High Yield Strategy
Quartery Update

Quarterly Update | Q3 2020

For professional clients only

Thoughts on the Market

Following the economic and market malaise in February and March, high yield and risk assets generally experienced five straight months of strong performance, only to pull back in September. With a coordinated push from central banks in the form of zero rates and $3 trillion in QE the markets rebounded sharply from their lows in March with the equity markets, as measured by the S&P 500, posting a second quarter return of +20.54%, followed by a +8.93% return in the third quarter. The renewed confidence in the US economy because of Fed stimulus and general improved understanding and combating of COVID-19 helped to propel risk assets higher. In September that sentiment reversed course. Growing concerns surrounding a second COVID-19 wave in the US combined with the upcoming flu season, questions about when another US stimulus deal is approved, and the uncertainty around the US election outcome all added to uncertainty that weighed on the markets as the third quarter closed.

We continue to expect monetary support from the central banks and while we have stated before we are not fans of such massive stimulus programs, we believe renewed uncertainty in the markets will create attractive entry points to risk assets generally and specifically for high yield. As rates remain near zero on absolute terms and negative on real terms, traditional investment grade fixed income is experiencing somewhat of an existential crisis, while high yield has recently increased in size, after 6 years of modest decline. Given the maturation of the high yield market, and its proven long-term benefits, we expect the high yield market to continue the growth experienced in 2020 as the benefits of higher income and lower volatility come to bear. The excess in the credit market may this time come via the leveraged loans and private credit, or at least more heavily tilted in those areas relative to high yield. While there is the potential for credit loss in the public high yield market, the bottom-up perspective of our investment process navigates any market environment well. As well, our rigid margin-of-safety requirements never change, and our relative value methodology across the risk spectrum of credits and that fit our process naturally accounts for increased economic uncertainty.

The **US High Yield** market, as represented by the ICE BofAML US High Yield Constrained Index (HUC0) followed up the tumultuous first six months of the year with a solid third quarter, posting a +4.70% total return. This pushed the index total return for YTD'20 nearly positive with a return of -0.38%, practically wiping out the -13.13% return in the first quarter. As of quarter end, the spread and yield of the US High Yield Market was +547 bps, and 5.78%, which represent moves tighter/lower of 102 bps, and 1.11%, during the period. The **Leveraged Loan** market also exhibited another solid quarter in 3Q'20 with a total return of +4.11%, pushing the YTD'20 total return to -0.57%.

From a **credit quality perspective**, similar to 2Q'20, CCCs led the way higher, up +7.40% relative to single Bs and BBs at +4.57% and +4.20%, respectively. However, the significant underperformance of CCCs in 1Q'20 left their YTD'20 total return lagging at -6.86%, compared to single Bs and BBs at -2.49% and +2.20%, respectively.

Investment Grade Credit posted solid returns during the quarter and YTD'20, returning +1.69% and +6.62%, respectively. The YTD'20 return advantage relative to high yield was due to the very strong 1Q'20 return, driven by the collapse of the 5-year UST rate from 1.69%, to 0.38%. The ICE BofA US (IG) Corporate Index (C0A0) ended 3Q'20 with a spread duration of 7.4 years, compared to just 3.8 years for high yield. Big picture, we continue to see IG issuers susceptible to downgrades throughout the year. As well, investment grade corporate new issuance has already surpassed last year's total and is just 7% below the prior annual record of $1.25T in 2017. Barring negative UST rates, IG corporate returns seem challenged at an index spread and yield of +155 bps and 2.22%. On the other hand, we look forward to potential relative value opportunities among fallen angels.

Exhibit 1: Returns of Various Assets

As of September 30, 2020

Asset Class	3Q'20	2Q'20	1Q'20	YTD'20	CY 2019	CY 2018
S&P 500	8.93%	20.54%	-19.60%	5.57%	31.48%	-4.39%
Emerging Market Stocks	9.65%	18.18%	-23.57%	-0.96%	18.50%	-14.60%
10-Year US Treasury	0.04%	0.68%	12.09%	12.73%	9.19%	-0.03%
Investment Grade Corp	1.69%	9.27%	-4.05%	6.62%	14.23%	-2.25%
US High Yield Corp Bonds	4.70%	9.54%	-13.13%	-0.38%	14.41%	-2.27%
Leveraged Loans	4.11%	9.78%	-13.00%	-0.57%	8.64%	1.08%
Euro High Yield Corps	2.61%	11.25%	-14.63%	-2.55%	11.29%	-3.63%
EM High Yield Corps	3.68%	14.46%	-14.45%	1.58%	13.49%	-2.29%
US High Yield by Rating						
BB US High Yield Corps	4.20%	9.68%	-10.57%	2.20%	15.74%	-2.57%
B US High Yield Corps	4.57%	9.35%	-14.73%	-2.49%	14.26%	-1.72%
CCC US High Yield Corps	7.40%	10.81%	-21.74%	-6.86%	9.56%	-4.91%

Source: JP Morgan, ICE BAML

High Yield Market Commentary

During 3Q'20, the ICE BofA US High Yield Constrained Index (HUC0) total return was +4.70%, while the S&P 500 Index returned +8.93%, and 10-Year US Treasuries returned +0.04%. Total returns for YTD'20 were -0.38% for the HUC0 HY Index, +5.57% for the S&P 500, and +12.73% for 10-Year US Treasuries as central bank policy remains steadfast.

At quarter end, the high yield market, as represented by the ICE BofA US High Yield Constrained Index (HUC0), spread-to-worst (STW) and yield-to-worst (YTW) were +547 bps and 5.78%, and 102 bps and 1.11% tighter/lower during the quarter. Retail High Yield Fund flows, while overall a tailwind, provided a similar pattern as returns, i.e., following the exodus from HY funds in March (-$11.7 billion) high yield funds posted five straight positive flows only to see that reversed in September with a -$4.3 billion outflow. While negative for September, 3Q'20 posted a net inflow of +$10.7 billion. New issuance continued the record setting pace set by 2Q'20 to produce the second largest quarter on record at $132 billion.

ICE BofA US High Yield Constrained Index (HUC0) Index Characteristics

	3Q'20	2Q'20
Yield-to-Worst	5.78%	6.86%
Spread-to-Worst (bps)	+547	+649
Duration-to-Worst	3.78	4.14
Average price	$99.20	$94.73

Source: ICE BAML

Returns for the First Sentier Investors' High Yield strategy remained solid during 3Q'20. The Broad High Yield strategy returned +5.35%, outperforming its benchmark index by 65 bps. The Quality and Select strategies returned +5.00% and +5.91%, outperforming their benchmark indices by 67 and 121 bps for the quarter, respectively. The Short Duration strategy returned +3.54%, underperforming by 3 bps.

Top performers included Energy, Basic Industry, and Telecom. Across all three industries performance has been driven by bottom-up security selection, as we continue to be able to find good investment ideas that have positive catalysts driving total return. Bottom performers include Services, Healthcare, and Retail. In Services, we had a security underperform the rally this quarter, but still have conviction in the name, and in Healthcare and Retail, we didn't see much value in a lot of the names across these industries, and missed some of the general tightening that occurred in both.

Annual Performance (% in USD) to September 30, 2020

As of 30 September 2020 — Inception April 30, 2017

	3Q'20	YTD'20	2019	2018	Since Inception (Annualised)	3 year	2 year	1 year
Broad High Yield	**5.35%**	**3.82%**	**16.09%**	**-1.62%**	**6.37%**	**6.12%**	**7.22%**	**6.64%**
ICE BofAML US HY Constrained Index	4.70%	-0.38%	14.41%	-2.27%	4.25%	3.81%	4.24%	2.22%
Active Performance	0.65%	4.20%	1.68%	0.65%	2.12%	2.31%	2.98%	4.42%
Select High Yield	**5.91%**	**4.02%**	**16.55%**	**-2.06%**	**6.41%**	**6.18%**	**7.06%**	**6.92%**
ICE BofAML US HY Constrained Index	4.70%	-0.38%	14.41%	-2.27%	4.25%	3.81%	4.24%	2.22%
Active Performance	1.21%	4.40%	2.14%	0.21%	2.16%	2.38%	2.82%	4.70%
Quality High Yield	**5.00%**	**3.57%**	**15.75%**	**-1.34%**	**6.30%**	**6.02%**	**7.19%**	**6.35%**
ICE BofAML BB-B US HY Constrained Index	4.33%	0.55%	15.10%	-2.04%	4.74%	4.41%	5.48%	3.14%
Active Performance	0.67%	3.02%	0.64%	0.71%	1.56%	1.61%	1.71%	3.21%
Short Duration High Yield	**3.54%**	**1.52%**	**10.84%**	**0.53%**	**4.51%**	**4.33%**	**4.62%**	**3.67%**
ICE BAM 1-5 YR BB-B US Cash Pay HY Index	3.58%	-1.14%	10.98%	0.67%	3.73%	3.48%	3.36%	0.88%
Active Performance	-0.03%	2.66%	-0.14%	-0.15%	0.78%	0.85%	1.26%	2.79%

Past performance is not indicative of future performance. Performance figures do not reflect the deduction of investment advisory fees. If a client place $100,000 under management and a hypothetical gross return of 10% were achieved, the investment assets before fees would have grown to $259,374 in 10 years. However, if an advisory fee of 1% were charged, investment assets would have grown to $234,573, or an annual compounded rate of 8.9%.

The performance of the Broad High Yield Composite is hypothetical, as the assets of the Select High Yield strategy and the Quality High Yield strategy have been combined to create the Broad High Yield strategy.

Strategy review

We are the beneficiaries of an investment process that is contrarian by design. While many of our competitors may be stretching for yield at the expense of uncompensated default risk, we expect our investment process to result in an underweight in relative credit risk. Over the life of our investment process, we've never experienced a meaningful high yield market correction that wasn't a net opportunity to increase yields and total return over the longer term, net of any default experience. Therefore, rather than fear market corrections, we view them as net opportunities to set up our portfolios for their strongest, absolute total return. As you can see from our performance in the first quarter, second quarter and YTD for 2020, our investment process has guided us to strong outperformance in the current volatile markets.

With our disciplined process as our foundation, we expect market dynamics will continue to present both opportunities and challenges for investors. As the overall landscape changes for fixed income investors (e.g., negative yields, increased use of derivatives), we continue to remain confident in both our process and our team's relentless commitment to execution in all markets. We believe that the High Yield market is among the most attractive markets in fixed income, and we remain able to construct a diversified portfolio that overcompensates us for the risk that we are taking. Finally, we believe First Sentier Investors is well-positioned in this market to produce dependable outperformance versus both peers and the benchmark.

FSI High Yield eVestment Performance and Risk Metrics

Performance Rankings	Since Inception	%ile Rank	3 YR	%ile Rank	2 YR	%ile Rank	1 YR	%ile Rank
FSI Broad High Yield Strategy	6.37	4	6.12	4	7.22	5	6.64	5
FSI Select High Yield Fixed Income	6.41	4	6.18	4	7.06	6	6.92	4
FSI Quality High Yield Fixed Income	6.30	5	6.02	5	7.19	11	6.35	7
FSI Short Duration High Yield Fixed Income	4.51	10	4.33	9	4.62	19	3.67	15

Risk Metrics Since Inception	Information Ratio	%ile Rank	Sharpe Ratio	%ile Rank	Upside Market Capture	%ile Rank	Downside Market Capture	%ile Rank
FSI Broad High Yield Strategy	1.64	2	0.57	7	111	12	88	41
FSI Select High Yield Fixed Income	1.43	4	0.52	15	118	4	97	64
FSI Quality High Yield Fixed Income	1.57	3	0.60	5	108	14	89	46
FSI Short Duration High Yield Fixed Income	0.41	7	0.49	29	94	25	78	55

Peer group percentile rankings are versus eVestment's US High Yield Fixed Income (for Broad & Select High Yield), Quality High Yield Fixed Income (for Quality High Yield) & Short Duration High Yield FI (for Short Duration High Yield) universes. Data shown includes all results reported in eVestment as of October 16, 2020 and does not reflect any selection by FSI.

Past performance is not indicative of future performance.

Positioning

During the quarter, from a sector standpoint, led by our bottom-up relative value analysis, the Broad strategy* increased its exposure to Technology, Transportation and Utilities and took reduced exposure to Healthcare, Basic Industry and Services.

At quarter end, the Broad strategy is overweight in Basic Industry and Leisure. We continue to find good opportunities to deploy capital that meet our investment process in these sectors.
We are underweight in Media and Healthcare as both of these sectors have tightened materially and we are not seeing as many attractive opportunities. Lastly we are approximately market weight in Energy and Retail, where the focus is on higher quality.

While our default-adjusted, relative value methodology is indifferent to rating agency metrics, we still track our composite exposures. Underweight exposures to CCCs and BBs were maintained, with a corresponding overweight to Bs. During the third quarter we maintained our exposure to Bs with a slight increase in cash to 4.5% as we look at relative value heading into October/November.

At quarter end, the Broad high yield strategy had a modest, single-digit % allocation to bank loans, and we've found select loans that fit our investment process and offer attractive relative value.

Breakdown by Rating

As of September 30, 2020

	Broad	Index
BB	41.7%	54.3%
B	45.8%	29.8%
CCC	2.7%	10.2%

Sector Weightings

Security Description	Broad	Index
Automotive	2.0%	4.0%
Basic Industry	13.9%	10.0%
Capital Goods	3.3%	6.7%
Consumer Goods	7.0%	5.2%
Energy	12.9%	13.2%
Financial	2.7%	6.8%
Healthcare	8.0%	9.3%
Leisure	8.7%	5.8%
Media	6.8%	9.4%
Real Estate	2.5%	4.0%
Retail	4.3%	5.1%
Services	6.3%	4.6%
Technology & Electronics	4.4%	5.1%
Telecommunications	7.4%	6.8%
Transportation	2.1%	1.4%
Utility	2.9%	2.6%

Outlook

The US election season is shaping up to be particularly interesting given the uncertainty of both the results and the timing of such results, and higher volatility than normal seems to be priced into current market conditions. The increasingly uncertain elements around the impact of a spike in COVID-19 cases and the uncertain timing of a new stimulus package, among other risks, highlight our conviction that effective investing in the High Yield market is first and foremost about risk control. Our investment process requires strict, absolute **minimum margins-of-safety**, based on real-world asset coverage and free cash flow generation.

We think current spreads are supportive of attractive relative value in high yield, with a focus on being in the "right" credits. Spreads have retraced ~80% of their COVID-related widening, but there still remain plenty of opportunities among sectors hit harder by COVID-related slowdowns in business fundamentals. As well, our portfolios have slowly repositioned to being underweight risk once again as our process naturally rotated our portfolios into a market neutral risk position after spending much of the first half of 2020 underweight risk. We expect active management to outperform over the foreseeable future as getting credit right remains paramount, and as always, we believe high yield investing is often as much about what you don't own as what you do.

* The Broad High Yield strategy is a hypothetical portfolio, as the assets of the Select High Yield strategy and Quality High Yield strategy have been combined to create the characteristics of the Broad High Yield strategy.

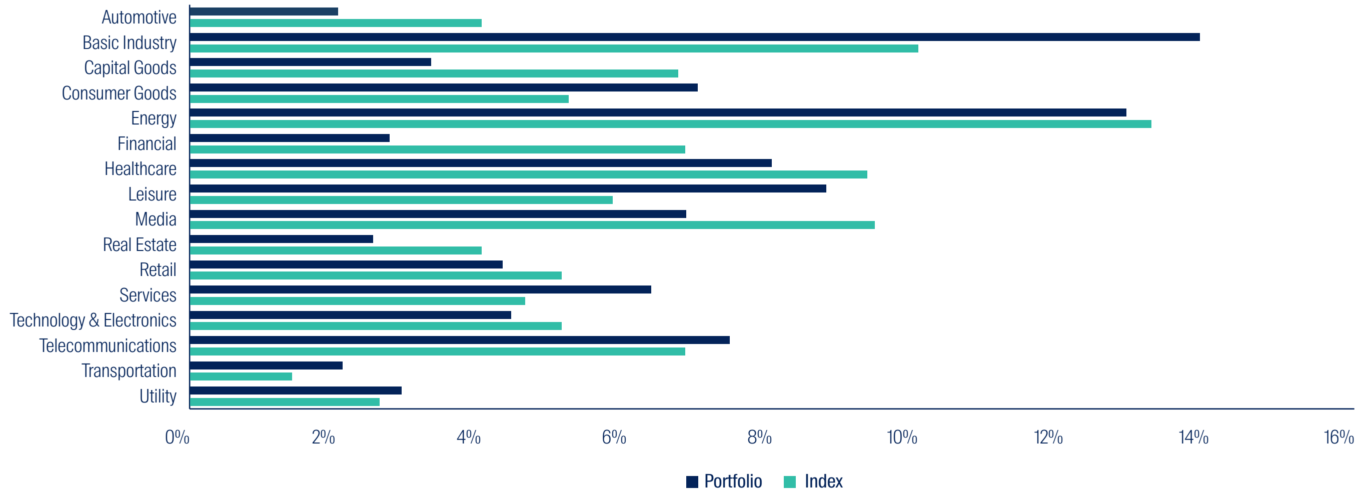
Broad High Yield

Characteristics

	Broad	Index*
Yield to Worst	5.26%	5.78%
Spread to Worst	498	547
Duration to Worst	3.53	3.78
# of Issuers	138	
AUM	137	
Avg. Rating	B1/BB-	

* Index as of quarter end rebalance

Sector weightings: Portfolio, Benchmark



Breakdown by Rating

	Portfolio %
BBB-	2.5
BB+	7.7
BB	18.1
BB-	15.9
B+	21.6
B	16.6
B-	7.6
CCC+	1.2
CCC	1.5
CCC-	0.0
Other*	2.7

* CC, C, D & NR

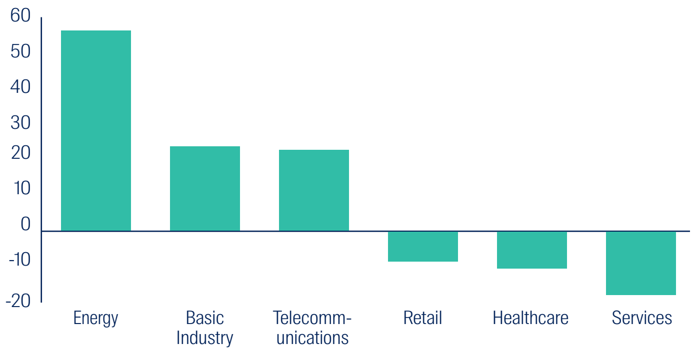
Breakdown by Country

	Risk Contribution %
United States	91.4
Canada	4.3
United Kingdom	1.5
Ireland	0.8
Australia	0.6
Greece	0.5
Austria	0.4
France	0.2
Brazil	0.2

Top 10 Issuers

	Market Value %
Allied Universal	1.9
Sprint	1.8
Icahn Enterprises	1.8
Horizon Therapeutics	1.8
Bausch Healthcare	1.7
Asurion	1.7
Albertsons	1.7
Brookfield Residential	1.7
TranDigm Group	1.6
Gates Global	1.5

Top 3/Bottom 3 Contribution to Excess Return



* The Broad High Yield Composite is hypothetical, as the assets of the Select High Yield strategy and the Quality High Yield strategy have been combined to create the characteristics of the Broad High Yield strategy. Source: First Sentier Investors. Data as of September 30, 2020

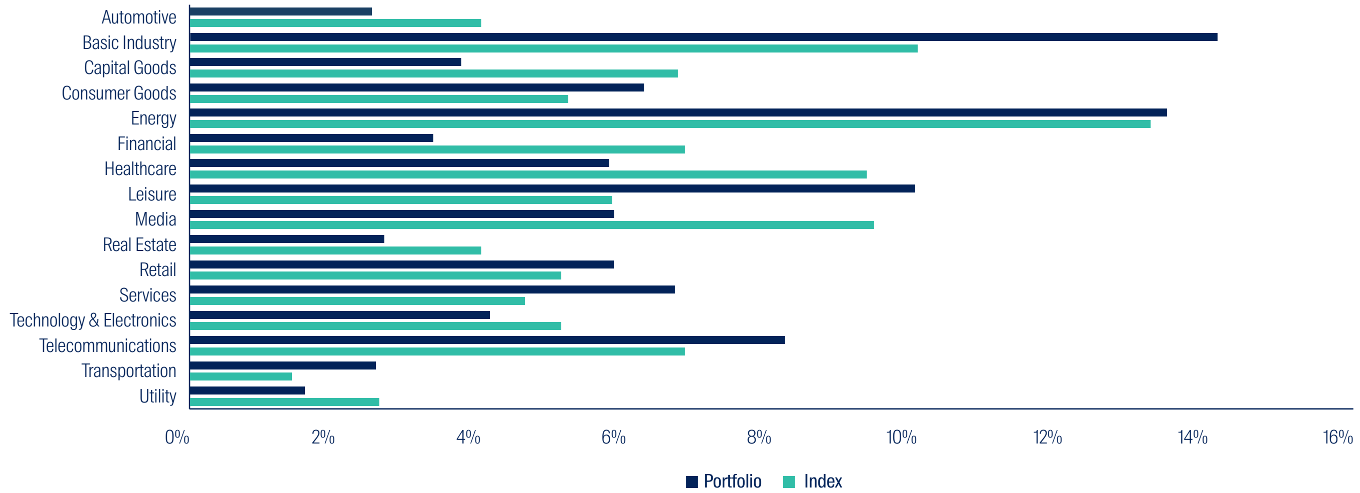
Select High Yield

Characteristics

	Select	Index*
Yield to Worst	5.89%	5.78%
Spread to Worst	560	547
Duration to Worst	3.66	3.78
# of Issuers	117	
AUM	53	
Avg. Rating	B1/B+	

* Index as of quarter end rebalance

Sector weightings: Portfolio, Benchmark



Breakdown by Rating

	Portfolio %
BBB-	1.7
BB+	5.9
BB	13.9
BB-	15.1
B+	20.0
B	19.9
B-	10.2
CCC+	3.1
CCC	3.8
CCC-	0.0
Other*	2.8

* CC, C, D & NR

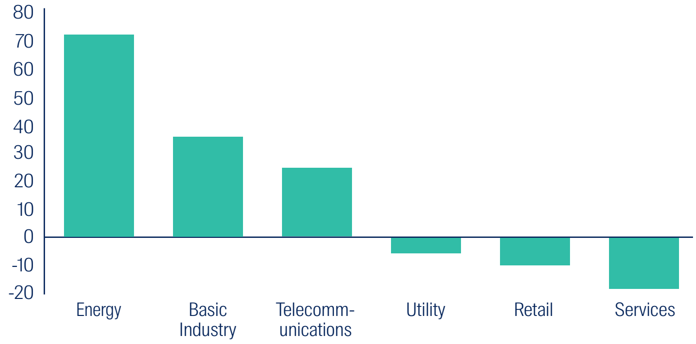
Breakdown by Country

	Risk Contribution %
United States	90.0
Canada	4.5
United Kingdom	2.0
Ireland	1.3
Australia	0.6
Austria	0.5
Greece	0.5
Brazil	0.3
France	0.3

Top 10 Issuers

	Market Value %
Alberstons	2.4
Asurion	2.2
Allied Universal	2.0
Icahn Enterprises	1.9
Ascend Learning	1.9
Sprint	1.8
Gates Global	1.8
Viking Cruises	1.7
Hecla Mining	1.7
Bausch Healthcare	1.7

Top 3/Bottom 3 Contribution to Excess Return



Source: First Sentier investors. Data as of September 30, 2020

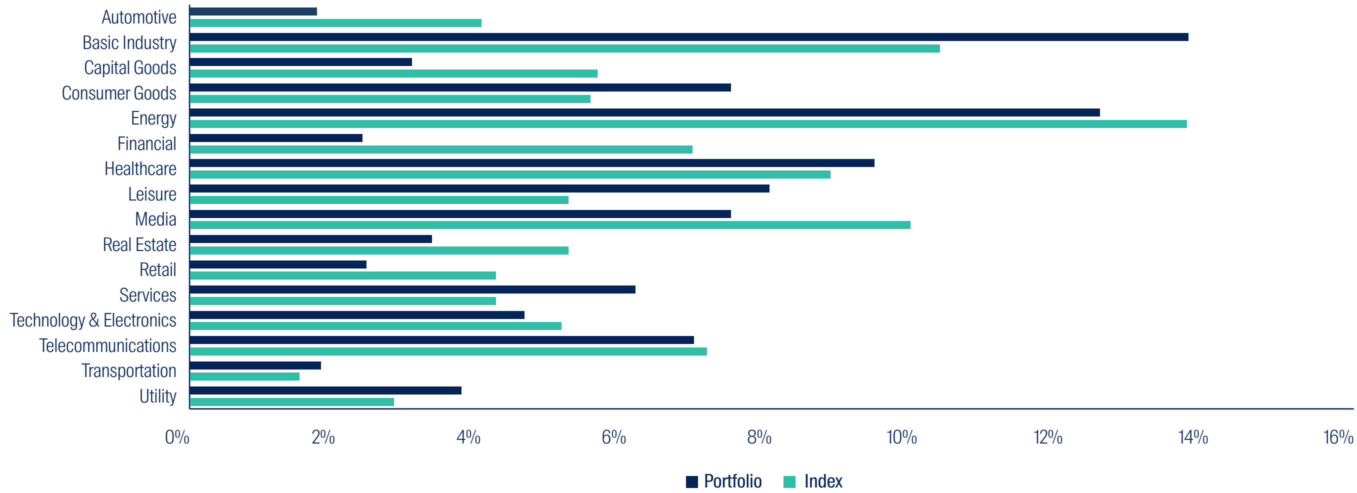
Quality High Yield

Characteristics

	Quality	Index*
Yield to Worst	4.86%	5.00%
Spread to Worst	459	467
Duration to Worst	3.44	3.89
# of Issuers	132	
AUM	84	
Avg. Rating	B1/BB-	

* Index as of quarter end rebalance

Sector weightings: Portfolio, Benchmark



Breakdown by Rating

	Portfolio %
BBB-	2.9
BB+	8.8
BB	20.7
BB-	16.4
B+	22.6
B	14.4
B-	6.0
CCC+	0.0
CCC	0.0
Other*	2.6

* CC, C, D & NR

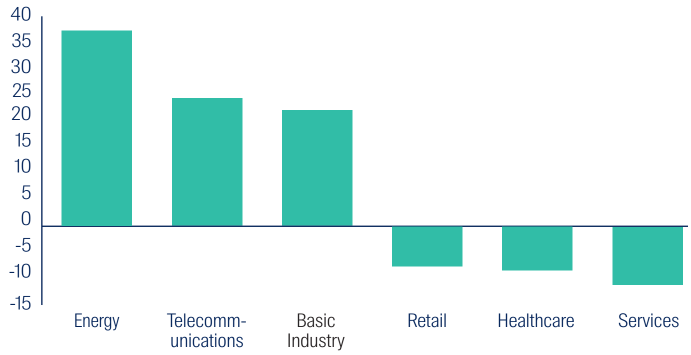
Breakdown by Country

	Risk Contribution %
United States	92.6
Canada	4.1
United Kingdom	1.2
Australia	0.6
Ireland	0.5
Greece	0.5
Austria	0.2
France	0.2
Brazil	0.1

Top 10 Issuers

	Market Value %
Horizon Therapeutics	2.5
Sprint	1.8
Allied Universal	1.8
Bausch Healthcare	1.8
Icahn Enterprises	1.7
Summit Materials	1.7
Brookfield Residential	1.7
TransDigm Group	1.7
NRG Energy	1.6
SiriusXM Radio	1.5

Top 3/Bottom 3 Contribution to Excess Return



Source: First Sentier Investors. Data as of September 30, 2020

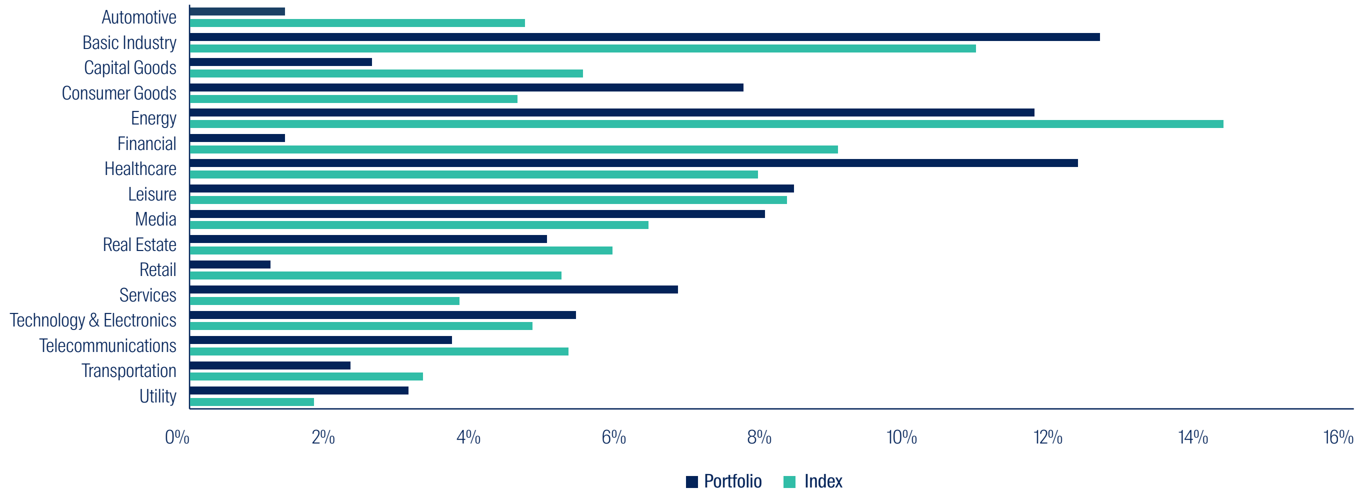
Short Duration High Yield

Characteristics

	Short Duration	Index*
Yield to Worst	4.69%	5.16%
Spread to Worst	455	499
Duration to Worst	2.02	2.29
# of Issuers	93	
AUM	29	
Avg. Rating	Ba3/BB-	

* Index as of quarter end rebalance

Sector weightings: Portfolio, Benchmark



Breakdown by Rating

	Portfolio %
BBB-	2.1
BB+	9.8
BB	12.4
BB-	20.2
B+	20.5
B	17.1
B-	5.7
CCC+	0.0
CCC	0.0
Other*	4.1

* CC, C, D & NR

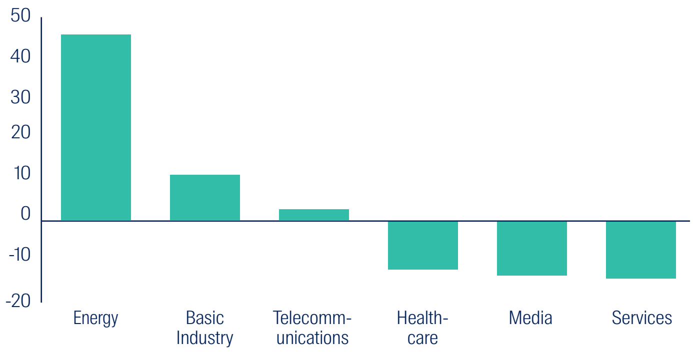
Breakdown by Country

	Risk Contribution %
United States	90.7
Canada	4.0
Ireland	2.0
Greece	1.1
Australia	0.9
Austria	0.8
France	0.3
Brazil	0.2

Top 10 Issuers

	Market Value %
Horizon Therapeutics	2.6
Sprint	2.3
Allied Universal	2.1
Bausch Healthcare	2.1
Icahn Enterprises	2.1
Summit Materials	2.0
Brookfield Residential	2.0
TransDigm Group	1.9
NRG Energy	1.9
SiriusXM Radio	1.8

Top 3/Bottom 3 Contribution to Excess Return



Source: First Sentier Investors. Data as of September 30, 2020

High Yield Portfolio Managers

Jason Epstein
Senior Portfolio Manager,
Co-Head of High Yield

Jason joined First Sentier Investors in September 2016, and has 18 years of industry experience.

Jason was a Managing Director with Oak Hill Advisors where he was responsible for managing a team of analysts covering a broad range of sectors.

While at Oak Hill he was responsible for managing leveraged credit investments in the building products, chemicals, homebuilding, lodging and paper & packaging sectors.

Prior to Oak Hill, Jason was an analyst within investment banking at Credit Suisse First Boston where he was a member of both the Financial Sponsors and Technology groups.

Jason has a BS in Economics from The Wharton School, University of Pennsylvania.

Matt Philo, CFA
Senior Portfolio Manager,
Co-Head of High Yield

Matt joined First Sentier Investors in May 2016, and has 31 years of industry experience.

Matt was Executive Managing Director & Head of High Yield at MacKay Shields LLC, serving as Portfolio Manager to $22 billion of assets across institutional and retail accounts. He joined MacKay Shields in 1996 and managed institutional accounts for the firm from September 1996 through May 2014.

He managed the Mainstay High Yield Corporate Bond Fund (MYHIX) from December 2000 through May 2014.

Matt has an MBA in Finance from New York University Stern School of Business, and a BA in Economics from University at Albany SUNY. Matt is a CFA Charterholder.