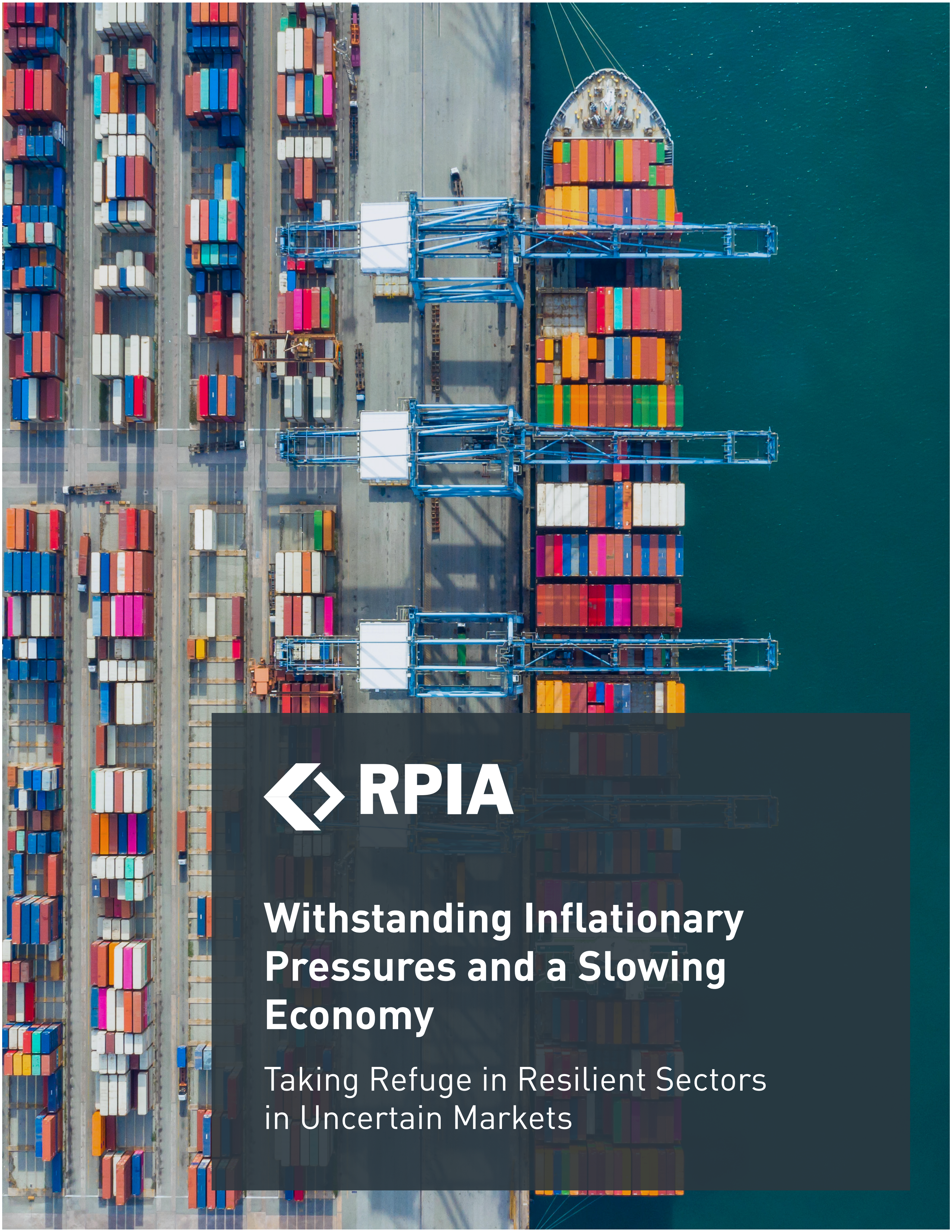


Withstanding Inflationary Pressures and a Slowing Economy

Taking Refuge in Resilient Sectors in Uncertain Markets

The rate of volatility in the first five months of 2022, coupled with the persistently uncertain macro backdrop, has driven us to take a conservative approach in our sector positioning year-to-date. Two broad concerns are leading us to believe that a cautious stance on credit is needed right now:

1

An uncertain inflation picture highlighted by:

- Widespread raw material and commodity inflation due to surging demand intersecting with a stumbling supply chain, exacerbated by COVID-driven lockdowns.
- Significant labour cost inflation is making it difficult for companies to hire enough workers to meet the surging demand for goods and services in a reopening economy.

2

An uncertain economic growth picture highlighted by:

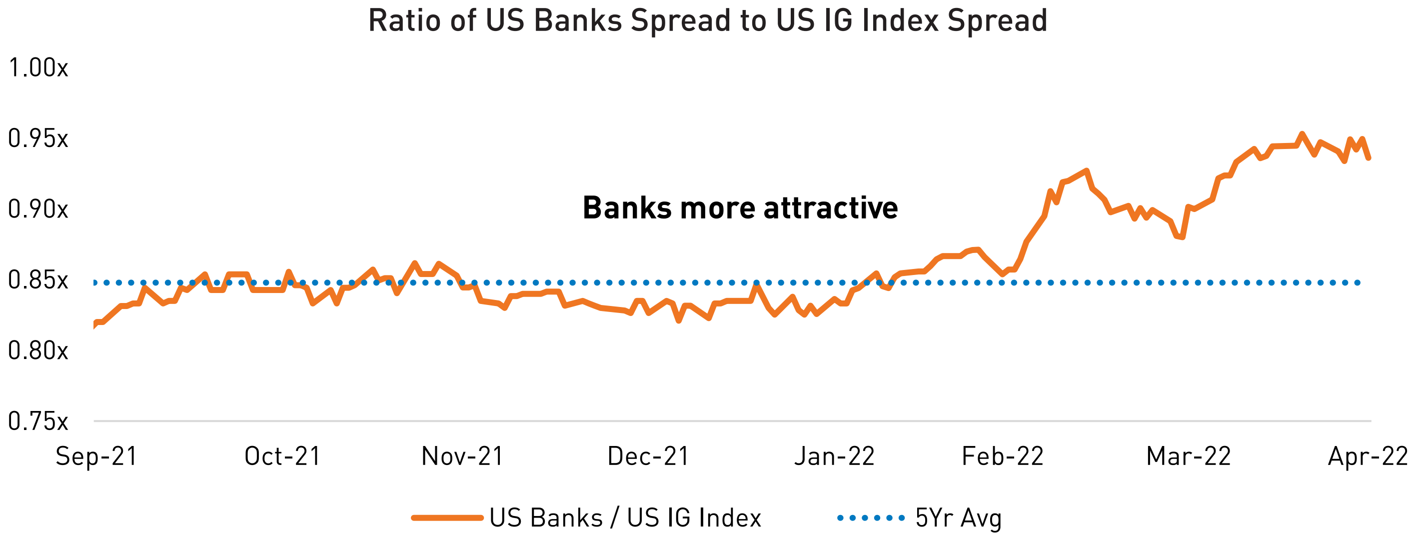
- Growth that was pulled forward during COVID and large corporate capital expenditures over the last two years could prove to be overzealous and cause downside risk to long-term earnings projections.
- A weakening consumer, despite adding nearly $2 trillion of excess capital to their balance sheets over the last couple of years, is beginning to see inflation eat into their wallets and affect their confidence to spend discretionary money.

With these risks in mind, we are finding value in more resilient businesses, which allow us to capture higher yields available in today's market without necessarily adding credit risk that we believe is uncompensated at this point in the cycle.

Example 1: Finding Strength in Diversified Banks

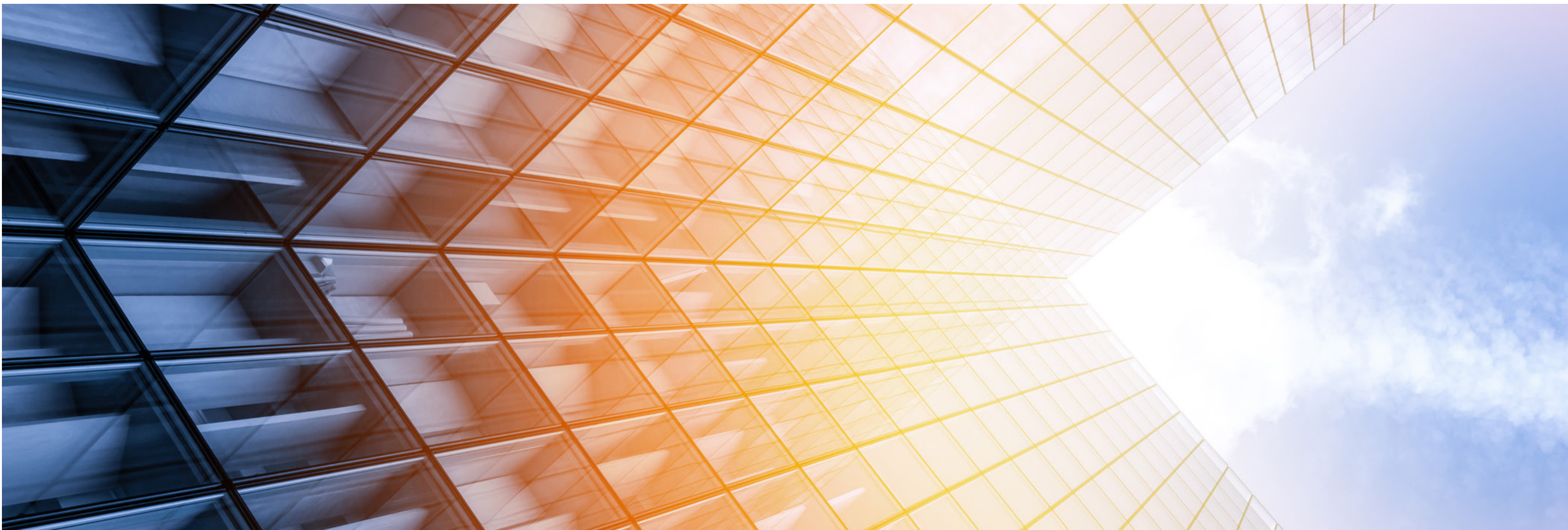
US banks have a strong fundamental profile entering this downturn compared to previous cycles. Bank balance sheets are generally healthy today, with high-quality loan portfolios, low loan loss rates and delinquencies, and high reserves, capital, and liquidity levels. Banks have also diversified their businesses, either organically or through M&A, and have grown their fee-generating business segments to provide a more stable revenue stream and help manage profitability through cycles.

US banks also look attractive from a valuation perspective as front-loaded supply year-to-date has driven underperformance versus the broad investment-grade market. With the expectation of issuance slowing in the second half of the year, technical factors should support relative valuations.



Source: ICE BofAML. Data as of Apr. 30th, 2022

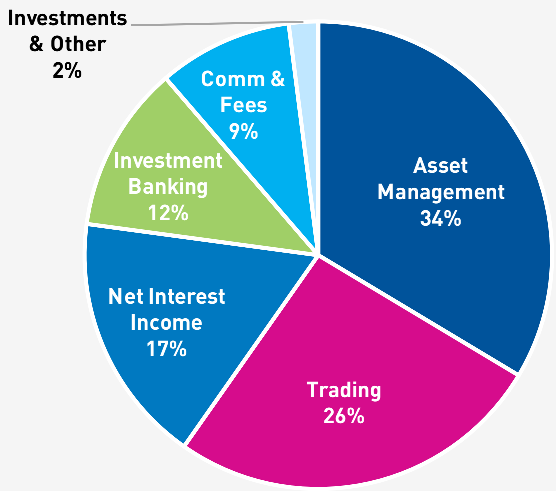
While we see several risks across the macro environment, including supply chain issues, elevated inflation, and growing geopolitical risks, operating conditions for banks remain favourable with rising interest rates and steady loan growth. As a result, we expect their profitability to remain strong in the near term. We particularly favour US banks focused on the domestic market with stable and diversified revenue streams and maintain substantial capital buffers above regulatory requirements.



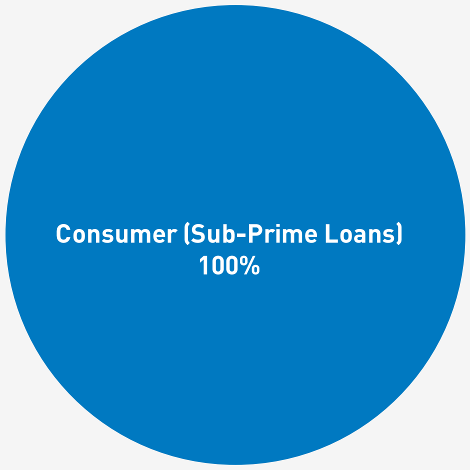
US Diversified Banks vs. Monoline Lenders

One example of a bank that fits this profile is Morgan Stanley ("MS"). The bank has taken strategic steps to shift its business towards wealth and investment management over the past several years. Recent acquisitions of E*TRADE and Eaton Vance are highly complementary to MS's existing businesses and have helped diversify its business mix towards lower-risk, recurring revenue streams to deliver more stable profitability. The on-boarding of E*TRADE has also grown MS's deposit base significantly and lowered its reliance on the higher cost and more market-sensitive wholesale funding. Moreover, MS has maintained very healthy capital levels, with sizable buffers over regulatory requirements and solid performance in annual Federal Reserve stress tests. We believe these factors leave the bank well-positioned for the current environment.

Morgan Stanley - Revenue Mix



World Acceptance - Revenue Mix



Source: Morgan Stanley Q1 2022 company financials, World Acceptance Q1 2022 company financials.

On the other hand, we take a less constructive view on monoline lenders, such as World Acceptance. Generally, these lenders are more exposed to borrowers with lower household incomes and lower credit scores. These names tend to perform well in periods of economic expansion, but we expect to continue seeing higher prices across food, energy, and housing, which account for well over half of lower-income household budgets. Consequently, the borrower base for these companies is likely to experience the greatest adverse impact from an economic slowdown, and they are likely to feel that impact earlier than households with better balance sheets.

Given where we are in this process, we want to avoid lenders who are overwhelmingly exposed to the weakest borrowers. Although markets have already responded to expected weakness and pushed security prices down, the unprecedented withdrawal of central bank support makes it difficult to call a bottom as there could be more room for prices to fall. With that in mind, we remain focused on finding relative value opportunities within sectors, favouring the diversified lenders mentioned above and avoiding the monoline lenders at this stage of the economic cycle.

Example 2: Consumer Staples Showing Resilient Demand and Pricing Power while Discretionary Spending Outlook is Shaky

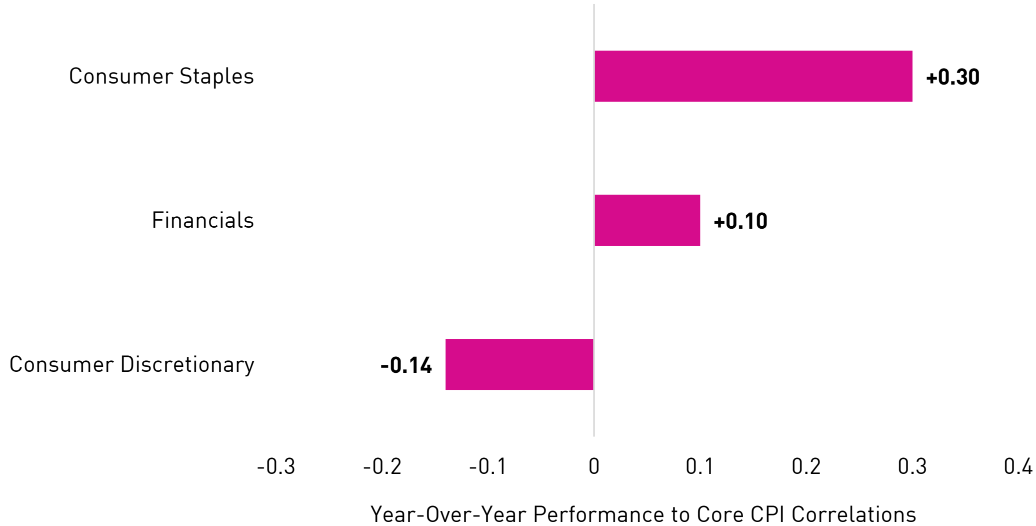
We like consumer staples because of their non-cyclical nature, particularly when demand for products is mostly uncorrelated to the state of the economy. These businesses exhibit weaker price elasticity, meaning consumer demand for their products is not as impacted by rising prices. As a result of the current inflationary environment and concerns about an impending recession, the ability to pass-through costs and maintain demand is becoming increasingly important.

This has been evident with this past quarter's earnings results, where sectors we like and have exposure to across our funds, such as food, beverage, household goods, and alcohol companies, were largely able to increase prices to match the significant cost inflation while maintaining demand. Molson Coors, for example, delivered record quarterly revenue growth this past quarter while also demonstrating margin improvement.

> We expect to continue to be impacted by inflationary pressures in areas including materials and transportation costs, and expect those pressures to increase for the balance of the year. However, we intend to judiciously pull our multiple levers to help mitigate the impact.
>
> - Molson Coors' CFO, Tracey Joubert, Q1 2022 earnings call

We expect consumer staples to continue to outperform and have positioned accordingly. We have tried to specifically identify consumer staples that we believe can continue to pass through cost increases, are continuing to benefit from the economy reopening post-COVID and are improving credit fundamentals.

Sector Performance Correlations with Core Consumer Price Index (CPI)



Source: Wells Fargo Investment Institute, Strategas. Data as of May 18th, 2021. Correlations between year-over-year performance of sectors and core consumer price inflation. Performance based on the S&P 500 GICS sector classifications.

Conversely, we do not like consumer discretionary-focused businesses as consumers facing price increases across the board are forced to cut back their expenses somewhere, causing them to pull back on discretionary purchases.

> …the rate of inflation in food pulled more dollars away from [general merchandise] than we expected, as customers needed to pay for the inflation in food.
>
> – Walmart's CEO, Doug McMillon, Q1 2022 earnings call

We are positioned cautiously on consumer discretionary, specifically taking a negative position on issuers we expect to experience challenged operating performance and see the risk for secondary impacts of increased M&A or shareholder returns to lead to material credit deterioration.

PC Hardware

Cost inflation and a pull-forward of demand for items such as PCs, laptops, and related accessories over the last couple of years should lead to slowing demand and lower margins. As a result, we are short a large computer hardware firm, which generates more than half of its revenues from personal systems (notebooks, desktops, workstations).

The company has shifted its capital allocation policy toward being more shareholder-friendly by returning capital to shareholders through dividends and significant share repurchases, which is a negative development for holders of its bonds.

Re-opening Theme is the Exception

However, we remain constructive on the reopening trade and believe this current environment is unique, especially for experiential discretionary spending. While consumers are broadly looking to cut their spending, given their pandemic experience, we continue to see strong demand from consumers who seek to get out of their house and enjoy experiences with friends and family.

For example, on their Q1 2022 earnings call, Target Corp. specifically highlighted the spend shift from TVs to luggage, which we believe supports continued recovery and strength in travel, including airlines, cruises, and lodging.

Sector Research and Selection Plays an Important Role in Capturing Upside

We feel that our team-based approach allows us to differentiate and apply our sector views intelligently to add value to our investment process. Our research team conducts a deep-dive analysis on sectors and credits and works closely with our execution team to identify tactical, opportunistic investment ideas.

We feel well-positioned across our funds for the current investment environment and the unique challenges each sector faces. But we are also mindful that significant downward moves in the equity market could lead many companies to pursue debt-funded share buybacks to support their stock prices and put further pressure on their bonds.

RPIA

39 Hazelton Ave.
Toronto, ON
M5R 2E3

www.rpia.ca
General Line: +1 647 776 1777
Investor Services: +1 647 776 2566