Income Webcast Series #2

Live with the CIO: Sourcing income and growth in uncertain times

Transcription

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Presentation

00:00:01 Moderator

Good morning everyone and a very warm welcome to you all. My name is Karen Chen, Senior Product Specialist of the Income and Growth team. In light of the heightened and uncertainty in global markets, it is more important than ever to identify sound investments. Today, we're going to take a deeper look at our Income and Growth strategy, and examine how to find income in the current global market environment.

At Allianz Global Investors, we dedicate ourselves to be your best investment partners, especially in income investing strategies. To help you and your clients hunt for income, today, we have invited Doug Forsyth, CIO of US Income and Growth strategies, and Justin Kass, Portfolio Manager of the team, to share with you their views on the markets and especially on US high-yield, convertibles and US equities.

Doug Forsyth is the Head of the firm's Income and Growth strategies team. He's the Lead Portfolio Manager of the firm's US high-yield strategy, as well as convertible strategy. He's the Lead Portfolio Manager of the Income and Growth strategy since its inception in 2007 and he also provides oversight for the US short duration high income strategy.

And Justine Kass is the Lead Portfolio Manager for the firm's Income and Growth strategy since its inception in 2007, and is responsible for the day-to-day portfolio manager's responsibilities for the firm's convertible strategy. Justin also manages multiple closed-end and open-end funds.

On today's webcast, over the next thirty minutes, Doug and Justin will share their views on the US markets and our Income and Growth strategy. And after the presentation, if you have any questions, please feel free to submit them via the Q&A column and we will try our very best to answer all of your questions.

And now let's welcome Doug and Justin.

00:02:05 Doug Forsyth

Thank you, Karen. Thank you Justin. And we welcome all of our clients and friends and colleagues to this presentation. Unfortunately, we have to do it remotely, we hope to be with you in person very soon. But we hope that this presentation is informative, we hope it's helpful. We're here together to try to help each other to make sure we're remembering all the important factors that we're seeing in the markets today because clearly, it's been a dynamic environment. There's a lot happening day-to-day, week-to-week.

It's not without very close scrutiny that we needed to observe the current market environment because of the incredible

human loss that we've all suffered around the world. Many of us, in every region – this is a global crisis that is upon us – many of us know individuals who might have become sick and we certainly hope that all of you going forward are happy and healthy and can avoid any further damage from this healthcare crisis.

So, let's start at that point, but then we do of course need to use your time in the best way possible and that's to talk about most importantly our views, what we've seen and where we want to go. So, Justin will you help me advance the slide?

Thank you. The assets on the team, this is just really to illustrate of course, that our core focus in our group is, within the various sleeves of Income and growth, of equity, convertibles and high yield. Of course, we have unique focus in high yield, in short duration high income, CLO (Collateralised Loan Obligation) strategies and other fixed income assets, but for today, we're going be focused primarily on Income and Growth and talk about the various components there.

Our team, what's notable about our team not just in 2020 but going back many, many years, is Justin and I have worked together since the year ended 1999 into 2000. So, we've been together quite a long time, but that's not unique to just Justin and I. Many of our senior people have been here for many, many years. And I think also notable is we've only had one person leave our team in the history, since I've been at the firm, since 1994. So, we're extremely proud of our tenure. Why is this important to you?

It's important, because when we go through crises, when we go through market cycles like this, especially as violent, and as sudden as this one came upon us, we can reflect back the previous cycles, other downturns, other rebounds. And we can be effective immediately because of our tenure together, our experience together, and also, of course, our cross asset class research platform that we have, where we're looking at multiple parts of the capital structure, all under one roof and one team.

Just a couple of highlights, and I just mentioned, of course, as reiterated here, the low turnover, the senior team being together for so long. And also, Justin, I think it's important to remember. It's not just us. We have thousands of meetings each and every year, in each and every day and every week, and we've had to adjust in the recent cycle, we've had to make phone calls and video conferences within our own team of late.

And actually, that was almost seamless. And I say "almost" in the sense that it might have taken a day for us to get the wheels turning the right way. But no more than that. And we've been very effective working remotely as we're all in the office. Now, Justin and I are actually presenting from the office together and we are slowly getting back to work here in the United States today.

The universe, when we think about Income and Growth, that's critical to remember also is the diverse asset class performance. Now we'll talk about this a little bit more further in the presentation, but convertibles, high yield and equities combined to a "participate and protect" type of return profile. Income and Growth, through multiple market cycles now, has provided that type of return for expectation purposes, but also in reality.

So, when we look at the overall return profile, we can think about a convertible bond. Convertible bonds participate with those equity market moves higher and convertible bonds can protect and have that bond floor, that downside protection, when equity markets go lower.

Now, we'll get a little bit more granular about what's happened here in 2020.

It's incredible. None of us have seen this before in the speed and violence, and I use that term on purpose, of the nature in which the markets moved down. And then how it's also moved back up. So, here we've represented on the slide, this is a total return only through May 29th, and it's very important to know that this was a month-end number, and as we've moved into June things have improved even more.

So, as we look at these asset class returns, we can only look back just a few, short months ago that things look very dire. And the performance in the market was on a significant decline because of the vast uncertainty about the healthcare crisis. The incredible speed in which most individuals were quarantined. They had to stay home and they couldn't go to work. They couldn't buy goods and services the way they have in the past. And some industries were hit significantly.

What we learned, over now looking in the rear-view mirror, and we don't have to look too far back, is there were certain industries and certain companies that actually performed better because of this new environment in which we all had to work in. Many remote locations required more cloud service, more remote computing, more software. There's a very long list, quite frankly, of those services that individuals needed to continue their normal lifestyle as well as their work

environment.

These are things that benefited us very quickly from a market return standpoint. So, when we look at the large cap and small cap stocks, and the significant rebound we've seen, there are several factors there that we're going to illustrate as we continue through this presentation.

But all of the rebound is based on changes in the fundamental outlook. It isn't just technical in nature. There was tremendous uncertainty as the market declined and, as the market rebounded, there was significant certainty added back into elements of both company profitability, company liquidity and the long-term outlook for the economy.

So, I'll pause there and just move ahead. There's of course, positive returns across the board and the least of which, of course, are now the 10-year yield, because there's very little to earn there.

So, let's look at the economic statistics briefly. We usually show these two slides, both on the US economy from unemployment, consumer confidence, what is the ISM (Institute for Supply Management) and manufacturing environment, from a certain perspective and we talk about it every quarter and we update the slides. Well, this is a unique environment. This is completely different than anything we've looked at before. And we have an extremely important perspective, just in the very first chart.

Never in my career, and I don't believe Justin in yours either, have economists ever been more wrong than the US employment report that we had just a short time ago. When we look at the employment reports, most economists were expecting a significant continuation of lay-offs, departures of employees, cost cutting measures, for the month of May. And what we saw was the exact opposite of that, and the reopening was happening faster than expected throughout the United States and actually, two and a half million jobs were added. Why am I pausing on this?

Because usually, economic conditions is something that I wouldn't spend that much time on--we wouldn't usually present Income and Growth and focus on the economics--but in this particular environment, this is an outstanding figure, because it's never been more incredibly disconnected with reality of what economists thought.

So, we certainly, didn’t know, we didn't have a pulse. We actually reside in California, which was somewhat behind many other states in the US, and when they were reopening, and I can tell you is, as of now, things are reopening in even those states that hadn't reopened before.

We're seeing a significant snap back in all of those industries that were hit with the lay-offs and downturns of those services that could not be used under quarantine. When we look at restaurants, hotels, certainly airlines, autos - and the list goes on and on - of those cyclical industries that were shut down to zero, many of those have not only restarted, they've already hired all their employees back to service the demand that is there.

Because another fear was that that the US consumer, which is on this board as well, would have no interest in going back to restaurants, and being very fearful of theme parks that might open up, or being fearful of going back to a retail store that they were going to be near someone.

The opposite has happened. Many of those consumers are actually running right back to the stores. They're going back to restaurants, and we're seeing a very big snap back. So, even more demand for hiring. We certainly expect the economic recovery to be pretty quick coming out of this, but we'll continue forward here.

Retail sales: we know that retail sales from a store-front standpoint has been down, but you can look at many large companies that sell online and see that retail sales have been just fine from a remote location perspective. And people are buying things that they might not have in 2020.
So, I'll continue on past the economic point. We'll circle back to that again, later in the presentation.

Yields: where is the opportunity today for investors to earn a monthly distribution, a monthly income, where they might have an opportunity to pay off bills, meet expectations for their household, where are those people going to invest today?

And this has certainly been thematic and true for quite a long time, because especially when we look in many parts of the world, like Europe, rates have been zero or even lower than zero, versus what we’ve seen in the Americas or in Asia. But again, this crisis has caused new things to happen. And what has happened is yields have dropped globally, making it even that much harder in that search, in that quest for yield.

When we look at Treasury curve and economic growth, we’re in a period when, we could say, when there’s an inversion in the 10-year Treasury and the short-end dated bonds. That is not constructive for economic growth and we circled in red

these times historically when we've been in a recession in the United States. And quite frankly, when yields started to invert, towards the end of 2019 and early 2020, due to a host of factors, the most notable of which is the absolute low rates, both in short bonds and in long bonds and that contraction was caused by many technical factors as well. Where was the opportunity for the economy to continue to improve when things are actually pretty good anyway, but the curve wasn't steep. Would we see an economic downturn?

Lo and behold, through a healthcare crisis, we received our economic recession and many of the factors that happen in economic recessions were collapsed into a very short timeframe because of what this global pandemic has caused.

And I want to stress this point: we don't need to look forward to another recession because this has washed out many of those businesses that were on thin ice. They had either over-levered themselves, they had weaker businesses, they were companies that were struggling to get by. Most of those companies were impacted immediately and the weaker companies are going away.

The companies that have already downsised and terminated employees- cost reductions are significant and those healthier companies have had immediate access to capital.

So, what am I summarizing here? Our opinion is that we have already seen the recession that will be caused by an inverted curve. We don't need to look forward into next year to think about when that might happen. We've already seen it. What is one of the primary catalysts? I was excited to talk about this earlier in the presentation, I held off knowing this slide was going to come up.

Unprecedented, global, fiscal and federal stimulus.

And when I say global, it's not all termed "federal", but the point is governments globally have gone over and above any previous market cycle and downturn to help boost every element of the economic situation for their own individual countries and this, on a combined basis, has no historical precedent.

Let's focus on the US. In the US, there's nearly $3 trillion of fiscal stimulus and Federal incentives for companies, individuals, to both benefit themselves, get by from a, call it, payroll protection policy, for unemployment, additional benefits, extended terms – all of these things help the individuals but one of the most impactful, was when the Fed came forward and said that they would buy individual corporate bonds and ETFs. That is unprecedented, we've not seen that before, in addition to all the TALF (Term Asset-Backed Securities Loan Facility) and everything else that was happening in 2008.

When it came to this particular cycle, they learned from previous downturns that when you have the motor stop for the capital markets, and companies are not able to finance themselves. Those that had sound balance sheets when their revenues are cut to zero, those balance sheets don't looks so sound any more. They can't earn enough money to pay back those debt obligations. They needed liquidity, but it's very troubling for investors like ourselves or anyone else to lend them new money because we're uncertain of when will this end; we didn't know a lot. We didn't know about the healthcare outcome. So that would've been very difficult,

But when the Fed put in that floor, capital markets opened We've seen, just in the case of the high-yield market, I believe, over a hundred billion of new issuance, just in the last couple of months. It's an incredible amount of funding that was not seen in the fourth quarter of 2018, certainly in the second half and early 2008 and early 2009, capital markets were shut down.

We can point to many industries that were hard hit, that were not getting the revenue and they're still down materially, and those sectors, whether it be travel and leisure or retail-focused, many of those sound operators were given that more than a lifeline; they were fully funding capital for the next year or two! And here they are, in many cases they're already operating and taking bookings today. So, they're actually financed at a better level than they might have been in the past.

Keeping an eye on time, because I like to get excited about these things, what that links directly into is a question about default and should defaults rise from here.

We have already seen defaults. We've already seen companies that cannot meet their obligations file. What is important to remember is that the occurrence of defaults and the markets are not correlated, meaning when defaults peak that's not when the equity markets bottom. When defaults peak, the equity markets have already re-ramped back up, spreads they're tightening, things are moving into the better part of the economic cycle because there is a lag of as much as twelve to eighteen months from the announcement of we're having trouble to actually filing for default. Some of them come quicker. But every cycle has pointed to that.

And the only time that didn't happen was the double turn in the early 2000's. When it looked like we might be rebounding in 2002 and that didn't happen until 2003. There were a lot of factors I'm not going go into today of what the recession in 2000 and 2001 and 2002 was, the methodology and components were very different than they are today. So we are not looking for that.

So, risk asset market participation: thinking about when rates are falling and rates are rising. As we are not looking at a rising rate environment in the near term, this is a standard slide but this is not something we'd be forecasting or concerned about today.

Market yields: we talked about this a few moments ago, very difficult to get income. Only the first three bars are going give you anything that's mid-single digit or better. So, when you look around the world and the opportunity set of where you might get your income, that's difficult to come by and that's why other solutions are necessary today.

A couple of moments specifically on a high yield asset class and then we'll go over to Justin.

We looked at this in the context of when the curve inverts, what are we going to see our spreads going to widen and I've already covered that point when I was talking about it from an economic perspective. But that's absolutely true here. We saw again the curve invert, we cannot say that the current healthcare crisis was enabled by an inverted curve but again, we're going be drawing another red line because we have a spike in defaults, and we have an economic downturn. So, this will follow the historical pattern, but for a very different reason.

I mentioned this before but it's worth repeating: defaults are running about five percent right now; spreads ballooned out significantly beyond this level. Defaults will continue to occur, but at a much lower pace, than the most bearish forecasts and actually might even come below some of the bullish forecasts for where defaults are ultimately going to come out. We're seeing most companies that were in good shape, they will not file because of liquidity purposes. They've all been funded and are in good condition. Those weaker companies have already filed. They're behind us and we certainly have visibility into those others that might be on the borderline.

So, I think with that, I will pause and hand it over to Justin to talk about the convert market.

00:23:05 Justin Kass

Great. Thanks, Doug. And thank you again for everyone for being on this webcast. Like Doug said, my name is Justin Kass and I'm going start my opening comments and our opening discussion on the convertible market.

The convertible asset class is a very unique asset class, because you have the defensive characteristics of a bond, that downside protection, and you also have that unlimited upside potential of the common stock.

When you put those two components together, and I'm looking at the return profile on page 15, if you look at the long term return profile, the convertible asset class, and that's over 30 years of data has provided investors with equity-like returns with a lot less volatility and there are certain years in the convertible market where the convertible market actually significantly outperforms the broad based equity market. And when we look at 2020, that is the case through May of 2020, the convertible market has significantly outperformed the S&P500.

As far as some convertible market characteristics, on page 16, when we think of the convertible market, the total market size is roughly about two hundred and fifty billion.

Many investors think that the convertible market is just small cap companies but when you look at the market capitalization of the convertible market, there's close to over 90% of the market has a market capitalization greater than one billion. And over 70% has a market capitalization of greater than five billion. So it's really a mid and large cap market when you think of the convertible market.

A couple of other characteristics I would highlight on this page: one is the delta. And a delta of 0.61, what that really tells you is that the convertible market is very balanced right now. That means that it provides investors this upside participation and downside protection, where you're capturing more of the upside movement of the underlying equity and less of the downside.

On page 17, as I mentioned, just a second ago, the convertible market size is roughly 250 billion. And what's surprised us most this year, or I guess specific to the convertible market because there were a lot of surprises so far in 2020, but what surprised us for the convertible market was first its resiliency but then the massive amount of new issuance that we've seen.

And when we look at 2018 and 2019, new issuance in both of those years was greater than 50 billion. And when we enter 2020, most market strategists were predicting a very similar year of roughly 50 billion dollars of new issuance. By the end of May, the convertible market had already reached that number, and now these strategists are predicting 80 to a 100 billion dollars of new issuance in the market. When you think of a convertible market, that's 250 billion in size, that's really significant growth.

There's a couple of reasons for why we've seen an increase in new issuance. One, as Doug mentioned, companies want to shore up balance sheets, have access to capital and get a little enhanced liquidity, so we've seen companies access to capital. The other thing is we've always told investors that the cost of capital on the convertible market is lower than others. And when we saw some spread widening in the fixed income market, we saw the convertible market as an attractive opportunity for companies that wanted a lower cost of capital will come to the market.

Why new issuance is important to Income and Growth? First off, it provides new opportunities for us to look at new names that are coming to the market.

Historically, the convertible market was largely focused on technology and healthcare issuance, but in this new wave of new issuance, we're beginning to see a broadening out of the convertible market. We're seeing companies in consumer discretionary, energy, financials and industrials come to market. So, we're starting to see a broadening out and a diversification.

The other thing we talked about, liking new-issue convertible bonds, or total return convertible bonds, that have that upside participation and downside protection; most new issue, convertibles have those attractive characteristics that we look for.

On page 18 is a long-term snapshot of earnings growth compared to stock market performance. By looking at this chart, we see that during periods of accelerating or improving earnings growth, you tend to have positive equity market moves. Doug mentioned the significant shutdown at the global economies and in the March time period, we did begin to see a down shift in earnings in select companies that needed to shut down in retail, energy, industrials. And that led to a market sell off.

Now we're beginning to see an opening up or beginning to see a re-acceleration of earnings, and there's no doubt when we get into 2021, we know the first half is going to have very easy earnings comps, so it's possible that we could see significant earnings growth and re-acceleration of earnings as we get into the second half of 2020 and, if history repeats itself, that could lead to a positive performance for broad risk assets.

On page 19, this is a long-term snapshot of the volatility index, or the 'VIX'. In the time period of the heart of the pandemic, in the February and March sell off, we did see a significant spike up in volatility.

By the end of May, the volatility index had come back down. It's still above historical levels so, when we look at the VIX index today, we still see plenty of opportunities of attractive yield when it comes to the covered call writing.

So, before we get into Q&A, I was just going quickly turn it over to Doug just to see if he had any closing comments .

00:30:48 Doug Forsyth

It's an exciting time and thank you, Justin, for going through that. There are so many stories that we can tell about the dramatic rebound and to those that think "Well, the equity market didn't price in", there were a lot of industries that were down 75-80% from a stock price standpoint and those were tough periods. I just would like to reiterate that experience matters and going through those periods historically, not that we can say anything's been like this before, but both the determination to make sure we're focused on the fundamentals, focusing on liquidity early, and then as things rebounded and there was some opportunity and some indicators that were improving quickly, Income and Growth, across the three asset classes, we were able to capture and move quickly into those new opportunities.

So I think I'll summarise with: we are committed to continuing to meet the investment goals of our investors and that is to combine the opportunities of growth assets with a stable distribution and where income is so hard to come by it is difficult these days to come through any bond performance that would justify receiving just a very small income stream. Over time, investors need to grow their asset base and this asset mix is designed to meet those goals. So I think with that, Karen, we'll go ahead and pause the presentation and move right into Q&A, and hopefully there's been some good questions submitted.

Q&A

00:32:41 Moderator

Okay, great. Thanks, Doug. Thanks, Justin. And now we'll be taking a few questions or comments from our audience. And let's see, seems that the first question that we have got is on the US economy. So we have a viewer here asking is this strong us market rebound really sustainable?

I mean, as the US economy starts to reopen, are we expecting to see a V-shaped recovery and is there any dislocation between the current market levels and the fundamental weakness?

So, can you please share your views on that Doug, Justin?

00:33:25 Doug Forsyth

Sure. I'll kick off and then you can join in. I think that's an excellent question because it's on everybody's minds today. What have we seen and how did we rebound the way we have?

So, let's look at the factors which were most impactful. One is that, while the healthcare crisis was so critical for concern for everyone around the world, this wasn't unique to one area. This was actually a global issue. There was fast and decisive action from the healthcare professionals globally and world leaders to shut down all economic activity. We've never seen that before, but it was an abrupt stop. It was almost overnight. And there were certain industries that were going be impacted immediately, because they were closed. And then, as we discussed before, there were other industries that were doing pretty well. So the healthcare issue is unique.

And part of the quick rebound is associated with the fact that this was essentially a created, or whether it be government, individual or otherwise, recession. One that was created through a not normal, either over-levered or economic downturn, or lack of demand or a consumer recession, whatever those may be.

Further that to the earnings power of individual companies throughout the entire period most, throughout every company, and said, “No one's going make any money”. And we found out very quickly there were many companies, many industries, they were actually producing better than expected earnings. That's a fundamental portion of this discussion.

The next factor is the fast and furious response from global governments to aid all aspects of the economic condition. And in the US, it's unprecedented. Not only did they come in with everything they've learned since the Great Depression, they added in new elements. And one of those I’ve already addressed, which was the liquidity. If the liquidity in the corporate bond market dries up, it might not be universally known, but that is a devastating outcome. When companies cannot refinance, and look at those maturing issues especially, if they were cyclically driven and impacted from a revenue standpoint, because of the crisis. The fact that they were able to refinance gave them liquidity and automatically buffered their base value because they were probably going to have the sustainability to return.

Next factor in the pipeline, and while it’s debatable I know we could point to every chart, the fact is most of the world has reopened. When we go back and rewind only a few short months ago, no one knew if we’d reopen in 2020 at all. And here we are, not even halfway through the year, and this is something that has clearly exceeded expectations from a return to business. Now, it’s at various levels and there're still concerns: “Will there be a rebound?”, and those are all things we're paying attention to.

But every stimulus effect of the Fed is carrying through and we're also seeing the consumer demand, as I mentioned early in the presentation, rebound extremely quickly. New home buying is still happening, retail and restaurants are, the charts are, moving higher. Now it's slow and it's off a low base, but it is moving higher. And this is universal across all of these industries in bookings. Now, some will take more than others.

But the last point that professional investors and all investors should be paying attention to, is that when companies looked at the first thing that is most important to them and in a crisis is liquidity, they terminated or laid off employees. And this is both a social catastrophe as well as, for every individual affected, a personal catastrophe. But, because the reopening is happening faster than expected, we saw an incredible rehiring and a big miss by economists on what was going be happening already, which we've seen in the government statistics, is a quick rebound.

However, we don't expect that it's going to rebound fully and this is the main point of a recovery when we're thinking about profitability, going into end of 2020 and 2021. Companies might decide that they don't need to spend the same amount that they spent before; there will be a specific cost-centric focus. For the balance of 2020, companies will likely be smarter, more agile, more flexible, especially about office space, and there could be fantastic savings going into next year. Therefore, from a sustainability standpoint, as well as a rapid recovery, all of these are based on facts and factors that are fundamentally changing for the positive as we look forward.

Now, Justin, if I missed something, please do add in.

00:38:36 Justin Kass

I'm just going to add onto the fundamental aspect of what Doug talked about, because if you think of a traditional recession, there aren't necessarily industries that benefit. Pretty much everything's going down in a recession. And to Doug's point, this downturn created significant winners, whether it was E-commerce, 5G deployment, building out networks for bandwidth so people can work from home, educate from home, play from home.

So, there was a subset of the market that, from a fundamental perspective, and it goes to the question of, you know, deteriorating fundamentals, we actually saw some significant improvement in fundamentals. To Doug's point, when we look at companies going forward for those that were in the heart of the downturn, whether it's consumer discretionary, industrials, energy, financials, the number cuts were so severe, that it's possible that we can see, to Doug's point a re-acceleration, not only in earnings, but a significant surprise for earnings in 2021 and markets are forward-looking.

When we do our fundamental work, when we talk to companies, when we talk to management teams, when we talk to sell side analysts, all of our focus is on these fundamentals, not what already happened but what is going to happen over the next couple of quarters and, more importantly, in 2021.

00:39:57 Moderator

Okay great. Thanks, Justin. Thanks, Doug. Okay onto the second question. Well, Doug you talked a lot about the Fed responses, as well as the stimulus package. What about the US government? Do you think their policies are effective enough to bridge the gap between to stimulate consumption as well as investment back to normal?

00:40:20 Doug Forsyth

Well, it's interesting what type of weaponry is associated with this answer, whether it's a bazooka or it's just an explosion of stimulus in the United States specifically, there is a divide between the two political parties on what they like to provide.

In this case, you had uniform, immediate, distinct and decisive outcomes, which is, I'm not going say I'm unprecedented, but unique certainly in the last decade or more in the United States where both political parties were aligned to look at all of the factors that were helpful, not only in 2008, but in previous recessions, again going all the way back to the Depression.

Here, as we look forward into the back half of 2020, there will be more politically divisive type of outcomes. And that might be that we have some that are looking more to protect the common worker and the unemployed. Some might be looking more like a payroll tax cuts for those that are more focused on the company. So there's a lot of different potential political outcomes there.

But the most important factor is, as Justin and I provided some evidence here today, we don't need more fiscal stimulus because we're already seeing the economy improve on its own without more fiscal stimulus. And it doesn't mean that something won't happen and some of the early signs could get delayed or paused where there might be more fiscal stimulus. But we certainly agree that companies, consumers, workers, and all of those components together, will have a fundamental change in demand and behaviour that far exceeds what some might have thought.

And therefore we are not looking for another round, a phase four or phase five. That's not necessary for what we see in all the fundamental change at the company and profitability level.

00:42:40 Moderator

That's great to hear. Okay. Well, given the essence of time, we will be able to take one more question here. So I think I'm going pick more asset class specific one. Okay Doug, for one of our viewers who's asking the default rate, as you have said, you know, is a lagging indicator for investment. But is it possible that we're seeing a more prolonged and damaging default cycle? Is this still a good time to allocate to risky asset classes for the long term? Following a very big rebound since late March?

00:43:15 Justin Kass
So, yes, we think it's appropriate to allocate to risk asset classes. And I think, to Doug's point from what he said about the Fed and what the goal of the Fed was trying to do was to provide companies ability to access capital and liquidity was key to all of this.

And what we've seen, whether it's through high-yield issuance, high-grade, issuance, convertible issuance, we've seen significant liquidity come to the market, and the companies that are filing for bankruptcies are the companies that had stressed balance sheets, stressed business models not just in the last couple of months, but over the last couple of years. So yes, we think that the default rate is a lagging indicator. And, like Doug said in the presentation, we think that the estimates of default rates from many leading strategists are too high. And because of that, we are very positively predisposed to buy risk assets.

And I will leave it at that. I don't know if you have anything to add?

00:44:20 Doug Forsyth
I was only going add that, when we think about what the catalyst for defaults, and I'm repeating but I think it's critically important, stage one is the liquidity: that's been met, solved. We don't need to look for that any more.

Stage 2 is company preparedness to use that liquidity effectively and not get on a path where they're spending irrationally or doing irrational things, over zealous buybacks of stocks and those types, we're not seeing that either. So, good company behaviour, which is actually one thing that we didn't mention earlier, is this downturn was not because of bad company behaviour or bad management or over-leverage.

So we have all those things aligned and the last factor is: will demand rebound? And we are seeing already, multiple areas where it didn't turn down at all, demand actually turned up for many companies, but we're also seeing all those that were heavily impacted, all the early signals is that the consumer is returning more quickly than expected, which will dampen that default rate going forward. Any higher expectations are probably unwarranted.

00:45:32 Moderator
Right, okay. Thank you. So, for all the unanswered questions, we will be providing you with the written responses later in the following weeks.

So, before we finish up today, I'd like to thank Doug and Justin, and also would like to remind all of you to fill out our online survey form, so that we can know more of your valuable feedback.

A transcript of today's webcast will also be available in the following days. In the near future, we will continue to host a series of live webcasts and bring you investment insights to help guide you through these uncertain times.

Thank you for joining today's webcast. We wish you a safe and pleasant day.

00:46:15 Dough Forsyth and Justin Kass
Thank you, bye.

Q&A — Unanswered questions during the webcast

Q: What's your view on the forecast of high yield default for 2020 and 2021?

A: High yield strategists generally expect the default rate to increase over the remainder of the year before declining next year. It is important to note however that defaults typically peak after high-yield prices have bottomed because the market's discounting mechanism of present and potential future events.

Q: Is the US market overheating now? Will we see a pullback soon? With US equity index almost covered its loss from the impact of COVID-19, do you think the market has priced in positive factors you mentioned in the presentation?

A: In general, an improvement in investor sentiment has had a positive impact on risk asset performance based on economic recovery optimism, Fed support, slower case growth and constructive medical developments. Going forward, while the near term is less certain, the intermediate-

and long-term market outlooks are constructive. Importantly, investors must not allow short-term market uncertainty and volatility to derail their long-term goals.

Q: Given that US presidential election is happening this year, what is the team's view on its impact to the investment market?

A: US presidential election and the result may cause market volatility, however any volatility could also provide attractive investment opportunities.

Q: What do you think about this long period of low interest around the globe? What is the impact towards the change of the economy globally?

A: The current low interest rate environment calls for a broader income toolkit for investors to not only to provide a consistent stream of income but also enough income to meet their long-term objectives, which is especially critical today given low interest rates globally.

In the US, the Fed has signaled that they will keep interest rates low (among many other highly accommodative policy actions) for the foreseeable future in an effort to help stabilise financial markets and accelerate the economic recovery. Thus far, the Fed's response is working with further evidence of healing in the credit markets as well as a number of recent data points that suggest a resumption of economic activity.

Q: After COVID-19, many daily BAU may have changed. Would should an investors change the strategy for stock selection?

A: The post COVID-19 world may alter the way consumers behave and businesses operate going forward. There will be industries and issuers that may benefit or face greater challenges against this backdrop. Today's discriminating market environment rewards corporations for exceeding expectations which bodes well for the Income and Growth strategy's bottom-up investment approach that actively manages risk while identifying companies that are opportunistically capitalizing on change.

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There is no guarantee that these investment strategies and processes will be effective under all market conditions and investors should evaluate their ability to invest for a long-term based on their individual risk profile especially during periods of downturn in the market.
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