Fund exhibited very low, near zero, 0.06 correlation to the Bloomberg Barclays Global Fixed Income Aggregate index, a very low, near zero, 0.03 correlation to the High Yield Index and a low 0.26 correlation to the S&P 500 Index[4]. The Fund has a current 30-Day SEC yield of 3.66% subsidized[5] and 0.93% unsubsidized[6], while the Advisor continues to subsidize the fund for reimbursement of startup expenses.

Overview

A3 Financial Investments launched AAACX on October 1st, 2019 with an objective of building a non-correlated, income focused fund through a portfolio of carefully researched, alternative income investments principally comprised of public and private collateralized, structured credit. The strategy includes exposure to diverse loan pools or portfolios with investment selection based on income, continuation of cash flow, collateral and structural credit enhancement amongst other criteria. Typically, these are accompanied by a thematic macro overlay such as government supported cash flows or guarantees, taxation, longevity, and technology adoption. We have found that this often leads to low correlations with broader markets.

Reverse Mortgages

The largest percentage holding of the A3 Fund is currently allocated to reverse mortgages, which provides our investors with exposure to hundreds of thousands of residential homes across the country. This asset class is not only secured by property but also is accompanied by government guarantees which insure against default and late payment. These attributes we believe provide excellent downside protection, while allowing investors to collect attractive current income.

We believe there is a historic buying opportunity present today in reverse mortgages, where we can take advantage of high home sales and refinance activity, which has suppressed market valuations. Additionally, the sector is responding to unique, idiosyncratic factors which we believe have temporarily curtailed demand for the product. The recent push to retire LIBOR as the benchmark floating rate sparked fears of reduced new loan supply and further bifurcation of an already small market; while a late 2020 policy change to increase the maximum available loan balance drove increased cash out refinance to approximately 3x historical averages and as a result, created the opportunistic entry point which exists today.

Throughout 2020 we maintained a cautious credit outlook, in light of the severe global economic lockdown measures, which led to a strategic overweight of government insured cash flows which would not be subject to the same cash shortfalls caused by job loss or corporate revenue deterioration commonly associated with credit products. Despite contributing to the year-end total return, these government insured reverse mortgages trailed the risk on rally in the late fall. Our expectation is that over the next few quarters we will see a reversion to historical mean prepayment levels which may provide future upward price support.

Private Debt

Our private debt exposure has been principally obtained via investments in portfolios of syndicated loans, participations and structured collateralized loan obligations. These investments provide exposure to thousands of underlying corporate loans across a diverse set of industries and are most often collateralized, senior secured positions. We have been growing this investment exposure where we find opportunities at significant discounts to their net asset values, and favor investments that have historically traded at compressed price-to-NAV multiples, and are accompanied by double digit income streams with dividend growth potential, while hedging risks where possible with the use of futures.

CLO Debt and Equity

CLO debt and equity exposures, which consist of high cash flowing securities, contributed to the Fund's annual performance this year. Loan and CLO fundamentals have improved following aggressive action on the part of rating agencies to downgrade credits, while bankers worked to modify and extended loans. Liquidity in the loan market has remained strong with new issuance growing. The S&P Leveraged Loan Index, a benchmark for collateralized loan obligation "CLO" collateral, ended the year at 96.19% of par, up from a March low of 76.23% of par. The rally in loan prices during the second half of 2020 seeped into US CLO debt tranche pricing, as higher loan prices caused an increase in equity NAV as well as market value coverage ratios, which are both important valuation metric used to determine CLO pricing.

2021 Outlook

2020 was a remarkable year in the credit markets. The first half of the year saw some violent downward pricing, while the second half of the year saw optimism take hold. Our portfolio saw almost the inverse of this; remarkable stability and income for the first 3 quarters, and some unusual macro factors in the 4th quarter impacting our largest holdings, reverse mortgages. We believe that our fund is primely positioned to take advantage of both the unusual current pricing in the reverse mortgage market and also selectively take advantage of opportunities that are presenting themselves in other credit securities. As mentioned, we have added to our CLO positioning, will continue to research appropriate private debt, and believe there are selective hedging strategies developing that allow us to take advantage of currency devaluations and monetary policy trends.

In times of high equity valuations and ultra-low expected returns for traditional fixed income investments, alternative credit presents a unique often uncorrelated source of alpha. This is a strategy that we believe offers quality income and total return potential in all markets and tends to enhance diversification. On behalf of all of us at A3 Financial Investments, thank you for your continued trust, and we look forward to serving you in the year ahead.

Best Regards,
The A3 Financial Team

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1 Inception date is September 30, 2019. Returns are net total returns.
2 U.S. Government Agency securities are considered to have an "implied AAA rating". Government National Mortgage Association issued securities carry the full faith and credit guarantee of the U.S. Government.
3 Current Distribution Rate is expressed as a percentage equal to the projected annualized distribution amount (which is calculated by annualizing the current cash distribution per share without compounding), divided by the current net asset value and does not reflect any return of capital.
4 Correlation is a statistic that measures the strength of the relationship between two securities. The correlation coefficient ranges from +1.0 and -1.0 which indicate perfect positive and negative linear relationships. A value of 0 indicates no linear relationship between the two securities.
5 "30-Day SEC Yield (subsidized)" is an annualization of the Fund's total net investment income per share for the 30 day period ended on the last day of the month and reflects any net fees waivers and reimbursements in effect during the yield calculations period.
6 "30-Day SEC Yield (unsubsidized)" reflects the 30-day yield if the investment adviser were not reimbursing the fund for part of its expenses or waiving all or part of its fee.

The returns quoted present past performance. The performance shown is net of all fees (including a monthly advisory fee of 1.50% per annum) and expenses and reflects the reinvestment of dividends and investment income. Depending on an investor's investment date, holding period and other factors, an investor may have an overall performance that underperforms or outperforms the data shown.

Inception date for AAACX is 09/30/2019. Returns greater than one year are annualized. Current performance may be lower or higher than the performance data quoted. Investment return and principal value will fluctuate so that shared, when redeemed, may be worth more of less than their original cost.

Management fee: 1.50%
*Net Expense Ratio/ **Gross Expense Ratio: 1.95%/7.99%
***Expense limitation: 1.95%

*The Net expense ratio reflects the reduction of expenses from fee waivers and reimbursements. Elimination of these reductions will result in higher expenses and lower performance. These reductions are contractual and will continue until at least 1/31/2022.
**The Gross Expense Ratio reflects additional expenses embedded in the Fund's performance, such as the indirect costs of investing in other investment companies.
***The Adviser has entered into an expenses limitation agreement to pay the ordinary operating expenses of the Fund that exceed 1.95% per annum.

The AAACX prospectus is available here.
The A3 Alternative Credit Fund is a continuously-offered, non-diversified, registered closed-end fund with limited liquidity.
Distributor – Foreside Fund Partners LLC

Past performance is no guarantee of future results.

A3 Financial LLC is a SEC-Registered Investment Adviser. Registration as an investment adviser with the SEC does not imply any level of skill or training. A3 Financial LLC complies with the current notice filing requirements imposed upon SEC-registered investment advisers by those states in which A3 Financial LLC maintains clients.

Registered Representative with Foreside Financial Services LLC, which is not affiliated with A3 Financial Investments LLC or its affiliates.