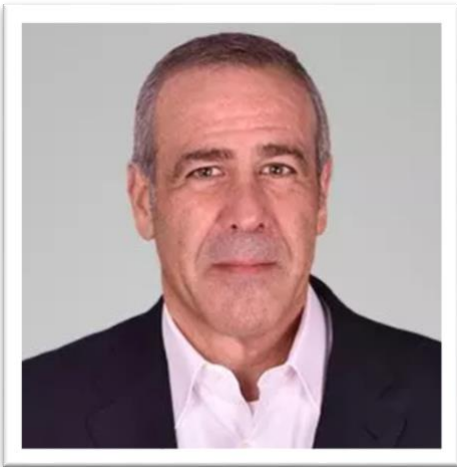




ARDC's Brufsky on how active management drives opportunities in a changing rate environment"

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Chuck Jaffe, in this episode of The NAVigator podcast interviews Seth Brufsky, Chief Executive Officer for the Ares Dynamic Credit Allocation Fund. Seth talks about how the start of rate cuts and a falling interest rate environment impacts high-yield bonds, leveraged loans, and collateralized loan obligations, noting that fixed-rate high-yield investments should get a boost from lower rates, but that the floating-rate paper also can benefit thanks to better arbitrage opportunities and improved

credit quality. Brufsky notes that rate-cut environments should give active management an edge over passive funds, at least for a time as the market adjusts to the changes.

The podcast can be found on AICA's website by clicking here: <https://aicalliance.org/alliance-content/pod-cast/>

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CHUCK JAFFE: We're talking about the rate cut cycle with Seth Brufsky, chief executive officer at the Ares Dynamic Credit Allocation Fund, this is The NAVigator. Welcome to The NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator is brought to you by the Active Investment Company Alliance, which is a unique industry organization representing the full spectrum of the closed-end fund business from investors and users to fund sponsors and creators. If you're looking for excellence beyond indexing, The NAVigator's going to point you in the right direction. And today we're looking at how rate cuts are impacting the high-yield, leveraged loan, and collateralized mortgage obligation markets, we're doing it with Seth Brufsky, chief executive officer for the Ares Dynamic Credit Allocation Fund, it's ticker symbol ARDC, and you can learn more at [AresPublicFunds.com](https://arespublicfunds.com), Ares, A-R-E-S, [AresPublicFunds.com](https://arespublicfunds.com). If you want to learn more generally about closed-end funds, interval funds, and business-development companies, go to [AICAlliance.org](https://aicalliance.org), that's the website for the Active Investment Company Alliance. Seth Brufsky, thanks for joining me again on The NAVigator.

SETH BRUFISKY: Thanks, Chuck, looking forward to it.

CHUCK JAFFE: We are early stages in a rate cut cycle, the market is clearly expecting more, at ARDC you are looking to generate income and attractive total returns, you're doing high-yield, leveraged loans, and CLOs, what happens to those markets in a falling rate environment?

SETH BRUFISKY: It's an interesting mix of assets in a falling rate environment, because on the one hand you have exposure to high-yield bonds, which are fixed rate, therefore technically if rates come down, the prices of those bonds should go up. Our goal is to actually find the bonds before that happens so we can take advantage of the capital appreciation, while at the same time we're creating a base of very strong high-yield bond investments that you can't replicate as the price actually goes up. On the flip side, the CLOs, collateralized loan obligations, and leveraged loans, are all based off of SOFR, which is obviously a floating-rate benchmark. So you would think as rates go down, you'll collect less interest associated with

those investments, however there's a little bit of counter-intuitiveness that goes into that, because as rates come down, in the CLO market new issue CLOs are issuing their liabilities at lower rates, so you're actually improving the arbitrage opportunity in the CLO market. That enables you to take advantage of the fact, even though you're in a floating-rate instrument, to take advantage of the fact that rates are going down. On the leveraged loan side, because of this floating rate, one of the benefits is actually you're improving credit quality in those loans, because essentially as SOFR comes down, those companies are actually having to pay out lower interest coupons each month or each quarter or each six months. They actually have more cash flow to attend to their business, so you're actually improving credit quality, so on one hand, while you're actually receiving fewer interest payments, you're actually having a stronger investment.

CHUCK JAFFE: You're talking about where rates can go, Treasury rates, I've talked to plenty of people who don't think they're going to respond to the rate cuts, does that wind up playing into any of this? I recognize the tie to SOFR, but if you were looking at the different asset classes, is anything that's more tied to Treasuries more likely to perform differently? If you're looking at the three asset classes that you deal with, which one's going to be best, and is there one that is different because of that?

SETH BRUFISKY: On the baseline [inaudible 0:04:43] high-yield bonds from a price perspective should perform better just because they are fixed rate, so as the Treasury rates come down, bond math says the price has to go up of the instrument, assuming all else is equal of course, meaning that the credit quality of the company is the same, the risk premium you're assigning to holding that asset is the same.

CHUCK JAFFE: In the high-yield space, the issue has been spreads, so what we're saying there is it's going to become a more attractive environment there. Will you see the same kinds of gains elsewhere? Or in a falling rate environment, high yield is going to be the place where you'd want to go?

SETH BRUFISKY: I think it all depends on the reason why rates are coming down, right? If the reason rates are coming down is because you believe inflation's coming down, great. If you think rates are coming down because the economy's going to be much worse, I'm going to say much worse as opposed to on more of a glide path to lower positive performance, if you believe that the economy's going to be doing much worse, that's going to hurt all asset

classes, right? Just the performance, the credit risk premium above the Treasury rate or above the SOFR rate is going to widen out, so it really depends on the reason why rates are coming down. I think in the current environment and the reason why we're seeing rates come down is not that instance, so our view on spreads, putting aside the interest rates for a moment, is that they should be pretty well within the ranges that we have today, which are pretty good. Unless we have a recession, you're not going to see the risk premiums spike, but where we stand today with low single digit growth rates, there is stimulus through a lot of the programs that the current administration's putting through, that should help offset any sort of slowing in the economy that we're in a pretty good range to take advantage of the rates, markets the way that they are trading, and the spread premium that we're getting for the instruments that we hold.

CHUCK JAFFE: You used the word "taking advantage", at ARDC you are actively managed, not all of your competition is, and of course we see times when active management pays off and doesn't pay off, but rate cutting cycles, is that when we would expect there to be a payoff to active management?

SETH BRUFISKY: There should definitely be a payoff because it enables you to shift your portfolio, just like being in all three of these asset classes rather than say just one, just leveraged loans, CLOs, or high-yield bonds, it just opens up the universe. I mean, also when you look at a place like Ares Management, we do a lot of different things within credit that enable us to see a pretty wide funnel of instruments, of assets that we can invest in, if we find a good investment, we can always find a good home for that here at Ares, so we're sharing a lot of deal flow, a lot of idea flow between the other parts of Ares that enable us to do that. But in terms of active management, it all comes down to if you think rates are coming down and you think fixed rate is better, we're going to access the high-yield bond market, whereas a specific leveraged loan manager, if it's just 80 to 100% leveraged loans, is going to be stuck in a lower income asset class at that point in time, so they're not going to be able to shift their portfolio, and vice versa for that matter. So active management I think should really be advantageous in either a rising or a lowering interest rate environment, just because the opportunity set is that much bigger for you. A lot of people can say, we'll do CLOs as an example, not a lot of people are familiar with CLOs, and not having that expertise is a really good way to make mistakes, you can't just blanket say, "I'm going to go into the CLO market

because it's providing me better income than loans or high yield," you need a team who's been doing it for quite some time to identify what those opportunities are, because then you end up making mistakes just saying I'm blanket going into some asset class that looks better.

CHUCK JAFFE: The asset class more generally that everybody's been trying to get into has been private credit. There's a lot that goes into the private credit market but there's a lot that's going into funds, and anytime you have a rush of money into a whole bunch of things and you get some of those less experienced managers going, "Wait, hold it, here's where the demand is," you wind up having blowups. They are not easy for the public to sort out and find, but are there hidden risks in a portfolio like yours? And what do you, or should any fund manager, be doing to address them so that we wind up liking private credit and not going, "Ah, told you so, there'd be a blowup there."

SETH BRUFISKY: Right, and definitely, for the folks who, obviously we're on a podcast, they can't see me shaking my head when you're saying, "As money flows into an asset class," mistakes are always made. People always run to an asset class thinking that they can easily set up business, underwriting standards definitely do change when there's more capital chasing the same ideas, so the idea really is to grow the pie. A lot of it comes down to experience, the easiest thing to say is we're an asset manager, we're getting money to manage assets, do your diligence, simple as that, right? It sounds simple, it's not so simple, you need a pretty big team to be able to do it. It's obviously some of the specific names that people have seen blow up in the last few months, those are more fraud related, and it's very difficult to diligence fraud. However, those managers with experience who are doing their diligence, I think should have enough experience over the course of time to see those warning flags. To your point, a lot of money rushes into asset category X, whatever, in this case you're talking private credit, or wherever it is at any given time, and people do go, "I need to ramp up my portfolio, therefore I'm going to stretch my underwriting standards." That's a difficult place to be. Fortunately, we at Ares are not in that space just because we have experience, many, many decades of experience in all the asset classes, being pioneers in many of these asset classes. The other thing is, as it relates to ARDC, we're very well diversified, you're talking about a portfolio that has 250 to 300 names in it, so you don't really have position sizes, if you do make a mistake or you do have a fraud mistake, it's really well contained because of the diversification that we have. And then on top of it, say it's in any specific industry, in this

case there's a lot of talk about in the auto industry over the last couple months, our exposure to auto, it's less than 3%, so we're diversified just not by single name but also by sectors, there's 30 different sectors that we're investing in across these different portfolios. So in terms of hitting risks, I would argue that we all make mistakes, we all want to bat a thousand, but we all make mistakes and the idea is to make sure that if you do make a mistake you do two things, it's contained, and we also have something, a policy called "First Sale, Best Sale", meaning that if something doesn't smell right, our universes to invest in are big enough that we can sell that asset, buy something else to replace it pretty easily, our markets are very, very liquid to be able to do that. If you're wrong, you can always go back and buy that asset. It might cost you a quarter or a half point if you're wrong like it didn't blow up, but if you're right that it did blow up, it's costing you, in the case of a couple of these names, they traded down 50 to 75 points in a week, which is very, very painful to be able to do. It's just, taking it one step further as it relates to Ares itself, we're able to tap in across our platform to get a lot of information flow, that might be a little bit different than some of our other competitors out there in the market, so we're checking in with our cousins on the private credit corporate private credit side, how are their companies performing? Are they seeing any warning signs in any specific type of company or sector? And then we vice versa can go back to them, "This is the way that we're seeing stuff trade in our market." Just being able to tap into that really helps us quite a bit in avoiding that, and that's led at ARDC, our default rate is 0%, where the market, high-yield bonds with a liquidity management exercise, which is another one of those things that's been happening, is somewhere between two and 3% for high yield and leveraged loans, so over the course of the 12 years we've been doing this ARDC, we've had minimal defaults.

CHUCK JAFFE: As you look at the lessons of 12 years, is there one particular one that stands out that maybe when this all started you wouldn't have foreseen sharing 10 years, 12 years into the future?

SETH BRUFISKY: Again, getting that due diligence, if you have the ability to have this large funnel, or first just have access to such a broad platform or get as much information as you can, you can never get enough information. Now it's your job to parse through that information as one thing, but I think active management very much helps is one of the lessons that we've learned, because it's easy to make an investment and stick it in a drawer,

then there is a factor of you've got to cross your fingers a little bit that you've made the right ones, right? You have to be able to recognize if you've made a mistake, minimize that mistake. I've seen too many people who can talk themselves into holding investments. I always used to say you should love it at par, you should marry it at 90, you should let the in-laws move in at 80, but once it gets below that, it's a little bit past the true love that you might see in any given market. You've really got to be careful about talking yourself into investments, because as an active manager, getting back to that point for a second, you can really open your universe, and your options are there to be able to minimize your loss on something that just isn't going away.

CHUCK JAFFE: Seth, glad that we got a chance to catch up and talk about it, look forward to talking with you again on The NAVigator down the line.

SETH BRUFISKY: Thanks much, Chuck, and good luck to all your listeners out there. It's a fun time, there's a little bit of stress out there, but it's fun to be in that environment.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe, and I am Chuck Jaffe, I'd love it if you'd check out my show on your favorite podcast app or you can find it at [MoneyLifeShow.com](https://www.MoneyLifeShow.com). To learn more about closed-end funds, interval funds, and business-development companies, go to [AICAlliance.org](https://www.AICAlliance.org), that's the website for the Active Investment Company Alliance. Thanks to my guest Seth Brufsky, he's chief executive officer for the Ares Dynamic Credit Allocation Fund, that's ticker symbol ARDC, and you can learn more about it at [AresPublicFunds.com](https://www.AresPublicFunds.com). The NAVigator podcast has something new for you every Friday, make sure you never miss an episode by subscribing or following along on your favorite podcast app, and if you liked this podcast, leave us a review and tell your friends about us, because that stuff really does help. Until next week, happy investing, everybody.

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