BARINGS VIEWPOINTS

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MULTI CREDIT INVESTING: EMBRACING THE HIGH YIELD OF TODAY

Over the past decade, the growth and expansion of the global high yield markets has contributed to a transformation in investors' attitudes toward the asset class, with many investors viewing high yield as a core, strategic contributor to their portfolio. In fact, many investors today, rather than questioning *when* to invest in global high yield, are questioning *how*.

One answer may be through a high yield multi credit approach, which can have several benefits both in the current environment and through a full credit cycle.

> *"An integrated multi credit high yield strategy can be particularly valuable in providing managers with the flexibility to tactically shift weightings and capital allocations"*

What is high yield multi credit?

The definition of multi credit is far from standardized. At Barings, we think of multi credit investing as a "corporate focused" rather than "go-anywhere" strategy that consists primarily of allocations to the "core four" high yield sub asset classes—U.S. high yield bonds, U.S. loans, European high yield bonds and European loans—with the ability to make opportunistic allocations to collateralized loan obligations (CLOs), and stressed and distressed credits (special situations):

CORE ASSETS

The "core four" sub asset classes account for roughly 75% of the assets in Barings' high yield multi credit strategy.

OPPORTUNISTIC ASSETS

The remaining 25% of our strategy consists of opportunistic allocations to CLOs and special situations.

Finding value through the credit cycle

While the U.S. and European high yield markets tend to exhibit some correlation and share similar risk/return profiles, these markets have historically been punctuated by periods of dislocation during which prices have become decoupled from underlying fundamentals, creating widely different opportunities at different points in the credit cycle.

This variation in performance and pricing between high yield sub asset classes is often the result of headline risk or technical factors, which are typically temporary and sentiment-driven. While these factors may drive prices down in the short term, they have often been followed by a relatively quick recovery, particularly in cases where the underlying fundamentals remain solid. A multi credit strategy can help an investor take advantage of the short-term opportunity that has arisen, by positioning investors to promptly reallocate assets to the area that may be offering the most value at any given point in time.

The benefit of being able to quickly and efficiently reallocate capital during a market dislocation was particularly apparent in 2015, when the U.S. high yield bond market, with greater exposure to energy than the European market, experienced significant spread widening despite the fact that many issuers were benefitting from lower commodity prices. Within the U.S. market, bonds had significantly more exposure to energy than loans, and therefore offered better return potential when the market recovered. Managers with the ability to look at the high yield markets from a broader perspective were in a position to capitalize on this market dislocation; in many cases, those who shifted into U.S. high yield bonds benefitted a year later when the asset class went on to outperform.

Flexibility is key

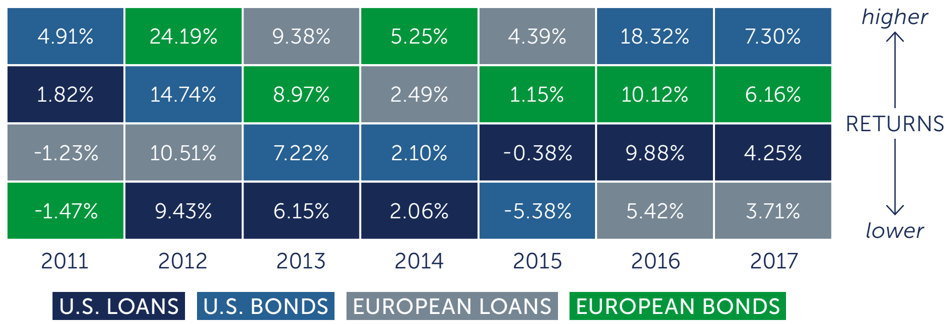
When an opportunity emerges in a specific area of the global high yield markets, a timely response is of the essence. In recent years, there have been a number of instances in which an opportunity came and went relatively quickly, including the 2011 Eurozone crisis, 2013's "taper tantrum" and the 2016 Brexit vote. The fleeting nature of such opportunities can prove challenging for investors, who often lack the flexibility to respond in real time.

It is therefore unsurprising that many investors choose to delegate their reallocation decisions to well-resourced investment managers with large, global high yield teams. At Barings, we have 71 high yield investment professionals across the U.S. and Europe, providing the resources and expertise required to thoroughly analyze the fundamentals of every credit we underwrite. As relative value opportunities come and go across the core four markets, we dynamically reallocate investors' capital toward opportunities as they emerge, all while keeping a close eye on potential technical risks.

The current opportunity

While global high yield markets had a strong run in 2016 and 2017, we see many positive indicators—strong fundamentals, generally low default rates, improvements in global growth and the possibility of a potential tailwind from U.S. tax reforms—that continue to

VALUE IN HIGH YIELD SHIFTS OVER TIME



SOURCE: *U.S. HIGH YIELD BONDS*—BAML NON-FINANCIAL HIGH YIELD CONSTRAINED INDEX; *EUROPEAN HIGH YIELD BONDS*—BAML EUROPEAN CURRENCY NON-FINANCIAL HIGH YIELD CONSTRAINED INDEX; *U.S. LOANS*—CREDIT SUISSE LEVERAGED LOAN INDEX; *EUROPEAN LOANS*—CREDIT SUISSE WESTERN EUROPEAN LEVERAGED LOAN INDEX. AS OF DECEMBER 31, 2017.
PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS.

"The true strength of a multi credit approach is exhibited not during periods of calm, but rather during market dislocations"

support the markets. Against that backdrop, we believe that the high yield bond and senior secured loan markets across the U.S. and Europe were roughly neck and neck on a relative value basis at the end of 2017, although U.S. bonds began to look more attractive as the markets experienced increased volatility in early 2018.

To this end, the true strength of a multi credit approach is exhibited not during periods of calm, but rather during market dislocations. While it may be difficult to pinpoint precisely when these dislocations will occur, they do, inevitably, occur. A multi credit strategy gives managers the ability to quickly and efficiently redirect investors' allocations in real time, in response to these dislocations, and positions them to pivot to those regions or sub asset classes that they believe offer the best value at any given point in time.

When looking at the high yield markets today, corporate fundamentals look stable, with most companies in the U.S. and Europe generating top and bottom line revenue growth and exhibiting reasonable balance sheet leverage. Global growth, which appears to be synchronized across North America, Europe and Asia, remains supportive. That said, there are a handful of potential volatility triggers on the horizon that could cause volatility and price dislocation in the near-term including ongoing Brexit negotiations, concerns over inflation and the reaction of the U.S. market to higher interest rates. There are also a number of sector-specific risks in the U.S., particularly around energy, healthcare and retail.

An integrated multi credit high yield strategy can be particularly valuable in providing managers with the flexibility to tactically shift weightings and capital allocations to those regions or sub asset classes that they believe offer the most attractive relative value at any given time. In our view, managers with the ability to look holistically across these markets—through the use of a multi credit approach—are best positioned to capitalize on the ever-evolving opportunity set within today's global high yield markets.

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*As of December 31, 2017

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