Capital at risk. The value of investments and the income from them may fall as well as rise and is not guaranteed. Investors may not get back the full amount invested.

Analysis

US High Yield – Current Market Considerations

January 2022

We believe a recent rise in volatility presents an interesting opportunity for investors in US high yield.

The US HY market performed relatively well through January 20th with spreads for the ICE BofA ML US Cash Pay High Yield (J0A0) and the ICE BofA ML BB B US Cash Pay High Yield Constrained Index (JUC4) only widening 1 and 2 basis points (bps), respectively, despite the indices declining 1.14% and 1.24%, respectively.

Essentially, this indicates to us that the year-to-date decline through this date was related to the increase in Treasury rates surrounding US Federal Reserve (Fed) policy and inflationary fears.

The high yield market was not, in our view, exhibiting any leadership to the downside (i.e., a potential increase in credit risk and default expectations), rather the reset in sovereign yields was readjusting yield levels across fixed income and terminal Discounted Cash Flow (DCF) valuations for equities.

However, over the two trading sessions of 20th and 24th January, high yield spreads have come under pressure due to the risk-off environment led by the equity selloff.

The J0A0 and JUC4 index spreads widened by 33bps and 32bps, respectively, while returns lagged by -0.78% and -0.77%, respectively, as the 10-year Treasury yield tightened slightly by 3bps. The spread widening coincided with the VIX[1] spiking from the moderately elevated mid-20s level on January 20th to an intraday high of 37 on January 24th. It is clear to us that high yield is taking a cue from equities.

Bryan Petermann

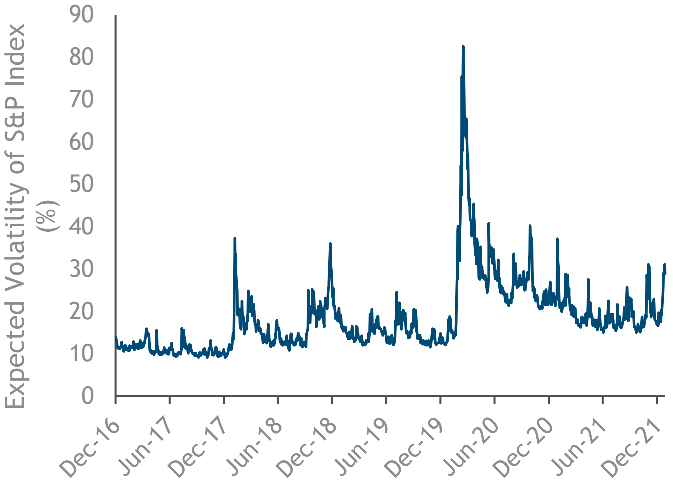
Portfolio Manager

Prior to joining Muzinich, Bryan worked for Pinebridge Investments (formerly AIG Investments) where he served as Managing Director, Head of High Yield for the last five years of his tenure. Bryan started his career in the banking sector. He worked in the media and cable groups at the Union Bank of California and Banque Paribas. Previously, he participated in the start of Société Générale's cable and media group. Bryan received a B.A. from the University of California, Los Angeles where he was a Phi Beta Kappa scholar, and an M.B.A. from the University of California, Berkeley.

The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy.

1. Source Bloomberg, as of 26th January 2021. Chicago Board Options Exchange's CBOE Volatility Index

Fig. 1 – Volatility has Increased



Source: Bloomberg, as of 26 January 2022. Chicago Board Options Exchange Volatility Index. For illustrative purposes only.

The VIX can be a reasonable predictor of short-term spread moves in high yield. Since the Great Financial Crisis (GFC), the VIX has tended to trade within a range of 10-20 during periods of stability; during these times high yield spreads have tended to tighten or remain stable.

Over the last 5 years, high yield spreads have typically traded in the 310-400bps range when the VIX has been below 20. However, high yield spreads tend to widen when the VIX elevates above the mid-20s, as we have seen over the past week.

The correlations are not perfect, as demonstrated by high yield spreads widening materially in late-2015 into early-2016 around the energy default crisis which was largely an issue of the high yield market's making, but they typically hold up well over time. The converse also occurs when the VIX declines precipitously as crises are resolved; high yield spreads tighten quickly and materially.

Over the long-term, high yield returns are a function of coupon income, rate and spread changes, and default losses. Earnings and equity volatility don't impact high yield returns, and cash flow generated for debt repayment is the primary source of high yield returns over time. Our current view of high yield fundamentals is still forward leaning.

We believe high yield fundamentals continue to improve. Leverage has declined precipitously from Q1 2020, interest coverage is over 4x, and cash remains elevated at levels last seen after the GFC. These indicators are positive for credit.

The asset class has elevated BB rated credits and trough CCC rated credits. These rating classes are both around 20-year best levels, in our view.[2]

In our view, rising stars should accelerate in 2022 as we move two-years beyond the Falling Angel events of H1 2020. High yield managers will sell the upgraded names and reinvest in high yield bonds as Rising Stars are announced.

The maturity wall is manageable and can be serviced by coupons through 2024, if necessary. Meanwhile, distress in high yield is minimal. The market has not experienced a default in six months and ended 2021 with a 0.29% default rate.[3] We expect below average defaults in 2022 and 2023 at this point.

It is difficult to call market bottoms, but high yield investors don't need to do this to make positive returns since coupon is the largest contributor to total return over time.

As of January 24, 2022, the J0A0 has a spread of 356bps over Treasuries; a level above the July 1, 2021 low of 310bps, but inside the recent November 30, 2021 peak of 379 bps and the 400-450 bps levels experienced during a choppy 2019.[4] The J0A0 has a current yield of 5.56% and we expect investors to achieve that bulk of this as defaults remain low.[5] This will also result in minimal default losses going forward in our opinion.

Investors need to assess the prospects of future rate changes coupled with spread movement to determine total return expectations from current levels. These expectations are clearly improved from recent levels given the increase in Treasury yields, the widening of spreads, and stable fundamentals.

We believe further spread widening will only improve the total return prospects of the asset class, and we believe that longer-term investors should begin to assess entry points and be prepared to act if spreads hit their targets.

The VIX will not remain elevated forever and spreads will compress quickly when equity volatility subsides. Buying before a clear buy signal and before we reach the bottom will be required to capture outsized returns.

2. ICE Platform, as of January 24th 2022
3. JP Morgan Default Monitor, High Yield and Leveraged Loan Research, January 3rd, 2022.
4. ICE Platform, as of January 24th 2022
5. IBID

Index Descriptions

J0A0 – The ICE BofA ML US Cash Pay High Yield Index tracks the performance of US dollar denominated below investment grade corporate debt.

JUC4 - The ICE BofA ML BB B US Cash Pay High Yield Constrained Index contains all securities in the ICE BofA ML US Cash Pay High Yield Index (J0A0) rated BB1 through B3, based on an average of Moody's, S&P and Fitch, but caps issuer exposure at 2%.

VIX – Chicago Board Options Exchange Volatility Index – The VIX Index is a financial benchmark designed to be an up-to-the-minute market estimate of the expected volatility of the S&P 500 Index and is calculated by using the midpoint of real-time S&P 500 Index option bid/ask quotes.

Risk: Index performance mentioned in this material is for illustrative purposes only. You cannot invest directly in the index.

Important Information

Muzinich & Co. referenced herein is defined as Muzinich & Co., Inc. and its affiliates. This material has been produced for information purposes only and as such the views contained herein are not to be taken as investment advice. Opinions are as of date of publication and are subject to change without reference or notification to you. Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy. The value of investments and the income from them may fall as well as rise and is not guaranteed and investors may not get back the full amount invested. Rates of exchange may cause the value of investments to rise or fall. Emerging Markets may be more risky than more developed markets for a variety of reasons, including but not limited to, increased political, social and economic instability; heightened pricing volatility and reduced market liquidity.

Alternative investments can be speculative and are not suitable for all investors. Investing in alternative investments is only intended for experienced and sophisticated investors who are willing and able to bear the high economic risks associated with such an investment. Investors should carefully review and consider potential risks before investing. Certain of these risks include: (a) Loss of all or a substantial portion of the investment;(b) Lack of liquidity in that there may be no secondary market for interests in the Fund and none is expected to develop in advance of an IPO; (c) Volatility of returns; (d) Restrictions on transferring interests; and (e) Potential lack of diversification and resulting higher risk due to concentration within one of more sectors, industries, countries or regions.

This material and the views and opinions expressed should not be construed as an offer to buy or sell or invitation to engage in any investment activity; they are for information purposes only. Opinions and statements of financial market trends that are based on market conditions constitute our judgement as at the date of this document. They are considered to be accurate at the time of writing, but no warranty of accuracy is given and no liability in respect of any error or omission is accepted. Certain information contained herein is based on data obtained from third parties and, although believed to be reliable, has not been independently verified by anyone at or affiliated with Muzinich and Co., its accuracy or completeness cannot be guaranteed. Risk management includes an effort to monitor and manage risk but does not imply low or no risk

This discussion material contains forward-looking statements, which give current expectations of the Fund's future activities and future performance. Further, no person undertakes any duty or obligation to revise such forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events. Muzinich makes no representation or warranty (express or implied) with respect to the information contained herein (including, without limitations, information obtained from third parties) and expressly disclaims any and all liability based on or relating to the information contained in, or errors omissions from, these materials; or based on or relating to the recipient's use (or the use by any of its affiliates or representatives or any other person) of these materials; or based on any other written or oral communications transmitted to the recipient or any of its affiliates or representatives in the course or its evaluation of Muzinich.

United States: This material is for Institutional Investor use only – not for retail distribution. Muzinich & Co., Inc. is a registered investment adviser with the Securities and Exchange Commission (SEC). Muzinich & Co., Inc.'s being a Registered Investment Adviser with the SEC in no way shall imply a certain level of skill or training or any authorization or approval by the SEC.

Issued in the European Union by Muzinich & Co. (Ireland) Limited, which is authorized and regulated by the Central Bank of Ireland. Registered in Ireland, Company Registration No. 307511. Registered address: 32 Molesworth Street, Dublin 2, D02 Y512, Ireland. Issued in Switzerland by Muzinich & Co. (Switzerland) AG. Registered in Switzerland No. CHE-389.422.108. Registered address: Tödistrasse 5, 8002 Zurich, Switzerland. Issued in Singapore and Hong Kong by Muzinich & Co. (Singapore) Pte. Limited, which is licensed and regulated by the Monetary Authority of Singapore. Registered in Singapore No. 201624477K. Registered address: 6 Battery Road, #26-05, Singapore, 049909. Issued in all other jurisdictions (excluding the U.S.) by Muzinich & Co. Limited. which is authorized and regulated by the Financial Conduct Authority. Registered in England and Wales No. 3852444. Registered address: 8 Hanover Street, London W1S 1YQ, United Kingdom. 2022-01-26-7888