Flash Notes – Market comments and Fund update

April 2020

Lord Abbett High Yield Fund

Dear Partners,

Please find below a summary of actions taken by Portfolio Managers investing in the **US High Yield debt market**, severely impacted by the liquidity crisis sparked by the development of the pandemic outbreak.

US Credit update

The U.S. Federal Reserve Expands Efforts

The Fed announced a major series of programs on April 9, timed to coincide with the release of weekly new unemployment claims reaching a record 6.6 million. This new series of programs expanded some existing facilities, introduced new ones, and generally broadened the reach of lending backed by the Fed to proactively reach new areas of the broader US economy.

Lending to non-investment grade companies.

Main Street Lending is unprecedented in that the Fed is essentially expanding lending to non-investment grade companies. Among other things:

- Addresses some key concerns from investors regarding which borrowers would be able to directly benefit from the Fed, no longer limiting access to investment grade corporate borrowers or larger municipal borrowers.
- It includes **multiple asset classes**, including a range of structured products. In addition to providing direct support to these asset classes it indicates that the Fed is looking to support numerous markets.
- It indicates that the Fed is **actively monitoring markets** and the overall economy, very much leaving the door to future actions that expand on existing actions and will introduce new mandates as needed.

The likely market implications are as follows:

- This Fed announcement should be broadly **favourable for risk assets** and provides additional relief for many businesses and municipalities that were outside the scope of some of the initial programs.
- In broadly expanding the scope of eligible borrowers, the **new programs will reach smaller companies** that fell between the investment grade-based PMCCF and SMCCF, but weren't small enough to be eligible for the generous Small Business Administration loans, as well as municipal borrowers.
- In general, many markets will be impacted. The Main Street Lending program should be a big **boost for the high yield and loan markets,** and for **small and mid-cap companies**, where prior announcements seemed to primarily help large cap IG companies. Inclusion of downgraded companies in the PMCCF and SMCCF is a huge relief to many lower quality BBB companies, and some fallen angels have traded significantly higher following the announcement.
- The **inclusion of CMBS and AAA CLOs** is a clear positive for structured products, even though it only includes AAA legacy CMBS and new issue AAA CLOs. Some investors had concerns that the Fed was only interested in helping corporate borrowers. This material expansion indicates that the Fed is listening to investors, willing to be proactive and interested in helping to stabilize and support all areas of the

markets, as needed. Even securities and asset classes not directly impacted are likely to benefit from the combination of relative value versus supported assets, and overall market stabilization.

To take benefit from the high yielding US credit market, **our pick is the Lord Abbett High Yield Fund**

Lord Abbett - U.S. High Yield - Navigating Through the Volatility

The U.S. high yield market has priced in default rates greater than 40%. Though increased defaults and ratings downgrades are expected within high yield, it's worth noting that the overall credit quality of the high yield market has strengthened since the 2008-09 financial crisis. Going back to 2007 (as of June 30), high yield market was made of over 20% by triple C issuance, which has since come down to only 13% today. The highest ratings tier of below investment grade, said BB, now accounts for nearly half the index, versus 36% in 2007.

During the late-March rally in high yield, Lord Abbett's investment team opportunistically added risk to the portfolio. In doing so, they bought risk on Friday, March 20 and Monday, March 23, mainly on issues rated 'BB'- and 'B'. In contrast to previous months where they had increased allocations to BB while reducing some CCC-rated issues.

Q1 Update & Positioning

- The portfolio's relative weight in Energy has added to performance YTD. They entered the year with a modest overweight to the energy sector built primarily through oversold conditions in 4Q19. However, outperformance over the turn of the year and slowing macro momentum led them to reduce risk in this sector during the first half of Q1, with a particularly large reduction in mid-February. They plan to remain underweight energy, and up-in-quality within the industry—with a focus on scale, liquidity, and long operating history.
- They also came into the year and the recent sell off by being positioned against the consensus, maintaining an underweight position in BB's in early 2020, as the BB market continued to show high levels of negative convexity and unattractive relative values. Their credit quality positioning added to the performance from early Dec. 2019 through the end of Feb. 2020, though it has detracted YTD. COVID-19 and the simultaneous supply and demand shocks to oil, created a dramatic reversal in risk sentiment. At first, the selloff was concentrated in larger more liquid 'BB' credits. However, as the sell-off persisted, lower quality underperformed BB. When volatility became more two sided later in the month, BBs continued to outperform on an absolute and risk-adjusted basis.
- PMs started to rotate the portfolio up in quality when volatility arose. This involved "taking the pain" in selling less liquid CCCs, which they felt was worth the cost of transacting to improve portfolio quality amidst the sell-off.
- Finally, in the last week of March, given the recent spread widening, they have incrementally added back risk to the strategy while remaining liquidity mindful.

Lord Abbett High Yield Fund

Portfolio characteristics as of 31.03.2020

Average coupon:	5.97% vs. 6.23%
Average maturity:	6.79 years vs. 6.12
Average modified duration:	5.02 years vs. 4.56
Average price:	$84.69 vs. $85.79
Average quality:	B+ vs. BB-
Average Yield-to-Maturity:	10.01% vs. 9.30%
Number of issues:	633 vs. 1792
Cash:	1.14%

WSP Analyst Conclusion

Although painful in the short term (-11.3% vs. -9.1% YTD), the fund's portfolio management team has made the necessary changes in this rough but so far indiscriminate environment. They have done so, on the one hand by selling companies that will find it difficult to survive in this new environment, and on the other hand by taking advantage of a dislocated market to acquire healthy business debts, punished for the wrong reasons.

Due to the unprecedented widening bid and ask price the portfolio manager had to give up some short-term performance in order to reposition his portfolio over the long term.

In our view, Lord Abbett has one of the most skilled and ample research in credit, more particularly in the US high yield segment. We therefore keep our trust unaffected to the PM and his team to successfully go through the current market, as they have done in many instances in the past.