CIFC Asset Management

CIFC Portfolio Intelligence

The continued case for senior secured loans

October 2024

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Featured Views and Insights

Summary

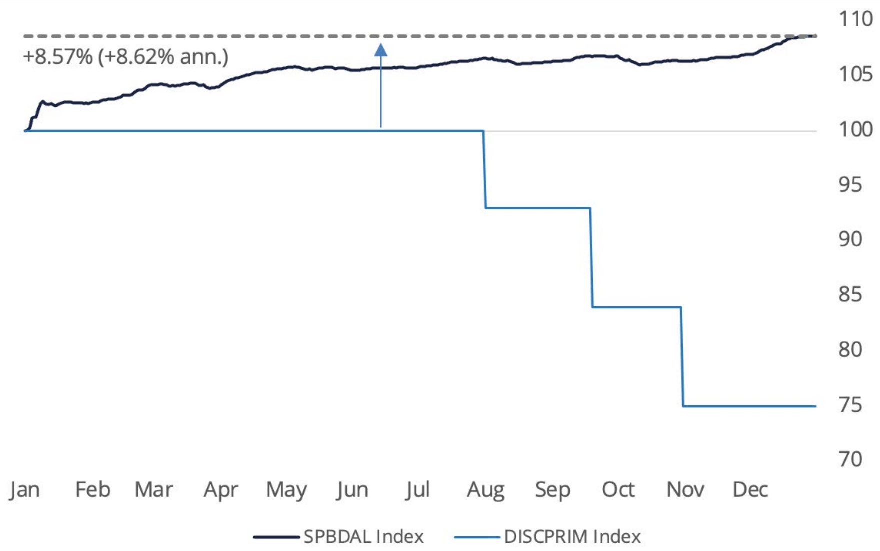
- Fixed income portfolios that utilize senior secured loans alongside traditional bonds have seen greater annualized returns with lower volatility since 1994. This has been consistent through various rate environments and bear markets that investors have faced in the past 30 years.[1]
- During the longest continuous **falling** rate environment since 1994, a 100% bond fixed income portfolio only slightly outperformed a fixed income portfolio with a 40% allocation to loans. In our view, the performance difference of ~170 bps was offset by the reduced volatility profile of the portfolio that employed loans.[2]
- During the longest continuous **flat** and **rising** rate environments, a portfolio that employed a 40% loan allocation outperformed the bond-only portfolio by over 300 bps.[3,4]
- While fixed-rate bonds slightly outperform loans when rates are falling, we believe this effect does not outweigh the outperformance senior secured loans demonstrate in flat and rising rate environments.[5]
- We believe investors should maintain loan allocations as they evaluate the long-term risk / reward performance prospects of their portfolios.

Stan Sokolowski is Managing Director, Senior Portfolio Manager and Deputy Chief Investment Officer

Mr. Sokolowski has 33 years of credit, portfolio management and trading experience. He is the lead portfolio manager for CIFC's Corporate Credit Loan Funds and a member of the firm's Investment Committee. Mr. Sokolowski has a broad range of investment management skills and experience in private and public credit markets. He has invested and traded across the spectrum of credit from high yield to investment grade as well as distressed and stressed credit, fixed and floating rate instruments, bonds, loans, CDS and index products.

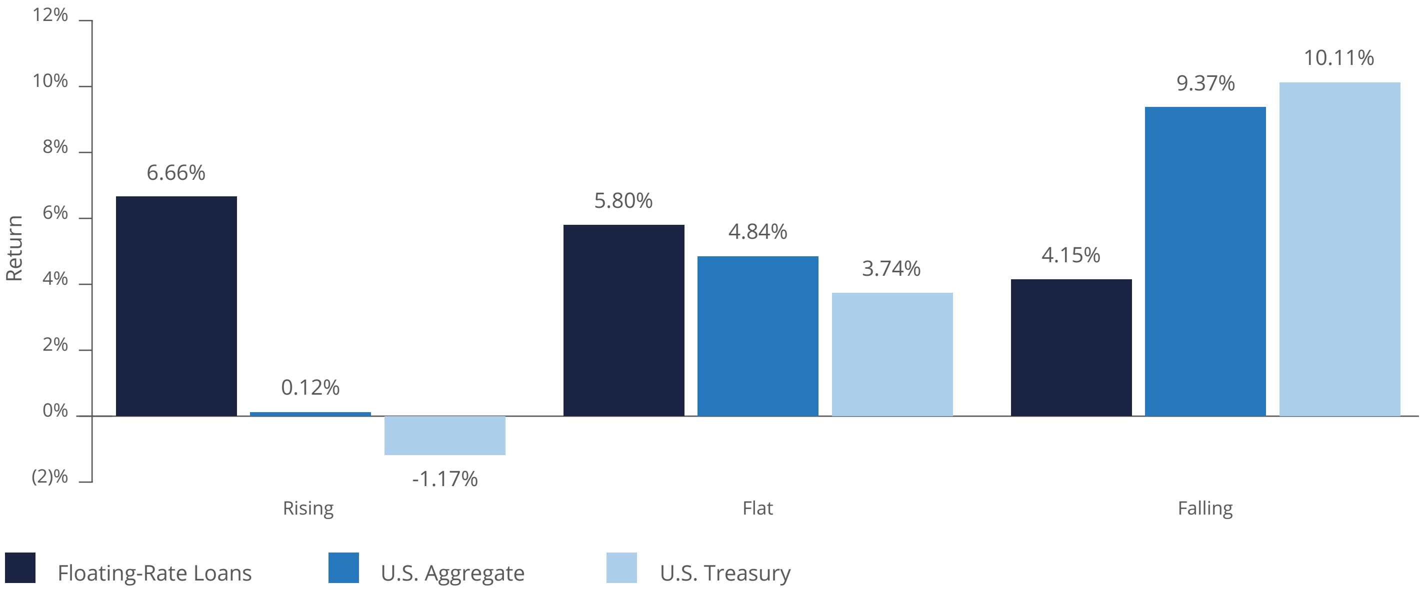
Traditionally, many investors have (mistakenly) viewed senior secured loans as a tactical, rate-based trade. However, more are now recognizing the many resilient attributes of the asset class and loans are now becoming a strategic core holding in a variety of investor portfolios. This shift is being driven by a deeper understanding of how the asset class performs across different interest rate and economic environments. The most recent case study to look to is the pre-pandemic year of 2019, when the Federal Reserve executed three interest rate cuts to the tune of a total 75 bps. The loan market delivered a +8.57% return that year, as shown in the following chart.

Pre-Pandemic Case Study on Rate Cuts[6]



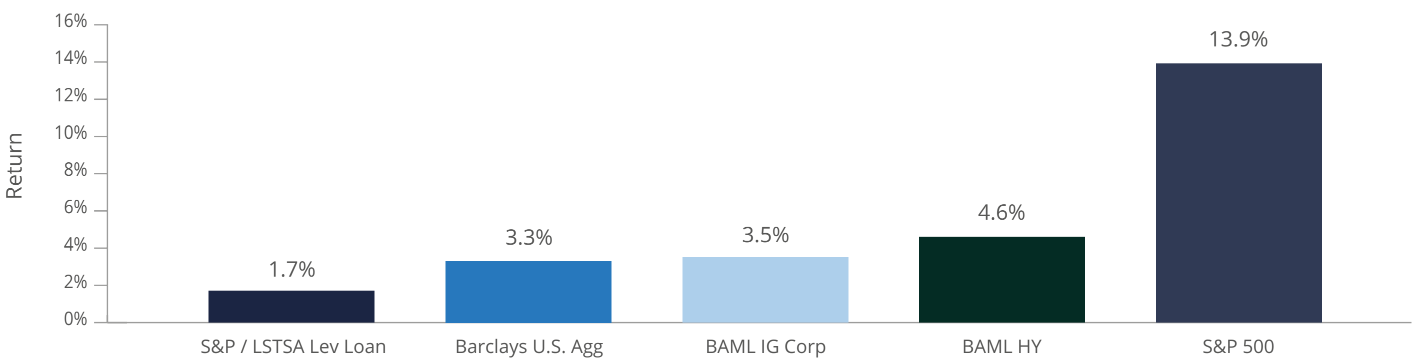
While we understand the impulse to move assets to fixed-rate bonds as rates fall, we remind investors that senior secured loans have demonstrated resiliency in rising, falling and flat interest rate environments. We therefore encourage investors to look at the past 30+ years of data and take a long-term approach to constructing their portfolios.

Floating-Rate Loans in Rising, Flat, and Falling Rate Environments[7]



Moreover, while every investor likes to buy at the lows and sell at the highs, practice has shown that trying to time the market can be a fool's errand. When it comes to loans, our analysis has shown that the asset class can be added to regularly without having to make a call on interest rates or the peril of making a bad trade. As shown in the chart below, we looked at over 20 years of data over multiple time horizons to demonstrate the potential outcomes of bad market timing across equities, high yield bonds, loans and the Bloomberg Barclays Aggregate Bond Index ("Bloomberg Barclays Agg" or "Agg"). The key takeaway for investors is that any market timing skills should probably be deployed in equities and high yield bonds and not loans or the Bloomberg Barclays Agg.

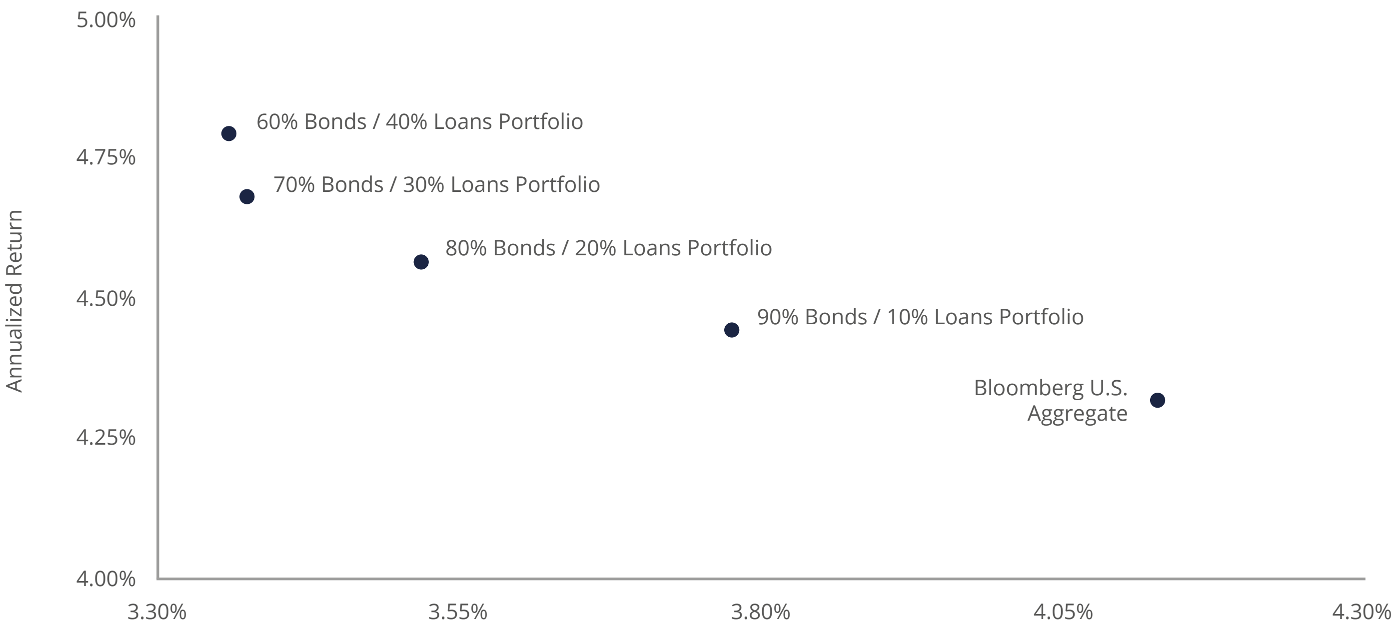
Bad Market Timing – Portfolio Impact: 5-Year Horizon (2000–YTD 2024)[8]



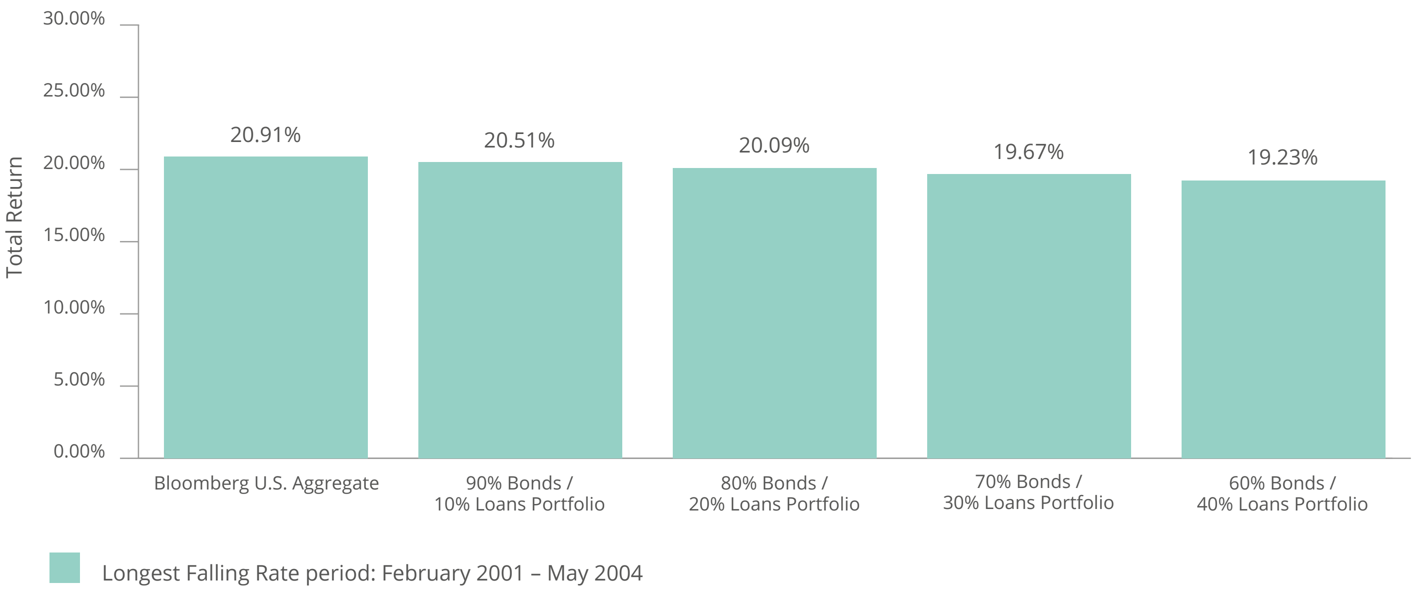
An important piece of analysis that many investors have underappreciated is the 30+ years of data which demonstrates that senior secured loans have historically enhanced fixed income portfolios and reduced overall portfolio volatility, as shown in the chart below. While fixed-rate bonds may slightly outperform during periods of intensely falling rates, the long-term benefits of loans should not be overlooked.

The following charts outline the combined returns of the **Bloomberg U.S. Aggregate Bond Index** and the **Credit Suisse Leveraged Loan Index** to showcase how adding a percentage of this asset class has historically enhanced traditional fixed income portfolios.

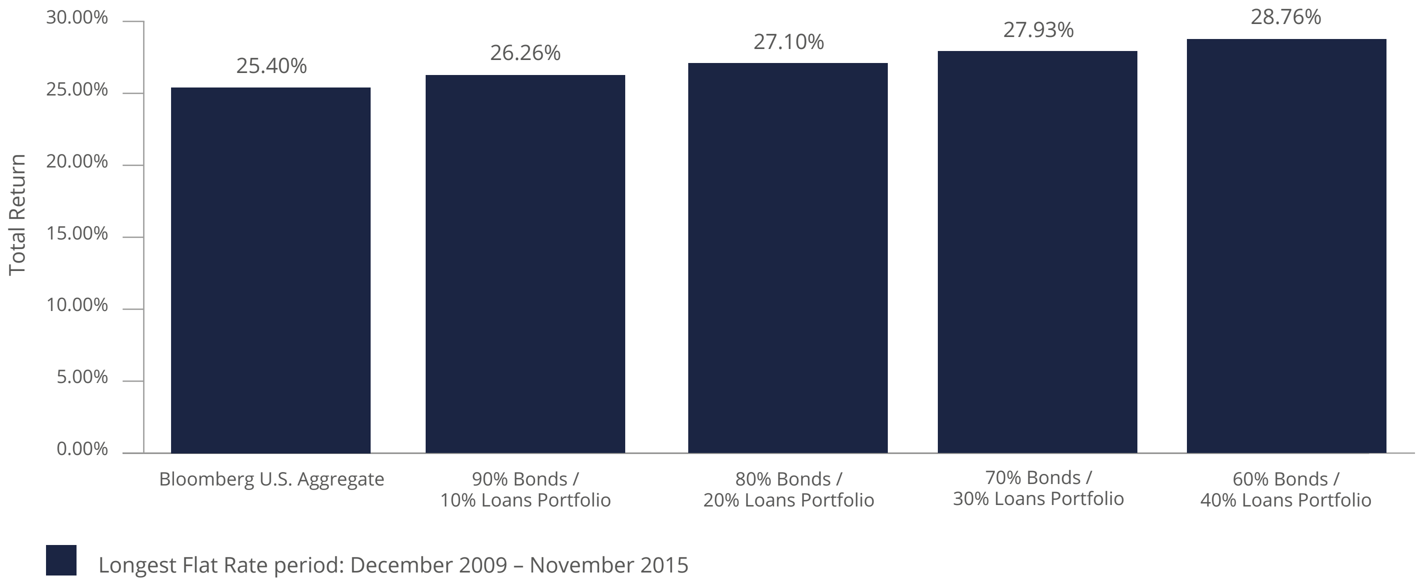
Allocating to Loans Has Historically Increased Returns and Reduced Risk[9]



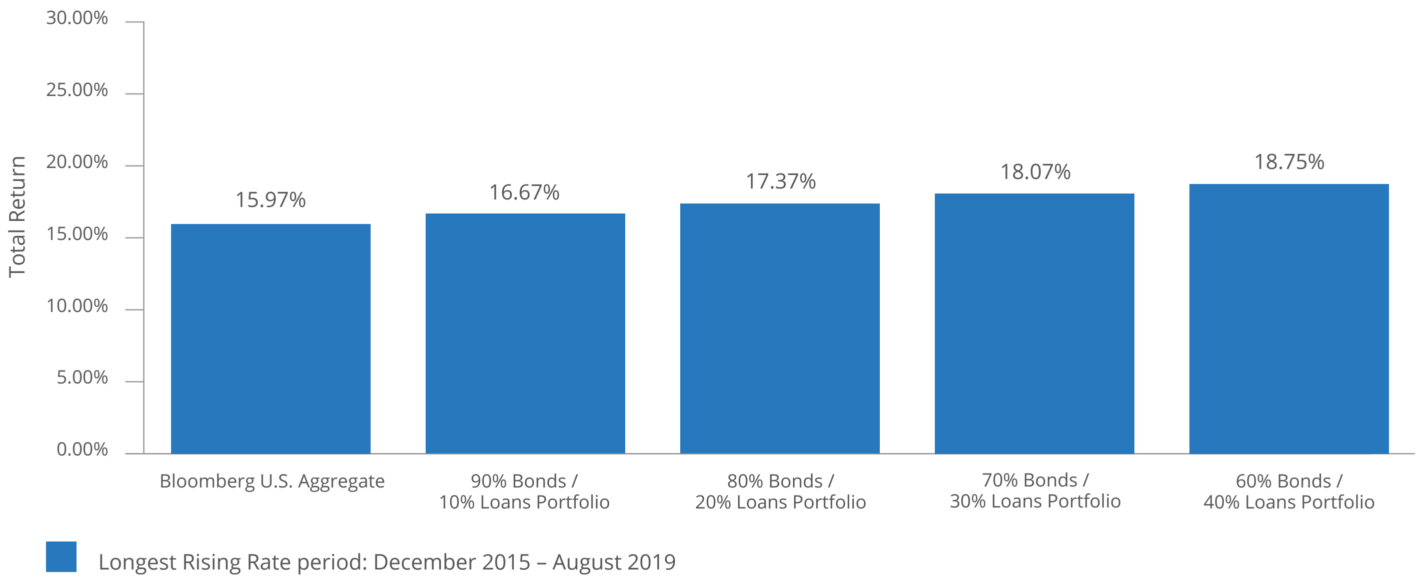
Bonds Only Slightly Outperformed Loans During the Longest Falling Rate Period Since 1994[10]



Loans Outperformed Bonds During the Longest Flat Rate Environment Since 1994[11]



Loans Outperformed Bonds During the Longest Rising Rate Environment Since 1994[12]



Conclusion

- Our view is still that interest rates remain "high for longer" and that the likelihood of a return to a zero-interest-rate policy (ZIRP) or negative-interest-rate policy (NIRP) environment in the foreseeable future is very, very low.
- We see a performance similar to that of 2019 in store for the loan asset class in the near and medium term, given that senior secured loans provide a much higher income profile than many alternatives today – even with further rate cuts.
- We maintain our constructive view and call for exposure to loans in investor portfolios to continue given our expectation that the cutting cycle will be shallow.

1. Source: Catalyst Capital Advisors LLC., Bloomberg LP, and Credit Suisse. Based on monthly return data from 12/31/1993 to 6/30/2024.
2. Source: Bloomberg LP and Credit Suisse. Total return based on monthly return data from 2/28/2001 to 05/31/2004, where the Longest Falling Rate period occurred, defined as a decrease of more than 50 bps, based on the Federal Funds Target Rate rolling 12-month periods from 12/31/1993 to 6/30/2024.
   Percentage breakdown shown herein is ratio of % allocation to the Bloomberg U.S. Aggregate Bond Index / % allocation to the Credit Suisse Leveraged Loan Index.
3. Source: Bloomberg LP and Credit Suisse. Total return based on monthly return data from 12/31/2009 to 11/30/2015, where the Longest Flat Rate Period occurred, defined by a decrease of less than 50 bps or an increase of less than 50 bps, based on the Federal Funds Target Rate rolling 12-month periods from 12/31/1993 to 6/30/2024.
4. Bloomberg LP and Credit Suisse. Total return based on monthly return data from 12/31/2015 to 08/31/2019 where the Longest Rising Rate Period occurred, defined by an increase of more than 50 bps, based on the Federal Funds Target Rate rolling 12-month periods from 12/31/1993 to 6/30/2024.
5. Credit Suisse and Bloomberg Barclays Indices. "Rising" indicated by an increase of more than 50 bps. "Falling" indicated by a decrease of more than 50 bps. Data reflects rolling 12-month periods from January 1993 through December 2020. Most recent data available upon request.
6. Source: Bloomberg. Data as of August 27 2024. Please see the disclaimer for a description of the indices. **Past performance is not an indication of current and future returns.**
7. Source: Credit Suisse and Bloomberg Barclays Indices. "Rising" indicated by an increase of more than 50 bps. "Falling" indicated by a decrease of more than 50 bps. Data reflects rolling 12-month periods from January 1993 to December 2020. Most recent data available upon request.
8. Source: Copyright © 2024 by PitchBook Data, Inc, BAML, Barclays. Data as of March 31, 2024. Case study is representative of the time period from 2000 to YTD 2024. Please see the disclaimer included at the end of this presentation for a description of the indices.
9. Source: Catalyst Capital Advisors LLC., Bloomberg LP, and Credit Suisse. Based on monthly return data from 12/31/1993 to 6/30/2024.
   Source: Bloomberg LP and Credit Suisse. Total return based on monthly return data from 2/28/2001 to 05/31/2004, where the Longest Falling Rate period occurred, defined as a decrease of more than 50 bps, based on the Federal Funds Target Rate rolling 12-month periods from 12/31/1993 to 6/30/2024.
10. Percentage breakdown shown herein is ratio of % allocation to the Bloomberg U.S. Aggregate Bond Index / % allocation to the Credit Suisse Leveraged Loan Index.
    Past performance is not a guarantee of future results.
11. Source: Bloomberg LP and Credit Suisse. Total return based on monthly return data from 12/31/2009 to 11/30/2015, where the Longest Flat Rate period occurred, defined by a decrease of less than 50 bps or an increase of less than 50 bps, and reflects Federal Funds Target Rate rolling 12-month periods from 12/31/1993 to 6/30/2024.
12. Source: Bloomberg LP and Credit Suisse. Total return based on monthly return data from 12/31/2015 to 08/31/2019 where the Longest Rising Rate period occurred, defined by an increase of more than 50 bps, based on the Federal Funds Target Rate rolling 12-month periods from 12/31/1993 to 6/30/2024.
    Percentage breakdown shown herein is ratio of % allocation to the Bloomberg U.S. Aggregate Bond Index / % allocation to the Credit Suisse Leveraged Loan Index.
    Past performance is not a guarantee of future results.

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The Morningstar LSTA Leveraged Loan Index is a market value weighted index designed to measure the performance of the U S leveraged loan market based upon market weightings, spreads and interest payments. The index is reviewed weekly to reflect pay downs and ensure that the index maintains its characteristics The index returns are calculated daily as described in Morningstar.

ICE BofA US High Yield Index tracks the performance of US dollar denominated below investment grade rated corporate debt publicly issued in the US domestic market. To qualify for inclusion in the index, securities must have a below investment grade rating (based on an average of Moody's, S&P, and Fitch) and an investment grade rated country of risk (based on an average of Moody's, S&P, and Fitch foreign currency long term sovereign debt ratings).

ICE BofA Euro High Yield Index tracks the performance of Euro denominated below investment grade corporate debt publicly issued in the euro domestic or eurobond markets.

US CLO Equity Return is published monthly by Citigroup. The return methodology calculates actual CUSIP-level CLO equity total returns using month-end prices from the Citigroup CLO trading desk and takes the average total return after excluding the outliers (top and bottom 5% percentile).

Credit Suisse Leverage Loan Index tracks the investable market of the U.S. dollar denominated leveraged loan market. It consists of issues rated "5B" or lower, meaning that the highest rated issues included in this index are Moody's/S&P ratings of Baa1/BB+ or Ba1/BBB+. All loans are funded term loans with a tenor of at least one year and are made by issuers domiciled in developed countries.

JPM CLO Composite consists of equal weighted JP CLO BBB, JP CLO BB, JP CLO B Indices.

The J.P. Morgan Leveraged Loan Index is designed to mirror the investable universe of USD institutional leveraged loans, including US and international borrowers.

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