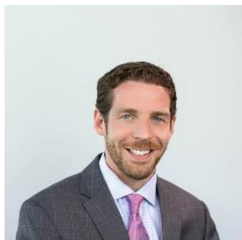
Panelists discuss sustainable income from the credit markets during the 2021 AICA Income Spotlight.

Thursday, June 17, 2021

Matthew Kence from Aberdeen Standard Investments, Navid Abghari from Angel Oak, Charles Arduini from Ares, and Gretchen Lam from Octagon were panelists at the AICA Income Spotlight Event held on June 17, 2021. The moderator of the panel was Michael Spatacco of Bancroft Capital. Read the transcript from the discussion below to hear insights from the panelists.


Michael Spatacco

Matthew Kence

Navid Abghari

Charles Arduini

Gretchen Lam

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Michael Spatacco: Hello, good afternoon. Thank you to everybody for coming today, very excited to be here, and I'm pretty excited to have the panel that we do. It's a pretty impressive group of people here and I'm very excited to jump into this topic.

Michael Spatacco, I am director of cash management for Bancroft Capital. I'm also kind of a closed-end fund nerd, somebody who has been chasing closed-end funds around for a really long time and it's a topic that has always interested me. And through my conversations with John and our business as a syndicate member in closed-end funds and helping in the distribution, I've stayed involved and it's a naturally synergy for me. So I'm really excited to kick off this panel about sustainable income from credit markets and I will make brief introductions here. I think in keeping with how we did the pre-call, I'm going to go clockwise Brady Bunch for myself, first

up I'm going to give an opportunity to introduce himself to Charles Arduini. Thanks for joining us, Charles.

Charles Arduini: Sure Mike, thanks. Glad to be here, I work for Ares. Ares is a global alternative investment manager with over $200 billion in assets across credit, private equity, real estate, and our strategic initiatives. I work in our credit group, the credit group is about $150 billion. I'm a portfolio manager and partner, and in particular most interest on the Ares Dynamic Credit Fund, ARDC which is a publicly listed closed-end fund that invests in high-yield bonds, leveraged loans, and CLOs, and I'm looking forward to the conversation.

Michael Spatacco: Thank you so much, Charlie. Next up, we have Gretchen Lam from Octagon Credit.

Gretchen Lam: Hi, good afternoon all and thanks for the opportunity to speak with you today. [inaudible] manager at Octagon Credit [inaudible] manager of about $28 billion in leveraged loans, CLO [inaudible] closed-end fund investing in loans and CLO debt and equity.

Michael Spatacco: Thank you very much. Next up we have Matthew Kence from Aberdeen.

Matthew Kence: Hi everyone. Yeah, my name's Matt Kence, so I've been at Aberdeen for about 11 years now. So Aberdeen, if you're not familiar with it is about $560 billion global asset management company, we have about 40 locations globally and of that about $170 billion is credit. So I'm one of the managers on ACP, which is our closed-end high-income based fund. So looking forward to talking with everyone today.

Michael Spatacco: Thank you very much, Matt. Last but not least, I don't think I have to give a firm name because if anybody's really looking at their camera they're going to figure it out, it is Navid Abghari. Thanks for joining us.

Navid Abghari: Of course, my pleasure. Thanks for having me. Navid Abghari, senior portfolio manager at Angel Oak. We are an $11 billion AUM asset manager with a focus on structured credit. Within structured credit we're involved in residential mortgages, commercial mortgages, as well as CLOs, but also corporate credit where we participate in financials debt and high yield. I'm a senior portfolio manager of the corporate credit sleeve where our largest allocation is financials debt.

Michael Spatacco: Thank you very much. I'm having a little bit of background envy here, Navid, it's very professional. And I actually ran home from the office where I was today for the first time in a little bit to make this video appearance. It's funny, you work at home for a long time and you get your tech set, and suddenly it's like, "Ah, I don't have what I need at the office." But I'm very excited to be here and I'm very appreciative for the time of all the panelists. We're going to kick it off and get into the question section here.

With rates as low as they've really ever been and predicted to stay low for a foreseeable time, even with the Fed tweaks that went on earlier this week that pushed the front end of rates up just a tiny bit higher, five basis points. We know that liquidity and principal preservation have been

paramount for clients, that's been surveyed to death. But for you, how do you prioritize yield, liquidity, and credit quality? I'll kick it off to Gretchen, and then we'll go with an open discussion thereafter with each question if that's okay with everybody.

Gretchen Lam: [inaudible] about yield and credit [inaudible] of relative value, which [inaudible] those two really [inaudible] broadly syndicated loan market in the US and the US CLO market. We have been very constructive on the macro in the United States today, and so as we think about that tradeoff between yield and risk, we're really [inaudible] opportunities, so we're looking at [inaudible] loans and CLO debt [inaudible] and CLO debt and equity which is [inaudible] in periods of illiquidity to trade off [inaudible].

Michael Spatacco: Thank you very much. I would like to throw that one out to the group. Is there a resetting, so to speak, of your hierarchy here? Of yield, liquidity, credit quality? Are you seeing a new normal there where last year, call it this time, there was definitely a push toward liquidity and principal preservation. Everybody wanted to push to cash, everybody drew down bank lines. What do you see and how do you prioritize it? Navid, I'll go to you.

Navid Abghari: Yeah. Yeah, absolutely. I would say these are obviously key considerations for us as portfolio managers. What I would say is there's somewhat of a dichotomy between liquidity in the risk-return paradigm. What I would say as it pertains to liquidity specifically, here at Angel Oak we manage a full array of investment vehicles; we have daily liquid mutual funds, we have quarterly liquid hedge funds, we have a closed-end fund, we have private credit strategies that have much longer investment horizons. And really SMAs that span the full spectrum. And the focus on liquidity is trying to match the liquidity of the underlying portfolio with the liquidity of the fund structure.

Clearly you are paid for illiquidity risk, and being able to have a fund that isn't constrained by liquidity allows for more flexibility for us as portfolio managers to focus on that risk-return paradigm. Liquidity as a constraint I think just limits your investable universe, and that's something that we're always mindful of and our fund structures are aligned in that manner. Clearly in our more liquid strategies we use less leverage as well, in fact our daily liquidity strategies have no leverage. And there is a full spectrum of leverage as well which I would add to the discussion as something that else that is a key consideration.

And so for us I think as we look at risk-return more specifically, I think it's interesting because oftentimes you see portfolio managers taking a more negatively convexed trading strategy. Which is during times of market richness when assets are generally tight, you see people adding risk and moving out, stretching for yield. And when markets are wide you see the inverse. And that's really to investors detriment. That's a negative convex trading strategy and I think that's something that we try to shy away from here. What I would mention is during the pandemic we were able to sell many of our bonds in the strategy that we're trading around par and rotate into similar bonds that were trading in the 80s. And so I think being very mindful of liquidity and risk-return, and having a longer investment horizon and approach is really how you can optimize the whole process and add the most value.

Michael Spatacco: I would love to jump in and just piggyback on your timeframe comment there and segue into the next question. And that would be, you had mentioned having a longer time horizon, having less limitations, having a greater domain of investable assets can give you flexibility to generate more yield. I guess the contra side of that is if you are focusing on credit quality is there an expectation of defaults to stay where they are? To be higher, to be lower? And Matthew, I'll kick it off to you and ask, do you have an opinion on whether or not we're going to see default rates? Because Navid said the credit quality right now is in a very good spot, and are we going to see as a response some sort of default mechanism?

Matthew Kence: Right, right. Thanks for the question. If I could just before I go onto that maybe just address Navid's point too in terms of liquidity in terms of the type of vehicle. And so that's something that we've dealt with over the past obviously year or so, is that one of the advantages of a closed-end fund obviously is you don't have to deal with flows so that money is locked in. So you can often capture that liquidity premium. But of course if you have leverage on that fund and then you're subject to the revolver in terms of movement to breach [inaudible] and covenants such as that. Well, that sort of works against you because as assets are selling off you have to unwind that leverage. So you end up being a seller in a weak market.

And quite frankly, that's something that as the Covid thing hit, we weren't as optimistic as we would have liked to have been because we were quite cognizant of making sure we were staying within our covenants on a revolver. But what we've done recently though is we've issued some pref shares which will give us more stable capital sort of debt in the fund, so that movement to breach is much larger and now we can be much more proactive in terms of taking advantage of market opportunities. I just thought it was an interesting point, is that one of the advantages of closed-end funds is the liquidity, but then if you add leverage on it that could actually work against you unless you come up with some other solutions to that.

So just going to your question in terms of defaults, we actually think defaults are going to remain quite low here. One, obviously companies are benefiting from the stimulus that's in the market, whether it be governments or obviously central banks. But what that's done too is that's allowed the new issue market to be completely wide open. We've seen record issuance last year which blew through the prior record. I think last year was around $430 billion in the US market. The prior record I think was in 2013, which was like at $320. We're probably on pace this year to do $500 billion of new issuance. And so really anyone who has any desire to issue whatsoever can come to the market. So we think that will help.

Well, there's two things. One is companies are able to lock in very low rates. And secondly, if there's any sort of maturity trigger, obviously that's pushed out. So that has good and bad consequences, right? And it really just means in terms of credit analysis, you have to really do your work and make sure that you're investing in companies that have good sustainable outlook going forward.

Matthew Kence: Scrambling for the mute button, that's going to be my theme for 2021. Scrambling for the mute, I'll get it in a marquis. You touched on something in the middle of your answer and you had mentioned scrambling for other alternatives. The marketplace has an uncanny knack of pushing people to find what they're looking for. And Charlie, I'll ask it to you,

what are some of your preferred sources for generating yield in the marketplace? And how creative have you had to be in finding them and finding them in sources that you can deliver on any repeatable basis?

Charles Arduini: Sure. I think when we look for places for income that's available in a market like this, we go to what we're good at, which is what everyone should do, right? And we're good at credit. Ares is a firm that has been doing credit for over 20 years. Our group has been investing in high-yield loans, and bonds, and CLOs in particular across multiple cycles. I would say two things in particular that I can think of is on the single name credit we've seen somewhat of a convergence between the direct lending and the broadly syndicated. We've been able to work together with our large direct lending franchise to source deals that are not really available in the broader market with preferential economics that flow through to our investors. Interesting deal flow, we think better credits than you could find elsewhere at really good pricing, so that's been a source of extra income.

And then the other area in particular in the ARDC fund is in the CLO space, where we think that the CLOs have proven once again through a cycle that they work. People forget that they're not a forced seller of loans despite maybe some misconceptions. And in fact they've performed very well once again in a different type of cycle. And I think part of the large issuance we've seen this year and the flows we've seen into the asset class are showing that that's being recognized. So on CLO debt and equity is the other space that we're really good at that we're finding value.

I think tying it back to your first question just to wrap up, of the three yield, and liquidity, and credit, to us it's always credit. Get the credit right and you'll have something that's liquid in a time. Get the credit wrong and you have tomorrow's problem. While defaults are low and we expect them to be low like Matt said earlier, companies are going to miss their numbers if you get the credit wrong. And while it won't be a default, it'll be one of these companies that no one wants to own and there'll be no bid on in a year or two. The difference in yield pickup going down in credit to accompany that may be a little shaky, not enough to offset the potential future losses and loss of liquidity in a tough market.

So to us that's an easy answer, is look at credit for us which is what we're good at. Whether on those types of loans that I talked about at the border between direct lending and broadly syndicated, or in the CLO space.

Michael Spatacco: You know what, Charlie, I'm going to jump in there because you mentioned CLO space and we actually have something from Q&A, and I want to try and make this as engaging as possible for those who were kind enough to share their time with us. So this question comes from Steve [inaudible]. Gretchen and Charles, what levels of credit losses, i.e. default X losses given default are you modeling going forward? And what impact would the various loss levels have on CLO earnings? Gretchen, I'll kick it to you. And then Charlie and everybody else, please feel free to jump in on it as well.

Gretchen Lam: Sure, absolutely. So we [inaudible] different scenarios that typically don't run a [inaudible] a recession [inaudible] or some [inaudible]. And we'll look at a number of different scenarios. We'll also look at scenarios where [inaudible] in low defaults [inaudible] compression

in credit spreads [inaudible]. So we always try to [inaudible] flavor of how [inaudible] perform under different outcomes, different paths.

Look at the experience of last year, what you find is that default rates in CLOs were actually relatively low. Certainly low in the context of what happened last year and the extraordinary nature [inaudible] pressure on CLOs was not defaults, it was very high levels of triple Cs as rates accelerated in the spring and early summer. And while that was [inaudible], those had an impact on the CLO that are the primary governor to the [inaudible]. That impact [inaudible] to the extent that those C's don't ultimately become [inaudible]. So you're seeing some of that pressure come off CLO managers. If you look at, getting back to the original question, [inaudible] for many experienced, top-tier CLO managers, [inaudible] default experience [inaudible] average default rate for the loan market as a whole is just under 3%.

Charles Arduini: Yeah, just to add there, that's exactly what we've seen. Last year, the default rate, depending on what source you use, peaked at 4% or 5% percent, and if you look through to the collateral in CLOs, it was in the 1%'s. And that's consistent if you look back to the last time we had elevated defaults. In the Great Financial Crisis, the broader loan market default rate was around 11%, and the average CLO was 5% or 6%, about half of it. And that's the average. If you can look through to the collateral and do the things that Gretchen and her team do and our team do, you can find managers that have default rates last year below 1%, and back then at the 2% or 3% even.

So I think that one thing to look at to the question is, CLOs in our view will have a fractional percentage, whether it's a quarter or a third or a half of the broader loan market. And so I think that's part of the reason why the assets have performed as well as they have. We see that even if you stress them out to a 6% or 7% default rate, which in this construct would mean the broader loan market has default rates of 12% or higher, you're still getting low single digit type returns even in that scenario. So we feel very comfortable from a high level modelling standpoint that the risk-return is correct here.

Gretchen Lam: I totally agree, Charles [inaudible]. What I would add is that 2020 was not as bad for CLO equity as you might [inaudible] the period of elevated [inaudible] loan market [inaudible] was the case in 2020 [inaudible] credit spreads [inaudible] that flows through to equity.

Michael Spatacco: Do we have any dissenting viewpoints on the CLO perspective? I saw a couple little nods there but I'm also always interested to see if we have differences of opinion on topics as well. We do have another question out of the Q&A if there's nobody jumping on. How useful is earnings coverage for your funds? I see 56 to 96%, three funds under 75%. Now I'm not sure specifically which funds that's referring to, it's in through the Q&A, but how useful is earnings coverage for your funds? I'll just throw it out to the group. Matthew or Navid, you guys have had a little time off, we'll throw it to you.

Matthew Kence: Navid, you do want to take a shot at that? I don't know, are they talking about dividend coverage? Anyone has a thought on interpreting, I just want to answer the right question.

Michael Spatacco: "Yes" was what came back there. He was pretty quick on it.

Matthew Kence: Yeah, I think on our fund right now, the earnings and etcetera in terms of dividend coverage it really depends, there's a lot of accounting going on there. Just to put it in perspective, we actually bought our fund from another firm a long time ago. So if your high watermark in terms of what the value is below that, even though your assets increase in value, that isn't considered a capital gain for example until you hit that high watermark.

So in terms of what is actually earnings, to us we're really agnostic. Whether it's interest coverage or whether we're getting total return on the investments that we have, as long as we're maintaining the NAV of the fund and being able to have those assets service those dividends, we're actually pretty relaxed about it. In terms of this year how we're looking at it, we have a pretty high bar for our fund, but we've also had some good total return ideas. So we don't feel like we need to go and make sure that what our assets yield exactly comes from the dividend, because we've banked some, I'll call them total return or capital gains, with the other stuff. So at the end of the year we feel like we can maintain or grow that NAV and very easily cover the dividend of the fund. If we do that, we feel like we're doing our job.

Navid Abghari: Yeah, I can jump in there, and I would agree with Matthew's comments there. In terms of the distinction between gains, or interest income, or income in general, for us we're agnostic to that. Ultimately I think the key point to be made here is our focus is never to play games with our dividend rate, our distribution yield. We're not looking to pay back principal or deteriorate the NAV with our distribution policy. Our distribution policy is merely designed to pay back to our investors whatever we're able to generate, whether that comes through in gains or interest and income generated on the fund.

Michael Spatacco: Gretchen or Charles, you want to jump in on that one?

Charles Arduini: Same. Navid just has echoed what I would have said. Whether it's from income or total return, we've covered our dividend and we're looking for the best opportunities out there in the market. So he said it well.

Michael Spatacco: A lot of James Carville going on out here. I have no answer, that was perfect. Do appreciate the questions from Q&A, so if you're in the audience, you want to throw more at us, please feel free. But we're going to run to the next question here on the more prepared side.

Last year we saw basically a total stoppage in capital markets issuance, the commercial paper market came to a screaming halt. And there were some disconnects in net asset values in closed-end funds that coincided with those times, call it end of Q1 2020. Why has the closed-end fund market been resilient enough to continue issuing when some of the other products were not able to do so? And do you see it as a viable issuance vehicle going forward since it has proven able to weather such storms? And I will go to Navid with this.

Navid Abghari: Yeah, I think the best way to think about it is strong capital wins during times of stress. Regardless of whether we're talking about a closed-end fund or a private strategy that has a strong long-term capital, generally speaking having that steady capital base really allows you to take advantage of a lot of opportunities. And the closed-end fund is one fund structure that really does allow for that. So I think there is merit to it, I think it does make sense. I think having investors that have that long-term investment horizon enter into a closed-end fund is generally something that could add value to them as investors.

I'll even go back to a prior comment that Matthew made about leverage. During this pandemic period, call it Q1 when you did see that stress, there were in our segment of the market which we focus on financials in the corporate space, there were some levered players that were forced sellers. During that time I think we sold about $100 million of bank debt at an average price of 99.5. Whereas the forced sellers were selling them in the mid to high 80s, and we were able to take advantage of that. And we were able to redeploy in similar rated assets, similar capital structures and credit quality from our perspective, and add that value. And I think a fund structure like this, a closed-end fund is ultimately where you'd want to allocate those type of investment opportunities or a private strategy that is similar.

I think looking at liquidity, looking at dislocations, looking at risk-return, the less constraints you have a portfolio manager, the more value you can add. And so I think that's one main reason why you've seen a pickup in terms of closed-end fund issuance during that time. With that said, I think it is a double-edged sword. I think that funds that trade a persistent discounts will make it hard for new issuance. I think all of us would say here, whatever the best risk-return is even for the investors of closed-end funds is something that investors should be mindful of. So if there is a fund that still has a credit quality, still attractive, still is managed well and is trading at a discount, that would probably still be a good investment opportunity even relative to new issue.

I think one thing that I would point out in terms of that discount to NAV that sometimes gets lost in the shuffle, is that oftentimes that's a measure of investors belief in the actual NAV. There are some closed-end funds that don't have a daily NAV. We have a daily NAV and we actually are focused in CUSIP securities, these trade electronically through DTC. There's a lot of price transparency in the bonds that we trade but I think that's a key consideration, is being able to be confident in that NAV. And I think oftentimes that discount to NAV is really a misnomer because the NAV may not actually be correct. These persistent discounts to NAV may seem like you're going into a good investment but that could actually be a situation where the NAV is not reflective of the actual portfolio value. So I think it's a lot more nuanced than just saying, "Discount to NAV," I think there's a lot that goes into making the judgment on any potential closed-end fund investment. But overall I would say the fund structure itself does add a lot of value to portfolio managers like ourselves, but you need to be very mindful of what that discount to NAV really is made of.

Michael Spatacco: Thank you very much. I've got a question from Steve [inaudible], it's actually for Matthew specifically. So Matthew, I'll throw it to you and again we can toss it around thereafter. Matthew, ACP and other funds that pay higher distributions say they can pay those levels because they can swim in the B/CCC pool, and essentially pick the right issuers. What's your secret?

Matthew Kence: Yeah, it's a good question and obviously it's a challenge, and with markets where they are now it becomes even more challenging. I think for us, we're a part of a global organization and so we really have to leverage all parts of the company to find opportunities. So just for example, we recently took advantage of some pockets of volatility, whether it be in some Italian bonds, we bought some Swedish Krona bonds not too long ago. We've been looking at the Chinese property area as well, fortunately we have analysts on the ground there. It'd be very difficult I think to have conviction in some of those names unless you have somebody or a group of people who really have their finger on the pulse of what's going on there.

So I think the other thing is you can't get married to just one area. I'll give you an example, earlier this year within the really active US high-yield issuance market, we were buying a lot of bonds through that. Even if they weren't yielding our hurdle rate, if we could get a decent coupon and then everything was trading quite well, we get another three or four points on the break. Or maybe on the break is an exaggeration but over time and we could sort of hit our hurdle rate, then that works out really well. As long as we're buying good credits we'll continue to do that. However, whereas the market's still been active, we're just seeing much less attractive pricing and some degree much less attractive companies as well. So we've had to kind of move away from that. You just have to be dynamic and go where the pockets of volatility give you some good values. But it's an ever changing market and we've got to adapt at all times to make sure we stay ahead of it.

Michael Spatacco: Thank you very much. Question, I'm not sure if it's related so I'm going to throw it to Charles out there, haven't heard from you a while. And when Matthew said Italian bonds, I had to keep myself from going with the Chef Boyardee handle a little bit. I can't help it, it just comes out. Yeah, exactly. I was like, "Hey, you know who would relate to this? Charles."

Charles Arduini: Thank you.

Michael Spatacco: Hedging credit spreads, what do you do and how does it vary by vehicle and structure?

Charles Arduini: I think that we're generally picking credits we like and we're long credit. I mean, that's kind of what we do, that's how we get our income. When we do feel the need to hedge, it is a vehicle-specific decision. And there's various instruments out there, whether it's the CDS market on the index basis, on the tranche index basis. Generally not single name, not pairs trading, generally not. But I think all of those are tools there. But again, our focus if you will is to pick credits we like and invest in them and earn the income that comes from those, as opposed to overlaying a macro pair trade. That's not really our core, certainly not in the ARDC fund.

Michael Spatacco: Navid or Matthew, you want to take a swing at that one? How do you hedge your credit spreads?

Matthew Kence: I can jump in there. Yeah, I would agree with Charles. These aren't money market funds, these aren't treasury funds, we're paid to manage credit risk. That's the key focus

of us, is trying to provide an attractive risk-return profile. And the less credit risk you take, the less in theory you're earning your management fee, and less you're giving the investor potential to generate that risk-return profile that they're hiring you for. So I would agree with Charles in the sense that I think hedging is more opportunistic. And I think in the instruments that most of us play on this panel, there is basis risk associated with hedging using broader market indices. But that also is in and of itself a view as well, where you'd hedge the broad market moves through some kind of hedging instrument. Whether it's a CDX indices as Charles alluded to or iBoxx indices. There are very liquid broad market hedging instruments that we utilize from time to time. But I think in general more broadly speaking, we do like credit risk, especially the credit risk that we're putting on our balance sheets.

Michael Spatacco: I'll jump in because in the pre-conversation Navid, you touched on something that I was [inaudible]. I had asked if we were hitting a new world of yield and if everybody is crowding the marketplace and making it more difficult. And you made a point that was stuck in my head for the last couple of days actually. And yeah, overall yield, total yield might be more difficult to achieve. But we live in a relative yield world and everybody else is playing a similar game as you are, and so maybe the client expectation hasn't met that real market machination. But are you seeing that play out in the world stage? Are you seeing everybody finding a great comfort with this new normal?

Navid Abghari: I'm not sure I would say greater comfort, but I do think people are understanding, or more understanding of the environment.

Michael Spatacco: Acceptance?

Navid Abghari: Yeah, yeah, I guess that's the first stage, right? No, I agree. I think with time you're seeing people adjust their targets, and that's part of our job as portfolio managers to help explain and illustrate what the market opportunity is. And so I think in an environment where people have an arbitrary bogey and absolute yield target, that's where you can get caught offsides for stretching for yield and going into risks that you aren't necessarily being rewarded for.

It goes back to my earlier comment that employing a negatively convex trading strategy is never beneficial over the long run, and when rates or yields are low, going out the credit spectrum, you're not really being paid for that incremental risk. And so it's really our job as portfolio managers to be able to explain the risk-return dynamic that we see in the market and where we think there's opportunities.

As it pertains to Angel Oak specifically, we do focus on niche markets. I think there still remains markets that are fragmented and relatively dislocated, on an absolute basis all yields are tighter. But I think it's still an environment where you can find value. And I think Matthew was mentioning this, you do have to be dynamic, you do have to dig a little deeper but there still is value there. And I think being able to find those pockets of risk-return that make sense and explaining that to investors, over time they get it and they adjust their targets as well.

Michael Spatacco: Matthew, you want to take a stab at the marketplace acceptance or grievance?

Matthew Kence: No, I think Navid did a good job. As I mentioned before, you've got to be dynamic and find the opportunities but there are opportunities still. We'll see what happens. Interest rates, obviously that could be a big driver of volatility within the market, and there's differing views whether inflation is increasing [inaudible] or not. We're seeing that play out on a daily basis. And so that's one other area that can drive some areas to where you'll find value.

Michael Spatacco: How about you, Charlie?

Charles Arduini: I think it's hard to see it right now but we've seen a much more regular stress in markets, but they last a lot shorter period of time. And if you go back from the '03 tech bubble, six years to the Great Financial Crisis, and those lasted three and two years respectively. But since then we've had 14', we've had '15 into '16, we've had late '18, we've had a fair amount in '19, we had last year. And I think about the late '18, it was maybe 11 days, trading days of a selloff. And so we're seeing regular episodic bouts of volatility where you can take advantage and it's that dynamics strategy that Navid mentioned. It's that ability to have access across different asset categories that we think can add value even in an otherwise low yield world.

And if you were set up, and I think the closed-end fund's structure, where last year the first thing to sell off was the most liquid best asset out of ETFs and more flow products. If you can take advantage of that, you can actually make up for what you otherwise aren't getting in a calm world. And so I think that managers that have that ability and structures that have that ability are another way to counter that and provide incremental income as opposed to just suffering with low yield.

Michael Spatacco: The question, Gretchen, was how are your clients, how do the people who interact with your funds, are they coming to terms with the new lower yield marketplace? Navid touched on it in the pre-call, the relative yield versus the nominal total yield, and that is something that stuck with me. That, hey, everybody's trying to find it and we're all looking for the same thing. How are you managing that and how do your clients feel about it?

Gretchen Lam: Yeah, absolutely. And thank you for recapping because I'm having technology issues, so I cut out.

Michael Spatacco: Your Brady Bunch box disappeared, so I was like, "Eh, she may not have heard."

Gretchen Lam: Appreciate that. Yeah, I think we're in a world where something like a quarter of all IG credit is yielding negative on a real basis. The comment, which I did hear that Navid said about yields being relative, and that's absolutely spot on. Having said that, our investors are looking for yield, that's kind of core to the proposition if you will. And I think it's being nimble, as Charles said, being able to take advantage of opportunities in periods of volatility when they come. And I was relaying with a colleague the other day, I wish I had overpaid more for CLO

BB back in April. I wish I had more three point covers on options because the time was right at that moment to really take advantage of the time. And so I think it's really important because there is a global search for yield, to augment that with nimble portfolio management. To take the opportunity to generate total return even if it's not coming from interest income. Ideally the combination of the two gets an all-in income generating capability that's attractive for our investors.

Michael Spatacco: I think you touched on something, that you wish you had piled into something that was retrospectively more attractive, obviously 20/20's always hindsight. But it speaks to in my mind what you just said, Charlie, in that we may not have as many protracted downturns but we do have those shorter snippets that are somewhat fast and furious and they create those trading opportunities that Gretchen's talking about.

Q&A coming in. If long-term average equity return is 8-10%, is it reasonable for investors to think they can earn an equity without equity via a high-yield credit alternative, credit asset, CLOs, etcetera? Anybody want to take a stab at that? I've got one last question in my pocket but if we keep getting audience participation, unfortunately we're going to have to miss it.

Matthew Kence: I mean, I would just say if you look at the data, and granted it depends on the timeframe, but there's a lot of stuff out there that shows that high yield returns are very similar to equity returns or maybe slightly less. But in terms of volatility, they're actually quite attractive on a Sharpe Ratio basis. So if you do have to put a little leverage on those, you should be pretty close. So I would think that that's very achievable.

Michael Spatacco: Anybody else want to jump in? I saw a few little nods there. Nope, hearing not. All right, I am going to go to the last question. We only have a couple minutes left and I want to be respectful of everybody's time, we end at 4:20 for this session. So if you are in the audience out there and if you have questions, now would be the time to get them in.

Last question here, I talked about it on the frontend because I was back to the office. We have a bit of a return economics going on here and how do you see that impacting credits? I know that I have very closely been monitoring the commercial markets. Commercial real estate markets are in maybe one of the biggest question mark times of all with everybody decentralizing from cities. How do you see that impacting your investible world going forward? Do you see everybody returning to work, pushing assets in a better direction? How do you see the Covid return impacting marketplaces? I'll go to Matthew. Lucky you.

Matthew Kence: I would just say that it's really going to depend on the company. It is company analysis or corporate credit analysis, so it's going to depend on the company, depend on the sector. And there's some that aren't necessarily obvious like one that we've been looking at recently is an office supply distributor company who actually you could argue has fairly negative secular trends as more and more people are working from home. But in the near term, there's actually probably some positive trends. For one, the company sells cleaning supplies. So as people come back to work, people are going to be much more focused on cleaning so they're going to sell more cleaning supplies. Everyone's reconfiguring their offices, so they're going to

sell a lot of furniture. So I think you just have to take it on, A, there's different timeframes and there's different sectors, and how each company is going to be impacted by this.

Gretchen Lam: Yeah, I would agree with Matthew's statement. I think there's generally a fair bit in our view of pent up demand as not just people come back to work but people come back to flying, and going on vacation, and sending their kids to camp, and commuting and all that stuff. Anyone who's tried to rent a rental car in the last three months would tell you it's nearly impossible, or buy a car for that matter. You look at travel bookings, I think there's a lot of economic activity that is on the come and I think will continue to impact the companies that we invest in.

Navid Abghari: I guess since it's the last question I can jump in there and add my closing remarks to this question. But no, I think the reopening trade is definitely something that is of key focus. I think with the reopening trade, there's the obvious impact to economic activity which is going to impact GDP. There's also this dynamic between old business, new business, dying businesses, growing businesses. But everything must add up to the GDP, and I think that's going to be the key tailwind that we see over the remainder of the year, is that strong amount of economic activity that we're seeing.

It's actually interesting to note that in 2019, income levels were lower than 2020, a pandemic year had higher incomes than in 2019. And that's really due to government intervention and stimulus. I think that is ultimately what the markets will be focused on, is how that transition plays through. We saw some volatility yesterday as the market is still trying to grapple with ultimately what's going to happen. My view is that there is going to be rate normalization. I think people are very mindful of that. We've seen some rate normalization already. But I think the reopening trade also will impact that, and it's just purely a matter of time. With the amount of money that's in circulation now, there's concerns about inflation. But I think the question is, is it going to be spurred by economic activity or just excessive liquidity injection? So I think that's the dynamic that we're seeing the market.

I think one beauty of what we're focused on is that the banking sector which is our strongest overweight, really is somewhat immunized from a lot of these dynamics. A rate normalization is beneficial to banks. They receive the interest rate, they don't pay the interest rate. So you see improved credit quality with rate normalization in the banking sector, which for fixed-income assets is something that is a natural offset to that rate duration that you have in your portfolios. But also the reopening trade itself is something that is accretive to banks as they're spread lenders. And so I think trying to find areas, and I think we've said this a million times so people are bored and waiting for the end of this call, risk-return, risk-return, risk-return. Looking at the reopening trade and trying to identify area that show the most attractive risk-return, we think the bank sector's probably in our view at least one of the most, if not the most, attractive sector given that it's kind of immunized from a lot of these different uncertainties that we see in the market.

Michael Spatacco: I don't think anybody's looking to end this call. If you want, I've got a little extra time on the backend. Charlie, last but not least, you take a swing at that?

Charles Arduini: Well, everyone kind of covered all the points that I would agree with. I think maybe just something a little different and I would imagine that Gretchen can confirm this. One of the things that we're seeing in the reopening trade, and I'll talk particularly about the CLO market, is there's capacity constraints, and how fast can you open? And what I mean is lawyers, and accountants, and rating agencies, and bankers, and pipeline, and there's only so much that can get done at one time. It could mean that this is protracted. It means that there's got to be new staff. And the good news about folks returning to the office is that you can actually start to bring people on.

I'm sure that everybody did some of that over the past year and a half, but it's very hard to bring on new employees and work cohesively remotely. And so the good news is that I think we'll be able to work through this but we're feeling that pinch right now and that's just in our little corner of the market in the CLO market. And I'm sure that's the case across all industries, not just finances, there's just a backlog of work. The reopening trade is not as easy as just turn everything on, because people are overwhelmed. So we're seeing that, we're feeling that. It's all long-term positive, but it's part of the if you will growing pains of restarting.

Michael Spatacco: The adding staff in the previous year has been a really interesting thing. "Hey, welcome aboard. Hope you enjoy the culture of your house, you may never meet any of your coworkers." Gretchen, you want to say something?

Gretchen Lam: I was just going to say that I think cross the economy and certainly in the little corner of CLO land we're seeing some of the growing pains or the friction if you will of just reallocation of labor, and that's going to take some time. So in the meantime if anyone wants to go work for Standard & Poor's in rating CLOs that would be much appreciated, because right now they're the bottlenecks. So thank you in advance.

Michael Spatacco: I think anybody who came here to watch one of the participants hit another with a chair, you've been disappointed. And I do apologize for that but it's not that kind of panel. It seems like everybody here has some prevailing thoughts and there's a bit of agreement amongst the group. We're in an almost pegged to zero yield world, but each of the panelists in their own different way, Gretchen, you just touched on it, in little silos of CLOs, and banking, and infrastructure, there are opportunities there. But you have to be mindful about how you deploy the capital, and you have to do it in a way where you don't limit your domain so much that your investable universe becomes so small and you can't actually deliver your proposed goals to the investing public.

Navid, you made a really good comment in that your main job, and I've never heard a portfolio manager say this before, so your main job is to understand and convey the investment philosophy. To me that's a really interesting take on it, but it speaks to how each of you have managed in this very interesting past 18 months and some real market machinations, but everybody continues to soldier on and work their investment philosophy here. I'm appreciative for everybody's time, can't say thank you enough to the public for your questions and to our panelists for coming on and spending a couple minutes here. Thank you very much, everybody.

John Cole Scott: Thank you all very much. Thank you again, Michael, for moderating the panel. Great presenters. It helps that you had a good moderator to do the prep call to keep anyone organized. And I didn't see any virtual chairs being thrown either but maybe that's an app we can develop for future conferences. So with that, I'm just going to do the quick closing comments so we don't have to go out and come back in.

Again, I want to thank everyone for being here. I want to thank our members whose membership dues underwrite this event. Our actual event sponsors, my firm, Closed-End Fund Advisors, NASDAQ, and Broadridge, they helped underwrite this event as well. We are going to work very quickly with everyone's compliance departments to get this stuff approved and available in replay mode. We do a transcription, we commission an article per panel, and we'll work very hard to get that up hopefully in under two weeks. We're going to try for a record this time around.

And with that, we are working very hard on content for the fall. We're working with membership to get that up and running. And if you were curious, on the registration page on the AICA website, that's where you'll find the replay content when you're logged in once it's available. We will let people know via email that registered for this live or replay when that is available. And also we did post links off of the CEF Data fund profile pages for the funds that have been referenced on this panel, so you can grab that right from the AICA website.

Please fill out the survey. Without your survey we won't know how to do it better next time. This is our fourth time using Remo, we like it but we definitely want feedback from you, the audience who we put this event on for. And so with that I thank my support staff, they took a lot of crazy questions and emails live during the event and they solved a lot of problems, thank you Jennifer and Katherine. And hopefully enjoy the summer, check out the podcast, and be in touch. Stay well, and good luck investing.

Oh, and stick around and network if you'd like. If you have time, jump around tables, turn your mic on, make a friend, grab a drink and enjoy the time here together. Bye everyone.

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