SHENKMAN

Trade is the Talk of the Town

Second Quarter 2018

Major Market Themes: Trade, IPOs and M&A

In the theater of global economics, international trade agreements have clearly moved to center stage, while monetary policy has stepped upstage and further away from the audiences view. The trade issues have been triggered by an activist executive branch in the U.S., which cued responses from the Eurozone and China.

Reactions in the high yield bond market to trade concerns during the quarter have been more negative in European issues than U.S. based issues. The key European currency index (ICE BofAML HP00) saw spreads and yields move wider and higher during the quarter. In the U.S., the main dollar index (ICE BofAML H0A0) saw both spreads and yields decline. The High Yield Global Index on a local currency basis (ICE BofAML HYDC) was relatively unchanged.

Most American businesses want the U.S. to have better trade terms, but there may be a disagreement about how to go about achieving this goal. Some view the public and aggressive strategy being used by the White House as a temporary strategy undertaken with an eye to what will win votes in the mid-term elections. However, it should be noted that trade negotiations have taken a long time historically and those people that expect a post-election end to the trade banter may be disappointed. The U.S. appears primarily focused on trade terms with China and this may lead other countries to try to fill any void the U.S. leaves, which could favor some countries for selected exports.

Currency moves have continued to influence capital flows in the fixed income markets. The EUR:USD weakened during the quarter. Meanwhile, the EUR:GBP was fairly range bound, but a touch weaker during the same period. The EUR:USD move was more notable, and it appeared to be a response to the interest rate outlook, as the U.S. Fed raised rates, while the European Central Bank continued to equivocate in its statements and actions. We continue to believe that rates are much less likely to move up in Europe than in the U.S. We do believe that the continuation of high profile trade actions by the U.S. should put some pressure on the USD, although the Euro seems to face very regular political volatility that might create a counterweight to the trade issues.

In the non-U.S. western hemisphere, commodity prices helped the price of some credits in markets like Canada. However, the commodity rally was not large enough in Latin America to counteract general unease about the markets. For example, in Brazil benchmark Petrobras bonds were down in the quarter. The Mexican election also appeared to cause uneasiness in security markets, as benchmark names Cemex and Grupo Televisa were down in the quarter as well.

M&A and IPOs Back with a Bang

Corporate actions in the M&A and IPO markets have increased considerably and are becoming important themes globally. In the first half of 2018, Dealogic reported increases in IPO activity in most regions with $105.5 billion being announced globally. This included a 28% increase in Europe and a 19% increase in Japan. Technology is, not surprisingly, the biggest industry category participating in IPOs. In the M&A space, the global pace is up 57% year-over-year. We believe this is driven by increasingly confident corporate boardrooms, as well as efforts to strategically position companies in the face of technology driven disruption. Some of this activity has involved investment grade companies buying high yield companies, such as Lyondell buying A. Schulman and Conagra buying Pinnacle Brands. Both an increase in access to equity markets, as well as an increase in M&A activity, auger well for the high yield market and continue to help support the current spread levels of the market.

Notable Segment Performance

Once again there was significant divergence in the segment performance in the U.S. dollar and the European currency markets by sub-category. The top performing industries in the U.S. dollar market were satellite, food & drug retailers, and oil & gas. Meanwhile, in Europe the top industries were consumer products, diversified media, and cable. The same was true among the worst performing segments, where in the U.S. dollar market they were banking, automotive, and consumer products; and in the European market they were insurance, oil & gas, and gas utilities.

Both markets saw underperformance in the longest maturity segments. However, there was divergence by rating category. In the U.S. dollar market, there was meaningful outperformance in the CCC part of the market, while this rating tier meaningfully underperformed in the European market.

Exhibit 1: Asset Class Performance

As of June 30, 2018	June-18	2Q 2018
Shenkman Capital Global High Yield Composite (Gross,)*	0.10%	0.44%
Shenkman Capital Global High Yield Composite (Net)*	0.05%	0.29%
U.S. Corporate Index (C0A0)	-0.54%	-0.94%
Global High Yield Bonds (HYDC)*	0.22%	0.66%
U.S. High Yield Bonds (H0A0)	0.35%	1.00%
U.S. Short Duration (H42C)	0.21%	0.94%
European High Yield Bonds (HP00)**	-0.48%	-0.77%
S&P LSTA U.S. Leveraged Loan Index	0.12%	0.70%
S&P European Leveraged Loan Index**	-0.51%	0.09%

*USD Hedged. **Returns in local currency.
Source: ICE Data Indices, Bloomberg, S&P.

Strategic Positioning

On a currency basis, we increased our Euro exposure meaningfully. We believe we identified value in both single B issues and BB issues and continued to feel comfortable being slightly longer duration in Euro than U.S. dollar based issues. By country of risk, we decreased positions in Canada, the United States and Germany, primarily driven by relative value, while increasing exposure in the United Kingdom and France. We decreased exposure to CCC issues and increased BB issues. About 18% of our portfolio is invested in multicurrency issuers and 54% of those are in Euros. Industry-wise, there were no material strategic shifts during the quarter, but in the global portfolio we decreased healthcare and environmental exposure and increased telecom and cable.

Closing Remarks

The divergence in performance by region continued to create opportunities that are unique to the global high yield market. Corporate actions and earnings gains generally appear to be helping support recent spread levels, even if they are tighter than historical averages. In this environment, we are comfortable having increased the rating quality of the portfolio based on relative value and likelihood of greater volatility. We also continue to see an increasing impact on the market performance due to both positive and negative idiosyncratic credit events.

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3. The Shenkman Capital Global High Yield Bond Composite has an inception date of August 1, 2016, and consists of comparable fee-paying, discretionary accounts that employ Shenkman's global high yield bond investment strategy and excludes multi-sector and structured funds and accounts that are not fully discretionary or have investment guidelines and restrictions that impair Shenkman's ability to implement its investment strategy (e.g., prohibitions on investing in, or requirements to maintain minimum exposures to, certain types

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4. The ICE BofAML U.S. Corporate Index (C0A0) has an inception date of December 31, 1972, and tracks the performance of U.S. dollar denominated investment grade corporate debt publicly issued in the U.S. domestic market.

The ICE BofAML Developed Markets High Yield Constrained Index (HYDC) has an inception date of December 31, 1997 and contains all securities in The ICE BofAML Global High Yield Index (HW00) from developed markets countries, but caps issuer exposure at 2%. The ICE BofAML Global High Yield Index (HW00) has an inception date of December 31, 1997 and tracks the performance of USD, CAD, GBP and EUR denominated below investment grade corporate debt publicly issued in the major domestic and Eurobond markets.

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The ICE BofAML 0-2 Year Duration BB-B U.S. HY Constrained Index (H42C) is a subset of the HUC4 that consists of all securities that have a duration-to-worst of 2 years or less. The ICE BofAML U.S. High Yield, BB/B Rated, Constrained Index (HUC4) has an inception date of December 31, 1996, and is a subset of the ICE BofAML U.S. High Yield Index (H0A0) that consists of all securities rated BB1 through B3, based on an average of Moody's, S&P and Fitch, but caps issuer exposure at 2%.

The ICE BofAML European Currency High Yield Index (HP00) has an inception date of December 31, 1997 and tracks the performance of EUR and GBP denominated below investment grade corporate debt publicly issued in the eurobond, sterling domestic or euro domestic markets.

The S&P/LSTA U.S. Leveraged Loan Index is a daily total return index that tracks the current outstanding balance and spread over LIBOR for fully funded term loans. The facilities included in the S&P/LSTA Leveraged Loan Index represent a broad cross section of leveraged loans syndicated in the United States, including dollar-denominated loans to overseas issuers.

The S&P European Leveraged Loan Index is a market-value-weighted index designed to measure the performance of the European institutional leveraged loan market, and tracks the current outstanding balance and spread over EURIBOR for fully funded term loans. The facilities included in the S&P European Leveraged Loan Index represent a broad cross section of leveraged loans syndicated in Europe.

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