A Dynamic Allocation Across Multiple Market Environments

Dynamic portfolio management without traditional benchmark constraints can benefit investors across market regimes. Yet, it also pays to be strategic when incorporating different phases of an economic cycle.

The Strategic Bond Strategy, managed by MacKay's Global Fixed Income Team, is a high conviction, top-down and bottom-up investment solution that offers a number of important benefits across a variety of markets. And in today's challenging market environment, our focus is on strong risk controls, diversified sources of return and income generation.

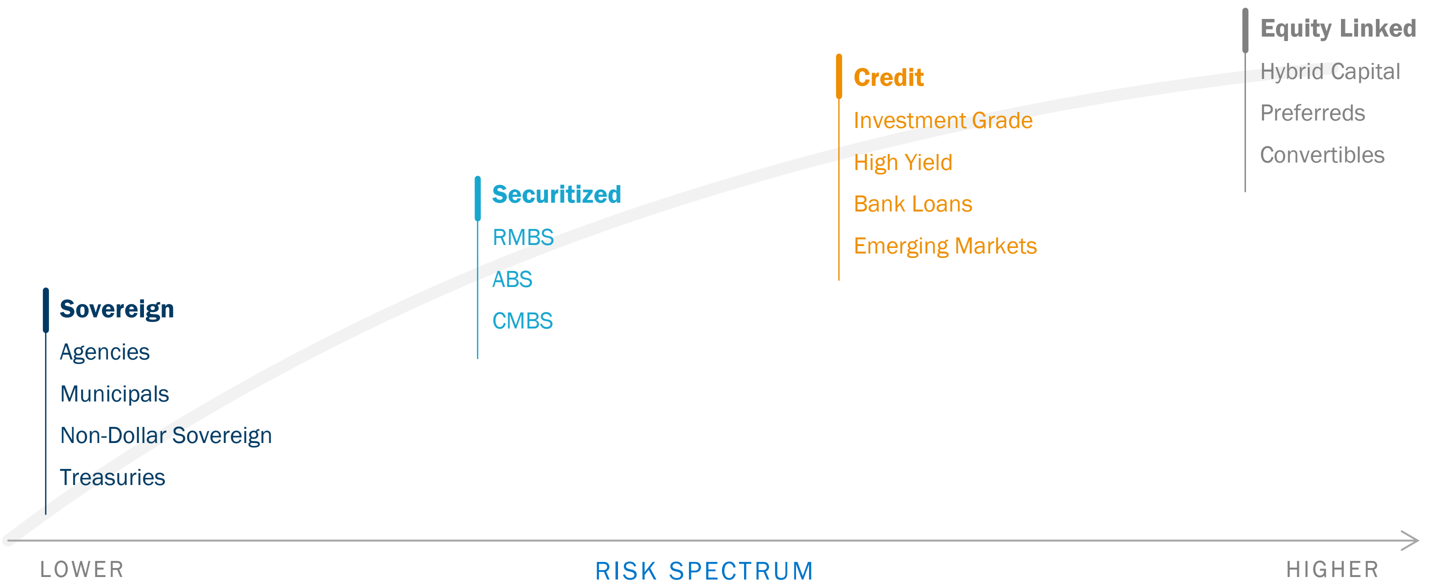
Similar to the events we experienced during the Global Financial Crisis, the recent pandemic has ushered in another era of ultra-accommodative monetary (and fiscal) policy. With risk premiums back to the previous cycle levels across many sectors of the fixed income markets, and inflationary pressures mounting, the Federal Reserve has a very delicate balancing act ahead of them. The risk of a miscalculation is very high, which means the capital markets and traditional bond strategies remain vulnerable. The importance of active management is critical in today's environment. Understanding the implications of central bank policies and implementing a rigorous bottom-up investment approach, while agnostic to traditional market benchmarks, can help position investors for better outcomes.

In a low interest rate environment, traditional index-aware strategies are not necessarily the best path to achieve total return and income goals today. In fact, approximately 70% of the Bloomberg Barclays US Aggregate Index is comprised of US government-related debt generating low yields and in our view little total return potential.

For investors that allocate a portion of their fixed-income risk budget to the Strategic Bond strategy (the "Strategy"), we believe total return and income are still very attainable, despite the challenging yield environment. The benchmark-agnostic nature of the Strategy allows it to seek diversified sources of return on a wider investment opportunity set without being limited by traditional benchmark exposures (see Figure 1 below).

Total Return and Income Are Not Off the Table

FIGURE 1: BROADLY DIVERSIFIED SOURCES OF POTENTIAL ALPHA



For illustrative purposes only.

Key Differentiators

The Global Fixed Income Team	
OUR SIZE	Large enough to be influential in the market but nimble enough to make a difference
OUR APPROACH	Combination of fundamental macroeconomic and unique bottom-up research resulting in high-conviction decision making
COMPREHENSIVE RISK MANAGEMENT	We identify, measure and control key risk factors

The Strategic Bond Strategy	
SEEKS HIGH ALPHA CAPTURE	Targets diversified sources of alpha to harness market upside.
CONCENTRATED & HIGH CONVICTION	Only adds positions once strong convictions are built.
BENCHMARK AGNOSTIC	Positioning not constrained by index limitations.
SOLUTIONS ORIENTED	Seeks to help resolve client concerns, provide extra income, greater diversification, and additional return.

What Sets Strategic Bond Apart

MacKay Shields' Global Fixed Income team's influential size, high conviction approach and potential to capture upside by navigating the cycle uniquely supports the Strategy we employ within the Strategy to offer a truly multi-asset fixed income allocation.

The Strategy's asset allocation, duration positioning and overall risk positioning is established based on what is most appropriate at a given point in the cycle. This allows the Strategy to concentrate on diversified sources of alpha across the spectrum of market segments most likely to achieve better risk-adjusted returns.

At the early stages of an economic cycle, the Strategy will typically have a growth orientation with a particular focus on capital appreciation opportunities across a variety of markets and instrument types. During the latter stages of an economic cycle, the Strategy will typically have a more defensive orientation given the vulnerabilities of the economy coupled with reduced levels of compensation.

Our Advantages Offer Benefits Throughout the Cycle

We highlight five pillars of the Strategy's investment process, which contribute to a portfolio construction that seeks to deliver performance in any market environment:

1. **The Strategy seeks diversified sources of alpha,** participating in fixed income markets unbound by geography, ratings, structure, or liquidity.
2. **We engage in active sector rotation,** with a wide flexibility to rotate across sectors, while abiding by a risk-controlled framework.
3. **Our strategic investment focus** is anchored in longer-term macroeconomic developments.
4. **Tactical positioning** within the Strategy seeks to exploit pricing inefficiencies, especially during periods of market dislocations.
5. **Bottom-up security selection** is driven by the fundamental research conducted by our industry-focused analysts.

Our size allows us not only to get involved in a variety of different segments of the market, but to do so in a way that will have an impact on our portfolios. In the Strategy today, that includes a meaningful overweight to credit: high yield, securitized product and emerging-market debt.

Why It's Time to Be Strategic

When interest rates rise, most bond investors become fearful when the reality is these investors should in our view embrace higher rates. A rising interest rate environment, particularly one driven by strong economic growth, can help improve the return profile of fixed income instruments—and even more so through a flexible, active asset allocation and security selection approach.

ACTING ON PRECISE OPPORTUNITIES IS ESSENTIAL

For example, as we survey the market landscape today, we expect quality curves will continue to compress, and BB securities will broadly outperform BBBs. Additionally, as spread curves continue to flatten, 10- to 30-year risk premiums should contract toward two- and three-year spread products. But it's important to be very specific about those areas of the market to shop. The Strategy's fundamental bottom-up research approach that aligns to industry, regardless of rating or geography, along with trading and portfolio management helps us identify the best opportunities across markets.

As investors grow increasingly concerned about inflationary pressures and its impact on higher rates, they've begun seeking products with less interest rate sensitivity. Some turn to short duration strategies, which typically favor five-year and shorter paper. However, because of the massive liquidity in the market today, those credit curves are already trading tighter than pre-COVID levels. As mentioned previously, we see more value in owning spread product further out, along the 10-year and longer portion of the maturity spectrum. We believe the Strategy can capitalize on that value we've identified for our investors, while also limiting duration risk by hedging back down to the levels we target.

OUR VIEW: STRATEGIC BOND IS MORE COMPELLING TODAY

The Strategy's benefits span a variety of market regimes. In today's environment, we believe investors should allocate a portion of their passive fixed income budget to the strategy to benefit from a number of attractive qualities:

- **Affords the opportunity to pick up income and reduce interest rate risk.** The Strategy historically offers a higher yield than the Bloomberg Barclays Global Aggregate Bond Index (Aggregate Index), with significantly less duration.[1]
- **Offers strong diversification.** Over the last five years, the strategy has shown low correlation, just 0.42, with the Aggregate Index.[1]
- **Target diversified sources of alpha to capture early-cycle upside potential.** The strategy is positioned across a dozen global fixed income sectors and deemphasizes government bonds to reduce rate sensitivity.

A Solutions-Oriented Product in Multiple Market Environments

The Strategy offers investors attractive portfolio allocations that are both evergreen and topical, particularly in the early stages of the new economic cycle today.

The Strategy is actively managed and isn't limited by traditional benchmark constraints. It seeks to access areas—and amounts—of the market that index-aware strategies cannot, and then capitalize on the high conviction/best security selection opportunities available. We believe that the high conviction position selection allows the Strategy to deliver greater yield, lower interest rate risk, better risk-adjusted returns and diversified sources of alpha.

Supported by the team's size, approach and ability to navigate the cycle, they have demonstrated how an expanded investment approach that considers a wider multi-asset universe can deliver compelling opportunities, even in low-yield environments and volatile market regimes.

High Conviction Positioning in Today's Market

On average, these five high conviction categories equate to BBB credit quality and intermediate maturity, offering greater income potential and total return advantages with less interest rate-risk, relative to the overall BBB market.

COVID Recovery Sectors	Of the Covid recovery sectors, our preference is the transportation sector including airlines and hotels; select retail operators; and leisure sectors.
Housing Market	Due to demand and lack of inventory, we favor the housing market through credit risk-transfer securities, legacy non-agency mortgages, and mortgage loan originators that issue unsecured credit.
Consumer Credit	Excess savings are at all-time highs due to low unemployment. We favor securitized credit and asset-backed securities, as well as certain specific finance names.
Subordinated Financials	We view this as an attractive relative value opportunity, especially when compared with traditional BB-rated corporate debt. Particular appeal in certain European Tier-1 names, along with specific preferred securities.
Premium Mortgage-Backed Securities (MBS)	We view premium MBS as attractive high-quality, income-producing assets that are poised to perform well in a rising interest rate environment.

1. Source: eVestment. Past performance is not indicative of future returns.

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