BARROW
HANLEY

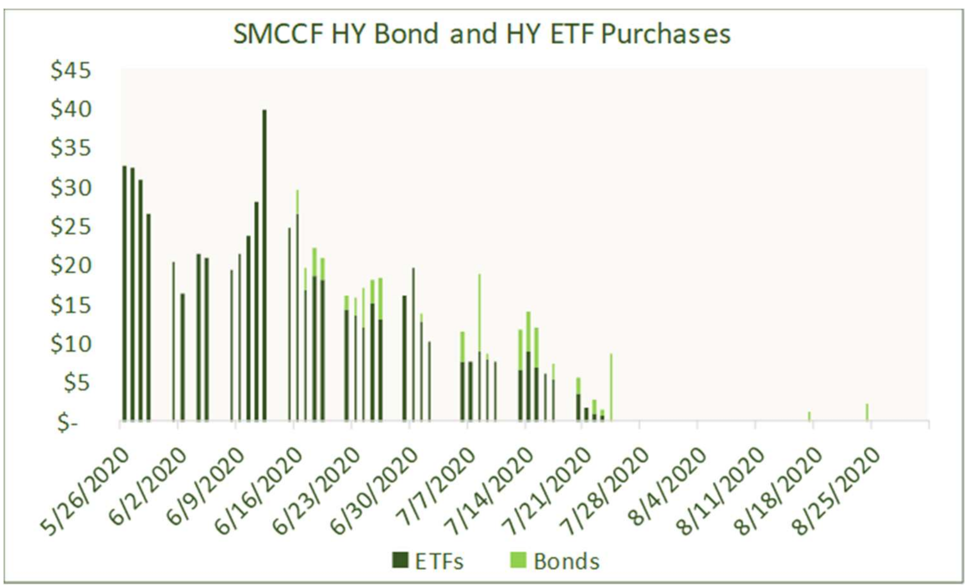
2200 Ross Avenue, 31st Floor • Dallas, TX 75219 • 214-665-1900

August 2020 Leveraged Finance Update

High Yield And Loan Market Recap

The risk-free rate climbed while credit spreads tightened across the board in August. The High Yield (HY) market enjoyed another strong month with a +0.98% return, while Leveraged Loans also performed well with a +1.5% return. Unlike recent months, lower rated loans and bonds performed admirably. Within HY, the CCC-rated segment was +2.85%, while BBs lagged at +0.63%. The CCC-rated segment within the Loan market generated a +4.25% return, but the BB sector was only +0.68%. There was a new historical record achieved in the HY market during August: Ball Corp. (Ba1/BB+) priced a new 10-year bond with a 2.875% coupon (+230bps spread) for $1.3B in proceeds. We declined to participate in this history as we viewed its valuation unattractive relative to other available credit opportunities.

The Fed has pulled back from its intervention in credit markets almost completely. During August, the Fed only purchased $10.2mm of HY bonds and bought no Investment Grade (IG) or HY ETFs. HY bonds comprised only 1.1% of the Fed's total purchases in August, a decline from 2.5% in July. Even though the Fed has pulled back from the HY market, we believe it would intervene again if conditions deteriorated unexpectedly.

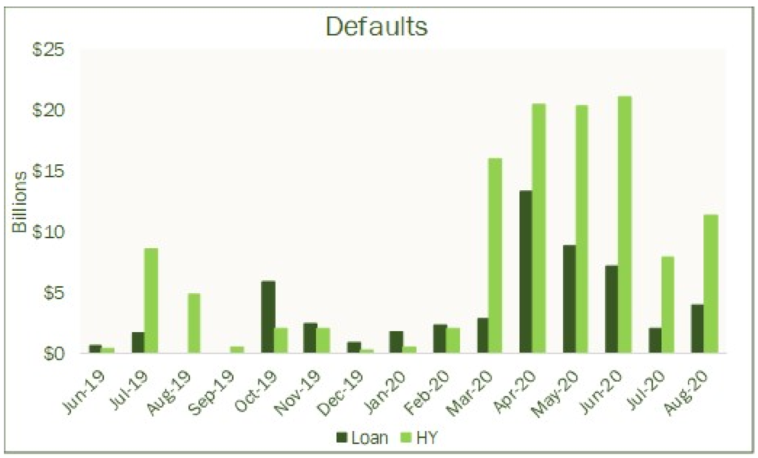


Source: Federal Reserve

New HY issuance continued at a breakneck pace with $52.9B, the busiest August on record. By comparison, August 2019 saw only $9.5B of new HY issuance. Loan issuance revived as participants grew more comfortable with the perceived path of economic recovery. There was $20B of new Loan issuance during August. For the first eight months of 2020, new issuance in HY reached $297.7B (up 74% year-over-year) and $250B for Loans.

DEFAULT RATES

Since COVID-19 forced the economy into recession in March, there has been an expected increase in default rates. The current HY default rate is 6.2% while Loans are at 4.1%. While these default rates are higher than 2019, they have declined from the elevated rates of March-June. Unfortunately, we do not expect the decline to continue. More defaults will likely materialize as temporary fiscal policy support is eventually withdrawn from consumers and businesses, forcing a potential reckoning across weaker credits in 2021.

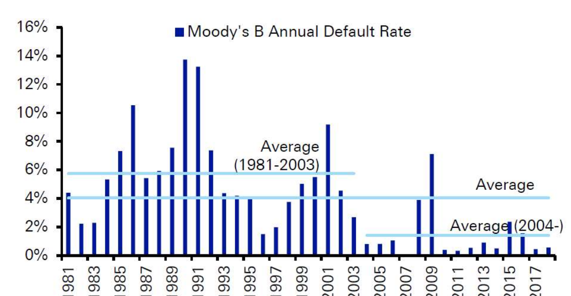


Source: Moody's and Standard & Poor's

Last year, Deutsche Bank performed an analysis that showed a structural decline of default rates since 2004. The authors highlighted how lower rates and more generous covenants provide leveraged companies with increased financing flexibility:

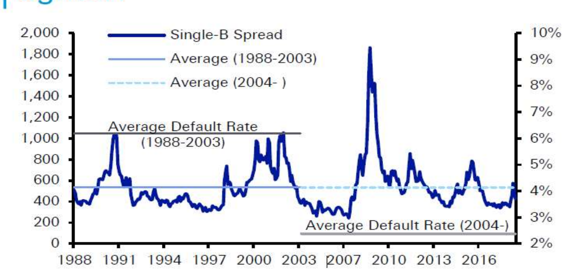
- Between 1981-2003, the average single-B default rate was 5.7%;
- Between 2004-present day, the average single-B default rate was 1.4%; and
- Spreads remained relatively constant through both periods of high and low default rates.

Figure 1: Are average default rates meaningless? Big step down >'04...



Source:Moody's

Figure 2:.. but no step down in spreads. Average identical pre/post '04. Should spreads be structurally tighter?



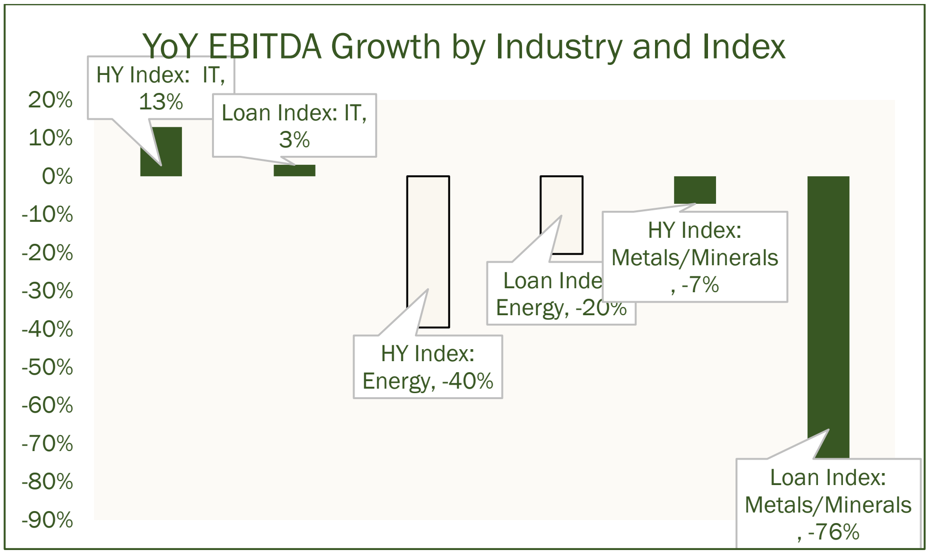
Source:Deutsche Bank, FactSet (ICE BAML), S&P

Source: Deutsche Bank

If investors expect nominal interest rates to remain lower for longer, then default rates may remain below historical averages over the next credit cycle.

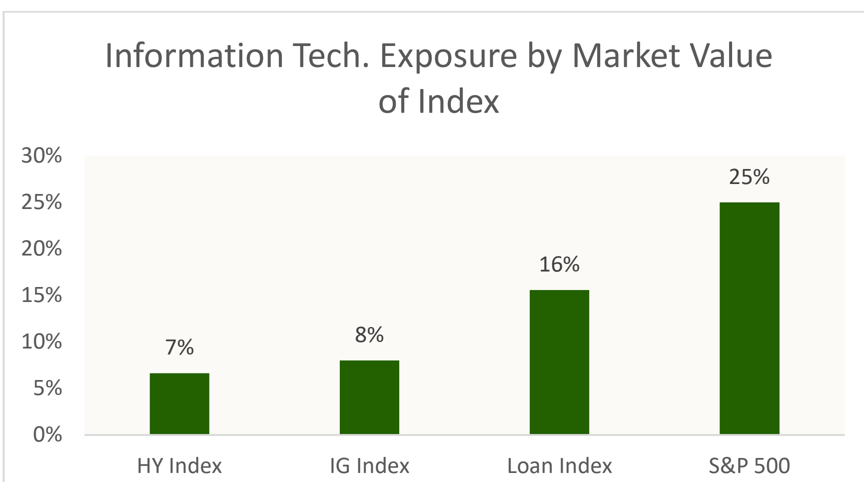
LEVERAGED FINANCE INDUSTRY EXPOSURES

We believe certain sectors within the Loan market are attractively positioned relative to IG and HY bonds. Even before the COVID-19 pandemic, the Information Technology (IT) generated solid EBITDA growth.

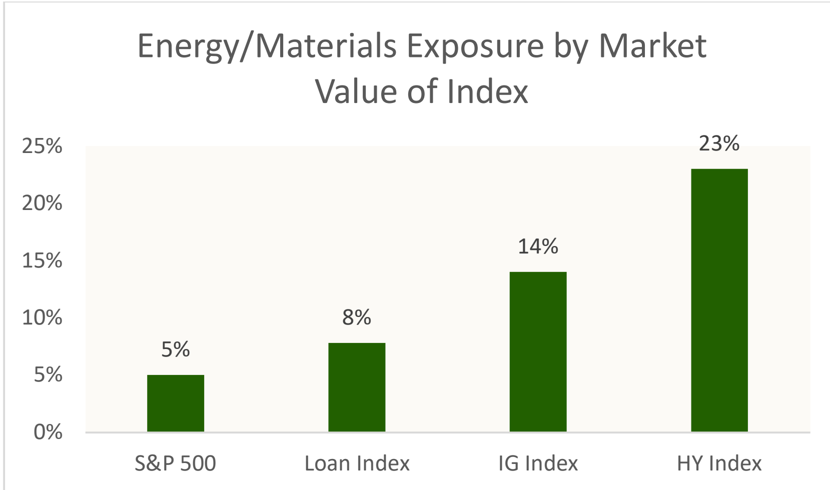


Source: Barrow Hanley, S&P LCD

- The IT sector comprises 16% of the LL universe, versus 7% in HY and 8% in IG. (see chart below).
- The Energy/Basic Materials sector comprises 8% of the LL universe, versus 23% for HY and 14% for IG. (see 2nd chart below).
- The EBITDA growth within IT has created meaningful outperformance through individual Loan selection by active managers.



Source: Barrow Hanley, Credit Suisse, ICE BAML, S&P LCD



Source: Barrow Hanley, Credit Suisse, ICE BAML, S&P LCD

Even if spreads remain constant with an uptick in the default rates across HY and LL there will be opportunities through proper sector allocation. We believe a prudent manager can avoid problematic industries, such as Energy and Basic Materials, and outperform through rigorous fundamental credit analysis in higher performing sectors such as IT.

BHMS Strategy Returns	Mo	QTD	YTD	Index
High Yield Composite	1.89%	5.53%	3.07%	BHMS
Bank Loan Composite	1.46%	3.63%	-1.22%	BHMS
Asset Class	Mo	QTD	YTD	Index
HY Return	0.98%	5.81%	0.76%	ICE BAML HY Index
HY BB Return	0.63%	5.67%	4.21%	ICE BAML BB HY Index
HY B Return	0.94%	5.56%	-1.05%	ICE BAML B HY Index
HY CCC Return	2.85%	7.22%	-8.72%	ICE BAML CCC HY Index
Leveraged Loan Return	1.50%	3.41%	-1.51%	CS Leveraged Loan Index
LL BB Return	0.68%	2.35%	-2.19%	CS Leveraged Loan BB Index
LL B Return	1.36%	3.52%	-0.73%	CS Leveraged Loan B Index
LL CCC Return	4.25%	6.33%	-6.61%	CS Leveraged Loan CCC Index
HYG	-0.02%	5.04%	-0.32%	Ishares Iboxx High Yield
BKLN	1.31%	2.95%	-1.63%	Invesco Senior Loan ETF
S&P 500 Return	7.19%	13.23%	9.74%	S&P 500
Russell 2000 Return	5.63%	8.56%	-5.53%	Russell 2000 Index
CS Leveraged Equity Index	1.11%	10.59%	1.99%	CS Leveraged Equity Index
10yr Beg	0.53%	0.66%	1.92%	10yr Treasury
10yr End	0.71%	0.71%	0.71%	10yr Treasury
10yr Return	-1.33%	-0.18%	12.48%	10yr Treasury
	Beg Mo	Beg Qtr	Beg Year	Ending YTW/STW
HY YTW	5.46%	6.85%	5.41%	5.36%
HY BB YTW	3.89%	5.14%	3.85%	3.94%
HY B YTW	5.66%	7.03%	5.38%	5.52%
HY CCC YTW	12.69%	14.53%	11.80%	11.94%
HY STW	521	647	372	506
HY BB STW	359	473	213	357
HY B STW	547	672	370	529
HY CCC STW	1,248	1,414	1,012	1,171
LL YT3Y	6.50%	7.25%	6.27%	6.13%
LL BB YT3Y	4.08%	4.75%	4.29%	3.86%
LL B YT3Y	6.11%	6.82%	6.36%	5.78%
LL CCC YT3Y	16.71%	17.88%	15.29%	14.98%
LL ST3Y	629	700	461	589
LL BB ST3Y	389	452	262	363
LL B ST3Y	590	657	470	555
LL CCC ST3Y	1,649	1,760	1,365	1,474

Contact Information

For any inquiries please reach out to:

Alex Grause, agrause@barrowhanley.com. 617-759-1110 or marketing@barrowhanley.com

General Disclosures:

All opinions included in this report constitute Barrow Hanley's judgment as of the time of issuance of this report and are subject to change without notice. This report was prepared by Barrow Hanley with information it believes to be reliable. This report is for informational purposes only and is not intended to be an offer, solicitation, or recommendation with respect to the purchase or sale of any security, nor a recommendation of services supplied by any money management organization. Past performance is not indicative of future results. Barrow, Hanley, Mewhinney & Strauss, LLC is a value-oriented investment manager, providing services to institutional clients.

These investment summaries are provided for informational purposes only and should not be viewed as representative of all investments by the firm. This report includes certain "forward-looking statements" including, but not limited to, BHMS's plans, projections, objectives, expectations, and intentions and other statements contained herein that are not historical facts as well as statements identified by words such as "expects", "anticipates", "intends", "plans", "believes", "seeks", "estimates", "projects", or words of similar meaning. Such statements and opinions contained are based on BHMS's current beliefs or expectations and are subject to significant uncertainties and changes in circumstances, many beyond BHMS's control. Actual results may differ materially from these expectations due to changes in global, political, economic, business, competitive, market, and regulatory factors. Additional information regarding the strategy is available upon request.

Index Disclosures: