SLC Management

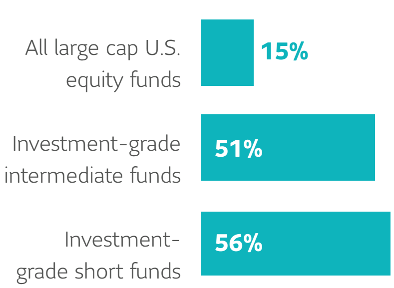
Fixed income – a compelling place to take active risk

Much has been written about the trend towards passive management and it has merits in many market segments, particularly those where the opportunity to add value is limited. However, we believe there are a number of structural reasons for favouring an active approach within investment grade fixed income allocations.

The success rate of active managers is significantly higher in the fixed income market than the equity market; the relative probability of outperforming in the fixed income markets has historically been about three times that of equity markets.[1]

In addition, over the past 10 years, the actual level of out-performance achieved by 25th percentile active core fixed income managers has been positive +54 bps, versus a negative - 21 bps for the 25th percentile active large cap core equity managers.[2]

Percentage of mutual funds outperforming benchmarks[3] *(10-year net of fees)*



Why the difference?

A broader opportunity set – All else being equal, a broader opportunity set allows a skilled manager to take many independent positions and generally provides a better chance of success. The fixed income market has huge breadth compared to the equity market. At a high level, there are over 40,000[4] non-matured USD investment grade bonds listed with CUSIP (Committee on Uniform Securities Identification Procedures), which is approximately 10 times that of the 4,397[5] public equities listed in 2018.

More active levers – Within this broader market, managers also have more active levers to pull. Whereas an equity manager may have one or two ways to gain exposure to a particular issuer, an active fixed income manager typically has much more choice. For example, a single entity may issue at multiple terms on the yield curve, in both the securitized and corporate markets, and have debt trading in both the new-issue and secondary markets. This allows a manager to express issuer preferences within their portfolios more precisely.

[1, 3] Source S&P Dow Jones Indices, SPIVA® U.S. Scorecard, https://www.spglobal.com/_assets/documents/corporate/us-spiva-report-11-march-2019.pdf

[2] Source Informa Investment Solutions, http://www.informais.com. Note: Performance presented is gross of fees. There are 193 Firms and 394 Products in this core fixed income universe. There are 179 Firms and 300 Products in this large cap core equity universe. Data as of 10/8/2019.

[4] Source Bloomberg, investment grade rated USD bonds, as of 5/3/2019

[5] Source https://data.worldbank.org/indicator/cm.mkt.ldom.no

Market inefficiencies – By design, the fixed income markets are inherently less efficient than equity markets. Equities are typically exchange traded, meaning pricing information is readily available to all participants. Bonds on the other hand, are typically traded "over-the-counter" (negotiated for each transaction), resulting in less price transparency and therefore greater opportunities for active managers to exploit relative value opportunities.

A less "random" market – Outcomes for investment grade fixed income investments are normally more bounded than those of equities. If an active equity manager misses the next Amazon or Google that rises 10 times in value, the impact on fund performance will be pronounced vs. the index. Conversely, in the investment-grade fixed income universe, fewer bonds tend to exhibit such significant over or under-performance. This means the relative risk of being significantly underweight the largest benchmark names is less significant.

Non-economic investors – The decisions of many participants in investment grade fixed income markets are not focused solely on return maximization. Rather, decisions are often driven by regulatory or liability matching considerations. This provides less constrained investors seeking return maximization an opportunity to outperform.

Competitive fees –There are three certainties in life: death, taxes and fees. The lower the fees you pay, the more likely you're able to generate returns in excess of those fees. Typical fees for active investment grade fixed income are less than half that of a typical active equity manager.

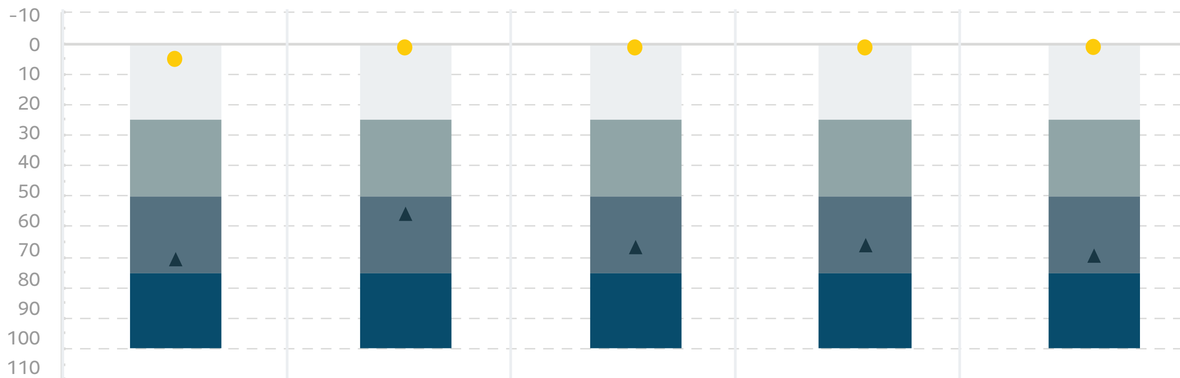
Assessing credit relative value – a higher probability of success versus rate bets

While the fixed income market offers an extraordinary opportunity set, security selection can sometimes be swamped by a binary active duration bet. We believe that such active duration positioning undermines the structural benefits previously described, introducing significant unpredictability. Success with rate bets is notoriously inconsistent. Therefore, we seek to match benchmark duration, "neutralizing" this factor in our client portfolios, and focusing our active management decisions where we believe we can consistently deliver a higher probability of success.

We have approached our investment grade fixed income management with a focus on bottom-up security selection and exploiting the relative value of different credits and sectors. This has led to consistent outperformance over the long term and industry leading information ratios (excess return relative to risk taken).

Consistent excess returns over medium and long term

Information ratio percentile ranking



	6/2016 - 6/2019		6/2014 - 6/2019		6/2009 - 6/2019		6/2004 - 6/2019		6/1996 - 6/2019	
	Value	Rank	Value	Rank	Value	Rank	Value	Rank	Value	Rank
Percentile Ranking - Information Ratio										
● SLC Management Total Return U.S. Core Fixed Income (gross)*	1.69	5	1.48	1	1.45	1	1.27	1	0.82	1
▲ Bloomberg Barclays U.S. Aggregate Index	0.00	71	0.00	56	0.00	67	0.00	66	0.00	70
Percentile Ranking - Rate of Return										
● SLC Management Total Return U.S Core Fixed Income (gross)*	3.15	16	3.68	10	5.00	18	5.22	7	6.00	7
SLC Management Total Return U.S. Core Fixed Income (net)*	2.88	N/A	3.39	N/A	4.69	N/A	4.91	N/A	5.68	N/A
▲ Bloomberg Barclays U.S. Aggregate Index	2.31	71	2.95	56	3.90	67	4.27	66	5.23	70

Data as of 6/30/2019
Source: Informa Investment Solutions (www.informais.com)
Note: Performance presented above is gross of fees. There are 193 Firms and 394 Products in the universe. Data as of 10/8/2019.
*The performance of the SLC Management Total Return U.S. Fixed Income portfolio are the historical performance of Ryan Labs Asset Management Inc.

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