Interval Fund Track Panel #5: Specialized Credit Manager in an Interval Fund: Strategies not available in a Listed CEF

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JONATHAN RICKMAN: Welcome to panel five, which is about specialized credit manager in an interval fund, strategies not available in a listed CEF. As I'm sure most of you are aware, interval funds are a type of SEC registered closed-end fund that expand investor access to illiquid investment strategies through low investment minimums, frequent valuations, and 1099 tax forms. They have become the breakaway star of the alts universe due to their ability to diversify portfolios and solve some of the structural and regulatory limitations associated with private funds while offering the potential to generate higher total returns. We have some knowledgeable speakers on panel five today who will help us look deeper into interval fund strategies and structures, they are Kevin Dockrell, institutional portfolio manager at RBC BlueBay, and Larry Holzenthaler, managing director, portfolio manager, and senior alternative strategist at First Eagle Investments. Kevin and Larry, please introduce yourself further, and tell us about your firms and describe each of your respective strategies at a high level.

KEVIN DOCKRELL: Sure, I can go first. Can you hear me okay? I never know how close or how far away to sit from these mics, but you can hear me good? Excellent. Yeah, thanks for the

intro. So Kevin Dockrell, I head up the institutional portfolio management team at RBC Global Asset Management, the asset manager subsidiary of the Royal Bank of Canada. Within RBC, I represent the BlueBay fixed-income team, and BlueBay is the active credit specialist manager headquartered in London, and it's BlueBay, the BlueBay team that manages the BlueBay Destra International Event-Driven Credit Fund, which will be the focus of much of my comments here. Maybe just a couple of numbers; RBC globally manages about $500 billion in AUM, of which BlueBay, the BlueBay investment team manages about $135 across all areas of fixed income, IG, high-yield, securitized, EM, you name it, but the team responsible for this interval fund is our special situations team based out of London, manages about $500 million. So the fund itself, as I said, International Event-Driven Credit, it's incepted back in 2018, has about $300 million, ticker is CEDIX for those interested. As the name suggests, it focuses across the whole spectrum of stressed, distressed, special situations type of investments. So stressed, looking at intrinsically cheap bank debt or bonds, typically trading about 60 to 90 cents on the dollar, but in decent company is where we expect a par recovery. Distressed on the other end of the spectrum, where we expect a full-on restructuring, both financial and operational, kind of rolling our sleeves up, getting onto steer co's, bond holder committees, and ultimately taking equity on the other side. And then special situations, ad-hoc event-driven catalysts, trades, be it M&A or equity infusions, change of control, et cetera. So that's the bulk of what we do, it's global in nature, we don't have any sort of regional bias, although we do focus a lot more on Europe, sector agnostic as well, no real macro input, it's more of a bottom-up driven strategy. That's basically it.

LARRY HOLZENTHALER: My name is Larry Holzenthaler, I'm a portfolio manager for First Eagle Alternative Credit. As the name would suggest, we're part of First Eagle Investments, which for anyone familiar with First Eagle is probably most familiar with our global equity strategies, but over the last few years First Eagle's tried to diversify away from the value equity business. So my team was acquired by First Eagle about four years ago, we used to sit at THL, Thomas H. Lee, the private equity firm, so we joined, the team I work on joined about five years ago. We also have another affiliate within the First Eagle umbrella, Napier Park, which focuses on credit hedge funds, CLOs, securitized. And then most recently, I'll mention again a separate team, but First Eagle brought over John Miller who runs municipal bonds for us, just about six or seven months ago. John's already raised four or five billion dollars or

so, so he's been pretty successful. At this point First Eagle runs about $130 billion of assets, about $50 billion of that is within what we define as alternative credit, the rest of it is within John's strategies as well a global value. And so at FEAC, as we call it, we run an interval fund, the ticker is FECRX, again, we launched about four years ago. We also have another 40 Act structure that we'll be launching later this year that is going to be in more of a business-development company format. And so really what I would say about our team is we operate in what we think is a little bit of a unique spot in the interval fund space, in the sense that the way that our team thinks about credit, specifically corporate lending, corporate loans, we tend to view the corporate loan market as one big universe. I can make loans to companies in a direct lending origination type arrangement where it's a bilateral agreement between our team and a company, we might make them a $30 or $40 million dollar loan, up through our liquid credit group where we might own the loan of a multi-billion dollar syndicated issuer, and really everything in between, but our sweet spot is really liquid credit and direct lending. And so where we sit is a little bit of a unique position is within the interval fund space, I think on one extreme you find funds that pretty much everything they own is in these illiquid direct lending type of assets, we could talk about this in more detail, but my personal opinion is what's driving the vast majority of money into direct lending is the lack of marked to market. There's other benefits as well, but I think that NAV stability is what optically is driving a lot of dollars in. So you have funds that try to keep a lot of their assets in illiquid assets to keep that NAV stable, and then on the other extreme you have the funds that are more, I would say multi-strategy, where they might have liquid credit, direct lending, high yield, CLOs, ABS, MBS. And for us we're in the middle, we have liquid credit, we have direct lending, but that's it, everything we do is basically making first lien senior secured loans to companies. So we'll talk a little bit about the interval fund wrapper, but really the way I think about it is, it's kind of an entry-level step for folks who are looking at the direct lending market, have experience with the syndicated market, to obviously invest in something that looks and feels a little bit more like a mutual fund wrapper within the interval fund space.

JONATHAN RICKMAN: Let's talk a little bit more about that wrapper. Why do you both believe your respective strategies are befitting of the interval fund structure?

LARRY HOLZENTHALER: So it's really interesting, for my entire career I've worked across everything from limited partnership vehicles to open-end daily liquidity mutual funds, and

even if we're talking about syndicated loans, which compliance doesn't like you to refer it, but liquid loans, because they can be liquid, they can be illiquid, but syndicated loans have a secondary trading market, so if I look at BKLN or a closed-end fund, they're typically going to be more involved in the syndicated part of the market. Even those quote/unquote "liquid loans", liquidity can vary, and liquidity sometimes can ebb and flow at the wrong time, you can have open-end mutual funds that all get hit with outflows at the same time, and you have a lot of price action that's driven by this dynamic of these daily liquidity mutual funds operating in kind of an over-the-counter less liquid market. More recently you've had private credit, it's the hot dot asset class clearly. What I would argue is that private credit at its heart and soul is really nothing new, you're making first liens, senior secured hopefully, loans to companies, it's really just more the structure and origination process that that is kind of new, but even within the liquid market, an open-end mutual fund is not the best home for syndicated loans. On the flip side you have closed-end funds which I personally love closed-end funds, I own a lot of them in my personal account, they can be very inefficient at different points in time, but the really unique feature about loans is they're very stable, they don't move around a lot. So if I stick a lot of these stable loans in a closed-end fund where the price can swing around a lot, that's not an ideal home either. So an interval fund, it's not perfect, but certainly it's a great option in the sense that we can kind of control the flows, we can invest in illiquid assets, but I would argue that even in an interval fund format, you want to have some liquidity built in. Most of these interval funds have been lucky, they've seen nothing but inflows on the credit side for the last four or five years, at some point that's not going to be the case anymore. So I think investors need to understand, underneath the wrapper, what type of liquidity does the manager have if they have four or five quarters in a row of outflows and the inflows stop? So the interval fund is a great wrapper, but it's still important to understand that unlike a BDC that 5% tender process has to be managed inside with some liquidity.

KEVIN DOCKRELL: I think from our perspective on the BlueBay platform, we manage across the entire spectrum of daily liquidity mutual funds, monthly liquidity hedge funds, quarterly private funds, all the way out to five-year lockup on the private side, so we're pretty agnostic. I must say the Destra fund that we manage is the only interval fund that we manage, and there's definitely lots to be said for it. I think in particular for the event-driven fund that I

mentioned, there's probably two things that I would point to; first is just the nature of the liquidity of the underlying investments, now it's relevant to an extent, but probably not the overarching view as to why we think it's a good wrapper. If I look at the liquidity of our underlying investments across stressed, distressed, special sits, maybe about 40% of those could be liquidated within a day, rough numbers here, but 30% in a week, another 20% in a month, and only really that tail of 10-15% of names that would take more than a month to liquidate, so that's one point. But probably the main thing from our perspective as to why we think the interval fund makes sense for our event-driven strategy is just the time horizon for the trades that we're putting on. If I think about at one end of the spectrum at the shortest investment horizon for some of our trades would be three months, but if we're going into a full-on restructuring, that might take two, three years plus to play out. We wouldn't want to necessarily go through all the work, credit committee, deploy the capital, only to be forced to look to exit before the value has been realized. So really I think that kind of investment time horizon that we have lends itself well to the interval structure.

JONATHAN RICKMAN: Let's take a step back and talk about the market and talk about recent events. Could you both give us a market outlook and describe where you're seeing interesting opportunities from your different areas of focus?

KEVIN DOCKRELL: Yeah, sure, I can kick off. Yeah, it's definitely an interesting time. Although one big source of uncertainty has been removed over the course of the last week insofar as we now know who the next president of the US will be, but still from our standpoint there's still lots of other sources of uncertainty that need to play out. Just to name a few, what will a Trump 2.0 presidency look like? What will the path for inflation be here in the US and overseas? What the different central bank reactions will be, the world over as well, and how that will differ. Geopolitics clearly is another source of uncertainty with the war in Russia/Ukraine ongoing, Middle East as well, and clearly China, another source of uncertainty. So it feels like there's a lot of macro crosscurrents out there as we look into 2025, but at the same time it feels like markets, at least on the liquid public market side, are prized for perfection. See the S&P hitting new heights every day it seems, on the credit market side it seems that spreads at multi-year heights, so it feels like there's a bit of complacency out there, at least in the more mainstream traditional markets. So you look at things like IG corporate spreads at 75 basis points, or even high-yield spreads at 260, it's

really hard to make a very strong, compelling argument from a valuations perspective as to why they're a really good place to be, at least from my seat. Not to say that you still couldn't get away with mid-single digit returns in your fixed-income portfolio over the course of the next year, but for clients, investors who want to get to that high single digits into the teens, probably should be looking into alternative credit. In terms of where we're seeing the most opportunities, it really is not in the US, it's more in Europe where we do think if you have that stressed or distressed lens, that there could be lots of really good opportunities to come.

LARRY HOLZENTHALER: Yeah, and a few things I mentioned, from a high level I would say that the absolute value of credit spreads right now, I would agree are fairly tight, whether I'm looking at the direct lending market or the syndicated market, or some areas that are in between I would argue. But I would still say the relative value of credit, to your point, yeah, the last year or so the S&P is up almost 50%, about 25% this year, high yield is getting a lot in flows, the high-yield corporate bond asset class, and spreads in high yield are basically 300, maybe even a little bit inside of that depending on which index you look at, which is very unusual. If I go back to the mid-1980s for high-yield spreads to be flirting with inside of 300 basis point type levels now, people would tell you that the high-yield market is better quality than it has been historically, that's a fair point, but I would still say just take a step back, valuations are not super compelling, versus if I look at syndicated loans, they're probably 450 over. Again, that's probably a lower credit quality, so not a no-brainer, but potentially a little bit more value within credit. And equities, we are not rate people, we're credit people, but what I would say is we have 55 people on our investment team, we have about 40 analysts, and so we talk to a lot of companies on a monthly, quarterly basis, and I always like to say we're credit people, so we tend to be somewhat cynical and kind of look at the glass kind of half empty, and I would say that the economy is doing pretty well right now. Coming through earnings season, we're seeing a lot more beats than misses, GDP is still in the mid-twos, so to us that still feels inconsistent with a 3% fed funds rate, we think it's likely to remain higher than that based on what we see. So if I take a 3.5-4% fed funds rate, or SOFR rate which our loans typically key off of, I add a spread of let's say 450-500, even net of credit losses you're still looking at an equity-like return with obviously less risk. I'm not talking about volatility, I'm talking about actual risk, your senior secured first lien. So where we've been trying to find value within the credit market, one thing I would mention is the direct

lending market has grown so much that you now have direct lending deals that are literally multi-billion dollar deals between a single or a couple lenders and an issuer or private equity sponsor, and then you still have the traditional direct lending market where you're looking at companies that might be doing $20 or $30 million of EBITDA, that might be looking for a $30 or $50 million loan, we refer to that as the lower middle market, and there again is there no competition? No, there's competition everywhere, but there's less. And the reason that there's less is you have a lot more companies doing $25 million of EBITDA than doing a billion of EBITDA, and you have fewer direct lending managers fighting over these deals. I always like to remind people, if you're a direct lending manager and you make, let's say a billion dollar loan to a company, that loan's going to be outstanding for probably three or four years, so if I'm getting 1% management fee, it's probably higher than that, I can generate $40 or $50 million of revenue for doing three weeks of work. So what are managers going to focus on? They're going to focus on trying to do those billion dollar deals, because obviously the economics are a tenth the attractive for $100 million deal, and it takes just as long to underwrite a $100 million loan as a billion dollar loan. So that's one area, the lower middle market. If you looked at a lot of BDCs today, you look at the top 10 holdings, these are multi-billion dollar issuers, most of them were broadly syndicated loans that sat in BKLN a year ago that have refinanced into the private market. The last place I'll mention that you'll probably hear a lot in the press about, because right now everyone, it's the greatest thing ever, the truth is probably in the middle, is asset-based lending. So not asset-backed lending, but asset-based, where I come in, I make a loan to a company, but the collateral for that loan is not cash flows, it's maybe something like inventory or accounts receivable or a patent, intellectual property, so the assets can vary. You're hearing a lot of articles, of course the first articles that come out are this is the greatest thing ever because you're going to get bigger spreads, not a lot of people are doing it, it's lending, so I would argue it's just another arrow that you guys have in the quiver to generate attractive returns with hopefully excess return per unit of risk. So ABL is an area where it's pretty specialized, it's a little bit newer, that we're still finding some interesting transactions.

KEVIN DOCKRELL: Maybe just to chime in, I definitely agree with your point on the US. Definitely consensus is US has managed to navigate this soft landing, but maybe just to contrast that the picture in Europe is a lot bleaker. You look at somewhere like Germany,

which is historically been the manufacturing powerhouse of Europe, and some of the issues that it's having, even most recently with the government collapsing, it just seems that a lot of countries over in Europe are either in recession or on the brink of recession, and a lot of the companies that we're looking at now are really just showing signs of stress. Rewinding back, I think with the benefit of hindsight, a lot of companies just borrowed a hell of a lot back in the glory days of QE, were then hit with the pandemic, and a lot of them had to shudder their doors and still pay staff, pay rents, so emerged from the pandemic with a lot more leverage and less profitable. Were then hit with supply chain issues, hyperinflation on energy prices, and a pretty seismic rate cycle, so now we're just looking, kind of staring down the barrel of a lot of companies who are just far too levered and need to get their ship in order when at a time when bank lending standards are tightening and other elements of the capital markets are turning their back. So we see not as many opportunities in the US, absolutely, but certainly in Europe we feel it's a pretty fertile opportunity set from a stressed investor standpoint.

JONATHAN RICKMAN: Did you want to add to that, Larry? Keep it going? I got another question for you, if you want.

LARRY HOLZENTHALER: Yeah, no, I'll definitely just reiterate that so far we're all US-based as you would guess, especially in that lower middle market, where we definitely do expect a bit of a more firm backdrop where we operate, versus obviously overseas you clearly have a little bit of a different economic dynamic happening for sure.

JONATHAN RICKMAN: All right, some good insights. I'm sure you both would agree that good fund management is important, but you both talked about teams that you work with. Could you give us a flavor for how some of your teams help you navigate future events and due diligence and special situations and so forth?

KEVIN DOCKRELL: Yeah, sure. I think when you're looking at the segment of the market that we are, companies, very highly levered companies that are going through varying forms of stress or distress, clearly you need to have a very experienced team, individuals who have been through a number of default cycles and just have that deep credit expertise, that's absolutely part of the case. Also I think by virtue of the fact that we're a large investment platform that is a subsidiary of the Royal Bank of Canada, just having that pretty large sourcing network and that being plugged into various segments of the market is pretty

important. So in terms of sourcing opportunities, that's very important, but then clearly just being able to do your homework and identifying the right investments and pricing that risk, it's of paramount importance.

JONATHAN RICKMAN: Yeah, and so I was lucky, I started my career 20 years ago in the credit market, my mentor, we always used to tease him that he had been in the loan market since before there was even a loan index, which is the Credit Suisse Leveraged Loan Index which started in 1992. So if you've been in the loan market earlier than 1992, you've literally been in the market longer than there really was an asset class. With credit especially, experience matters. You're risk in credit is asymmetric to the downside, you make a loan at par, if everything goes well, you get your par back, and so avoiding not getting your par back is how you outperform in the loan market. It's less about finding the next Elon Musk and more about avoiding losers. So I joined First Eagle, and again I can tease our CIO Jim Fellows, because Jim also has been in the credit market since before there was an index. Why I think that's particularly important now is the credit landscape is really changing, you're seeing the word "creativity" used much more frequently than you typically would. I always like to say, take it back to the analogy of if you try to get a mortgage on a house, and you tried to replicate that terms sheet with the mortgage company, would they make you the loan? So as an example, we're now seeing a lot of BDCs that have loans that day one are what they call PIK, paid in kind, which means I'm not paying you in cash, I'm paying you more in the loan you already own. Now PIK used to be historically associated with stressed companies, so the thinking was if the company has problems, I will allow you to pay your interest in kind, it's to give flexibility to the issuer. But what we're seeing today are companies that are doing what I call PIK as plan A, meaning your first interest payment you know is going to be paid in kind. So imagine if you went to the mortgage company and you said, "I want to buy a house, I want to put 30 or 40% down on the house, it's in a good neighborhood, we appraised the house. But here's the thing, I'm not going to be able to make my first five interest payments," the bank would never make you that mortgage. I don't care if you put 90% down, they're going to walk away from the loan. That kind of flies in the face of lending. What we're seeing now are things like life sciences, bio, now there's nothing wrong with that, there's a lot of very smart people doing that, so I'm not sounding a fire alarm, but it's very different. If you had asked the typical credit investor 10 years ago that 10 years from now people are going to be willingly buying

into transactions that are PIKing day one, they would have said, "No, no, no," to that. So I think, look, it's good that you're able to do more creative things, but our team is a pretty traditional back to basics kind of corporate lending mentality, and I think a reason for that is our team has been together a long time and we've made mistakes, and we'll make more in the future, and credit is all about learning from your mistakes, trying to avoid them in the future. So we definitely take that experience seriously, and we take a bit of a cynical view quite frankly on some of the more creative quote/unquote "lending" going on within some of these different portfolios.

JONATHAN RICKMAN: Did you want to add anything, Kevin, before we turn it over to the audience?

KEVIN DOCKRELL: No, I think that was very comprehensive, yeah.

JONATHAN RICKMAN: Okay, good. Well, this is a good time for Q&A. Does anyone have a question? Right there.

AUDIENCE QUESTION: This one's geared towards Larry, you mentioned two different buckets that you're playing with, syndicated sponsor-driven loans where you make lower yield than a roll-up-your sleeves [inaudible 0:25:56] capital provider, senior secured first lien where you can use a little less leverage. But in a syndicated loan, [inaudible 0:26:05] slightly lower [inaudible 0:26:08]. Question is, [inaudible 0:26:13] talked about M&A activity, lower regulation versus advantages of small caps, smaller companies. What are you thinking? I'm not going to say just one year, but maybe over the next two, three years, where do you feel [inaudible 0:26:32] returns between those two strategies?

LARRY HOLZENTHALER: So we're a little bit biased, but what I would say is in the lower middle market where these guys are not going to have access to the syndicated market, they're smaller issuers, you're going to get a little bit of excess spread, there's going to be less competition, there's more of them, I think you're able to drive credit terms three turns of leverage or less, loan to value of less than 50%, and still get a pretty decent spread, 550-575 maybe. And I think in the syndicated market, the syndicated market has kind of gotten a bad rap because of the volatility associated with it, but what I would say is that volatility comes with liquidity. It's nice to know I can pick up the phone and call J.P. Morgan and say, "I want to sell this, what's the level?" And I can transact at that level or not, but it's nice to have the option. So I think a lot of people are discounting that volatility as risk, it's actually that excess

vol might actually means it has less risk because it's liquid. Where I think again, and we're biased, where I think there's some area for concern is that middle ground, this upper middle market where you may not have covenants. Everything we do has covenants, it has to, and if we are going to go in and make $100 million loan to the company, we're the only lender and we don't have covenants? That's unacceptable, so we have to have covenants. So if you have an illiquid loan that doesn't have covenants, that's suboptimal. And the spreads associated with this re-financing of broadly syndicated loans into the upper middle market, the really cool thing about that is I can see the transaction. So like Equinox gyms, which is right down the street here, they're all over Manhattan, used to live in the broadly syndicated loan market. I know the company inside and out because we used to own it. They couldn't refinance their loan a year ago, so they had to go to the private market, so now I can see what kind of spread is the private market getting on that Equinox loan? It's the same loan, it just now lives in a BDC basically, and I would say that anecdotally the spread on that loan for the risk they're taking, and now it's illiquid, it's not a no-brainer to me. So I think the upper middle market is an area where there's so much competition and there's so few billion dollar transactions to fight over, where the return per unit of risk is questionable. I think in the lower middle market and the core middle market there's still some value, and again I think the syndicated market is overlooked. I think everyone loves private credit right now and hates the syndicated market, that doesn't make a lot of sense, they're both making loans to companies. So that's our view.

JONATHAN RICKMAN: Anyone else? How about right back there?

AUDIENCE QUESTION: Yeah, this question is for Larry. You brought up ABL, asset-based lending, do you see that from a market standpoint, do you see that that asset class sits nicely next to what you guys are doing in direct lending? Is there not a lot of crossover there? [inaudible 0:29:33]?

LARRY HOLZENTHALER: They do complement each other pretty well. One thing about asset-based lending, if you think about it, it's somewhat countercyclical. As an example, retailers might look to get a loan on inventory when times are tough, and no one's ever going to make them a cash flow loan at that point, so it's kind of another lever that you can pull. You're also going to get, I would say that over time the spread attached to ABL is generally going to be higher than the spread attached to cash flow loans because they're riskier. I grew up as a

credit analysis and I was a shipping analyst, and you have a lot of hard assets associated with the collateral of shipping companies, and it makes it a lot harder to value, because how do I know what the value of that ship is? It's easier to value cash flow coming off of a hotel or something. So as a result of that, you're always going to have extra spread attached to ABL, which when spreads are tight I can get excess return per unit of risk, but again sourcing those loans is trickier, so it's hard to build, we think at this point, an entire fund around ABL, certainly to be multi-billion dollars. But within a portfolio of cash flow loans, it's just an interesting lever you can pull or area that you can look at to generate new originations.

JONATHAN RICKMAN: Anyone else? We have time for one more. Any parting thoughts? I think we got it. I think we're good, thank you.

KEVIN DOCKRELL: Thank you.

LARRY HOLZENTHALER: Appreciate it, yeah.

KEVIN DOCKRELL: Thanks, everybody.

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There are risks involved with any investment. The principal risks associated with an investment in the Fund, which could adversely affect its net asset value, yield and return, are set forth below. Please see the section "Further Information About Principal Risks" in the Prospectus for a more detailed discussion of these risks and other factors you should carefully consider before deciding to invest in the Fund. An investment in the Fund may lose money and is not a deposit of a bank or insured or guaranteed by the Federal Deposit Insurance Corporation or any other governmental agency. Investment Strategy Risk: The Investment Adviser uses the Fund's principal investment strategies and other investment strategies to seek to achieve the Fund's investment objective of attractive total returns, consisting of income and capital appreciation. There is no assurance that the Investment Adviser's investment strategies or securities selection method will achieve that investment objective. Because of the risks associated with investing in high-yield securities, an investment in the Fund should be considered speculative. An investment in interval Funds involves a high degree of risk. In particular: The fund's shares will not be listed on an exchange in the foreseeable future, if at all. It is not anticipated that a secondary market for shares will develop and an investment in an interval fund is not suitable for investors who may need the money they invest within a specified time frame. Interval Funds are suitable only for investors who can bear the risks associated with the fund's limited liquidity and should be viewed as a long-term investment. The amount of distributions that the fund may pay, if any, is uncertain. The fund may pay distributions in significant part from sources that may not be available in the future and that are unrelated to the fund's performance, such as a return of capital, borrowings or expense reimbursements and waivers. Interval funds may use leverage which may cause a portfolio to liquidate positions when it may not be advantageous to do so to satisfy its obligations or to meet segregation requirements. Leverage, including borrowing, may cause a portfolio to be more volatile than if the portfolio had not been leveraged.

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