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Webcast Summary

Trusting Our Convictions

Global growth slowed in late-2018, led by non-US economies, which fueled global financial market volatility. Emerging markets fell victim to a strong US dollar and fears of weaker global growth while corporate credit succumbed to US recession fears. Even structured products couldn't escape a Fed that seemed predetermined to hike its way into a recession. In 3Q18, we trimmed select exposures; as valuations became more attractive in December 2018, we added exposure, primarily to our highest-conviction selections within corporate credit, high-yield and investment-grade. Throughout the bumpy ride, we maintained our convictions with an overall bullish bias, but identified certain sectors where relative valuations weren't obvious. Our convictions were rewarded in the rapid reversal that followed in 1Q19. Looking ahead, we believe that "carry" will be the theme of 2019. We think that the macro backdrop is in place to support our view that the credit cycle, while long by historical standards, will endure.

2019 Macro Backdrop

- US financial conditions are moderating. It's clear that the Federal Reserve (Fed) is on hold. Fed officials now expect zero hikes in 2019 and one hike in 2020.
- We expect an uptick in eurozone conditions. The European Central Bank (ECB) has also delivered more dovish messaging.
  - We think the slowdown in Germany, led by manufacturing, may abate as trade tensions alleviate.
  - Regarding Brexit, we believe that a deal or a delay is likely and that a hard Brexit will be avoided. We think this will improve sentiment both within the UK and outside of Europe.
- In China, growth in the services sector has helped offset weakness in manufacturing. We believe that a lot of the stimulus incorporated over the past six months (e.g., reserve requirements, tax cuts) will begin to have some benefits.
  - With respect to the US/China trade conflict, we expect some type of agreement. While likely not all encompassing, markets will likely respond positively even to a "paper victory."
- We think markets will continue to benefit from central bank dovishness, as indicated by messaging from both the Fed and ECB.

Leveraged Loans

- While we're finding very compelling idiosyncratic opportunities within the high-yield market, and have a reasonable amount of high-yield exposure, bank loan valuations look attractive relative to high-yield.
- EBITDA growth within the bank loan market has been reasonably stable and, in our view, the trajectory of the trend is positive.
- In the CLO space, yields of various tranches offer value as they have retraced less than other markets over the past few months.

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Investment-Grade

- The 2018 "BBB glut" has fanned market concerns that if an economic downturn or a pullback or a recession occurs, then a lot of these BBBs can make their way into the BB space and that could cause an oversupply situation.
- We see an opportunity here as investors can take advantage of cheap BBB credits that are embracing a "debt diet"—companies whose management teams are committed to paying down debt or have explicitly stated they plan to reduce leverage.
- We like US banks, non-US banks, energy and basic industries as they are the sectors with the most upgrade potential.
- From a technical standpoint, we believe investment-grade credit is poised to benefit from a decline in hedging costs which have weighed on non-US investor demand over the past few years.

Emerging Markets (EM)

- Fundamentals and valuations support the case for EM debt. Compared with real yields in developed markets (DM), real yields in EM still look very high.
- We see value reappearing in USD-denominated EM with opportunities present in the new-issue market.
- EM has been resilient versus DM; we think there continues to be a strong fundamental case for EM.

Structured Products

- Households have also been on a debt diet. Bank lending remains very tight and consumers have responded by deleveraging. We think this creates a sound fundamental backdrop for investing in residential mortgage securities.
- Compelling opportunities can be found in single-asset, single-borrower, mezzanine transactions.

Q&A Highlights

- While we are late in the credit cycle, it's difficult to know what this means and the current cycle could last a long time. Issuers are not yet indicating signs of fundamental decay. Historically, corporate credit performs best in slow-growth environments; robust growth tends to lead to more aggressive management behaviors, more acquisition activity and more levering of the balance sheet. The slow growth of the recovery has been one reason among many that this cycle has had longevity.
- It's difficult to predict where the price of oil is going, so we invest in companies that are generally low-cost producers and that can survive a whole range of different oil prices. We're looking at balance sheet strength and at companies that are conservative (i.e., living within their cashflow).
- We're always looking for diversified sources of return. As much as we may be passionate on a sector or even passionate about a credit, we want to make sure within our portfolio that we have offsets to that. US duration or DM duration has historically been a very good offset for risk positions. Within corporate credit, this is how we think about duration. We want to balance the risk profile of our credit positions with an appropriate duration position.

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