Question 1

Paige: We have with us today Venk Reddy, Chief Investment Officer and founder of Zeo Capital Advisors, and Marcus Moore, Assistant Portfolio Manager at Zeo Capital Advisors.

Marcus, you've actually been talking about this a lot with the press recently on TD TV, CNBC, and Reuters—**What is going on at the Fed?** Can you make some sense of this for us?

[00:01:05] Marcus: I'll try to the best of my abilities. I think, big picture, the Fed is just struggling with both aspects of their mandate right now, price stability, and full employment. From a price stability standpoint, the challenge is that the Fed doesn't really have a feel for what they can do to help. I don't know if higher interest rates are really going to fix the supply chain disruptions. I don't know if it's going to fix the significant amount of pent-up demand that consumers currently have, as a result of being locked down for most of 2020.

I think the Fed on one hand is looking at that and saying, "Okay, yes, inflation is running higher and hotter, but what can we really do?" Then you look at the other part of that mandate, full employment and yes, you know, the jobs number in October was great, really strong, robust job gains, wage growth but if you look deeper, you understand that you are seeing underrepresented minority employment lag the main index. You're also seeing a participation rate that's still well below where we were pre-COVID. On top of that, now, you're seeing women and low-wage employees quit at record rates.

The Fed is clear that we've not met the test for full employment. They're definitely going to stand pat, because of those two mandates that they need both to see progress against to liftoff, they don't really have a sense for what they can do from an inflation standpoint, and then we're far from meeting the test of full employment, especially when you factor in underrepresented minority employment.

Venk: Yes, I'm going to jump in here too -- There's a theme over here at Zeo in general, that I think folks listening will probably appreciate, which is, there's the thing you're looking at, and there's a thing that's over here, that is worth looking at but maybe isn't the place where you're focused. Look, if you just looked at inflation, top-level inflation, you looked at topline employment numbers, you looked at the housing market, it's understandable for Wall Street economists, sitting in their 48th-floor offices in New York City, to think that the economy is really strong, and the Fed doesn't really know what they're doing.

The reality is when you dig into these numbers that Marcus was talking about—quit rates, participation rates, minority unemployment, the supply chain—that what we're actually seeing happen in real-time, there's a bit more chaos going on here. Ultimately, there's order in the chaos and we'll get there, we'll reorder into stability but it's still messy. There's a lot of noise.

I do think Chair Powell is a little once bitten twice shy from raising rates in 2018 so he's not going to be in a hurry to do that until he feels comfortable he's got his arms around the noise, and for any baby boomers in our audience, if you remember what your parents thought of you in the '70s and '60s, it looked a little chaotic and messy, but there was method in the madness. It really had to-- We had to get through that to get to the stability we saw the

decades later. It's important. It's all going to come with volatility. I think there's another piece to it. We've been talking about policy, but let's go think about personnel as well.

I do think one thing that the market is starting to pay attention to but isn't really giving enough credence to is the increasing, and I don't know if it's over 50% yet, but the increasing likelihood that Lael Brainard might get the nod from President Biden for the chairship over Jay Powell, which, gosh, I don't know, six months ago would have been an unthinkable outcome. I think that's a really important thing.

It's important no matter what happens. Jay Powell is an excellent politician, as well as an economist. I don't know if anybody paid attention to his comments. I think it was last week, maybe this week before, where he basically said he is going to defer to the Vice-Chair of the Fed when it comes to banking oversight. That was a very clear message, in my opinion, to President Biden that you can make Ms. Brainard the Vice-Chair, that's okay, and keep me as chair and she'll still get to run the whole banking system. Because that's one of the biggest criticisms of Jay Powell. What does this mean?

Well, if Powell keeps the seat, whilst we will get some continuity, which is probably good, he is effectively making the case for….to be fair, Jay Powell has been about as clear as we've had a Fed chair and about as reasonable as we've had a Fed chair in a very long time, people are willing to listen to what he's saying…He's basically saying, "Well, the banking oversight is going to be-- The person in charge of it is going to be much more dovish than people think I am." If he loses his seat, well, then that's still the case.

What does this mean? Honestly, it's not great for banks. It's not great for bank profitability, it's not great for the restrictions the banks are going to see placed on them as they go about their core business of lending. 2008 through 2018 is a great example—banks have this remarkable ability to just pick up their ball and go home when they're not happy with the game they're playing. They can walk away from Main Street lending, and walk over to corporate lending and corporate debt, where, they've been a veritable, broken open piggy bank for the better part of the last five, six years.

Unless we believe that this is the first time that the banks will do something that's not in their best interest, I would imagine that no matter what happens, personnel-wise, the dovishness that we're going to see coming toward, or I guess it's going to be the aggressive nature that a dovish person in charge, whether vice-chair or chair, we're going to see toward bank oversight may very well result in a hiccup to Main Street lending. Given that we've seen another period where the housing market and Main Street lending has finally gotten its resurgence, people have been waiting for it for a decade.

I don't know if that's great for the housing market or it's great for the stock market. I would be concerned about a catalyst for volatility, but then for anybody who's listened to us talk for a while, at Zeo, we're always concerned about catalysts for volatility. This just feels like, we're setting up for a disappointment no matter what happens on the personnel side. That would be my thoughts there.

Question 2

[00:08:39] Paige: Thank you both for those comments to kick us off. I do feel like we're all playing armchair economists these days. I think the next question continues and springboards from where we started: **Why are our interest rates not increasing in front of the Fed moves?**

Venk: I love the armchair economists comment because I'll be honest with you, most Wall Street economists at banks are playing armchair economists. I'm not sure most of them are any more qualified than we are—that's a little unfair—or really that much better than we are really reading the tea leaves here. At the end of the day, Marcus was talking about minority unemployment. Look, as credit analysts, we are well familiar with the fact that Wall Street analysts always put buys on Bloomingdale's because they can walk into it because they live in New York City. They were never really that keen on Dillards because it was in the Midwest somewhere.

I think it's the same sort of thing. I think, if people are only focused on that, which is their lived experience, which quite frankly, Wall Street economists are watching top-level unemployment, they've never really had to care about minority unemployment. They're too busy watching top-level inflation without paying attention whether it's good inflation or bad inflation, whether it's supply-driven or demand-driven. You're going to miss stuff.

Our job, at Zeo at least, is to build a portfolio that is designed to withstand the potential for the industry missing stuff. That's how we've operated most of our careers and how we run our portfolios here.

Thinking about interest rates, in general, the short-end of the rate curve tends to be driven more directly by Fed policy, that's what we've just been talking about. The long-end has more cooks in the kitchen. It's driven by a lot of different things, and sometimes they're conflicting things. It's inflation expectations. It is just reactions to the market. It's reactions to where people want to be when people feel like they need to be safe. This COVID outbreak happening in Europe right now is no joke. We, in the US, whatever you think of the policies that have taken place across the US, we're getting to a place where we're fine, we're okay again. Maybe that'll change in a few months. Everything could change in a few months—that seems to be the theme of the last year and a half—but there's an argument for a flight to safety a little bit.

Then, there's just good old-fashioned wishful thinking. If rates go up, whether short or long-end, leverage could get sucked out of the system, and this huge asset bubble party could end. I'm not saying it's going to happen or not going to happen, but the long end of the curve, where there's all these conflicting factors, and where right now, they all seem very acute, is where you get a lot of whipping around. Whereas the short end, it's policy-driven, and the duration doesn't hurt you as much, and it doesn't whip around as much, and so the volatility side of it is less impactful.

I think that is probably why you're not seeing the curve steepening. We're still a believer in a steep upward sloping yield curve at some point. Why hasn't it gotten steeper faster? There's some impact of driving this demand for treasuries on the long-end. The interesting thing here is the market seems to be listening to what the Fed is saying, even if they don't understand

it. The rhetorical question is, what happens when the market stops listening to the Fed, stops hearing what the Fed is saying?

Marcus: I think the more pertinent question around interest rates is that, to take Venk's analogy and run with it farther, all the cooks are basically cooking off the same menu sheet right now. There's an understanding in the market that the Fed is going to be patient with interest rates. Now, there are numerous people or market participants out there talking about how the Fed's behind the curve. I think Larry Summers just put out a piece about the dramatic political implications of inflation and what could happen if the Fed doesn't do anything, or act soon, but market participants right now are pretty comfortable with this Fed being relatively patient and taking its time.

The risk is if the Fed stopped, or if market participants stopped listening to the Fed, now you're going to have a bunch of cooks in the kitchen, and they're all going to be cooking off of a different menu sheet. That's where you're going to get the volatility and the potential chaos in the market. One of the big things we're watching for is when the market decides that Jay Powell is no longer trustworthy, we have to take matters into our own hands and start pricing in interest rates, interest rate rises, that even he's not communicating. That's going to lead to that upward sloping yield curve we've been talking about and should bring about significant volatility with it.

Question 3

[00:13:55] Paige: Venk, in your comments, you use the words asset bubble party. Marcus, I'd love to get your thoughts on this. **People seem to agree that the market is frothy, but we're not seeing people take the gains and exit, we just see them staying on the same path. What do you make of this?**

Marcus: First and foremost, I think it's just FOMO. The byproduct of that is that ever since the lows in March, April of 2020, every dip has been to be bought, and so market participants are now trained that at any period of volatility, you sit for a couple of days, and then once it settles, you rush back into the market. It's been an interesting phenomenon throughout most of 2021 in that, we'll get three, four, or five days maybe even a 10-day bout of volatility that you feel. I'm like, "Oh, great, this is what we've been waiting for."

Then, it's quiet for a week, and then a week or two later, everyone rushes back in the market, and you're back higher than you were before that bout of volatility. If that continues to happen, market participants are trained, and we all can, to some extent, read the tea leaves and go, "Okay, if I'd bought the dip in April, I'd have made money. If I'd bought the dip in July, I'd have made money. If I'd bought the dip in October, I'd have made money," you're just going to keep buying the dips. I think that's a huge piece of that. Buying the dip is not a sustainable investment strategy. That's not one we're going to start employing here at Zeo.

What we are going to do is keep the focus on solid fundamental credit. A name that we've recently added to the portfolio is American Greetings. Interestingly, it's a CCC credit but the metrics don't represent a CCC at all. Gross leverage is two times, the company generates about 30% total debt. It started with 30% free cash flow to total debt on an annualized basis. The more impressive part of the story for me was that this company was able to grow EBITDA at 13% in its last fiscal year, during a pandemic, when revenues declined 13%.

I had the fortune of speaking with management, and I asked the question, "How did you do that?" The thing they were most proud of is, they did it without massive headcount reductions. They stayed loyal to their employees that have been there for years and years and just ran the business better. Improved operations, reduced scrap, using more recycled products, introducing sustainable displays at their retailers…all of these things help drive better margins in the face of revenue declines. And now we fast forward into this current fiscal year, and through the first two quarters, EBITDA was up 50% on a 30% increase in revenue, because those margin gains have been sustainable.

These opportunities aren't plentiful by any stretch of the imagination in the market, but you can still find them if you're willing to do the work, and that's what we're here for at Zeo.

Paige: Venk, do you have anything to add on to those comments?

Venk: Do you have to ask that question? Of course, I always have something to add.

Look, we feel like we're in this tale of two markets right now when we think about the zeal with which investors are buying the markets and buying the dips. On the one hand, there are companies like American Greetings that are fundamentally attractive pieces of paper that--

we’re not equity owners but you could imagine the equivalent on the equity side-- that are good businesses that are misunderstood by the marketplace.

Where the management team is particularly focused on executing on strategy and they're aware of the issues that they face, they have a strategy to manage them, they're executing on that strategy, and they're holding themselves accountable, and measuring and reporting so that we can all have some visibility in what they're doing. Then, there are companies that are trying to-- How should I put it?...There's the indiscriminate buying that takes place in the marketplace that companies take advantage of.

The example that I'm going to use for that for this purpose is one we just wrote about in our last letter, it's that Philip Morris is issuing a sustainability-linked bond. Philip Morris is issuing a responsible investing bond. I don't think I can say this nicely. Who the hell is going to buy a responsible investing bond from Philip Morris? This will be a bit of a repeat for the folks that read that letter so I'm not going to dwell on it too much.

The bottom line is Philip Morris has basically said, "Okay, we know that our long-term survivability is dependent on reinventing ourselves a little bit away from tobacco." And with that “business transformation”, their words not mine, “we can get better cost of capital from the market if we call it a business transformation bond.” No real commitments to it, just labeled that way. Look, if we're going to treat all asset classes, or all bonds, or all securities within an asset class the same…if we're going to treat the market as a monolith, if we're going to say, “high yield bonds”, as opposed to this bond from this issuer and this bond from this issuer…and we don't as managers distinguish between the two. Between the things that fundamentally are worth owning and the things that are just cynical ploys to take advantage of indiscriminate buying. Then you're really at the mercy of the overall market and not just the best instruments or issuers within that market.

“Frothy”, to use that term, doesn't necessarily mean you're at the top of the market. But if you are at the top of the market, then you also want to make sure that you're not buying everything without caring about what is actually quality and what is worth owning. Now, I'm talking our book obviously because we take a risk-first mindset to our portfolios.

Even in our duration unconstrained portfolio, we're not trying to be on the right side of a directional move. That seems to be where the markets are going. It's this notion of, okay, let's go buy high yield because equities are toppy or investment grade's not yielding enough and generally there's an asset allocation decision there that’s not invalid, but the notion that we can then treat the entire asset class as the same, I think is flawed and doesn't recognize the nuance. There is something worth owning and something not worth owning within every index.

The focus is so much on outcomes and not process and I think most of the people listening probably are nodding their head because if you're following Zeo, it's because you understand that process matters.

There's this focus on outcomes rather than process and the markets have generally evolved to where investors are just looking for someone who knows how to be on the right side of the market at all times. Quite frankly, that's just hard. I'll be the first person to admit, I think, if

I'm sitting in the allocator seat, it's a lot easier to find a manager who's an expert in an asset class and can credibly determine what's safe and what's not within that asset class than the manager who just knows which asset class is going to go up for the next three months or six months or a year within their mandate.

When we think about what we are offering to our client base and to the investors that are considering investing with us, we are trying to offer to you that former thing. Someone who knows our asset class and knows how to distinguish creditworthy from not creditworthy and can come to an educated and plausible determination of what's safer versus what's not within the asset class. It's a risk-first mindset, whether it's in our short duration portfolio that's a lot more constrained on taking a certain type of fixed income risk, or whether it's our duration unconstrained portfolio where we're trying to deliver a portfolio that's not just us trying to guess which is the right side of a directional move and is not us being tactical.

I jumped on a lot there. But it is really important to understand that in this environment, in particular, where you've got these two markets: the frothy market because something's worth buying and the frothy market because it's indiscriminate buying of “responsible bonds” from Philip Morris. It's important to distinguish the two, because we can't tell you that the market is not toppy. I can tell you that I can sleep at night knowing that we have bought bonds that we believe to be fundamentally, at their core, at their issuer level, strong and intentional and reasonable bonds.

Question 4

[00:23:50] Paige: With so much money pouring into senior floating rate and TIPS, are the opportunities all played out here?

Venk: There's always opportunities. Paige actually, do you have that chart we usually use when we talk, when we help clients think through asset allocation and use cases? I think it's important to share a little bit on where we think, what does floating rates, senior floating rate loans, that sort of thing, where they fall in.

What folks see here is something we talk about a fair amount with respect to our approach to credit. You're seeing the two dimensions of fixed income risk. I'm taking out liquidity for a second because once you start taking on meaningful liquidity risk, you're really just taking on equity risk with a fixed income asset class and that's not really appropriate for core fixed portfolios. Most core fixed income sits in this bottom right, call it, solidly blue quadrant, the 36% there which is sort of intermediate duration investment-grade paper.

The case that we would always make is, if one can diversify the risks within an allocation, you end up with a portfolio that's more resilient. It's not as tactical, you don't have to decide, "Oh gosh, I got to get out of this because rates are going up." Everything will be impacted by the sensitivities of that particular subset of the market. Our goal is not to take on broad market high yield risk in core fixed income as a result because rates are so low. It's to trade duration for credit so that you're not doubling down on risks, you're just diversifying the singular risk within each component of the portfolio.

The reason I bring that up is, in our view, there's always a place for shorter duration credit. Whether it's in senior floating rate portfolios or whether it's in short duration high yield bond portfolios, or in our case we buy both. I'll get into that a little bit as to how that mix comes together, but ultimately, it's just fundamentally driven.

From our perspective, there's always a place for the shorter duration credit portfolios but today's senior floating rate market is concerning. There's a lot of demand. There is a huge amount of money flowing into the bank loan space and I think what people don't appreciate is, bank loans as an asset class, not as an individual instrument, which again, we own some in our portfolio, but as an asset class is marketed as sitting in that top left quadrant but really the interest rate sensitivity of it is in the top left quadrant, but the credit spread sensitivity is actually in the top right quadrant.

Loans, the interest rate resets, but they're usually long weighted average life things. Your average loan portfolio is 5-7 years of weighted average life, which means that its sensitivity to credit spreads moves more like a 5-7 year or 4-6 year duration thing. Whereas, at sensitivity to interest rates, it'll move more like a 0-1 year duration thing.

In our view, unless you can tolerate the additional volatility that comes with the credit and the credit is being selected carefully so you're not buying long-term bad credit, the best risk to take in this market is reinvestment risk. It's the shorter duration credit end, it's portfolios that keep both their credit sensitivities and their interest rate sensitivity short. That's kind of

where we are. That's what our short duration portfolio does, but that's also where our duration unconstrained portfolio is tilted that direction for the same reason.

In this environment, it makes little sense in a toppy market to go full speed into long-duration anything, given that credit spreads are particularly tight and interest rates are particularly low. The short answer to the question is “yes”, there's always an opportunity in the bank loan space but we think it's in individually selecting loans that fit within a short duration credit mandate, not as an asset class as a whole. I get a little concerned about the asset class as a whole unless it's a selective portfolio.

Question 5

[00:28:55] Paige: One of the questions that came in was an observation that **there doesn't seem to be enough spread in high yield and bank debt given the risk that investors are taking on and the inflation is eating away at fixed income returns.** I think this piggybacks a little bit to what Venk said, so Marcus maybe you want to kick this off on this one just in terms of what you're seeing in the market and some of the takeaways specific to our portfolio.

Marcus: There's something to be said for that. Just yesterday a name in our portfolio, US Foods, brought a 4.5% range 10.5-year maturity, tenor bond unsecured. We like US Foods. We actually are participants in the bond, like the company, think the story is performing well post-COVID. We're currently in a 6.5% piece of paper that matures in 2025, and that just gives you an indication of how much things have moved. They would have priced that bond sometime late summer, early fall of last year. You're saying that senior secured in the US Foods capital structure at that time was 6.25%.

Now we're saying 14 to 15 months later that senior unsecured-- and 5 year tenor also—now we're saying 10.5 year tenor, unsecured is about 4.5%...that's moved a lot. Obviously yes, US Foods credit has improved. It's an improving story, no doubt, very happy holders of the bonds we're in. But, to that question, you are seeing a lot more of that in this market, whereas a lot of this new issue because the demand for credit has been very robust. Again, we've set another record year for new issuance on top of the record we set last year.

As you see, you could make that an example of a "frothy market." For us, the responsibility is just not allowing the market to dictate to us the prices or our sense of value. As much as I like US Foods as a company, a very happy holder, at this time 4.5% percent isn't really all that attractive in a name that has a 10.5-year tenor that also went through significant change and issue through the most recent pandemic.

Their business, to some extent, is definitely tied to economic cycles. That just doesn't feel like the risk-reward. For us, the responsibility is to be mindful of that and say no to those type deals. If that deal would have come with maybe more spread, I don't know, we'll see. Granted big picture we're just much more in tune with being shorter on the duration end of the spectrum right now, again, as we've talked about rising interest rates.

It's a simple equation that if the longer you have duration and if interest rates rise, your bond price falls, that's not what we're trying to have happen within the portfolio right now. We were definitely more sensitive to duration. Even in the US Foods case where we think the business is rock solid, it just didn't make sense for us at this time. Those are the choices we're having to make in this market.

They always exist, but I do think you're seeing a lot more of that. US Foods just happened yesterday. My guess is within the last four months, probably four or five names in the portfolio have demonstrated something similar in a sense that the performance is great, but they're bringing an 8, 10-year bond, and it just isn't a fit for us from a duration standpoint and even less of a fit sometimes from a risk-reward standpoint, given where the interest rate is when it comes out.

Venk: Yes. I'm going to piggyback on that a little bit and say that… gosh, there's a lot to say here. First of all, we're in a tricky market here because it's becoming increasingly likely that in the next I'm going to say 18 to 48 months—I'm picking a very long-range there… a year and a half to four years, but probably somewhere more like two to three years—we're going to be in a scenario where the market is going to have to come to a reckoning with the reduction of a money supply, bringing it back to the Fed.

Rates are going to have to go up at some point, and that is going to coincide with a market decline. That will mitigate the amount rates go up, but they're probably still likely to go up. What's weird about that is if most people think back to asset allocation 101 is one of the reasons you want duration and duration paper as a fixed income portfolio is if markets declined, theoretically, as flight to safety, rates go down, bonds go up, they offset the market decline a little bit and you get this nice little mini hedge. I don't know that we're going to see that. I think we're going to… we're just as likely to see a scenario where bonds and equities are more correlated as they have been for the better part of the last two, three years in the normalized markets.

What does that really mean? If we're thinking about risk-adjusted returns and sort of core fixed income and capital preservation, I think we want to be thinking about how do we do two things. How do we make sure we're invested in that which is good, from a fundamental standpoint, and how do we mitigate volatility?

The obvious answer in fixed income to mitigating volatility has always been, in every investments 101 class, is shortened duration if you want to get out, reduce volatility in fixed income and pay attention to your credit. Just for that reason alone, when we see the last two years, really three years, there's a massive refinancing wave of corporate credit.

Giving the listeners a little bit of a picture into what that market dynamic has looked like. You have whatever stuff on the short end, stuff on the long end. Then as time passes, and the long end becomes short and companies refinance, that's obvious. What you end up with is a situation where the more refinancing takes place, it's not a steady thing. We've had this massive wave and there's been, there's this hole that's been left on the short end of the curve of the, what I'm going to say, the low hanging fruit to refinance.

What that really means is you're left with a market where you have the stuff that wasn't low-hanging fruit to refinance, and I'll explain what that is in a second, and a bunch of long-duration stuff. The more demand there is for the long duration stuff, as we've seen the lower the interest rates. It gets even trickier in that, all of that I'm just describing, you're left with a very flat yield curve. Very flat for interest rates, but very flat also for credit spreads. Not just yields in our coupons, but credit spreads.

On top of all of this, you're left with a situation where you're not really getting paid to take on duration. You're not getting paid any more, it's not an upward-sloping yield curve. You're not getting paid to take on longer-term of locking in your money for longer-term risk. Which also again, makes you want to say, "Okay, if I'm not getting paid to take on more risk and the catalyst in the marketplace are likely to drive a lot more longer-term volatility and the natural hedge I was hoping for out of my fixed income portfolio is maybe less likely, maybe not

unlikely, but certainly less likely to work in my favor," you start gravitating toward the shorter end.

That's why we have, what we said at the end of the last town hall, that these are the markets that our portfolios are designed for. There are markets where we do good enough, and then there are markets where we're designed to really deliver on the environment and we believe these are the markets for that.

Let's talk about what's in the shorter end. If the low-hanging fruit's gone, what's left? It's not just all crap. That's the thing that I think people don't fully appreciate. There is the remaining unsecured paper where for whatever reason, companies strategically are seeing opportunities, they're seeing improvement.

Actually in the remaining unsecured paper, it breaks into two things. There's truly hairy stuff, that I just want to put people's minds at rest we don't go anywhere near. Then there's paper where companies are actually seeing improvement. And they are playing a little bit of a game of saying, "Okay, when we get this improvement, once this comes through, we're going to get such a better cost of capital, we're better off paying the slightly higher coupons a little bit longer until we can show the world that we are what we know we are." And that takes a forensic effort. That takes a sleuth like Marcus to identify one from the other.

Then there's the secured paper. The secured paper is interesting because companies refinance for a couple of reasons. One, they refinance to shore up liquidity. That's what I would call the pre-pandemic argument. It's where you go through a pandemic, it doesn't matter how good your company is, if you don't have liquidity, you're not going to make it to the other side. Or they refinance for cost of capital. The current market is one where companies refinance for cost of capital. They don't need liquidity. They are just trying to lower cost of capital.

If you have a secured piece of paper and you can only refinance into a longer-term unsecured piece of paper, yes, technically that's an improvement for your capital structure, but it doesn't save you any money. It actually costs you money because of the fees and from that perspective, the view is, let's just keep our low cost of capital, and then if the capital markets close on us, we always know we can re-encumber the assets. We don't need to unencumber the assets today to re-encumber them later, as a source of liquidity. We'll just re-encumber the assets and keep our cost of capital low.

In this short end, the hole is created, but what you're left with is unsecured paper, which breaks into these two areas, like stuff that really you don't want to go anywhere near and stuff where you've got improving credit stories that the companies are legitimately looking to capitalize on for better cost of capital. Then you have secured paper that is paying you basically what the longer duration stuff is paying you, but higher up in the capital structure and shorter duration. I guess if I paint it that way, I don't know why you would buy the long duration unsecured paper and get paid the same thing as being higher up in the capital structure to get paid the same thing in the shorter end unless you're afraid that when the time comes to reinvest that money, yields are going to be lower. I just don't worry about that. When I think about this market, there's a lot of interesting stuff to look at. Look, if you guys collectively decide to double the capital in our funds, it'll get put to work. If this market, if this

environment stays the same for like three years, then three years from now is when I would be concerned like, "Okay, are we going to have enough to buy?"

These market cycles have never been that long. We will see entry points between now and then. In the meantime we're not running out of things to look at or running out of things to invest in just because this refinancing environment has created this little bit of a hole on the short end and has really pushed a lot of the credit managers, especially short duration credit managers, out further, further, and further out, trying to capitalize on new issue alpha, whatever that is…-buying new issue, hoping it'll mark up so they can make a little extra money or they go by SPACs. We see that happening quite a bit or they go do things that are fixed income-like, or that are trying to capture a mark-to-market, to try to generate the returns.

Hopefully, folks have looked at the performance of our funds this year to recognize you don't have to do that to be able to find decent risk-reward in this marketplace. We're excited about what we're seeing and where we're seeing the opportunities. We're not doing a lot of trading, don't get me wrong. We're not churning and burning and actively selling and buying and trading around a lot. We're buying stuff. We like it. We position it in the portfolio. It continues to perform. It'll mark up a little bit here, mark down a little bit there much less than the marketplace, than the overall market. We're seeing some really exciting things to deploy capital into, it's just a little bit different than what people—if you look at it from just an asset class model standpoint—would imagine is happening within the market and within the asset class.

I wanted to give you a picture of how we are thinking about it. We don't strategically say, "Okay, now we're going to go buy loans and now we're going to go buy this. Now we're going to go buy that." It's really just a relative risk-reward, opportunity cost assessment. That's all it is. We're looking at everything with the same lens, and we're saying, okay, relatively speaking, we are not getting paid, even in our duration unconstrained portfolio. We're not getting paid to go further out. We don't want to put the risk in the portfolio to get the super high-yielding super dodgy remaining short duration unsecured credit.

We're going to stick to the stuff that's a little bit safer. That's really in a strong credit situation, a misunderstood business in a strong credit situation, or we're going to stick to the secured paper or whatever because of the relative opportunity costs and risk/rewards. That's how we think about assembling all this hard credit work into a risk profile that can be consistent over time. It's by thinking about it in risk terms and being risk first.

Marcus: I was going to jump in real quick and just give some context from a numbers perspective. Right now, 20% of the entire high yield market is scheduled to mature before 2025. That speaks to how much this refi cycle has left very little for short duration, but even with that backdrop, as Venk mentioned, we are not at any way, shape, or form out of ideas and opportunities.

Paige: If anybody's been curious how we're thinking about the Duration Unconstrained Strategy versus our Short Duration, I hope you were just listening to what Venk said. Everything comes down to risk-reward. Right now those two, the Short Duration Strategy is constrained by duration, by design. Duration Unconstrained is basically given flexibility but right now that flexibility is not to take on duration. At some point, maybe it will. But the two

portfolios are not the same by any means, but they look more similar now in terms of we aren't taking a lot of risk. We're not stepping out there because it's not paying us to do so right now.

Venk: That's one place where we've tilted, when we talk about the loans, having a little bit more credit sensitivity, and a little bit less of interest rate sensitivity, our duration unconstrained portfolio has a bit more in the loan space simply because when we get our arms around a credit and we really like a credit, that portfolio has a little bit more tolerance for the wiggles that might come with movements in the credit market so long as our primary objective is creditworthiness. Our primary objective is only buying those credits where we have a high degree of confidence an issue will repay. Whereas we're less tolerant of that sensitivity on our short duration portfolio.

Question 6

[00:45:32] Paige: Believe it or not, we're on our last question and we're going to wrap up, but thinking back through this town hall, I think we've described these markets as interesting, challenging, overbought, frothy**. It just begs the question, are you all having fun investing in this type of market?**

[00:45:58] Marcus: Yes. I am actually, and we are. We may go each day depressing each other with the state of the world and the state of the markets, but at the core of our beings, we're both very happy to be doing what we're doing. We're both having a great time right now.

I think, in a market that's always going up to the right, as a credit analyst, one of the first things you do is just ask yourself, "Okay, what am I missing? Why is everything going up? And this isn't sustainable" Your Spidey senses start tingling and you start really asking yourself, "Okay, what could go wrong." Venk's favorite question to me. I get it all the time but that is just the nature of what we do.

In that, you ask yourself that more often now, because you know tops, you know everything rolls over. There's a top and there's no longer a top, there's a record high and then no longer a record. The thing we've really just been focused on over the last three to four months and historically always, but it just feels even more just because of how the market just continued to be one-way traffic up and to the right, is that “what could go wrong?” What do we need to know about these companies in terms of their ability to sustain another inflation shock, a tight labor market, higher interest rates? What happens if the company thinks they can refi at 5%, but they have to refi at 6%? Is there enough free cash flow cushion to manage through that?

One of the misperceptions in this market is that when everything's going up, you can just buy everything. The time to buy everything was April and May of last year, those days are now gone. The time now is to really focus on solid, fundamental credit. We're going to show that our approach works.

It is the right approach in this market and in all markets because the fundamentals, especially in credit, always win. As long as we keep that focus, I feel really good about where we are. I think the portfolios performed really well this year, happy with what we have in it. There may be some tweaks here and there but at the end of the day, I feel like we're in really good hands. I'm pretty excited to see what 2021 brings. Hopefully, knock-on-wood, we can carry this thing across the finish line for the next six weeks and go on to 2022 and have as much success as we've had this year.

Venk: Fun, huh? Hopefully, you got a sense from me dissecting the short end and the long end of the high yield market and why and what, and all that stuff. Marcus and Paige can attest to the number of times I unmute our Team Meeting and just start talking into the ether about those types of analyses and thought processes to show that that's what gets us up in the morning. That's what gets the blood flowing. In the investment world, all too often, especially if things go well, people don't ask why or what happened. They just look at the numbers and they go, "Woo." Then they move on. It's the reason that I'm dating myself and going way back. You'll see investment-grade markets going straight up. I guess you don’t have to go that far back, you can look at 2019. If you find yourself up 10% to 12% in an investment grade

portfolio, you took more than just fixed income risk, but nobody asks that question. People don't ask the question, why and what happened? Really understanding that and finding these nuances, and understanding that underneath the asset class label, it's not a monolith, there's different people.

We were talking about this earlier, it's not all math, at the end of the day. There's a little bit of analysis, a little bit of English in there. There's a little bit of interpretation. There's a little bit of understanding what's going on inside the head. If we think about how we raise, for the folks on the call that have kids, how we raise our kids, we don't just take a grade and say, okay, that's what you got. It's, okay, what can you learn from this? How do we understand where we can go from there and where to go next, whether it's supporting where support is needed or providing challenge. It's that why that every market presents those opportunities. And this market in particular, which is so easy to misinterpret. It's so easy to misinterpret the latter half of 2020 as a "everything is fine" kind of interpretation.

The reality of it is this feels—Marcus and I were talking about this yesterday. This feels a lot more like *Empire Strikes Back* and *The Return of The Jedi* is still to come than it does the end of the story. I feel like there's another chapter to be written here and figuring out, not what's going to happen, because we're not trying to guess what's going to happen, but really understanding the dynamics so that we can properly position the portfolios that you're invested in to be resilient, and to be consistent, and to be intentional, and to be focused on, not just on what the outcome is, but how it got there in the event that something else happens that is unexpected. That's what's always been fun. These markets are particularly fun for that.

I don't want to smile in the face of folks that are having a rougher time of it in the markets or outside the markets for the better part of the last couple of years, but our interest in getting up every day and sitting in front of these screens and doing this job, I think we're as engaged as we've been in years and that's pretty exciting. I don't know. It's fun for me. With that Paige, I'm going to hand that back to you.

Paige: Don't ask me the question. Thank you all. With that, we're actually going to wrap up. I appreciate you taking the time. Thank you so much for the questions. Every single one came from this audience. If there's anything else still outstanding, you know how to get ahold of us and then the replay will be available in the coming weeks once it gets through editing and compliance. Thank you all. Have a great holiday week next week.

Marcus: Thank you.

Venk: Thanks, folks.

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