Monthly Fund Commentary

Muzinich & Co

Supra Institutional: MZLSX

July 2020

Fund

Muzinich Low Duration Bond Fund

Portfolio Commentary

After a largely flat second half of June, global credit markets[1] strengthened through July as new issuance volumes faded. We saw a continued improvement in the economic outlook, with a broad-based stabilization in the COVID-19 situation, and increasing normalization for many industries. The EU Recovery and Resilience Facility announcement marked the long-awaited fiscal cooperation that the European Central Bank (ECB) has been encouraging and was a landmark development in Europe's crisis response. The market was further supported by continued buying from the ECB, coupled with a seasonal drop in new issuance. The US high yield market[2] was similarly strong despite rising political tension, social unrest, and unabating virus cases. The US market took comfort in the Federal Reserve's continued commitment of support, improving economic data, positive surprises in corporate earnings and the expectation of a second fiscal stimulus package. The Federal Reserve's buying program remains active and is currently providing a backstop to sentiment in US credit markets.

Strategy and Outlook

In this environment, the fund generated positive performance and outperformed its benchmark[3]. The fund had another strong positive month in July, with performance coming steadily throughout the month. By sector, robust performance was seen in sectors that have been out of favor in recent months, including leisure and diversified financial services. Credit selection in banking and automotive & auto parts also bolstered relative fund performance. By rating, the fund benefitted from an overweight in BBB- rated bonds, as high yield[4] credit spreads[5] tightened with the market favouring more highly rated names. We have worked on two primary themes in the portfolio through July – 1) adding longer-dated USD exposure; and 2) adding shorter-dated, higher yielding names in 'unloved' sectors. In the second theme, we added short-dated exposure in the airline, automotive, and aerospace/defense sectors. Regarding USD exposure, we remain cautious around the US in light of the political calendar, social unrest and virus developments. However, we feel that a second stimulus package remains likely in the near term, and that this will be well received by the market. We also see value in exposure to the US Treasury as a risk mitigant, should we return to a sustained risk-off environment. Against these additions we have reduced our energy exposure, cycled out of tighter trading names that have largely recovered, and exited a small number of names whose full recovery now looks less likely, in our view. In energy, these sales have been in pure energy issuers as well as diversified commodity names. This has been in light of strong performance, which has brought these names closer to their proper valuations in our view, though this also coincides with some of the Environmental, Social, Governance) concerns highlighted by the Norges Bank Investment Managements (NBIM) exclusion list. We have continued to participate in new issues across various markets, seeking to take advantage of shorter-dated new issues and taps of existing issues, as companies continue to strengthen their liquidity positions.

In our view, the worst economic numbers seem to be behind us, as recent data suggest the global economy is stabilizing and slowly improving. This is not the V-shaped recovery investors had hoped for, and companies will need liquidity to survive the coming months. Fortunately, the capital markets are open. We believe solid companies can raise money and COVID-19-impacted companies can also raise money, albeit at higher rates through secured debt (collateralized). Global central banks have given a life line to companies by supporting the credit markets. We believe the recent agreement on the European Recovery and Resilience Fund will be beneficial for peripheral credit as well as sovereigns and corporates coming into next year. This is reflected in the distressed ratio (companies trading at 1000 bps[6] over) which has come down materially, as a result of the Fed's intervention, as have default expectations. Many companies have extended their maturities and built their cash positions. While yields are low, we see, what we believe to be a once-a-decade opportunity to buy bonds that are either: secured (typically a feature of the loan market) or fallen angels (investment grade bonds downgraded to high yield). We believe elect fallen angels are particularly attractive as they are larger and typically have many options to raise liquidity if needed.

All references to market performance are sourced from Bloomberg as of July 31, 2020. [1]GI00 – The ICE BofA ML Global Corporate & High Yield Index tracks the performance of investment grade and below investment grade corporate debt publicly issued in the major domestic and eurobond markets. [2]J0A0 – The ICE BofA ML US Cash Pay High Yield Index tracks the performance of US dollar denominated below investment grade corporate debt, currently in a coupon paying period that is publicly issued in the US domestic market. [3]B1A0 – The ICE BofA ML 1-3 Yr US Corporate and Government Index is a subset of ICE BofA ML US Corporate & Government Index (B0A0) including all securities with a remaining term to final maturity less than 3 years. [4]High-yield bonds are bonds that pay higher interest rates because they have lower credit ratings than investment-grade. [5]Spread is the difference between yields on differing debt instruments of varying maturities, credit ratings, issuer, or risk level, calculated by deducting the yield of one instrument from the other. [6]Basis Points (bps) are a unit of measure used in finance to describe the percentage change in the value of financial instruments or the rate change in an index or other benchmark.

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