



Sycamore Tree
Capital Partners

The Impact of Credit Strategies on Asset Allocation

November 2020

Preliminary Matters

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Summary

Over the past 20 years' unprecedented period of falling interest rates*

- US equities and fixed income returns were mid-single digits;
- The traditional 60/40 portfolio returned 5.6%, with volatility of 10.5%
- Credit strategies delivered returns comparable to, or higher than equities with lower volatility

In 2020, the markets experienced their largest and fastest declines and rebounds in market history

- The sell-off in credit has been less significant than during the GFC, and much less than in equities
- The rebound in credit has been muted, given limited support from the Fed
- Credit strategies offer the potential for current income, price appreciation and capital preservation, while equities have rebounded to near pre-pandemic highs, in spite of significant economic uncertainty

Over the next ten years, average returns are expected to be even lower than in the past 20 years*

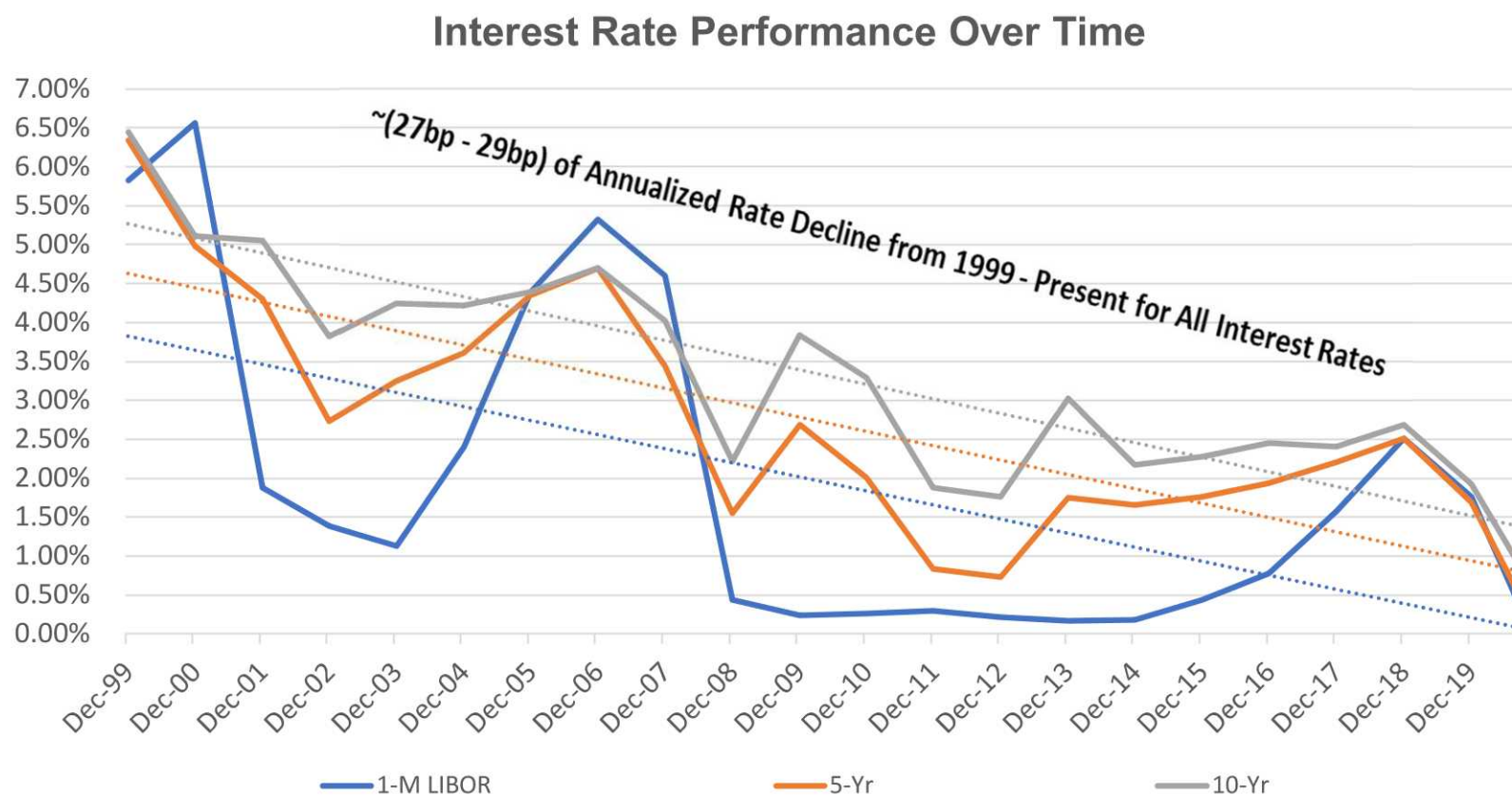
- Low global growth, interest rates and inflation for 3-5 years
- US equities and fixed income returns in the 3.0-5.5% range
- The conventional 60/40 portfolio yields a 4.6% return with volatility of 8.7%

Floating-rate credit strategies could materially enhance conventional 60/40 asset allocation

- Potential total return, risk-adjusted return, diversification and hedging benefits
- Senior loans as a complement to conventional fixed income
- Private debt as a complement to public equities

*Source: JPMorgan Asset Management Long Term Capital Market Assumptions 2020 Report

Looking Back: Unprecedented, 20-year Period of Falling Rates



- The unprecedented decline in interest rates enhanced the performance of equities and fixed income
- Nominal US interest rates are now close to zero; real interest rates are negative
- Looking forward, potentially rising interest rates may create headwinds for equities and fixed income

Source: Bloomberg

Historical Performance: Selected Public Markets, Credit and Alternatives

	Annual Return ¹ 1999-2019	Annual Volatility ¹ 1999-2019	Sharpe ² Ratio
Public Markets:			
S&P 500	6.1%	17.2%	0.27
Barclays US Agg Bond Index	5.0%	3.3%	1.06
60/40 Equity/FI Portfolio	5.6%	10.5%	0.39
US inflation	2.2%		n/a
Credit Strategies:			
Senior "Leveraged Loans" - S&P LSTA Index	4.9%	13.3%	0.25
Barclays High Yield Bonds	7.1%	15.9%	0.36
Private Debt/Direct Lending	7.5%	14.2%	0.42
Distressed Debt	9.5%	14.5%	0.55
Alternative Investments:			
PE: Buyout & Growth Equity	11.0%	14.4%	0.66
U.S. Core Real Estate	8.0%	16.2%	0.40
Commodities / Oil & Gas	7.5%	17.8%	0.34

▪ Notwithstanding the significant boost from declining interest rates, returns from equities and fixed income were only mid-single digits, and the traditional 60/40 portfolio returned 5.6% with portfolio volatility of 10.5%

▪ Volatility has been high, with the S&P 500 experiencing an average annual *intra year* decline of 13.8% over the past 40 years and an annualized volatility of 17.2% over the past 20 years

▪ Credit strategies delivered returns comparable to, or higher than equities with lower volatility, even though as floating rate investments (with the exception of High Yield Bonds) they enjoyed little benefit from the massive decline in interest rates over this period

▪ Several of the alternative investment strategies delivered absolute and risk-adjusted returns superior to public markets, albeit in return for minimal liquidity

¹ Source: All data from 1999-2019 unless stated otherwise. All Burgiss data for North America. Public Markets => Bloomberg. Senior Leveraged Loans => S&P/LSTA Leveraged Loan Index from Bloomberg. High Yield Bonds => Barclays US Corporate High Yield Bond Index from Bloomberg. Private Debt/Direct Lending => Burgiss data for Generalist and Senior subcategories under Debt asset class. Returns for Generalist and Senior subcategories for 1999-2019 and volatility for 2004-2019. Distressed Debt => Burgiss data for Distressed subcategory under Debt asset class. PE Buyout & Growth Equity => Burgiss data for Buyout & Expansion Capital subcategories under Private Equity asset class. US Core Real Estate => Burgiss data for Real Estate subcategory under Real Assets asset class. Commodities / Oil & Gas => Burgiss data for Oil & Gas subcategory under Real Assets asset class. Note: Burgiss data is reported quarterly using Time Weighted Returns for each asset class.

² Sharpe Ratio utilizes 20-year historical average 90-Day T-Bills Rate of (1.50%).

Historical Performance: Impact of the Great Financial Crisis (GFC)

	Annual Return ¹ 1999-2019	Annual Volatility ² 1999-2019 (ex-08/09)	Sharpe ³ Ratio (ex-08/09 Vol)
Public Markets:			
S&P 500	6.1%	14.2%	0.32
Barclays US Agg Bond Index	5.0%	3.5%	1.00
60/40 Equity/FI Portfolio	5.6%	8.9%	0.46
US inflation	2.2%		n/a
Credit Strategies:			
Senior "Leveraged Loans" - S&P LSTA Index	4.9%	3.5%	0.96
Barclays High Yield Bonds	7.1%	8.7%	0.65
Private Debt/Direct Lending	7.5%	6.4%	0.95
Distressed Debt	9.5%	8.4%	0.95
Alternative Investments:			
PE: Buyout & Growth Equity	11.0%	12.7%	0.75
U.S. Core Real Estate	8.0%	8.8%	0.74
Commodities / Oil & Gas	7.5%	18.4%	0.33

- The 20-year performance of strategies, excluding the downside and upside volatility of 2008 and 2009 during the "black swan" GFC yields materially different results²
 - Equity volatility declines from 17.2% to 14.2%
 - 60/40 portfolio volatility declines from 10.5% to 8.9%
- Given the unprecedented sell-off and rebound in credit strategies during the GFC, the long-term volatility and Sharpe ratios of credit strategies are significantly better
 - Senior loan volatility drops dramatically from 10.3% to 3.5%
 - High yield bond volatility drops from 15.9% to 8.7%
 - Private debt volatility drops from 14.2% to 6.4%
 - Distressed debt volatility drops from 14.5% to 8.4%
- Credit strategies have absolute returns comparable to, or higher than equities with slightly over half the volatility
 - Sharpe ratios better than both Public Markets and Alternative Investments

¹ Source: All data from 1999-2019 unless stated otherwise. All Burgiss data for North America. Public Markets => Bloomberg. Senior Leveraged Loans => S&P/LSTA Leveraged Loan Index from Bloomberg. High Yield Bonds => Barclays US Corporate High Yield Bond Index from Bloomberg. Private Debt/Direct Lending => Burgiss data for Generalist and Senior subcategories under Debt asset class. Returns for Generalist and Senior subcategories for 1999-2019 and volatility for 2004-2019. Distressed Debt => Burgiss data for Distressed subcategory under Debt asset class. PE Buyout & Growth Equity => Burgiss data for Buyout & Expansion Capital subcategories under Private Equity asset class. US Core Real Estate => Burgiss data for Real Estate subcategory under Real Assets asset class. Commodities / Oil & Gas => Burgiss data for Oil & Gas subcategory under Real Assets asset class. Note: Burgiss data is reported quarterly using Time Weighted Returns for each asset class.

² Removed both negative and positive volatility from 2008 and 2009 from all asset classes in an effort to illustrate a more normalized long-term asset class volatility (i.e. removed 2008 and 2009 annual differences in average return from the standard deviation of returns calculation to approximate long-term asset class volatility, excluding outliers).

³ Sharpe Ratio utilizes 20-year historical average 90-Day T-Bills Rate of (1.50%) and the revised annual volatility presented above (i.e. excluding 2008 and 2009 volatility). We did not adjust annual returns for any asset class.

2020: Unprecedented Challenges, Volatility, Government Intervention

	Q1 2020 Drawdown ¹	3/23-6/30 Rebound ²	YTD 6/30 2020
Public Mkts:			
S&P 500	(33.9%)	38.6%	(8.4%)
Barclays US Agg Bond Index	(6.3%)	6.8%	0.1%
60/40 Equity/FI Portfolio	(22.9%)	25.9%	(5.0%)
US inflation	N/A	N/A	1.73%
Credit Strategies:			
Senior "Leveraged Loans" - S&P LSTA Index	(20.7%)	19.5%	(5.3%)
Barclays High Yield Bonds	(20.8%)	19.9%	(5.0%)
Private Debt/Direct Lending	(7.8%)	2.8%	(5.3%)
Distressed Debt	(11.4%)	5.0%	(7.0%)
Alternative Investments:			
PE: Buyout & Growth Equity	(9.0%)	7.7%	(1.9%)
U.S. Core Real Estate	(5.4%)	0.0%	(5.4%)
Commodities / Oil & Gas	(30.5%)	4.6%	(27.4%)

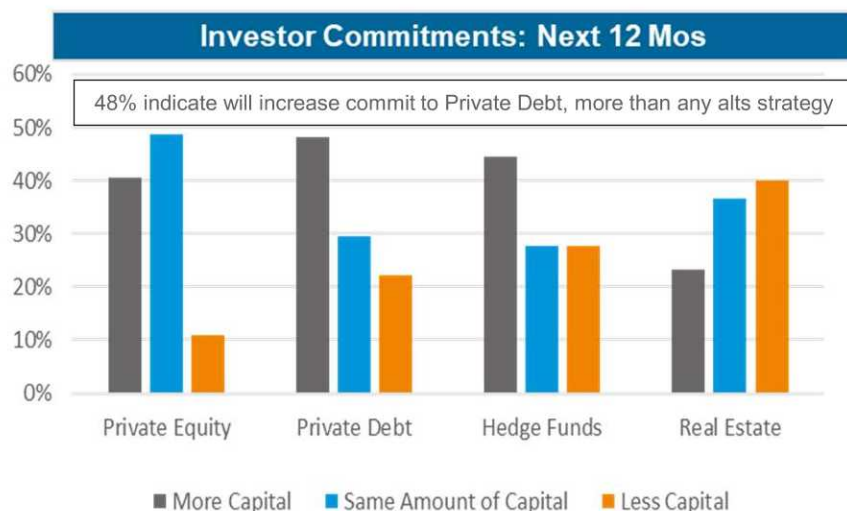
- During 2020, the markets experienced their largest and fastest declines and rebounds in their history
 - Declines driven by Covid-19
 - Rebound driven by unprecedented Federal Reserve and US Treasury intervention and stimulus
 - Capital flows into risk assets given near zero interest rates
- In contrast, the sell-off in credit has been less significant than the GFC, but the rebound has been somewhat muted given limited support from the Fed
- Credit strategies offer the potential for significant current income, price appreciation and capital preservation

¹ Source: All data from 1999-2019 unless stated otherwise. All Burgiss data for North America. Public Markets => Bloomberg. Senior Leveraged Loans => S&P/LSTA Leveraged Loan Index from Bloomberg. High Yield Bonds => Barclays US Corporate High Yield Bond Index from Bloomberg. Private Debt/Direct Lending => Burgiss data for Generalist and Senior subcategories under Debt asset class. Returns for Generalist and Senior subcategories for 1999-2019 and volatility for 2004-2019. Distressed Debt => Burgiss data for Distressed subcategory under Debt asset class. PE Buyout & Growth Equity => Burgiss data for Buyout & Expansion Capital subcategories under Private Equity asset class. US Core Real Estate => Burgiss data for Real Estate subcategory under Real Assets asset class. Commodities / Oil & Gas => Burgiss data for Oil & Gas subcategory under Real Assets asset class. Note: Burgiss data is reported quarterly using Time Weighted Returns for each asset class.

² Rebound data for asset classes that utilize Burgiss reflects only Q2 vs. Bloomberg data that illustrates precise timing to the day (i.e. 3/23/20).



Near term Prospects: Uncertainty and Volatility Favor Credit*



*Source: Preqin H2 2020 Investor Survey

- Depth/duration of recession unclear with potential for recurring volatility spikes:
 - COVID resurgence
 - Stimulus plan, or lack thereof
 - Presidential election
 - Blue Wave
 - European recession/Brexit
 - Tariffs & Trade Wars
 - Deflation
- Investors view credit more attractively now than prior to the pandemic
 - Improved performance
 - Increased allocations
- “Conventional fixed income is now 100% fixed, and 0% real income. Invest in equity-like bonds and bond-like equities”
 - Jan Loeys, Senior Market Strategist JPMorgan Asset Management
- Investors value credit’s floating rate income, collateral and return of capital through a cycle with volatile capital markets

Looking Ahead: Long-Term Capital Market Assumptions

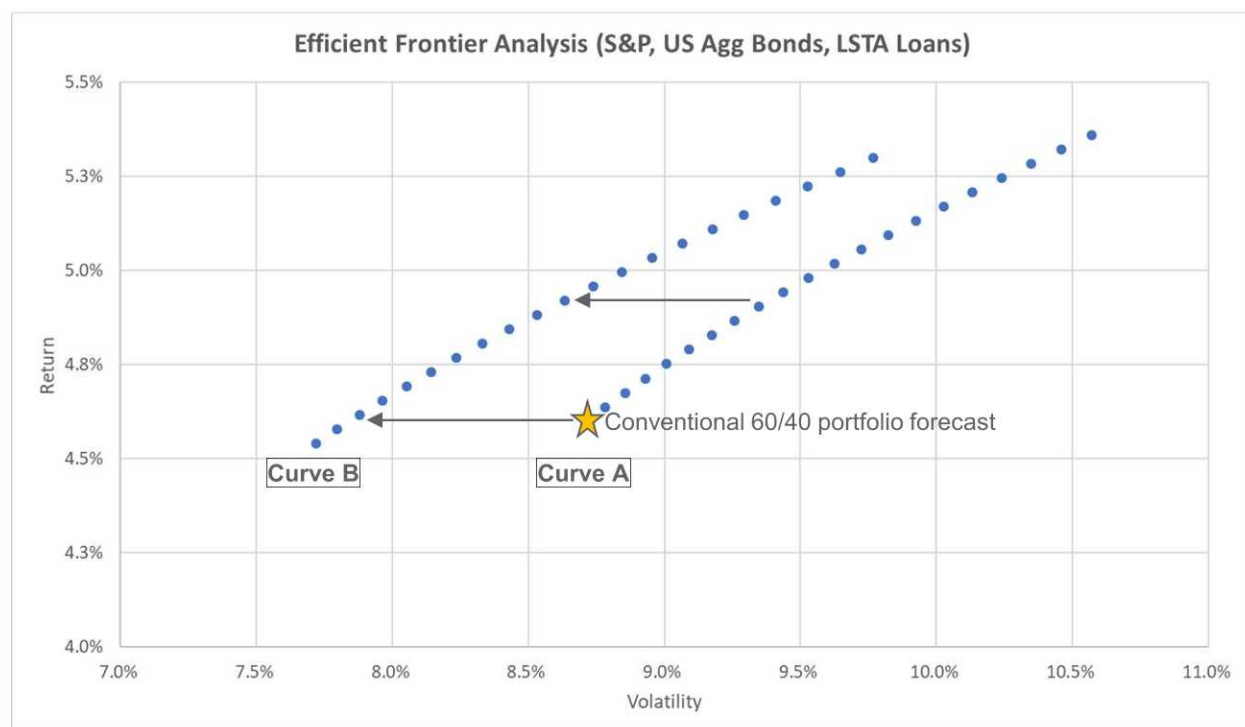
	10 Year CAGR Forecast ¹	10 Year Ann Volatility Forecast ¹	Forward Sharpe Ratio ²	Correlation U.S. Large Cap ¹	Correlation Inflation ¹
Public Mkts:					
S&P 500	5.6%	14.3%	0.34	1.00	0.05
US Agg Bonds	3.1%	3.4%	0.70	0.00	(0.18)
60/40 Equity/FI Portfolio	4.6%	8.7%	0.45	0.60	(0.04)
US inflation	2.0%	1.4%	n/a	n/a	n/a
Credit Strategies:					
Senior "Leveraged Loans" - S&P LSTA Index	5.0%	7.6%	0.57	0.55	0.34
Barclays High Yield Bonds	5.2%	8.2%	0.54	0.69	0.13
Private Debt/Direct Lending	7.0%	13.9%	0.45	0.54	0.38
Distressed Debt	n/a	n/a			
Alternative Investments:					
PE: Buyout & Growth Equity	8.8%	20.2%	0.40	0.73	0.19
U.S. Core Real Estate	5.8%	11.1%	0.46	0.53	0.34
Commodities / Oil & Gas	2.5%	16.1%	0.11	0.45	0.28

- The impact of COVID on global growth and the Fed's commitment to maintain low rates until 2023 are projected to reduce 10-yr returns even lower than the prior two decades
- 60/40 portfolio expected to exhibit lower return of 4.6% with 8.7% volatility
- Credit strategies are forecast to deliver equity-like returns with approximately half the volatility
- Credit strategies' modest correlation to US large cap stocks, suggest potential portfolio diversification benefits
- Credit strategies' positive correlation to inflation suggest potential hedging benefits
- The forecast assumes continued low inflation and interest rates. Higher rates may enhance the performance of floating-rate credit strategies and impair the performance of fixed income and equities

¹ Source: Returns, Volatility and Correlation Data sourced from JPMorgan Asset Management Long Term Capital Market Assumptions 2020 Report for all asset classes

² Forward Sharpe Ratio utilizes 10 year Treasury as of 10/15/20 (0.72%)

Looking Ahead: Adding Bank Loans To A 60/40 Portfolio



- **Curve A** plots the return and volatility of a 60/40 portfolio, where senior loans are added in lieu of US Agg in increments of 2%, yielding higher return and volatility, but also providing interest rate and hedging protections
- In a scenario where interest rates are rising more quickly or significantly, senior loans could potentially enhance both return and volatility, creating a more traditional backward/upward sloping efficient frontier
- **Curve B** plots the return and volatility of a portfolio with 50% equity and adds senior loans as a substitute to US Agg in increments of 2%
- Substituting 10% of equity for senior loans shifts the entire risk/return curve to the left, implying that for a given level of risk (volatility), this reduced equity mix (50%) portfolio generates higher returns nearly across the board, with comparable or lower volatility

A) 60% Equity / Sensitize Bond:Loan Mix

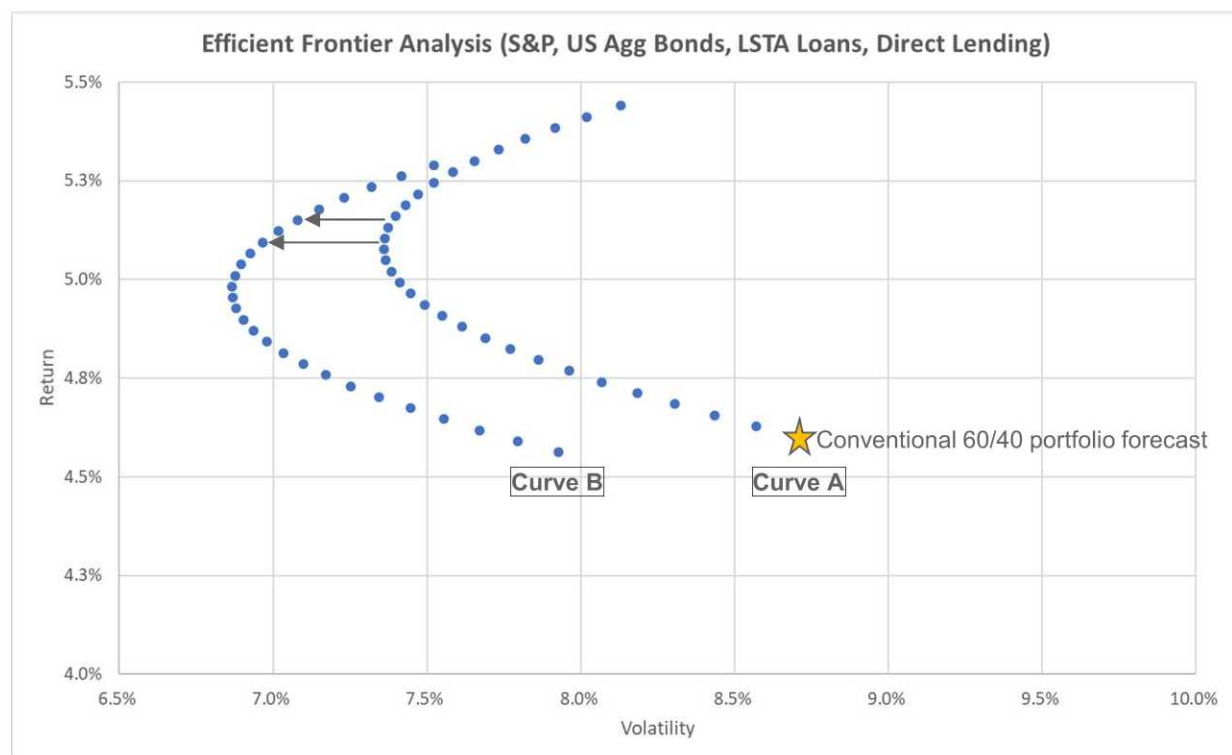
S&P 500	US Agg Bond Index	S&P LSTA Loan Index
60.0%	40.0%	0.0%
60.0%	20.0%	20.0%
60.0%	0.0%	40.0%

B) 50% Equity / Sensitize Bond:Loan Mix

S&P 500	US Agg Bond Index	S&P LSTA Loan Index
50.0%	40.0%	10.0%
50.0%	20.0%	30.0%
50.0%	0.0%	50.0%

Source: Performance Data: JPMorgan Asset Management Long Term Capital Market Assumptions 2020 Report; Sensitivity Analysis: Sycamore Tree Capital Partners

Looking Ahead: Adding Bank Loans & Private Debt To A 60/40 Portfolio



- **Curve A** plots the return and volatility of a 60/40 portfolio, where private debt is added in lieu of equity in increments of 2%
- The substitution of private debt for public equity consistently and materially reduces volatility and enhances total return
- However, private debt has no liquidity as compared to public market equity, fixed income, as well as bank loans
- **Curve B** plots the return and volatility of a portfolio with 40% US Agg / 7.5% bank loans and where private debt is then added in lieu of equity in increments of 2%
- Incorporating 7.5% of senior loans into this mix shifts the entire risk/return curve to the left, illustrating a clear diversification benefit and/or return enhancement across multi-asset class portfolios

A) 40% Bonds / Sensitize Equity:Direct Loan Mix

US Agg Bond Index	S&P 500	Private Debt Direct Lending
40.0%	0.0%	60.0%
40.0%	30.0%	30.0%
40.0%	60.0%	0.0%

B) 40% Bonds / 7.5% Loans / Sensitize Equity:Direct Loan Mix

US Agg Bond Index	S&P LSTA Loan Index	S&P 500	Private Debt Direct Lending
40.0%	7.5%	0.0%	52.5%
40.0%	7.5%	26.0%	26.5%
40.0%	7.5%	52.0%	0.0%

Source: Performance Data: JPMorgan Asset Management Long Term Capital Market Assumptions 2020 Report; Sensitivity Analysis: Sycamore Tree Capital Partners