Fort Washington
Investment Advisors, Inc.
A member of Western & Southern Financial Group

Uncompromised Focus®

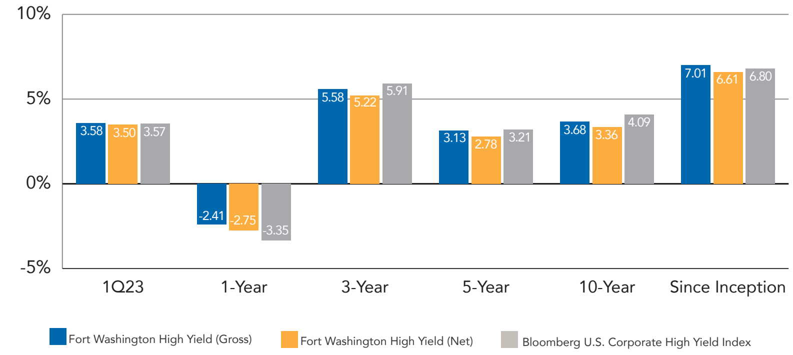
# FORT WASHINGTON HIGH YIELD FIXED INCOME — 1Q2023

## HIGHLIGHTS

- Risk assets started the year firing on all cylinders with the Russell 2000 (+9.75%), S&P 500 (+6.28%), and CCCs (+6.06%) exhibiting strength in January. High Yield issuers took advantage of the appetite for risk by accessing the new issue market to the tune of $20B, the highest monthly tally in the previous 12 months. The euphoric rise in January gave way to weakness in February as better than expected payrolls and elevated inflation drove terminal rate expectations higher. Banking turmoil in March led to spread widening in the midst of a material Treasury rally.
- The High Yield strategy returned (3.58%/3.50%) on a gross/net basis or +1bps gross to the index return. Sector allocation was notably positive, but security selection was largely offsetting. A material underweight to the poorly performing Wireline sector was highly additive and effectively provided all positive allocation. In security selection, strong operational results at a printer/publisher holding led to a +20% return and the lead contribution. Limited exposure to the largest Wireline constituent generated similar contribution as that capital structure sold off sharply on poor guidance. A position in a struggling e-commerce retailer was the largest detractor. One negative secular trend, cord-cutting, affecting this retailer also continued to weigh on a holding in a cable operator, hampering performance.
- Unlike the rally at year end 2022, low quality credit was a strong performer. Even so, companies reporting poor results or providing weak guidance were severely punished. Risk assets outside of High Yield also performed well. These positive results were remarkable in that they occurred in the face of a banking crisis. The confidence enabling this outcome was restored through rapid action by regulatory authorities which halted the spread to regional banks. A concurrent Treasury rally ensued as market participants anticipated the end of the Federal Reserve rate hiking cycle and the start of rate cuts.

### Historical Performance

Annualized Return as of March 31, 2023



Inception Date: 07/01/1994. Past performance is not indicative of future results. This supplemental information complements the High Yield GIPS Report.

### Top Issuer Attribution

| | Attr | Rel Wgt |
|---|---|---|
| Cimpress | 0.09 | 0.58 |
| Lumen Technologies | 0.07 | -0.16 |
| Bausch Health | 0.06 | -0.68 |
| South Jersey Industries | 0.03 | 0.34 |
| Royal Caribbean Cruises | 0.03 | 0.60 |

### Bottom Issuer Attribution

| | Attr | Rel Wgt |
|---|---|---|
| QVC | -0.16 | 0.34 |
| Altice USA | -0.05 | 0.19 |
| Carvana | -0.05 | -0.23 |
| Consensus Cloud Solutions | -0.04 | 0.41 |
| AMC Entertainment | -0.04 | -0.14 |

Fort Washington considers the presentation of attribution as part of the investment management process and not advertised performance. Portfolio attribution and allocation is subject to change without notice.

## INVESTMENT PROFESSIONALS

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Portfolio Manager
*26 Years Experience*

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*30 Years Experience*

**Casey A. Basil**
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*21 Years Experience*

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Portfolio Manager
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**Jon P. Westerman, CFA**
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Credit Analyst
*7 Years Experience*

Source: Fort Washington Investment Advisors, an investment advisor registered with the U.S. Securities and Exchange Commission. Past performance is not indicative of future results. Quality and sector distribution as well as portfolio attribution and allocation is subject to change at any time.

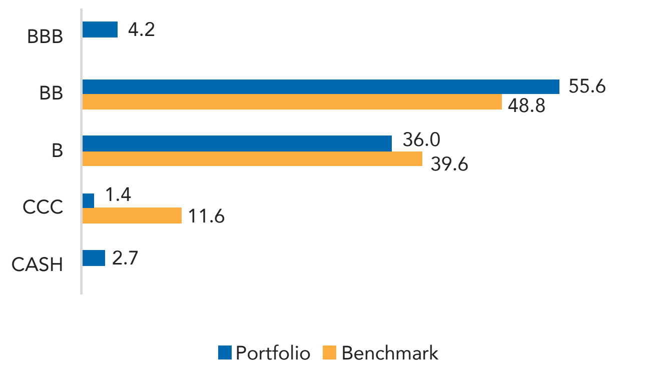
## MARKET OVERVIEW

- Across a broad range of asset classes, securities markets began the year on an optimistic note, in part driven by expectations for a near term end to Federal Reserve rate hikes. In January alone, multiple asset classes generated returns which would have been respectable over a full year. However, a blowout payroll report on February 3rd marked the top in the quarter. A highly negative Senior Loan Officer Survey and surprisingly strong inflation data applied further pressure to markets. A widespread selloff followed with higher quality outperforming through quarter end in High Yield (BBs –1.33% vs. CCCs –3.07%) and equities (S&P 500 –1.37% vs. Russell 2000 -9.64%). That said, volatility was subdued for a time period which saw multiple bank runs and failures.
- Overall returns in High Yield were quite solid and surprisingly so for BBs (+3.44%) and Bs (+3.47%) as both had also produced above coupon results in 4Q22. However, CCCs (+4.96%) came out on top, though gains melted away for much of the quarter. Not surprisingly, on a sector basis, the primary theme within outperformers was also low quality. Leading sectors including Leisure (+9.37%), Building Materials (+5.76%) and Healthcare (+5.64%) were driven by low B and CCC-rated constituents. Returns were more idiosyncratic for laggards. The worst performing sector of size, Wirelines (-3.69%), saw its second largest constituent issue weak guidance and initiate a poorly received distressed debt exchange. Banking (-0.41%) was a victim of the banking crisis late in the quarter and Pharmaceuticals' (-0.17%) largest component continues to be weighed down by multiple issues (litigation, patent loss and high leverage).
- As High Yield's rally extended into January and spreads reached lows last seen in early 2022, issuers returned to the market printing $19.8B, the highest monthly new issuance total in a year. Subsequent volatility and wider spreads doused issuers' enthusiasm; March saw just $5.2B issued. Flows were materially negative (-$16B) in total and during the majority of weeks. Default activity rose again and is now well above the historically low level reached in 2021. For leveraged credit as a whole, default and distressed exchange activity in 1Q23 ($20.6B) was 43% of the full year 2022 experience and the universe of securities trading at a distressed level (1000bp+ for bonds and sub $80 for loans) is 5x the 12/31/21 figure. While there was an appetite for risk in the quarter, weak credits are skating on thin ice. More than a dozen capital structures fell $20+ for a variety of reasons including weak guidance and distressed debt exchanges. Distress is expected to spread as the full impact of the tight lending standards which were in place prior to the implosion of a quartet of banks, (Silvergate, Signature, Silicon Valley and Credit Suisse) is felt.

### Statistics

| | Composite | Benchmark |
|---|---|---|
| Quality | BB- | B+ |
| Coupon | 5.25 | 5.87 |
| Price | 88.75 | 90.41 |
| Duration | 3.66 | 3.69 |
| Current Yield | 5.76 | 6.64 |
| Yield to Worst | 7.51 | 8.52 |
| OAS | 343 | 455 |
| Number of Issues | 312 | 2021 |
| Number of Issuers | 216 | 1021 |

### Credit Quality
(% of Market Value)



Source: Fort Washington Investment Advisors. Past performance is not indicative of future results. Quality and sector distribution as well as portfolio attribution and allocation is subject to change at any time. This supplemental information complements the High Yield GIPS Report.

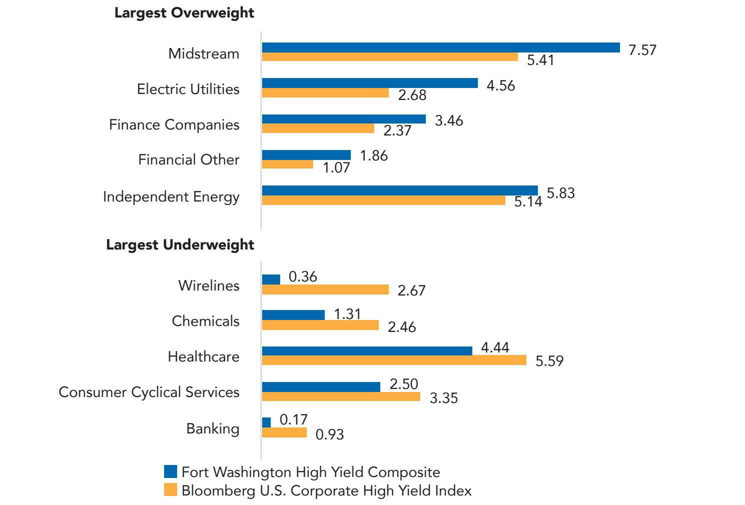
## PORTFOLIO ACTIVITY

Considering the potential for contagion, the U.S. financial system withstood a serious storm in the form of multiple runs on banks and bank failures with remarkably little damage. Outweighing concerns over the impact these events will have on lending is a clear belief that the rate hike cycle is all but over. The soaring Treasury market, particularly at the front end, provides the clearest evidence of this. High Yield was little changed in the quarter, slightly tighter and nearer to median spread levels. Though the portfolio is tilted heavily to higher quality, positioning overcame the low quality leadership which prevailed in 1Q23. A longer duration relative value trade into BBBs executed late last year was notably beneficial. This trade was partially reversed as the trade played out, in part due to the rally in Treasuries. At the margin, purchases leaned lower in quality as BBs were richly priced.

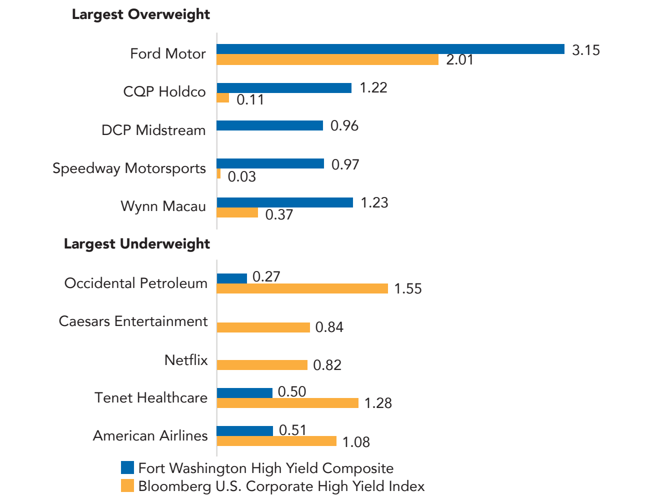
March 16, 2023 marked the one year anniversary of the Federal Reserve's first rate hike this cycle. With monetary policy working with a long lag, the full effects have yet to be felt. The unemployment rate remains historically low even in the face of rising participation. Overall inflation appears to have peaked, but service inflation is still robust. That said, parts of the economy have been materially affected. ISM Manufacturing PMI has declined for two years (now 46.3), New Orders are similarly down to 44.3 and housing activity has plummeted. Higher rates and spreads have throttled the new issue market in High Yield and the Leveraged Loan market. A year ago, one could say there was no maturity wall to speak of, but one is now being built.

It seems probable that recent banking turmoil has solidified a near term end to this hiking cycle. Yet, the time spent at peak rate may be lengthy as the Federal Reserve seeks to avoid allowing inflation to reignite. Lending standards at the start of the year were at recessionary levels. A banking crisis was added to this environment, which likely leads to increased scrutiny internally at lending institutions and externally from regulators. As a result, we have reduced our Outlook to Slightly Negative in light of our concern over the extended impact of tight financial conditions. Under-risked positioning is being maintained and purchase activity will tilt towards BBs.

## Largest Sector Exposures
(% of Market Value)



## Largest Issuer Exposures
(% of Market Value)



Source: Fort Washington and PORT. Holding allocations are subject to change. Weights shown are subject to rounding. This supplemental information complements the High Yield GIPS Report. This should not be construed as investment advice or a recommendation of any particular security, strategy, or investment product.

## OUTLOOK

| Factor | Outlook | Comments |
|---|---|---|
| Economy | Slightly Negative<br>◀ ▶ | • GDP grew 2.6% in the fourth quarter; slightly down from 3.2% growth in 3Q and up meaningfully from negative growth earlier in the year. GDP expectations for 2023 currently stand at 1% and are expected to inflect upward for 2024 but below 2%.<br>• Employment remains healthy with strong payroll numbers, low unemployment (3.6%) and strong wage growth (4-6%).<br>• Consumer confidence and sentiment are stable on labor market strength and lower inflation; Business confidence shows further softness with most ISM numbers below 50. |
| Financial Conditions | Negative<br>◀ ▶ | • Financial conditions have meaningfully contracted with the rise in interest rates and net 45% of lenders are tightening conditions; levels not seen since the COVID pandemic and the GFC before that. We expect these levels to tighten further on the back of recent bank volatility and uncertainty.<br>• The Fed increased rates by 25bps at its February and March meetings; hitting 5.0%. Expectations are mixed for more Fed hikes and the market has priced in 50bps of rate cuts for 2023.<br>• Credit spreads for BBB Industrials were flat on the quarter and High Yield was slightly tighter; all-in High Yield yields were 8.52%. |
| Rates | Slightly Positive<br>◀ ▶ | • The U.S. 10 year Treasury rallied in the quarter on concerns over slowing economic growth and bank uncertainty ending at 3.47%.<br>• Ten year TIPS breakevens are trading near 2.32%; implying that real yields are +114bps.<br>• U.S. rates remain higher than many other developed market levels; making them attractive in a global context and leading to significant strength in the dollar; although off of its highs in the Fall of 2022. |
| Fundamentals | Slightly Negative<br>◀ ▶ | • Declining business sentiment, business spending, tightening financial conditions, and softening housing markets have led to downward revisions in GDP; these factors are being offset by a resilient consumer and job market.<br>• Bond issuance for the quarter was muted with $39.0B in 1Q23 vs $15.5B in 4Q22 and $43.3B in 1Q22. New issuance was heavily skewed to January ($20.0B) and trailed off significantly in March ($5.2B).<br>• Defaults ended February at 2.3%; up from 0.9% one year ago. We expect default rates to increase over the next several quarters as financial conditions tighten and the economy slows. |
| Valuation/ Spreads | Neutral<br>◀ ▶ | • High Yield spreads tightened 14bps and ended the quarter at +455bps (53rd percentile); fairly rangebound in aggregate over the last 6 months. BBs tightened 12bps (48th), Bs 24bps (55th), and CCCs 34bps (69th).<br>• Aggregate yields at March end were 8.52%; up meaningfully from 4.21% at 2021 year end; due to the increase in Treasury rates as well as the widening in spreads.<br>• CCCs meaningfully outperformed BB/B in the quarter; however, March saw a broad risk off tone take hold. |
| Outlook & Positioning | Slightly Negative<br>▼ | • We are downgrading our opinion on High Yield to Slightly Negative due to the increasing level of economic uncertainty, material tightening of financial conditions, and deteriorating company fundamentals; partially offset by attractive all-in yields and median spreads.<br>• We expect defaults to increase over current levels; however, we also anticipate bond defaults to be lower than previous cycles as the quality of High Yield is higher than historic periods. We expect spreads to widen as the economy weakens and unemployment increases while recognizing that yields at current levels are attractive in a longer term context.<br>• Purchase activity is being focused towards BBs and sale activity tilted towards Bs with a preference for less cyclical exposure. We will look to maintain risk near current levels; relying on credit selection in this volatile credit environment. |

Source: Fort Washington. The above outlook reflects subjective judgments and assumptions; subject to change at any time. Unexpected events may occur and there can be no assurance that developments will transpire as forecast. This is for informational purposes only and should not be construed as investment advice or a recommendation of any particular security, strategy, or investment product. Past performance is not indicative of future results. Fort Washington rankings of Bloomberg U.S. Corporate HY Index statistics for quarter, against Index history.

## COMPOSITE PERFORMANCE DISCLOSURES

| | 1Q2023 | 2022 | 2021 | 2020 | 2019 | 2018 | 2017 | 2016 | 2015 | 2014 | 2013 | 2012 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| High Yield Fixed Income (Gross) | 3.58% | -10.02% | 4.97% | 4.55% | 15.30% | -1.94% | 7.75% | 12.84% | -3.82% | 2.50% | 6.26% | 14.08% |
| High Yield Fixed Income (Net) | 3.50% | -10.33% | 4.60% | 4.19% | 14.93% | -2.24% | 7.44% | 12.52% | -4.09% | 2.23% | 6.01% | 13.83% |
| ML-Bloomberg Linked Benchmark[1] | 3.57% | -11.19% | 5.28% | 7.11% | 14.32% | -2.08% | 7.50% | 17.13% | -4.55% | 2.45% | 7.39% | 15.44% |
| High Yield Fixed Income 3-Year Annual Standard Deviation[2] | -- | 11.24% | 8.96% | 9.11% | 4.02% | 4.01% | 5.32% | 5.82% | 5.59% | 4.53% | 5.75% | 5.89% |
| ML-Bloomberg Linked 3-Year Annual Standard Deviation[2] | -- | 10.97% | 9.00% | 9.24% | 4.02% | 4.62% | 5.59% | 6.01% | 5.27% | 4.42% | 6.33% | 6.93% |
| Dispersion[3] | 0.03% | 0.23% | 0.19% | 0.62% | 0.13% | 0.07% | 0.24% | 0.40% | 0.75% | 0.15% | 0.35% | 0.56% |
| Number of Accounts | 9 | 9 | 9 | 9 | 10 | 11 | 15 | 18 | 20 | 21 | 17 | 21 |
| Composite Assets ($ Millions) | $1,578.3 | $1,532.8 | $1,746.8 | $1,791.3 | $1,897.5 | $2,085.3 | $2,916.2 | $3,287.2 | $3,474.8 | $3,868.0 | $4,057.0 | $4,285.5 |
| Total Firm Assets ($ millions) | $68,722 | $66,365 | $73,804 | $65,086 | $59,174 | $49,225 | $52,774 | $45,656 | $42,959 | $45,002 | $43,671 | $42,465 |

Composite inception and creation date: 07/01/94. [1]Effective 01/01/16, the benchmark for this composite is the Bloomberg U.S. Corporate High Yield Index. Prior to 01/01/16, the benchmark for this composite was the Merrill Lynch U. S. Cash Pay High Yield. Given the strong similarity between the benchmarks, the change was made to enhance portfolio analysis capabilities. [2]The 3-Year annualized ex-post standard deviation is calculated using monthly gross-of-fee returns to measure the average deviations of returns from its mean. [3]Dispersion is not calculated for years in which the composite contains five portfolios or less. Dispersion is calculated as the equal weighted standard deviation of gross-of-fee returns for those portfolios held in the composite during the entire period. Past performance is not indicative of future results.

Fort Washington's High Yield strategy seeks to outperform over a full market cycle (typically 3-5 years) by protecting principal in periods of market decline while providing a stable base of income across all periods. The focus is on the higher-quality credits exhibiting lower default risk and mature sectors that can be expected to weather a full market cycle. All fee-paying fully discretionary portfolios managed in the High Yield Fixed Income style, with a minimum of $20 million under our management, are included in this composite. Effective 01/22/14, the High Yield Fixed Income fee is 0.50% for the first $100 million and 0.45% on additional amounts over for separate accounts. The benchmark for this composite is the Bloomberg U.S. Corporate High Yield Index. Portfolios in this composite include cash, cash equivalents, investment securities, interest and dividends. Cash is maintained, within each separately managed account segment, in accordance with our asset allocation ratio. The U.S. dollar is the base currency. The specific securities identified and described do not represent all of the securities purchased, sold, or recommended. Returns are presented gross and net of management fees and include the reinvestment of all income. Gross returns will be reduced by investment advisory fees and other expenses that may be incurred in the management of the account. Net of fee performance was calculated using the actual management fees charged. Individual portfolio returns are calculated on a daily valuation basis. Prior to 01/01/97, individual portfolio returns were calculated on a monthly basis using a time-weighted return method. Past performance is not indicative of future results. Fort Washington Investment Advisors, Inc. (Fort Washington), a wholly owned subsidiary of The Western and Southern Life Insurance Company, is a registered investment advisor and provides discretionary money management to a broad range of investors, including both institutional and individual investors. Assets under management include all portfolios managed by Fort Washington and exclude assets managed by and marketed as its Private Equity business unit. Fort Washington claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS Standards. GIPS® is a registered trademark of CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. Fort Washington has been independently verified for the periods 7/1/94 - 12/31/21. The verification reports are available upon request. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. Verification does not provide assurance on the accuracy of any specific performance report. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request. To receive a complete list and description of composites, contact Fort Washington by phone at 888.244.8167, in writing at 303 Broadway, Suite 1200, Cincinnati, Ohio 45202, or online at fortwashington.com.

## RISK DISCLOSURES

The High Yield Fixed Income strategy invests in fixed-income securities which can experience reduced liquidity during certain market events, lose their value as interest rates rise and are subject to credit risk which is the risk of deterioration in the financial condition of an issuer and/or general economic conditions that can cause the issuer to not make timely payments of principal and interest also causing the securities to decline in value and an investor can lose principal. The High Yield Fixed Income strategy invests in non-investment grade debt securities which are considered speculative with respect to the issuers' ability to make timely payments of interest and principal, may lack liquidity and has had more frequent and larger price changes than other debt securities. The High Yield Fixed Income strategy invests in foreign securities which carry the associated risks of economic and political instability, market liquidity, currency volatility and accounting standards that differ from those of U.S. markets and may offer less protection to investors.

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