LONGFELLOW

High Yield Q&A

Longfellow Investment Management Co.

Why does Longfellow use high yield?

We use high yield for the potential to enhance returns in client portfolios. Because our "Plus" strategies are not benchmarked against a high yield index, our actual investment exposure can (and does) vary subject to valuation and market fundamentals. In effect, we do not always "have to be invested" at any cost. Many clients have given us the flexibility to invest a portion of their portfolio (typically to a maximum of 10%-15%) in high yield securities across a variety of mandates including Short Duration, Intermediate Duration and Core as well as "Crossover" strategies for taxable clients.

What do you focus on when analyzing a high yield credit?

We first analyze the industry that the particular company operates in, using a key-variables analysis that identifies the macroeconomic factors and industry trends that could influence investment performance. By doing this, we determine where the prospective company fits within the industry and if the company is likely to benefit from current and projected industry conditions/trends. Second, we perform a comprehensive analysis of the credit fundamentals of the company with a specific focus on the firm's financial flexibility, free cash flow, asset coverage, and its ESG factors. Third, we assess bond valuation and determine, in tandem with our industry and fundamental analysis, if we are being fairly compensated for the risk involved.

What is LIM's investment strategy/approach in high yield?

LIM seeks to lower the inherent level of default risk within the high yield investment arena via our "higher quality" high yield investment strategy. First, we seek to identify stable to improving companies with sound financial flexibility, solid free cash flow, asset coverage and a stable/improving ESG score. Second, our high yield investments tend to cluster within the cross-over (Baa/BB or Ba/BBB) and higher rating zones of the high yield universe (BB to B) where default risk is lower. We also focus on short and intermediate maturities where financial visibility is greater and pricing volatility is reduced. Overall, we believe our higher quality, high yield strategy decreases the likelihood of default so that enhanced yield and capital appreciation may be realized.

What are the major risks of high yield bonds?

High yield bonds have a higher default risk than investment grade bonds, and the level of default risk ebbs and flows with the economic cycle. As a result, high yield investors always demand a higher level of compensation (yield) versus investment grade bonds as compensation for incurring a higher degree of risk.

What is LIM's outlook for the high yield market?

We believe that the U.S. economy will continue to improve and that the Federal Reserve will respond by raising interest rates, which will precipitate bouts of high yield market volatility. In this type of investing environment, opportunities will surely occur for us to identify and invest in attractively priced high yield securities.

Disclosure:

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