RPIA

Credit Market Themes in 5 Charts

Q2 2023

Financial Stability Fears Recede as Economies Prove More Resilient

Financial Stability Fears Recede as Economies Prove More Resilient

Financials Q2 brought us a banking crisis and the now-resolved US debt ceiling issue, which heightened fears of financial market instability and concerns about the resilience of global markets. This gave rise to volatility in credit markets, but also presented opportunities for security selection as bonds repriced.

However, the economy remains resilient and central bank projections of a higher-for-longer interest rate environment led to a notable increase in risk-free yields during the quarter. Consequently, we believe the all-in yields offered by high-quality corporate bonds are very attractive. As we enter the third quarter of 2023, we continue to see a market ripe with relative value opportunities as well as higher yields waiting to be captured.

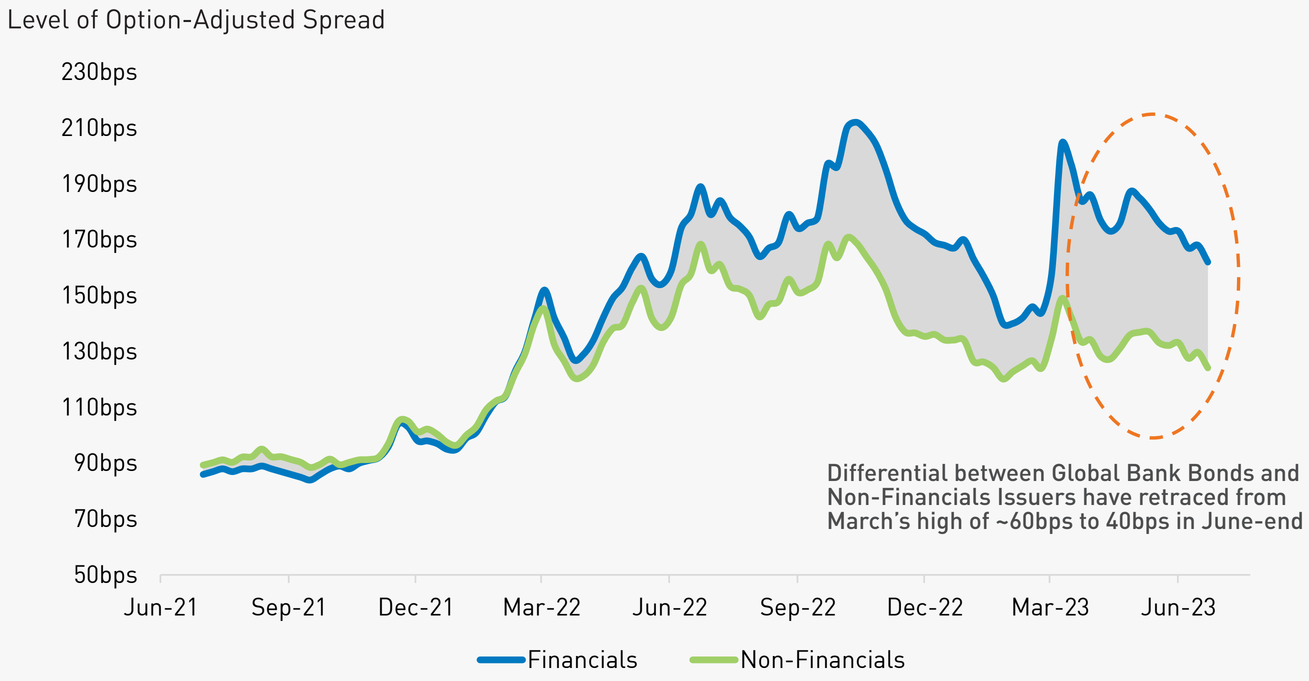
Over the course of the last three months, our team has compiled some of the most pertinent themes we are seeing and acting on. We believe these five themes set the stage for the market environment in the second half of the year.

Please feel free to contact us if you would like to discuss further or learn how we can help you meet your investment objectives.

1 Corporate Bonds Issued by Banks are Still Trading at a Discount to Those Issued by Non-Financial Corporations

Credit spreads have narrowed following the banking crisis in March and the resolution of the US debt ceiling in June. Particularly, we have seen bonds issued by banks rebound faster than those issued by non-financial borrowers. However, bank bonds are currently trading at 40bps wider than non-financial bonds, much higher than what the differential was two years ago. This leads us to believe there are more opportunities to be explored in the Financials sector due to attractive absolute and relative valuations.

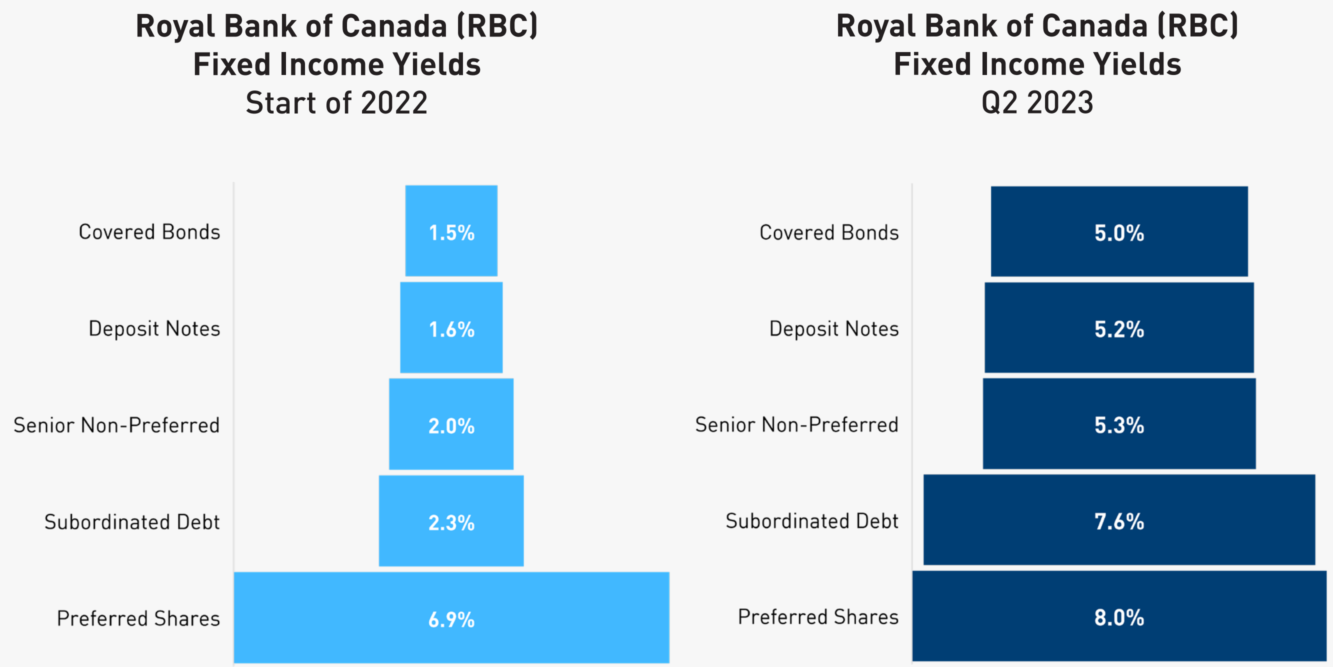
Average Credit Spread of Global Bank Bonds vs. Non-Financial Bonds - Past 2 Years



Source: BarclaysLive. Data as of June 30th, 2023. Indices Used: Bank Bonds = Bloomberg Barclays Global Corporate Bond Index - Financials; Non-Financials = Bloomberg Barclays Global Corporate Bond Index - Industrials and Utilities.

2 It is Possible to Capture Yield Without Investing Lower Down in Bank Capital Structures

18 months ago, bond investors could triple their yield by investing in preferred shares compared to senior debt. Today, the incremental yield captured by investing in the subordinated areas of a bank's capital stack is much more modest. Given current valuations, we believe there is better relative value higher up in bank capital structures, allowing us to capture strong yield for our investors from high-quality investment grade bonds.

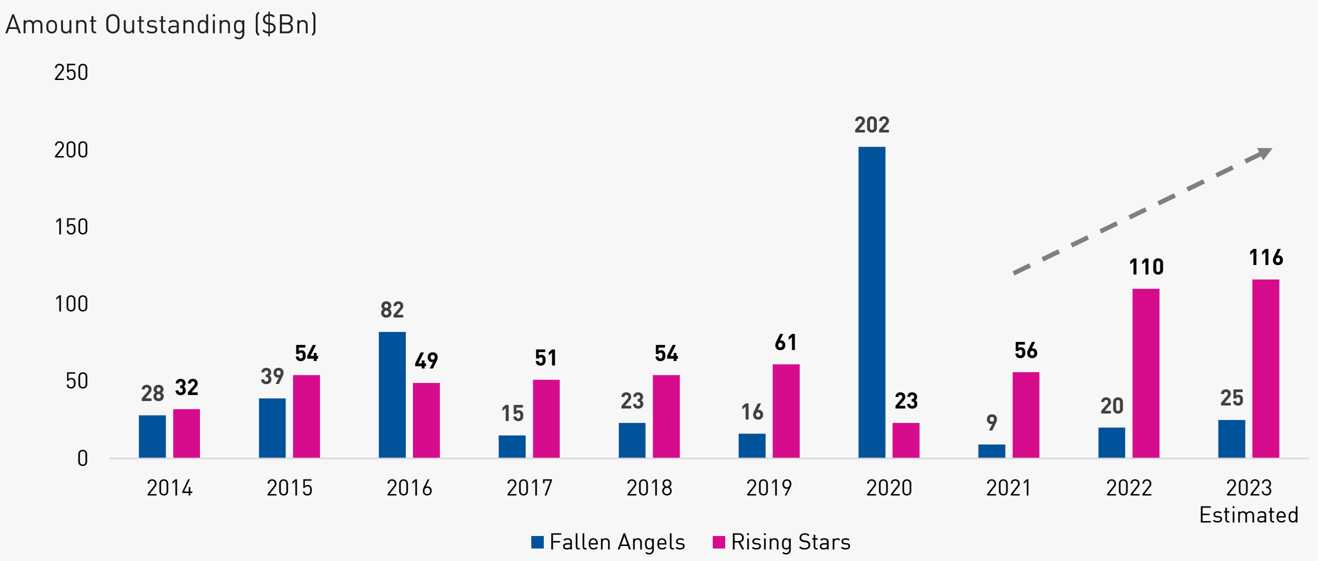


Source: Bloomberg. Data as of June 30th, 2023. Bonds used: Covered Bonds = RY 1.05 09/14/2026; Deposit Notes = RY 4.93 07/16/2025; Senior Non-Preferred = RY 1.589 05/04/2026; Subordinated Debt = RY 4.65 01/27/2026 Corp; Preferred Shares = RY 4 1/2 11/24/2080.

3 The Number of "Rising Stars" Continues to Exceed the Number of "Fallen Angels"

The number of Rising Stars (high yield issuers getting upgraded to investment grade) has been on an upward trajectory over the past 3 years. Over the same time period, the number of Fallen Angels (issuers moving in the opposite direction) has been fairly steady. As a result, the supply-demand imbalance has been exacerbated by the reduced new issue supply of high yield bonds. In response to this, we have rotated some of our exposure to BB-rated bonds (the highest quality high yield bonds) to BBB-rated bonds (the lowest quality investment grade bonds) to capture the opportunity presented by this trend.

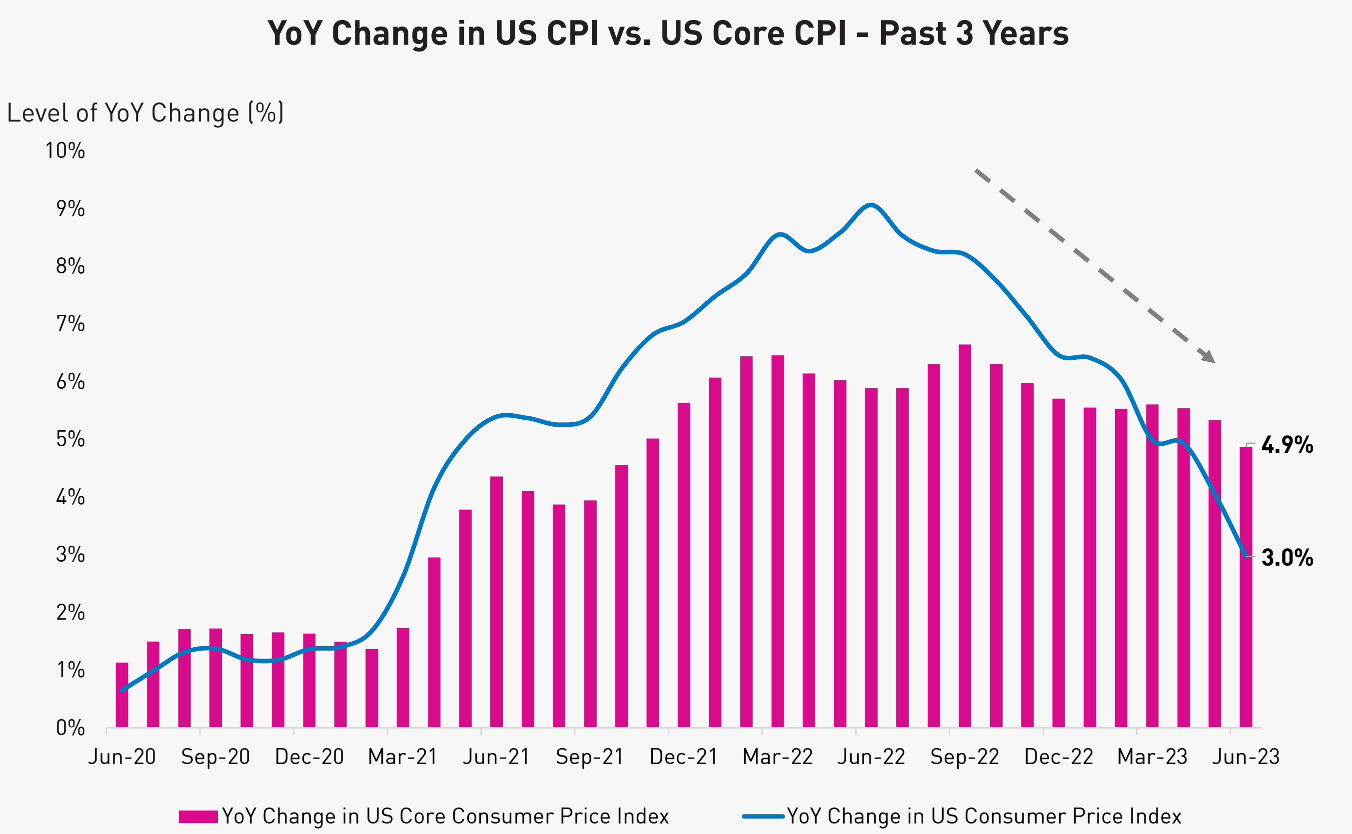
Amount of Fallen Angels vs. Rising Stars in US High Yield - Past 10 Years



2023 amount estimated by multiplying the current amount of Fallen Angels and Rising Stars by 2x.
Source: BarclaysLive. Data as of June 30th, 2023.

4 US Inflation is Cooling and as Rates Start to Fall in the Coming Quarters, Investors Will Need to Redeploy Their Cash

Both the Consumer Price Index (CPI) and Core CPI (which excludes energy and food prices) continue to drop, with Core CPI demonstrating more resilience. As this downward trend continues, the lower the need for further rate hikes from the Fed, meaning there will come a time when the job is done and the Fed will start lowering rates. At that time, investors will want to rotate out of cash to other investments in search of yield. As an active credit manager, we believe we have the toolkit necessary to add value for clients irrespective of the level of interest rates.

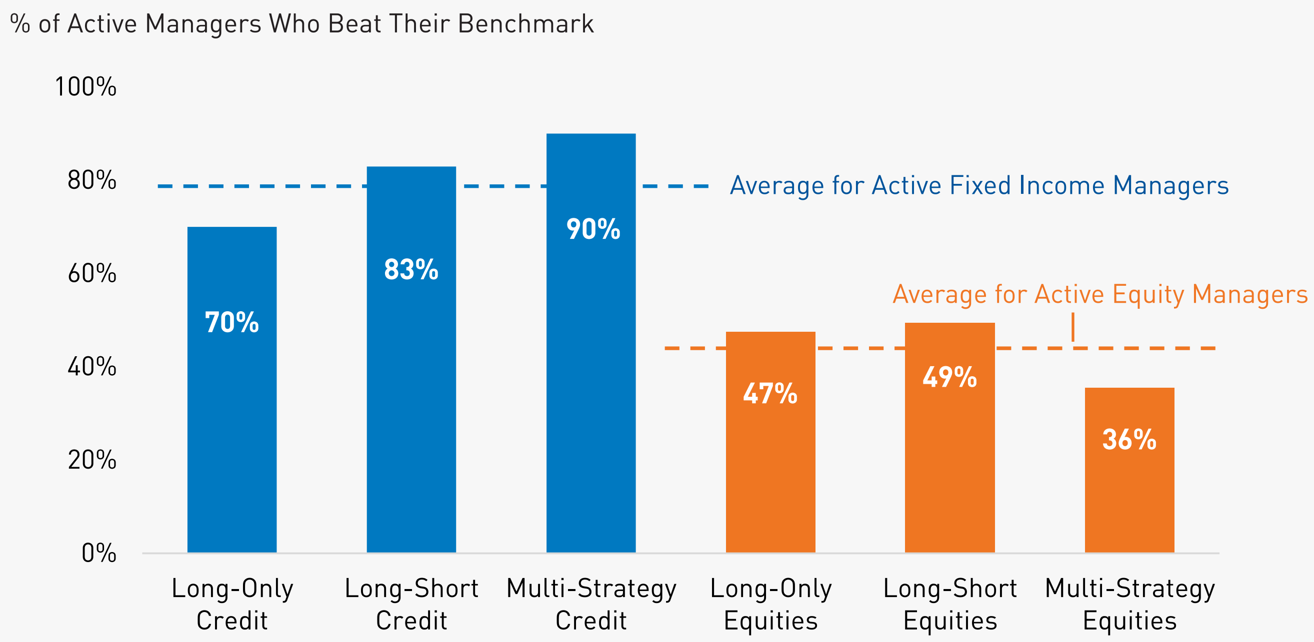


Source: Ycharts. Data as of June 30th, 2023.

5 Active Fixed Income Managers Continue to Consistently Beat the Benchmark, Highlighting the Inefficiencies of the Asset Class

Over the past 5-year period, over 80% of active fixed-income managers globally have beaten their benchmark, while less than half of equity managers have been able to do so. We believe a key reason for this relates to the structural inefficiencies of the bond market. These inefficiencies do not exist in the equity market, which is by nature, much more transparent. Active fixed income managers can deliver alpha for investors through tactical security selection and active management. Given the level of yields and opportunities in the market, we believe now is an attractive time for investors to increase their fixed income exposure.

Percentage of Active Managers Who Beat Their Benchmark (5-Yr) - Fixed Income vs. Equities



Source: eVestment. Data as of May 31st, 2023.
Benchmark: Fixed Income = Bloomberg Barclays Global Aggregate Corporate Bond Index; Equities = MSCI World Index.

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