DDJ CAPITAL MANAGEMENT, LLC
SPECIALISTS IN HIGH YIELD AND LEVERAGED CREDIT INVESTMENTS

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CIO's Perspective
2017 Half-Time Leveraged Credit Review and Outlook

> Inflection point in the credit cycle is not on the near-term horizon, but expect an increase in volatility over the coming months

> Relatively healthy U.S. economy, low expected defaults, and decent fundamentals all positives for the leveraged credit market

David J. Breazzano
President, Chief Investment Officer, Portfolio Manager

Mr. Breazzano is a co-founder of DDJ and has more than 36 years of experience in high yield, distressed, and special situations investing. At DDJ, he oversees all aspects of the firm and chairs the Management Operating, Remuneration, and Investment Review Committees. Mr. Breazzano also serves as the portfolio manager of DDJ's U.S. Opportunistic High Yield and Total Return Credit Strategies. Prior to forming DDJ, from 1990 to 1996, he was a vice president and portfolio manager in the High Income Group at Fidelity Investments, where he had investment management responsibility for over $4 billion in high yield and distressed assets. Specifically, he was a portfolio manager of the Fidelity Capital & Income Fund, which was one of the largest high yield funds in existence at that time. In addition, Mr. Breazzano co-managed the distressed investing operation at Fidelity.

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1st Half 2017 Review

During the first half of 2017, seemingly unwavering economic optimism and sustained accommodative monetary policy by many developed market central banks outside of the U.S. led to strong performance in the high yield market. This economic optimism, largely attributed to expected pro-growth policies from the new U.S. presidential administration, has continued largely unabated despite no significant new policies actually being implemented. The impressive performance has occurred against a mixed backdrop, as the U.S. economy has improved since this time last year, albeit marginally, but renewed energy price volatility and increased geopolitical concerns continue to pose risks to the overall market. In addition, the U.S. Federal Reserve (the "Fed") has continued on its rate normalization path, increasing rates two times in the first half of 2017; however, U.S. Treasury yields have been volatile this year, and after reaching over two and half year highs in mid-March, 10-year U.S. Treasury yields began to fall and actually declined over the first half of the year. Furthermore, the rally in high yield has occurred despite the negative technicals of sizable high yield fund outflows of approximately $9.5 billion and a robust supply of new issuance; though on a net basis new issuance is much lower, as repricing/refinancing continue to account for a majority of new issuance.

Exhibit 1: Performance and Characteristics of High Yield Bonds and Leveraged Loans

	Dec 31, 2016	1H 2017	1H 2016	Change v. 1H 2016
High Yield Bonds (HYBI)				
Total Return YTD	17.49%	4.91%	9.32%	-4.41%
Yield (YTW)	6.17%	5.68%	7.36%	-1.68%
Spread (OAS)	422 bps	377 bps	621 bps	-244 bps
Price	99.60	101.33	95.27	6.06
Coupon	6.51%	6.46%	6.60%	-0.14%
Current Yield	6.54%	6.38%	6.93%	-0.55%
Average Rating	B1	B1	B1	Unch
Effective Duration	4.25	4.04	4.41	-0.37
Default Rate (Par)	3.98%	2.02%	4.68%	-2.66%
Leveraged Loans (LLI)				
Total Return (YTD)	9.78%	1.85%	4.31%	-2.46%
Yield (3-Yr)	6.23%	6.02%	6.52%	-0.50%
Spread (3-Yr)	458 bps	430 bps	571 bps	-141 bps
Price	98.22	98.16	95.56	2.60
Default Rate (Par)	1.49%	1.42%	2.18%	-0.76%

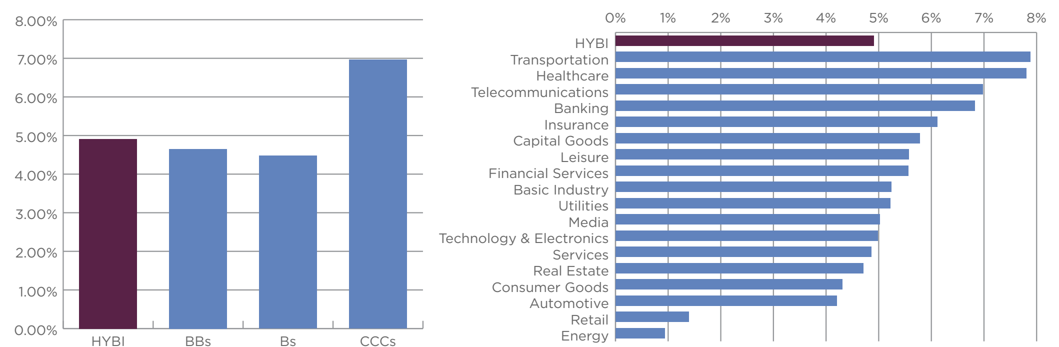
Source: BofA Merrill Lynch, JP Morgan, Bloomberg. Default statistics for 2016 and 2017 include distressed exchanges "HYBI" information is from the BofA Merrill Lynch U.S. High Yield Bond Index, and "LLI" information is from the JP Morgan Leveraged Loan Index.
Past performance is no guarantee of future results

> ...the distribution of returns amongst the various quality buckets was not nearly as wide as during calendar year 2016.

As one can see from Exhibit 1 above, high yield bonds (as measured by the BofA Merrill Lynch U.S. High Yield Bond Index ("HYBI")) produced gains of 4.91% in the first half of 2017 ("1H17") while spreads tightened by 45 basis points. The positive performance was fairly evenly distributed throughout the period, with each month except March (-0.21%) experiencing a positive return. Overall, high yield performance for 1H17 underperformed the first half of 2016, which was buoyed by improving commodity prices and easing macroeconomic fears.

Looking at performance by rating category reveals that, similar to calendar year 2016, triple C rated high yield bonds (6.96%) outperformed both double B rated (4.65%) and single B rated (4.48%) high yield bonds during 1H17. However, the distribution of returns amongst the various quality buckets was not nearly as wide as during calendar year 2016. From a sector perspective, all sectors generated positive returns during 1H17, with the Transportation (7.88%) and Healthcare sectors (7.80%) the top performers. The Transportation sector benefited from strong demand for shipping, lower fuel costs, and optimism that economic improvement would further increase demand. The Healthcare sector, which was the worst performing sector in 2016, outperformed as fears of a full repeal and replace of the Affordable Care Act ("ACA") dissipated. The two worst performing sectors over the period were Energy (0.94%) and Retail (1.39%). Oil price declines, particularly in June, led to underperformance in the Energy sector. Meanwhile, the difficulties in the Retail sector are widely known as traditional retailers continue to lose share to online competitors, a trend that I believe will continue for some time.

Exhibit 2: HYBI Rating and Sector Performance: 1/1/2017 - 6/30/2017

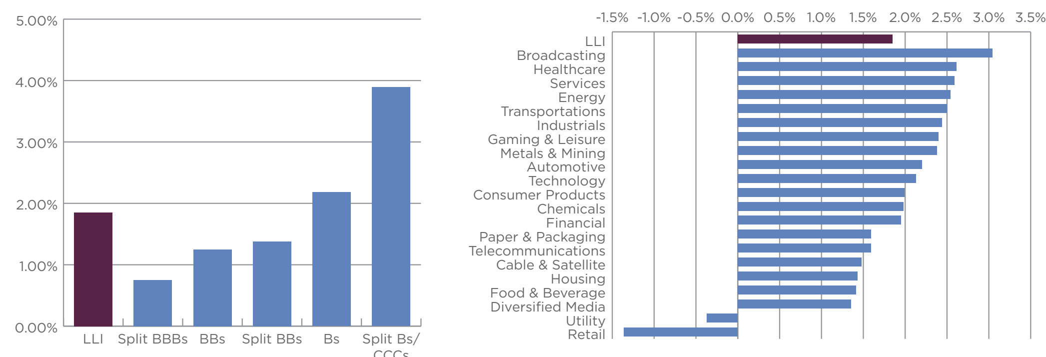


Source: Bloomberg, BofA Merrill Lynch; The BofA Merrill Lynch U.S. High Yield Index ("HYBI").
Past performance is no guarantee of future results

Meanwhile, leveraged loans (as measured by the JP Morgan Leveraged Loan Index ("LLI")) generated positive returns of 1.84% during the first half of 2017, with spreads tightening by 28 basis points. Leveraged loan performance was subdued as minimal potential for price appreciation (with a majority of the index trading above par and the limited call protection typical of leveraged loans), combined with easing concerns over rising rates, resulted in underperformance relative to high yield bonds. As Exhibit 3 demonstrates, similar to high yield bonds, lower rated leveraged loans outperformed higher rated loans, and loans in the Healthcare sector (2.61%) were amongst the top performers while loans in the Retail sector (-1.36%) lagged during 1H17. However, unlike high yield bonds, the Energy sector (2.54%) was amongst the best performing sectors over the period, though the sector did underperform significantly in June.

Unlike their high yield peers, leveraged loan funds experienced significant inflows of approximately $17 billion on a year-to-date basis, though the size of inflows decreased in the second quarter. Gross loan new issuance is on pace to set a record in 2017; however, approximately 75% of such issuance has been in connection with repricing/refinancing transactions. Finally, CLO new issue activity in the first half of 2017 is well above the same period in 2016, which, combined with retail inflows, provided a positive technical tailwind for leveraged loan performance during 1H17.

Exhibit 3: LLI Rating and Sector Performance: 1/1/2017 - 6/30/2017



Source: JP Morgan; The JP Morgan Leveraged Loan Index ("LLI")
Past performance is no guarantee of future results

2nd Half 2017 Outlook

We entered 2017, after a period in which favorable technicals were the dominant driver of strong returns in 2016, believing that issuer fundamentals would be a more important factor driving returns in the leveraged credit market. However, this outcome has not occurred thus far in 2017, at least not to the extent that I expected, as a positive economic outlook led to strong, broad performance in the overall high yield market during the first half of 2017. Looking ahead to the second half of 2017 and beyond, I still believe that issuer-specific fundamentals will ultimately drive performance in the high yield market, with increased volatility expected as the market begins to focus more on the credit profile of individual issuers. While the overall U.S. economy is in better shape now than it was at this time last year, the level of optimism about economic prospects in the U.S., largely as a result of expected pro-growth policies from the new presidential administration, can only last so long without seeing signs of concrete progress. If such policies are delayed and/or disappoint, there is the potential for a correction in the leveraged credit market as future expectations are reset. Furthermore, any meaningful increase in already elevated geopolitical tensions globally could also result in increased market volatility. As such, I cannot rule out a short-term market correction and/or an increase in volatility over the coming months, though if such a situation was to unfold, we at DDJ would view it as a potential opportunity to purchase solid but undervalued credits at attractive prices.

When assessing the overall health of the leveraged credit market over a longer-term horizon and where we are in the credit cycle, I typically look at a handful of factors that help form my view. Over my 35+ years of experience investing in the leveraged credit market, I have found these

The current credit cycle has been long by historical standards, largely due to the anemic economic recovery...

factors to have some predictive power with respect to the general timing of a future change in the direction of the credit cycle – which I refer to as the "inflection point" in the cycle. I have not, however, found these factors to have much power accurately forecasting with any precision when such inflection point will be reached. In addition, each credit cycle is somewhat unique and bears certain distinctive risks, or "wild cards", that I watch to gauge the extent to which these risks are materializing or not. The current credit cycle is no different.

In this CIO perspective, I thought it would be informative to explain what indicators I watch broadly across all credit cycles, as well as touch on which risks I believe are specific to the current environment. The broad indicators I watch across all credit cycles are: 1) trends in the current market, particularly regarding new issuance, 2) valuations, with a focus on spread levels, and 3) fundamentals, both of issuers in the leveraged credit market but also of the broader economy. A few of the potential risks that I believe are unique to this credit cycle include the level of uncertainty in the Healthcare sector – primarily regarding the Affordable Care Act; risks in the Energy sector – more specifically, oil prices; and secular changes in the Retail sector. When incorporating all of these factors, my overall takeaway is that the likelihood that the current credit cycle is approaching an inflection point has increased at the margin, but more criteria need to be met before I can conclude that an inflection point is looming on the horizon. The current credit cycle has been long by historical standards, largely due to the anemic economic recovery; as a consequence, lenders have remained relatively conservative, which has likely reduced the amount of capital available to riskier issuers. Furthermore, in my view, the current cycle has been extended a few times by macro events that instilled credit discipline back in the market (e.g., the Fed's 2013 "taper tantrum", the oil price downturn in 2015, and the 2016 Brexit vote).[1] It is certainly conceivable that another macro-level event reinstates credit discipline, potentially extending the credit cycle yet again.

I would note, however, that at DDJ, we adhere to a bottom-up, fundamental investment process that focuses on building portfolios on a security-by-security basis. We do not try to "time" the market. Put simply, we task our analysts with understanding the fundamental health of the companies in which we invest, with an emphasis on downside protection and the ability of the issuer to pay back principal at maturity, regardless of where we are in the credit cycle. We maintain a long-term investment horizon, and are primarily concerned with avoiding capital losses. This perspective enables us to look through any short-term market price volatility, provided that we are confident in the fundamental health of the underlying issuer. Given our focus on individual issuers/issues, we have historically found attractive investment opportunities throughout the course of a credit cycle.

Current market observations:

What I see on a daily basis offers me valuable insight into real-time aspects of the market, such as risk appetite. The indicators I typically focus on in the current market revolve around new issuance, in particular the trends in lending standards and the use of proceeds. In general, when I see a pattern of increased new issuance from the lower tier of the market (e.g. CCC-rated issues), that is a sign that lending standards may be easing, thereby opening up the capital markets to more risky issuers who may not be able to obtain capital under "normal" market conditions. This development sets the table for a challenging environment when lending

[1] Taper tantrum is the term used to refer to the 2013 surge in U.S. Treasury yields, which resulted from the Federal Reserve's use of tapering to gradually reduce the amount of money it was feeding into the economy.

CCC-rated new issuance has remained stable as a percentage of total new issuance...

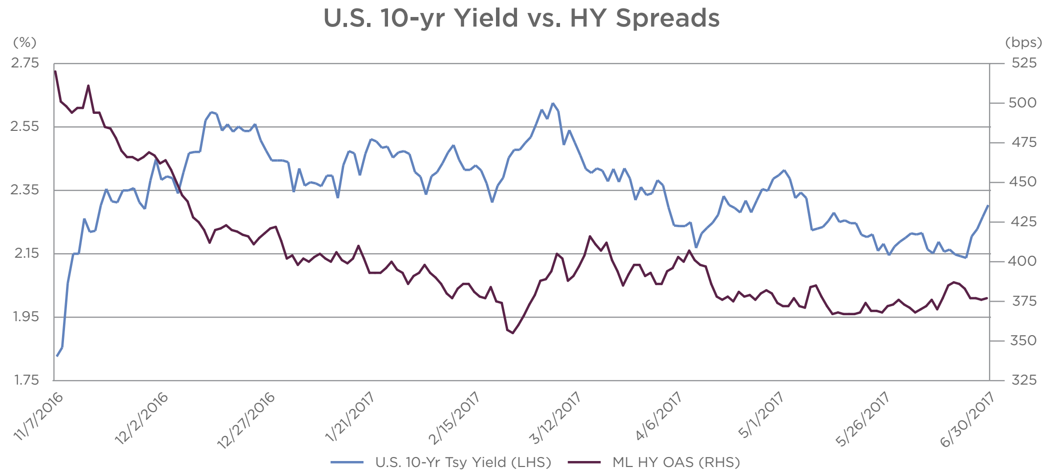
standards eventually tighten, thereby preventing many lower-rated issuers from refinancing their existing debt at maturity and leading to defaults. One such indicator of lending standards that I review closely is the quarterly U.S. Federal Reserve's Senior Loan Officer Opinion Survey on Bank Lending Practices, which surveys multiple large domestic banks and summarizes trends in lending standards for a number of loan categories. Additionally, I focus on the use of proceeds associated with new issuance, looking for signs of a meaningful uptick in transactions that increase the level of leverage in the market. Examples of such transactions include issuing debt to fund an acquisition, a large increase in capital expenditures, or a special dividend to shareholders. Alternatively, debt issued to "roll" or refinance existing debt are viewed as non-leveraging transactions, as they generally do not add leverage (debt) to the overall system while at the same time extending the maturity profile of the issuers. Each of these factors individually or in some combination can foreshadow an increase in defaults on the horizon. For example, if lower quality issuers represent a disproportionate percent of the new issue market, defaults are likely to rise if economic performance deteriorates, as these issuers typically have less capacity to withstand an economic slowdown.

Currently, however, I am not seeing worrying signs across these categories. For example, CCC-rated new issuance has remained stable as a percentage of total new issuance and use of proceeds is not outside of historical norms. I am, however, seeing the beginning stages of an erosion of credit discipline in the market. For example, market participants, who appear to be less sensitive to credit risk than current market conditions would seemingly warrant, are exhibiting signs of complacency with respect to their willingness to invest in high yield instruments, resulting in such risk not being appropriately priced in some situations. This complacency is particularly evident in the new issue market, where some issuers with questionable credit profiles are having no trouble accessing capital while new issues are being valued using overly optimistic assumptions of issuer fundamentals. In addition, new issues with relatively weak covenants are being met with robust demand. While the level of complacency is not widespread enough to be evident in the broader indicators of the new issuance market, these examples are nonetheless troublesome, as they exhibit signs of irrational investor behavior, and my concern would increase if these trends continue and begin to be reflected in broader market data.

Valuations – with an emphasis on spreads:

In the past, I have described why, in general, high yield bonds historically have absorbed interest rate increases through spread compression. This is because interest rates typically rise in connection with improved economic conditions, which usually results in improved financial performance for high yield issuers, leading to better credit profiles that can support tighter credit spreads. However, high yield spreads do not currently have much "cushion" to absorb a meaningful increase in interest rates. The chart below depicts how high yield spreads and 10-year U.S. Treasury yields have behaved since the U.S. presidential election. As can be seen, high yield spreads have generally continued to tighten since the election, despite 10-year U.S. Treasury yields peaking late in the first quarter before declining for most of the second quarter. If high yield spreads continue tightening in the face of declining Treasury yields, it will be more difficult for high yield spreads to absorb any future increases in interest rates, increasing the chance that rising interest rates could adversely impact the performance of the high yield market.

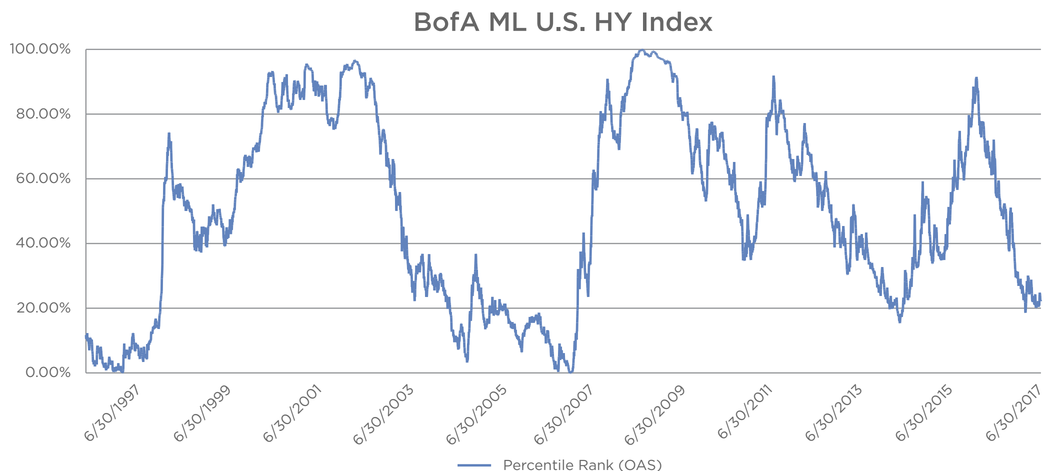
Exhibit 4: High Yield Option Adjusted Spread ("OAS") and U.S. Treasury yields diverge from "normal" relationship post-election



Source: Bloomberg

In addition, the decreased cushion is also evident when examining high yield spreads on an absolute basis over the longer-term, as in the chart below, with spreads currently hovering around the 20th percentile (lower percentile = lower spreads). There have only been two periods over the last 20-years in which spreads have remained at or below the 20th percentile for an extended period of time: in the run up to the dot-com bubble and just prior to the 2007-08 global financial crisis. I do not currently see excessive risk taking across the global economy close to the levels seen prior to such global financial crisis, which should serve to reduce the severity of the market correction following the inflection point when it eventually occurs.

Exhibit 5: Historical Percentile Rankings of High Yield Spreads



The above chart is based on the daily spread levels of the BofA ML U.S. High Yield Index over the period 12/31/1996 to 6/30/2017 – the dates for which historical spread data was available. Source: Bloomberg

The broader U.S. economy appears to be relatively healthy, as reflected by recent Fed rate increases...

Current spread levels give me pause, primarily due to the lack of a sufficient cushion to withstand or dampen the impact from an external shock, rising interest rates, or the economy underperforming the optimistic forecasts currently priced in the market. It is important to note that inflection points in the high yield market are typically caused by events outside of high yield (e.g., the role U.S. residential housing mortgages and securities tied those mortgages (e.g., Collateralized Debt Obligations), many of which were investment grade rated, played in the global financial crisis). It is after these external events cause broader economic deterioration that one typically observes an increase in defaults in the high yield market, typically led by issuers with questionable credit profiles that had easy access to capital described above.

However, when looking at spreads on an expected default-adjusted basis (i.e., the spread that one should expect to earn after incorporating forecasted default losses), such spreads are currently very close to the same levels as at this time last year, as reflected in the chart below. We know that the performance in the high yield market has been strong over the past year, so a case can certainly be made that spreads are not currently too tight, particularly on a risk-adjusted basis. However, the expected excess spread is currently less than the long-term average by a fairly significant amount, supporting the argument that current spread levels lack a sufficient cushion – on both an absolute and risk-adjusted basis – to absorb a significant negative event. Importantly, valuations must always be analyzed in the context of fundamentals, which we at DDJ continuously do on an individual issuer basis, as I believe issuer fundamentals, which we will discuss next, ultimately drive performance in the high yield market over the long-term.

Exhibit 6: Excess Spread given expected High Yield ("HY") defaults and historical recoveries

	Average	June 30 2017	June 30 2016
HYBI OAS*	575 bps	377 bps	621 bps
HY Default Rate**	3.0%	2%	6%
HY Recovery Rate**	41%	41%	41%
Expected Default Loss	176 bps	118 bps	354 bps
Excess Spread	399 bps	259 bps	267 bps

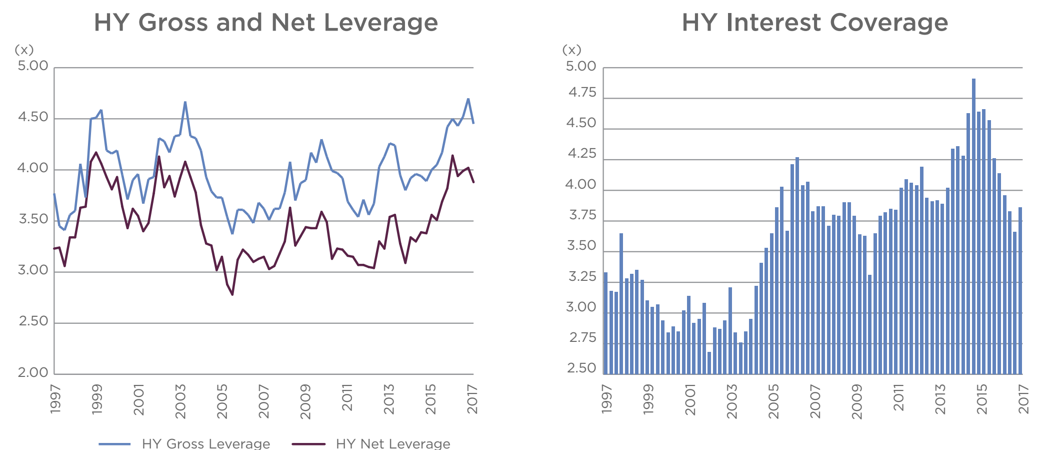
Source: BofA Merrill Lynch, JP Morgan, Bloomberg
Past performance is no guarantee of future results
*Average option adjusted spread (OAS) calculated based on month-end OAS from 1/31/1997 – 6/30/2017. All other OAS figures are as of the date provided
**Average default rate and recovery rate during the past 25 years according to JP Morgan Data. Other default rates reflect JP Morgan's forecasted default rate (including distressed exchanges) for respective calendar year as of the date provided

Fundamentals – broad economy and leveraged credit specific

When looking at fundamentals, I focus on both the broader economy as well as fundamentals in the leveraged credit market. The broader U.S. economy appears to be relatively healthy, as reflected by recent Fed rate increases, a declining unemployment rate, and strong consumer confidence. However, there are signs certain segments of the economy are plateauing – auto sales for example. In addition, the traditional Retail sector is in secular decline. Fortunately, the market recognizes these issues and has reacted accordingly. While there will likely be an increase in defaults in the (relatively small) Retail sector, I expect such default activity to be confined to the Retail sector and not have a meaningful impact on the overall leveraged credit market.

Broadly speaking, I would characterize the current fundamental state of the overall leveraged credit market as neutral, and there has been no significant deterioration in fundamentals thus far this year. When considering trends in issuer fundamentals, examples of metrics that I look at include leverage and interest coverage. Leverage, which declined slightly in the first quarter, remains near peak levels. Interest coverage also improved in the first quarter, after trending downwards from peak levels over the past two years, and is currently closer to the long-term median. The fundamental profile of the leveraged credit market could support an argument that spreads should be higher. However, when one incorporates the low expected default rate together with the absence of any significant pick-up in aggregate debt maturities over the next few years, the case for higher spreads is not as strong. Accordingly, I believe that based on fundamentals of the leveraged credit market and expectations for continued improvement in the U.S. economy, there is potential for further, albeit likely modest, narrowing of high yield spreads.

Exhibit 7: Fundamentals – High Yield Leverage and Interest Coverage



Source: Morgan Stanley, Bloomberg, Capital IQ, Citigroup Index LLC
Quarterly data provided from 3/31/1997 - 3/31/2017
Gross Leverage is equal to total debt/EBITDA; Net leverage is equal to total debt minus cash/EBITDA
Interest coverage is equal to EBITDA/total interest expense
EBITDA is an acronym for earnings before interest, tax, depreciation and amortization
Past performance is no guarantee of future results

Sectors in Focus: Healthcare and Energy

As mentioned earlier, there are a few sector-specific potential red flags unique to this cycle – namely, within the Healthcare and Energy sectors. Healthcare, which lagged the market in 2016, has been one of the best performing sectors year-to-date, largely due to reduced fears of a full repeal and replacement of the ACA. In my view, there is still an abundance of uncertainty surrounding the eventual outcome of healthcare reform, if there is any meaningful reform passed at all. Higher levels of uncertainty translate into higher levels of risk, and with the Healthcare sector spread on par with the overall high yield market spread, I do not believe that the risk of a negative outcome is adequately incorporated into the valuations of many issuers in the sector. In the Energy sector, I see risks related to the price of oil, such as OPEC abandoning

...the Energy sector has seen a sell-off, primarily in mid-June as oil prices briefly declined into bear market territory...

its production cut agreement or a slower than anticipated pick-up in U.S. growth. While the Energy sector has seen a sell-off, primarily in mid-June as oil prices briefly declined into bear market territory, time will tell if the correction is sufficient enough to more appropriately price the risks that I view in the sector (for example, when West Texas Intermediate ("WTI") crude oil was at/below $45/barrel earlier in the oil price downturn, Energy issues offered considerably higher yields than they do currently). More importantly, these two sectors together represent approximately 24% of the BofA Merrill Lynch U.S. HY index. In reality, this number is likely even higher when considering how interwoven the Healthcare sector, and in particular the breadth of the ACA, is with the remainder of the economy. Any negative events impacting one or both of these two sectors could spill over to the broader economy. Inflection points historically have occurred when multiple sectors have experienced challenges at the same time, resulting in defaults increasing across the board. We will be closely watching these two sectors for signs that risks are materializing, which could increase the chances of the leveraged credit market reaching an inflection point sooner than I believe is currently likely.

However, it is important not to paint sectors with a broad brush. DDJ's research process, which analyzes investment opportunities on a security-by-security basis with a keen focus on downside protection, has identified what we believe to be attractive investment opportunities within both the Energy and Healthcare sectors notwithstanding the challenges and uncertainties that these sectors presently face. In an effort to ward against unexpected adverse circumstances, we remain vigilant in our credit research and investment process, which includes continuously monitoring existing investments.

While these red flags exist, there are also positives present in the global economy. I believe that the broader global economic outlook is better today than it was a year ago, particularly in the U.S., China and most of Europe. In addition, the equity market, especially in the U.S., has been strong, which has contributed to a rise in consumer confidence and improved corporate valuations. Furthermore, if Washington does make some progress on the legislative front, such as passing comprehensive tax reform, there is the potential for a meaningful pick-up in economic growth.

Summary

The first half of 2017, in some ways, felt like a continuation of 2016. Performance in the high yield market remained strong, supported by an optimistic view of the prospects for the U.S. economy. Issuer specific fundamentals still do not appear to be a major factor driving high yield returns, but I believe that it is only a matter of time until fundamentals move to the forefront.

In my view, the likelihood that the current credit cycle is approaching an inflection point has increased at the margin. This view is driven by early signs of an erosion of credit discipline in the market as well as valuations that provide little cushion to absorb a significant negative event, should one occur. In addition, there are certain sectors, namely Healthcare and Energy, which need to be monitored closely, due to high levels of uncertainty. However, other signals that tend to preclude an inflection point are not currently present in the market; for example, use of proceeds and lending standards are not alarming, and issuer fundamentals are decent, absent a significant economic downturn, which I view as unlikely as the U.S. economy appears to be relatively healthy. Accordingly, while we are likely getting closer to an eventual inflection point, it seems premature to conclude that such an event looms on the immediate horizon.

Nonetheless, I believe that trying to time the high yield market by accurately forecasting the exact timing of when such an inflection point will occur is a very difficult, and in all likelihood, fruitless exercise. Based on my experience, issuer fundamentals ultimately drive performance in the leveraged credit market over the long-term. At DDJ, we will continue to conduct exhaustive, bottom-up fundamental research to identify attractive investment opportunities for our clients throughout the credit cycle irrespective of when an inflection point eventually arrives.

Organizational Update

Six Months Ending	**June 30, 2017**
Total Assets Under Management (MM)	$7,617
Total Number of Accounts	41
Personnel Updates: Material Changes (Positions)	None
Material Departures (Positions)	Akbar Causer (Senior Research Analyst)
Material Additions (Positions)	Eric Hoff, CFA (Senior Research Analyst)

Appendix

BPS: Stands for basis points. A basis point is one one-hundredth of one percent (0.0001).

Brexit: Brexit is an abbreviation for “British exit,” which refers to the June 23, 2016, referendum whereby British citizens voted to exit the European Union.

Call Protection: is a protective provision of a callable security prohibiting the issuer from calling back the security for a period early in its life.

Collateralized Loan Obligation (“CLO”): A CLO is a form of securitization where payments from multiple middle sized and large business loans are pooled together and passed on to different classes of owners in various tranches.

Coupon: The stated interest rate paid on a bond. Coupon payments for high yield bonds are typically made semi-annually.

Effective Duration: A duration calculation for bonds with embedded options. Effective duration takes into account that expected cash flows will fluctuate as interest rates change.

High Yield Bond: A high yield bond is a debt security issued by a corporate entity where the debt has lower than investment grade ratings. It is a major component – along with leveraged loans – of the leveraged credit market.

Investment Grade: investment grade are those securities rated Baa3/BBB-/BBB- or above by Moody’s, S&P, and/or Fitch, respectively.

LBO: A leveraged buyout (LBO) is the acquisition of another company using a significant amount of borrowed money to meet the cost of acquisition.

Monetary Policy: Monetary policy is the actions of a central bank, currency board or other regulatory committee that determine the size and rate of growth of the money supply, which in turn affects interest rates. Monetary policy is maintained through actions such as modifying the interest rate, buying or selling government bonds, and changing the amount of money banks are required to keep in the vault (bank reserves).

Option Adjusted Spread: A measurement of the spread of a fixed-income security rate and the risk-free rate of return, which is adjusted to take into account an embedded option. Typically, an analyst would use the Treasury securities yield for the risk-free rate. The spread is added to the fixed-income security price to make the risk-free bond price the same as the bond.

Spread: The yield of a bond minus the yield of the government bond that matches the maturity (or appropriate call date) of the bond.

Spread Compression: Spread compression is when spreads go down.

Yield: The yield is the income return on an investment, such as the interest or dividends received from holding a particular security.

Disclosures

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The BofA Merrill Lynch US High Yield Index tracks the performance of US dollar denominated below investment grade corporate debt publicly issued in the US domestic market. Please note that one cannot invest in the index.

The J.P. Morgan Leveraged Loan Index is designed to mirror the investable universe of USD institutional leveraged loans, including US and international borrowers. Please note that one cannot invest in the index.

Moody’s Investors Service and Standard and Poor’s Financial Services use a different nomenclature for their ratings system. For example, the Moody’s equivalent to a S&P rating of CCC+ is Caal. For information on the rating agencies’ methodology go to: https://www.moodys.com or www.standardandpoors.com.

Diversification does not guarantee investment loss.

Past performance is no guarantee of future returns.

Investing involves risk, including potential loss of principal.

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CIO's Perspective
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ABOUT DDJ CAPITAL MANAGEMENT

DDJ Capital Management's goal is to consistently produce attractive long-term investment returns, while minimizing downside risk for our investors, which include:

- Corporate pension accounts and public retirement plans
- Endowments and foundations
- Insurance companies
- Other institutional clients

The underpinning of DDJ — a disciplined investment philosophy, coupled with a commitment to exhaustive credit research — has remained constant since our founding in 1996. Our highly skilled team is steadfast and focused on executing our strategy to identify strong risk-adjusted investment opportunities in the leveraged credit markets.

For information on DDJ's investment capabilities, please contact:

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Jack O'Connor, head of business development and client service at DDJ, is a representative of ALPS Distributors, Inc.