

*At Shenkman, we believe short duration high yield ("SDHY") offers a compelling risk/reward profile that has led many investors to actively allocate to this strategy as an attractive addition to a diversified fixed income portfolio and a higher income alternative to short duration investment-grade ("IG") credit and other higher quality, shorter-term fixed income strategies. The dramatic market movements seen over the last five years highlight the necessity to offer investment strategies that are both resilient and provide attractive risk-adjusted returns. This report illustrates several examples of how and why a quality short duration high yield strategy can help investors capture incremental yield while seeking to minimize risk.*

### Summary

- SDHY combines high coupon income with opportunities to add alpha and manage the portfolio through calls, tenders, and other credit-specific catalysts, while mitigating interest rate risk.
- With negative correlation to U.S. Treasuries, increased "duration coverage", and a moderate level of volatility, we believe it is an attractive addition to a diversified fixed income portfolio and a compelling alternative to short duration investment-grade (IG) credit and other higher quality, shorter-term fixed income strategies.
- We believe in-depth credit research and prudent active management are critical to identifying alpha potential and discerning "money good" credits.

### Introduction

Many institutional and high net worth investors have increasingly allocated to SDHY with the goal of enhancing the returns of their core fixed income allocations while still limiting volatility. We have also witnessed investors utilizing SDHY as an alternative or complement to lower-yielding investment grade and U.S. Treasury bond portfolios. In addition to a low duration profile, SDHY offers important benefits such as incremental income generation over investment grade and U.S. Treasury fixed income alternatives and the potential to minimize volatility/drawdowns for diversified fixed income portfolios. Today's uncertain economic environment and rate volatility has led investors to explore ways to increase income yield while balancing credit and interest rate risk. Key to this analysis is finding the optimal mix of yield, volatility, and duration that results in enhanced income while limiting potential capital losses.

For the purpose of this analysis, we define the universe of short duration high yield as the ICE BofA 0-2 Year Duration BB-B U.S. High Yield Constrained Index (H42C). Much more than simply shortening the tenor and duration of a broad high yield exposure, this index omits the lowest rated issues, which we believe is appropriate for investors seeking to mitigate downside volatility and capital losses. When investing in SDHY, the primary objective is to capture the high

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coupon income while avoiding negative credit events and add value through owning bonds with attractive optionality through calls and tenders and credit selection of misrated "money good" issuers.

Over the past 10 years, the 5-year U.S. Treasury yield has risen meaningfully to 4.25% as of February 29, 2024, versus approximately 1.50% then (please see **Exhibit 1** below). The volatility in the 5-year U.S. Treasury yield during this time period has also been dramatic, with a range of as much as 477 basis points. The yield was as high as 4.96% in October of 2023 and as low as 0.19% in August of 2020. Over the trailing ten-year period ending February 29, 2024, the short duration high yield universe (H42C) returned 3.58%, comparing favorably to 1.86% for the U.S. 1-3 Year Investment Grade Corporates (C1A0), 2.10% for the U.S. 1-5 Year Investment Grade Corporates (CVA0), and 1.43% for the Bloomberg Capital U.S. Aggregate Bond Index (LBUS). In this report, we examine the current data and re-examine the merits of SDHY versus other alternatives and consider the benefits of its inclusion within a diversified, core fixed income allocation.

### Exhibit 1: 5-Year U.S. Treasury Yields 2/28/2014 – 2/29/2024



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### Merits of Short Duration High Yield

***Potential for Enhanced Returns.*** For many investors, the premise of allocating to the shorter durated debt of high yield companies is simple: rather than earn lower yields in cash and much of the investment grade and Treasury fixed income universe, clip the higher coupon in "money good" credits with ample near-term liquidity while seeking to avoid defaults. We believe active portfolio management and in-depth credit research are critical to the execution of such a strategy. Beyond simply modeling the issuers' financials, investors must develop insights into how the management teams of high yield companies intend to manage their balance sheets and address near-term financing needs. Understanding these nuances helps managers potentially add alpha through prudent credit selection, while preserving principal and ultimately earning attractive coupon income. While investors may experience some mark-to-market volatility in times of significant stress (please see Volatility & Return section below), we believe the thesis for SDHY as

part of a diversified fixed income portfolio or tiered cash management program is sound given the potential to improve Sharpe ratios.

### Yield-to-Likely™

*Structural Alpha Opportunities and Yield-to-Likely™*. An important aspect of SDHY is gauging the appropriate yield in light of the fact that the majority of bonds in the high-yield market are callable and can be redeemed at various call dates prior to maturity. As a result, it is critical to consider the impact of embedded options on a bond's potential return profile and duration. It is important to note that market convention in pricing high-yield callable bonds is to quote the corresponding yield-to-worst and duration-to-worst for a given price. From a yield perspective, the resulting quoted yield will be the lowest and most conservative outcome of the multiple redemption scenarios. This ensures specific income or yield requirements will still be met even in the worst redemption scenario. However, our experience has proven that yield-to-worst can often-times be an overly conservative metric for an actively managed strategy. This is particularly true when callable bonds are trading at discounts or premiums as compared to their call prices and par. A key driver of this dynamic is the fact that an issuer's decision to call or redeem its bonds is not solely based on refinance economics such as payback period and NPV, but more often driven by company specific motivations and circumstances. Some motivations beyond refinance economics can include the following:

- Issuer is seeking to make a large acquisition that may require additional debt financing and looking to delay refinancing to occur in conjunction with the acquisition so as not to harm or frustrate investors.
- LBO sponsor may be approaching the end of its investment horizon on a portfolio company, or a bond's issuer is either in process or seeking to be acquired and not pursuing a refinancing of currently callable debt that would likely result in new call protection premiums making the target less appealing and more costly to potential suitors.
- Issuer is awaiting conclusion of a strategic review that could result in a sale, spinoff, or IPO of certain significant assets or the entire company, all of which can be an extended process.
- Issuer is awaiting the benefit of improved operational trends over several quarters or expected/targeted credit rating improvement in anticipation of more favorable refinancing terms.
- Issuer is looking to remove onerous covenant provisions tied to a specific bond indenture that could incentivize them to redeem the bonds early due to the additional financial flexibility incentives.
- Issuer seeking to coordinate redemption timing with other upcoming callable bonds or refinancing opportunities, or senior management may simply be philosophically averse to paying large premiums to redeem bonds even if payback economics justify.
- Issuer seeking to redeem bonds early due to rising rate (or rate volatility) expectations or a desire to not have bonds become a current liability on the balance sheet within one year of maturity, putting them at risk for a going concern qualification or potentially being forced to refinance in an unfavorable environment.

These are just a few of the multitude of company-specific circumstances that will ultimately drive the timing of refinancing and redemption decisions. As a result, yield-to-worst (YTW) for callable bonds trading at a premium can often-times not be the best indicator of the likely yield. Likewise, the current yield (coupon divided by price) is not an accurate judge of yield either as amortizations of premium or discount in price must be factored in as well thus impacting a bond's ultimate realized yield. So, the question becomes "What is a better or additional estimate of yield to

consider?" We refer to it as "Yield-to-Likely" (YTL)<sup>TM</sup> – a proprietary metric that incorporates our insights into when bonds are most likely to be redeemed (or not called). When bonds are trading at premiums to par, this YTL<sup>TM</sup> metric tends to fall much closer to the yield-to-maturity (YTM) which also lies between the YTW and current yield as it incorporates the amortization of a bond's premium over time. Investors may be able to capture greater yields and returns with more informed assumptions beyond the standard worst-case metric. When bonds are trading at discounts to par, this YTL<sup>TM</sup> metric has the potential to highlight incremental yield opportunities above the YTM/YTW where bonds can be retired prior to maturity. Through in-depth research of catalysts driving the call and tender activity on each individual issue, a skilled manager can potentially add value and evaluate when bonds are most likely to be called to determine the yield to that more "likely" call date. Strong bottom-up fundamental research process can help a manager to understand issuers' financing needs and seize upon idiosyncrasies within the SDHY universe. The illustrations below demonstrate currently callable bond examples at purchase, both above and below par. It highlights how quickly a bond's yield can ramp beyond the yield-to-worst or yield-to-maturity if it is not redeemed per the "worst" assumption as well as the meaningful incremental yield that can be captured when a manager's likely call date may differ with market expectations.

**Theoretical Short Duration Callable Bond Examples Based on Premium Bond Price**

Bond Purchase Information		First (Worst) Call	+30 days	+60 days	Likely Call* +90 days	Maturity
Coupon	7.75%					
Final Maturity	2/1/2026					
Purchase Date	1/1/2022	Call Date	2/1/2022	3/1/2022	4/1/2022	5/1/2022
Purchase Price	104.34	Call Price	103.875	103.875	103.875	100
Yield-to-Worst	2.0%	Annualized Yield	2.0%	4.7%	5.6%	6.1%
Duration-to-Worst	0.08					6.5%

\* Manager estimate.

Theoretical bond information is provided for illustrative purposes only and subject to change. . Any trends depicted above may not continue. Past performance is not a guarantee of future results.

The above theoretical example highlights where a callable short duration bond may have been trading prior to the dramatic Fed rate hike cycle in early 2022. As shown, the Yield-to-Likely<sup>TM</sup> of this particular bond is 6.1%, representing an incremental annualized return of over 410 basis points above the quoted YTW. If this bond is called at the earliest opportunity, a yield-to-worst return would be realized. But if the call date is ultimately later than this date (but prior to maturity), then it's possible for an investor to achieve enhanced returns in a lower risk manner, without having to look to bonds with higher credit or default risk to capture higher yields.

The below theoretical example is more indicative of where a callable short duration bond is trading in the current higher rate and discounted price environment. In the below theoretical example, the Yield-to-Likely<sup>TM</sup> of this particular bond is 7.5%, representing an incremental annualized return of over 50 basis points above the quoted YTW/YTM. If this bond remained outstanding until maturity, a yield-to-worst return would be realized. But if the bond is ultimately called prior to maturity, then it is possible for an investor to achieve enhanced returns, and similar to the example above, also in a lower risk manner, without having to look to bonds with higher credit or default risk to capture higher yields.

Theoretical Short Duration Callable Bond Examples Based on Discounted Bond Price

Bond Purchase Information		Next Call	3yrs early	2yrs early	Likely Call* 1yr early	(Worst Call) Maturity
Coupon	6.25%					
Final Maturity	3/15/27					
Purchase Date	1/1/24	Call Date	1/31/24	3/15/24	3/15/25	3/15/26
Purchase Price	\$97.0	Call Price	\$103.1	\$101.6	\$100.0	\$100.0
Yield-to-Worst	7.3%	Annualized Yield	81.8%	29.2%	8.9%	7.8%
Duration-to-Worst	2.80					7.3%

\* Manager estimate.

Theoretical bond information is provided for illustrative purposes only and subject to change. . Any trends depicted above may not continue. Past performance is not a guarantee of future results.

While past experience is never a guarantee of future outcomes, looking back historically provides a valuable perspective at how this favorable dynamic with callable bonds has played out. Over the past ten years, the SDHY investable universe that we cover and analyze has had a large majority of callable bonds that did not come out at their first call date. They are typically retired after (or before) their first call dates resulting in measurable incremental returns beyond their first call and/or "worst" yield calculations for investors. Additionally, over the last 20 years, our research indicates that roughly 94% of bonds in the high yield market were retired at least 12 months prior to maturity, and over 77% of bonds were retired at least 24 months prior to maturity.

Another potential benefit of investing in SDHY (especially in rising and volatile rate environments) involves its still relatively short final maturity tenor and related higher level of corporate action activity and turnover. In our experience in managing SDHY, this asset class has experienced a larger volume of calls, tenders, and maturities than our traditional longer duration portfolios. As these bonds are called, redeemed, or mature, this situation creates natural inflows within the portfolio that can be reinvested at higher yields, especially in a rising rate environment. Investment grade portfolios have very low exposures to callable bonds and therefore will tend to see much less corporate action activity.

With an average price of \$98.7, YTW of 7.1%, Current Yield of 6.6%, and Yield-to-Maturity of 7.5% as of February 29, 2024, SDHY (H42C) has an attractive overall yield profile while embedded options imply what we believe is an attractive Yield-to-Likely™ metric for higher quality portfolios.

Alternative Solution to Investment Grade Duration Risk. Many investors have reached the conclusion that the yield an investor receives from traditional investment grade strategies, as reflected by the Bloomberg Capital U.S. Aggregate Bond Index (LBUS) or the ICE BofA U.S. Corporate Index (COA0), does not adequately compensate for the interest rate risk that the investor assumes. The yield and duration metrics of investment grade fixed income, as shown in **Exhibit 2** below, support such a conclusion. While investors in those fixed income segments may not be taking on significant credit risk, they are in fact taking on meaningful duration and interest rate risk. That said, while the market is currently anticipating the Fed Funds rate to come down after a historic and rapid period of increases, given how inverted the yield curve currently is, markets may not behave as they have historically posted an aggressive rate hiking campaign. If the yield curve is going to return to a more positive and historical steepness, we could get substantial movement on the short end from rate cuts and potentially little to no benefits on the longer end.

## Exhibit 2. Yield &amp; Duration Comparison

Data as of 2/29/2024

	Yield-to-Worst	Average Coupon	Yield-to-Maturity	Duration-to-Worst
U.S. Aggregate <sup>1</sup>	4.92%	3.17%	4.92%	6.24 years
U.S. IG Corporate <sup>2</sup>	5.46%	4.12%	5.50%	6.68 years
Short Duration High Yield <sup>3</sup>	7.12%	6.46%	7.48%	1.22 years

<sup>1</sup> U.S. Aggregate is based on the Bloomberg Capital U.S. Aggregate Bond Index.<sup>2</sup> U.S. IG Corporate is based on the ICE BofA U.S. Corporate Index (COAO).<sup>3</sup> Short Duration High Yield is based on the ICE BofA 0-2 Year Duration BB-B U.S. HY Constrained Index (H42C).

Source: ICE Data Indices, Bloomberg, Shenkman Capital. Any trends depicted or described above may not continue.

Given the meaningful interest rate sensitivity in investment grade fixed income (i.e., duration>yield), the next logical question is, "What is the alternative?" Over the past 10 years, SDHY has exhibited a correlation of 0.06 to the 5-year U.S. Treasury note. That is, when the 5-year U.S. Treasury note sold off and interest rates rose, SDHY has tended to outperform. Conversely, short duration investment-grade corporate bonds had positive correlations to the 5-year U.S. Treasury note (+0.54 and +0.60 for 1-3 year investment-grade corporates and 1-5 year investment-grade corporates, respectively, over the trailing 10-year time period), thus tending to lose value when interest rates rose (please see **Exhibit 3** below).

## Exhibit 3. Correlation to 5-Year U.S Treasury Note

Data as of 2/29/2024

	Trailing 5-Year	Trailing 10-Year
Short Duration High Yield <sup>1</sup>	0.07	0.06
U.S. 1-3 Year IG <sup>2</sup>	0.54	0.54
U.S. 1-5 Year IG <sup>3</sup>	0.59	0.60

<sup>1</sup> Short Duration High Yield is based on the ICE BofA 0-2 Year Duration BB-B U.S. HY Constrained Index (H42C).<sup>2</sup> U.S. 1-3 Year IG is based on the ICE BofA 1-3 Year U.S. Corporate Index (C1A0).<sup>3</sup> U.S. 1-5 Year IG is based on the ICE BofA 1-5 Year U.S. Corporate Index (CVA0).

Source: ICE Data Indices, eVestment. Any trends depicted or described above may not continue.

While investing in SDHY entails incrementally more credit risk than other short duration and broader fixed income alternatives, we believe one can help mitigate credit risk via active management, fundamental research and portfolio diversification. Although investment grade short duration options are higher credit quality, they have lower yields and greater interest rate sensitivity, making them potentially less attractive options in periods of rate volatility or low rate environments. This is an important consideration as there is only so much that can be done to limit capital losses in investment grade portfolios when rates rise. To illustrate, we compare characteristics of SDHY to those of investment grade short duration benchmarks as well as the broader investment grade benchmark in **Exhibit 4** below.

Also included in **Exhibit 4** below is a measure we refer to as "duration coverage," or the amount of yield per unit of duration (YTW and/or YTM divided by DTW). For SDHY, it is also sometimes useful to consider YTM/DTW in particularly low yield environments where YTW may be depressed as most bonds are not redeemed at their first and/or worst call.

Currently, long duration investment grade bonds provide less compensation to investors for the interest rate risk they are assuming.

#### Exhibit 4. Short Duration HY vs IG Bonds Data as of 2/29/2024

	Short Duration HY <sup>1</sup>	U.S. 1-3 Year IG <sup>2</sup>	U.S. 1-5 Year IG <sup>3</sup>	U.S. IG Corporate <sup>4</sup>
Average Price	\$98.70	\$96.51	\$96.52	\$91.74
Current Yield	6.55%	3.64%	3.99%	4.49%
Yield-to-Worst	7.13%	5.42%	5.36%	5.46%
Yield-to-Maturity	7.49%	5.49%	5.43%	5.50%
Modified Duration-to-Worst	1.22 years	1.82 years	2.58 years	6.68 years
Duration Coverage (YTW/DTW)	6.1x	3.0x	2.1x	0.8x
Estimated Return after +100 bps curve Shift <sup>5</sup>	5.91%	3.60%	2.78%	-1.22%
Estimated Return after -100 bps curve Shift <sup>5</sup>	8.35%	7.24%	7.94%	12.14%

<sup>1</sup> Short Duration High Yield is based on the ICE BofA 0-2 Year Duration BB-B U.S. HY Constrained Index (H42C).

<sup>2</sup> U.S. 1-3 Year IG is based on the ICE BofA 1-3 Year U.S. Corporate Index (C1A0).

<sup>3</sup> U.S. 1-5 Year IG is based on the ICE BofA 1-5 Year U.S. Corporate Index (CVA0).

<sup>4</sup> U.S. IG Corporate is based on the ICE BofA U.S. Corporate Index (COA0).

<sup>5</sup> Assuming parallel shift in the U.S. Treasury yield curve as an instant shock, approximated by adding/subtracting DTW against YTW as a proxy for 12mo performance, all else being equal.

Source: ICE Data Indices, Bloomberg, Shenkman Capital. Any trends depicted or described above may not continue. Past Performance is not a guarantee of future results.

In the above illustration, we also consider the estimated effect of a 100 basis point upward parallel shift in the yield curve over a one year period. All else equal, short duration investment-grade corporates lose a meaningful portion of their yield as rates rise. In contrast, SDHY's meaningful current yield provides much higher incremental cushion to overcome the capital depreciation, resulting in an estimated 5.91% return. In an environment of rate volatility, we believe duration risk in investment-grade fixed income clearly appears to be meaningfully higher, especially across non-maturity constrained corporates where the lack of duration coverage is most evident. Conversely, while longer durated indices will benefit in declining rate environments, it is important to observe the unique characteristics of the current rate environment given the significant Treasury yield curve inversion. (See additional detailed discussion on this point further ahead in section Performance in Declining Rate Environments.)

The following analysis highlights periods of rising/declining interest rates that were not also associated with significant recessionary, credit, or geopolitical events.

*Performance in Rising Rate Environments.* Given the dramatic rise in Treasury yields over the past several years, we believe a look at more recent relative performance in specific past rising rate environments is instructive. See **Exhibit 5** below. While each period has its own unique circumstances and conditions, the data supports the longer-term correlations and general view that duration and duration coverage are among the primary drivers of returns in periods

of rising rates. As a result, SDHY (H42C) posted positive returns in all the rising rate environments displayed below, in contrast to many of the fixed income segments noted in the exhibit and elsewhere in this report.

**Exhibit 5. Periodic/Annualized Returns During Periods of Rising Rates (10-Year Treasury)**  
Data as of 2/29/2024

	5/1/2013 – 12/31/2013	9/1/2017 – 9/30/2018	8/1/2021 – 10/31/2023
SDHY (H42C) *	2.75%	3.62%	2.38%
U.S. IG Short Duration 1-3 (C1A0)	0.91%	0.74%	-0.87%
IG Short Duration 1-5 (CVA0)	0.39%	0.06%	-2.23%
High Yield Bonds (HOA0)	2.49%	3.56%	-2.68%
Investment Grade (COA0)	-3.15%	-1.22%	-8.20%
Bloomberg U.S. Agg (LBUSTRUU)	-2.89%	-1.56%	-7.60%
ICE BofA Current 5yr Treasury (GA05)	-3.15%	-2.66%	-5.86%
ICE BofA Current 10yr Treasury (GA10)	-9.14%	-5.15%	-10.57%
ICE BofA 0-3 Year Treasury (G1QA)	0.12%	0.39%	-0.03%
5-Year Treasury Change in Yield	+107 bps	+125 bps	+315 bps
10-Year Treasury Change in Yield	+136 bps	+94 bps	+269 bps

\*Short Duration High Yield is based on the ICE BofA 0-2 Year Duration BB-B U.S. HY Constrained Index (H42C).

Source: ICE Data Indices, Bloomberg, Shenkman Capital. Any trends depicted or described above may not continue. Past Performance is not a guarantee of future results.

*Performance in Declining Rate Environments.* Given SDHY's logical outperformance during periods of rising rates, the rational conclusion would be that SDHY should lag behind other longer-durated segments of the fixed income market during periods of declining rates. See **Exhibit 6** below. While the returns during the indicated periods of declining rates prove this out, we note that SDHY held its own despite the economic uncertainty during those periods. However, it's important to highlight a key difference between prior periods of rate decline and today. Both declining rate periods observed in the chart below were during periods where the Treasury curve was not as inverted as it is today. The 12/31/13 – 1/31/15 rate decline period began the period with a 3 month to 10-year Treasury curve spread of 296bp (245bp average period spread). The 10/31/18 – 8/31/19 rate decline period began with a spread of 82bp (average period spread of 13bp); however, we note that the Treasury curve did invert during the final 100 days of this period, reaching a peak inversion of -51bp on 8/27/19.



## Exhibit 6. Periodic/Annualized Returns During Periods of Declining Rates (10-Year Treasury)

Data as of 2/29/2024

	1/1/2014 – 1/31/2015	11/1/2018 – 8/31/2019
SDHY (H42C) *	2.55%	4.92%
U.S. IG Short Duration 1-3 (C1A0)	1.59%	5.20%
IG Short Duration 1-5 (CVA0)	2.91%	7.03%
High Yield Bonds (HOA0)	2.96%	7.73%
Investment Grade (COA0)	9.60%	15.13%
Bloomberg U.S. Agg (LBUSTRUU)	7.52%	11.77%
ICE BofA Current 5yr Treasury (GA05)	4.96%	9.74%
ICE BofA Current 10yr Treasury (GA10)	14.52%	17.51%
ICE BofA 0-3 Year Treasury (G1QA)	0.76%	3.69%
5-Year Treasury Change in Yield	-59 bps	-157 bps
10-Year Treasury Change in Yield	-139 bps	-163 bps

\*Short Duration High Yield is based on the ICE BofA 0-2 Year Duration BB-B U.S. HY Constrained Index (H42C).

Source: ICE Data Indices, Bloomberg, Shenkman Capital. Any trends depicted or described above may not continue. Past Performance is not a guarantee of future results.

Given the steep inversion of the Treasury curve that we are witnessing in the current environment (-111bps as of 03/15/24), futures markets are implying that the unwind of the most recent rate hike cycle may be different than prior rate cut cycles. This is likely due to market expectations that the Treasury curve should return to a more normal steepness between front-end rates and longer-term rates. The 20-year average spread of 3-month to 10-year Treasury rates is 143bps. See **Exhibit 7** below. Current Treasury Forward curves are calling for 5-year and 10-year Treasury rates to not change much from current levels while 3 month rates are forecast to drop by 142bps over the next 2 years. In this scenario, longer duration exposures may not benefit from a declining rate environment in the way they have historically.

## Exhibit 7. U.S. Treasury Forwards

Data as of 3/15/2024

	Current	1-Yr Forward	2-Yr Forward
3 months	5.40%	4.31%	3.98%
5-Year	4.29%	4.14%	4.13%
10-Year	4.29%	4.26%	4.31%

Source: Bloomberg. Any trends depicted or described above may not continue. Past Performance is not a guarantee of future results.

*Volatility & Return.* An attractive aspect of SDHY is that as bonds near maturity, or likely call dates, the key drivers of price volatility often shift toward credit-specific factors. As a result, the influence of macro drivers diminishes, resulting in less volatility from swings in global risk sentiment. For instance, when Coronavirus rocked the global financial markets in the first quarter of 2020, the S&P 500 Index and broad high yield market (HOA0) plummeted nearly 20% and 13%, respectively, while SDHY limited the decline to 6.7%, which was closer to the drawdown seen with investment grade corporates (COA0) which declined 4.0%, despite the latter benefiting from a 125 basis point decline in the 10-year U.S. Treasury rate to 0.67% at March 31, 2020.

Notwithstanding that SDHY's historical volatility is higher than that of its investment-grade counterparts, we believe that investors appear well-compensated given SDHY's moderate level of volatility, particularly in light of the potential for alpha opportunities and relatively attractive downside protection. **Exhibit 8** illustrates that over the last 10+ years, the incremental risk of SDHY has been rewarded, as exemplified by higher risk-adjusted returns across the various short duration alternatives.

### Exhibit 8. Annualized Risk & Return Comparison Since Inception 4/30/2006 – 2/29/2024

	Short Duration HY <sup>1</sup>	U.S. 1-3 Year IG <sup>2</sup>	U.S. 1-5 Year IG <sup>3</sup>
Annualized Return	5.36%	2.95%	3.40%
Standard Deviation	4.70%	2.59%	3.36%
Sharpe Ratio	0.86	0.63	0.62

<sup>1</sup> Short Duration High Yield is based on the ICE BofA 0-2 Year Duration BB-B U.S. HY Constrained Index (H42C).

<sup>2</sup> U.S. 1-3 Year IG is based on the ICE BofA 1-3 Year U.S. Corporate Index (C1A0).

<sup>3</sup> U.S. 1-5 Year IG is based on the ICE BofA 1-5 Year U.S. Corporate Index (CVA0).

Source: ICE Data Indices, eVestment. Any trends depicted or described above may not continue. Past Performance is not a guarantee of future results.

*Beneficial Addition to a Diversified Fixed Income Portfolio.* SDHY is part of an often overlooked asset class when creating or managing a diversified fixed income portfolio. We believe SDHY is particularly compelling given the uncertain economic and market environment, especially as investors search for income, risk mitigation and risk-averse returns. Inclusion of an actively managed high quality and SDHY strategy can provide diversification within the fixed income segment of an overall portfolio given its low correlation with the broad intermediate-term bond market, as measured by the Bloomberg Capital U.S. Aggregate Bond Index (see **Exhibit 9** below). In addition, an allocation to the strategy may act as a hedge against rising interest rates or interest rate volatility due to its negative to low correlation with the ICE BofA Current 10-Year U.S. Treasury Index (GA10).

Exhibit 9. Short Duration High Yield and Index Characteristics Since Inception  
4/30/2006 – 2/29/2024

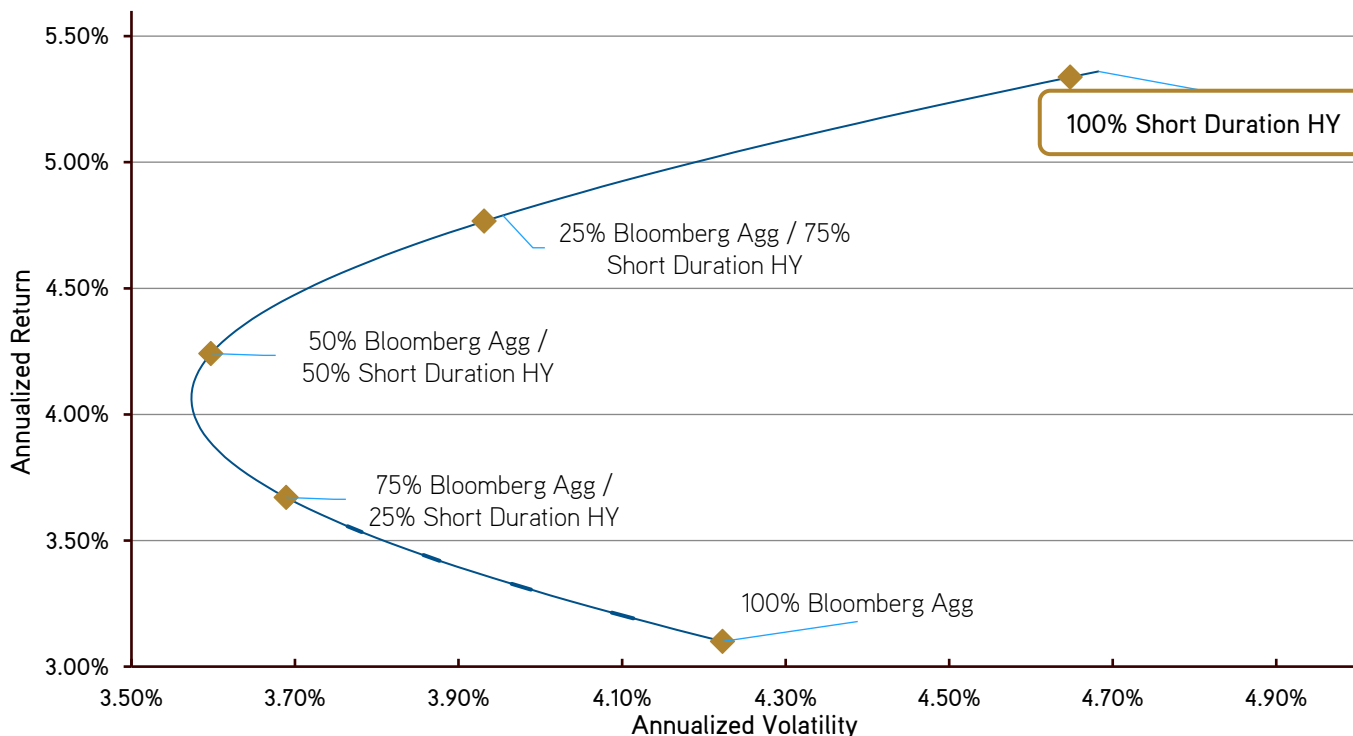
	St. Deviation	Jensen Alpha	Beta	Sharpe Ratio	Correlation to SDHY	Returns
Short Duration High Yield*	4.70%	3.46%	0.34	0.86	1.00	5.36%
ICE BofA Current 10-Year U.S. Treasury Index (GA10)	7.43%	-0.89%	1.52	0.23	-0.09	3.00%
Bloomberg Capital U.S. Aggregate Bond Index (LBSTRUU)	4.23%	0.00%	1.00	0.42	0.30	3.13%

\*Short Duration High Yield is based on the ICE BofA 0-2 Year Duration BB-B U.S. HY Constrained Index (H42C).

Source: ICE Data Indices, Bloomberg, eVestment. Any trends depicted or described above may not continue. Past Performance is not a guarantee of future results.

The below chart shows how adding a SDHY bond allocation to the Bloomberg Capital U.S. Aggregate Bond Index can potentially increase returns while reducing volatility. With negative correlation to U.S. Treasuries, increased "duration coverage" and a moderate level of volatility, we believe SDHY is an attractive addition to a diversified fixed income portfolio.

Exhibit 10. Efficient Frontier: Bloomberg U.S. Agg and Short Duration High Yield  
4/30/2006 – 2/29/2024



\* Short Duration High Yield is based on the ICE BofA 0-2 Year Duration BB-B U.S. HY Constrained Index (H42C).

Source: Shenkman Capital, Bloomberg. Any trends depicted or described above may not continue. Past Performance is not a guarantee of future results.

*SDHY Versus Money Markets and T-Bills in Today's Environment*. Given the current inverted Treasury yield curve, many investors have been slow to allocate away from cash equivalents such as money market funds and Treasury bills. However, in addition to the long-term track record of SDHY's incremental yield and outperformance versus shorter-term fixed income alternatives, there are several points for investors to consider as they manage their portfolio allocations.

**Reinvestment risk:** Short-term rates can move very quickly and investors need to consider what their total return will be over a various time horizons. For example, the one year T-Bill rate dropped 80bps from a high of 5.5% on 10/2/23, to 4.7% on 1/12/24. While current rates remain attractive, having risen more recently to 5.1% on 3/15/24, investors should anticipate what their potential "realized" yields may be over their holding period.

**Total return potential:** Given the limited volatility and duration of money market funds and front end T-Bills, comparing their current yields to the current yield-to-worst of SDHY may not fully reflect the latter's total return potential. Previously discussed factors such as Yield-to-Likely™, capital appreciation and duration can provide potential incremental return opportunities beyond the quoted yield-to-worst. More specifically:

- **Yield-to-Likely™:** YTL™ can provide potential incremental yields and returns beyond yield-to-worst as callable bonds trading below par are most likely to be retired prior to maturity generating higher returns as they are redeemed at par or higher call prices.
- **Capital Appreciation:** The SDHY market continues to trade below its historical average price providing the potential for capital appreciation beyond current yield-to-worst should bond prices narrow their gap to historical average prices. The average bond price of the H42C index since January 1, 2010 post the Great Financial Crisis is \$103.2 compared to the February 29, 2024 price of \$98.7.
- **Duration:** While the SDHY market is short duration, it is not zero duration. When anticipated Fed rate cuts ultimately come to fruition, they should provide an additional tailwind to the SDHY market given its 1.2 year duration and 2 year average final maturity, and offering some potential benefit should reinvestment rates decline as well. Conversely, cash equivalent and money market instruments will simply have their rates adjusted lower without the benefit of duration, magnifying the earlier point on reinvestment risk.

## Conclusion

Our analysis continues to support our belief that SDHY allocations benefit investors' fixed income portfolios. With a differentiated set of investment characteristics, SDHY continues to provide a potentially attractive income solution to challenges faced by fixed income investors, particularly in an environment where rates remain volatile, and the yield curve inverted. SDHY bonds provide income generation, minimal duration risk and the potential for alpha opportunities versus other fixed income alternatives. When included as part of a diversified fixed income portfolio, it can increase a portfolio's income while lowering duration and volatility by seeking to protect investors' capital to a greater degree than many other fixed income alternatives as a result of the attributes described throughout this investment note. In our view, the asset class's negative correlation to U.S. Treasuries, increased duration coverage and risk-adjusted return profile makes this subset of high yield a compelling alternative to investment-grade strategies and a potentially attractive addition to a diversified fixed income portfolio. We believe the successful execution of a short duration high yield strategy requires in-depth credit research, long-tenured experience in managing below investment grade assets through multiple market cycles, a view of management's handling of their capital structure, and prudent active management in order to maximize "Yield-to-Likely"™ alpha while preserving principal.

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