Trade Finance

Access uncorrelated alpha potential with limited reliance on traditional return drivers

Federated Hermes

For professional investors only.

Dating back to the 13th century, trade finance is one of the oldest forms of credit – yet it has only become accessible to institutional investors in recent years.

Due to its ability to provide uncorrelated alpha with limited reliance on traditional return drivers, more investors are turning towards this asset class as a diversifier in their portfolios.

Trade finance refers to loans that provide short-term financing to support the physical flow of goods.

These deals are structured to help all parties mitigate the challenges associated with cross-border trade – which can range from foreign currency exchange rates to regulatory compliance and non-payment.

Trade finance loans are vital for financing trade with emerging markets to help reduce risk exposure and bridge the liquidity gap for distributors. These loans are collateralized by the goods being financed.

Trade finance loans generally have the following qualities:

- Self-liquidating as goods are delivered
- Low interest rate and credit duration risk
- Float at a spread over a short duration index, such as Secured Overnight Financing Rate

The lender uses several risk mitigation techniques to reduce risks to an acceptable level, such as collateral management of the goods, permanent control of the title over the goods and ring-fenced cash flows. The arranger of a trade finance transaction, often a bank, holds a significant part of the deal on its own books to maturity.

A large, global market that has demonstrated resilience

Over the last decade, world trade has been up against a variety of economic shocks – collectively referred to as the "polycrisis." This includes the COVID-19 pandemic, disruptions to the supply chain and geopolitical concerns.

Trade finance: fast facts

- In 2025, the global trade finance gap was estimated at **2.5 trillion**.[1]
- Global trade flows are expected to surge past **$35 trillion** for 2025.[2]
- **80% of trade** is dependent on trade finance vs. corporate loans.[3]

2022

Rising rates and inflation

In 2022, rising interest rates and inflation increased the demand for trade finance with the gap expanding to $2.5 trillion.[1]

2023

Red Sea disruptions

Maritime trade flows passing through the Red Sea were disrupted by Iran-backed Houthi rebels operating out of Yemen. While this resulted in increased shipping times and trade cost, the chief economic impact felt by container shipping companies has been positive – a significant boost to income from four-times higher charter rates.

2025

Resilient trade amid shifting tariffs

Global trade has continued to demonstrate resilience despite evolving tariff regimes, supported by adaptive supply chains and sustained flows of essential goods, reinforcing the stability of international commerce in a more complex policy environment.

The value of investments and income from them may go down as well as up, and you may not get back the original amount invested.

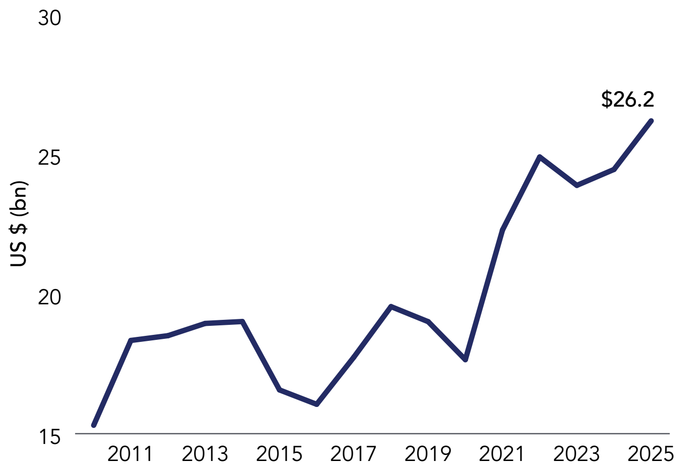
Through these challenges, trade finance has continued to show resilience due to the ongoing demand to serve a critical need for international economic development. In fact, during the aftermath of the 2008-2009 global financial crisis, it was trade finance that helped keep shipments moving, according to the International Monetary Fund.[4]

Accordingly, trade volume has increased by 6.3% since 2019 and 19.1% compared to the average level in 2015.[4]

South-to-South trade amongst developing countries in the Southern Hemisphere should be the largest driver of future growth in the near term, as it is tracking to grow from 17% in 2010 to an estimated 40% of total global trade by 2030.[5] This surge can be closely linked to the international fragmentation of production in the context of global value chains.

Global trade flows are expected to surge past $35 trillion for 2025.[2] This data paints a promising picture of the future for global trade.

Figure 1. Global export value of trade in goods (2010 to 2025)



Source: United Nations Conference on Trade and Development (Unctad).

The benefits of investing in trade finance

- **Alpha potential.** Inefficiencies exist for non-bank investors, which can be consistently exploited.
- **Diversifier.** Trade finance can reduce reliance on traditional return drivers.
- **High income potential.** Coupons can be higher than those of many short-term debt securities.
- **Low volatility.** Historical annualized volatility has been low. According to Trade Finance Global, export lines of credit had a 0.02% exposure-weighted loss given default rate in 2023 with imports standing at 0.10%.[6]
- **Short duration.** These transactions are self-liquidating, and our firm's portfolios have a strategy-weighted average life of less than 24 months.[7]
- **Uncorrelated returns.** Historically, there have been low-to-negative correlations with most major market indices and other short-duration indices.

The trade finance gap

It is estimated that 80% of world trade is dependent on some form of financing.[3] This can be attributed to tighter credit conditions for obtaining alternative sources of capital. But as the demand for trade continues to grow, a complex regulatory environment, coupled with a lack of understanding for the asset class, has contributed to a global shortage of financing.

In a survey by Asian Development Bank, the global trade finance gap was estimated at $2.5 trillion in 2025, a steady increase from $1.5 trillion in 2015.[1]

This opportunity in trade has been largely untapped by asset managers because of the high operational costs due to asset granularity and short instrument tenors.[8]

Advancement in developing trade finance as an investable asset class can help bridge this gap, through the continuing engagement with investors, as well as the improvement of industry practices around the sale of trade finance assets.

Common trade finance structures

The type and characteristics of trade structures can vary depending on the nature of the transaction, countries involved and party creditworthiness. Some structures available to investors are listed below.

- **Supply chain finance transactions** finance payment obligations of very large corporates (buyers, investment grade, multisector) to their suppliers (varying credit quality). This allows suppliers and buyers to optimize working capital cycles as a cost that is reflective of the stronger counterpart's credit risk.

  Investors can utilize these loans as short-term exposure (30-180 days) to investment-grade publicly listed Developed Market corporates, allowing for low payment default probability and limited country risk.

- **Financial institution trade loans** are hard currency loans to systemically important financial institutions with a typical duration of six months to two years. These are used as senior unsecured bank funding instruments, with on-lending to key trade sectors of the local economy.

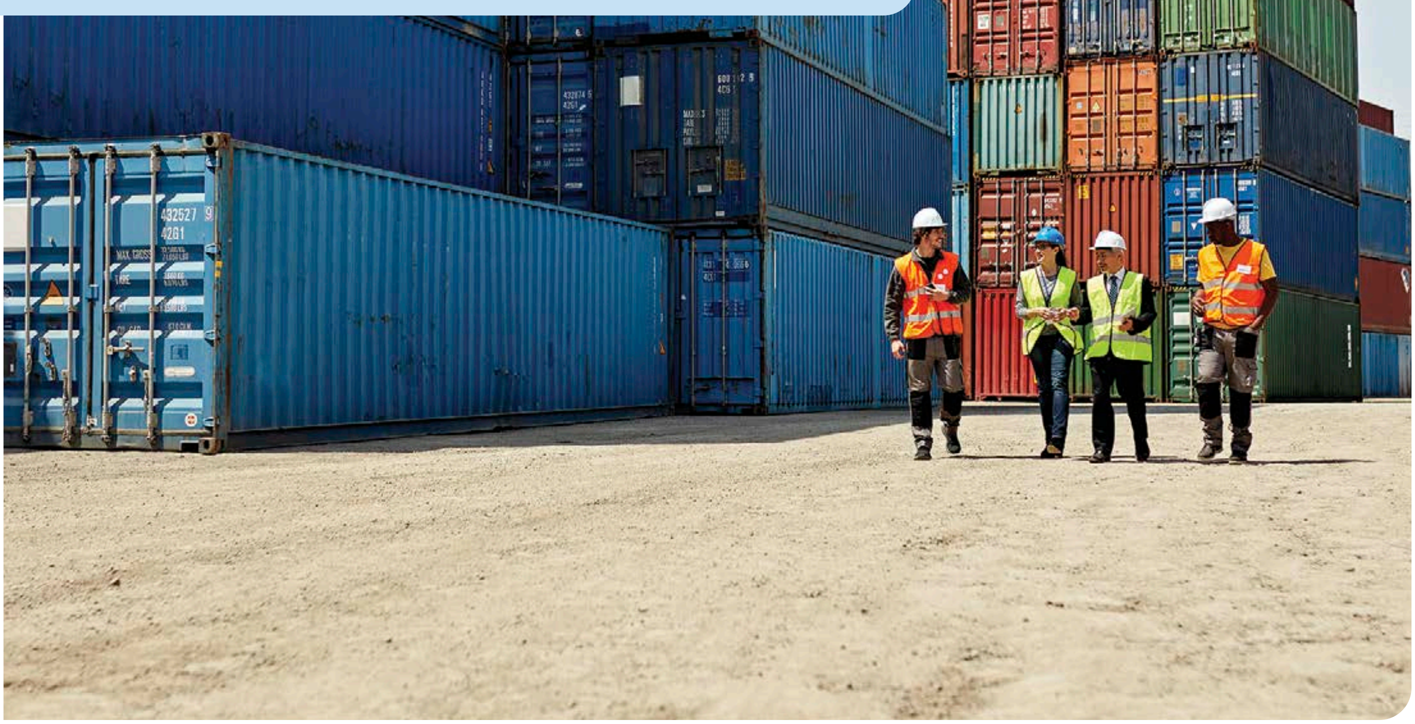
- **Sovereign loans** are hard-currency loans extended to developing and emerging market governments, typically with tenors of one to three years. Proceeds are used to finance key infrastructure projects or the import of essential goods and are linked directly to approved expenditures within the central government budget, rather than being used for general budgetary purposes.

- **Project finance loans** fund long-term infrastructure, industrial projects and public services using a nonrecourse or limited-recourse financial structure with a typical duration of up to seven years. The debt and equity used to finance the project are repaid solely from the cash flow generated by the project itself, and investors benefit from revenues underpinned by long-term, inflation linked contracts.

Qualities of a successful trade transaction

A successful trade finance transaction typically involves the following key qualities.

1. **Risk management:** Effective identification, assessment and mitigation of risks such as credit risk, currency risk and geopolitical risk are crucial.
2. **Clear documentation:** Accurate and complete documentation, including contracts, shipping details and certificates of origin, ensure that all parties are on the same page and can avoid disputes.
3. **Strong relationships:** Building and maintaining good relationships with banks, insurers and trading partners can facilitate smoother transactions and better terms.
4. **Compliance:** Adhering to international trade regulations and standards helps avoid legal issues and ensures the transaction proceeds without unnecessary delays.
5. **Efficient cash flow management:** Utilizing financing solutions like factoring or supply chain finance can help maintain liquidity and manage cash flow effectively.



[1] "2025 Trade Finance Gaps, Growth and Jobs Survey." Asian Development Bank, December 2025.

[2] "Global Trade Outlook and Statistics." World Trade Organization, October 2025.

[3] "Trade finance and SMEs." World Trade Organization, 2016.

[4] "Trade and Trade Finance in the 2008-09 Financial Crisis." International Monetary Fund, 2011.

[5] "South-South Trade and its Implications for the World Economy." International Banker, 2015.

[6] "Trade finance default rates rise slightly, 2023 ICC Trade Finance Register." Trade Finance Global, November 2023.

[7] Average life refers to the underlying securities held by Federated Hermes portfolios which are not available to the public and are used by the multi-sector portfolios to provide more effective diversification than is available through the purchase of individual securities.

[8] "How investing in trade finance can be profitable and help SMEs thrive." World Economic Forum, June 2022.

ICE BofA U.S. Dollar 1-Month Deposit Offered Rate Constant Maturity Index is an independent calculation of the 1-month Secured Overnight Financing Rate (SOFR). SOFR is a broad measure of the cost of borrowing cash overnight collateralized by Treasury securities. Prior to October 1, 2022, the index was based on the 1-month London Interbank Offered Rate (LIBOR). LIBOR was a widely used benchmark for short-term interest rates, providing an indication of the average rates at which LIBOR panel banks could obtain wholesale, unsecured funding for set periods in particular currencies.

Indexes are unmanaged and cannot be invested in directly.

Portfolio information is from a representative portfolio and for illustrative purposes only. Actual account characteristics of individual accounts may be different. Portfolio characteristics are as of the date indicated and are based on individual securities in the portfolio on that date. Securities in the portfolio are subject to change.

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A word about risk

Bond prices are sensitive to changes in interest rates, and a rise in interest rates can cause a decline in their prices.

Diversification does not assure a profit nor protect against loss.

Trade finance related securities will be located primarily in, or have exposure to, global emerging markets. International investing involves special risks including currency risk, increased volatility, political risks, and differences in auditing and other financial standards. Prices of emerging markets securities can be significantly more volatile than the prices of securities in developed countries and currency risk and political risks are accentuated in emerging markets.

The value of investments and income from them may go down as well as up, and you may not get back the original amount invested. Past performance is not a reliable indicator of future results.

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