PINEBRIDGE INVESTMENTS

MARCH 2016

Does the Loan Market Continue to Offer Attractive Opportunities?

Q&A

The leveraged loan market has more than doubled in the past decade to US$872 billion, with over 1,000 issuers. Steven Oh, Global Head of Credit and Fixed Income at PineBridge Investments, provides his views on the current state of the loan market, and whether this opportunity is attractive and sustainable.

FEATURING:

STEVEN OH, CFA
Managing Director,
Global Head of Credit and Fixed Income,
PineBridge Investments,
Los Angeles

Q: *Why are loans an attractive asset class in the current environment?*

A: The outlook for US GDP growth for 2016, while weakening somewhat recently, is still in the 2%-2.5% range, providing a stable backdrop for leveraged-loan issuers.

The unemployment rate should trend even lower and wage growth is expected to accelerate modestly. Coverage ratios (EBITDA-capital expenditures/interest) are near all-time highs. The current default rate of 1.33% is still significantly below its historical average and is forecast to increase at a gradual rate[1].

Q: *What are the characteristics provided by loans that appeal to investors?*

A: Leveraged loans can perform well in all market cycles. Loans rank at the top of the capital structure, so recoveries are generally higher than for high yield bonds. They provide a hedge against rising interest rates since spreads are typically based off of three month LIBOR.

Leveraged loans provide a high level of current income, with the loans market offering transparency and some liquidity.

Furthermore, leveraged loans are a stable asset class: There have been only two years of negative returns since 1997[2].

Q: *Do you believe that the opportunity to invest in loans will be sustainable? If so, why?*

A: The leveraged loan market has more than doubled in the past decade to US$872 billion, with over 1,000 issuers. It is now a mature market that offers several benefits to issuers and investors alike.

Q: *What will be the impact of stricter rules and regulations on the banking sector?*

A: While most loan issuers have multiple market makers, stricter regulations have adversely impacted liquidity. In general, commercial

WINNER AssetView USD Loans AWARDS \ 2016

1) As of 31 January 2016
2) Source: S&P Leveraged Loan Index
This material must be read in conjunction with the Disclosure Statement.

and investment banks that trade loans now hold less inventory. Additionally, regulators are scrutinizing leverage loans much more thoroughly than prior to the financial crisis. This is having the effect of keeping leveraged levels at more moderate levels. The amount of leveraged buyouts with debt multiples of seven times or higher is currently less than 4% as compared with 30% in 2007.

Q: *How do you think this market differs across Europe and the US?*

A: The European loan market had been holding up better than the US market in 2015. Spreads are generally tighter despite intrinsic European challenges of lower liquidity and diverse jurisdictions.

But Europe has also weakened in 2016 due to reduced demand from one of the largest participants in the European loan market: CLO's. At current levels, we believe investors are adequately compensated for expected defaults, although we could see further volatility.

Q: *Will that affect your portfolio positioning?*

A: Given that the US market is considerably larger, the vast majority of our holdings are US domiciled; however, we are constantly evaluating relative value between the US and European markets. In our Global Secured Credit Fund, we shift allocations between the US and Europe based on our determination of relative value.

Q: *How do you analyze companies?*

A: We conduct a detailed bottom-up credit analysis combined with top-down economic views. It is highly credit intensive and involves a globally coordinated team approach.

Q: *What are you typically looking for when deciding whether to invest?*

A: We seek companies with sustainable business models, and consistent, positive cash flows. We also focus on fixed charge coverage, liquidity, and operating cash flow to ensure the amount of leverage is appropriate given the industry sector. Companies in cyclical industries should have less leverage and more liquidity to ride out commodity cycles.

Q: *How much more significant will company analysis be in this asset class compared with traditional assets?*

A: In our view, fundamental credit analysis is the key to success in the leveraged loan asset class. Issuers are generally rated BB or B, and therefore have higher levels of risk compared with investment-grade issuers.

> “We seek companies with sustainable business models, and consistent, positive cash flow”

Q: *What risks are associated with loans, and how can you ensure you are compensated sufficiently for them?*

A: The primary risk associated with leveraged loans is default risk. The key to avoiding credit loss is extensive analysis and monitoring of credits.

We evaluate current spread levels to ensure we are being compensated for the expected level of default risk.

In the current environment, we believe spread levels are very attractive given our default expectations.

Q: *Are you being compensated enough for the associated illiquidity risk?*

A: Although there has been a slight reduction in liquidity levels due to increased regulation, liquidity in the leveraged loan market is much less of a concern today than a decade ago.

Given current spreads, we believe investors are being well compensated for both illiquidity risk and default risk.

About PineBridge Investments

PineBridge Investments is a global asset manager with experience in emerging and developed markets, and investment capabilities in multi-asset, fixed income, equities and alternatives. Our firm is differentiated by the integration of on-the-ground investment teams of approximately 220 professionals, providing investors with the combined benefits of global fundamental perspectives and analytical insights. We manage over US$84 billion as of 31 December 2015 for a global client base that includes institutions, insurance companies, and intermediaries.

MULTI-ASSET | FIXED INCOME | EQUITIES | ALTERNATIVES

2016 Camradata Asset View Award, based on our in-house proprietary model, Camrdata IQ, for USD Loans, PineBridge Total Return Aggregate. Source: Copyright 2016 by Camradata. The Camradata Independent Quantitative (IQ) scores is a ranking reflecting five statistical factors (excess return, information ratio, wins-losses, hit rate and downward strength) measured over a three year period.