Why It's Time to Add High Yield Bonds

With solid long-term fundamentals and compelling valuations, we believe high yield bonds remain one of the most resilient asset classes.

High Yield spreads widened significantly over the course of 2022, making valuations more attractive. While spreads had widened further during the mid-2022 selloff, we believe the market now recognizes the quality differences between today's issuers and the HY market of the past. Just as we have seen in the last two years, Q3 2022 once again saw free cash flow increase, leverage decrease and solid cash on hand which we expect to provide a strong buffer to bridge an economic downturn if the economy stalls.

The extra yield investors demand to hold high yield bonds over U.S. Treasuries (as reflected in the option-adjusted spread, or OAS) has risen to 481 basis points (bps) as of 12/31/22 from 310 bps on 12/31/21. Meanwhile, the yield to worst, or the lowest rate an investor can expect to earn short of a default, on the ICE BofA US High Yield Index hit 8.99% on 12/31/22.

Chart 1. Spread Alert: High Yield OAS Represents an Enticing Entry Point

	Date	$ Price	YTW	OAS
High Yield Bonds	12/31/21	103.31	4.32%	310
	12/31/22	85.88	8.98%	481
BB Rated Bonds	12/31/21	105.51	3.40%	211
	12/31/22	89.25	7.26%	308
B Rated Bonds	12/31/21	102.25	4.69%	351
	12/31/22	87.04	9.34%	515
CCC Rated Bonds	12/31/21	96.21	7.81%	678
	12/31/22	70.05	15.69%	1170

Source: Standard & Poor's; High Yield Bonds represented by ICE BofA US High Yield Index (H0A0); BB Rated Bonds represented by ICE BofA BB US High Yield Index (H0A1); B Rated Bonds represented by ICE BofA Single-B US High Yield Index (H0A2); CCC Rated Bonds represented by ICE BofA CCC & Lower US High Yield Index (H0A3). **Past performance is not indicative of future results.**

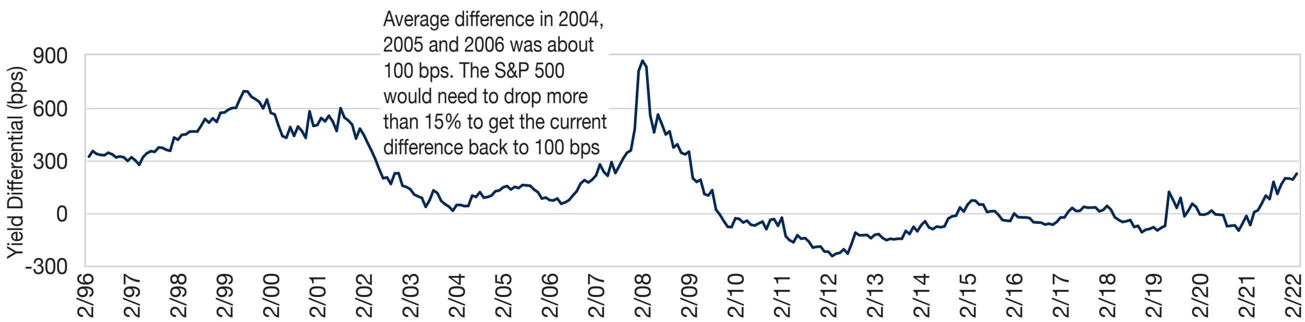
continued

TWO B'S OR NOT TWO B'S?

BB yields are now exceeding the earnings yield* for the S&P 500®, underscoring the potential benefit of diversifying away from equities (Chart 2). We believe this graph demonstrates the relative attractiveness of the higher quality portion of the high yield market versus equities as BBs outyield the S&P 500 earnings yield at the greatest amount since the GFC.

Chart 2. BB Yield Exceeds S&P 500 Earnings Yield

Difference Between S&P 500 Earnings Yield and BB Yield



As of 12/31/22.
Past performance is not indicative of future results.
Source: Standard & Poor's; BB Rated Bonds represented by ICE BofA BB US High Yield Index.

CURRENT YIELDS SUPPORT IMPROVED RETURN OUTLOOK

Chart 3 illustrates how investors can still capture much of the upside of equities. With yields at current levels, high yield bonds have historically shown strong performance over the next 12 months.

Chart 3. High Yield Forward Performance as Yields Breach Various Barriers

	HY Forward Returns (%)				HY Spread-to-worst Change (bps)			
Yield Barrier	**3 months**	**6 months**	**9 months**	**12 months**	**3 months**	**6 months**	**9 months**	**12 months**
7.0	-0.30	0.52	4.06	3.22	48	40	28	85
7.5	1.13	0.88	6.00	7.08	14	33	-25	-18
8.0	2.61	3.31	9.27	13.05	-29	-25	-106	-155
8.5	2.45	5.67	11.70	15.41	-30	-49	-124	-189
9.0	4.89	10.44	15.30	19.19	-89	-150	-209	-289

Source: JPMorgan Research 1/6/23. **Past performance is not indicative of future results.**

RISING STARS COULD PRESAGE AN ATTRACTIVE SUPPLY/DEMAND CONSTRUCT

The high yield sector is seeing value through several avenues…but at what risk? Trading activity at the end of 2022 exposed less liquid, more controversial type positions cheap to many of their more liquid counterparts. However, technical issues within the sector are providing an overlay to an already attractive BB segment of the HY market. Strong balance sheets, high free cash flow, lower leverage, a benign ratings

*The earnings yield refers to the earnings per share for the most recent 12-month period divided by the current market price per share. The earnings yield (the inverse of the P/E ratio) shows the percentage of a company's earnings per share.

profile for high yield bonds (11% of high yield universe is rated CCC – versus the historical average of 22%) shows the underlying strength of the high yield space. Lower expected issuance and an expected record-high par value of HY bonds becoming rising stars, moving up to investment grade ratings, makes for an attractive supply/demand construct. Should expectations become reality, the BB segment could contract by approximately 9-10% creating a shortfall of securities while demand rises.

COMPANIES ARE PERFORMING A GREAT BALANCING ACT: LOOK AT THE BALANCE SHEET CASH AND FREE CASH FLOW

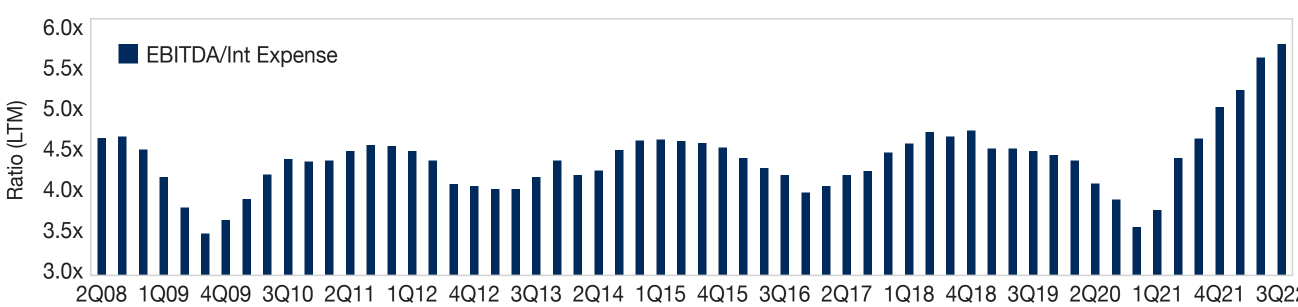
Chart 4. High Yield Issuers Maintain $225bn in Cash and Generate $116bn in FCF

Sector	Debt	Cash	FCF	Cash+ FCF/Debt
Utilities	54,201	2,196	465	5%
Telecoms	60,161	1,735	3,199	8%
Cable	154,182	5,053	10,951	10%
Packaging/Paper	56,745	5,386	925	11%
Travel	136,964	21,834	-3,133	14%
Food Producers	32,034	2,924	1,558	14%
Capital Goods	71,556	11,433	694	17%
Retail	113,379	13,171	8,868	19%
Gaming	90,962	14,015	4,407	20%
Media	118,326	18,326	7,325	22%
Real Estate	65,013	8,397	6,046	22%
Chemicals	36,988	5,415	3,704	25%
Transportation	28,113	8,314	-1,315	25%
Healthcare	140,503	20,172	16,082	26%
Energy	160,543	13,770	36,865	32%
Technology	59,758	15,090	7,098	37%
Autos	95,582	51,673	5,772	60%
Metals	20,163	6,422	6,193	63%
BB	731,637	122,694	101,695	31%
B	607,233	93,598	17,343	18%
CCC	156,305	9,033	-3,333	4%
HY	**1,495,175**	**225,325**	**115,705**	**23%**

Source: BofA Global Research 9/30/22. **Past performance is not indicative of future results.**

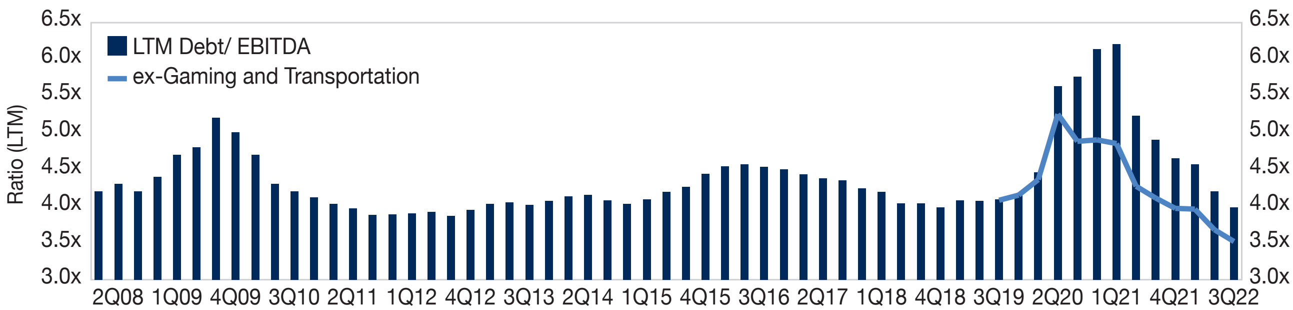
The fundamentals of the market are also supportive. As the following graph shows, interest coverage ratios for the asset class are at the highest levels ever reported for the asset class.

Coverage



Source: JPMorgan 9/30/22.

Further, leverage ratios are right at the lowest levels ever for the asset class and are at the lowest levels ever if adjusted for gaming and transportation that are still benefiting from the economy reopening.



Source: JPMorgan 9/30/22.

While fundamentals will likely weaken through 2023, the asset class is entering the expected slowdown in its best fundamental shape ever. We believe this will be an important consideration keeping defaults below past cycle highs. In addition, we believe the asset class has evolved over the past 15+ years to consist of larger companies. As a result, we believe investors waiting for past recessionary spread levels to reenter the asset class could end up being disappointed as the asset class ends up proving more resilient than many anticipate.

TIME TO SAY HI AGAIN TO HIGH YIELD?

Better valuations, stronger earnings yields, historically attractive performance, and solid balance sheets for many issuers may provide a liquidity buffer and downside protection IF we enter an economic downturn.

Chart 5. High Yield May Offer Downside Protection vs. Equities While Allowing Investors to Potentially Still Capture Much of the Upside

High Yield Bonds vs. Equity Market

				Rolling 3-Year Periods		
7/1/83-12/31/22	Annualized Return	Standard Deviation	Return per Unit of Risk	Best	Worst	% Negative
High Yield	8.12%	8.40%	1.0	26.4%	-7.6%	5%
Large-Cap Equity	10.82%	15.22%	0.7	33.3%	-16.1%	13%
Small-Cap Equity	8.58%	19.52%	0.4	32.0%	-17.8%	11%

The High Yield, Large Cap Equity, and Small Cap Equity Markets are represented by the Bloomberg U.S. Corporate High Yield Index, S&P 500® Index, and the Russell 2000® Index, respectively. Returns were calculated using monthly data and begin with the inception of the Bloomberg High Yield Credit Index on 7/1/83.
Past performance is not indicative of future results.
Source: Standard & Poor's, FTSE Russell, Bloomberg

About Seix Investment Advisors

Seix Investment Advisors is an investment management boutique focused exclusively on managing fixed income strategies since 1992. Seix seeks to generate competitive absolute and relative risk-adjusted returns over the full market cycle through a bottom-up focused, top-down aware process. Seix employs multi-dimensional approaches based on strict portfolio construction methodology, sell disciplines, and trading strategies with prudent risk management as a cornerstone.

To learn more about Seix Investment Advisors, please visit seixadvisors.com.

For information regarding our subadvised mutual funds, please visit virtus.com or call 1-800-243-4361.

The **J.P. Morgan U.S. High Yield Index** is designed to mirror the investable universe of the U.S. dollar domestic high yield corporate debt market. The **ICE BofA US High Yield Cash Pay Index** is an unmanaged index consisting of all domestic and Yankee high-yield bonds maturing over one year. The quality range is less than BBB-/Baa3 but not in default (DDD1 or less). The index does not reflect the deduction of expenses associated with a mutual fund, such as investment management and fund accounting fees. A fund's performance reflects the deduction of fees for these services. The **ICE BofA US High Yield Index** (H0A0) tracks the performance of U.S. dollar denominated below investment grade rated corporate debt publicly issued in the U.S. domestic market. To qualify for inclusion in the index, securities must have a below investment grade rating and an investment grade rated country of risk. The **ICE BofA BB US High Yield Index** (H0A1) is a subset of the ICE BofA US High Yield Master II Index and includes all securities with a given investment grade rating BB. The **ICE BofA CCC & Lower US High Yield Index** (H0A3) subset includes all securities with a given investment grade rating CCC or below. The **ICE BofA Single-B US High Yield Index** (H0A2) subset includes all securities with a given investment grade rating B. The **Russell 2000® Index** is a market capitalization-weighted index of the 2,000 smallest companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. The index is calculated on a total return basis with dividends reinvested. The **S&P 500® Index** is a free-float market capitalization-weighted index of 500 of the largest U.S. companies. The index is calculated on a total return basis with dividends reinvested. The **Bloomberg U.S. Corporate High Yield Bond Index** is an unmanaged market value weighted index that covers the universe of fixed rate, non-investment grade debt. The indexes are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and are not available for direct investment.

IMPORTANT RISK CONSIDERATIONS

Credit & Interest: Debt securities are subject to various risks, the most prominent of which are credit and interest rate risk. The issuer of a debt security may fail to make interest and/or principal payments. Values of debt securities may rise or fall in response to changes in interest rates, and this risk may be enhanced with longer-term maturities. **High Yield-High Risk Fixed Income Securities:** There is a greater level of credit risk and price volatility involved with high yield securities than investment grade securities. **Foreign Investing:** Investing internationally involves additional risks such as currency, political, accounting, economic, and market risk. **Industry/Sector Concentration:** A fund that focuses its investments in a particular industry or sector will be more sensitive to conditions that affect that industry or sector than a non-concentrated fund. **Market Volatility:** The value of the securities in the portfolio may go up or down in response to the prospects of individual companies and/or general economic conditions. Price changes may be short- or long-term. Local, regional, or global events such as war (e.g., Russia's invasion of Ukraine), acts of terrorism, the spread of infectious illness (e.g., COVID-19 pandemic) or other public health issues, recessions, or other events could have a significant impact on the portfolio and its investments, including hampering the ability of the portfolio's manager(s) to invest the portfolio's assets as intended. **Prospectus:** For additional information on risks, please see a fund's prospectus.

A Basis Point (bp) is equal to 0.01%.

Not all products or marketing materials are available at all firms.

Not insured by FDIC/NCUSIF or any federal government agency. No bank guarantee. Not a deposit. May lose value.