CORPORATE CREDIT

ARISTOTLE
CREDIT PARTNERS

3Q 2023 Commentary – Institutional

Summary

U.S. corporate credit markets were mixed in the third quarter, as the yield curve bear steepened and credit spreads ended the quarter nearly unchanged. For the second consecutive quarter, bank loans outperformed both high yield bonds and investment grade corporate bonds, returning 3.37%, as measured by the Credit Suisse Leveraged Loan Index. High yield bonds ended the quarter marginally higher, as the Bloomberg U.S. Corporate High Yield Bond Index gained 0.46%. With higher yields impacting longer duration bonds, investment grade corporate bonds struggled, and the Bloomberg U.S. Corporate Bond Index returned -3.09%. The Bloomberg U.S. Aggregate Bond Index recorded its worst quarter of the year, returning -3.23% during the quarter and -1.21% for the year-to-date period.

Equities declined modestly during the third quarter, as the S&P 500 Index returned -3.27%, its first quarterly loss in a year. While the Index had a strong start to the third quarter on the back of rising expectations for a "soft landing," growing concerns about the higher-for-longer trajectory of Federal Reserve (Fed) policy began to weigh on risk assets. Higher U.S. yields added fuel to the fire, as markets began scaling back expectations of policy easing in 2024. The selloff in longer-dated bonds accelerated in September, following a larger-than-expected quarterly refunding announcement from the U.S. Treasury. Furthermore, both energy prices and the U.S. dollar also rose during the quarter, with West Texas Intermediate (WTI) crude oil gaining 28.5%, hitting its highest level for the year, and the U.S. Dollar Index adding 3.2%.

U.S. economic data remained fairly strong but showed signs of slowing in the latter half of the quarter. Consumer price inflation (CPI) showed signs of stabilizing, as the annual headline rate bounced from a low of 3.0% in June to 3.7% in August. The annual core CPI rate, however, fell to its lowest since September 2021 at 4.3%, still well above the Fed's target. Labor market conditions showed signs of easing slightly, as monthly job gains fell below 200,000 for the third straight month in August and the unemployment rate ticked up to 3.8%, above expectations and its highest level since February 2022.

At its July meeting, the Fed announced another 25-basis-point hike, bringing its benchmark rate to a range of 5.25% to 5.50%, a 22-year high. Despite leaving rates unchanged at its September meeting, the Fed left the door open to further increases and reiterated its stance that interest rates will likely remain higher for longer. The Fed's Summary of Economic Projections released in September signaled that the committee only expects 50 basis points of cuts in 2024, indicating the benchmark rate could remain above 5% through the end of next year. Nonetheless, concerns around the lagged impact of monetary policy in an environment of slowing global growth added uncertainty to the macroeconomic picture at the end of the quarter.

Market Environment

U.S. Treasuries were weaker across the curve in the third quarter, as the bear-steepening move partially reversed some of the flattening that occurred in the first two quarters of the year. While the yield on the U.S. 2-year note rose roughly 17 basis points during the quarter, yields in the longer-end accelerated higher, with the yield on the U.S. 10-year note and 30-year bond climbing roughly 76 and 85 basis points, respectively. Although the yield curve remained inverted at the end of the quarter, the yield spread between the 2-year and 10-year notes narrowed by nearly 60 basis points.

Despite the abrupt move higher in U.S. yields, credit spreads held in relatively well. After falling to the lows of the year in early September, high yield bond spreads retraced the move and ended the quarter roughly 4 basis points wider, as measured by the Bloomberg U.S. Corporate High Yield Bond Index. Investment grade corporate bond spreads were also reasonably well contained, tightening roughly 2 basis points, as measured by the Bloomberg U.S. Corporate Bond Index.

High yield bond and leveraged loan issuance picked up, with particularly strong volumes in September, following a prolonged period of moribund activity. High yield bond issuance totaled nearly $25 billion in September, the highest monthly volume since January 2022, bringing the quarterly total to just over $41 billion. Year-to-date high yield bond issuance of nearly $137 billion is roughly 52% higher than the same period in 2022 but still low by historical standards. Leveraged loan new-issue volume also bounced back, topping $122 billion during the quarter and bringing the year-to-date sum to nearly $260 billion, roughly 26% higher than the total in the first three quarters of 2022.

High yield bond funds experienced modest outflows, reversing inflows seen during the second quarter. The quarterly outflow of nearly $4 billion brought the year-to-date total outflow from high yield bond funds to just over $14 billion, well below 2022's total outflow that topped $54 billion in the first nine months of the year. Leveraged loan fund flows saw a slight reversal of fortunes in the third quarter, with inflows in August and September breaking a string of 15 consecutive monthly outflows. The quarterly retail inflow of roughly $1 billion cut the year-to-date total outflow from leveraged loan funds to roughly $18 billion, significantly below the $66 billion outflow seen in the first nine months of 2022. Additionally, collateralized loan obligation (CLO) demand picked up during the quarter, with U.S. CLO volume topping $38 billion, the highest since the second quarter of last year.

Within the high yield bond market, lower-quality bonds continued to outperform in the third quarter, as 'CCC's (+2.15%) outperformed 'B's (+0.84%) and 'BB's (-0.39%). With the rout in interest rates impacting the higher-quality, more rate-sensitive segment of the market, 'CCC's added to year-to-date outperformance, topping 'B's by roughly 5.77% and 'BB's by 8.15% in the first nine months of the year. From an industry perspective, within the Bloomberg U.S. High Yield Bond Index, Banking (+3.18%) outperformed, while Utilities (-0.98%) underperformed, given the steeper yield curve.

Defaults and distressed exchanges moderated, as high yield bond and leveraged loan default rates fell from 2-year highs in June. The 12-month trailing, par-weighted U.S. high yield default rate, including distressed exchanges, fell roughly 60 basis points to end the quarter at 2.11% (1.32%, excluding distressed exchanges), below the long-term historical average of 3.20% (2.90%, excluding distressed exchanges). Meanwhile, the loan par-weighted default rate, including distressed exchanges, fell roughly 30 basis points to end September at 2.66% (1.90%, excluding distressed exchanges), also below the long-term historical average of 3.10% (3.00%, excluding distressed exchanges).

Performance and Attribution Summary

High Yield Bond

The Aristotle High Yield Bond Composite returned 0.32% gross of fees (0.26% net of fees) in the third quarter, outperforming the 0.23% return of the ICE BofA BB-B U.S. Cash Pay High Yield Constrained Index. Security selection was the primary contributor to relative performance. Industry allocation and sector rotation also contributed modestly to relative performance.

Security selection contributed to relative performance led by holdings in Finance Companies and Pipelines & Distributors. This was partially offset by selection in Cable & Satellite and Energy. Industry allocation also contributed to relative performance led by overweights in Energy and Finance Companies. This was partially offset by underweights in Cable & Satellite and Industrials. Additionally, sector rotation contributed to relative performance led by the allocation to cash. This was mostly offset by the allocation to investment grade corporate bonds.

Top Five Contributors	Top Five Detractors
Air Lease	DISH Network
Ferrellgas Partners	**Hughes Satellite Systems**
Energy Transfer	**Resolute Investment Managers**
Vermilion Energy	**Lions Gate Capital**
Precision Drilling	**Dynegy**

**Bold securities held in representative account*

Investment Grade Corporate

The Aristotle Investment Grade Corporate Bond Composite returned -2.29% gross of fees (-2.35% net of fees) in the third quarter, outperforming the -3.09% return of the Bloomberg U.S. Corporate Bond Index. Security selection was the primary contributor to relative performance. Industry allocation and sector rotation also contributed modestly to relative performance.

Security selection contributed to relative performance led by holdings in Banking and Utilities. This was partially offset by selection in Brokerage and Healthcare. Industry allocation contributed to relative performance led by overweights in Insurance and Utilities. This was partially offset by an overweight in Gaming and an underweight in Energy. Sector rotation also contributed to relative performance led by the allocations to high yield bonds and cash. There were no offsetting detractors. Duration and yield curve positioning also contributed to relative performance, with no offsetting detractors.

Top Five Contributors	Top Five Detractors
Wells Fargo	**Discover Financial**
PG&E	**State Street**
Alexandria Real Estate	**Cigna**
MetLife	**Ally Financial**
Energy Transfer	**VMware**

**Bold securities held in representative account*

Outlook

While U.S. yields continued to push higher and volatility began to pick up during the third quarter, we believe U.S. corporate credit markets remain in good shape. In our opinion, solid corporate balance sheets and a resilient U.S. economy should be supportive of corporate credit. Even with a more uncertain outlook and the potential for an economic slowdown, we believe attractive income opportunities and favorable underlying fundamentals make a strong case for owning higher-quality corporate credit.

The third quarter ended with U.S. yields surging to levels not seen in over a decade, with the long end beginning to catch up with short-term yields. To put the move in perspective, compared to the end of 2021—less than 2 years ago—the yield on the U.S. 2-year and 10-year notes has risen roughly 430 and 300 basis points, respectively. After an extended period of artificially low interest rates following the global financial crisis (GFC), we believe markets could be entering a period of more "normal" interest rates from a historical perspective. With breakeven rates having been fairly rangebound this year, inflation expectations have not been the catalyst for higher rates. Instead, it has more likely been the result of a rising term premium and uncertainty around expectations for increased supply, which will be required to finance fiscal deficits going forward.

Globally, we think markets are slowly beginning to adjust to an environment of elevated interest rates. While interest rates may have less room to run to the topside in the short term, there are additional risks that could add pressure over the next year, including the Fed's continued commitment to quantitative tightening (QT), the marginal impact of lower foreign demand for U.S. Treasuries and additional changes in global central bank policy. In particular, we will be watching for any potential tweaks to the Bank of Japan's yield curve control policy, which could have knock-on effects for financial markets. Overall, we believe it is prudent to expect rates to remain elevated, and we would not rule out another leg up in rates next year.

Nonetheless, U.S. economic resilience continues to surprise markets, as widespread fears of a looming recession keep getting pushed back. While consumer spending and economic growth are beginning to show some signs of slowing, the labor market remains much stronger than expected given where we are in the cycle. Additionally, fiscal stimulus from the Inflation Reduction Act (IRA) can be expected to continue flowing into the economy, which could act as a counterweight to cyclical headwinds. Wages are also beginning to catch up with inflation, which may help offset potentially weaker consumer spending.

We believe corporate credit spreads may widen from current levels, with more differentiated performance across quality tiers. Technical factors have been a tailwind for bond markets this year, especially in the high yield market. However, we expect these factors to recede in the coming quarters, as more companies face the reality of higher interest rates. Higher yields will likely be much slower to impact the investment grade corporate bond markets, as many high-grade companies termed out debt in the past few years. In the high yield market, the impact of higher rates will likely be felt by the lower quality segment of the market, especially those facing large maturities in the next two years. As a result, we expect to see increasing default rates next year. Nonetheless, we believe the higher-quality segment of the market should be able to withstand a mild downturn, thus offering an opportunity for income potential and positive total returns.

High Yield Bond Positioning

In our high yield bond portfolios, we continued to focus on higher-quality credits, while maintaining a duration underweight relative to the benchmark. From an industry perspective, we reduced exposure to more cyclical industries while selectively adding exposure to more idiosyncratic themes, remaining cautious on lower-quality credits with significant refinancing needs over the next few years.

Higher-quality credits underperformed during the quarter, driven mostly by rate sensitivity, and if rates are to stabilize at current levels, we would expect to see them begin to outperform. For the lower-quality segments of the market, we believe the emerging refinancing risk outweighs any short-term opportunities. With credit spreads ending the quarter at historically low levels, we also remain cautious on segments of the market where we see tighter spreads than the broader market, which we would expect to underperform in the event of spread widening driven by slowing economic growth.

From an industry perspective, we reduced exposure to more cyclical industries such as Transportation, while selectively adding exposure to idiosyncratic themes, including propane distributors within Retailers & Restaurants. At the end of the

quarter, we held overweights in Energy, Transportation and Lodging & Leisure alongside underweights in Technology, Telecommunications and Cable & Satellite.

Investment Grade Corporate Positioning

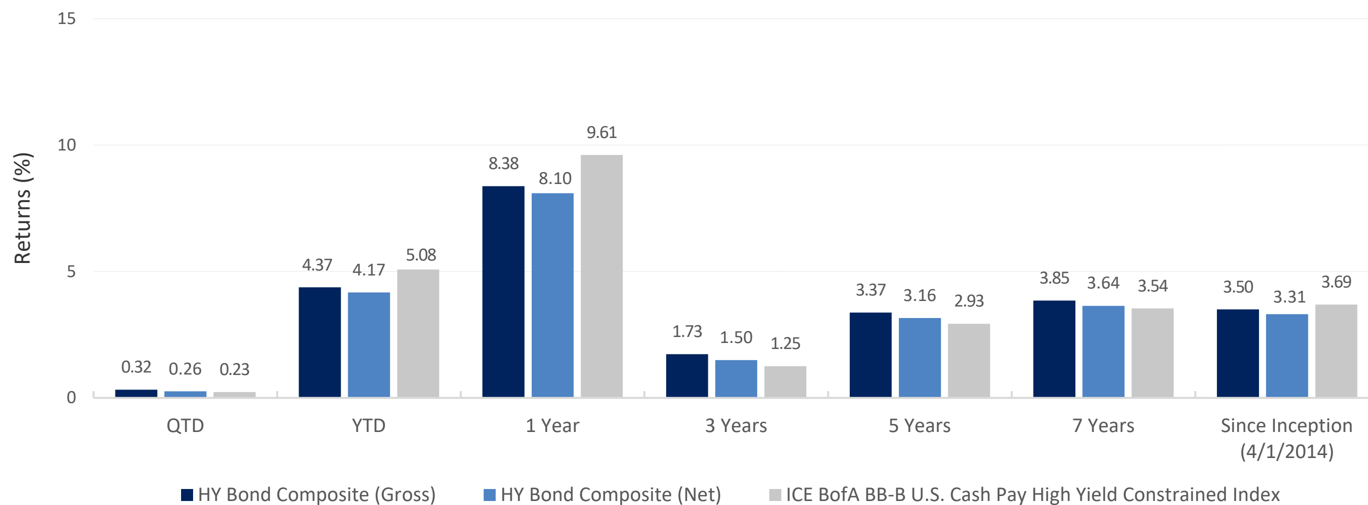
In our investment grade corporate bond portfolios, we maintained a neutral stance on duration relative to the benchmark, while also reducing an overweight to 'BBB'-rated credits. From an industry perspective, we reduced cyclical exposure.

From a duration perspective, we began shifting to a more neutral stance relative to the benchmark toward the end of the second quarter and kept duration positioning fairly consistent during the third quarter. We continued to reduce exposure to split-rated/crossover credits (BBB/BB) and began reducing exposure to 'BBB'-rated credits, shifting into higher-quality tiers, specifically 'A'-rated credits. While we believe corporate earnings and balance sheets should remain strong, we think current valuations do not warrant additional risk-taking.

Industry-wise, we continued to add exposure to less cyclical industries, increasing overweights in Utilities and Insurance, and reduced exposure to more cyclical industries, reducing overweights in Finance Companies and Pipelines & Distributors. At the end of the quarter, we held overweights in Utilities, Insurance and Real Estate Investment Trusts (REITs) & Real Estate-Related alongside underweights in Banking, Food, Beverage & Tobacco and Diversified Manufacturing & Construction Machinery.

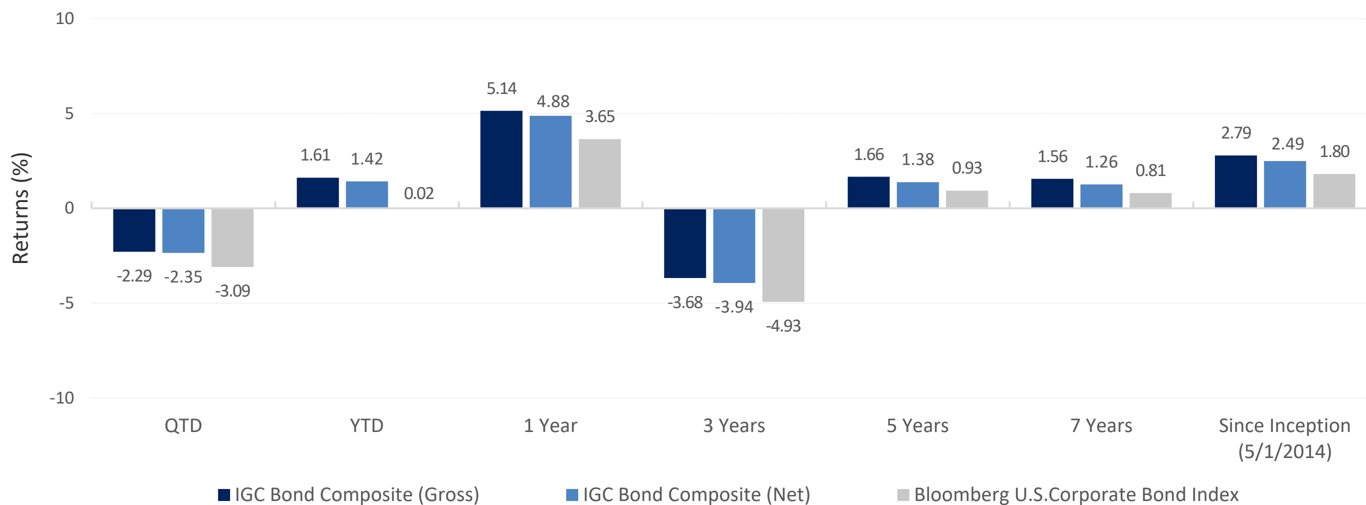
Aristotle High Yield Bond Composite Performance

All Periods Ended September 30, 2023



Year	High Yield Bond Composite (Gross %)	High Yield Bond Composite (Net %)	ICE BofA BB-B U.S. Cash Pay High Yield Constrained Index (%)
2023 YTD*	4.37	4.17	5.08
2022	-7.26	-7.48	-10.59
2021	4.30	4.09	4.58
2020	6.01	5.81	6.32
2019	13.61	13.41	15.09
2018	-0.94	-1.12	-2.04
2017	6.42	6.24	6.98
2016	12.05	11.86	14.76
2015	-2.21	-2.37	-2.82
2014**	-1.21	-1.30	0.49
SUPPLEMENTAL PERFORMANCE			
2013	7.87	7.29	6.29
2012	14.32	13.70	14.58
2011	4.55	3.97	5.43
2010	14.77	14.15	14.25
2009***	27.88	27.31	39.81

Sources: SS&C Advent; ICE BofA
**Composite returns are preliminary pending final account reconciliation.*
***2014 is a partial-year period of nine months, representing data from April 1, 2014 to December 31, 2014.*
****2009 is a partial-year period of ten months, representing data from March 1, 2009 to December 31, 2009.*
Past performance is not indicative of future results. Composite returns are presented gross and net of investment advisory fees and include the reinvestment of all income. Gross returns will be reduced by fees and other expenses that may be incurred in the management of the account. Net returns are presented net of actual investment advisory fees and after the deduction of all trading expenses. The Aristotle High Yield Bond strategy has an inception date of April 1, 2014; however, the strategy initially began at Douglas Lopez's predecessor firm. A supplemental performance track record from March 1, 2009 to December 31, 2013 (Mr. Lopez's departure from the firm) is provided. The returns are based on a separate account from the strategy while it was being managed at Doug Lopez's predecessor firm and performance results are based on custodian data. During this time, Mr. Lopez had primary responsibility for managing the account. Please refer to disclosures at the end of this document.



Year	Investment Grade Corporate Bond Composite (Gross %)	Investment Grade Corporate Bond Composite (Net %)	Bloomberg U.S. Corporate Bond Index (%)
2023 YTD*	1.61	1.42	0.02
2022	-14.15	-14.37	-15.76
2021	-0.81	-1.10	-1.04
2020	8.64	8.41	9.89
2019	16.34	15.94	14.54
2018	-2.41	-2.76	-2.51
2017	6.93	6.56	6.42
2016	8.69	8.46	6.11
2015	0.58	0.08	-0.68
2014**	3.87	3.84	3.16
SUPPLEMENTAL PERFORMANCE			
2013	0.63	0.28	-1.53
2012	15.38	14.98	9.82
2011	8.48	8.10	8.15
2010	11.42	11.04	9.00
2009***	2.93	2.81	3.15

Sources: SS&C Advent, Bloomberg

**Composite returns are preliminary pending final account reconciliation.*

***2014 is a partial-year period of eight months, representing data from May 1, 2014 to December 31, 2014.*

****2009 is a partial-year period of four months, representing data from September 1, 2009 to December 31, 2009.*

Past performance is not indicative of future results. Composite returns are presented gross and net of investment advisory fees and include the reinvestment of all income. Gross returns will be reduced by fees and other expenses that may be incurred in the management of the account. Net returns are presented net of actual investment advisory fees and after the deduction of all trading expenses. The primary benchmark was retroactively changed from Bloomberg U.S. Credit Bond Index to Bloomberg U.S. Corporate Bond Index effective March 31, 2017. The Aristotle Investment Grade Corporate Bond strategy has an inception date of May 1, 2014; however, the strategy initially began at Terence Reidt's predecessor firm. A supplemental performance track record from September 1, 2009 to December 31, 2013 (Mr. Reidt's departure from the firm) is provided. The returns are based on a separate account from the strategy while it was being managed at Terence Reidt's predecessor firm and performance results are based on custodian data. During this time, Mr. Reidt had primary responsibility for managing the account. Please refer to disclosures at the end of this document.

DISCLOSURES:

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Composite and benchmark returns reflect the reinvestment of income. Composite returns are presented gross and net of investment advisory fees and include the reinvestment of all income. Gross returns will be reduced by fees and other expenses that may be incurred in the management of the account. Net returns are presented net of actual investment advisory fees and after the deduction of all trading expenses.

The Bloomberg U.S. Aggregate Bond Index is a broad base, market capitalization-weighted bond market index representing intermediate term investment grade bonds traded in the United States. The Index is frequently used as a stand-in for measuring the performance of the U.S. bond market. In addition to investment grade corporate debt, the Index tracks government debt, mortgage-backed securities (MBS) and asset-backed securities (ABS) to simulate the universe of investable bonds that meet certain criteria. In order to be included in the Index, bonds must be of investment grade or higher, have an outstanding par value of at least $100 million and have at least one year until maturity. The Bloomberg U.S. Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes securities publicly issued by U.S. and non-U.S. industrial, utility and financial issuers that are all U.S. dollar denominated. The Bloomberg U.S. Corporate Bond Index is a component of the Bloomberg U.S. Credit Bond Index. The Bloomberg U.S. Corporate High Yield Bond Index measures the U.S. dollar-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on Bloomberg EM country definition, are excluded. The S&P 500 Index is the Standard & Poor's Composite Index and is a widely recognized, unmanaged index of common stock prices. It is market cap weighted and includes 500 leading companies, capturing approximately 80% coverage of available market capitalization. The ICE Bank of America (ICE BofA) BB-B U.S. Cash Pay High Yield Constrained Index measures the performance of the U.S. dollar-denominated BB-rated and B-rated corporate debt issued in the U.S. domestic market, a fixed coupon schedule and a minimum amount outstanding of $100 million, issued publicly. Allocations to an individual issuer in the Index will not exceed 2%. The Credit Suisse Leveraged Loan Index is a market-weighted index designed to track the performance of the investable universe of the U.S. dollar-denominated leveraged loan market. Consumer Price Index is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. The WTI Crude Oil Index is a major trading classification of sweet light crude oil that serves as a major benchmark price for oil consumed in the United States. The U.S. Dollar Index (DXY) is a measure of the value of the U.S. dollar relative to the value of a basket of currencies of the majority of the United States' most significant trading partners. The volatility (beta) of the Composites may be greater or less than the indices. It is not possible to invest directly in these indices. Composite and index returns reflect the reinvestment of income.

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