



HIGH YIELD Detailed Investment Strategy

Investment Philosophy

H&W is a disciplined investment manager committed to the principles of bottom-up, fundamental value research in both debt and equity markets. We believe superior risk-adjusted returns can be achieved in the high yield market by relying on fundamental analysis and unlevered asset valuation. With asset value as the foundation, we can build a portfolio of BB and B credit quality securities and reduce our exposure to the damaging effects of high defaults and low recoveries.

Many investors concentrate on the lower quality tier of the high yield market and in some cases aggressively pursue the riskiest issues to generate returns. In contrast, we focus on risk-adjusted returns and asset valuation, which generally leads us to BB and B rated issuers. We also have a preference for the more senior structures such as senior or secured bonds versus subordinated bonds. Historically, this market segment has offered a superior risk/return profile than the lower quality tier. We believe our focus on true asset valuations should result in superior risk-adjusted performance in the long-term.

The final portfolio is built on a foundation of sound, top-tier BB and B rated “core” credits that exhibit defensive characteristics (50% - 75% of the portfolio). These names typically have lower yields and lower volatility than the overall high yield market. The second portion of the portfolio represents attractive return opportunities—names that are trading at significant discounts to fair value but exhibit improving fundamentals (25% - 40% of the portfolio). The third and final portion of the portfolio represents short-term or special situations capitalizing on our experience and flexibility (0% - 10% of the portfolio).

Investment Process

Over its 30 year history, H&W has developed an extensive knowledge of individual companies and industries. The high yield universe encompasses approximately 1000 issuers, many of which were originally rated investment grade. H&W analysts attempt to identify BB and B credits with improving characteristics. Our process ultimately narrows this universe to create a portfolio with a target of 80-100 issuers that exhibit superior risk/return characteristics.

The investment process has four general stages: Screening, Initial Review, Detailed Review and Relative Valuation.

Screening

This stage reviews the universe for opportunities that meet our investment criteria ranging from issue size/availability and structure, to industry attractiveness and direction. This approach helps the portfolio manager identify candidates that will fit into one of the three segments of our portfolio: core holdings, high return opportunities, and special situations.

Initial Review

This stage involves the portfolio manager and analysts working together to identify the basic risks and opportunities with an individual issuer. This review focuses on downside analysis and is often used to identify names that have a high potential of default, exhibit high volatility, or have other unattractive characteristics. These issuers only pass this screen if they have exceptionally attractive short-term return opportunities.

Analysts gravitate toward credits in stable or growing industries with strong asset coverage and cash flow. We seek management teams that are experienced, skilled, and ethical.

Detailed Review

This stage is the core of HWCM's investment process. The analyst conducts research, prepares models, often meets management, and ultimately makes a recommendation based on the following:

Competitive Position	Companies that play an important role in their industry
Management Strength	Management teams that are experienced, properly incentivized, and have high ethics
Cash Flow	Companies with stable and growing cash flows
Financial Flexibility	Companies that have the ability to divide assets to raise cash or have alternative funding sources
Asset Coverage	Companies that have tangible, measurable asset values that cover a debt issue by at least 110%-125%

Relative Valuation

Throughout the first three stages, the portfolio manager and analysts focus on the fundamentals of credit with an emphasis on downside protection provided by sufficient asset coverage and cash flows. Once those stages are complete, relative value and yield are assessed—these are secondary considerations to the detailed review. During this final stage, the portfolio manager compares the yield and total return potential of the credit to other similarly priced securities in the market and to other instruments in a credit capital structure: credit default swaps, convertible bonds, and bank loans.

Portfolio Construction

The research process culminates with the construction of the portfolio. While the fundamental research focuses on the credit fundamentals of the underlying issuer, the portfolio construction stage focuses on the valuation of the individual security. When evaluating individual securities, we assess the structural characteristics including call features, embedded options, maturity, coupon, price/yield, covenants and seniority. This is done both at the individual security level and the overall portfolio level. These criteria are secondary to the underlying fundamental research but are crucial components of the process nonetheless. The manager then compares the individual security to

other instruments such as credit default swaps, convertible bonds, and bank loans. At this stage we have evaluated the underlying fundamentals of the issuer, assessed the particulars of the individual issue, and appraised the fit within the existing portfolio. The final portfolio will target 80-100 issuers with no more than 5% in a single issuer and no more than 20% in a single industry.

Sell Discipline

The sell discipline is largely the inverse of the purchase discipline. HWCM does not, however, employ any predetermined rules for sales. Each sell candidate is considered on a case by case basis. When considering a sale, we evaluate many factors including: 1) relative valuation; 2) fundamental operating trends; 3) changes in asset coverage; 4) structural nuances of a particular issue and; 5) call options within a particular issue.

Financial Definitions

Cash Flow: Measures the cash generating capability of a company by adding non-cash charges (e.g. depreciation) and interest expense to pretax income.

Credit Quality weights by rating were derived from the highest bond rating as determined by S&P, Moody's or Fitch. Bond ratings are grades given to bonds that indicate their credit quality as determined by private independent rating services such as Standard & Poor's, Moody's and Fitch. These firms evaluate a bond issuer's financial strength, or its ability to pay a bond's principal and interest in a timely fashion. Ratings are expressed as letters ranging from 'AAA', which is the highest grade, to 'D', which is the lowest grade. In limited situations when none of the three rating agencies have issued a formal rating, the Advisor will classify the security as nonrated.