SEIX INVESTMENT ADVISORS LLC®
A VIRTUS INVESTMENT PARTNER

Another Strong Quarter as Economy Re-opens

> Leveraged loans continued to enjoy substantial inflows in the second quarter of 2021 as investors pursued higher yields and diversification and economic recovery reduced the prospects for loan defaults.

> Solid growth should allow leveraged loan and high yield issuers to delever and grow into their balance sheets.

> The high yield market is at or near its highest average credit rating ever while the investment grade corporate market is at or near its weakest average credit rating ever.

> Strong economic growth has significantly reduced default risk.

LEVERAGED LOANS

Taking Profits in COVID-Impacted Sectors

Leveraged loans continued to enjoy substantial inflows in the second quarter of 2021 as investors pursued higher yields and protection from inflation, and diversification and economic recovery reduced the prospects for loan defaults.

We kept our focus on taking profits on names that have run up a lot, especially some of the COVID-impacted sectors, but maintained our energy positions given strong fundamentals that should continue for the near-to-medium term. We also started selectively adding some second liens in the portfolio. While second liens may sacrifice some liquidity relative to first liens, we are compensated for the smaller size with additional yield.

From a sector perspective, technology continues to be our largest allocation at around 14% of the portfolio. Health care is over 10%, which is up quite a bit over the last six months. While we added to our aerospace holdings, chemicals are now about 5.3%, down from over 9% pre-pandemic. We also trimmed our positions in the cable sector given the weaker relative value found there.

In terms of the biggest allocations, the key factor was earnings momentum, the most obvious example being the technology sector where the work-from-home trend led to explosive demand for innovative networking products such as remote troubleshooting. Meantime, health care has benefitted tremendously from government support payments made over the last year.

In metals and mining, even coal did well as a lot of utilities switched to coal given a steady rise in natural gas prices. With record heat in a large part of the United States expected to continue, natural gas prices should remain firm this year.

From a technical standpoint, one of the most significant drivers in the loan market remains demand from collateralized loan obligations (CLOs). An indicator of future demand are warehouses, which are opened before a CLO is finalized, to purchase loans. With about 200 warehouses now open, the pipeline for the balance of 2021 appears robust.

2Q 2021 Bank Loan Trends

Performance: For 2Q, the JP Morgan Leveraged Loan Index returned 1.57%. The year-to-date return was 3.45%, with Split B/CCC loans (+10.51%) outperforming B loans (+3.18%) and BB loans (+1.69%). For the quarter, notable contributors by industry were metals & mining (+4.61%), energy (+2.56%) and retail (+2.42%), while laggards were utilities (-0.46%), broadcasting (+0.47%), and cable/satellite (+0.82%).

As of 6/30/21, the yield to 3-year takeout was 4.76%, down 13 basis points (bps) for the quarter. The price on the index was approximately $98.59, up from $98.07 at 3/31/21.

Issuance: Gross issuance totaled $193.6 billion, or $113.1 billion net of refi/re-pricing. Year to date, issuance totaled $494.9 billion, or $186.2 billion net of refi/re-pricing, which is up 102% and 141% year over year, respectively.

The year-to-date profile of issuance was as follows:

> repricing	33%
> refinancing	30%
> mergers & acquisitions	29%
> dividends	5%
> general corporate/other	3%

Year-to-date middle-tier volume totaled $396.9 billion (80%), upper-tier volume totaled $93.2 billion (19%), and lower tier volume totals $7.4 billion (1%).

Demand: Loan inflows totaled $12.7 billion, a slight moderation from 1Q's $14.1 billion inflow and compared with outflows of $687 million and $4.2 billion in the last two quarters of 2020. Year to date, inflows for loan funds totaled $26.8 billion ($6.9 billion in ETFs), which compares to outflows of $22.1 billion over the first half of 2020.

CLOs: U.S. CLOs have priced at $108.8 billion. Year to date, 476 U.S. CLOs have priced totaling $215 billion ($82.2 billion ex-refinancing) compared with 133 U.S. CLOs totaling $59.8 billion for the same period last year.

Default Rates: The loan par-weighted rolling 12-month default rate ended June at 1.43% (ex-energy 1.26%), down 53 bps month over month, down 284 bps year to date, and down 172 bps year over year.

Takeaway: Retail inflows moderated but remained healthy. CLO formation provided continued support. 2Q index pricing ticked up contributing to performance. In a lower interest rate environment with the Fed indicating near-term accommodation, LIBOR levels remained low with the period end 3-month LIBOR at 14 bps compared to 24 bps at year-end 2020.

Outlook

The outlook for the second half remains bright, and we still think the leveraged loans asset class can return about 5.5% this year. Therefore, a modest allocation to loans should provide a hedge in case inflation overshoots prevailing expectations. We're not expecting 1970's inflation, but north of 2.5% is very plausible.

We also believe that growth will be solid for the next 12 months, allowing leveraged loan issuers to delever and grow into their balance sheets.

We wouldn't get too caught up in what the 10-year Treasury is doing or what LIBOR is doing. Loans are positioned well. We expect continued strong new issuance, along with a lot of pay-downs. We've seen a lot of mergers & acquisitions. We even had our first special-purpose acquisition company (SPAC).

HIGH YIELD

Duration and Distressed Outperform as Economy Reopens and Vaccinations Increase

The big themes for high yield in the second quarter were duration and distressed debt, both of which showed significant outperformance.

Case in point: the sub-index that comprises maturities with 15-plus years was up 7.63%. In fact, anything with a 10-plus-year maturity was up just under 6.5% for the period. Distressed high yield was up 10.2% as CCCs, particularly the riskiest CCCs, drove performance, followed by BBs, which drove a lot of the duration and the move in Treasuries. Single-B's, our largest overweight, was the underperformer.

"Zombie" companies, particularly ones that once could not earn enough to cover their interest payments, have dwindled. Take steel companies, for example, which underwent a tremendous amount of consolidation that culminated in greater discipline. U.S. Steel and Cleveland-Cliffs are doing very well right now, and there is tremendous demand in the pipeline. Steel prices may not stay as high as they've been, but they are probably going to be at levels that allow companies to generate some free cash flow and continue to demonstrate some credit quality improvement. As for lodging and regional gaming, companies with enduring balance sheets and solid management are in good shape now that they have re-opened.

From an option adjusted spread perspective, the CCC part of the market is beating post-financial crisis tights by 40 bps at this point, whereas the BB and B cohorts are still 30 bps wide of that mark.

High Yield Trends

Market Return: The overall ICE BofA U.S. High Yield Cash Pay Index gained 2.75%, and the ICE BofA U.S. High Yield Index Constrained index advanced 2.57%. For the second straight quarter, CCC's had the best return by ratings. Reopening of the economy, continued increase in vaccination rates and wide-open markets continue to be tailwinds for this rating cohort. Single-B's were up 2.095%, and BB's were up 2.9%.

The ICE BofA U.S. High Yield Index started the quarter with a 4.21% yield and tightened 41 bps to end 2Q21 with a 3.80% yield. The BB index started the quarter with a yield of 3.47% and tightened 37 bps to end 2Q with a yield of 3.10%. The yield on the single-B index started the quarter at 4.50% and ended at 4.20%. CCC's tightened 80 bps from 6.83 to 6.03%.

Default Activity: In 2Q, a total of $5.1 billion was affected by a default or distressed transaction, which was a slight increase quarter over quarter from $3.4 billion in 1Q. The par-weighted U.S. high yield default rate including distressed exchanges ended the month at 1.87%, down 119 bps month over month and 489 bps year to date. JP Morgan has revised its 2021 default rate forecast to 0.65% from 2%. The firm also lowered its 2022 forecast to 1.25%.

Supply: Gross issuance totaled $140.5 billion for 2Q21. Refinancing accounted for $83.7 billion of that total.

Flows: In 2Q, high yield funds saw $3.2 billion of outflows compared with $10.6 billion in Q1 and inflows of $8.9 billion and $7.3 billion in 4Q20 and 3Q20, respectively. Year to date, outflows for high yield funds totaled $13.8 billion ($1.7 billion in ETFs), which compares to inflows of $28.6 billion over the first half of 2020.

Outlook

We believe the fundamentals for high yield are very strong. The average credit rating on high yield is either at its all-time high or near its all-time high. We will have some idiosyncratic issues in the asset class, but we think the lower default risk environment will continue.

The time to get concerned in high yield is following long periods of record underwriting when excesses develop, and then we enter some economic downturn or industry downturn that works off those excesses. We don't have that. The weakest companies were cleansed out of the asset class last year, and we had the biggest influx of fallen angels following several years of below market averages for CCC issuance.

We believe one of the big themes through the end of 2022 will be rising stars. Depending on how long it takes the rating agencies, we could see as much as 10% (and potentially more) of high yield upgraded to investment grade. That rising star component historically has been a good path to solid risk-adjusted returns, which is why it's an increasing focus for us. If we are going to take on some rate risk, we want that catalyst to drive spread compression.

continued

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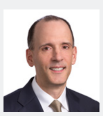
Leveraged Loans



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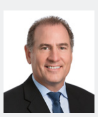

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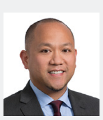

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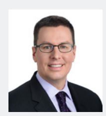
High Yield



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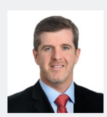

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ICE BofA U.S. High Yield Cash Pay Index is an unmanaged index consisting of all domestic and Yankee high-yield bonds maturing over one year. The quality range is less than BBB-/Baa3 but not in default (DDD1 or less). The **ICE BofA U.S. High Yield Constrained Index** is a market-value-weighted index of all domestic and Yankee high-yield bonds, including deferred interest bonds and payment-in-kind securities. Issues included in the index have maturities of one year or more and have a credit rating lower than BBB-/Baa3 but are not in default. The ICE BofAML U.S. High Yield Constrained Index limits any individual issuer to a maximum of 2% benchmark exposure. The **J.P. Morgan Domestic High Yield Index** is designed to mirror the investable universe of the U.S. dollar domestic high yield corporate debt market. The **J.P. Morgan Leveraged Loan Index** is designed to mirror the investable universe of U.S. dollar institutional leveraged loans, including U.S. and international borrowers. The indexes are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and are not available for direct investment.

LIBOR is a benchmark interest rate at which major global lend to one another in the international interbank market for short-term loans. LIBOR, which stands for London Interbank Offered Rate, serves as a globally accepted key benchmark interest rate that indicates borrowing costs between banks.

A **Basis Point (bp)** is equal to 0.01%.

Collateralized Loan Obligations are securities backed by a pool of assets often low-rated corporate loans.

Negative Convexity refers to the shape of a bond's yield curve and the extent to which a bond's price is sensitive to changing interest rates.

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