CANDRIAM
A NEW YORK LIFE INVESTMENTS COMPANY

Us High Yield: a compelling opportunity

60 seconds with the fund manager

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Marketing communication

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After a prolonged bond bull market, and in the face of rising interest rates, investors are searching for ways to generate income and shield against interest rate-driven price volatility. We believe the U.S. high yield market continues to represent a sensible, low duration fixed income option according to Andrew Susser, Portfolio Manager for the US Corporate High Yield Bond strategy. Andrew Sussser is a manager at MacKay Shields, a management company owned by Candriam's parent company. MacKay Shields manages this strategy directly.

How is the MacKay Shields High Yield team organized?

The High Yield team focuses purely on high yield debt. As of May 31, 2022, we manage approximately $29 billion in high yield assets for clients through funds and mandates. We have a non-bureaucratic team of experienced sector portfolio managers that have an average of 26 years investment experience; each of them has gone through different market cycles and understands the nuances of restructurings and covenants.

How do you define your investment philosophy?

Our investment philosophy has been consistent for over 30 years. We are bottom-up(1) investors with a long-term outlook. Due to the asymmetric reward and risk profiles, investing in high yield bonds requires special attention to managing downside risk. We look for that additional cushion, or "margin-of-safety"(2) through asset coverage. We define asset coverage as the value of a company compared to the amount of debt it has. For example, if we think a company is worth $4 billion and its debt is $2 billion, the asset coverage is 2x. For us to consider investing in a high yield security, we require the asset coverage to be at least 1.5x.

This investment process imposes a discipline that keeps us focused on credits with significant downside cushion, so that an unforeseen development does not immediately put a recovery value at risk.

Finally, we are credit selectors that spend a lot of time getting to know the companies we invest in, viewing ourselves as lenders to these companies.

What is your investment process?

We start out with the 1,000+ issuers(3) in the high yield space before narrowing the list to a group of companies that meet our investment process. We look for bonds that are offering at least 200bps spread(4) over similar maturity U.S. Treasuries and may look for higher spread minimums depending on market conditions.

60 SECONDS WITH THE FUND MANAGER

(1) Bottom-up investing is an investment approach that focuses on analyzing individual stocks and de-emphasizes the significance of macroeconomic and market cycles.
(2) A margin of safety is a built-in cushion allowing for some losses to be incurred without major negative effect.
(3) Indicative data which may change over time.
(4) Indicative data which may change over time.

The next step is our margin-of-safety analysis, making sure we have at least 1.5x asset coverage[5] for each security under review. We approach asset value in as many ways as we can, to make sure credits meet our asset coverage minimum through as many ways as possible. A lot of time is spent on due diligence, understanding companies, and judging the nature of their assets and how strategic they are. We speak to management teams and assess their views on their capital structure. Capital structure and covenants are very important to us.

We generally have fewer bond offerings from LBOs[6] than the index because they generally have weaker covenants[7] and our views on what the capital structure should look like often conflicts with those of the private equity shareholders.

Finally, we look for a catalyst[8]. For example, we may think that a company may be acquired by an investment grade company, or that a bond has a restrictive covenant that would compel a company to redeem it early. However, the most important catalyst for bonds is improving credit profiles.

How important is the price you pay for bonds you like?

We assess relative value through our system of Risk Groups. Every bond in our portfolio is grouped into different risk buckets, from 1 to 4, each of which has an assumed long-term default rate.

“Group 1” credits are our highest quality bonds which are least likely to default.

We think of “Group 2” credits as our typical high yield bond.

“Group 3” high yield bonds are higher on the risk scale and they are the most research intensive bonds, often trading at a discount to par. They still have 1.5x asset coverage based on our analysis.

Last, we have a Group 4 for special situations, which are typically a small part of the portfolio.

What is the overall health of the high yield market?

We believe the underlying credit fundamentals of U.S. high yield remain broadly constructive. Not only is high yield primarily exposed to the U.S. economy, but the overall credit quality of the market remains benign. Most issuers in the U.S. high yield market are large publicly traded U.S. companies. In addition, the overall credit quality of the market has improved in recent years.

Since 2013, more than half of high yield new issuance has been rated BB and higher, according to JP Morgan (by comparison, in 2007, less than one-third of new issuance was rated BB and higher). We observe that credit profiles for the bulk of high yield issuers continue to be resilient.

According to JP Morgan, leverage ratios in high yield have remained stable over the last several years, while interest coverage has improved. Moreover, the high yield investor base now consists of unleveraged investors that that tend to be more stable and take a long-term view. Although ETF flows may create short-term volatility, they represent less than 3% of the market.

What are the keys selling points of your strategy?

We believe that our focus in High Yield is a significant competitive advantage. The High Yield team has focused solely on the U.S. high yield market since 1991. During that time, our investment process has remained consistent through different economic cycles. In addition, we believe our seasoned team of high yield experts is another competitive advantage. Our nine senior team members have an average of 26 years investment experience and deep knowledge of the sectors they cover. We focus on credit selection, rather than indexing or pursing macro or momentum strategies. We have a long-term outlook, and do not attempt to time the market or trade excessively.

(5) Indicative data which may change over time.
(6) A leveraged buyout (LBO) is the acquisition of another company using a significant amount of borrowed money (bonds or loans) to meet the cost of acquisition.
(7) In its broadest sense, a covenant is a promise, agreement, or contract between two parties. As part of the covenant, the two parties agree that certain activities will or will not be carried out.
(8) A catalyst in the markets can be anything that leads to a drastic change in a stock’s current price trend.

We have excellent access to company managements, and are generally able to secure favorable allocations to new issues; we are often active in structuring deals. In addition, we have excellent relationships with trading desks and are able to respond quickly to potential trades for large amounts of bonds.

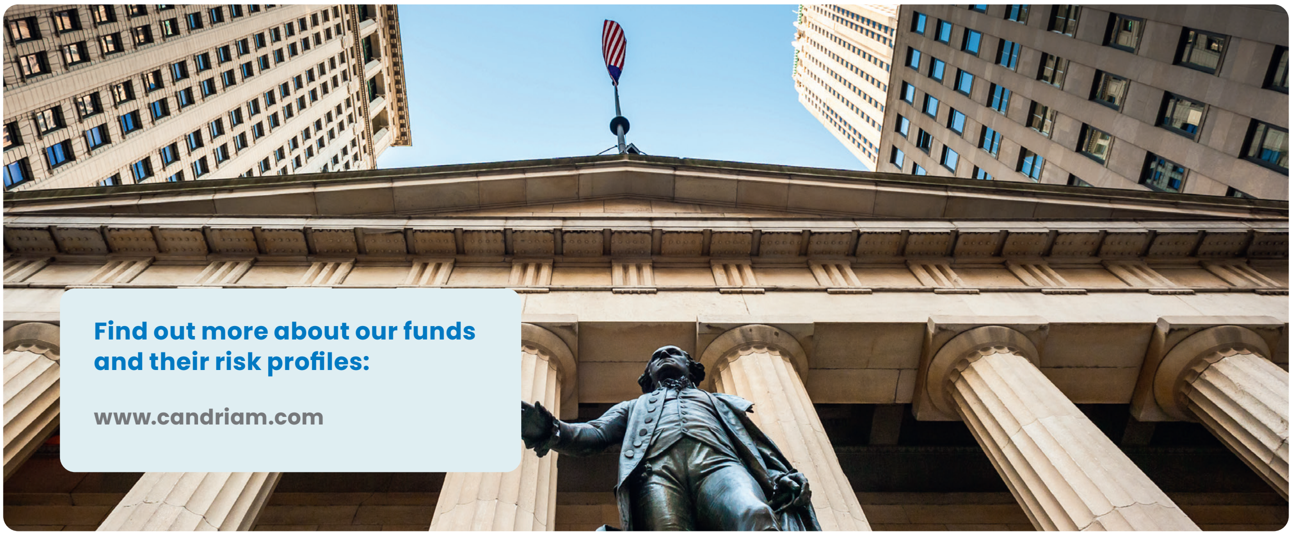
We believe the strongest evidence of our success is our historical returns(9).

(9) Past performance is no guarantee of future results and is not constant over time.

The main risks of the strategy are:

- **Risk of loss of capital**
- **ESG Investment Risk**
- **Sustainability Risk**
- **Equity risk**
- **Interest rate risk**
- **Credit risk**
- **Currency risk**
- **Liquidity risk**
- **Concentration risk**
- **Derivative risk**
- **Counterparty Risk**
- **External factors risk**

ESG Investment Risk: The non-financial objectives presented in this document are based upon the realization of assumptions made by Candriam. These assumptions are made according to Candriam's ESG rating models, the implementation of which necessitates access to various quantitative as well as qualitative data, depending on the sector and the exact activities of a given company. The availability, the quality and the reliability of these data can vary, and therefore can affect Candriam's ESG ratings. For more information on ESG investment risk, please refer to the Transparency Codes, or the prospectus if a fund.



Find out more about our funds and their risk profiles:

www.candriam.com