RPIA | 15 YEAR ANNIVERSARY

Credit Market Themes in 5 Charts

Q1 2024

Will 2024 finally be the *Year of the Bond*?

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While most bond indices and funds posted modest positive returns during Q1, fixed income markets were volatile as investors continued to assess the likely path of central bank policy. Currently, markets have priced in 3-4 rate cuts in the U.S. and Canada for 2024. However, there continues to be a wide spectrum of opinions – ranging from "no cuts at all" to 5+ cuts. Taken together, yields increased modestly in Q1, although this was partially offset by credit spreads tightening. The market continues to be ripe for active management with plenty of pricing dislocations and relative value opportunities around new issuance.

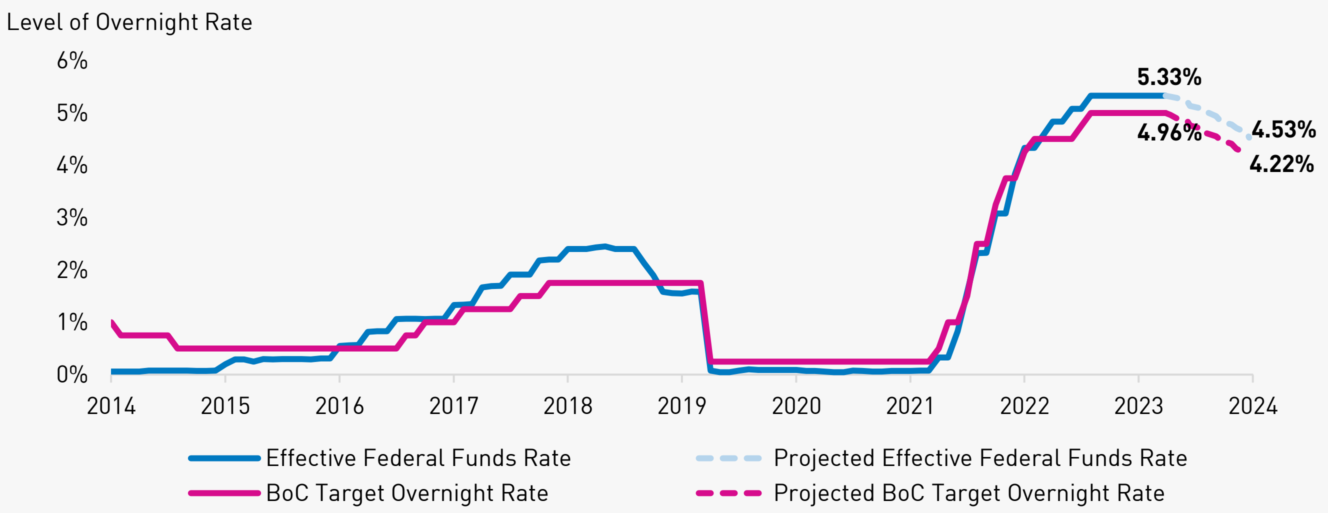
We believe volatility will continue into the second quarter of this year, but in spite of this, we are very constructive on the bond market. Bond yields still look very attractive by historical standards, both on an absolute basis and relative to other assets classes, and we continue to see opportunities to add significant value from security selection. Of specific note, we believe there are inconsistencies today in the valuations of private credit assets compared to public credit, and believe that investors should be looking to public markets at this time for better mark-to-market risk-adjusted returns.

We have compiled the following five charts, which we think highlight some of the themes and opportunities we see in the current market environment as we head into Q2. Please feel free to contact us if you would like to discuss these themes further or learn more about how we could help you meet your investment objectives.

1 U.S. and Canadian Markets are Pricing in 3 Cuts for 2024, With the Terminal Rate in the 3-3.5% Range

At the start of the year, market consensus was for 5-6 interest rate cuts in 2024 given the inflation trends at that point. The economic data ended up being more ambiguous, and as a result, expectations have moderated. North American bond markets are currently pricing in around three cuts for the remainder of the year with the likelihood of further cuts beyond 2024. That said, we believe the path may continue to be bumpy on the road to a lower rate environment.

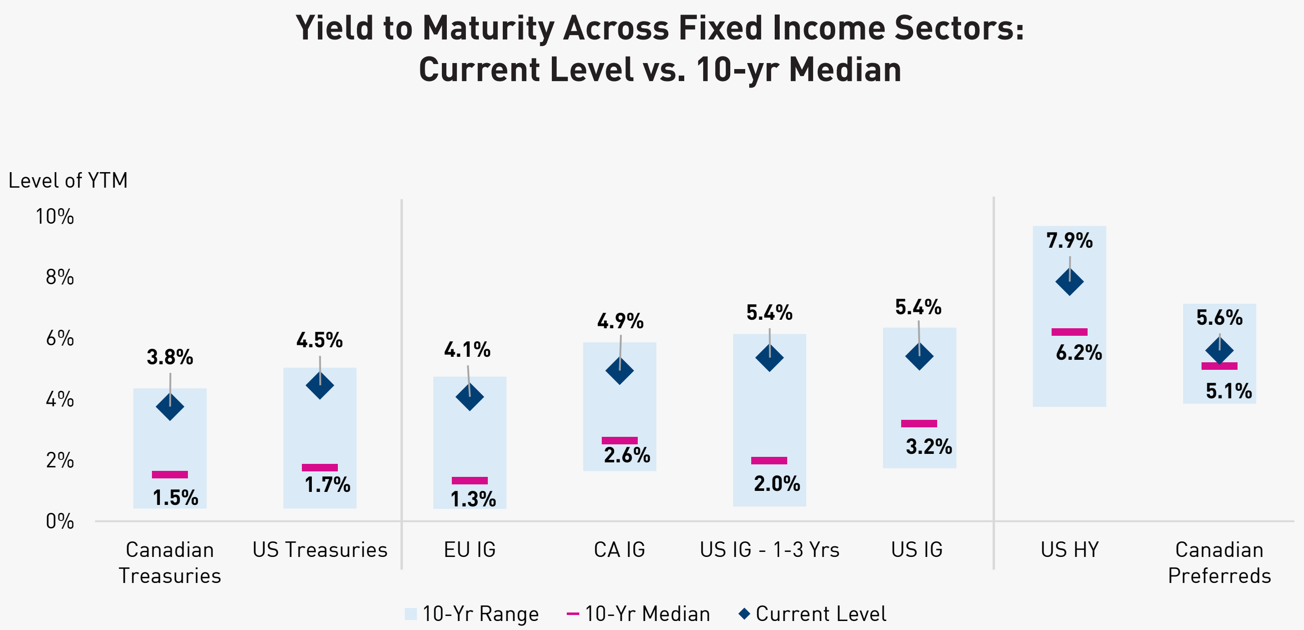
Expected Rate Path for the Federal Reserve and Bank of Canada



Source: Bloomberg.
Data as of March 31, 2024. Data is subject to change. Terminal rates are estimated with 1m3Y OIS futures as a proxy.

2 All-In Yields are Still Elevated for All Segments of the Fixed Income Market

Investors are still able to benefit from elevated yields across all segments of the fixed income markets, especially when compared to historical medians. We believe yields are particularly attractive in Investment Grade segments of the market compared to more subordinated or lower-rated segments. The majority of the yield increase has come from increases in risk free rates rather than credit spreads.

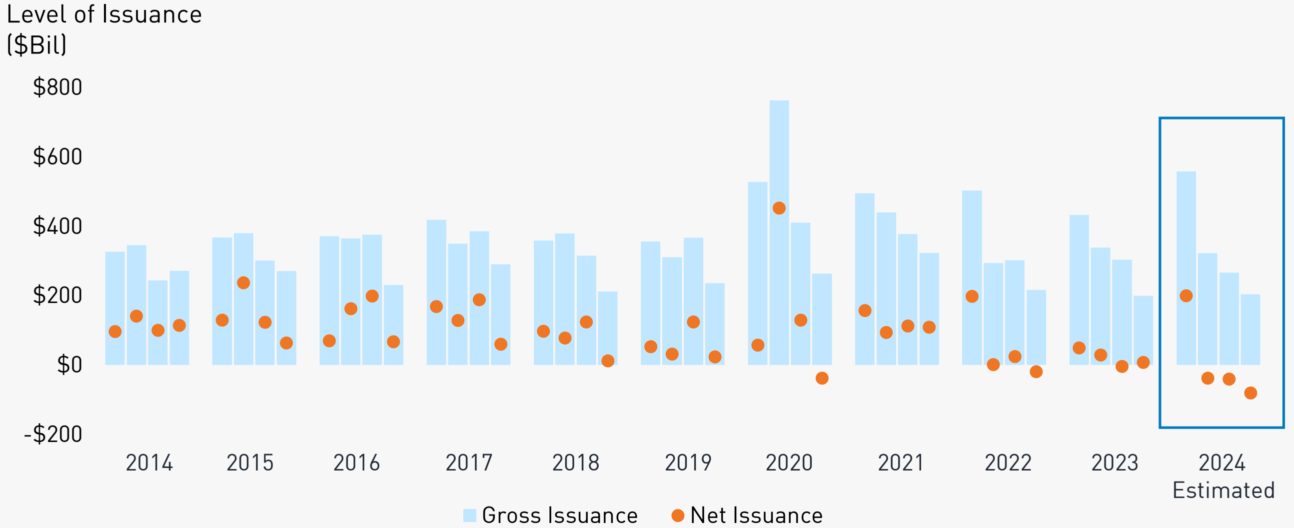


Source: BarclaysLive, YCharts.
Data as of February 29, 2024. BMO Laddered Preferred Share Index ETF (ZPR) used as a proxy for Canadian Preferreds.

3 Despite Record High Bond Issuance in Q1, Negative Net Issuance Expected in the Following Quarters

Q1 saw abundant issuance in the U.S. market, primarily driven by refinancing needs and elevated M&A activity. Going forward, however, net issuance for Investment Grade rated corporate bonds is expected to turn negative for the rest of 2024. This means the volume of coupon maturities and payments is expected to be greater than the volume of new bonds issued. This, combined with strong inflows into fixed income, presents a bullish set-up for credit spreads.

Quarterly U.S. Investment Grade Issuance Over the Past Decade

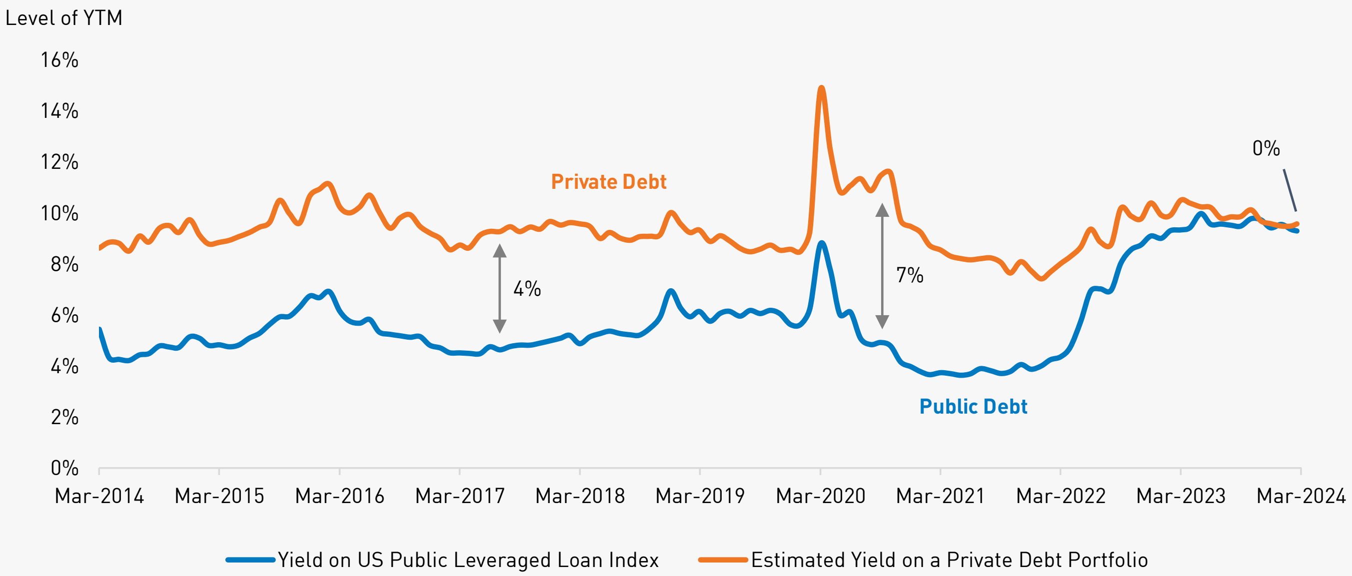


Source: BarclaysLive.
Data as of March 31, 2024. Net issuance is calculated as gross issuance – redemption – coupon payments.

4 The Estimated Liquidity Premium for Private Credit Has Reduced Significantly Over the Last 24 Months

Today's higher interest rate environment has diminished the estimated liquidity premium once offered by private debt to nearly nothing (by some estimates). Given this, we don't believe investors should be locking up their capital in search of return as they can now achieve comparable expected returns by investing in more liquid, lower risk asset classes. We believe actively managed public credit can strike the right balance, allowing you to obtain an attractive return without sacrificing liquidity or adding undue complexity.

The Estimated Liquidity Premium Has Fallen from ~4% on Average to Almost 0% Today



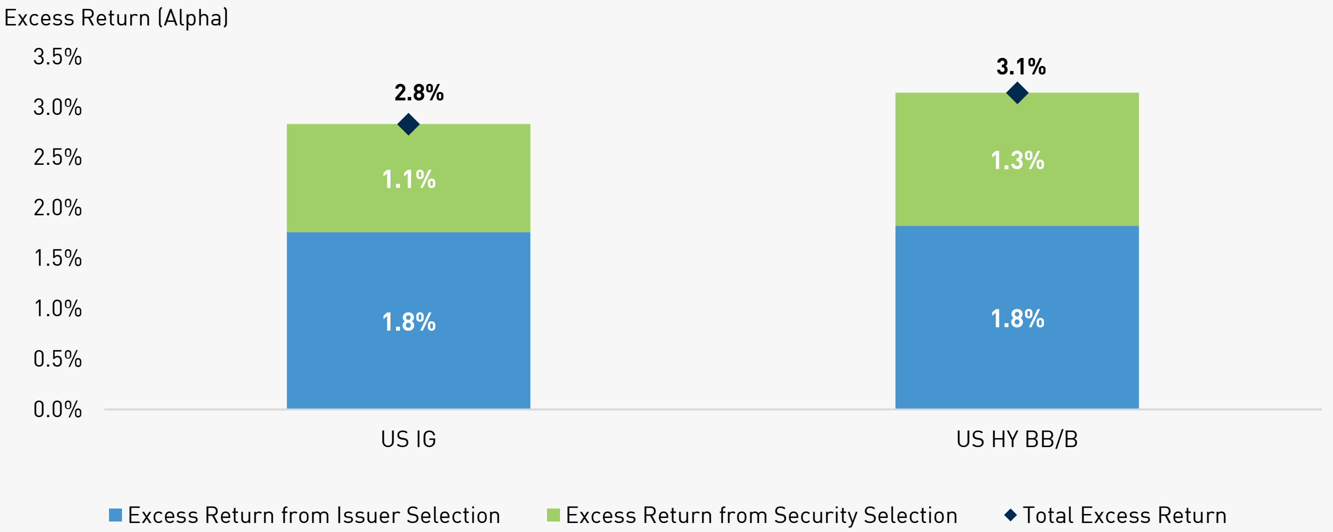
Source: Bloomberg, Morningstar LSTA.
Data as of March 18, 2024. Estimated Yield on a Private Debt Portfolio is estimated by the dividend yield on the Ares (ARCC) BDC Portfolio. This chart compares the Net Dividend Indicated Yield and the Morningstar LSTA US Leveraged Loan 100 TR USD Yield to Maturity; the credit quality of the indices/portfolios will differ. For illustrative purposes only.

5 Issuer Selection is Only Half the Game, Issue Selection in Fixed Income Can Be Just as Important

A recent study by Barclays aimed to quantify the importance of bond (individual security) selection, separate from the issuer selection decision. Barclays used data from 2005 to 2023 to determine the impact of security selection on alpha generation (excess returns) across both Investment Grade and High Yield segments of the U.S. bond market.

The study found that alpha generated from bond selection contributed to ~40% of total alpha on average. This means it's simply not enough to pick the right company – in order to optimize returns, it's crucial to select the right securities within that company's capital structure. A manager's expertise in doing this can play a significant role in their ability to generate outperformance for their clients.

Security Selection is Almost as Important as Issuer Selection for Delivering Excess Returns



Source: Bloomberg, BarclaysLive. Data as of February 5, 2024. Alpha numbers shown are per annum. The Systematic Value Credit Strategy above is a strategy designed by Barclays, which is rebalanced monthly by selecting bonds with above median "spread in relative value" (spread level unexplained by macro and fundamental characteristics) in the US Corporate IG/HY bond market. Alpha was measured by the difference in performance of top quintile portfolio (cheapest portfolios) and bottom quintile (most expensive portfolios).

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