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Turning to Alternatives: A Roadmap for Late-Cycle Investing

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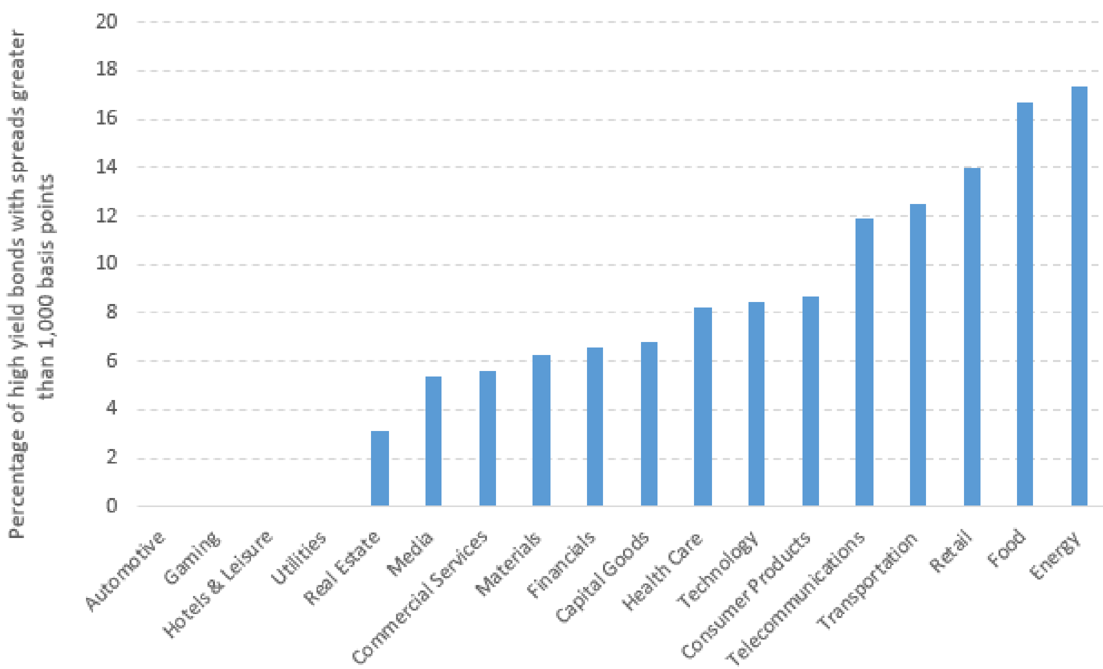
Title graphic: **Global Credit Markets**

Hedge funds just posted their best quarterly return in nearly ten years[1], and we expect that investors will become more interested in whether the environment has turned for alternative investments, as well as where we see opportunities going forward.

The volatility experienced in the fourth quarter of 2018 was short-lived, but we anticipate more to come as the cycle matures, which we believe makes "shorting" strategies such as Long/Short Equity and Long/Short Credit appealing right now. We also believe that opportunities will be found within global credit markets over the next three to five years, which could benefit hedge funds and private capital strategies focused on stressed & distressed investing.

The reason we expect these opportunities to exist is due to the tremendous growth of both corporate and sovereign debt post-crisis, the deterioration in underwriting standards, the utilization of debt for leveraged buyouts and other merger and acquisition activity, plus the normal aging of the credit cycle. These concerns are also reflected in our overall view of moving up in credit quality and maintaining a neutral position in equities. For qualified investors, we like combining allocations to both Relative Value and Event Driven hedge funds in an effort to capture a dynamic credit environment that is already beginning to see stress within certain sectors.

[1] Hedge funds are represented by the HFRI Fund Weighted Composite Index. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**



Source: Bloomberg, Bank of America Merrill Lynch, March 2019

For illustrative purposes only. 100 basis points equals 1%. The spread is the difference in yield to a Treasury bond of comparable maturity. The sectors provided above are included in the ICE BofAML US High Yield Corporate Bond Index. The index is capitalization weighted and measures the performance of short-term US dollar denominated below investment grade corporate debt publicly issued in the US domestic market. Qualifying securities must have at least 18 months to final maturity at the time of issuance, at least one year remaining term to final maturity as of the rebalancing date, a fixed coupon schedule and a minimum amount outstanding of $100 million. An index is unmanaged and not available for direct investment. **Past performance is no guarantee of future results.**

Within Private Capital strategies, we're looking for special situations to emerge among stressed or distressed companies, where Private Debt funds can invest in several types of corporate and related debt. Historically, this strategy has been able to generate positive returns even in a benign economic and credit environment.

***Title graphic:* Volatility on the Rise**

Global monetary policy appears to be at an inflection point, shifting recently to a more neutral stance. While volatility is currently low, we anticipate a gradual increase in equity, interest rate, and credit volatility, largely driven by changes in monetary policy, non-traditional or even inverted yield curves, and geopolitical stress. Like the fourth quarter, we believe this should present attractive opportunities for active management. It may also benefit Discretionary Macro strategies, which have historically provided much needed diversification in challenging environments.

***Title graphic:* Opportunities for Private Capital**

Given the illiquid nature of private capital strategies, we look for long term themes that can be capitalized upon over the next three to fifteen years. Currently, our focus is on smaller, niche, and stressed investments. We prefer smaller fund sizes that don't necessarily need broad market dislocations, and we like strategies that focus on stressed companies or assets where a restructuring potential exists. We're also looking for niche, global opportunities, such as those in emerging market healthcare, with key areas including the intersection of biotechnology and pharmaceuticals, medical technology & equipment, and medical service providers.

Conclusion:

Late-cycle investing can be challenging, but potentially rewarding for patient investors, in our opinion. We believe certain alternative investment strategies are well positioned to navigate this environment, and encourage qualified investors to consider these strategies and contact your investment professional for further information.

Risk Considerations

Alternative investments are not suitable for all investors and are only open to "accredited" or "qualified" investors within the meaning of the U.S. securities laws. They are speculative, highly illiquid, and are designed for long-term investment, and not as trading vehicles.

Alternative investments, such as hedge funds, private capital and private debt funds are speculative and entail significant risks that can include losses due to leveraging or other speculative investment practices, lack of liquidity, volatility of returns, restrictions on transferring interests in a fund, potential lack of diversification, absence and/or delay of information regarding valuations and pricing, complex tax structures and delays in tax reporting, less regulation and higher fees than mutual funds. Hedge fund, private capital and private debt fund investing involves other material risks including capital loss and the loss of the entire amount invested. They are intended for qualified, financially sophisticated investors who can bear the risks associated with these investments.

Hedge fund/private capital strategies, such as Event Driven, Discretionary Macro, Relative Value, stressed/distressed and special situations may expose investors to risks such as short selling, leverage, counterparty, liquidity, volatility, the use of derivative instruments and other significant risks. Short selling involves the risk of potentially unlimited increase in the market value of the security sold short, which could result in potentially unlimited loss to a portfolio. In addition, taking short positions in securities is a form of leverage which may cause a portfolio to be more volatile. Leverage can significantly increase return potential but create greater risk of loss. Counterparty risk is the risk that the other party to the agreement will default at some time during the life of the contract. At times, a fund may be unable to sell certain of its illiquid investments without a substantial drop in price, if at all. Derivatives generally have implied leverage which can magnify volatility and may entail other risks such as market, interest rate, credit, counterparty and management risks which may negatively affect a portfolio's performance. Employing derivatives for other than hedging purposes is considered speculative and involves greater risks than those associated with hedging. The use of alternative investment strategies may require a manager's skill in assessing corporate events, the anticipation of future movements in securities prices, interest rates, or other economic factors. No assurance can be given that a manager's view of the economy will be correct which may result in lower investment returns or higher return volatility.

Private debt investing consists of directly providing private debt capital to a company, typically to receive an interest income payment. Companies unable to secure debt financing or those in distress may seek private debt investors to provide them with a variety of loan-like investments across its capital structure. In private debt investments, an investor acts as a lender to private companies and loans have specific contractual interest rate terms and repayment schedules. Such investments are subject to potential default, limited liquidity, the creditworthiness of the private company, and the infrequent availability of independent credit ratings for them. Because of their distressed situation, private debt funds may be illiquid, have low trading volumes, and be subject to substantial interest rate and credit risks. Traditionally, private debt investment strategies include providing debt across a company's capital structure and may include senior-secured, junior-secured and mezzanine debt.

Distressed securities are "below investment grade" obligations of issuers in weak financial condition, experiencing poor operating results, having substantial capital needs or negative net worth. Such securities are therefore considered speculative. They often face special competitive or product obsolescence problems and may be involved in bankruptcy or other reorganization and liquidation proceedings. These securities are often risky investments although they may offer the potential for correspondingly high returns. Often, it is difficult to obtain information as to the true condition of such issuers. Such investments may also be adversely affected by laws relating to, among other things, fraudulent transfers and other voidable transfers or payments, lender liability and the bankruptcy court's power to disallow, reduce, subordinate or disenfranchise particular claims.

Special situations is a strategy that involves investing in a company based on the belief that its value will go up because of a specific, anticipated event related to the company. There is no guarantee that the specific event will occur or that the market will react as expected with respect to such events. In addition, the securities of such companies may lose more value that the securities of more stable companies which can result in greater share price volatility.

Long/short credit strategies seek to mitigate interest rate and credit risks regardless of market environment through investment in credit-related and structured debt vehicles. These strategies involve the use of market hedges and involve risks such as derivatives, fixed income, foreign investment, currency, hedging, leverage, liquidity, short sales, loss of principal and other material risks.

Equity long/short investing refers to buying perceived undervalued equity positions and selling short perceived overvalued positions. The strategy attempts to capture returns from both types of trades. Significant long or short exposure to a particular sector or sub-sector can magnify the risk level of a particular long/short equity strategy.

Sector investing can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio's vulnerability to any single economic, political or regulatory development affecting the sector. This can result in greater price volatility. Some of the risks associated with investment in the health care sector include competition on branded products, sales erosion due to cheaper alternatives, research & development risk, government regulations and government approval of products anticipated to enter the market. Investing in foreign securities presents certain risks not associated with domestic investments, such as currency fluctuation, political and economic instability, and different accounting standards. This may result in greater share price volatility. These risks are heightened in emerging markets.

Definitions

HFRI Fund Weighted Composite Index is a global, equal-weighted index of over 2000 single-manager funds that report to HFR Database. Constituent funds report monthly net-of-all-fees performance in U.S. dollars and have a minimum of $50 Million under management or a 12-month track record of active performance. The HFRI Fund Weighted Composite Index does not include Funds of Hedge Funds.

Index returns do not represent fund returns or the results of actual trading. Index returns reflect general market results, assume the reinvestment of dividends and other distributions and do not reflect deduction for fees, expenses or taxes applicable to an actual investment. Unlike most asset class indices, HFR Index returns reflect deduction for fees. Because the HFR indices are calculated based on information that is voluntarily provided actual returns may be lower than those reported. HFR Indices are compiled by Hedge Fund Research, Inc. ("HFR"), an industry service provider. The HFRI Indices are based on information self-reported by hedge fund managers that decide, on their own, at any time, whether or not they want to provide, or continue to provide, information to HFR. Results for funds that go out of business are included in the index until the date that they cease operations. Therefore, these indices may not be complete or accurate representations of the hedge fund universe, and may be biased in several ways.

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