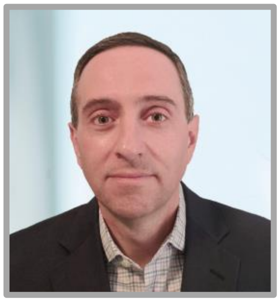
MERGANSER
CAPITAL MANAGEMENT

MERGANSER Q & A

WITH DAVID GOROVITZ

SPRING 2020



DAVID GOROVITZ, CFA
SENIOR VICE PRESIDENT

In February of this year, David Gorovitz joined Merganser Capital Management as a Senior Credit Analyst after spending 20 years in a similar role at Wellington Management. David's experience has been a valuable addition to our team during this unprecedented time in the global economy. We sat down with David to discuss the state of the IG credit market amidst the COVID-19 pandemic.

Q: How has liquidity in the credit markets changed since March? What lessons did you learn from that experience and how do you balance finding attractive opportunities for the portfolio while managing client liquidity needs?

A: Liquidity is better as the market is functioning more smoothly, bid/ask spreads are more reasonable, and bonds can be moved in size at levels close to where they were previously marked. Dealers who were unwilling to take on risk in March and caused massive bid/ask spread dislocation are now positioning risk on their balance sheets. Overall, the market has a more orderly feel to it, which is supporting the more positive sentiment that investors are experiencing.

In terms of Merganser client liquidity requirements, I think it is prudent to operate with a higher cash cushion than we would in a normalized environment as we anticipate our clients will experience much of the same uncertainty we are including within our credit analysis and may need to adjust their investment programs in response. Validating that trust is important for our relationships and the Merganser brand.

I think it is prudent to operate with a higher cash cushion...however, there are plenty of opportunities to invest.

Having said that, there are plenty of opportunities to invest and we cannot be too overweight cash or low-yielding liquid investments or else we will see underperformance in client portfolios. There is an art and a science to managing investment decisions, while also being prudent regarding our cash positions and the potential liquidity needs of our clients.

There are three items I have been thinking about when investing in the current environment:

1. It's challenging to invest without succumbing to fear, but we need to do it. That is where the buying opportunities occur and although it might be difficult, we need to make prudent investment decisions while relying on imperfect information and market outlook. One way to do that is by having a list of core names that we structurally like and can turn to when the market is in turmoil.
2. Higher credit ratings do not always mean lower risk. In times of extreme market volatility and reduced liquidity, the downdraft in securities can be more correlated than we think.
3. It is always easy to have a price target that's 20bps cheap to pricing today. Accept that you will never buy the bottom of the market and leg into trades, setting a better average cost, and adding risk where appropriate. Pricing is

attractive in many IG sectors, so put capital to work in a prudent way at various entry points.

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Investors tend to fall into the same traps, so we need to be able to review what decisions we have made in the past and hopefully it will inform us to become better investors in the future. Being new to Merganser, I have seen that the Merganser culture is predicated on teamwork. It is truly a supportive environment where everyone is looking to help one another and do the right thing for each other and our clients. I think that this leads to better outcomes, especially in times of stress.

Q: We have seen a meaningful recovery in credit spreads following the Fed stimulus announcements in late March. Is IG credit properly priced given expectations of a deep economic contraction? Based on the latest information, GDP estimates for Q2 2020 now range from -10% to -30%.

A: Segments of the IG market are attractive at current levels, particularly given the Fed stimulus. Because we have a non-traditional buyer with a mandate to support the flow of credit, it is creating increased demand for risk assets and a perceived pricing floor for high grade corporate bonds. If we think about this historically, in markets where a central bank is purchasing securities that include risk assets, the effects are apparent in tighter spreads, higher overall demand and buoyed investor sentiment. The Fed's presence has caused a stabilization in IG credit, but the actual economic environment is potentially at the precipice of a deep economic contraction and the reaction of the stock and bond markets are not consistent with that economic move lower when viewed in a vacuum.

Fed stimulus...is creating increased demand for IG credit and a perceived pricing floor for credit spreads.

However, IG credit still looks to be attractively priced when looking at it versus historical levels when contemplating the context of an unprecedented central bank intervention as the Fed has laid out. At current valuations, we believe the market is currently pricing in some amount of progress with COVID-19 but expect economic stress to persist through early 2021. If we are looking at 2-3 years of unknowns with respect to impacts of the virus, we could then see some further pressure on valuations. More succinctly put, the IG markets are probably pricing in some downside scenario with the Fed acting as a backstop, but not a more protracted period of economic stress measured in years not quarters. This is consistent with my view.

Q: How are you evaluating specific credits in your coverage given the uncertainty of the future of COVID-19's lasting impact on the economy, as well as the lack of guidance and forecasts coming from individual companies?

A: I focus first and foremost on credits where I like the underlying operating fundamentals, have defendable operating spaces and good management teams. When thinking about specific credits, I prefer those that might have near-term volatility but are unlikely to be permanently impaired and there is a line-of-sight beyond the next few fiscal quarters. I do not think it is the right time to dial up our risk budget dramatically by engaging in cheap credits where I don't like the underlying fundamentals. This is not the time to focus on valuations first. We can still buy preferred credits at a discount to intrinsic value and we think that the risks are overrepresented in current pricing. This also allows me to still engage with those secondary credits that I don't think satisfy all the prior criteria but have some of those traits and have attractive credit spreads. We need to have a longer investment time horizon. But, buying names that are simply attractive for the ratings is not a winning strategy for the longer term, especially in the current environment.

We can still buy preferred credits at a discount to intrinsic value where we think the risks are overrepresented in current pricing.

Investors need to accept the uncertainty and embrace broader and more numerous views of potential outcomes.

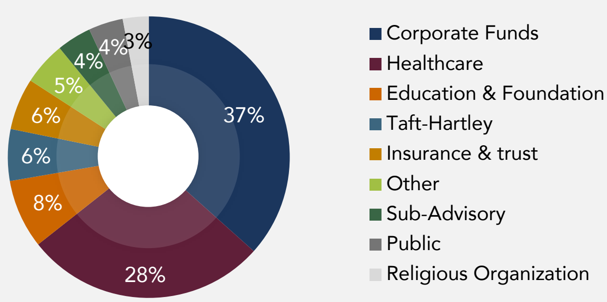
Right now, investors need to accept the uncertainty and embrace broader and more numerous views of potential outcomes rather than precise forecasting. Nobody has a definitive answer about when the environment will recover, and it is important to be aware of confirmation bias and ignoring conflicting points of view. We need to consistently analyze scenarios regarding the different potential durations of the downturn and what type of impact that will have on any specific credit. We need to have a macro view and have that filter down to bottom-up analysis.

Furthermore, we cannot look to company management teams for answers, which is a trap that many investors fall into and is discussed on every conference call. Management teams are massaging investor expectations, which is exactly what they're supposed to be doing. Almost all are removing 2020 guidance, stating that Q2 will be weak and expecting a recovery into the second half of the year. This is all that they can say, but investors cannot take comfort in this relatively optimistic view. It is challenging to know how much risk has been priced into credit spreads because almost everything looks attractive on a historical basis. I look at sectors in terms of the longevity of the COVID-19 pandemic and how that affects company fundamentals. The current lack of guidance from management teams is to be expected; however, having a view on what the company looks like for the next 2-3 years in different scenarios is important. If COVID-19's impact is short, what does that do to company operations and how soon can they return to normal? Conversely, if COVID-19's impact is prolonged, how will operations be impacted, for how long, and what impact will that have on financials and cash flow? I believe in investing client capital in names where the expected impact, irrespective of COVID-19 duration, is muted and cash flows are resilient. I also focus on solid management teams that can navigate the uncertainty.

FIRM OVERVIEW

About Merganser

- Formed in 1985, Merganser has been managing institutional fixed income portfolios for over 30 years
- Our strategies are long only, US dollar-denominated and do not utilize complex derivatives
- The investment team is highly collaborative and portfolios are managed on a team basis
- As a boutique manager, we embrace portfolio customization and solving unique issues for our clients
- As of March 31, 2020 our AUM totals $13.3 billion for 89 clients



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