TOP 10 REASONS TO INVEST IN HIGH YIELD

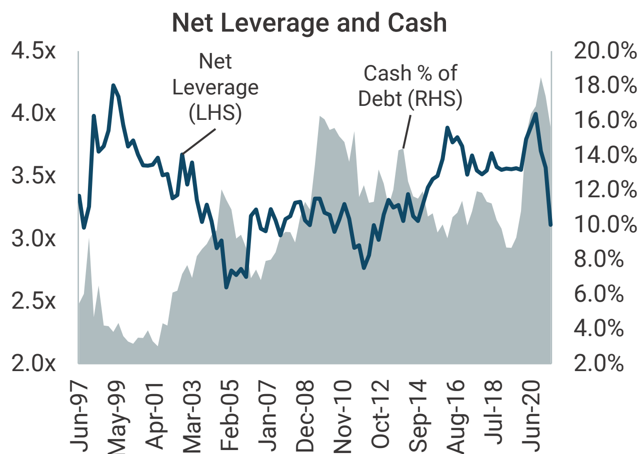
"New year, same goal" — Joe King, Former NFL defensive back

Introduction

The high yield market[1] returned +5.4% in 2021 and generated a +40.8% total return off the March 23, 2020, COVID pandemic lockdown bottom. With high yield market spreads, leverage, coverage, and EBITDA levels fully recovered from the COVID-induced bottom, we expect more muted high yield market investment performance going forward. For 2022, we expect a "coupon-like" total return for the high yield market, with the benefits of strong issuer fundamentals and low defaults offset by higher labor and energy input costs and Fed policy normalization.

We believe in the medium term, the high yield market should be a more subdued, less heart-wrenching environment relative to what we've been through over the past two years. While we expect muted high yield performance going forward, there are reasons for optimism and continued capital allocation to the high yield market. The remainder of this commentary highlights our top ten reasons.

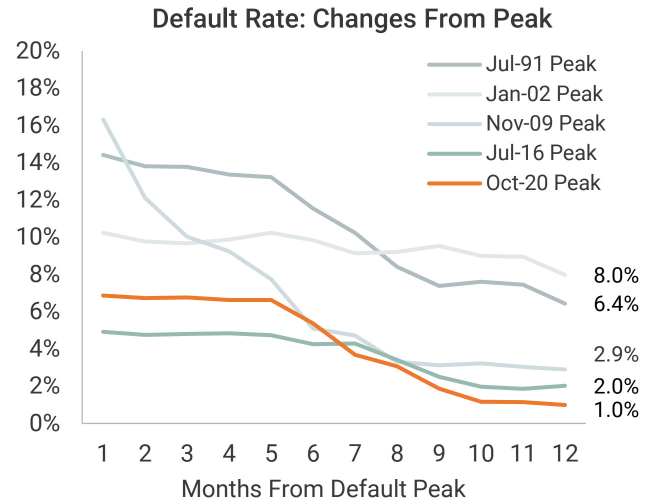
1: Strong balance sheet & liquidity



Source: Morgan Stanley, H&W – as of June 30, 2021.

As bottom-up credit pickers, we focus intently on issuer fundamentals, which we believe to be very solid. Net leverage has declined to near-record low levels while cash as a percentage of gross debt remains elevated versus history. We believe low leverage and strong liquidity provide high yield issuers with a margin of safety against adverse economic, industry, and company-specific developments for high yield issuers.

2: Low default rate environment



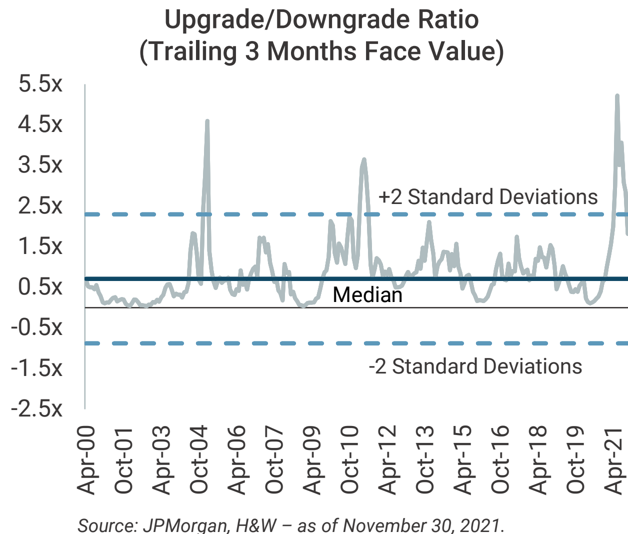
Source: JPMorgan, H&W – as of September 30, 2021.

Strong balance sheets and liquidity provide comfort that the current low default rate environment can persist, although more likely in the 2.0% range versus calendar year 2021's record low 0.3% level.

[1]All references to the high yield market are based on the ICE BofA U.S. High Yield Index

Hotchkis & Wiley

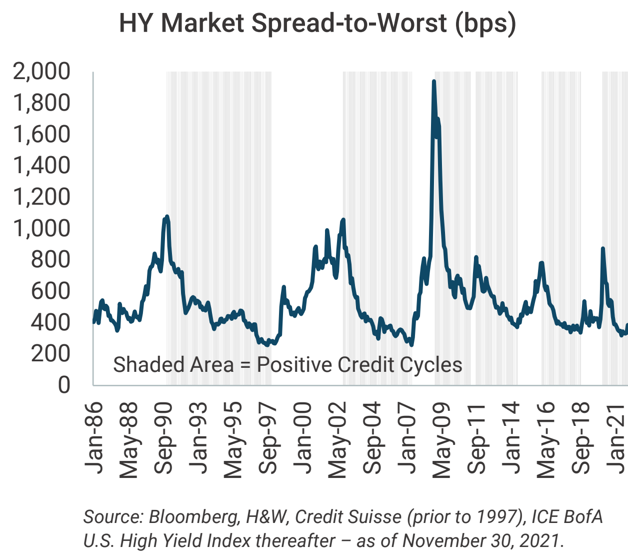
3: Favorable credit migration



Source: JPMorgan, H&W – as of November 30, 2021.

The U.S. economy's rapid COVID lockdown recovery, coupled with the high yield market's strong fundamentals, has resulted in a dramatic default risk reassessment by the rating agencies. As a result, the high yield market's upgrade/downgrade ratio has been significantly positive throughout 2021. While the ratio has likely peaked, it remains elevated versus history.

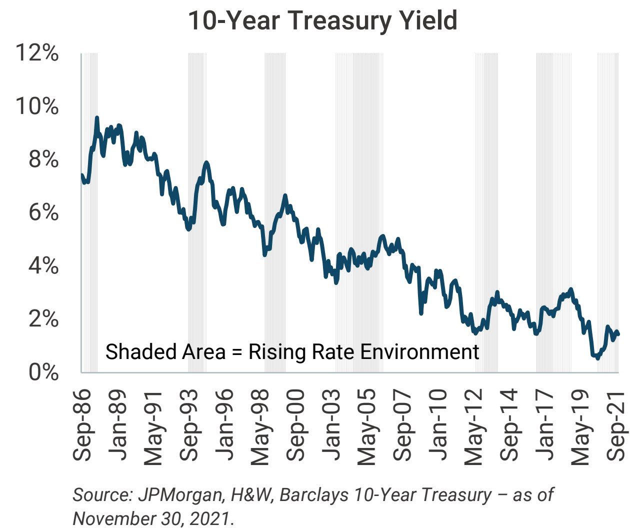
4: The credit cycle is young



Source: Bloomberg, H&W, Credit Suisse (prior to 1997), ICE BofA U.S. High Yield Index thereafter – as of November 30, 2021.

The post-COVID pandemic lockdown credit cycle is young by historical standards. Given the magnitude of the COVID shock, we believe this cycle could extend beyond the 5-year historic expansion period.

5: High Yield has done well when interest rates rise



Source: JPMorgan, H&W, Barclays 10-Year Treasury – as of November 30, 2021.

The 10-year U.S. Treasury yield has declined nearly 600 basis points (bps) since 1986. Within this 35-year timeframe, however, interest rates have risen in seven periods, including the current pandemic lockdown recovery period, during which the 10-year U.S. Treasury yield has increased 80 bps to 1.5%. Elevated inflation levels, Fed policy normalization measures, and simple mean reversion have today's fixed income investors concerned that interest rates will continue rising.

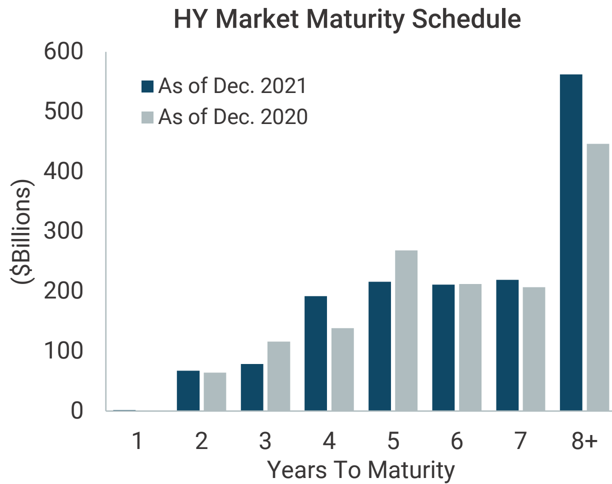
Average Annualized Returns: 9/1/86-11/30/21

	HY	IG	10 Yr Trsy
Rising Rates	7.3%	1.2%	-3.2%
Falling Rates	8.5%	9.9%	10.6%

Source: Bloomberg, H&W. ICE BofA U.S. High Yield, ICE BofA Corporate, Gov't & Mortgage and Barclays 10-Year Treasury Indices.

With its shorter duration profile and greater credit cycle sensitivity, high yield has historically outperformed investment grade within the fixed income market during periods of rising interest rates. If interest rates rise, high yield will likely hold up better than investment grade.

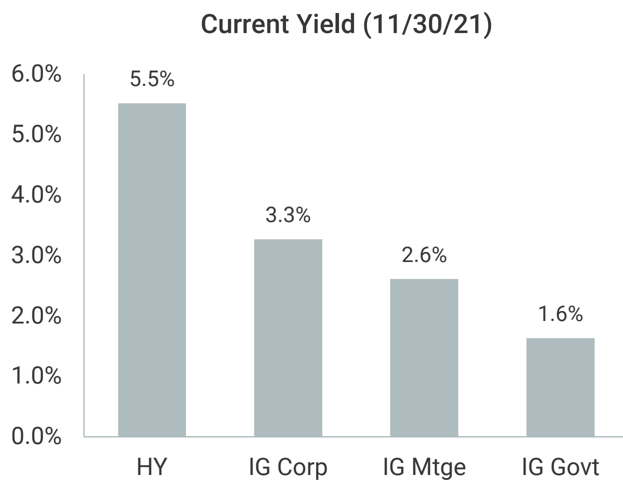
6: The maturity profile has improved



Source: JPMorgan, H&W.

New issuance has been robust of late, with $500 billion of high yield bonds issued in 2021 alone. Over 60% of new issue proceeds were used to refinance debt. This record new issuance has extended the maturity schedule, reduced interest costs, and improved liquidity within the high yield market, lowering credit risk.

7: Attractive income level within fixed income



Source: Bloomberg, H&W. ICE BofA U.S. High Yield, ICE BofA U.S. Corporate, ICE BofA U.S. Mortgage-Backed and ICE BofA All Maturity U.S. Government Indices.

The $1.6 trillion U.S. high yield market provides the highest current yield within the $34.3 trillion U.S. fixed income market. On a global basis, the high yield market represents 3.8% of the bond universe market value, yet contributes 12.7% of global coupon income, according to BofA Research. The high yield market provides higher coupon income as compensation for credit risk; a unique proposition within fixed income given today's low interest rates.

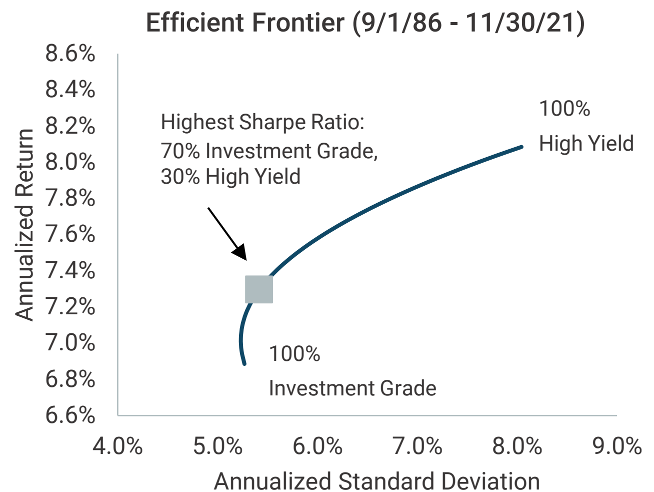
8: Portfolio diversification benefits

HY Correlation (monthly basis)
(9/1/86 - 11/30/21)

US Equity	0.60
International Equity	0.57
Investment Grade Bonds	0.56
Intermediate Treasuries	(0.05)
3-Month T-Bill	(0.06)

Source: Bloomberg, H&W. S&P 500, MSCI EAFE, ICE BofA U.S. Corporate, Barclays Capital US Treasury Intermediate, and ICE BofA 3-Month Treasury Bill Indices.

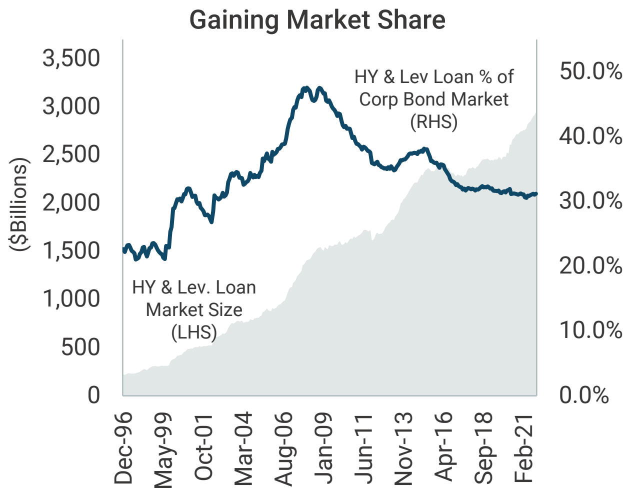
High yield's unique coupon income for credit risk proposition has historically translated into modest correlations with other risk assets. Combining risky assets with low correlations is the underlying premise behind Markowitz's modern portfolio theory.



Source: Bloomberg, H&W. ICE BofA U.S. High Yield and ICE BofA U.S. Corporate Indices.

The addition of high yield bonds to an investment-grade bond portfolio has the potential to improve its risk/return position along the efficient frontier.

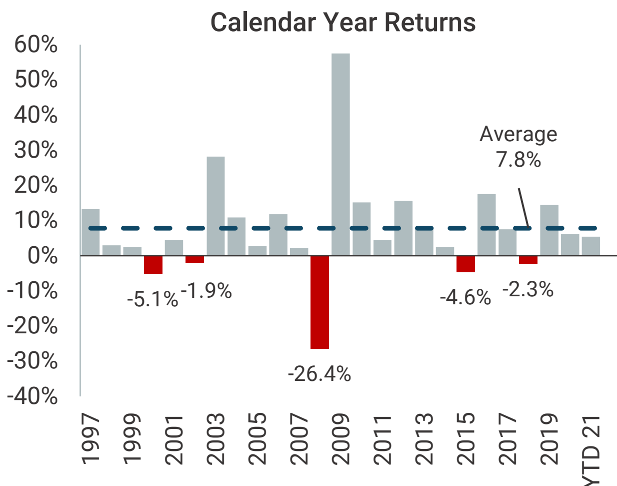
9: High yield is too big to ignore



Source: Bloomberg, H&W. ICE BofA U.S. High Yield, ICE BofA U.S. Corporate and High Yield and Credit Suisse Leveraged Loan Indices – as of November 30, 2021.

The combined high yield bond and bank loan market has grown at a 10.9% annualized rate over the past 25 years to $2.9 trillion and now comprises 31.2% of the corporate bond market. Today's high yield/bank loan market is a material component of the overall corporate bond market and, in our opinion, warrants consideration for inclusion in a diversified fixed income portfolio.

10: Positive calendar year return history



Source: Bloomberg, H&W. ICE BofA U.S. High Yield Index – as of November 30, 2021.

Throughout its history, the high yield market has generated attractive returns, driven primarily by higher coupon income. In fact, high yield has delivered a positive total return in 80% of the past 25 calendar years and has never posted consecutive negative calendar year returns. The five negative calendar year returns all coincided with exogenous credit market shocks (TMT, GFC, Metals & Mining, and Energy bubble bursts, respectively), which are difficult to predict. High yield's return profile, absent exogenous bubble burst events, has historically been steady and positive.

Summary

Valuations have tightened dramatically since the COVID pandemic lockdown bottom 20 months ago but for good reason—high yield market fundamentals have fully recovered, providing a legitimate reason for optimism going forward.

We expect "coupon-like" returns as low defaults offset higher interest rates. While we may be entering a period of more muted performance, our primary goal remains the same—to provide our clients with solid absolute and relative risk-adjusted performance.

Hotchkis & Wiley High Yield Portfolio Managers

All investments contain risk and may lose value. This material is for general information only and should not be relied on for investment advice or recommendation of any particular sector, industry, security, strategy, or investment product.

This material contains the opinions of the authors and not necessarily those of Hotchkis & Wiley Capital Management, LLC (H&W). The opinions stated in this document may include estimated and/or forecasted views, which are believed to be based on reasonable assumptions within the bounds of current and historical information. However, there is no guarantee that any estimates, forecasts or views will be realized. Certain information presented is based on proprietary or third-party estimates, which are subject to change and cannot be guaranteed. Any discussion and/or view on a particular event, asset class, industry, and/or

investment type are not investment recommendations, should not be assumed to be profitable, and are subject to change. H&W has no obligation to provide revised opinions in the event of changed circumstances. Information obtained from independent sources is considered reliable, but H&W cannot guarantee its accuracy or completeness.

Investing in high yield securities is subject to certain risks, including market, credit, liquidity, issuer, interest-rate, inflation, and derivatives risks. Lower-rated and non-rated securities involve greater risk than higher-rated securities. High yield bonds and other asset classes have different risk-return profiles and market cycles, which should be considered when investing.

The ICE BofA index data referenced is the property of ICE Data Indices, LLC ("ICE BofA") and/or its licensors and has been licensed for use by Hotchkis & Wiley. ICE BofA and its licensors accept no liability in connection with its use. MSCI makes no express or implied warranties or representations and shall have no liability whatsoever with respect to any MSCI data contained herein. The MSCI data may not be further redistributed or used as a basis for other indices or any securities or financial products. This report is not approved, reviewed, or produced by MSCI. See Index definitions for full disclaimers.

Market Disruption: The global coronavirus pandemic has caused disruption in the global economy and extreme fluctuations in global capital and financial markets. H&W is unable to predict the impact caused by coronavirus pandemic, which has the potential to negatively impact the firm's investment strategies and investment opportunities.

©2022 Hotchkis & Wiley. All rights reserved. Any unauthorized use, disclosure or distribution is prohibited. For Investment Advisory Clients.

Past performance is not a guarantee or a reliable indicator of future results.