SEIX
INVESTMENT ADVISORS
A VIRTUS INVESTMENT PARTNER

Why It's Time to Add High Yield Bonds

With solid long-term fundamentals and compelling valuations, high yield bonds remain one of the most resilient asset classes.

High Yield spreads widened significantly over the course of 2022, making high yield valuations more attractive. While spreads had widened further during the mid-2022 HY selloff, we believe the market now recognizes the quality differences between today's issuers and the HY market of the past, as spreads have since continued to slowly tighten from their highs. The fourth quarter 2022 saw interest coverage for HY increase over historically high levels, leverage stay near its lows, and continued solid cash on hand, which we expect to provide a strong buffer to bridge an economic downturn if the economy stalls.

The extra yield investors demand to hold high yield bonds over U.S. Treasuries (as reflected in the option-adjusted spread, or OAS) has decreased to 458 basis points (bps) from 481bps as of 3/31/23. Meanwhile, the yield-to-worst, or the lowest rate an investor can expect to earn short of a default, on the ICE BofA US High Yield Index hit 8.49% on 3/31/23.

Chart 1. Spread Alert: High Yield OAS Represents an Enticing Entry Point

	Date	$ Price	Yield to Worst	OAS
High Yield Bonds	12/31/21	103.31	4.32%	310
	12/31/22	85.88	8.98%	481
	3/31/23	88.21	8.49%	458
BB Rated Bonds	12/31/21	105.51	3.40%	211
	12/31/22	89.25	7.26%	308
	3/31/23	91.69	6.79%	288
B Rated Bonds	12/31/21	102.25	4.69%	351
	12/31/22	87.04	9.34%	515
	3/31/23	88.82	8.87%	491
CCC Rated Bonds	12/31/21	96.21	7.81%	678
	12/31/22	70.05	15.69%	1170
	3/31/23	73.13	15.10%	1130

Past performance is not indicative of future results. Source: Standard & Poor's; High Yield Bonds represented by ICE BofA US High Yield Index (H0A0); BB Rated Bonds represented by ICE BofA BB US High Yield Index (H0A1); B Rated Bonds represented by ICE BofA Single-B US High Yield Index (H0A2); CCC Rated Bonds represented by ICE BofA CCC & Lower US High Yield Index (H0A3).

continued

BBs: DOUBLE TROUBLE FOR EQUITY VALUATIONS?

BB yields continue to exceed the earnings yield* for the S&P 500®, underscoring the potential benefit of diversifying away from equities (Chart 2). We believe this graph demonstrates the relative attractiveness of the higher quality portion of the high yield market versus equities, as BBs outyield the S&P 500 earnings yield at the greatest amount since the GFC.

Chart 2. BB Yield Exceeds S&P 500 Earnings Yield

Difference Between S&P 500 Earnings Yield and BB Yield

Past performance is not indicative of future results. As of 3/31/23. Source: Standard & Poor's; BB Rated Bonds represented by ICE BofA BB US High Yield Index.

CURRENT YIELDS SUPPORT IMPROVED RETURN OUTLOOK

Chart 3 illustrates how investors can still capture much of the upside of equities. With yields at current levels, high yield bonds have historically shown strong performance over the next 12 months.

Chart 3. High Yield Forward Performance as Yields Breach Various Barriers

Yield	HY Forward Returns (%)				HY Spread-to-worst Change (bps)			
Barrier (%)	3 months	6 months	9 months	12 months	3 months	6 months	9 months	12 months
7.0	-0.30	0.52	4.06	3.22	48	40	28	85
7.5	1.13	0.88	6.00	7.08	14	33	-25	-18
8.0	2.61	3.31	9.27	13.05	-29	-25	-106	-155
8.5	2.45	5.67	11.70	15.41	-30	-49	-124	-189
9.0	4.89	10.44	15.30	19.19	-89	-150	-209	-289

Past performance is not indicative of future results. Source: JPMorgan Research 1/6/23.

A BAD MOON RISING . . . OR JUST BAD ADVICE

Market pundits preach of rising rates/rising defaults; the average investor has moved much of their investment dollars into cash/money market instruments; risk is removed from the portfolio as fear of a 'bad moon rising' appears to overtake sound research

> **"I see the bad moon a-risin**
> **I see trouble on the way**
> **I see earthquakes and lightnin'**
> **I see bad times today"**
>
> Creedence Clearwater Revival, "Bad Moon Rising"

*The earnings yield refers to the earnings per share for the most recent 12-month period divided by the current market price per share. The earnings yield (the inverse of the P/E ratio) shows the percentage of a company's earnings per share.

and advice. As the Federal Reserve (Fed) nears its terminal rate, how do we refocus the investor to understand how markets have reacted in the past? Dare we ask if there are pockets of opportunity in times of market dislocations? The following chart provides historical forward performance for high yield following a pause in Fed policy rate hikes.

Chart 4. High Yield Forward Performance Post a Pause in Fed Policy Hikes

Month of Last Hike	Fed Funds Terminal Rate (%)	HY Spreads at End of Hiking Cycle (bps)	HY Forward Returns (%)				HY Forward Spread Change (bps)			
			3 months	6 months	9 months	12 months	3 months	6 months	9 months	12 months
Dec-18	2.50	567	7.27	9.88	10.88	14.08	-115	-105	-91	-143
Jun-06	5.25	359	3.46	8.03	11.21	11.83	16	-41	-45	-35
May-00	6.50	661	3.57	-4.42	4.15	3.33	22	235	139	81
Mar-97	5.50	325	4.48	9.53	11.91	15.72	-12	-13	9	-7
Feb-95	6.00	437	6.51	8.96	11.93	16.51	13	11	34	-28
Average		**470**	**5.06**	**6.40**	**10.02**	**12.30**	**-15**	**17**	**9**	**-26**

Past performance is not indicative of future results. Source: JPMorgan 5/10/2023.

COMPANIES ARE PERFORMING A GREAT BALANCING ACT: LOOK AT THE BALANCE SHEET CASH AND FREE CASH FLOW

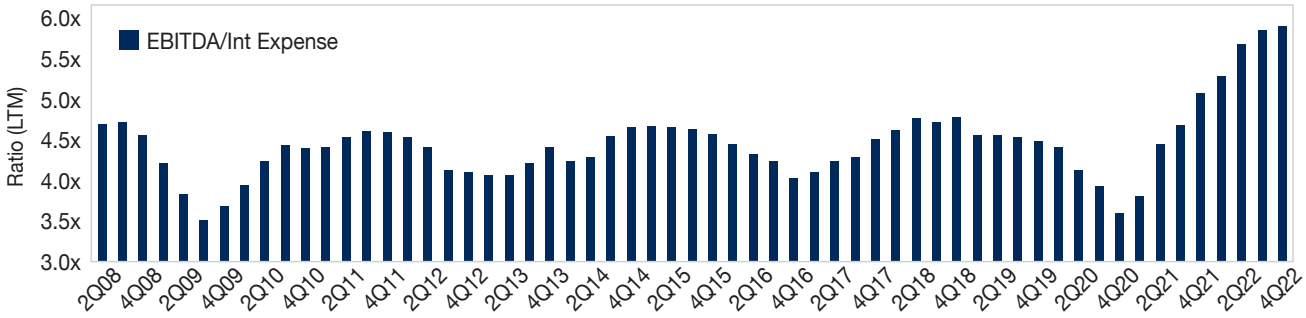
Chart 5. High Yield Issuers Maintain $252bn in Cash and Generate $96bn in FCF

Sector	Debt	Cash	FCF	Cash+ FCF/Debt
Utilities	55,574	2,053	-796	2%
Telecoms	54,563	2,844	1,315	8%
Cable	158,790	7,482	6,287	9%
Packaging/Paper	58,096	5,650	227	10%
Food Producers	32,405	2,446	1,555	12%
Capital Goods	73,251	11,267	330	16%
Travel	139,815	21,942	1,404	17%
Retail	123,885	18,522	2,864	17%
Healthcare	149,094	20,402	5,870	18%
Media	106,119	11,608	7,280	18%
Gaming	98,127	16,271	2,569	19%
Chemicals	38,696	5,667	3,138	23%
Transportation	139,440	39,901	431	29%
Real Estate	63,967	11,144	10,349	34%
Energy	156,000	13,474	40,577	35%
Technology	65,636	17,103	6,032	35%
Autos	93,445	38,643	209	42%
Metals	20,289	6,742	5,158	59%
BB	771,380	138,745	84,803	29%
B	638,080	94,104	18,940	18%
CCC	196,434	19,570	-7,766	6%
HY	**1,605,894**	**252,419**	**95,977**	**22%**

Past performance is not indicative of future results. Source: BofA Global Research, Bloomberg as of 4/14/23.

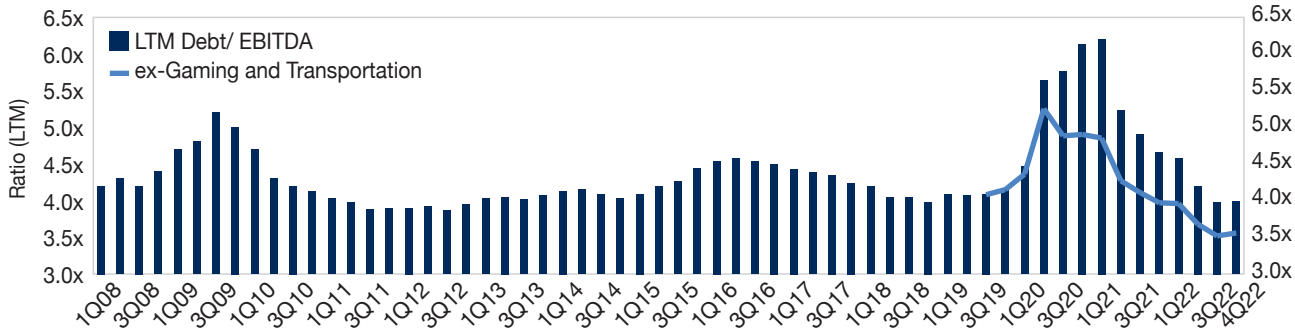
The fundamentals of the market are also supportive. As the following graph shows, interest coverage ratios for the asset class are at the highest levels ever reported for the asset class.

Coverage



Source: JPMorgan 12/31/22.

Further, leverage ratios are at historically low levels for the asset class and when adjusted for gaming and transportation (which are still benefiting from the economy reopening), are at the lowest levels ever.



Source: JPMorgan 12/31/22.

While fundamentals will likely weaken through 2023, the asset class is entering the expected slowdown in its best fundamental shape ever. We believe this will be an important consideration keeping defaults below past cycle highs. In addition, we believe the asset class has evolved over the past 15+ years to consist of larger companies. As a result, we believe investors waiting for past recessionary spread levels to reenter high yield could end up being disappointed as the asset class ends up proving more resilient than many anticipate.

TIME TO SAY HI AGAIN TO HIGH YIELD?

Better valuations, stronger earnings yields, historically attractive performance, and solid balance sheets for many issuers may provide a liquidity buffer and downside mitigation IF we enter an economic downturn.

Chart 6. High Yield May Offer Downside Mitigation vs. Equities While Allowing Investors to Potentially Capture Much of the Upside

High Yield Bonds vs. Equity Market

7/1/83-3/31/23	Annualized Return	Standard Deviation	Return per Unit of Risk	Rolling 3-Year Periods		
				Best	Worst	% Negative
High Yield	8.16%	8.39%	1.0	26.4%	-7.6%	5%
Large-Cap Equity	10.95%	15.21%	0.7	33.3%	-16.1%	13%
Small-Cap Equity	8.60%	19.54%	0.4	32.0%	-17.8%	11%

Past performance is not indicative of future results. The High Yield, Large Cap Equity, and Small Cap Equity Markets are represented by the Bloomberg U.S. Corporate High Yield Index, S&P 500® Index, and the Russell 2000® Index, respectively. Returns were calculated using monthly data and begin with the inception of the Bloomberg High Yield Credit Index on 7/1/83. Source: Standard & Poor's, FTSE Russell, Bloomberg.

About Seix Investment Advisors

Seix Investment Advisors is an investment management boutique focused exclusively on managing fixed income strategies since 1992. Seix seeks to generate competitive absolute and relative risk-adjusted returns over the full market cycle through a bottom-up focused, top-down aware process. Seix employs multi-dimensional approaches based on strict portfolio construction methodology, sell disciplines, and trading strategies with prudent risk management as a cornerstone.

To learn more about Seix Investment Advisors, please visit seixadvisors.com.

For information regarding our subadvised mutual funds, please visit virtus.com or call 1-800-243-4361.

The **J.P. Morgan U.S. High Yield Index** is designed to mirror the investable universe of the U.S. dollar domestic high yield corporate debt market. The **ICE BofA US 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 index does not reflect the deduction of expenses associated with a mutual fund, such as investment management and fund accounting fees. A fund's performance reflects the deduction of fees for these services. The **ICE BofA US High Yield Index** (H0A0) tracks the performance of U.S. dollar denominated below investment grade rated corporate debt publicly issued in the U.S. domestic market. To qualify for inclusion in the index, securities must have a below investment grade rating and an investment grade rated country of risk. The **ICE BofA BB US High Yield Index** (H0A1) is a subset of the ICE BofA US High Yield Master II Index and includes all securities with a given investment grade rating BB. The **ICE BofA CCC & Lower US High Yield Index** (H0A3) subset includes all securities with a given investment grade rating CCC or below. The **ICE BofA Single-B US High Yield Index** (H0A2) subset includes all securities with a given investment grade rating B. The **Russell 2000® Index** is a market capitalization-weighted index of the 2,000 smallest companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. The index is calculated on a total return basis with dividends reinvested. The **S&P 500® Index** is a free-float market capitalization-weighted index of 500 of the largest U.S. companies. The index is calculated on a total return basis with dividends reinvested. The **Bloomberg U.S. Corporate High Yield Bond Index** is an unmanaged market value weighted index that covers the universe of fixed rate, non-investment grade debt. The indexes are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and are not available for direct investment.

IMPORTANT RISK CONSIDERATIONS

Credit & Interest: Debt securities are subject to various risks, the most prominent of which are credit and interest rate risk. The issuer of a debt security may fail to make interest and/or principal payments. Values of debt securities may rise or fall in response to changes in interest rates, and this risk may be enhanced with longer-term maturities. **High Yield-High Risk Fixed Income Securities:** There is a greater level of credit risk and price volatility involved with high yield securities than investment grade securities. **Foreign Investing:** Investing internationally involves additional risks such as currency, political, accounting, economic, and market risk. **Industry/Sector Concentration:** A fund that focuses its investments in a particular industry or sector will be more sensitive to conditions that affect that industry or sector than a non-concentrated fund. **Market Volatility:** The value of the securities in the portfolio may go up or down in response to the prospects of individual companies and/or general economic conditions. Local, regional, or global events such as war, terrorism, pandemic, or recession could impact the portfolio, including hampering the ability of the portfolio's manager(s) to invest its assets as intended. **Prospectus:** For additional information on risks, please see a fund's prospectus.

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

Not all products or marketing materials are available at all firms.

Not insured by FDIC/NCUSIF or any federal government agency. No bank guarantee. Not a deposit. May lose value.