# March 2022 Virtual Event-AICA Spring Closed-End Fund Roundtable Day 1 Panel #3; “High Yield Income in Volatile Times”

Tuesday, March 15, 2022

Chuck Jaffe, Host of Moneylife, moderates the third and final panel of Day 1 of the AICA March 15th & 16th, 2022 virtual event; “High Yield Income in Volatile Times”. Read the transcript below to hear the discussion among Mr. Jaffe and panelists Gretchen Lam from Octagon, Bryan Lazarus from Pimco, and Erlend Lochen from Aberdeen.

Chuck Jaffe

Gretchen Lam

Bryan Lazarus

Erlend Lochen

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**John Cole Scott:** All right, ready for the last panel of today. If the panelists and moderator could please join me on stage, we’ll be happy to get started. Thank you so much guys, I’m going to let Chuck take over.

**Chuck Jaffe:** Thank you, John. Good afternoon, everybody, welcome to “High Yield Income in Volatile Times”. My name is Chuck Jaffe, I am a syndicated financial columnist and the host of *Money Life with Chuck Jaffe*. But more importantly to folks from the Active Investment Company Alliance, I am the host of *The NAVigator* podcast, which both appears on my show and as a standalone product of AICA. So you can find us there, it’s all over the AICAlliance.org website.

We have a great panel of speakers for you, their more complete bios are available for you in all of the conference materials. But joining me now, and I’ll do this in alphabetical order, Gretchen

Lam, senior portfolio manager for Octagon Credit Investors, manager of XFLT, that's the XAI Octagon Floating Rate and Alternative Income Trust. Bryan Lazarus, vice president of the product strategy group for PIMCO. And Erlend Lochen, head of North American fixed income and global high yield at abrdn, where we still pronounce the vowels even though they only use one of them.

As we jump in, and I'm going to try to keep the non-necessary chitchat to a minimum, I just want to point out that the funds that these guests represent are not necessarily your average fund. Like if you're talking about the average investor with a 60-40 portfolio, this is not necessarily what's going into that 40. We're going to explore how and why their fund products are different, how you want to use them. But before we can get to any of that we have to acknowledge the macro conditions that are causing the volatile times that's half of the headline for this discussion.

I will also point out that I very much appreciate these presenters, but I say this not only for the presenters in my session but for everybody who's doing this because they all got asked to participate weeks ago. And let's just point out, in the intervening weeks a lot has changed beyond the level that any of us could have foreseen, which makes the investment environment trickier but also makes it harder to talk about. So I very much appreciate that these folks have stuck with us and want to do this.

So the three biggest factors behind the volatility for the market right now, one, the war in Ukraine and the impact it's having and could have, two, inflation, how high it can go and how long it's likely to last, and three, interest rates and the impacts of rate hikes that everyone thinks are not just inevitable but are coming this month. With all of my guests, well, they could give their take on each of those things, and we'll let them weigh in on their own specialties a little bit later, but we're going to tap into each of them for a quick overview. We're going to start with Bryan Lazarus of PIMCO on the impact of current events. So Bryan, thanks for being here, please give us your take on how the fixed-income space is being impacted by events in Ukraine.

**Bryan Lazarus:** Sure, thanks Chuck. And thanks for having me today, excited to be here. Certainly it's a challenging situation in Ukraine of course from a humanitarian perspective, but obviously investment-wise as well, and has certainly made things a whole lot more interesting and challenging in managing portfolios today. I think it's clearly amplified volatility across markets. Obviously in emerging markets specifically, energy markets but really across the entire risk spectrum, in equity markets, in the entire fixed-income landscape as well. And ultimately I think looking ahead has really increased the overall level of uncertainty across the macro and investment environment going forward, and has increased the downside risk to markets as we look ahead as well.

When you couple that with, as you mentioned, likely central bank tightening, at least from the Fed, starting tomorrow, as well as just this ongoing volatility from Ukraine, we really see an increased risk of weaker economic growth or even a recession in the next couple years ahead. Not our base case. I think our base case is still that we have slowing growth but continued inflation that follows. Certainly think that a likelihood of a recession has increased over the last few weeks. And really when you look at the Fed, I think that there's a question of the Fed's in a bit of a tricky spot now, where it will look to obviously deal with inflation and likely move towards tightening starting tomorrow. But also with the potential around Ukraine and Russia for potential for declining growth puts them in a tricky spot to be able to serve both masters and solve both problems.

So from our perspective from a portfolio standpoint, really with that in mind have really just been looking to ensure we have adequate flexibility and diversification in our portfolios, looking for more resilient assets across the board, things that are a little bit removed from meaningful default risk. And with that, pulling other levers to obviously still produce attractive returns and yield, particularly in a closed-end fund vehicle where yield is so important to investors by looking at less liquid type opportunities, incorporating leverage to the extent appropriate, etcetera.

**Chuck Jaffe:** Thank you, Bryan. Now we're going to talk inflation with Erlend Lochen of abrdn. Erlend, nobody describes inflation as transitory anymore, but how has the uncertain duration of these conditions and the fact that we have moved so quickly to 40-year highs impacted the high yield space? And what's next?

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**Chuck Jaffe:** Let me set you up again so that you can start over and we can hear the full answer. Which is, how has the uncertain duration of inflation and these conditions, and the fact that we've moved so quickly to 40-year highs in inflation impacted the high-yield space? And what's next?

**Erlend Lochen:** So we're all seeing it, we're all feeling it, we know why it's happening. The supply chain, supply of money, the issue we had with labor, and I think it opened up after Covid. And we saw today the rent inflation is very strong. And I think on the back of the crisis, that energy and food will continue to put pressure on it. Before the crisis it was expected to drop in the second half, but I think that has changed completely and we're expecting 6-7% by the year-end. So as you said, the transitory is gone and it's probably higher for longer. And I think also not to forget that Covid in China started a bit of closing, so that could have an impact going forward.

But more specifically on high yield, it's definitely repriced the market. It's high yield again so that makes it interesting, it's gone towards 6%+ and 400 basis points. I think it's a short duration asset class that will be beneficial in this environment. We've seen that already versus the investment grade, and we're seeing more and more risk-reward opportunities. Not to go into too much but closed-end funds can really benefit and take advantage of this.

**Gretchen Lam:** I might just add to that sentiment with maybe two data points that have come out in the last couple of weeks with fourth quarter earnings coming to an end. We heard from a number of management teams talking about the very extraordinary level of inflation that they are seeing on their costs. One in particular was actually a large protein producer, this is actually an investment-grade company, not a company that's in the below investment-grade space. But they said that on a year-over-year basis their costs had gone up, their costs of goods have gone up 18% year over year and that their average selling price was up over almost 20% on the year.

Which is pretty extraordinary, these are chickens that you would buy in the grocery store. And so these will have really material effects as they filter through the economy.

We heard from another company, a manufacturer that said that their work-in-process inventory had ballooned because they had all but completed products saved for one missing piece that they were waiting, on a boat somewhere outside Long Beach. And so these are the types of anecdotes that we're hearing again and again and again. And agree with Erlend's sentiment that it's going to take quite some time even just for the unsnarling of the supply chain to say nothing of more persistent costs such as labor that are not going to fall anytime soon.

**Chuck Jaffe:** Let's turn the conversation over from inflation, Gretchen, to interest rates. Because we're expecting rate hikes, as Bryan noted, probably as early as tomorrow. Under a month ago that was probably the biggest of these three stories, and now it's almost an afterthought and people are talking about how it's not necessarily going to be as bad as we expected, etcetera. But how do you think the rate picture plays out and what does that do to the high yield market?

**Gretchen Lam:** Sure. I don't know how I drew the short straw talking about rates, especially talking about rates 24 hours before the final Fed meeting. But I think that the latest view, and I think the Fed has telegraphed that 25 basis points is to be expected tomorrow. In our view, anything different would be perceived as a big surprise by the market. Certainly while we can debate how many hikes are on the come after tomorrow, and to be clear, if I had any clarity on that I would not be sitting here. Most of us can agree that there are certainly many more to come in 2022 and likely in 2023.

As we think about the impact of future rate hikes, we separate those impacts into two categories. The first and the more simple category is what's the micro impact? So what is the mathematical result on the assets, the value of the assets that we're managing and their yields all things equal as rates move higher? Ironically I manage a fund, XFLT, that while it is high yielding, it actually holds less than 3% of its assets in fixed-income securities. The vast majority of the assets in the fund are floating rate, their loans are CLO tranches, and the income is generated off of a credit spread over LIBOR or SOFR, which is floating. And so in XFLT as rates move up, generally speaking the income stream coming off of those assets increases.

Now there are some short and medium term deviations from this statement as a result of interest rate floors and the markets transitioning from LIBOR to SOFR, but over the long term as rates move up, the income stream in the fund will move up. I think the more interesting question however is what's ultimately the macro impact? What's the economic impact of these rate movements? I don't think that you can have a conversation about this without more fundamentally having a conversation about inflation. How does the Fed thread the needle? And how do they allow for putting a damper on demand without pushing the entire economy into a recession? It's not something that there's a long history of success over the last 50 years in doing, and so I think there are some real risk there.

At the end of the day, rate hikes are a pretty blunt instrument that the Fed uses to control inflation, and I think it really remains to be seen whether they can use that blunt tool in conjunction with the more nuanced balance sheet management to successfully curve inflation. I think there is a very high degree of risk with the success of their strategy. In the meantime however, looking at the economic numbers, and there is good cover for the Fed to move to a relatively more hawkish stance, inflation's high and moving higher as Erlend had discussed, moving higher still with the Russian invasion. Unemployment is low and likely moving lower, and first quarter GDP tracking a bit better. So I think there's good support for the Fed moving to a more hawkish stance and I would expect that to start tomorrow.

**Chuck Jaffe:** Yeah, I would too. I'm not sure it becomes a blunt tool. With rates as low as they are. I'm not sure the first four to even maybe six, if they're staying at 25 basis points, I think we can go almost five or six rate hikes at that level before it becomes a blunt tool. But we'll see about that, and you guys are the experts, I'm not.

So now let's maybe dig down a little bit deeper and get away from the macro to the micro, Bryan, we're going to bring this back to you. PIMCO does a lot in the closed-end space, in the high-yield space. And again it was funny, I had a discussion off the air with somebody today who was saying he thinks that if inflation continues long enough he will be talking to people about when and where is high yield worth it? How big a loss are you taking when you go for quote/unquote "risk-free" and you're in treasuries where you're de facto losing 7% basically? And he's like, "Yep, but I don't know for sure that high yield will be worth it if we continue with this kind of thing." So for you, let's bring it down to the assets you guys specialize in, high yield, volatile market, what are the challenges?

**Bryan Lazarus:** Yeah, certainly a challenging market. As I mentioned, one of the things that we're really focused on in our strategy is just flexibility and diversification. And there's a lot of markets where that diversification works quite nicely. You go back to January-February of this year, that diversification was a nice help where you had things like corporate credit, you had emerging market debt, maybe more challenged, but things like securitized credit provided a nice protection from a downside standpoint. The environment today in some ways just from a pure performance standpoint looks a little bit like March 2020 where basically nothing's working. You have credit getting hit extremely hard, equity's getting hit hard, duration getting hit hard. So it's becoming more challenging, and certainly a higher yielding income focused strategy like a closed-end fund and more specifically our closed-end funds are not going to be immune from that.

On the positive side I think you can look at the benefits of the vehicle in that these types of strategies and funds are not faced with the outflows that open-end funds are. Where these open-end funds, not only are they dealing with these mark-to-market volatility challenges and price declines, they're also dealing with outflows. And with that having to raise cash to potentially meet those outflow requests and selling things that maybe they wouldn't ordinarily sell. But with a closed-end fund really that allows us to remain invested, not having to be as concerned on the outflow side, and be able to preserve that upside going forward.

I think I can say when we get to a recovery, I hope I don't need to say if, but when we get to that recovery, that upside's preserved and really you can see a strong recovery. And then on top of that, last thing I'll say is you also have some ability to go on offense. So not being faced with those outflows, you can try to buy into this market. The one thing particularly from a yield perspective in this market is it's created a lot of attractive opportunities and it's made yield a lot more attainable, as I think it was mentioned earlier, it's truly high yield today. And so from an overall earnings power perspective, it's increased the potential for funds like this as well.

**Chuck Jaffe:** Thank you, Bryan. Erlend, we're coming back to you. And Bryan was just talking about the yield side of things, but the other component when you're investing in a market like this, on the one hand there's yield, on the other hand there's the value. So how about we start there? In terms of the assets that you're looking at, what is the value picture right now? As this market is changing, are high yield which are not necessarily considered value investments for a lot of investors actually kind of bargains right now?

**Erlend Lochen:** Definitely on the back of the repricing it's looking a lot better than it looked even four weeks ago. So I think that is good for the investors in the market and particularly for anyone looking at it. And I think you have to not forget the fundamental part of the market. When it comes to levered, high yield and interest covered are both in good position. Defaults, we had I think one in December in the US high-yield market, and non-year-to-date there will be more, but I think the market is very well positioned. And we had a cleansing in the market 2016 and 2020, there's no maturity walls. So overall the high-yield market is in a good position fundamentally, and I think also technically because the market is quite domestically focused.

But I think to your initial point, where is treasury going? If treasury's going to 4%, then 6% doesn't look so good. But I'm not believer that it is going to go that quickly. I think personally in a low growth environment, inflation is obviously a challenge, but I think if you for closed-end funds buy good quality credit that are not going to default, offer you good yield, and where you can use leverage opportunistically, can create a very good distribution yield.

**Chuck Jaffe:** And in terms of the approach that you guys are using at abrdn, obviously it would depend on any individual fund that we are talking about. But as you guys have those meetings what is it that you're hoping is going to be like, "In these conditions this is the big point we want to drive home as, 'Hey, if you're a closed-end fund investor, this is where you're going to derive the benefits, the real benefits, of our fund now'?

**Erlend Lochen:** It comes down a lot to the defaults. With closed-end funds you really like to avoid defaults. At abrdn we have a strong research platform, we leverage that and find the best global opportunities that we can put into these closed-end funds. And understand and research the name we invest in and really minimize the downside risk.

**Chuck Jaffe:** Thank you, Erlend. Gretchen, let's bring this back to you. You were very clear talking about how your fund is not loaded up with high-yield bonds. You're working in some of those credit markets that again it's not the standard 40% that somebody puts that 60-40 in. So let's talk about some of the challenges but also the benefits there. Because some of those markets, and I am definitely not expert enough to try to describe what's going on, but I know from talking to a few people about 'em that there is a lot of, "Okay, well normally we find equilibrium by finding this kind of balance, and right now we have a little bit more here but we're finding way to rejigger the balance." So help us understand a little bit more in the illiquid stuff that we're not familiar stuff that you are.

**Gretchen Lam:** Sure. Yeah, it's a very interesting time given the backdrop, the price volatility that we've seen, in that we are seeing liquidity-driven volatility and not credit-driven volatility. And maybe just a couple of statistics that support that; in the corporate below investment-grade loan market, year to date the L100, these are the most liquid largest 100 loans in the loan universe, that subset is down 2.1% year to date. Loans rated CCC, which would be the riskiest credit strata of the loan market are down only 1.3%. That is remarkable for a period of time where the entire loan market is down over two points as a price matter. So what we're seeing is that holders of loans, and particularly cross-asset holders of loans, so these would be high-yield funds that are seeing outflows that hold some loans or core fixed-income funds, etcetera, are doing what people do when they have outflows, which is sell their highest priced assets first. That is more times than not loans.

We are not seeing CLOs sell loans, those are not forced sellers, they're non-mark-to-market vehicles. We are not seeing other institutional accounts that are focused on loans, we're not seeing material outflows there. So it's actually really interesting time, and fun time to be managing a closed-end fund, where you don't have that need for liquidity within the fund, you don't have to manage to outflows. And so it allows you to be nimble, actually sell into liquidity or sell credit and be a provider of liquidity, and create value in a way that doesn't increase credit risk. The volatility is very helpful for particularly investors in closed-end funds because it keeps those credit spreads high.

So earlier in the year 60% of the loan market was trading at a price above par. Today 60% of the loan market trades at a price below 98 cents on the dollar. This is the market that last year pre-paid 30%. So if you do nothing but just sit there and get your pre-payments, there's a real opportunity to reinvest at lower priced assets. So it's great to do that directly in the loan market, and then of course our investments in CLO tranches, those managers of those CLOs are doing the same thing.

**Chuck Jaffe:** Thank you, Gretchen. Before I jump back with a bit of a follow up, I want to remind our audience, guys, we'd love to get your questions. The best way we can make this about you is if we are answering your questions which may be vastly different than mine. So throw them into the chat and we will do what we can to get them answered, but please don't be shy because this is your opportunity.

I want to go back, Gretchen, based on something you said, but any of you can answer this one, or maybe we'll take turns. Which is again, as the non-money management pro here, what I wind up saying is junk bonds are high-yield bonds until they become junky. Junk bonds don't tend to become junky until the environment changes and somebody can't pay their bills. The environment is changing, rates are going up, yet you talked, Gretchen, about what percentage are now trading below par. Which means you're getting a great deal and a bit of a discount and a little bit more of a cushion against defaults and some of those other sorts of things.

Are we likely to see any significant increase in defaults in the high-yield space? Is there any part of it that you guys think is more vulnerable than any other? And I will simply point out that the last time I had people telling me they expected rampant defaults was when we were seeing all the problems with muni bonds and they're like, "Detroit's going bankrupt and whatever else, we're going to see massive defaults." And there were no defaults, none of it ever happened. So we do understand it's pretty tough to see it, but are we on the cusp of that?

**Gretchen Lam:** I'll take a stab at that. I'm going to answer for the loan market which is roughly the same size and with lots of overlap to the high-yield bond market. Last year in the loan market the default rate was about one tenth of the long-term average. Now that's backwards looking, that's ancient history. Let's talk about go forward, can defaults get any lower? If you had asked me on January 1st I would have said no. They did actually go lower in the month of January on an LTM basis, but I think it's likely that they do tick up. But even if they tick up, up to 1% or 1.5% in 2022, they'll still be materially below the long-term average for the below investment-grade loan market.

I would just underscore something that Erlend touched on in his earlier comments, which is fundamentally we are starting from a really good spot across the 1,300 or so corporate borrowers in the market. The capital markets have been extraordinarily receptive for the last year and a half, and so balance sheets are liquid, there's no maturity wall, interest coverage is the highest it's been in the last 15 years. Will it go lower? Absolutely, that's just a mathematical certainty, rates are moving up but we are starting from a position of strength. And so the headwinds are coming fast and furious, don't want to pretend that they're not, but I think most corporate borrowers are starting from a pretty good spot.

**Erlend Lochen:** I can say a couple more things on the high-yield market. To what I said before, I think there's no obvious sectors that stands out in the domestic US corporate high-yield market in terms of defaults. There's been a lot of refinancing, low coupons, good funding position. The cleaning that I said is very important for the high-yield market because a lot of potential default candidates was removed from the market in 2020 and also back in 2016. And also the yield we have now priced in a fair bit of default if we're not assuming a big change in the treasury market, which I don't foresee as much than perhaps other people. I think there's also opportunities in high-yield in the 8-9% bonds. So a lot is priced in basically.

**Chuck Jaffe:** Thank you, Erlend. Bryan, do you want to add to this or are we good to move on?

**Bryan Lazarus:** I think we can move on on this one, nothing more to add there.

**Chuck Jaffe:** Good, like it when we can move on. Again, I want to encourage the audience to ask questions, we have one. We don't mind if they're coming in anonymously, so this is a question that we don't know who to attribute it to, but the question itself, pretty interesting one. "Many of your funds are at premiums to NAV. Should be concerned about secondary offerings pushing the premiums down too much?" And I guess Bryan, since we didn't really include you in the last one, maybe we'll start this one with you.

**Bryan Lazarus:** Sure, and I'm just re-reading the question just to make sure I'm clear in terms of secondary offerings or just in terms of the secondary market pushing it down. I'll try to answer. I think, look, for the PIMCO funds certainly they do tend to trade at fairly consistent and persistent premiums over time in a market that actually tends to see the opposite, where you see most closed-end funds trading at discounts. I think this volatility has certainly led to some downward pressure on those premiums. We've seen even on our side some of our funds that have typically trade at premiums moving down to discounts as well. I wouldn't classify it as too much of a surprise. We tend to see a little bit of even if those underlying assets are credit or fixed income or higher quality fixed income in the case of our muni strategies, you tend to see a little bit more volatility and downside on the market price side just given that these are equity traded instruments.

And I would tell you that the conversions I'm having with clients are kind of twofold. You definitely have some that are expressing some fear and concern in the outlook of where these funds go given that they are so credit sensitive, but I think a lot of people are looking at it as a buying opportunity as well. Seeing that these funds that typically trade at these very consistent premiums are all of a sudden at a discount, in the same way that they were in March of 2020, and you saw obviously a sharp recovery post that. So I think there certainly could be an expectation of potentially further erosion of those premiums just given the continued volatility in equity markets and broader risk assets. But I think there also could be a buying opportunity for those looking to get in at what could be a very attractive price for some of these closed-end funds.

**Chuck Jaffe:** Bryan, before I let you go on this one, and I do want to ask Gretchen and Erlend if they want to add to it, but you've mentioned March of 2020 more than once here. And you talked just now about the kind of opportunity it proved to be. Seeing a market that's that condition is one thing, the market rebound that we saw there was almost extraordinary and unprecedented. I want to make clear, when you're talking about, "Hey, this could be an opportunity," it's not you expect that the market is going to have that kind of rebound. I don't even think you're making a market call per se, but it's that the market is poised to recover. That the economic underpinnings that allowed us to have a bounce back then would allow us to have a bounce back now. Is that correct?

**Bryan Lazarus:** Generally, yes. I definitely don't want to be overpromising anything in that regard. I do think there are some differences. I think obviously you saw huge government stimulus through 2020 and into 2021. I think this time as we discussed, I think the Fed is in a little bit of a more tricky spot of. If you do see signs of deteriorating growth, are they in the same position to act and support the markets like they did then just given the inflation background as well where they're looking to take more of a hawkish stand? So I don't think and certainly wouldn't anticipate you'll see any sort of level of stimulus. Hopefully we don't get to the point where that's necessary, but they certainly are different environments.

I think the point I'm trying to make is you look at, and again I'm not recommending anyone do this, but you look at where some of these closed-end funds might be trading today and where values on some of these risk assets are trading today relative to where it's been over the past year, you could view this as a very attractive entry point. Both for a closed-end fund investing in new assets as well as investors investing in those closed-end funds at [inaudible].

**Chuck Jaffe:** Let me bring Erlend and/or Gretchen back into the conversation because I don't want to finish with that first question especially when we got a bit of a clarification. So again, that first question was, "Many of your funds are at premiums to NAV. Should we be concerned about secondary offerings pushing the premiums down too much?" And we got clarification, secondary offerings in this case mean a shelf offering, adding shares while the fund is at a premium.

**Bryan Lazarus:** Yeah, maybe I can just wrap up quickly just since I misunderstood the question a little bit. So at PIMCO ourselves we have not really pursued any of these secondary offerings, we did have one a couple years ago. I would tell you I personally I don't think that is the main driver here of these premiums going down. I do think it goes back to my prior comments just about the volatility you're seeing in markets overall. Obviously having a secondary offering could kind of adjust the supply-demand balance of funds and you could see a little bit of an erosion specifically at times. But I would tell you generally at PIMCO we just did an IPO for a new fund in January, and I can tell you even in those challenging market conditions we continued to see exceptionally strong demand for these vehicles and for income overall.

And if you step back a step, even with this volatility we remain in a fairly low-yield environment and investors are struggling to find opportunities for income, and unique opportunities maybe away from traditional markets where you do see evaluations that are fairly expensive. So we still think there's very significant demand for these types of vehicles, perhaps some of this volatility has instilled a little bit of fear. Some of the fears around rising rates perhaps contributing as well. But just my own personal speculation and view, I don't really think it's the secondary offerings that's having the broader impact on the erosion of premiums we've seen in recent months.

**Chuck Jaffe:** Erlend, do you have anything to add on this one?

**Erlend Lochen:** I think the other thing to add to it, if you do a secondary offering you can definitely take advantage of the market to some degree if you see opportunities. Because in a normal closed-end fund, to buy something you have to sell something, that's not always as easy versus fresh money.

**Chuck Jaffe:** Let's go to the other question that we have. And again folks, we have a little bit more time so we're happy to take questions up to the end of our time here. Just put 'em into the chat function, the Q&A function. But our other question again an anonymous one, "How comfortable are you with your fund leverage levels given volatility in the underlying assets lately?" Anyone particularly want to volunteer for that one?

**Gretchen Lam:** Sure, I'll weigh in there. I think about leverage, really the good news is it amplifies your income, the bad news is of course it can impact your returns on the downside and it also can reduce your flexibility on the downside. And so as I think about the appropriate leverage, I'm really thinking about how can we preserve flexibility in the fund to make the right trades and make the right long-term financial decisions for the fund? So we have a target leverage, have remained within that range, but also I think the flexibility that I have as a portfolio manager is beyond just, what are we doing with leverage? It's also how are we swapping and trading in and out of assets that have varying levels of structural leverage within them and also varying levels of credit risk? So we can dial back or dial up the risk of the fund frankly without touching the leverage just by trading the assets. So it's really twofold, the risk level at the portfolio level and the risk level at the asset level as well.

**Chuck Jaffe:** I'm just curious as well, Gretchen, when you talk about, "We have a level of leverage, we have a plan that tells us where we're at." Obviously that plan was set in motion when the fund was created in different economic times. So do you ever revisit and say, "Okay, our plan when we were starting it with interest rates at record lows, not in this kind of inflationary environment, was to be at nose level and now we want to be at chin level. We don't want to go that high," or any of those things? Do these conditions make you at least rethink that basic plan that you had?

**Gretchen Lam:** We're always thinking about that. I would say that the current range is appropriate under today's environment as we see it. But absolutely, should we reach a March of 2020, that may spark a reassessment of the right leverage.

**Chuck Jaffe:** Erlend, I'm afraid I cut you off. You were ready to jump in and I wanted to get that follow-up before we got past. So we were talking about leverage levels, the question from the audience being how comfortable are you with leverage levels given the volatility in the underlying assets?

**Erlend Lochen:** Very comfortable. Be short. The key as I said before is really to minimize default risk, because drawdowns we can deal with as long as they don't go too far, but default is a major problem. And I don't foresee that at all. And I think this fund in particular that we manage, from a high-yield point of a closed-end, has been through quite a few significant drawdowns and we managed it comfortably.

**Chuck Jaffe:** Bryan, any take from you on the leverage picture?

**Bryan Lazarus:** I think that's right. I think as Erlend said, I think if your focus is on minimizing default risk, leverage can actually be a tool to utilize to keep your income level fairly high without taking on addition default risk. It does open you up to further mark-to-market volatility. But again going back to the comments I made earlier, allowing yourself to remain invested you can get through that mark-to-market volatility without any sort of permanent capital loss. The other thing I was going to add is the other consideration just maybe on the negative side that we're thinking about is with rising interest rates and the expectation that short-term rates will increase, you could also see and likely will see an increase in the cost of that leverage. So that's definitely something that we're thinking about as well, just in terms of the relative attractiveness. Not just the increased volatility but the increased cost of incorporating leverage in the portfolio.

**Chuck Jaffe:** We have time for one more question, and we have one more question from the audience. This comes from Chris [inaudible] who says this question is for any and/or all of you. "Given credit spreads are widening, when might you consider increasing the credit risk in your fund? And how much flexibility do you have to make such a change?" Gretchen, I think we're coming to you first again.

**Gretchen Lam:** Yeah, I would say I don't think you have to increase credit risk to enhance yield. In the loan market for example, today we can buy strong BB credits at 96 cents on the dollar that have relatively a good total return profile. And so probably more than two months ago I feel very comfortable not enhancing, not increasing credit risk, and can do so while at the same time capturing meaningful upside in the portfolio.

**Chuck Jaffe:** Erlend or Bryan, either one of you want to jump in as well?

**Erlend Lochen:** I'm happy to go first. I mean, one thing we don't miss over the last I would say two months, de-risk the fund somewhat. In the sense of de-risking we thinking, we're taking duration risk down and gone more short of paper, higher coupon, but further down the credit spectrum, but no refinancing risk and no default risk. So we are comfortable increasing the credit risk in the fund by doing that way or that trade.

**Chuck Jaffe:** Bryan, you want to wrap it up?

**Bryan Lazarus:** Yeah, sure. Yeah, I think I'd echo the comments. I don't think there's an exact time, I don't even think that's really our focus right now. I think it really is in some ways weathering the storm. But also looking opportunistically for opportunities to add more on an individual basis in an attractive valuation point, as opposed to a broad increase in risk in the portfolio. As I said at the start of the session, I think there's certainly a lot of uncertainty in the market today and we're definitely being mindful of that and cautious in terms of adding additional significant risk to the portfolio.

**Chuck Jaffe:** I want to thank each of you for being here. To the audience thank you for being active and involved. I want to remind everybody that this has been "High Yield Income in Volatile Times", my presenters have been Gretchen Lam from Octagon Credit Investors, Bryan Lazarus from PIMCO, and Erlend Lochen from abrdn. Their bios and everything else is available for you. My name is Chuck Jaffe, you can hear me on my show or on *The NAVigator* podcast, and I hope you will be active and involved in that too. Thanks so much for joining us, John Cole Scott, back to you.

**John Cole Scott:** Great, and thank you guys so much for a great, deep, thorough discussion, really appreciate ya. If you want to turn off your mic and camera, we'll just do a quick closing remarks and round out day one of this session.

So again I want to thank everyone for your involvement in day one of our Spring Closed-End Fund Roundtable. Tomorrow we have three more sessions with three groups of presenters. Fixed-income panel is up first, then a multi-sector equity panel session. And then we have one I will moderate with the institutional investors in the space, which I'm excited about, haven't done this in a while, with Stephen O'Neill from RiverNorth, with Ken Fincher from First Trust, and Rob Shaker from Shaker Financial. All very experienced and different managers in the space, looking forward to a timely conversation.

Again, I'm going to remind everyone that it's the same link tomorrow as today. If you enjoyed it, please share it with your friends and colleagues. We think we've put together some good events here, appreciate everyone's involvement. Thank the moderators, thank the members, thank you the attendees. So with that, I'm going to close us out for this session and feel free to mingle a bit if you can, markets are closed. Thanks so much.

*Recorded on March 15, 2022.*

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