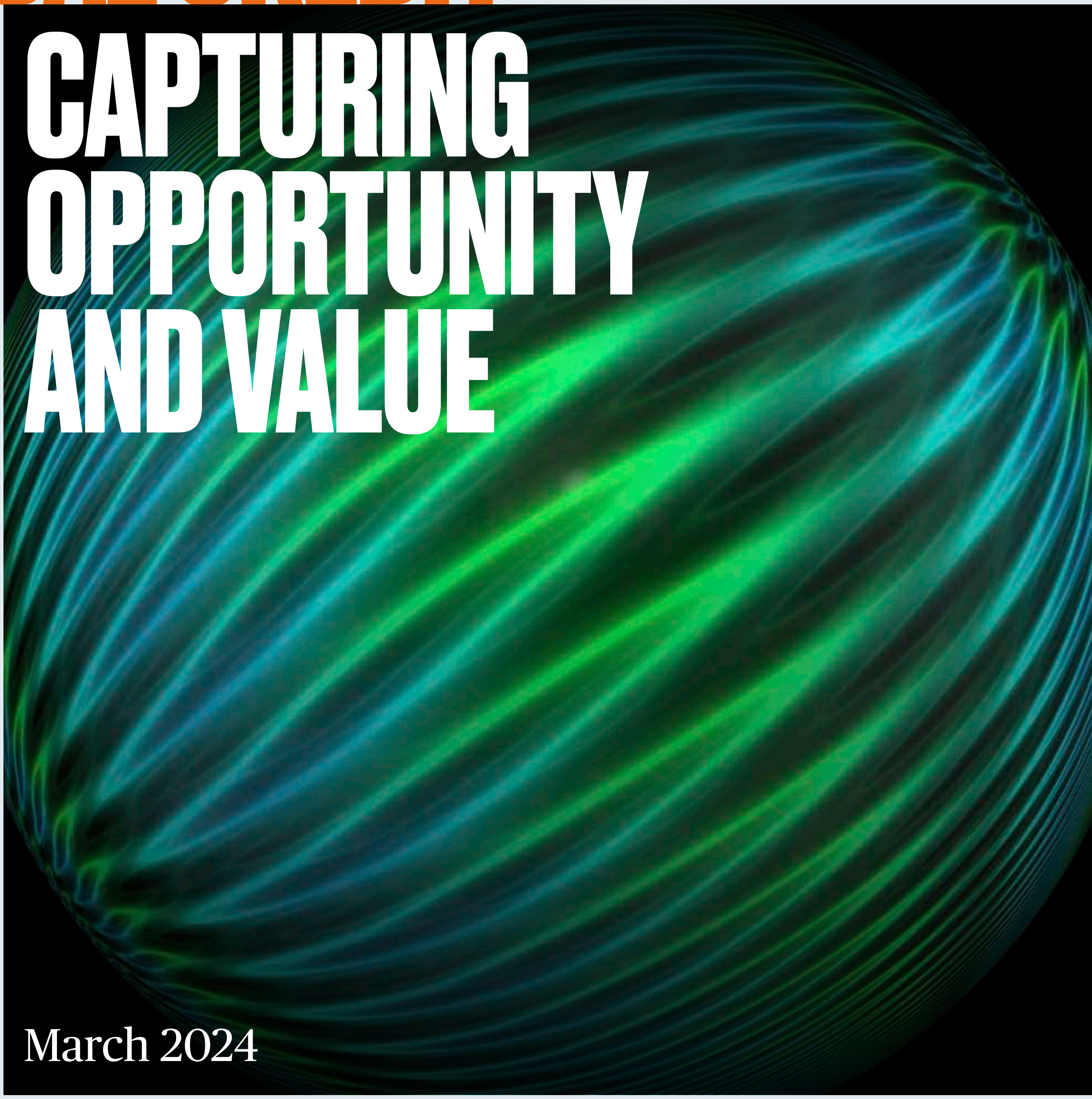
GLOBAL CREDIT

CAPTURING OPPORTUNITY AND VALUE



March 2024

BNY MELLON
INVESTMENT MANAGEMENT

Insight
INVESTMENT

THE ABSOLUTE LEVEL OF YIELDS HAS RETURNED TO HISTORICALLY ATTRACTIVE LEVELS

WE BELIEVE VOLATILITY PROVIDES A HEALTHY ENVIRONMENT FOR ACTIVE MANAGERS TO ADD VALUE

SOLID CORPORATE FUNDAMENTALS HAVE UNDERPINNED A RALLY IN SPREADS, BUT RELATIVE-VALUE OPPORTUNITIES REMAIN

HIGHER ABSOLUTE YIELDS COULD PROVIDE AN INCOME BUFFER AGAINST CAPITAL LOSSES SHOULD YIELDS RISE AGAIN

Executive summary

- Yield is back
  - The absolute level of yields available in global investment grade credit has returned to pre-global financial crisis levels
  - Strong corporate fundamentals have allowed credit spreads to return to fair value, but that does not prevent relative-value opportunities remaining within a global opportunity set
- Active managers can thrive on volatility
  - When credit volatility increases, so do alpha opportunities
  - A global approach can help investors weather extreme volatility
- Higher income may provide a buffer against potential capital losses
  - Yields need to meaningfully rise for investors to suffer negative total returns
  - If yields rally, there is the potential for meaningful gains
- Even in lower-rated credit defaults don't appear a concern for now
- Credit decisions form the core of our process
  - Our approach to adding value in global credit is focused on making decisions on credit strategy and security selection
  - We implement our credit views across four layers:
    1. Beta management
    2. Macro credit relative value
    3. Sector strategy
    4. Security selection
  - The results are clear, with a proven track record of adding value through credit strategy and security selection

WHY INSIGHT FOR GLOBAL CREDIT

PEOPLE AND PROCESS – Lead managers have managed the strategy since inception in 2011, leveraging Insight's regionally balanced global platform, applying our long-standing and effective investment process.

STRATEGY FOCUS – Investment grade focus with returns driven by applying risk through credit decisions, using our regionally balanced platform, which allows for idea generation that avoids geographical bias.

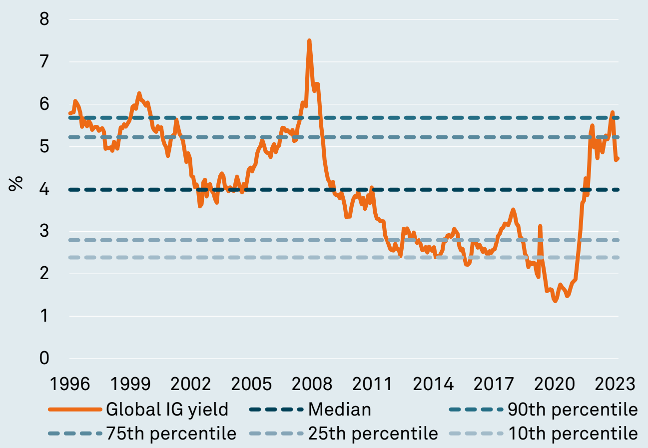
PERFORMANCE – The Insight global credit strategy achieved positive returns relative to the benchmark index in 11 of the 12 calendar years since then, and achieving more than 1.4% per annum outperformance (gross of fees) since inception.[1]

1 Performance calculated as total return, income reinvested, gross of fees in USD. Fees and charges apply and can have a material effect on the performance of your investment. Benchmark: Bloomberg Global Aggregate Credit Index hedged into USD. Inception: 31 January 2011.

Yield is back

The absolute levels of yields sits between the 75th percentile and the median (50th percentile) of what has prevailed since 1996, an area that we believe should still hold attractions for investors. Yields remain above levels that were common in much of the period prior to the 2008 global financial crisis (GFC) (see Figure 1).

FIGURE 1: YIELDS ON GLOBAL INVESTMENT GRADE CREDIT HAVE RISEN TO OFFER BETTER VALUE THAN FOR MORE THAN A DECADE[2]



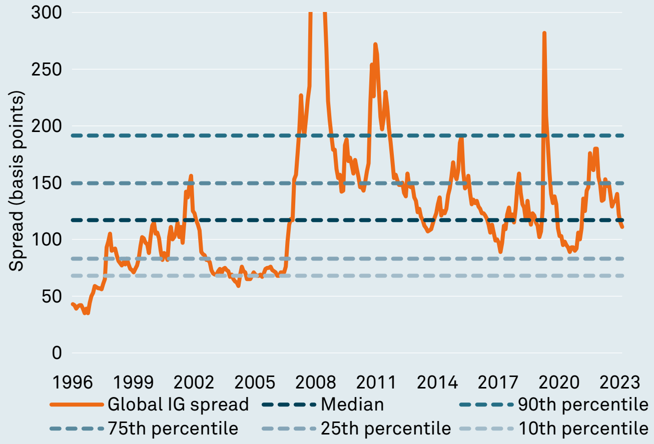
SPREADS HAVE RETURNED CLOSER TO FAIR VALUE, BUT RELATIVE VALUE OPPORTUNITIES REMAIN

Credit spreads tightened into the end of 2023 as investors became more comfortable that the macroeconomic backdrop appears less likely to deteriorate significantly, and in the belief that interest rate cuts will soon be forthcoming.

Although global credit spreads have moved below their long-term median (see Figure 2), we believe that in the current economic and monetary regime, in which the US experiences a so-called 'soft landing', they have the capacity to tighten further, although the lows seen prior to the 2008 global financial crisis are unlikely to be revisited quickly.

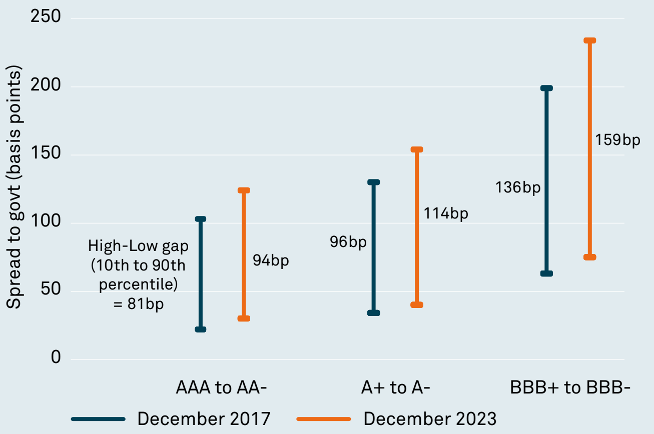
While the market may have got ahead of itself in expecting many and early interest rate cuts, we believe any improvements in the economic landscape can continue providing support for corporate fundamentals.

FIGURE 2: SPREADS HAVE TIGHTENED TO FAIR VALUE BUT HAVE SCOPE TO TIGHTEN FURTHER[3]



Although spread levels have tightened to fair value, there is still extensive opportunity for capturing value from the expanded levels of spread dispersion that previous market volatility has created. The turmoil and uncertainty introduced by COVID-19, the war in Ukraine, and the highest levels of inflation for a generation, provoked not just higher spreads, but also a greater dispersion of spreads across issuers and issues with the same credit ratings (see Figure 3). More spread dispersion can provide extra opportunities for active managers to identify where outperformance (alpha) can be captured in relative-value positioning.

FIGURE 3: EXTENDED SPREAD DISPERSION CAN HIGHLIGHT ALPHA OPPORTUNITIES[4]



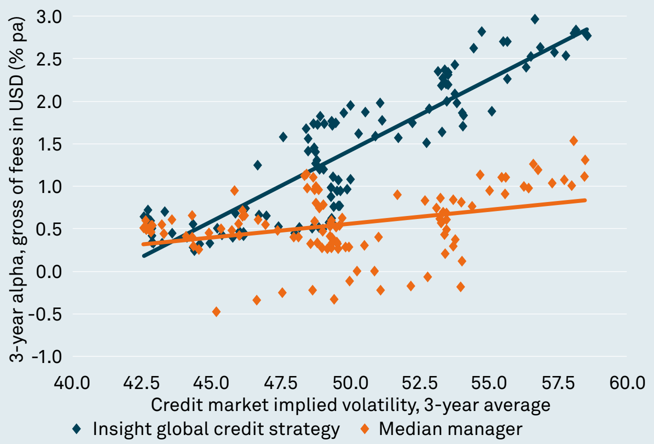
2 Source: Insight and Bloomberg as at 31 January 2024. ICE BofA Global Corporate Index.
3 Source: Insight and Bloomberg as at 31 January 2024. ICE BofA Global Corporate Index. Option adjusted spreads (OAS) were above 300bp from September 2008 – June 2009 and peaked in December 2008 at 469bp.
4 Source: Insight and Bloomberg as at 31 December 2023 based on ICE BofA Global Corporate Index.

Active managers thrive when volatility increases

Evidence suggests that active managers are typically able to achieve greater levels of alpha over the medium term when implied volatility in credit markets increases. Our analysis would support this when considering alpha generated by an actively managed Insight strategy over rolling three-year periods from 2011 to September 2023 (see Figure 4).

We believe there is good reason to expect volatility to remain elevated. Significant geopolitical tensions and the existence of competing fiscal and monetary priorities in many areas can create an environment of elevated market uncertainty, which in turn can present attractive value opportunities available for capture.

FIGURE 4: ALPHA HAS INCREASED AS IMPLIED VOLATILITY INCREASES[5]

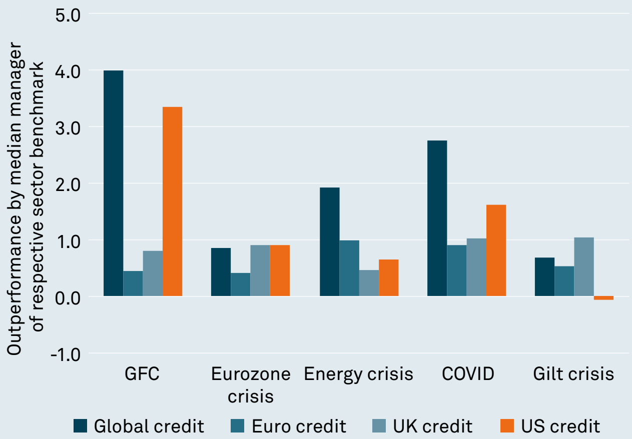


A GLOBAL APPROACH CAN HELP INVESTORS WEATHER EXTREME VOLATILITY

The broader opportunity set that investing in a global mandate brings may help investors weather a financial storm better than allocating on a regional level.

Looking at the outcomes of various crises that have affected bond markets (see Figure 5) in the last 20 years, global managers have typically performed comparatively well in the wake of the global crises, when viewed against regions individually. Following the GFC, the 2015-16 energy crisis during which oil prices fell substantially, and the 2020 COVID crisis, the median global manager generally achieved equivalent or better performance relative to their peers than did the median managers of regionally focussed (US, euro and sterling) strategies. The sole exception was the 2022 gilt crisis, where a global approach was only bettered by sterling credit market specialist approaches.

FIGURE 5: A GLOBAL APPROACH WORKS WHEN GLOBAL CRISES HIT[6]



Higher income may provide a buffer against potential capital losses

Higher yield levels could provide better insulation to investors who may be concerned about the potential for future capital losses should yields drift higher. The additional income earned when yields are higher can offer a cushion from potential capital losses if yields increase. They can act as a buffer to delay total returns becoming negative.

In the scenario analysis shown in Table 1, simulated returns over a year ahead across a broad range of potential economic scenarios, to which we've applied assumptions on how markets would react, all remain positive. We estimate that credit yields (the combination of government bond yields and credit spreads) on global investment grade (IG) credit would have to increase by approximately 90 basis points (bp), or 0.9%, over a year before capital losses exceeded the 5.4% income generated.[7]

If yields were to decline, the higher level of income combines with capital appreciation to potentially generate attractive total returns, even if any decline in yields is only relatively modest. For example, just a 50bp decline in yields could translate to approximately 8% total return over the course of a year for a global investment grade credit investment.

5 Source: Insight, Bloomberg and Mercer. Insight global credit strategy alpha (outperformance) in USD terms, of Bloomberg Global Aggregate Credit Index hedged into USD and trendline (dark green). Alpha of median manager of Mercer Insight global credit hedged universe versus Bloomberg Global Aggregate Credit index hedged into USD and trendline (light green). Performance calculated as total return, income reinvested, gross of fees in USD. Fees and charges apply and can have a material effect on the performance of your investment. Source: Bloomberg. Arithmetic average of 3 years of monthly data. 2/3rds CDX.NA.IG 3M Volatility Rolling maturity (Credit default swap index, North America, Investment grade 3-month volatility), 1/3rd iTraxx Europe 3M Volatility, rolling maturity. As at December 2023.
6 Source: Insight, Mercer Bloomberg. As at 28 December 2023. Recovery is measured as the Mercer Insight Universe median manager's outperformance of the respective benchmark index for each credit sector in the six-month period ending: June 2009 (GFC); April 2012 (Eurozone crisis); August 2016 (Energy crisis); September 2020 (COVID crisis); April 2023 (Gilt crisis).
7 Source: Insight, Bloomberg. As at 19 February 2024. Estimation based on prevailing market values and duration characteristics. Simulated scenario returns are for illustrative purposes only. Global credit duration: 5.9yrs, global credit yield: 5.4%, global credit spread: 105 basis points, 10-year US Treasury yield: 4.3%. Calculations based on the ICE BofA Global Corporate Index (G0BC).

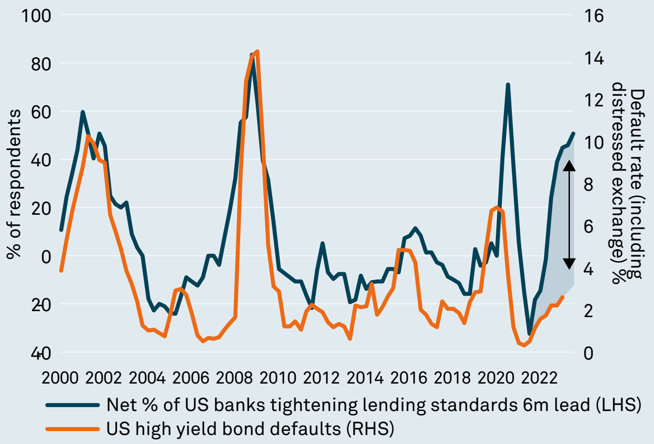
TABLE 1: ASYMMETRIC RETURNS FROM CREDIT – HIGHER INCOMES FROM YIELDS PROVIDE SOFTER CUSHIONS ACROSS MANY SCENARIOS[7]

Scenario	Higher for longer	Soft landing	Mild recession
Growth	Trend like	Positive but below trend	Modestly negative
Inflation	Sticky above target	Falls back to target	Falls back to target
US Treasury 10-year yield change	+0.2%	-0.3%	-1.3%
Global IG spread change	+30bp	-10bp	+80bp
Total change in yield	+0.5%	-0.4%	-0.5%
Global IG 1-year total return	2.5%	7.8%	8.4%

Even in lower-rated credit defaults don't appear a concern

For investments in lower grade credit, defaults can be critical. Levels of defaults in the US high yield universe have proven remarkably resilient following the sharp increase in interest rates and tightening of bank lending standards that has occurred (see Figure 6).

FIGURE 6: WHERE HAVE THE DEFAULTS GONE?[8]



To explain why this may be happening, we need to look at both fundamental and technical factors. On the fundamental side, corporate balance sheets are in good shape. As we illustrate in Figure 7, we believe the leverage ratios for both investment grade and high yield issuers should not be considered unusually high. A similar story can be seen across a range of credit metrics. Technically, there has been a dramatic increase in the number of private debt funds (see Figure 8), which are likely to be drawing lending away from more traditional sources such as public markets and the banking sector. It is our suspicion that the defaults haven't disappeared, they've simply changed hands. We believe the development and increased sophistication of the private lending market could help keep defaults in public debt markets lower than might have occurred in the past.

FIGURE 7: LEVERAGE RATIOS FOR US NON-FINANCIAL CORPORATIONS[9]

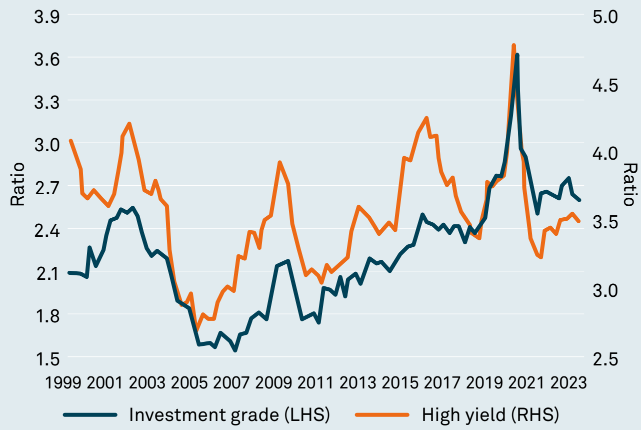
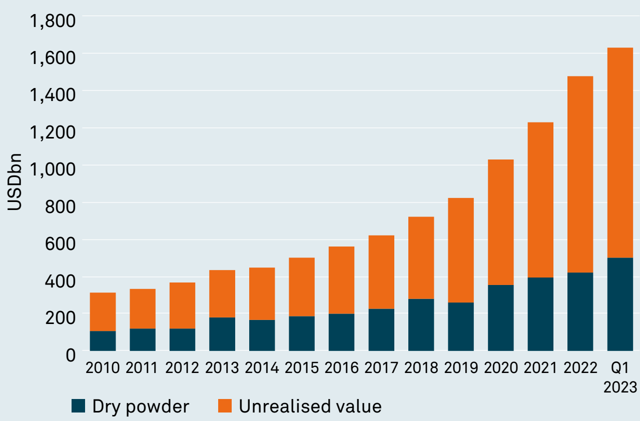


FIGURE 8: TOTAL AUM IN PRIVATE DEBT FUNDS[10]



8 Source: Federal Reserve Senior Loan offices survey and JP Morgan as at 31 December 2023.
9 Source: FactSet, Goldman Sachs Global Investment Research as at 5 January 2024. Leverage ratio is total debt divided by earnings before interest, taxes, depreciation and amortisation (EBITDA).
10 Source: Preqin and Goldman Sachs Global Investment Research as at 2 January 2024.

Putting credit decisions at the heart of Insight's approach to Global Credit

Our global credit strategy is focused on adding value through credit decisions. This means our investors can have confidence in what they may expect to see drive our performance. We don't seek to use allocations to currency or duration risk to meaningfully add value. We implement our credit views across four layers:

1

Beta management: the directional risk we take on credit spreads.

2

Macro credit relative value: our asset allocation decisions across regions/ markets.

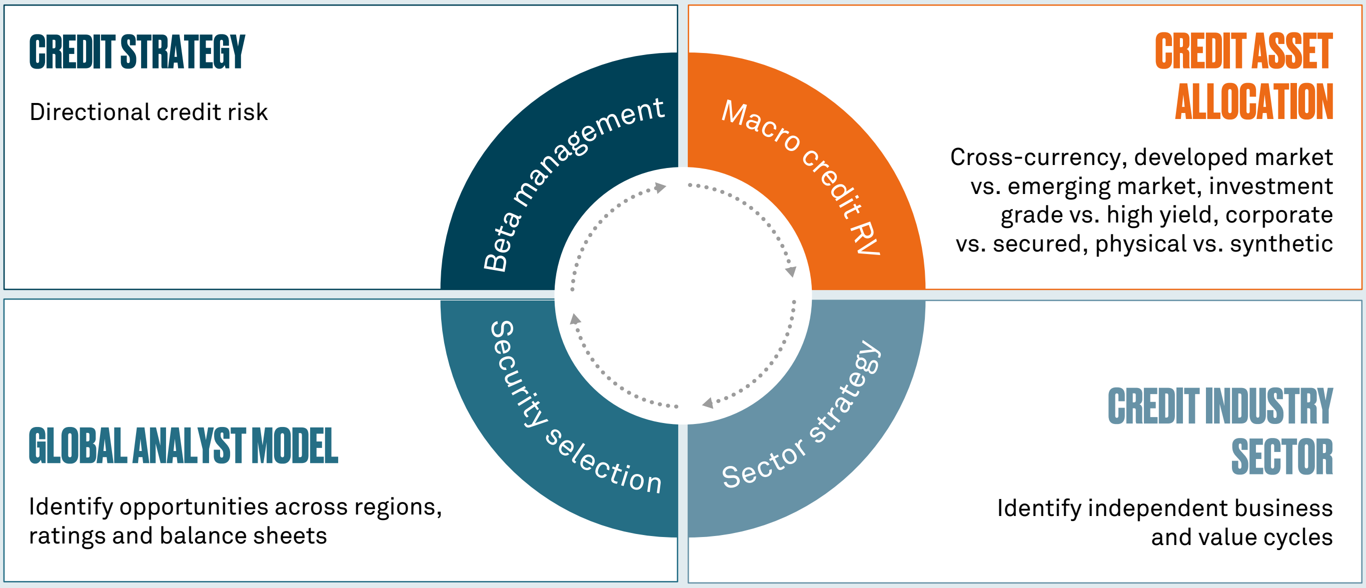
3

Sector strategy: taking positions across industry sectors based on fundamentals and relative value views.

4

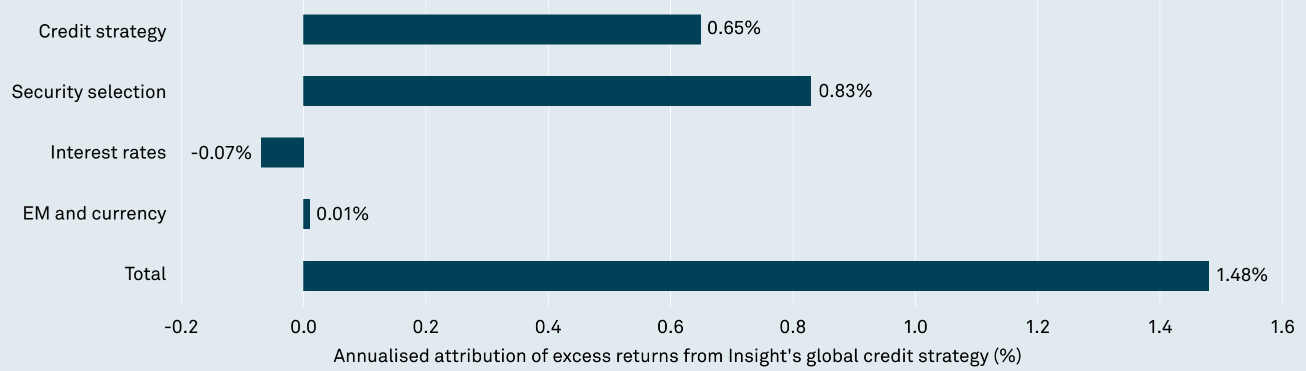
Security selection: picking the winners we see in regions/sectors and avoiding the losers.

FIGURE 9: WE TAKE A FOUR-LAYERED APPROACH TO CREDIT INVESTMENT



Since the inception of the strategy in September 2011, we have built a track record that we believe demonstrates the success of our approach. Gross of fees, the strategy has outperformed its benchmark index in 11 of 12 calendar years, underperforming in only one year, and has delivered those returns with a clear focus on credit decisions as Figure 10 demonstrates.

FIGURE 10: THE BENEFITS OF OUR APPROACH ARE CLEAR WHEN STRATEGY PERFORMANCE IS ANALYSED?[11]



That performance has been achieved across credit cycles, with gains also having been generated at times when spreads have widened as well as when they have tightened, helping to demonstrate that our process is not reliant on market momentum for success.

11 Source: Insight. As at 31 December 2023. The representative portfolio adheres to the same investment approach as Insight's global credit strategy. Annualised attribution of excess returns versus the benchmark (Bloomberg Global Aggregate Credit Index – USD hedged) since inception (30 September 2011), gross of fees in USD. A copy of a fully compliant GIPS report is available. Fees and charges apply and can have a material effect on the performance of your investment.

Contributors

Adam Whiteley
Head of Global Credit Insight Investment

Philip Barleggs
Senior Investment Content Specialist, Insight Investment

Important Information

TEN-YEAR PERFORMANCE RECORD TO 31 DECEMBER 2023

Simulated performance results have certain inherent limitations. Simulated results do not represent actual trading/returns and are not a reliable indicator of future performance. Simulated results are based on performance of the strategy synthetically hedged into USD from GBP.

	Calendar year returns									
	2023	2022	2021	2020	2019	2018	2017	2016	2015	2014
Insight's global credit strategy: representative portfolio (USD synthetic hedged)	9.80	-12.06	0.00	12.89	13.25	-0.57	6.18	6.01	1.00	8.42
Barclays Global Aggregate Credit Index Hedged into USD	8.68	-14.22	-0.95	7.78	11.85	-0.47	5.36	5.69	-0.13	7.49

	12-month rolling returns									
	2022-2023	2021-2022	2020-2021	2019-2020	2018-2019	2017-2018	2016-2017	2015-2016	2014-2015	2013-2014
Insight's global credit strategy: representative portfolio (USD synthetic hedged)	9.80	-12.06	0.00	12.89	13.25	-0.57	6.18	6.01	1.00	8.42
Barclays Global Aggregate Credit Index Hedged into USD	8.68	-14.22	-0.95	7.78	11.85	-0.47	5.36	5.69	-0.13	7.49

Source: Insight as at 31 December 2023. Returns are shown gross of fees in USD. The representative portfolio adheres to the same investment approach as Insight's global credit strategy. Performance calculated as total return, income reinvested, gross of fees in USD. Inception date: 30 September 2011. Fees and charges apply and can have a material effect on the performance of your investment. This track record is created by asset weighing the gross performance of all accounts following the Global Credit strategy, some of which have been synthetically hedged to USD. We believe this track record provides a truer reflection on our ability to generate alpha. Please note that this track record is not GIPS® compliant.

Risk disclosures

- **China Interbank Bond Market and Bond Connect risk:** The Strategy may invest in China interbank bond market through connection between the related Mainland and Hong Kong financial infrastructure institutions. These may be subject to regulatory changes, settlement risk and quota limitations. An operational constraint such as a suspension in trading could negatively affect the Strategy's ability to achieve its investment objective.
- **Geographic Concentration Risk:** Where the Strategy invests significantly in a single market, this may have a material impact on the value of the Strategy.
- **Objective/Performance Risk**: There is no guarantee that the Strategy will achieve its objectives.
- **Currency Risk:** This Strategy invests in international markets which means it is exposed to changes in currency rates which could affect the value of the portfolio.
- **Derivatives Risk:** Derivatives are highly sensitive to changes in the value of the asset from which their value is derived. A small movement in the value of the underlying asset can cause a large movement in the value of the derivative. This can increase the sizes of losses and gains, causing the value of your investment to fluctuate. When using derivatives, the Strategy can lose significantly more than the amount it has invested in derivatives.
- **Changes in Interest Rates & Inflation Risk:** Investments in bonds/ money market securities are affected by interest rates and inflation trends which may negatively affect the value of the portfolio.
- **Credit Ratings and Unrated Securities Risk:** Bonds with a low credit rating or unrated bonds have a greater risk of default. These investments may negatively affect the value of the portfolio.
- **Credit Risk:** The issuer of a security held by the Strategy may not pay income or repay capital to the Strategy when due.
- **Emerging Markets Risk:** Emerging Markets have additional risks due to less-developed market practices.
- **CoCo's Risk:** Contingent Convertible Securities (CoCo's) convert from debt to equity when the issuer's capital drops below a pre-defined level. This may result in the security converting into equities at a discounted share price, the value of the security being written down, temporarily or permanently, and/or coupon payments ceasing or being deferred.
- **Counterparty Risk:** The insolvency of any institutions providing services such as custody of assets or acting as a counterparty to derivatives or other contractual arrangements, may expose the Strategy to financial loss.

Past performance is not a guide to future performance. The value of investments can fall. Investors may not get back the amount invested. Income from investments may vary and is not guaranteed.