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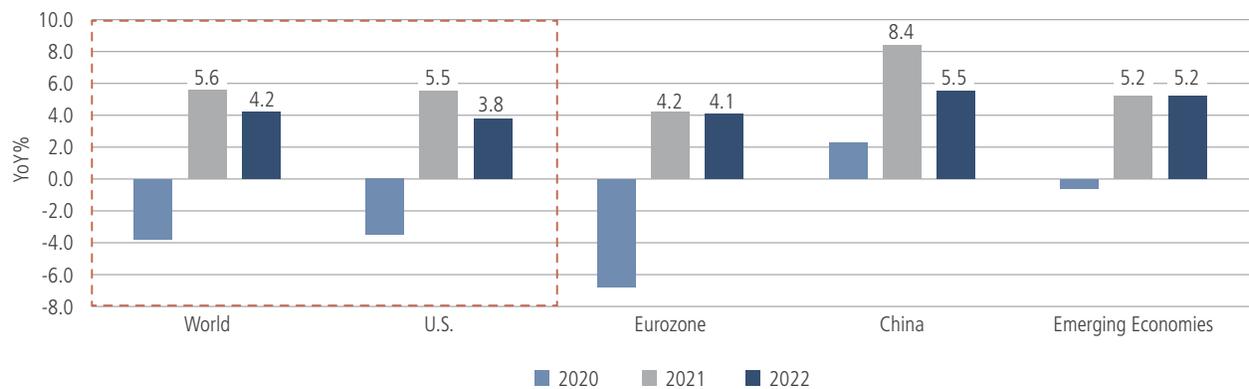
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Senior Floating Rate Loans: Opportunity as Rates Rise

Where to find yield without duration when inflation expectations and nominal long rates are on the rise.

Inflation expectations have been moving up as the outlook for economic growth continues to improve. Forecasts for real GDP growth have continued to rise in anticipation of reopenings, massive stimulus and better-than-expected employment trends. As a result, nominal longer-dated Treasury yields have spiked from historically low levels, with the 10-Year U.S. Treasury yield rising 81 basis points from 0.93% as of December 31, 2020, to the recent peak of 1.74% (as of March 19) and 122 basis points from the low of 0.52% reached last year on August 4, 2020.

BLOOMBERG AGGREGATED AVERAGE REAL GDP GROWTH FORECASTS



Source: Bloomberg. Data as of March 19, 2021. **Historical trends do not imply, forecast or guarantee future results.** Information is as of the date indicated and subject to change without notice. Nothing herein constitutes a prediction or projection of future events or future market behavior.

With about 60% of the global bond market yielding less than 1%, central banks anchoring policy rates lower for longer to address pandemic-induced unemployment, and an economic recovery that is shaping up to be much faster and stronger than expected, investors are facing some new and some not-so-new challenges. A newer challenge is how to think about elevated duration risk coming off historically low yield levels in the context of central banks anchoring short rates and being more tolerant of higher inflation and lower unemployment.

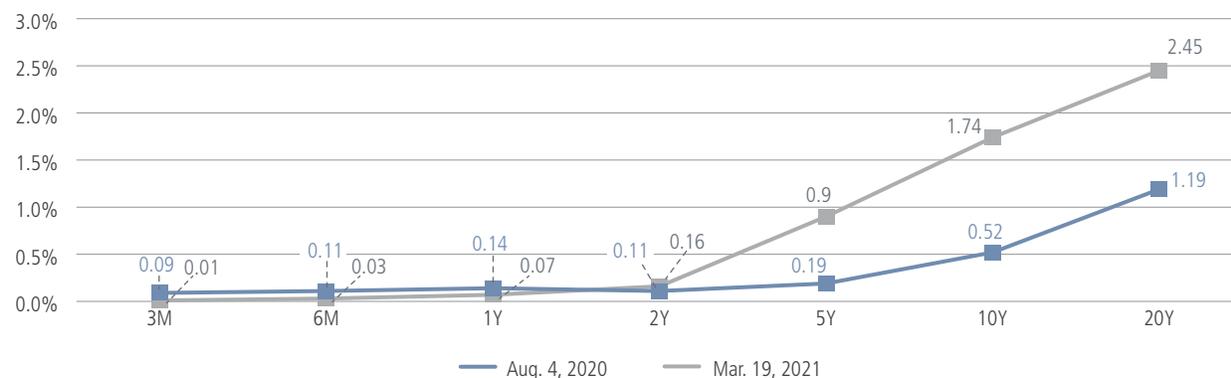
What should investors factor in about the current environment and outlook when considering their fixed income allocations as inflation expectations rise, the yield curve steepens, and many lower-yielding fixed income sectors have significant duration risk?

Powerful Forces for Growth, Inflation. In this cycle, unleashed pent-up demand from a high personal savings rate, positive wealth effects and another round of fiscal stimulus, in our view, could propel real economic growth rates to levels we have not seen since the mid-1980s.

- The expansion phase is starting from a lower GDP base due to the severely negative hit to the services sector as a result of the pandemic.
- U.S. real GDP growth forecasts from top economists are now in the 7.0% – 9.0% range for 2021, while trend or potential GDP growth is around 2.0% – 2.5%. Above-trend growth for an extended period tends to fuel inflation.
- Supply chain effects or demand/supply imbalances globally could also spur temporary bursts of inflation in some sectors.

A Steepening Yield Curve. The short end of the yield curve could remain anchored at lower levels for longer based on the new central bank framework, but investor expectations for future real GDP growth and inflation could continue to have a material impact on the shape of the curve, which has already steepened materially in the five-year-plus tenors since last summer, when we saw the low in the 10-year Treasury yield.

YIELD CURVE COMPARISON: RECENT PEAK IN 10-YEAR AND TRAILING 12-MONTH LOW IN 10-YEAR TREASURY



Source: U.S. Treasury. **Historical trends do not imply, forecast or guarantee future results.** Information is as of the date indicated and subject to change without notice. Nothing herein constitutes a prediction or projection of future events or future market behavior.

- A steepening curve is a historical norm at the end of a recession/beginning of an expansion, but this recovery is far from normal and, in our view, is likely to have much higher growth than is typical.
- Investors know that a steepening yield curve negatively impacts the returns of long-duration fixed income, but this time the impact could be more dramatic given the very low starting yields at the onset of this expansion.

Why Senior Floating Rate Loans and Why Now?

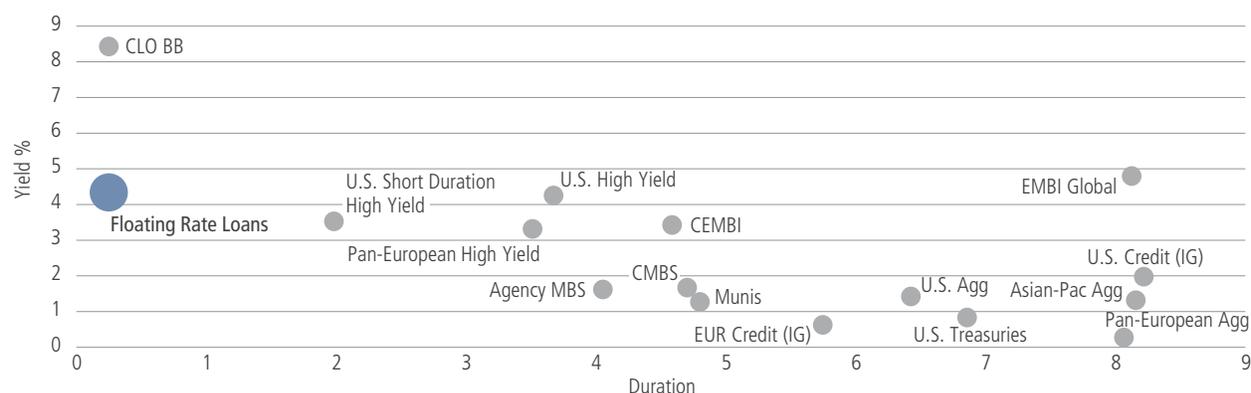
Given these factors, where can investors find durable income with lower duration and lower volatility in fixed income? We believe senior floating rate loans offers an appealing solution, where suitable. Key characteristics include:

- Attractive yield with very low duration, providing a cost-effective, inflation-hedged fixed income solution, which is critical in the current environment.
- Senior secured position in the capital structure with favorable return of capital to investors, durable income generation and lower volatility than other higher-yielding fixed income.
- Supportive supply/demand factors and improving issuer fundamentals.

Focus on Yield Without Duration Is Key in This Environment

Senior floating rate loans currently offer the most attractive yield relative to duration among fixed income alternatives.

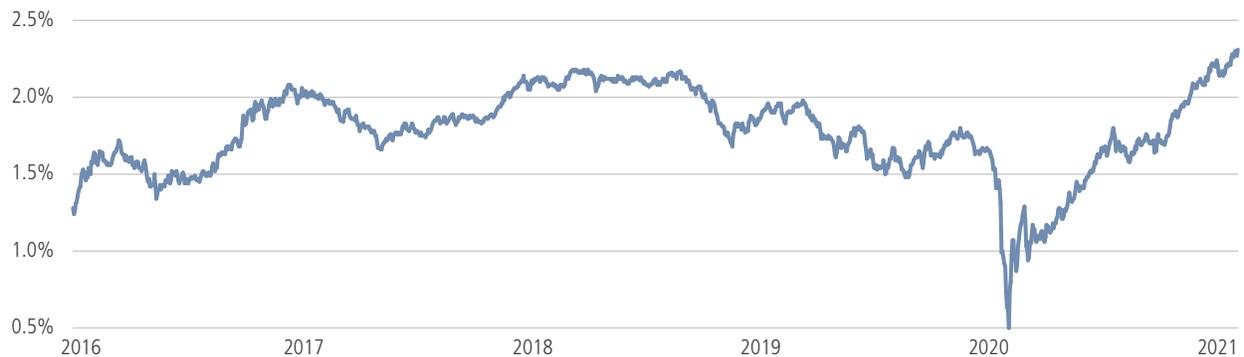
YIELDS AND WEIGHTED-AVERAGE DURATION: MAJOR FIXED INCOME INDICES



Source: Bloomberg. Data as of February 28, 2021. Indices used were Bloomberg Barclays Global Aggregate Index for Global Agg, Bloomberg Barclays U.S. Aggregate Bond Index for U.S. Agg, Bloomberg Barclays Pan-European Aggregate Index for Pan-European Agg, Bloomberg Barclays Asian-Pac Aggregate Index for Asian-Pac Agg, Bloomberg Barclays Global Treasuries Aggregate Index for Global Treasuries, Bloomberg Barclays U.S. Treasuries Aggregate Bond Index for US Treasuries, JPM CLOIE BB Index for CLO BB, Bloomberg Barclays U.S. Credit Index for U.S. Credit (IG), Bloomberg Barclays EUR Credit IG Aggregate Bond Index for EUR Credit (IG), Bloomberg Barclays U.S. High Yield Aggregate Index for U.S. High Yield, Bloomberg Barclays U.S. High Yield Ba/B 1-5 Years Index for U.S. Short Duration High Yield, Bloomberg Barclays Pan-European High Yield Aggregate Index for Pan-European High Yield, JPM EMBI Global Diversified Index for EMBI Global, JPM CEMBI Diversified Index for CEMBI, Bloomberg Barclays Muni's Aggregate Index for Muni's, Bloomberg Barclays CMBS Aggregate Index for CMBS, Bloomberg Barclays Agency MBS Aggregate Bond Index for Agency MBS, and S&P LSTA Leveraged Loan Index for Floating Rate Loans. The CLO BB duration has been overwritten with the duration from the S&P Leveraged Loan Index as calculated by Aladdin. **Historical trends do not imply, forecast or guarantee future results.** Nothing herein constitutes a prediction or projection of future events or future market behavior. For illustrative and discussion purposes only.

The yield curve is steepening as a result of shifting investor expectations about growth and inflation even though policy rates are anchored near zero in the intermediate term. The floating rate nature of senior loans provides a low-cost hedge against rising inflation expectations, which markets have been anticipating as shown by inflation breakevens in the chart below.

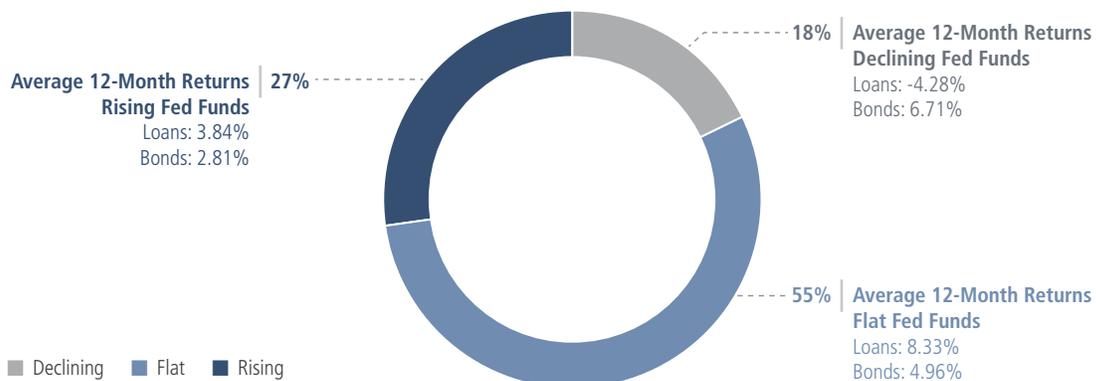
INFLATION EXPECTATIONS: 10-YEAR BREAKEVEN INFLATION RATE



Source: St. Louis Federal Reserve. Data through March 19, 2021. The breakeven inflation rate represents a measure of expected inflation derived from 10-Year Treasury Constant Maturity Securities and 10-Year Treasury Inflation-Indexed Constant Maturity Securities. The latest value implies what market participants expect inflation to be in the next 10 years, on average. **Historical trends do not imply, forecast or guarantee future results.** Information is as of the date indicated and subject to change without notice. Nothing herein constitutes a prediction or projection of future events or future market behavior.

Senior floating rate loans have typically been viewed as a solution in periods when the Federal Reserve is increasing policy rates, but it's not widely known that the asset class has also seen good historical returns in flat policy-rate environments. In fact, the S&P Leveraged Loans Index historically has outperformed the broader bond market—measured by the Bloomberg Barclays U.S. Aggregate Bond Index—in both flat and rising policy rate environments.

U.S. LOANS AND AGGREGATE BOND INDEX AVERAGE 12-MONTH RETURNS IN RISING, FLAT AND DECLINING RATE ENVIRONMENTS



Source: Bloomberg. As of February 28, 2021. Monthly observations from January 1999 to February 2021 based on 266 observations; The percentages of the pie chart are the percentage of time that the policy rate regime has been in place over the total period. Indexes used include the S&P Leveraged Loan Index for loans and Barclays U.S. Aggregate Bond Index for bonds. Based on historical average 12-month returns in three different interest rate environments as defined by the effective federal funds rate and FOMC policy regimes. **Past performance is no guarantee of future results.**

It is also worth noting that a steeper yield curve has historically been a positive indicator of future economic growth. Based on historical trends—with the fed funds rate at roughly zero—10-year Treasury bond yields could approach a range of 2.5% to 3.5% at some point in this expansion, especially given the stimulus in the pipeline and the reopening of the services economy as more of the population gets vaccinated. In the event of another 75- to 180-basis-point increase in Treasury yields, we believe allocation to senior floating rate loans would be prudent, where suitable.

YIELD CURVE: 10-YEAR MINUS 3-MONTH TREASURY



Source: St. Louis Fed, U.S. Treasury. Data through March 19, 2021. **Historical trends do not imply, forecast or guarantee future results.** Information is as of the date indicated and subject to change without notice. Nothing herein constitutes a prediction or projection of future events or future market behavior.

In prior periods back to 1998 where the 10-Year U.S. Treasury yield rose by 100 basis points or more, the S&P Leveraged Loan Index has outperformed the Barclays U.S. Aggregate Bond Index *nine out of nine times*.

S&P LEVERAGED LOAN INDEX RETURNS VS. BLOOMBERG BARCLAYS U.S. AGGREGATE BOND INDEX

Periods when 10-year U.S. Treasury yields have risen by 100 basis points or more (Oct. 1998 – Feb. 2021)

Period	Change in 10Y	Average Monthly Returns ¹		
		S&P LLI	BB U.S. Agg	Difference
Oct. 1998 – Jan. 2000	2.13	0.33%	-0.05%	0.38%
Jun. 2003 – Jun. 2004	1.40	0.62%	0.02%	0.59%
Aug. 2005 – Jun. 2006	1.11	0.51%	-0.02%	0.52%
Dec. 2008 – Apr. 2010	1.43	2.70%	0.73%	1.97%
Oct. 2010 – Feb. 2011	1.04	1.12%	-0.19%	1.31%
Aug. 2012 – Dec. 2013	1.22	0.56%	-0.01%	0.57%
Jun. 2016 – Dec. 2016	1.12	0.76%	-0.10%	0.86%
Jun. 2017 – Oct. 2018	1.00	0.36%	-0.07%	0.43%
Aug. 2020 – Feb. 2021	1.02	1.10%	-0.34%	1.44%
AVERAGE	1.27	0.89%	0.00%	0.90%

Source: Bloomberg. Monthly observations from January 1992 to February 2021. Indexes used include the S&P Leveraged Loan Index and Barclays U.S. Aggregate Bond Index.

¹ Not annualized returns; average of monthly returns over the period. **Historical trends do not imply, forecast or guarantee future results.** Information is as of the date indicated and subject to change without notice. Nothing herein constitutes a prediction or projection of future events or future market behavior.

Loans Are Senior-Secured and Provide Durable Income Generation

The senior-secured position of a loan in the capital structure helps to reduce credit risk. Loan investors have priority for repayments—in the event of a default—before stock or bond holders, and loans hold a first-priority lien on the assets of the borrower.

Over the past 32 years, the average recovery rate on loans that default has been roughly 65% – 70%, meaning that credit losses amount to 30% – 35% of the 3.1% average annual default rate, or about 1%.¹ This implies that about 99% of principal has been returned to investors over a period that has included a number of recessions, which means that almost all the annual income that is generated from a portfolio of loans has been retained by investors.

¹ Source: JP Morgan, data through 2020.

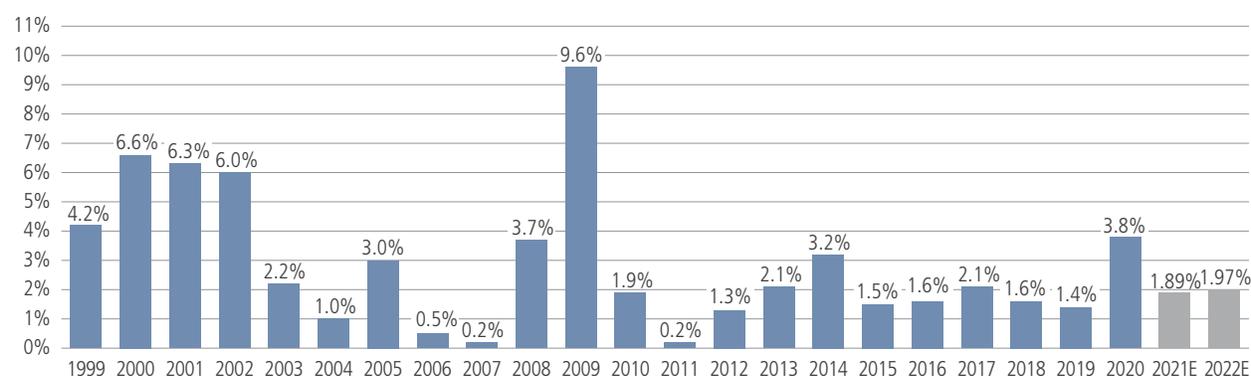
The income component of total return has historically aided in providing stability to overall returns as the significant and regular distributions have helped dampen any potential mark-to-market volatility on underlying loan prices.

Technical Tailwinds and Improving Issuer Fundamentals Favor Loans

Retail investor and CLO demand for loans has been very strong so far this year. Over the seven-week period ending February 28, 2021, inflows into floating rate loan funds amounted to 13% of assets under management, the most as a share of total AUM since December 2016. Furthermore, CLO volume, which is about 70% of demand for loans totaling \$15.8 billion (excluding refinancings/resets) in February alone, exceeded the April 2019 record of \$15.7 billion.²

Improving issuer fundamentals—such as declining default rate forecasts, recovering EBITDA and ample liquidity on balance sheets—are also a factor bringing investors to consider allocations to senior floating rate loans.

S&P LEVERAGED LOAN INDEX PAR-WEIGHTED ANNUAL DEFAULT RATES



Source: Neuberger Berman, S&P Global. Data as of February 28, 2021. Data represented by S&P/LSTA Leveraged Loan Index. Information is as of the date indicated and subject to change without notice. **Historical trends do not imply, forecast or guarantee future results.** Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed.

- Defaults have been trending downward, and there is generally much better visibility into troubled credits given that issuers have been stress-tested in a pandemic-induced recession.
- January was the third consecutive month without a default in the loan market, and February only saw two defaults in the secularly challenged Retail and Textiles & Apparel sectors.
- The bottom-up default estimate for 2021 from our research team stands at just under 2%, and recently JP Morgan revised its 2021 and 2020 default projections to 2.0% for each year from 3.5% previously.
- Loan issuers overall cut costs aggressively in 2Q20 and 3Q20, saw better-than-expected operating results, raised significant liquidity via refinancings and lowered borrowing costs. Issuers in the loan market are generally well positioned to benefit as nominal topline growth accelerates in the coming quarters. That said, loans are an asset class that requires active management for successful investment outcomes, as credit selection and avoiding credit deterioration have been key drivers of returns over time.

Positioning for Higher Inflation

Given that duration weighs heavy on longer-dated fixed income and that the repricing of inflation expectations will likely continue to push longer-term bond yields higher, we believe positioning in fixed income will become increasingly important. Senior floating rate loans are an attractive option to consider for investors when looking for total return opportunities *without* duration risk.

² Source: JP Morgan.

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