



Executive Summary

In 2010, we published an overview of what we described as opportunities for investors in secured bank loans¹. Since then, many of the trends we highlighted have developed further, and a clearer view is now emerging of the potential attractions of the loan market to investors. We have therefore produced an update restating our case for the asset class, reviewing important developments over the last year and providing our outlook for the market.

We believe an allocation to secured bank loans has the potential to provide:

- Absolute returns in high single digits
- Inflation protection through a floating interest rate (returns increase as interest rates rise)
- Direct, secured exposure to corporate credit, an easily understood, traditional asset class
- Low volatility of returns
- Access to assets via a deep pipeline of primary assets and an established and regularly traded secondary market
- The opportunity to diversify exposure by issuer, industry and geography
- The highest new issue credit spreads and strongest deal structures that have been available in over a decade

Since our original report, secondary market prices for loans have continued their recovery. However, we have not seen a return by investors to the practice of investing in the loan market on a levered basis. Consequently, we expect that the unprecedented drop in loan prices witnessed in 2008 and 2009 is unlikely to be repeated.

The new issue market for loans has re-opened. Loan issuance in Europe has outpaced that of high yield bonds for the first time since the global financial crisis. Companies seeking to manage their debt maturities are finding access to the high yield bond market restricted due to heightened perceptions of global risk and a desire to shorten duration, given the prospect of inflation and higher interest rates. Instead we find those companies are again turning to the loan market.

We consider terms for new deals to be exceptional with respect to potential returns and the strength of lender protection through security, leverage and covenant packages. In our view, the current vintage of loan origination is likely to provide the greatest return for the lowest risk that has been seen in the market for some time.

Investing in Debt: Opportunities in Secured Bank Loans

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¹ Paul Hatfield and Simon Perry, "Investing in Debt: Opportunities in Leveraged Loans," BNY Mellon Asset Management/Alcentra, June 2010. See Alcentra Group disclosures at back.

In addition, we believe Europe potentially offers better value than the US, with higher spreads and more secure deal terms.

The concentration of loan maturities between 2012 and 2015 identified in our last report has been reduced through loan refinancing, high yield bond refinancing and amend-to-extend agreements with lenders; however a significant “wall of maturities” remains. This will serve to keep new issue spreads wide and leverage low. As the stronger credits are refinanced, the average credit quality of the borrowers remaining in the “wall of refinancing” may deteriorate. We believe this will likely provide a compelling universe of opportunities for experienced distressed debt investors.

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Rethinking Asset Allocation Choices

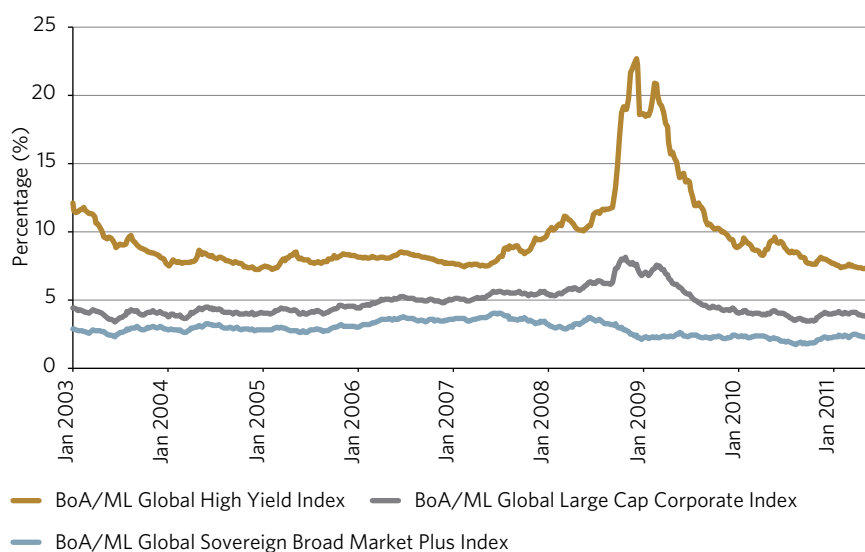
Continued volatility in equity and bond markets has caused many institutional investors to review their asset allocation choices. Some have chosen to reduce their allocations to equity markets in favour of other asset classes that provide a more predictable return profile.

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The fixed income markets have been a major beneficiary of this shift. Determining expected return in the equity markets requires forming a view of likely growth in earnings and profits over an investment horizon, which is very hard to do. By contrast, returns from fixed income are defined at the point of investment by the coupon and knowledge that the principal is to be returned by contract at maturity. Rather than take a view on equity market growth, the investor must analyse the risk of default of the issuer and the expected loss following default.² Each of these risks can be estimated through detailed credit analysis, particularly in the case of corporate credit where investors have access to detailed financial information on the borrower.

Within fixed income there are a variety of segments to consider: government bonds, investment grade corporate bonds and sub-investment grade corporate bonds and loans. Exhibit 1 shows the yields on these different categories since 2003.

Exhibit 1 - Yields on Global Fixed Income Asset Classes



Source: Markit Hub, BofA Merrill Lynch, June 23, 2011; please see appendix for index definitions.

Government bonds in particular have proven to be a challenging segment over the last year and are no longer regarded as the relatively risk-free asset they once were. The well documented debt problems in peripheral Europe and questions over US fiscal challenges have all contributed to uncharacteristic volatility in this asset class, presenting many more issues to consider before investing.

² In a hold-to-maturity approach, other risks, such as market value fluctuation, trading liquidity and changes in interest rates, may be less important.

The scale of institutional participation in the market for loans to sub-investment grade corporates in the US and Europe is comparable to that of the high yield bond market.

Many have come to regard investment grade corporate bonds a new safe haven. We believe this is indeed an asset class that provides transparency and liquidity. However, as more money flows to this sector, spreads are compressing. Corporate bond yields do not compete with those promised by the equity market, so by switching from equities to investment grade corporate bonds, asset allocators face a yield deficit that needs to be made up.

At this point, many investors begin to consider the potential higher returns offered in the sub-investment grade market.

Most investors consider high yield bonds to be the only instrument available to them within the sub-investment grade corporate space. This is perhaps due to the fact that bonds can trade through a centralised clearing system, so are easily accessible to large institutional investors and smaller asset managers. However, certain parts of the bank loan market have attracted increasing attention from institutional investors. The scale of institutional participation in the market for loans to sub-investment grade corporates in the US and Europe is comparable to that of the high yield bond market.

Understanding Secured Bank Loans

Unlike securities like corporate bonds, loans settle through the physical execution of legal documents. As a result, they require a higher degree of administration than a corporate bond. They are based on a floating interest rate, so Euribor/Libor settings and terms need to be noted. Lenders regularly have to respond to requests from borrowers for waivers to various terms of the loan documentation.

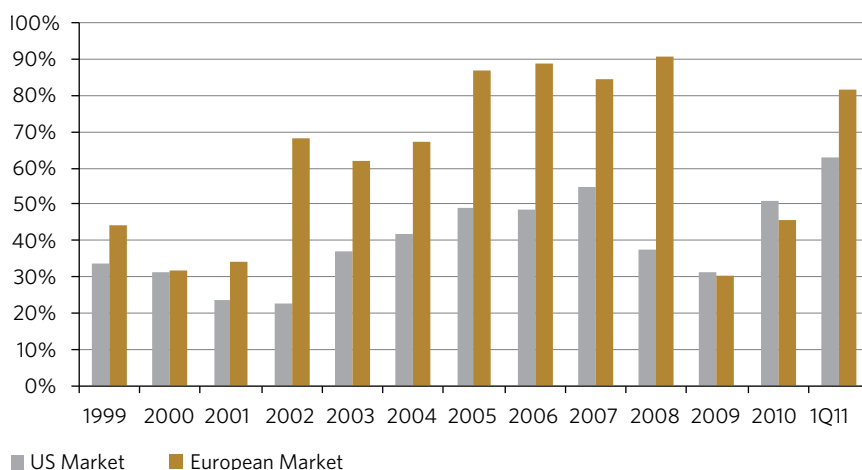
For these reasons, institutional investors, particularly in Europe, have been slow to embrace loans as an asset class. However, over the last 10 years the emergence of asset managers specialising in loan investment has made the asset class more accessible to less specialised investors.

When a company borrows from a bank, it typically does so via a loan. The loan is a bilateral agreement between the lender and the borrower. Banks are keen to lend to investment grade corporates and do so at interest rates typically lower than those available to the same company in the bond market. The banks aim to make up the difference by selling other services to the company like foreign exchange, derivatives and advisory, all of which command higher fees and which companies often source only from banks that agree to provide them with loan financing.

The sub-investment grade market is very different. In Europe, the majority of sub-investment grade borrowers are, or originally were, the subject of private equity-sponsored leveraged buyouts ("LBOs"). In the US, private-equity-backed LBOs account for around half the market (Exhibit 2). In these deals margins are higher to reflect the greater leverage applied to the businesses through the buyout and the absence of the corporate banking dynamics that drive traditional corporate facilities tighter. These are what are often referred to as "leveraged loans".

The loan is actually a collection of facilities ranking on an equal footing, typically consisting of a revolving credit facility, an amortising term loan A (TLA), and bullet maturity term loans B and C (TLB, TLC). Generally banks participate across all the tranches while institutional investors focus on the TLB and TLC parts, which are termed the “institutional tranches”.

Exhibit 2 – Sponsor Driven-Senior Loan Volume as Percentage of Total Volume



Source: Standard & Poor's LCD Leveraged Loan Review -US/Europe 1Q11.

In a typical deal, a private equity sponsor would put up between 30% and 70% of the purchase price of the business, then arrange an underwriting for a syndicated bank loan to finance the balance. A number of the larger banks (for example, JP Morgan, Bank of America, Deutsche Bank, Royal Bank of Scotland) specialise in underwriting this sort of loan. Once the private equity firm wins the bid for the company, the underwriting bank seeks to syndicate the loan to other banks and to institutional investors. Whilst bank buyers may further syndicate their position, institutional investors usually will retain the loan as their investment.

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A public rating is generally not required to ensure a successful syndication of the loan. Loan investors are comfortable forming their own view of the credit quality of the borrower through extensive due diligence. However, in the US and in some cases in the European market, the loan may be publicly rated and in many cases may have been privately rated. Typically borrowers in this market, were they to be rated, would in our opinion obtain sub-investment grade ratings in the BB to B range.

Borrowers represented in this market are generally substantial businesses with annual earnings before interest, taxation, depreciation and amortisation (“EBITDA”) in excess of US \$50 million per annum and enterprise values of over \$200 million. Often they are substantially larger. They are drawn from a diverse universe of industry sectors including healthcare, cable, telephony, chemicals, retail, broadcast media and manufacturing. Well known examples of borrowers in this market would include Wrigley's and J Crew in the US or Alliance Boots and Ineos in Europe.³

³ “J Crew Group Debt Weakens on 1Q Margin Compression,” Standard & Poor's LCD News, June 9, 2001; “Wrigley Plans High-Grade Bonds to Refi Bank Debt,” June 21, 2010; “Alliance Boots Term Debt Holds Steady on 1H Results,” November 3, 2010; “Ineos Tagets Cov-Lite Loan, Cross-Border Bond Issue for Refi,” June 30, 2011.

The more specialised nature of loan investors and the greater reliance on fundamental corporate analysis often means that in times of global market stress, new issues can be more successfully placed in this market than in the high yield market, which relies on building a much more diverse book of investors.

Secured Bank Loans Versus High Yield Bonds

High yield bonds and leveraged loans are issued by very similar sorts of businesses. Most high yield bond issuers will also have a bank loan in place, but not all borrowers via bank loans will want to or be able to access the high yield bond market.

The success of a high yield bond issue depends on the ability to build a large and diverse pool of investors. This requires the borrower to be well known and have a business that is easily understood by a wide range of investors. It also requires public disclosure of key financial information and typically a public rating.

Loans are different. They will often be syndicated to a smaller group of investors, each taking a larger slice of the loan. Loan investors are used to performing more detailed due diligence on companies that are less well known and may have shorter operating track records. Typically this will be the case when a private equity sponsor is seeking financing for a new LBO.

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In addition to this, there are some fundamental differences between the two forms of borrowing. Loans have the following characteristics that high yield bonds generally do not:

Secured on the operating assets of the borrower

Leveraged loans are secured on the assets of the operating company, in contrast to bonds, which are generally unsecured and issued at the holding company level. That is why leveraged loans are often referred to as “secured loans”. This gives lenders a much stronger claim on the assets of the business in the event of a default.

Higher recoveries

As a direct consequence of their secured nature, if the borrower defaults, recoveries under the loan generally will be greater than recoveries under the high yield bond. Typically loan recoveries have been between 50% and 100%, while recoveries on bonds have been between 30% and 50%. Specifically, between 1982 and 2010, average global corporate debt recovery rates on first-lien bank loans were 65.8% while the comparable figure for senior unsecured bonds was 36.7%.⁴

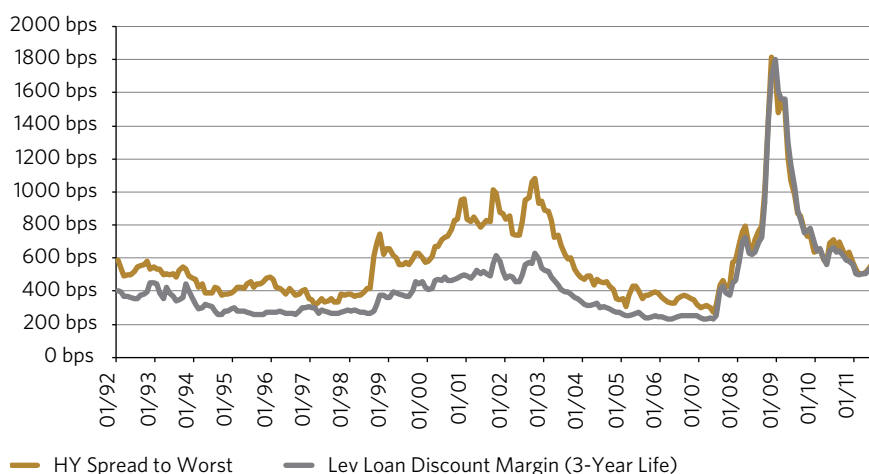
The higher recoveries and therefore lower risk in senior secured loans vs. high yield bonds have traditionally been reflected in a differential between the credit spreads offered on loans when compared to that offered on bonds. In order to compare credit spreads in the two asset classes it is necessary to adjust for the different duration of each instrument. We therefore look at the spread over the government yield curve for high yield bonds and the spread over Libor for loans.

⁴ “Corporate Defaults and Recovery Rates 1920–2010,” Moody’s Investor Service, February 2011.

Since it is nearly always the case that a default results in a lower loss to the secured loan lender than will be experienced by the high yield bond investor, it follows that signs of potential stress will have a greater effect on the price of the bond in the secondary market than they would on the loan.

Traditionally, bonds have offered higher credit spreads in compensation for the greater risk of loss due to the unsecured nature of the instrument. The differential is volatile, but tends to be anything between 50 and 150 basis points (bps). In specific periods, the differential can be much higher (Exhibit 3). However, since the credit crisis, this relationship has broken down and loans now offer a greater spread than bonds providing about 60bps more in credit spread. Part of this differential can perhaps be explained by a perception of lower liquidity in the loan market than is achievable in the bond market but this does not fully explain the yield gap. Historical data suggest this is a powerful argument in favour of loans offering a more attractive return given their higher expected recovery rate when compared to bonds.

Exhibit 3 - US High Yield and Leveraged Loan Spreads



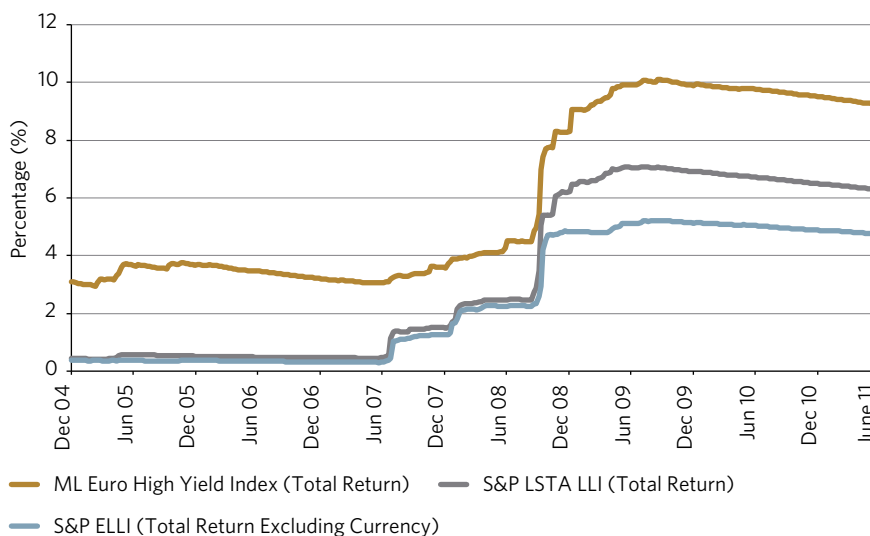
Source: Markit Hub, Credit Suisse, June 30, 2011.

Lower secondary market price volatility

Since it is nearly always the case that a default results in a lower loss to the secured loan lender than will be experienced by the high yield bond investor, it follows that signs of potential stress will have a greater effect on the price of the bond in the secondary market than they would on the loan. The loan market will therefore exhibit lower volatility in secondary market pricing than the high yield bond market. Exhibit 4 illustrates the annual volatility of monthly returns for the loan market and the high yield bond market.

Loans typically pay a floating rate of interest made up of a Libor or Euribor base rate, plus an additional margin to compensate for credit risk.

Exhibit 4 - High Yield, US Loan And European Loan Volatility



Floating rate asset class

Loans typically pay a floating rate of interest made up of a Libor or Euribor base rate, plus an additional margin to compensate for credit risk. Bonds, by contrast, are typically fixed rate instruments with a maturity of 7 to 10 years. The credit spread is built into the fixed rate as a margin over a government bond of a similar maturity. Since they have a higher duration, when the yield curve is positive, bonds will generally pay a higher coupon than loans.

The long duration of the bond is of value to an investor, like a pension fund, who is trying to match longer-dated liabilities. However, the longer duration of bonds over loans also makes them more price-sensitive to movements in the yield curve. If interest rates rise, the secondary market price of the bond generally will fall by much more than that of a loan in the same situation, contributing to the greater volatility of bonds vs. loans as demonstrated in Exhibit 4.

The loan investor is also likely to benefit from a higher Libor/Euribor reset on the next coupon roll date.

We believe this feature of loans is of particular value in the current market where expectations of a rise in global inflation are high and the current level of interest rates low, with a possibility of eventual interest rate hikes in the US and Europe.

Access to private, monthly, management accounts

In Europe, loans are private instruments and in the US a large proportion of the market is private. The lender receives monthly management accounting from the borrower detailing current trading, revenues and expenses. Bonds are public, so investors are restricted to trading on the basis of publicly available information and are denied unrestricted access to management and their projections.

Loan documents generally contain covenants that, amongst other things, limit the ratio of debt to earnings and require a minimum level of interest coverage to be maintained (“maintenance covenants”). These covenants are typically tested quarterly, and if they are breached, senior lenders may decide to enforce their security and take control of the borrower.

A loan investor typically has access to more detailed information on a more timely basis than a high yield bond investor and should therefore be able to make more informed investment decisions.

More protective covenants

Both loan and bond documentation contains restrictive covenants. Loan documents generally contain covenants that, amongst other things, limit the ratio of debt to earnings and require a minimum level of interest coverage to be maintained (“maintenance covenants”). These covenants are typically tested quarterly, and if they are breached, senior lenders may decide to enforce their security and take control of the borrower. Bond covenants usually are not tested on a regular basis but instead are reviewed only when the borrower plans to take on new debt or pay an equity dividend.

This key difference between bonds and loans allows loan investors a much greater ability to dictate the terms of their agreement on an ongoing basis. If a borrower knows that he risks breaching a covenant, he must seek a waiver from the lenders and will most likely be asked for a fee or wider loan margin in return. This has been used to great advantage over the last year by senior lenders to reset the lending margins from pre-crisis levels of 200 to 250bps to post-crisis levels of 400 to 500bps.

Hybrid products

Given the link between typical borrowers in the loan and high yield bond markets, it is perhaps not surprising that hybrid instruments have evolved, mixing and matching various features of the two markets.

Senior secured bonds and floating rate notes

During 2010, the high yield bond market sought to imitate the security advantage of secured loans and there have now been many instances of the issuance of senior secured bonds which share in the same security pool as the senior secured lenders.

However, senior secured bonds are a very different instrument as they typically do not incorporate maintenance covenants. There is also no standard wording for the intercreditor agreement which sets out how, in the event of default, the security pool is split between the senior lenders and the senior bond holders. Investors need to review the intercreditor agreement in detail in each case to determine if the expected recovery on a senior secured bond will indeed be similar to that on a senior secured loan.

Covenant-lite loans

Not all loans contain sufficiently tight covenants and some do not include maintenance covenants at all. These are covenant-lite loans, and they may have very similar recovery characteristics to senior secured high yield bonds.

Covenant-lite loans have never gained hold in the European markets, but have been issued extensively in the US. Borrowers argue that defaults are less likely under a covenant lite loan, since defaults are often triggered by the breaching of a covenant. Lenders argue that the presence of covenants allow them

The power the senior lender holds results from the ultimate sanctions they can use if a covenant is breached and remains unresolved. Through the security package, senior lenders may seize ownership of the operating assets of the company, forcing out the equity investors.

to take action earlier upon evidence of a slowdown in trading. Hopefully this prevents default, but if default is inevitable the early action may well help to maximise recovery.

High levels of issuance of covenant lite loans are generally a signal that a market is becoming overheated with an excess of investor demand over new issue supply.

The value of private information

The access a lender has to private information on the borrower is very important to the credit process. With access to this information, credit analysts can form a clearer view of how a company is trading. Perhaps more importantly, the lender can monitor compliance with the loan covenants and if there is a risk that a covenant may be breached, can assemble the senior lending group to approach the company and its private equity sponsors and require them to take action to address the situation.

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Bond holders are typically unsecured and do not have this right. Nor do they have timely access to the information that would lead them to conclude that a senior debt covenant has been breached. They rank lower than the junior secured lenders when it comes to allocating residual value in the business following default and take whatever is left after secured lenders have been fully repaid.

Restructuring process

In practice, senior lenders rarely seek to take control of the business through enforcing their security. They are unlikely to have the specialised skills required to run the business. So the rights of senior lenders are typically used to pressure the equity sponsors to address shortfalls in business performance. Investors in distressed debt are an exception to this trend. They are likely to have a great deal of experience taking a company in and out of bankruptcy and may well exercise their rights specifically to take control of the business.

Once a potential covenant breach is identified, the senior lenders typically form a restructuring committee to communicate with the borrower and its equity sponsors. They can request an independent business review, based again on access to material, non-public information. The committee can hear plans for restructuring put forward by the business, can submit its own plans for acceptance by the majority of senior lenders and can approach alternative providers of capital to the business if the existing owners show reluctance to propose a solution. Ultimately the senior lenders vote on the approach to adopt.

This is in contrast to an investor in a high yield bond issued by the same company. They may not have access to the same level of information as the senior lender and may not enjoy as much influence over the final restructuring outcome.

In the US, the bond market is larger than the institutional loan market, but significant issuance during 2006 to 2008 brought loan market outstandings close to those of the bond market.

Restructuring case study: Dometic

In 2008 senior lenders used the power offered to them through the presence of a strong covenant package to take control of the Swedish white goods manufacturer, Dometic.⁵ This is a good example of the power of covenants and also an example of a situation in which the senior lenders ultimately exercised the rights conferred to them through the loan documentation to take control of the company.

Following a sharp decline in earnings, Dometic breached the debt/EBITDA covenant in its loan documentation in late 2008.

The senior lenders formed a steering committee, engaged a third party advisor to perform market and financial due diligence, then prepared three different strategies for restructuring the business. Two strategies involved additional equity injections, either from the incumbent sponsor or from an alternative sponsor. The third required the senior lenders to take control of the business themselves through exercising their security and providing additional short term funding.

Negotiations with the equity sponsors resulted in final proposals which required the senior lending group to take a substantial write down on their loans without sufficient compensation through residual equity ownership. The group considered the company was experiencing a cyclical downturn in earnings and that there was a strong chance of recovery, so rejected the sponsors proposal and instead took control of the company themselves. Senior lenders then restructured their exposure, taking a small write down, but retaining the bulk of the equity in the business.

Earnings recovered through 2010 and early in 2011, the company was approached regarding the potential sale of the business. Following a competitive bidding process, the company was sold. Sale proceeds allowed the senior lending group to achieve a full recovery on their original amount lent to the company, so avoiding the weaker recovery that would have resulted had they accepted the original offer from private equity.

Evolution of the Secured Bank Loan Market

Exhibit 5 and Exhibit 6 show the evolution of the secured bank loan market and the high yield bond market since 2001 in the US and in Europe. Figures for the loan market include only the institutional tranches, which are those held by non-bank investors and traded freely between holders in the secondary market.

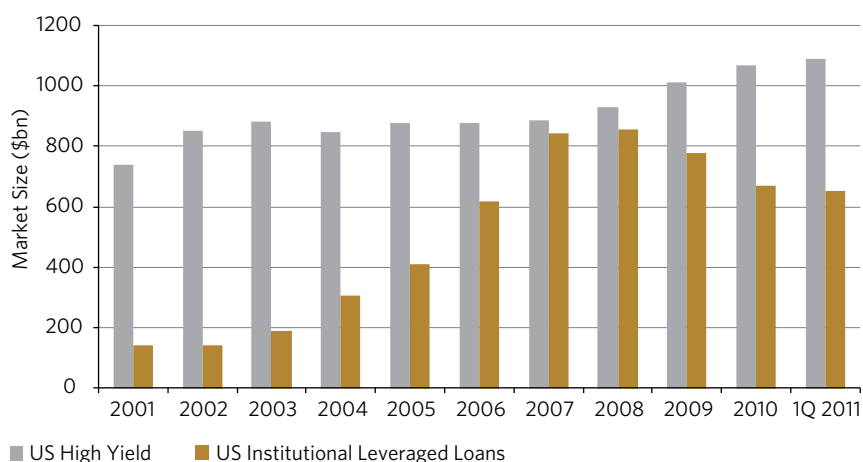
In the US, the bond market is larger than the institutional loan market, but significant issuance during 2006 to 2008 brought loan market outstandings close to those of the bond market.

⁵ Standard & Poor's, LCD News, May 20, 2009 and April 4, 2011.

In the immediate aftermath of the financial crisis, high yield bonds dominated new issuance in both the US and Europe. In Europe, loan issuance during this same period took loan market outstandings from a level well below that of the bond market between 2001 and 2004 to parity in 2005 and then to a point where loan outstandings substantially exceeded those of the high yield bond market. This contradicts conventional wisdom in Europe, which is that the bond market is deeper and more liquid than the loan market.

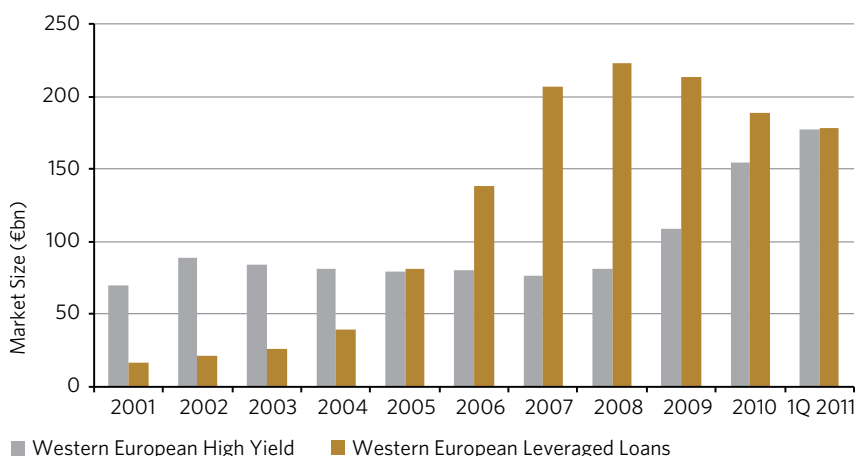
In the immediate aftermath of the financial crisis, high yield bonds dominated new issuance in both the US and Europe (as will be discussed later). In Europe this means that the two markets are now broadly similar in size, and loan outstandings in the US are about 60% of those of the bond market.

Exhibit 5 - Evolution of US High Yield and Loan Market



Source: Credit Suisse Leveraged Finance Strategy Update, June 1, 2011

Exhibit 6 - Evolution of European High Yield and Loan Market



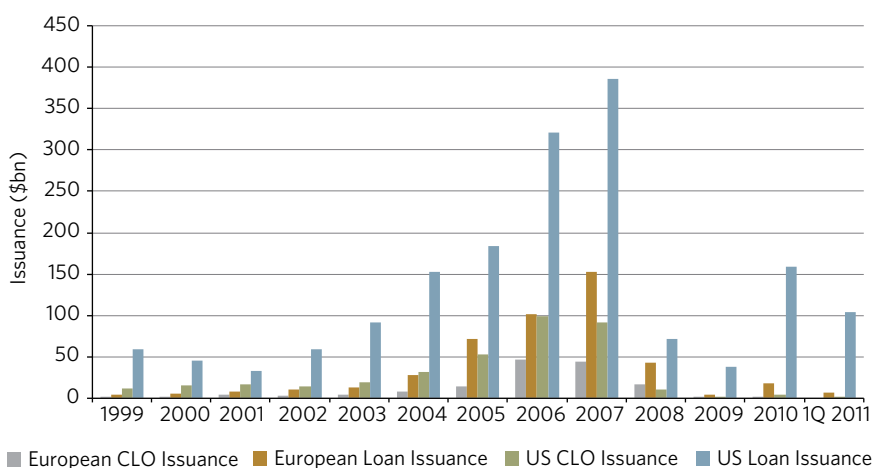
Source: Credit Suisse Leveraged Finance Strategy Update, June 1, 2011

While the US leveraged loan market has been well established for several decades, the concept of a “European loan market” is a fairly new one and was impossible to contemplate prior to the introduction of the euro in 1999.

While the US leveraged loan market has been well established for several decades, the concept of a “European loan market” is a fairly new one and was impossible to contemplate prior to the introduction of the euro in 1999. Before, the market was dominated by local banks lending in their local currencies to leveraged buy-outs (LBOs) in their region. Following the introduction of the euro, this situation persisted, but a number of banks emerged to dominate the leveraged finance scene. These banks made a business out of originating and syndicating leveraged loans, but also retained large proportions of the deals they arranged, making banks the dominant participants in the market. This was in marked contrast to the US, where banks had long since been disintermediated from the process, arranging deals, but then selling them on to institutional investors, predominantly insurance companies and mutual funds. As a by-product of this, it became market practice for a US borrower to obtain a public rating when borrowing through the loan market.

In Europe, institutional involvement in the loan market only started to become significant once the appetite for collateralised loan obligations (CLOs) grew between 2003 and 2007 (Exhibit 7). However, in this case private equity deal sponsors resisted the call for public ratings on loans. In their place, CLOs obtained private shadow ratings, which allowed the CLO liabilities themselves to be publicly rated, while enabling the underlying loans to maintain their private status.

Exhibit 7 - New Issue Volume in US and European CLO Market



Source: Standard & Poor's, LCD USD Leveraged Loan Review - US/Europe 1Q11

Institutional investors in the leveraged loan market were increasingly drawn to CLOs because they provided cheap, non-recourse leverage with potential annual percentage returns in the high teens.

CLOs are closed-end structures that match the term of the financing to the longest possible maturity date in the underlying portfolio, avoiding refinancing risk and locking in an attractive arbitrage. They require investors to commit to holding their investment to maturity (often up to 12 to 15 years).

As loans gained acceptance among institutional investors, hedge funds entered the market, seeking the high potential returns achievable via a leveraged investment in the asset class.

As loans gained acceptance among institutional investors, hedge funds entered the market, seeking the high potential returns achievable via a leveraged investment in the asset class. However, the liquidity requirements of hedge funds prevented them from participating in closed-end structures, so instead they financed their investment in loans through mark-to-market financing lines, with an advance rate based on the mark-to-market value of the loans. The consequences of this strategy were to have a significant impact on the market, as we will discuss later.

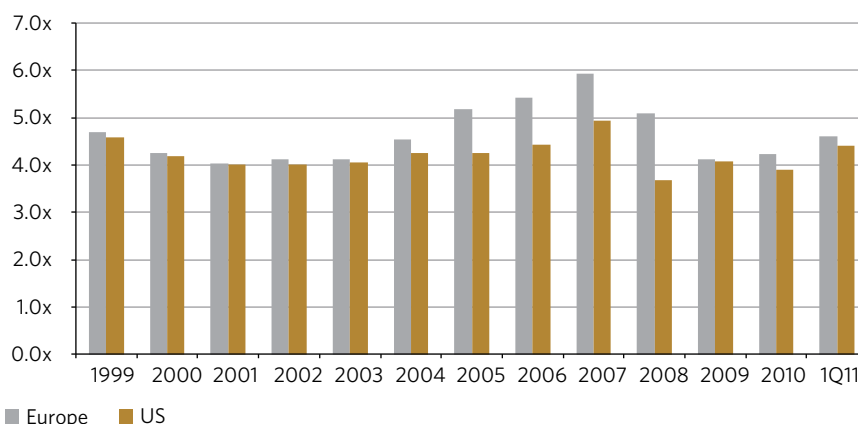
CLOs and institutional investors assumed an increasingly larger proportion of European loan new issuance, eventually accounting for 56.5% of the demand for primary syndication during 2007, reducing the banks' share of the market to 36.4% (the difference accounted for by securities firms).⁶ In the US, where the non-bank institutional loan market developed much earlier than in Europe, banks account for an even smaller share of the primary loan market, typically less than 10% of primary volume.

Popularity of CLOs increased loan demand, weakened terms

As more investor money flowed into CLOs and credit hedge funds, the demand for loans increased. This resulted in a weakening of deal structures between 2006 and 2007. The amount of debt senior lenders were prepared to offer increased (Exhibit 8), spreads narrowed from an average of 300 bps over Libor to close to 200 bps and in some cases covenant protection was significantly weakened.

The quality of loans on offer was reduced, but underwriting continued, buoyed up by resilient demand driven by investors who were relying on leverage to drive their returns rather than relying on informed credit selection. In Europe, the situation was exacerbated because Icelandic banks were aggressively expanding their balance sheets and building significant exposure to the loan market, financed largely through short-term retail and wholesale funding.

Exhibit 8 - Average Debt/EBITDA in US & Europe Market



Source: Standard & Poor's LCD Leveraged Loan Review - US/Europe 1Q11

⁶ Standard & Poors, LCD European Leveraged Loan Review, 4Q09, p. 136.

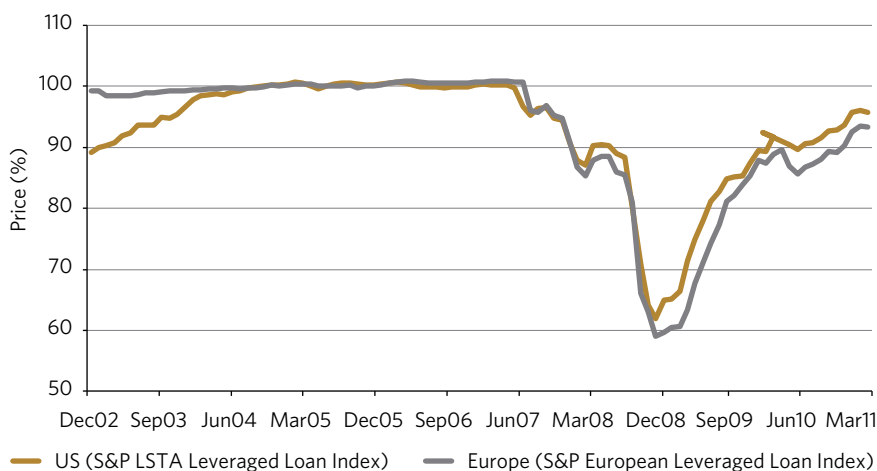
The closing of the securitisation market halted the issuance of new CLOs and instantly removed a large part of the anticipated demand for underwritten loans awaiting syndication. These loans remained trapped on bank balance sheets.

Credit crisis, rapid unwinding of leverage and a precipitous price drop

This was the situation as the credit crisis began in the middle of 2007. The meltdown in the sub-prime market and bank balance sheets bloated with loans caused a significant sell-off in July and August 2007. The closing of the securitisation market halted the issuance of new CLOs and instantly removed a large part of the anticipated demand for underwritten loans awaiting syndication. These loans remained trapped on bank balance sheets.

This sell-off persisted and was accelerated by banks that had provided financing to hedge funds calling in margin as market values declined. The collapse of one particular hedge fund typified the problems. The fund had built up a very successful track record investing in US sub-prime mortgages, but it also had a significant portfolio of leveraged loans. Both positions were financed through margin lines with their prime brokers. When the sub-prime market collapsed, collateral backing the margin lines was called in and the fund was forced to sell whatever assets it could to raise liquidity. Loans were the more liquid and valuable of their assets, so loans took a lot of the selling pressure. As this situation was repeated around the market, the price of loans fell precipitously, in turn triggering the unwinding of more leverage supporting other players in the market. Finally the collapse of some smaller US banks and the Icelandic banks released more loans onto the market, setting off an unprecedented fall in loan prices, as illustrated in Exhibit 9.

Exhibit 9 – Secondary Loan Weighted Average Bids



Source: Standard & Poor's, LCD Leveraged Loan Review – US/Europe 1Q11; please see appendix for index definitions

Thus the collapse in loan prices during 2008 was triggered by an unwinding of the excessive leverage applied to this asset class. It was not directly related to weakness in the underlying borrowers.

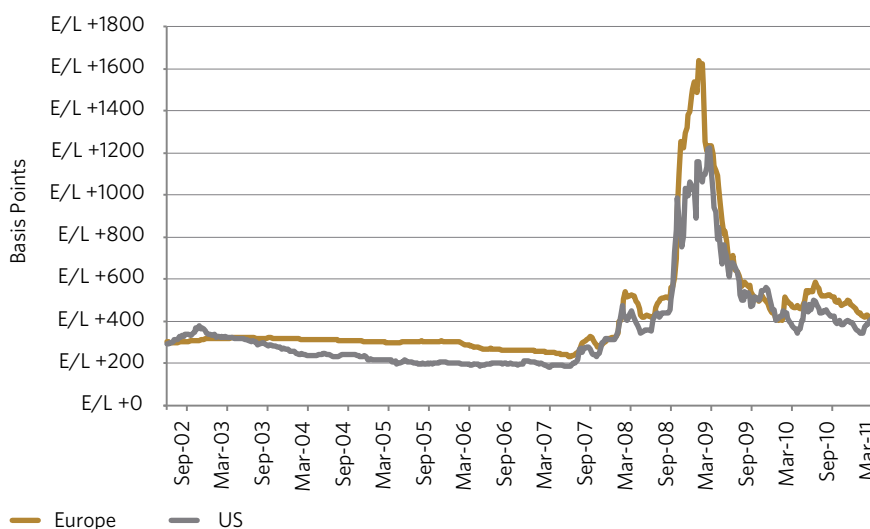
During 2009, global demand was impacted by the credit crisis. The auto manufacturing sector, amongst others, was severely affected and dramatically reined back production as consumer access to finance for new car purchases was restricted.

During 2009, global demand was impacted by the credit crisis. The auto manufacturing sector, amongst others, was severely affected and dramatically reined back production as consumer access to finance for new car purchases was restricted. This had a knock-on effect on all of their suppliers and related industries. Earnings in auto-related businesses started to show signs of weakness, and the number of leveraged borrowers forced back to the negotiating table with their senior lenders increased. This scenario played out in other troubled industry sectors such as building materials and chemicals.

However, against this backdrop, loan prices enjoyed the strongest rally ever witnessed, providing evidence that the sell-off in 2008 and early 2009 had been driven by the unwinding of leverage and an indication that, at their lows, prices had far overshot the price level that fairly represented the level of stress in the underlying borrowers and the likely recovery in any default.

S&P data on yields achievable on flow names traded in the secondary market show spread yields peaking in Europe at more than 16% over Euribor in February 2009 and in the US at more than 12% over Libor in March 2009. As investors sought to take advantage of this unprecedented yield opportunity for secured assets, secondary pricing rallied and by the end of 2009 spread yields in Europe and the US had fallen back to around 5.00% (Exhibit 10).

Exhibit 10 - Average Spread Yield for Flow Names



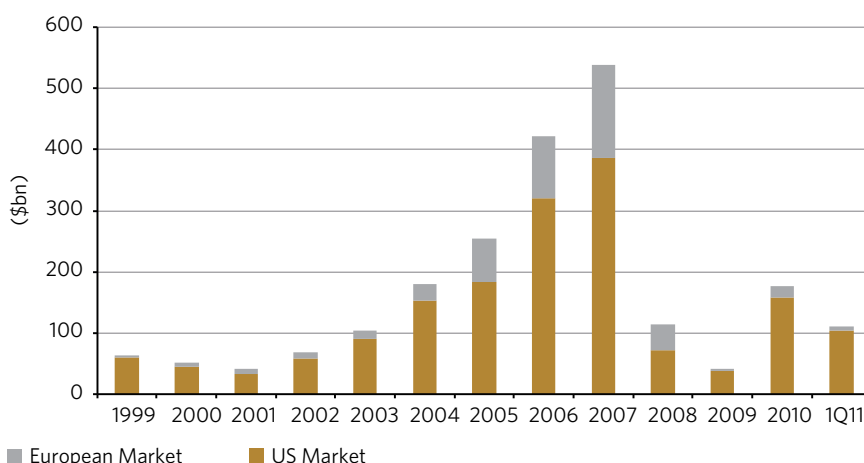
Source: Standard & Poor's, LCD Leveraged Loan Review - US/Europe 1Q11

While secondary market prices recovered rapidly in 2009 as institutional investors took advantage of the opportunity to buy secured loans at unprecedented yields, the primary market responded much more slowly.

Post-crisis recovery in new issuance

While secondary market prices recovered rapidly in 2009 as institutional investors took advantage of the opportunity to buy secured loans at unprecedented yields, the primary market responded much more slowly. Development of the new issue market was hampered by two factors. Initially, the yields on offer to buyers of loans in the secondary market far exceeded the levels any but the most desperate of borrowers were willing to pay on new financing. But more importantly, because the loan market had become so dependent on CLOs and new issuance of these vehicles failed to restart, much of the natural investor base for loans had been removed from the market. This led to a sharp reduction in primary loan issuance during 2008 and 2009 (Exhibit 11).

Exhibit 11 – Global Leveraged Loan Volume



Source: Standard & Poor's, LCD Leveraged Loan Review – US/Europe 1Q11

Market Outlook

With the leveraged investors removed from the system for all practical purposes, a repeat of the precipitous fall in loan prices witnessed in 2008 and 2009 is very unlikely, even if corporate earnings remain subdued. The gains in secondary market prices in 2009 are unlikely to be repeated, but with primary markets offering wide spreads and stronger deal structures, we believe the loan market offers the potential for attractive opportunities.

Recovery in loan new issue volumes

As a result of the removal of CLOs as purchasers of potential primary loan supply, highly levered companies and arranging banks switched to the high yield bond market to raise new capital. The high yield bond market does not rely on structured credit funds or levered investors as a source of capital, so arrangers were more confident that underwritten deals could be successfully placed in this market. Consequently, high yield bonds initially dominated post-crisis issuance.

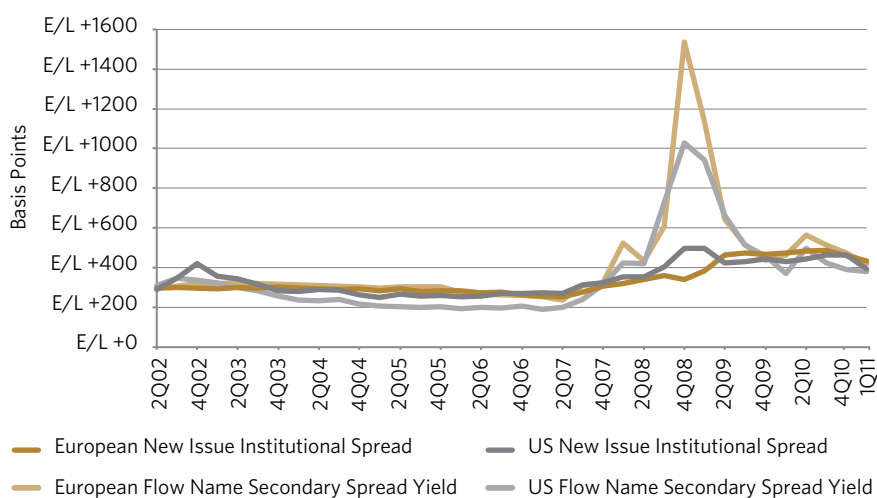
However, the loan market has recently staged a significant recovery. Three factors have contributed to the recovery in primary loan market volumes:

Interestingly, the capital committed to the secondary market by CLO vehicles was available not as a result of new CLO issuance, but from existing CLOs, which received high levels of repayments from borrowers who had successfully refinanced their outstanding loan positions through the issuance of high yield bonds or through trade sales.

Secondary yields fall to levels where primary can compete

First, capital has been committed by opportunistic investors and CLOs to the secondary loan market, pushing up secondary prices and dragging down yields to levels at which the primary market is again able to compete (Exhibit 12).

Exhibit 12 – Yield Spreads of European & US Flow Names & New Issues



Source: Standard & Poor's, LCD Leveraged Loan Review – US/Europe 1Q11

Interestingly, the capital committed to the secondary market by CLO vehicles was available not as a result of new CLO issuance, but from existing CLOs, which received high levels of repayments from borrowers who had successfully refinanced their outstanding loan positions through the issuance of high yield bonds or through trade sales. Significant repayments during this period came from Virgin Media and Casema (Ziggo), who refinanced their loans through the issuance of high yield bonds and from sales of highly levered sponsor owned businesses to trade buyers who financed the purchase on their own balance sheets at much lower levels of leverage (for example Polymer Latex and the more recent acquisition of Nycomed by Takeda).⁷

Inflation pressure and relative value favours floating rate assets

Secondly, growing inflationary pressures in Europe and the US have forced institutional investors who had been supporting the high yield bond market to consider the impact of higher interest rates on their fixed rate bond portfolios. Some have now started to shift their attention to the floating rate, secured loan market.

This trend has been supported by the higher relative value of loans when compared to high yield bonds. As discussed earlier, loans offer a higher level of security than high yield bonds, yet also currently offer a greater credit spread premium (as illustrated in Exhibit 3), further encouraging investors to switch out of bonds into floating rate loans.

⁷ "Virgin Media to Pay Down More of TLB After Issue Upsized," Standard & Poor's LCD News, February 25, 2011; "Ziggo Notes Price at Par to Yield 6.125%," Standard & Poor's LCD News, October 21, 2010; "Polymer Latex Sold to Yule Catto," Standard & Poor's LCD News, December 13, 2010; "Takeda Completes Nycomed Purchase," Financial Times, May 19, 2011.

With growth in the loan investor base, arranging banks have become more confident that they will be able to successfully syndicate underwritten loan deals. In contrast, their confidence in fully placing underwritten bond deals has been shaken by the shift to loans, but also by the weaker performance of recent new issues of high yield bonds in the light of heightened levels of global risk.

One example of a high yield deal that was recently pulled due to adverse conditions was Spotless, an aggressively levered deal financing a dividend to the equity sponsor. The Spotless financing was originally pitched to the loan market, but when initial sounding failed to get positive traction the deal was reattempted as a high yield bond. However, recent increases in global perceptions of risk have slowed appetite for new issue high yield bonds and the deal was shelved.

Private equity make new investments that require financing

Thirdly, private equity firms have begun to commit capital to new leveraged buyouts, increasing the demand for new financing over and above that required for the refinancing of already outstanding debt. According to a recent article in the Financial Times, quoting data from Mergermarket,

“the first six months of 2011 have been the busiest for private equity in three years with financial investors backing \$131.4bn worth of deals globally – an increase of more than half from the same period of 2010.”⁸

The combined result of all these factors is that secured loan issuance to support LBOs in Europe in June 2011 reached €4bn against just €1.9bn of issuance in the high yield bond market.⁹ That evens out the balance of loan issuance versus high yield bond issuance for the year at 47% market share for loans and 53% for bonds. In the US the new-issue market saw the highest volume since the second quarter of 2007 at \$103.7bn of new institutional issuance.¹⁰ We believe that demand for new financing will continue and that it will remain evenly split between the loan and bond markets.

Strengthening in New Issue Terms

Wider new issue spreads

New issue loan spreads in the US and Europe have tightened from their 2010 levels during the first quarter of 2011, but remain significantly wider than the average spread prior to the financial crisis (Exhibit 13).

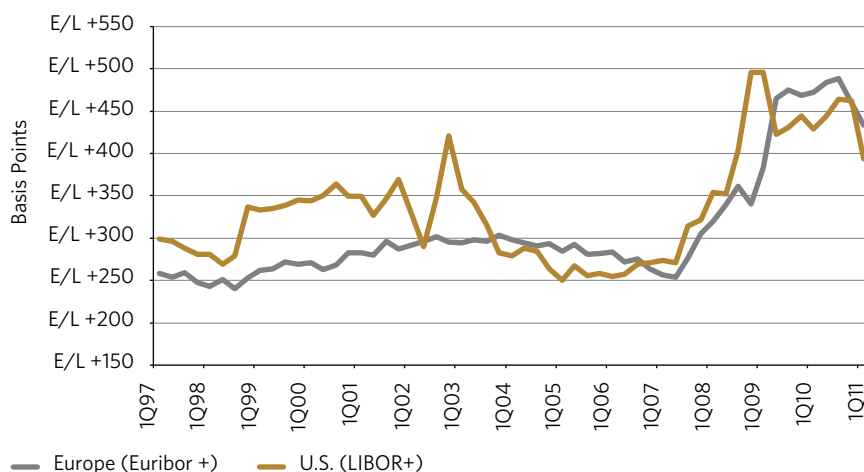
⁸ Daniel Schafer, “Busy Year for Private Equity as Debt Markets Bounce Back,” Financial Times, June 29, 2011.

⁹ “Sponsored Transactions Maintain Upward Trajectory,” LCD (EUR) Topical, June 29, 2011.

¹⁰ LCD Global Loan Stats, 1Q11.

Equity contributed to new buyouts has fallen to 35% in the US, just fractionally higher than was typical in the boom years of 2006 to 2007. In Europe it has remained close to historical highs at around 45%.

Exhibit 13 - Weighted Average New-Issue Institutional Spreads

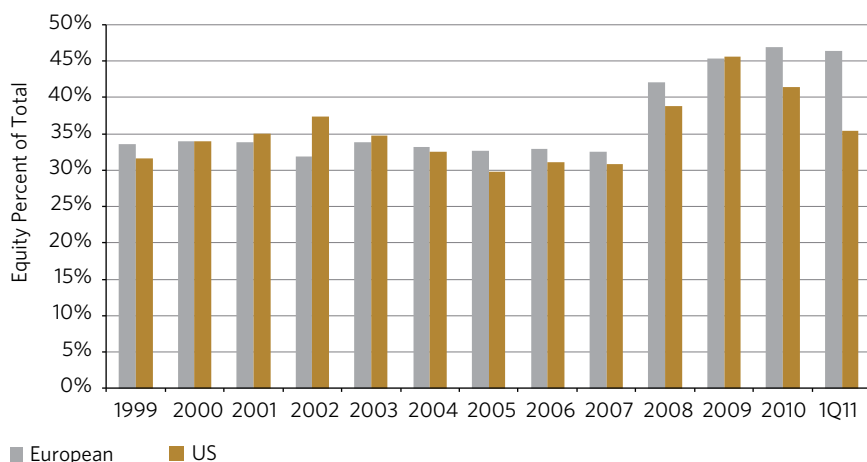


Source: Standard & Poor's, LCD Leveraged Loan Review - US/Europe 1Q11

Lower leverage and larger equity contributions from sponsors

Equity contributed to new buyouts has fallen to 35% in the US, just fractionally higher than was typical in the boom years of 2006 to 2007. In Europe it has remained close to historical highs at around 45% (Exhibit 14).

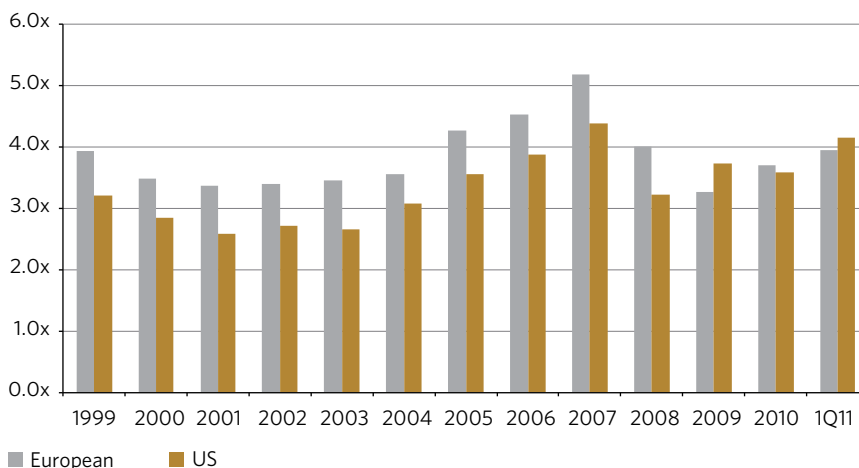
Exhibit 14 - Average Contributed Equity



Source: Standard & Poor's, LCD Leveraged Loan Review - US/Europe 1Q11

Leverage as a function of EBITDA has also fallen from the levels seen at the peak of the market in 2007. At the end of Q1 2011, average pro forma senior debt/EBITDA in the US was 4.2x versus 4.4x in 2007. In Europe the Q1 2011 level was 3.9x versus 5.2x in 2007 (Exhibit 15).

Exhibit 15 – Average Pro Forma Senior Debt/EBITDA



Source: Standard & Poor's, LCD Leveraged Loan Review – US/Europe 1Q11

The impact of higher inflows into the loan market has been most significant in the US market where large retail inflows into loan mutual funds have boosted liquidity and increased competition for assets. This has encouraged arrangers to push spreads tighter and allowed some more aggressive deal structures to be successfully placed.

But Europe offers better relative value than the US

The impact of higher inflows into the loan market has been most significant in the US market where large retail inflows into loan mutual funds have boosted liquidity and increased competition for assets. This has encouraged arrangers to push spreads tighter and allowed some more aggressive deal structures to be successfully placed.

In Europe, retail funds do not represent such a significant force in the market, so while there have been significant inflows, the leading players in the market have maintained more control, pushing back arranger proposals for tighter spreads and more aggressive deal structures.

One example of the better reception of more aggressive deals in the US vs. Europe is the cross border deal for Burger King which was allocated earlier in the year.¹¹ Having initially come to the market in late 2010 with a TLB priced at Libor+450 (Libor+475 for the European tranche), they returned to the market in 2011 tightening the spread to Libor+300 on the USD tranche. The European tranche was priced at Libor+325, maintaining the yield differential between the US and European offerings, but many of the European lenders chose instead to redeem, earn the call premium and re-invest elsewhere rather than face the reduction in spread income. As a result the size of the European offering was reduced.

The Spotless deal provides an example of a deal that was deemed too aggressive for the European loan market due to high leverage.¹²

European investors again demonstrated their ability to push back on more aggressive amendments from Elix, who were looking to extend their existing facility without providing a sufficient margin increase – the amendment was withdrawn, and Trader Media who did manage to get their amendment through, but only after revising the uplift in margin originally proposed.¹³

¹¹ Standard & Poor's, LCD News, April 14, 2011.

¹² Standard & Poor's, LCD News, June 13, 2011.

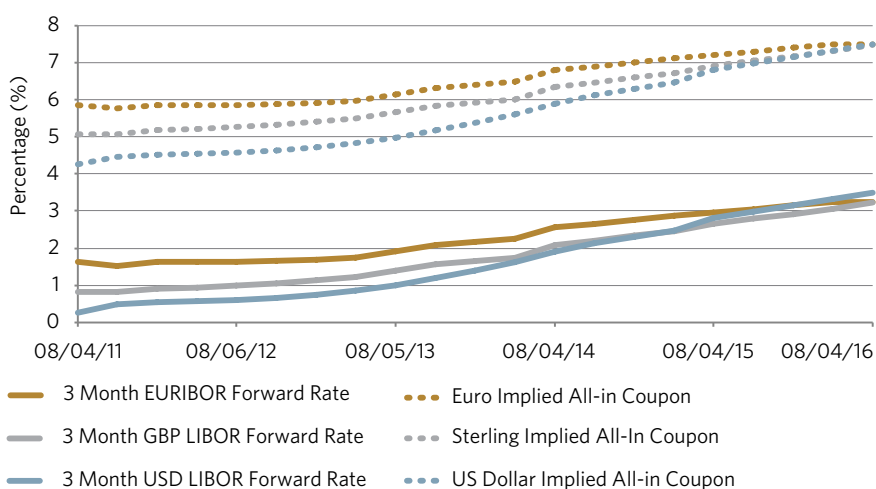
¹³ Standard & Poor's, LCD News, May 11 and 14, 2011.

Risks adjusted returns are also marginally higher in Europe as indicated by the spread per unit of leverage. However, the main trend that emerges from analysis of this parameter is that spread per unit of leverage in both the US and Europe at about 90 bps per turn of leverage, is significantly higher than the historical average level of closer to 50bps.

Higher Libor and forward curve in Europe

US new issue spreads are now slightly below 400bps, while in Europe margins on new deals remain between 425 and 450bps. In addition, floating interest rates and the forward Libor curve are higher in Europe vs. the US. This is offset to some degree by the availability of Libor floors in the US. These are not as commonly seen in the European market, but given the higher level of interest rates, they would be of less value in Europe in any case. Taking all of this into account, we believe higher absolute returns are more likely achievable on European loans than on US loans (Exhibit 16).

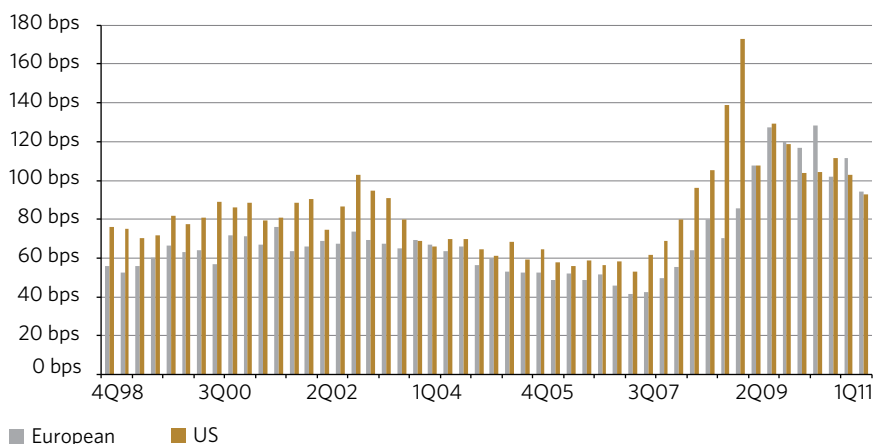
Exhibit 16 - Libor 3-Month Forward Rates & Implied All-In Coupons



Source: Bloomberg LLC, 3 Month Forward Inter-Bank Lending Rates, August 4, 2011

Risks adjusted returns are also marginally higher in Europe as indicated by the spread per unit of leverage. However, the main trend that emerges from analysis of this parameter is that spread per unit of leverage in both the US and Europe at about 90 bps per turn of leverage, is significantly higher than the historical average level of closer to 50bps (Exhibit 17).

Exhibit 17 - Spread Per Unit of Leverage



Source: Standard & Poor's, LCD Leveraged Loan Review - US/Europe 1Q11

The rapid growth in loan issuance between 2005 and 2008 has resulted in an unprecedented volume of loans outstanding in the market. Ultimately these loans will approach maturity and need to be repaid or refinanced.

It is for this reason that we believe the current vintage of loan origination is likely to provide the greatest return for the lowest risk that has been seen in the market for some time. We favour the opportunity in the European market, which has held onto the stronger deal structures established in the immediate aftermath of the financial crisis. Exhibit 18 provides summary details of some recent European new issues and highlights the difference in terms between the European borrowers and the US names (Burger King and IMS Health).

Exhibit 18 – Recent New Issue Loans

Borrower	Allocation	Country of Issuance	Senior Loan Margin	Issue Price	Senior Leverage	Industry
Towergate	Feb-11	UK	500bps, 1.5% Libor Floor	99.00	3.78x	Insurance
Takko	Mar -11	Germany	500bps, 1.5% Euribor Floor	100.00	3.64x	Retail
Mivisa	Mar-11	Spain	425bps, 1.5% Euribor Floor	100.00	4.7x	Metals and Mining
Novacap	Mar-11	France	450bps	99.00	3.2x	Chemicals
IMS Health	Mar-11	US	350bps, 1.50% Libor Floor	99.00	3.4x	Computers & Electronics
Burger King (Euro)	Apr-11	US	325bps, 1.50% Libor Floor	Repricing with no fee	4.0x	Restaurants
CABB	May-11	Germany	450bps	100.00	3.8x	Chemicals
R-Cable	May-11	Spain	450bps	99.50	3.75x	Cable
Iglo Birds Eye	May-11	UK	462.5bps	100.00	4.4x	Food & Beverage

Source: Standard & Poor's, LCD News US/Europe, May 2011

Progress reducing the wall of refinancing

The rapid growth in loan issuance between 2005 and 2008 has resulted in an unprecedented volume of loans outstanding in the market. Ultimately these loans will approach maturity and need to be repaid or refinanced.

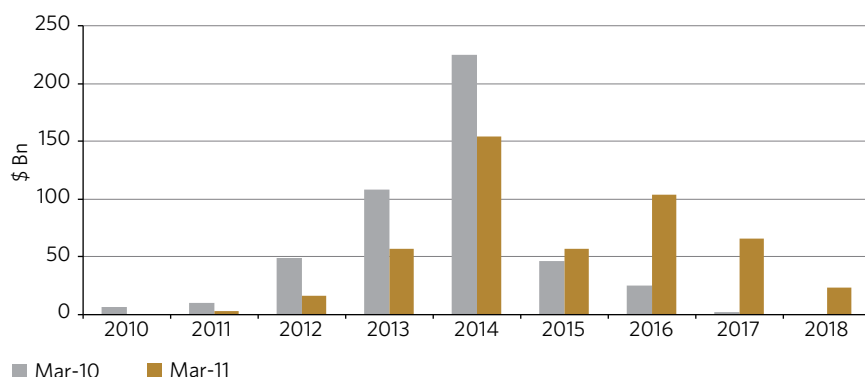
Leveraged loans have typically been structured with a maturity of 7 to 9 years, so the loans raised between 2005 and 2008 were originally due to be refinanced between 2012 and 2017. The greatest concentration of maturities was between 2013 and 2014 in the US. In Europe, the peak in maturities occurred slightly later, between 2014 and 2015. In mid-2010, this was highlighted as a major risk for the market, since the amount of debt that needed to be refinanced in the peak years, 2013 to 2015 dwarfed the annual issuance capacity of the new issue market at that time.

However, significant progress has already been made to address this issue. Exhibit 19 shows how the concentration of maturities has been reduced in the US loan market, spreading out the required refinancing over a much longer period between 2013 and 2017 and reducing the volume of refinancing

required in the peak years of 2013 and 2014. This has been achieved by refinancing loans through the issuance of longer-dated high yield bonds, taking advantage of high levels of liquidity in the bond market and by “amend-and-extend” agreements with existing lenders to extend the maturity of loans already in place. All of these solutions have required the consent of senior lenders and the request for consent is generally accompanied by a margin uplift and consent fee. So the threat of refinancing has actually proven a virtue for the market, allowing the margins on loans from earlier vintages to be reset to current higher market levels.

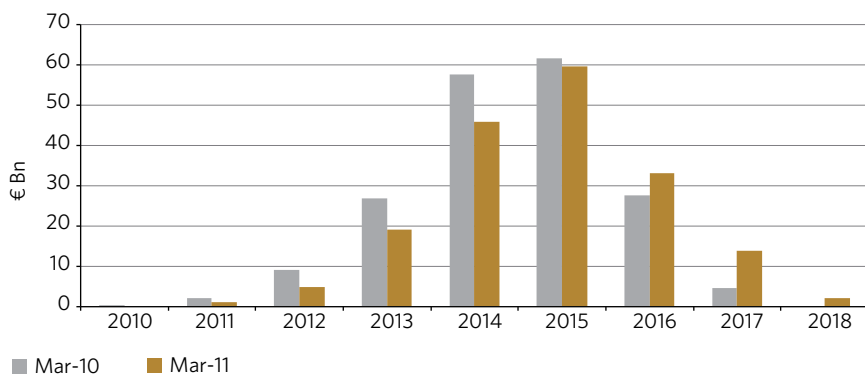
A recent example of a successful “amend and extend” is that of the Dutch waste-management firm, AVR who managed to achieve 100% lender approval to extend their maturity by 12 months in return for an increase in margins on the outstanding TLB/C from Euribor + 225/250 to Euribor + 375/400.¹⁴ Luxembourg-base Flint Group achieved a similar result, extending their maturities by 2 years in return for a 200 bps uplift in margins.¹⁵

Exhibit 19 – US Maturity Wall Then and Now



Source: Standard & Poor's, LCD Leveraged Loan Review – US/Europe 1Q10 & 1Q11

Exhibit 20 – European Maturity Wall Then and Now



Source: Standard & Poor's, LCD Leveraged Loan Review – US/Europe 1Q10 & 1Q11

A similar trend can be observed in Europe (Exhibit 20), although the scale of reduction is less than in the US. There is still a significant concentration

¹⁴ “AVR A-to-E Nets Close to 100% Lender Approval,” Standard & Poor's LCD News, May 3, 2011.

¹⁵ “Flint Group Holds Investor Meeting for Giant A-to-E Request,” February 14, 2011.

There is still a significant concentration of debt coming due between 2014 and 2016. We believe that eventually we will see defaults pick up as a result. However, over the next 12 months the rating agencies expect that default rates will remain modest as corporate fundamentals remain good.

of debt coming due between 2014 and 2016. We believe that eventually we will see defaults pick up as a result. However, over the next 12 months the rating agencies expect that default rates will remain modest as corporate fundamentals remain good. Moody's estimate the global speculative-grade default rate will remain between 2.0% and 2.3% until October 2011, then fall into a range of 1.5% to 1.7% from November 2011 to May 2012.¹⁶

We believe the remaining debt maturity wall is likely to influence the loan market in a number of ways:

New issue spreads to remain wide

First, we believe the maturity wall will prevent significant tightening in new issue loan spreads, since any reduction in spreads will quickly attract new supply to the market from those companies keen to reduce their demands on the capital markets during 2014 and 2015. This is positive for loan investors, as it allows them to commit new money to the loan market at attractive spread levels. It also means that cash from early pre-payments on loans over the next few years will be able to be re-invested at similarly attractive levels.

Bond market investors would regard this stability in spreads to be a negative feature of the market, since they are looking to spread compression to generate a capital gain on their investments. Loan investors are less focused on this effect since loans are generally pre-payable at par. This means there is little to be gained from spread tightening as it generally results in a higher level of pre-payments, giving cash back to investors early which then must be re-invested at the lower spread levels of the primary market.

Distressed debt opportunities to increase

The second impact of the maturity wall on the market will likely be an increase in the volume of distressed debt opportunities. No finance director wants to be relying on the capital markets to raise new debt in 2014 and 2015 if he can avoid it. That means that the companies that have the easiest access to the capital markets today, those who are performing well and those with the least leverage, will already be doing all they can to manage their maturities.

We believe this process of natural selection will result in a gradual reduction in credit quality of the universe of credits still needing to refinance in these years. In our view, some of these businesses may be operating under fundamentally challenged business plans, but for many we believe the problem is too much leverage. These situations provide fertile ground for distressed investors. Debt in these businesses will be volatile in the secondary market as their maturity approaches, and original investors without the stomach for uncertainty often look to sell out of the situation. This provides an opportunity for informed investors to build positions cheaply in the companies they believe offer the prospect of recovery, or those that are likely to go through a more distressed restructuring process where the objective is to end up with equity sourced at a discount to intrinsic value. We believe the opportunities to profit from these distressed opportunities will grow significantly over the next three years.

¹⁶ Moody's Investors Service May Default Report, June 7, 2011

By allocating capital to specialised managers, experienced in dealing with the operational complexities of the loan market, and with established credit expertise in the field, we believe investors can more effectively access the opportunities in this market.

Conclusions

In 2010 we predicted that unlevered institutional funds would gradually replace CLOs as the dominant non-bank participants in the loan market. In the ensuing year, we have seen this trend developing and expect it to continue, supported by what we perceive are the key strengths exhibited by the secured loan market:

- High absolute returns that will improve as interest rates rise
- Low volatility of returns due to the secured nature of the asset class
- Attractive risk-to-return opportunities, i.e., high lending margins for lower levels of leverage and stronger capital structures

Primary market volumes appear to be returning to healthy levels on the back of a return of private equity sponsored leveraged buyout activity and as a result of arrangers' perception of greater appetite for the loan asset class, particularly as the high yield bond market slows amid heightened global risk perceptions.

We favour the opportunity in the European market, which has shown itself to be better able to hold on to the stronger deal structures established in the immediate aftermath of the financial crisis.

In addition to this, we see potential opportunities for distressed investors to profit from the restructuring of balance sheets of those companies that have to date struggled to access the capital markets to manage their maturities.

By allocating capital to specialised managers, experienced in dealing with the operational complexities of the loan market, and with established credit expertise in the field, we believe investors can more effectively access the opportunities in this market.

Paul Hatfield, Chief Investment Officer, The Alcentra Group

Paul joined Alcentra in May 2003 as a portfolio manager and is now global Chief Investment Officer. Paul has 22 years' experience in leveraged finance and prior to joining Alcentra, was a senior analyst for the CDO operations of Intermediate Capital Group. Between 1995 and 2001, Paul worked at Deutsche Bank, originally in London for the Leveraged Finance Team. At this time, Deutsche (Morgan Grenfell) were the leading underwriter of European LBOs. Paul graduated from Cambridge University with an MA in Economics.

Simon Perry, Managing Director, Alcentra, Ltd

Simon is a Managing Director at Alcentra, responsible for the Business Development Team for EMEA ex Japan. Prior to joining Alcentra in 2009, Simon was involved in the development of the European CLO market, heading the European CLO business at UBS Investment Bank; he held similar roles at CIBC and Natixis. Simon was also part of the cross-asset class derivatives marketing team at CSFB. He is a graduate in mechanical engineering from Bath University.

BNY Mellon holds over 90% of the parent holding company of The Alcentra Group. The Group refers to these affiliated companies: Alcentra, Ltd and Alcentra NY, LLC. Only Alcentra NY, LLC offers services in the U.S.

Index Definitions

The Bank of America/Merrill Lynch Global Sovereign Broad Market Plus Index: The Global Broad Market Index tracks the performance of investment-grade public debt issued in the major domestic and Eurobond markets, including Global bonds. Sub-indices include Global Government Index, Global Broad Market Non-Sovereign Index, Global Broad Market Quasi-Government Index, Global Broad Market Corporate Index, and Global Broad Market Collateralized Index.

The Bank of America/Merrill Lynch Global Large Cap Corporate Index: tracks the performance of large capitalization investment grade corporate debt publicly issued in the major domestic and euro-bond markets. Qualifying securities must have an investment grade rating (based on an average of Moody's, S&P and Fitch). Qualifying currencies and their respective minimum size requirements (in local currency terms) are: AUD 500 million; CAD 500 million; EUR 500 million; JPY 60 billion; GBP 250 million; and USD 500 million.

The Bank of America/Merrill Lynch Euro High Yield Index: tracks the performance of EUR denominated below investment grade corporate debt publicly issued in the euro domestic or eurobond markets. Qualifying securities must have a below investment grade rating (based on an average of Moody's, S&P and Fitch) and an investment grade rated country of risk (based on an average of Moody's, S&P and Fitch foreign currency long term sovereign debt ratings). In addition, qualifying securities must have at least one year remaining term to maturity, a fixed coupon schedule and a minimum amount outstanding of EUR 100 million.

The Bank of America/Merrill Lynch Global High Yield Index: U.S. dollar, Canadian dollar, sterling and euro-denominated fixed rate debt of corporate issuers domiciled in an investment grade rated country (i.e., BBB or higher foreign currency long-term debt rating). Individual bonds must be rated below investment grade (i.e., BB or lower based on a composite of Moody's and S&P) but not in default; must have at least one year remaining term to maturity; a minimum face value outstanding of \$100 million, C\$50 million, 50 million pounds sterling, or 50 million euros; and have available price quotations.

S&P LSTA LLI (Standard & Poor's Loan Syndications and Trading Association Leveraged Loan Index) is a daily total return index that uses LSTA/LPC (Loan Pricing Corp.) mark-to-market pricing to calculate market value change. On a real-time basis, the LLI tracks the current outstanding balance and spread over LIBOR for fully funded term loans. The facilities included in the LLI represent a broad cross section of leveraged loans syndicated in the United States, including dollar-denominated loans to overseas issuers.

The S&P European Leveraged Loan Index (ELLI) is a multi-currency index that covers the European leveraged loan market back to 2003 and currently calculates on a weekly basis.

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