

# High Yield Bond Wrap

## TAXABLE FIXED INCOME STRATEGY

**SEIX**   
INVESTMENT  
ADVISORS LLC®

### Market Review

March 23, 2020, is categorized as the date that the high yield market reached its low and has since corrected and been on a positive trend through June. The positive result in June, while the weakest month of the quarter, contributed to the high yield market having its best quarter since 2009. For the month of June and 2Q20, CCCs, distressed high yield, and energy were among the top performing segments of the high yield market. BBs were also a top performer, but our analysis suggests that the strong performance was partly attributable to the fallen angel universe which we discuss in more detail below. Excluding fallen angels, BBs underperformed both Bs and CCCs for the three-month period ending June 30.

### Performance

The high yield bond wrap portfolios increased 8.03% in 2Q20 — 155 basis points (bps) less than the portfolio's benchmark: the ICE BofA US Cash Pay High Yield Index. This Index increased 9.58%.

While we are never pleased with underperformance over any time period, we would expect some underperformance in a period in which the top performing sectors of the market were CCCs, distressed high yield, and energy—all of which we are underweight in the high yield bond wrap portfolios. The underperformance in 2Q20 took our outperformance for the year-to-date period to 373 bps. Our goal is to capture more of the upside in up markets than we capture on the downside in down markets to achieve outperformance over time. We were able to capture 85% of the return in 2Q20 while only capturing 64% of the downside in 1Q20.

We were able to capture 85% of the upside in 2Q20 by overweighting the securities of fallen angel companies as well as segments of the investment grade corporate market despite being underweight in CCCs, distressed high yield, and energy. We believe our focus on fallen angels as well as the higher spread segment of investment grade corporates allowed us to capture a significant amount of the upside in the up market while taking less risk than the overall market. This universe of bonds (fallen angels and crossover investment grade) can produce returns that meet or exceed distressed high yield with lower default risk. Default risk can increase the potential for the permanent impairment of capital, which we seek to avoid.

From a sector perspective, our top performing sectors on a relative basis for 2Q20 were transportation, automotive & aerospace, restaurants, food, beverage & supermarkets, and cable & satellite. Offsetting these positive contributors was an underweight and unfavorable security selection in energy, an overweight in technology, and unfavorable security selection in hotels & REITs.

Our investment process was developed more than 20 years ago when Seix Investment Advisors began managing high yield investment assets. We have managed this strategy through several market dislocations including the Great Financial Crisis, the market dislocation of 2011 following concerns about the

### TOP 10 HOLDINGS

	% of Portfolio
CSC Holdings Llc	1.27
DaVita Inc.	1.25
Tri Pointe Group / Homes	1.23
EMC Corp.	1.22
Ford Motor Co.	1.20
Sprint Communications	1.12
Sysco Corp.	1.12
Cheniere Corp. Christi Hd	1.12
Verisign Inc.	1.12
CenturyLink Inc.	1.12

### PORTFOLIO MANAGERS



**Mike Kirkpatrick**  
Senior Portfolio Manager  
Industry experience  
since 1991  
Joined Seix in 2002



**James FitzPatrick, CFA**  
Head of Leveraged Finance  
Trading,  
Portfolio Manager  
Industry experience  
since 1996  
Joined Seix in 1997

Holdings are subject to change. The top holdings are as of the period indicated. There is no assurance that any of the securities noted will remain in a portfolio at the time you receive this commentary. Actual holdings and percentage allocation in individual client portfolios may vary and are subject to change. It should not be assumed that any of the holdings were, or will prove to be, profitable, or that the investment recommendations or decisions we make in the future will be profitable. A list of all securities held in this strategy in the prior year is available upon request.

To obtain the top/bottom holdings calculation methodology, call 800-243-4361.

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sustainability of the European Union, and the energy crisis of 2015/16. In each one of these instances, we have truncated the downside and then pivoted to attractive opportunities that we identified in the dislocated market. We have seen several competitors attempt to promise slightly higher yields to win business, but a lack of focus on downside protection has diminished their competitiveness.

### Current Strategy

We are currently experiencing the most severe economic downturn since the Great Depression. While the economic rebound will appear to be V-shaped for a period of time, we are not of the view that the bounce back will get us back to pre-pandemic levels any time soon. Further, it is unclear if we will return to 85%, 90%, 95%, or even 100%+ of pre-pandemic levels. There are also many sectors that will experience permanent change: technology, retail, airlines, cruise lines, lodging, and movie theaters to name a few. While we are hopeful that we will return to a normal economy, which could be facilitated by a vaccine, new therapeutics, and/or the virus being eradicated, we are not investing with the mindset that this will occur reasonably soon. As a result, we believe higher quality high yield and the higher spread portion of the investment grade market offer solid risk-adjusted and absolute return potential opportunities. Given the uncertainty of the timing of the economic rebound, we do not believe the weaker parts of high yield are generally attractive such as many CCC-rated bonds and distressed high yield.

We continue to believe that fallen angels offer one of the more attractive investment opportunities in the high yield market. Our analysis, using the ICE BofA US High Yield Indexes, suggests that the universe of fallen angels has exhibited more attractive investment results over time when compared to originally issued high yield. The following table shows the performance of the ICE BofA US Fallen Angel High Yield 10% Constrained Index (HOCF) versus the ICE BofA US Original High Yield Index (HOHY) and the ICE BofA US High Yield Index (HOAO) over different time periods that conclude June 30, 2020.

	Since 12/31/96			Since 6/30/2015			Since 6/30/2017		
	HOCF	HOHY	HOAO	HOCF	HOHY	HOAO	HOCF	HOHY	HOAO
Price Return	1.859	-2.244	-1.559	1.201	-2.415	-1.932	-0.955	-3.657	-3.306
Income Return	7.673	8.120	8.073	6.234	6.539	6.510	5.884	6.285	6.248
Total Return	9.533	5.905	6.514	7.435	4.124	4.578	4.929	2.628	2.942

Further, our analysis shows that the HOCF has outperformed the HOHY in more than 94% of rolling three-year periods since inception of the Index beginning December 31, 1996, (using monthly performance data) and more than 75% of the time over rolling one-year periods. Our analysis further suggests that the best time to invest in fallen angels has been during periods when the fallen angel universe was growing (i.e., there were a significant amount of downgrades), which is similar to the current market environment. According to JPMorgan, the U.S. high yield market has seen \$179 billion in fallen angels through June, which is the largest amount on record for a calendar year. Our bottom-up credit analysis is focused on identifying those fallen angels that are experiencing a cyclical hit to earnings, rather than secular, and have levers to pull to make it through the cyclical downturn. Having said that, it is also important to avoid companies that are experiencing a cyclical downturn that is so protracted that it begins to resemble a secular decline like we have seen in the offshore drilling sector.

### Outlook

On June 30, the ICE BofA US High Yield Index yielded 6.85% (144 bps greater than the year-end return on December 31, 2019), with a spread of 644 bps (roughly 294 bps wider than year-end). A spread of 644 bps is still considerably wider than the long-term median spread of 482 bps. Further, the increase in fallen angels that typically enter high yield as BB credits as well as the increase in defaults for high yield companies that cleanses the weakest credits from the Index are both working to upgrade the credit quality of the Index. We continue to believe that now is a good time to invest in high yield assets as both a core investment or an income enhancement addition to a broadly diversified portfolio. Investors understand the opportunity with nearly \$30 billion in flows year-to-date, which materially reversed the negative trends we saw through much of March.

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### ANNUALIZED PERFORMANCE (%) AS OF 6/30/2020



**Net returns are calculated by subtracting the highest applicable wrap fee (2.50% on an annual basis, or 0.21% monthly) on a monthly basis from the gross composite monthly return.**

**Past performance is not indicative of future results.** The information shown above is supplemental information only and complements the fully compliant presentations. Periods greater than one year are annualized.

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 index is unmanaged, its returns do not reflect any fees, expenses, or sales charges, and is not available for direct investment.

# High Yield Bond Wrap Composite Data

Year End	Total Firm	Composite Assets		Annual Performance and Standard Deviation					
	Assets (\$ mil)	US\$ (\$ mil)	# of Wrap Sponsors	Net Composite Return	Pure Gross Composite Return	Composite 3-Year Std. Dev.	ICE BofA US High Yield Cash Pay Index	Index 3-Year Std. Dev.	Composite Dispersion
2019	18,071	1,614	13	9.84%	12.60%	3.45%	14.40%	4.13%	0.05%
2018	21,160	1,414	13	-4.08%	-1.65%	3.08%	-2.26%	4.62%	0.00%
2017	24,843	2,020	9	2.91%	5.51%	4.11%	7.48%	5.58%	0.00%
2016	27,631	2,060	6	7.24%	9.94%	4.80%	17.34%	6.01%	0.20%
2015	25,698	1,527	6	-4.20%	-1.77%	4.93%	-4.55%	5.27%	0.10%
2014	30,989	1,482	6	1.52%	4.08%	4.23%	2.44%	4.42%	0.10%
2013	26,600	1,486	6	2.43%	5.02%	4.99%	7.38%	6.33%	0.10%
2012	26,141	1,535	6	9.91%	12.67%	5.44%	15.44%	6.93%	0.10%
2011	26,147	746	7	4.77%	7.41%	7.53%	4.50%	10.78%	0.20%
2010	25,855	682	8	8.67%	11.40%	-	15.24%	-	0.30%

N/A - Information is not statistically meaningful due to an insufficient number of portfolios in the composite for the entire year.

Seix Investment Advisors LLC claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Seix Investment Advisors LLC has been independently verified for the periods January 1, 1993 through December 31, 2018. The verification reports are available upon request.

Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation.

Seix Investment Advisors LLC is an SEC-registered investment adviser and wholly owned subsidiary of Virtus Investment Partners. The firm maintains a complete list and description of composites, which is available upon request.

The Seix High Yield Bond Wrap composite consists of all High Yield Bond Wrap Fee accounts managed by Seix in all participating Wrap Fee Sponsors' Programs. The minimum account size for inclusion in the composite is \$250,000. Prior to June 1, 2015, the account minimum was \$500,000. For comparison purposes, the composite is measured against the ICE BofA US High Yield Cash Pay Index. 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. Index returns do not reflect the deduction of any fees.

The Seix High Yield Bond Wrap Composite was created January 1, 2003, and has a performance inception date of July 1, 1997. Prior to September 30, 2017, the Seix High Yield Bond Wrap Composite was named the Seix High Yield SMA Composite.

Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. The U.S. dollar is the currency used to express performance. Returns include the reinvestment of all income. The annual composite dispersion presented is an asset-weighted standard deviation calculated for the wrap sponsors in the composite the entire year.

Pure Gross returns are presented as supplemental information, do not reflect the deduction of any trading costs, fees or expenses and are presented for comparison purposes only. Net returns are calculated by subtracting on a monthly basis the highest assumed wrap fee (2.50% annually or 0.21% per month) from the gross composite monthly return. The assumed wrap fee includes all charges for portfolio management, trading costs, custody and other administrative fees.

Actual wrap fees vary by Program Sponsor. Please refer to the Program Sponsor's ADV 2A for a full disclosure of the fee schedule for wrap fees. Returns realized by clients will be reduced by the actual wrap fee rates and rates incurred by clients will vary.

Performance presented for the period prior to March 31, 2008 occurred while the Portfolio Management Team was a part of Seix Advisors, the Fixed Income division of Trusco Capital Management, Inc. ("Trusco") and the predecessor of Seix Investment Advisors LLC. Effective as of March 31, 2008, Seix Advisors began operating as a separate legal entity, named Seix Investment Advisors LLC ("Seix"), and Trusco was renamed as RidgeWorth Capital Management, Inc. Effective as of May 23, 2014, RidgeWorth Capital Management, Inc. became RidgeWorth Capital Management LLC, and Seix merged with StableRiver Capital Management LLC, a wholly owned subsidiary of RidgeWorth Capital Management LLC. Effective June 1, 2017, RidgeWorth Capital Management LLC was acquired by Virtus Investment Partners, Inc. ("Virtus"). Seix is an SEC-registered investment adviser and is a wholly owned subsidiary of Virtus Partners, Inc., a wholly owned subsidiary of Virtus.

Seix has retained the identical investment style since the inception of the composite. Seix also maintains the records necessary to support the performance of all composites and will provide these records upon request. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request. **Past performance is not indicative of future results.**

A basis point (bp) is equal to 0.01%.

**Earnings before interest, taxes, depreciation, and amortization (EBITDA)** is an accounting measure calculated using a company's earnings, before interest expenses, taxes, depreciation, and amortization are subtracted, as a proxy for a company's current operating profitability (i.e., how much profit it makes with its present assets and its operations on the products it produces and sells, as well as providing a proxy for cash flow).

## 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. **Market Volatility:** Local, regional or global events such as war, acts of terrorism, the spread of infectious illness or other public health issue, recessions, or other events could have a significant impact on the fund and its investments, including hampering the ability of the fund's portfolio manager(s) to invest the fund's assets as intended.

## DEFINITIONS & DISCLOSURES

Bonds offer a relatively stable level of income, although bond prices will fluctuate providing the potential for principal gain or loss. Intermediate-term, higher quality bonds generally offer less risk than longer-term bonds and a lower rate of return. Generally, a Portfolio's fixed income securities will decrease in value if interest rates rise and vice versa. Although a Portfolio's yield may be higher than that of fixed income strategies that purchase higher rated securities, the potentially higher yield is a function of the greater risk of that strategy's underlying securities.

This information and general market-related projections are based on information available at the time, are subject to change without notice, are for informational purposes only, are not intended as individual or specific advice, may not represent the opinions of the entire firm, and may not be relied upon for individual investing purposes. Information provided is general and educational in nature, provided as general guidance on the subject covered, and is not intended to be authoritative. All information contained herein is believed to be correct, but accuracy cannot be guaranteed. This information may coincide or conflict with activities of the portfolio managers. It is not intended to be, and should not be construed as investment, legal, estate planning, or tax advice. Seix Investment Advisors does not provide legal, estate planning or tax advice.

Investors are advised to consult with their investment professional about their specific financial needs and goals before making any investment decisions.

**HOLDINGS DISCLOSURE** The information provided in this report should not be considered a recommendation to purchase or sell any particular security. There is no assurance that any securities discussed herein will remain in an account's portfolio at the time you receive this report or that securities sold have not been repurchased. The securities discussed do not represent an account's entire portfolio and in the aggregate may represent only a small percentage of an account's portfolio holdings. It should not be assumed that any of the securities transactions or holdings discussed were or will prove to be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein.