SEIX INVESTMENT ADVISORS LLC®
A VIRTUS INVESTMENT PARTNER

Dovish Fed, Rosier Forecasts, and Bullish Yield Chasers

> Rising rates and growing demand for higher yields spurred increased investment in leveraged loans in the first quarter. The JP Morgan Leveraged Loan Index returned 1.88% with Split B/CCC loans up 6.66%, outperforming B loans (+1.60%) and BB loans (+0.83%). Performance was led by the metals & mining and energy sectors, while laggards included the broadcasting, utilities, and cable/satellite sectors.

> In the high yield market, the three key dynamics were the COVID-19 vaccine rollout, the Treasury sell-off, and a record increase in supply. The ICE BofA U.S. High Yield Index had a 0.9% return.

> Amid rising inflationary expectations, Morningstar data on 100 different asset classes and strategies over the 20 years ended December 31, 2020, showed that bank loans and high yield bonds ranked first and fifth, respectively, in their correlations with inflation, which implies they may potentially offer a hedge to rising inflation.

LEVERAGED LOANS

Floating Up With Improving Fundamentals

As rates and inflationary expectations rose, investors in search of higher yields returned to the leveraged loan market in the first quarter. That allowed us to explore a number of new relative value opportunities. We also held on to the names we felt had the liquidity to ride through the pandemic lockdown, and we're starting to see that benefit now.

The most significant rebounds were in metals & mining, energy, transportation, and restaurants. In the energy sector, one case study in resilience was a midstream master limited partnership (MLP) that capitalized on accelerating oil demand growth and was able to buy back 15% of the float (as well as its private equity partner) and increase earnings guidance. The MLP was also able to pay off its term loan, thereby improving its consolidated capital structure.

From a positioning perspective, tech and health care continue to be the two largest sectors that we've been adding to, in addition to services and aerospace.

LIBOR floors, which mitigate the risk of falling interest rates, were almost half the portfolio, and the average floor size was 79 basis points (bps), providing some incremental yield in the current low rate environment we're in.

Performance Led by Metals & Mining and Energy

For 1Q, the JP Morgan Leveraged Loan Index returned 1.88% with Split B/CCC loans up 6.66%, outperforming B loans (+1.60%) and BB loans (+0.83%). For the quarter, notable contributors by industry were metals & mining (+5.41%), energy (+3.86%), and gaming & leisure (+3.75%), while laggards were broadcasting (-0.92%), utilities (-0.10%), and cable/satellite (+0.61%).

As of 3/31/21, the yield to 3-year takeout was 4.89%, down 21 bps for the quarter. The price on the JP Morgan Leveraged Loan Index was approximately $98.07, up from $97.11 at 12/31/20.

Issuance Led by Refinancing/Repricing

Gross issuance totaled $301.4 billion, or $73.1 billion net of refinancing/repricing, which was up 52% and 56% year-over-year, respectively. Loan issuance in 1Q was the second most on record behind 1Q17's $331.0 billion.

Refinancing/Repricing accounted for 76% of issuance; M&A was 18%; Dividends were 5%, and General Corp/Other was 1.0%.

Middle-tier volume totaled $245.0 billion (81%), upper tier volume totaled $52.1 billion (17%) and lower-tier volume totaled $4.3 billion (1%).

Demand

Inflows for loan funds totaled $11.1 billion ($3.2 billion ETF), which compared to outflows of $16.0 billion over the first three months of 2020. March's inflows totaled $2.7 billion ($400 million ETF and $2.3 billion actively managed), following February and January's inflows of $4.2 billion each month.

Collateralized Loan Obligations (CLOs)

In 1Q, 235 U.S. CLOs priced, totaling $106.4 billion ($38.1 billion ex-refinancing/resetting) as compared with 87 U.S. CLOs totaling $41.8 billion for the same time period last year. Notably, 1Q21's CLO volume ex-refi/resets was slightly below the quarterly high of $38.3 billion in 2Q14.

Default Rates

The loan par-weighted default rate ended March at an 11-month low of 3.34%, down 32 bps month over month, down 61 bps year to date, and up 144 bps from 1.90% in March of last year. Including distressed exchanges, the loan default rate ended the month at 3.66% (ex-Energy, 2.98%), down 33 bps month over month, down 61 bps year to date, and up 142 bps year over year.

Takeaway

Retail inflows gained traction. CLO formation provided continued support. 1Q index pricing increased nicely contributing to performance. In a lower interest rate environment and with the Fed indicating continued accommodation, LIBOR levels remained low with 3/31/21 three-month LIBOR at 0.19% compared to 1.91% at year-end 2019 and 0.24% and year-end 2020.

Outlook

We expect leveraged loans to benefit from strong economic growth coupled with higher inflation. With economic growth expected at roughly 6% this year and capital markets open for almost all issuers, companies should be able to continue to grow into their balance sheets. Thus, defaults are expected to trend lower, most likely ending the year below 3%. Near-term, we expect inflation to overshoot 2% as we lap two deflationary months (March and April 2020), and inflation could approach or even exceed 2.5%. Longer-term, it is unclear if inflation will be sustained over 2%, as commodities can cool off and the direction of rental prices is uncertain.

We expect new CLO issuance will be up meaningfully this year. CLO demand should continue to be a significant factor, especially if a large Japanese bank that was the largest buyer in the space returns to the market. A recent Bloomberg article reported that the bank has started to look at deals again.

We will continue to dabble in the secondary market where we see good potential opportunities. Lately we've been buying some low coupon loans at prices (and ratings) that appeared to offer some upside potential.

HIGH YIELD

Three Key Dynamics: the Vaccine Rollout, the Treasury Sell-off, and a Record Increase in Supply

What a difference a year makes. On March 23, 2020, the effective yield on the ICE BofA U.S. High Yield Index was nearly 11.4%. By April 6, 2021, the effective yield had dropped to 4.25%. A year ago, market participants were calculating the impact of the worst economic downturn since World War II and now are worried about the economy running hot and the resultant inflationary pressures.

Companies once under intense pressure during the pandemic lockdown were able to raise billions as investors spooked by inflationary expectations dumped Treasuries en masse and reached for yield amid rosier economic forecasts. As a result, the yield on a major cruise operator's $4 billion in bonds issued a year ago dropped from 11.5% to below 4% in early April 2021 as the bonds jumped in value.

The overall ICE BofA U.S. High Yield Index (H0A0) gained 0.9% in 1Q21, and the ICE BofA U.S. High Yield Index Constrained Index (HUC4) return was 0.3%. CCCs led the pack, advancing about 5.21% (H0A3) as vaccinations increased, businesses re-opened, and the default rate fell 129 bps to 5.37%, according to JPMorgan. We're forecasting a 2% default rate for the year. Single-B'S (H0A2) were up about 1.18% and the BBs (H0A1) return was -0.21%

Viewing high yield through the prism of ratings and how they performed on a spread basis told quite a story. After all, the first quarter started out with a 1.10% yield on the 10-year Treasury. It ended the quarter around 1.74% for an increase of 64 bps. The ICE BofA U.S. High Yield Index started the quarter with a spread of 383 bps and tightened to 329 bps. The BB index (H0A1) started the quarter at a spread of 276 bps and ended at 238. The spread on the single-B index (H0A2) started the quarter at 407 bps and ended March at 359 bps. CCCs (H0A3) started the quarter at 803 bps and tightened to 642 bps.

Sector Breakdown

Sectors one would expect to underperform after a Treasury sell-off did just that. Case in point: high quality Treasury sensitive names in cable and technology, mainly due to rates and supply. Outperforming sectors included energy (thanks to significantly higher oil prices) as well as cyclical sectors as more parts of the economy reopened and expectations for the economy improved.

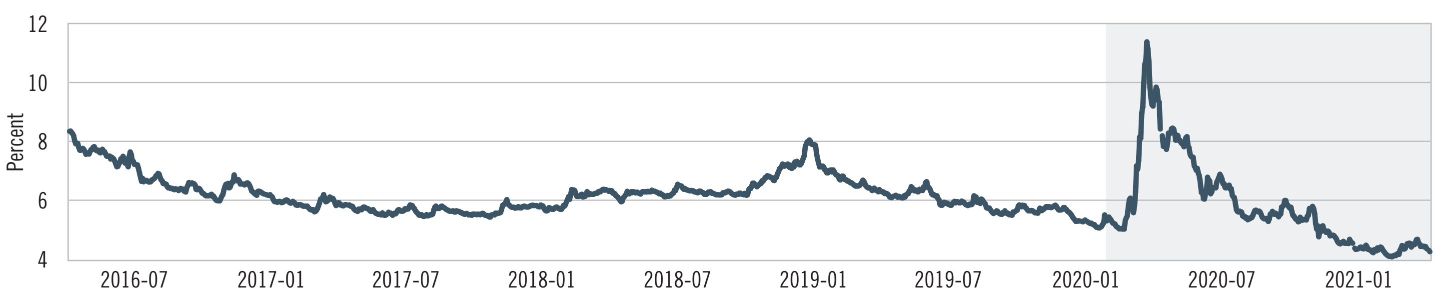
Supply Breaks Record

High yield supply for the quarter was $158.6 billion (on a gross basis)—a record high. Meantime, ETF outflows totaled $4 billion for the quarter, which essentially weighed on generic, good quality, high yield issues that are Treasury sensitive.

Strategy

One notable theme in the portfolio during the quarter was selling out of negatively convex bonds; i.e. full value bonds with not much upside, but vulnerable if rates continue to rise. The proceeds were used to buy good quality issues at a discount with attractive yields that had gotten beaten up due to supply and ETF outflows.

BIG SLIDE: ICE BOFA U.S. HIGH YIELD INDEX EFFECTIVE YIELD



U.S. recessions are shaded; the most recent end date is undecided. Source: Ice Data Indices, LLC.

continued

We were very cognizant of duration as we did this. We are entering a period where year-over-year economic numbers and inflation should be higher, which could bring pressure on rates. If so, we will look to take advantage of any dislocation in the market at that time.

At the current time, we are more comfortable with credit risk than rate risk. Having said that, we do not believe that rates (as measured by the yield on the 10-year Treasury) move materially higher from here and believe we have likely experienced at least half of the rate move from the lows for the time being. Our view is that the conditions that have contributed to low rates and subdued inflationary pressures since the global financial crisis continue to exist and may have been exacerbated by the pandemic. Nevertheless, we build the portfolio from the bottom up on a security-by-security basis and will go to where value exists in the market.

Outlook

High yield bonds continue to offer lower duration risk and a low correlation to investment grade bonds. They also offer enhanced diversification, relatively attractive yields, and lower volatility than equities.

As the second quarter gets underway we're looking to take advantage of dislocation. We feel like we're in a good spot in terms of convexity and duration, and we're hoping for a little bit of a rate sell-off so we can lock in good quality names with the potential to compensate for the negative technicals of Treasury widening, continued supply, and potential outflows.

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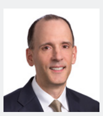
Leveraged Loans



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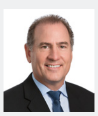

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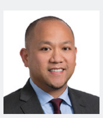

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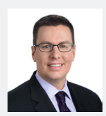
High Yield



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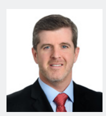

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Seix Investment Advisors is an investment management boutique focused exclusively on managing fixed income securities since 1992. Seix seeks to generate competitive absolute and relative risk-adjusted returns over the full market cycle through a bottom-up 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.

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.