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LIVE

IN CONVERSATION

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# Only Active Will Survive

**Marc-André Gaudreau, CPA, CGA, CFA**  
VP & Senior Portfolio Manager

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# The Specialized Credit Team

## Experience and access across the entire spectrum



**Marc-André Gaudreau**  
CPA, CGA, CFA

VP & Senior  
Portfolio Manager



**Roger Rouleau**  
BComm., CFA

VP &  
Portfolio Manager



**Jeremy Lucas**  
MBA, CPA, CA

VP &  
Portfolio Manager



**Philippe Caron**  
MSc., CFA, CAIA

Portfolio Manager



**Evan Hughes**  
M.Econ., CFA

Portfolio Manager



**Anita Hong**  
CFA, CMT

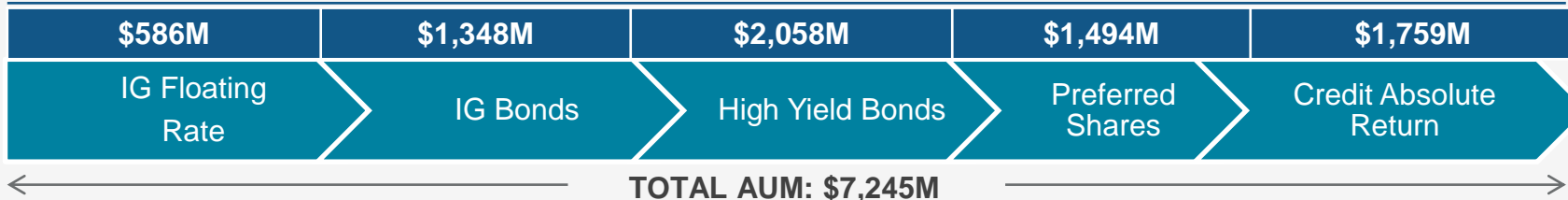
Associate  
Portfolio Manager



**Alexandre Mathieu**  
M.Sc., FRM

Senior Analyst

<b>Industry</b>	27 years	22 years	23 years	10 years	16 years	12 years	21 years
<b>Firm</b>	12 years	12 years	7 years	5 years	8 years	9 years	12 years

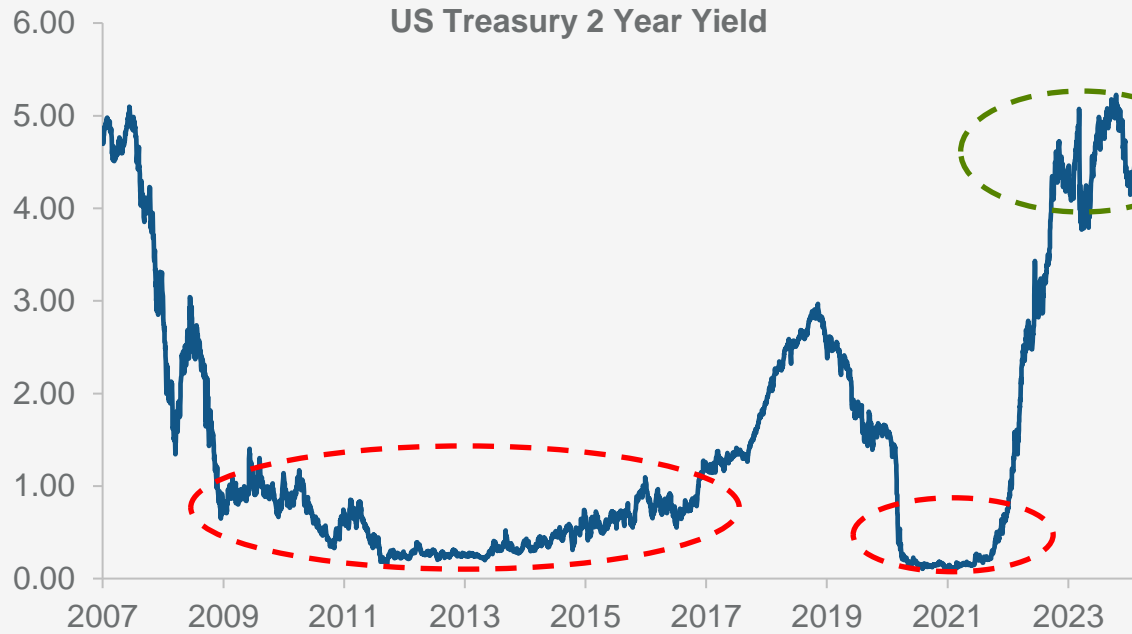


Source: 1832 Asset Management L.P. as of 03/31/2024.

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# The World Has Changed

## Big improvement in stakeholder alignment incentives



### Higher Yields

- Bond Buybacks at a Discount
- Deleveraging Focus
- Disciplined Spending
- **Bondholder Friendly**

### Lower Yields

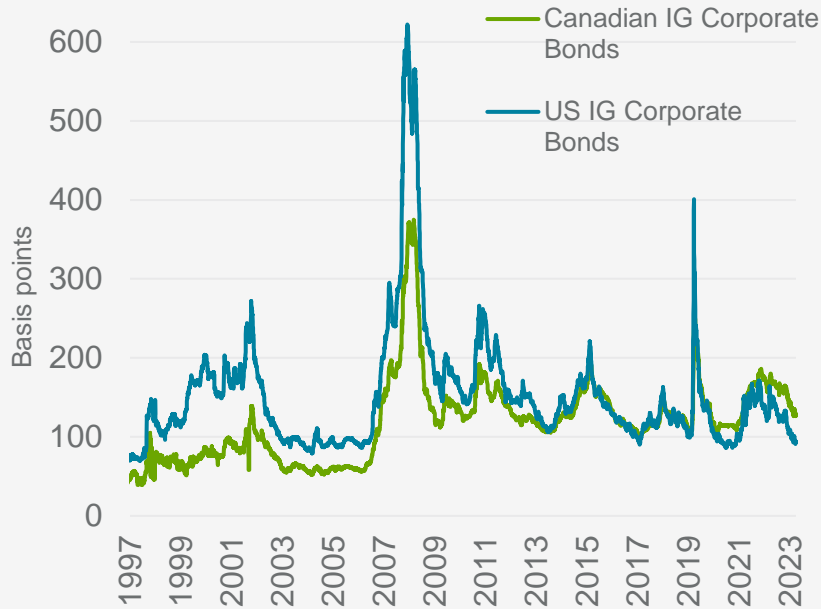
- Debt Funded Share Buybacks + Dividends
- Higher Leverage
- Risky Capex Spending
- **Shareholder Friendly**

Source: Bloomberg, 1832 Asset Management L.P. as of 03/31/2024.

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# Credit Spreads Evolution

## Passive investors are exposed to expensive valuations

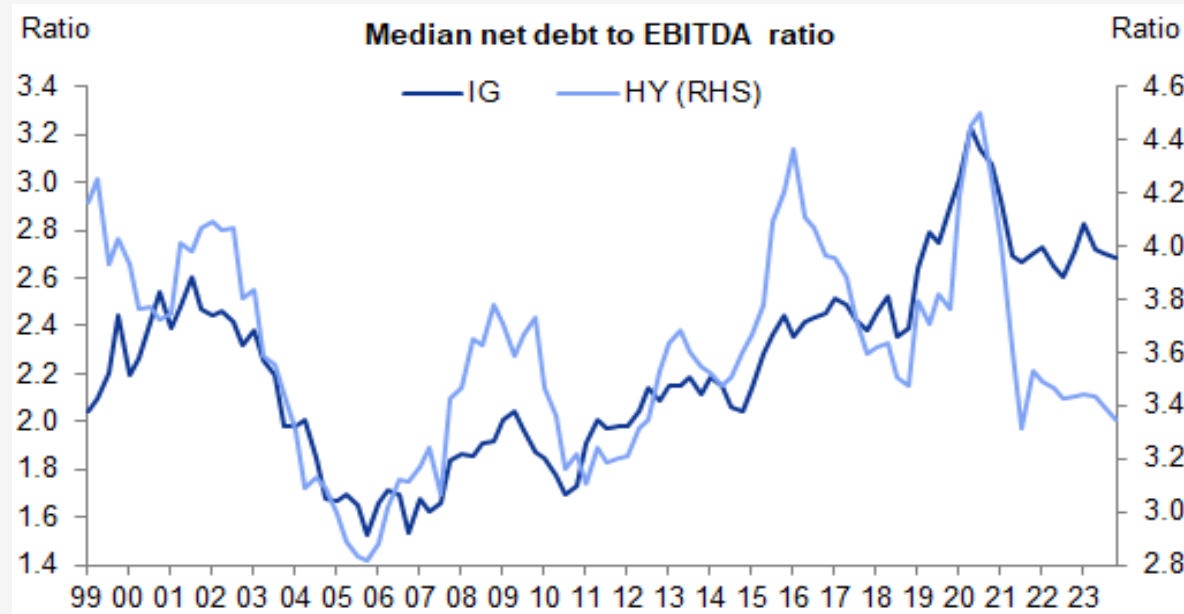


Source: Bloomberg, ICE BofAML Canada Corporate Index, ICE BofAML US Corporate Index and ICE BofA US High Yield Index in US dollars, period from 12/31/1997 to 03/31/2024.

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# Investment Grade Looking More Like High Yield

## Passive investors in IG are exposed to downgrade risk



Source: Goldman Sachs

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# Outlook

## Buckle up for a soft-landing ?



### REASONS FOR OPTIMISM

- Fixed income return profiles compete favorably against long term equity returns
- Discounted price bonds offer tax-advantaged returns
- Corporate credit profiles are generally strong

### REASONS FOR CAUTION



- Lagging impacts of record monetary policy tightening
- Expensive valuations
- Over-leveraged Canadian consumers

# Energy

## Stakeholder alignment supports positive returns in credit

- ✓ Disciplined and experienced management teams
- ✓ North American shale plays largely de-risked with predictable production profiles
- ✓ Rational capital spending to limit excessive production growth
- ✓ Strong free cash flow generation with balanced shareholder / bondholder returns
- ✓ Paying down debt and deleveraging

**= Improving credit profiles driving tighter valuations warrants sector overweight**





# Metals & Mining

## Energy transition supports credit upside

- ✓ Massive amounts of base metals (copper, nickel, cobalt, etc.) are required for broad electrification transition
  - ✓ Strong potential for free cash flow generation as commodity prices are driven higher by excess demand
  - ✓ Scarcity value for long-life assets with significant reserves
  - ✓ Bondholder alignment as issuers pay down debt and deleverage
- = Improving credit profiles driving tighter valuations warrants sector overweight**

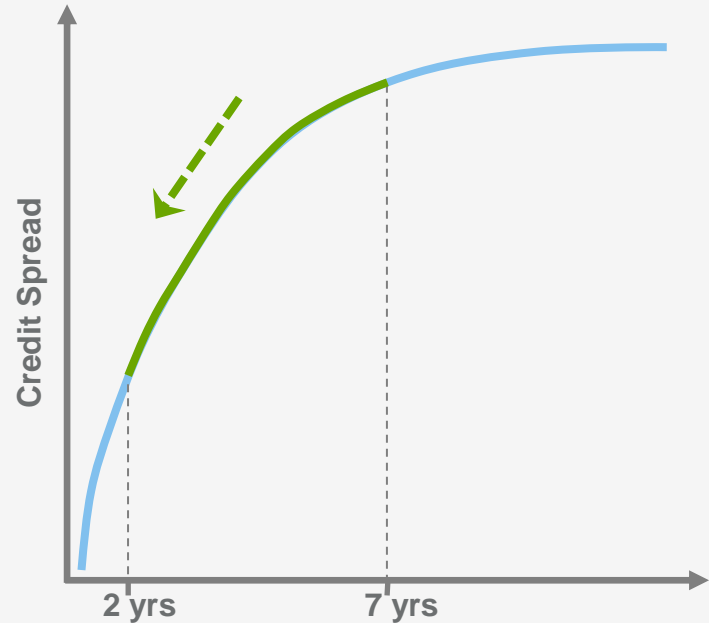


# Short Duration Investment Grade

## High quality income that can be enhanced through leverage

- ✓ Focus on attractive spreads and all-in yield that can generate decent income (senior bonds of banks and pipeline companies)
- ✓ High quality issuers with no default risk
- ✓ Isolate steep curves where spreads can “roll down” providing a tailwind
- ✓ Use leverage by shorting government bonds to enhance returns and eliminate interest rate exposure

= **Low volatility attractive carry strategy**



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# Discounted Price Bonds

## Tax-advantaged return profiles driven by capital gains

- ✓ Low coupons + higher yielding environment = bonds trading at a discount
- ✓ Discounts in the short-medium part of the curve offer capital gains as bonds are “pulled-to-par”
- ✓ Active managers can enhance tax attributes by focusing on the most discounted securities

= **Generational opportunity**



Source: Bloomberg, ICE BofAML Canada Corporate Index, from 12/31/1993 to 03/31/2024.

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# Underweights / Shorts

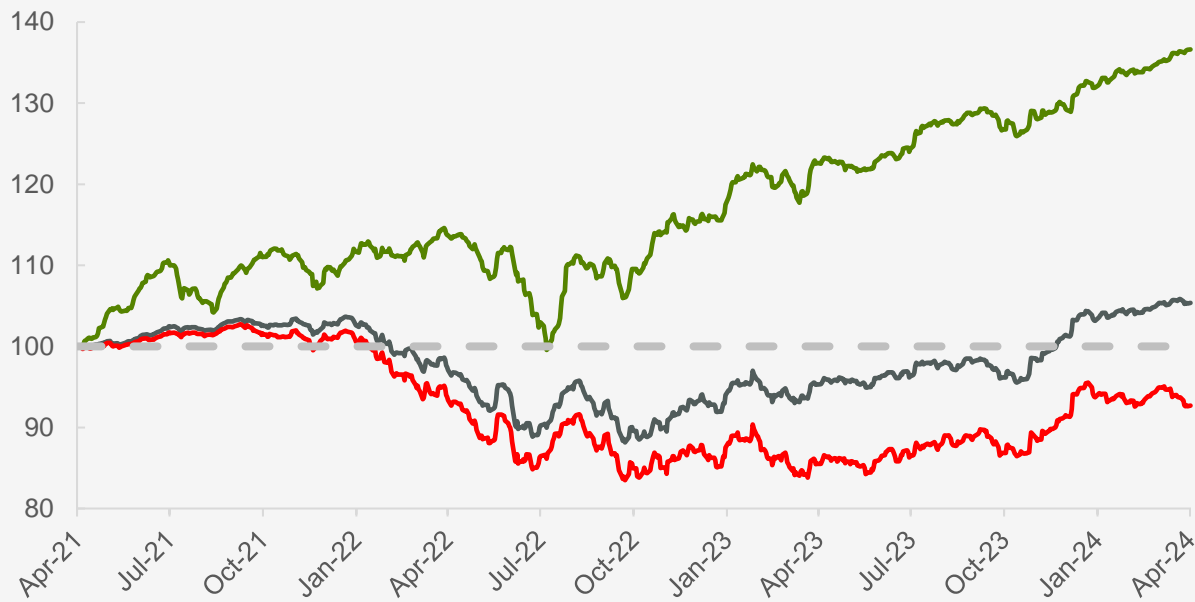
## Avoid risky securities over-represented in passive solutions

- ✗ Large, unstable capital structures with growing interest burdens
  - Over-levered telcos spending significant capex in a competitive environment
  - Office REITs dealing with growing vacancies and rent pressure
- ✗ Consumer discretionary issuers
  - Retailers, airlines, leisure, entertainment, etc.
- ✗ Expensive BB's trading on top of their investment grade peers
  - Return profiles asymmetrically skewed to the downside
- ✗ Lower-rated and subordinated debt
  - Most exposed to a recession, CCC's, LBO/MBO, etc.

# Active Advantage

## Capturing alpha through active sector and security selection

Risky index constituents are often over-represented in passive products



### Oil Field Services

- 2% Index Weight
- 7% DHYBF Weight
- **+9.40% Annualized**

### High Yield Index:

- **+2.02% Annualized**

### Communications

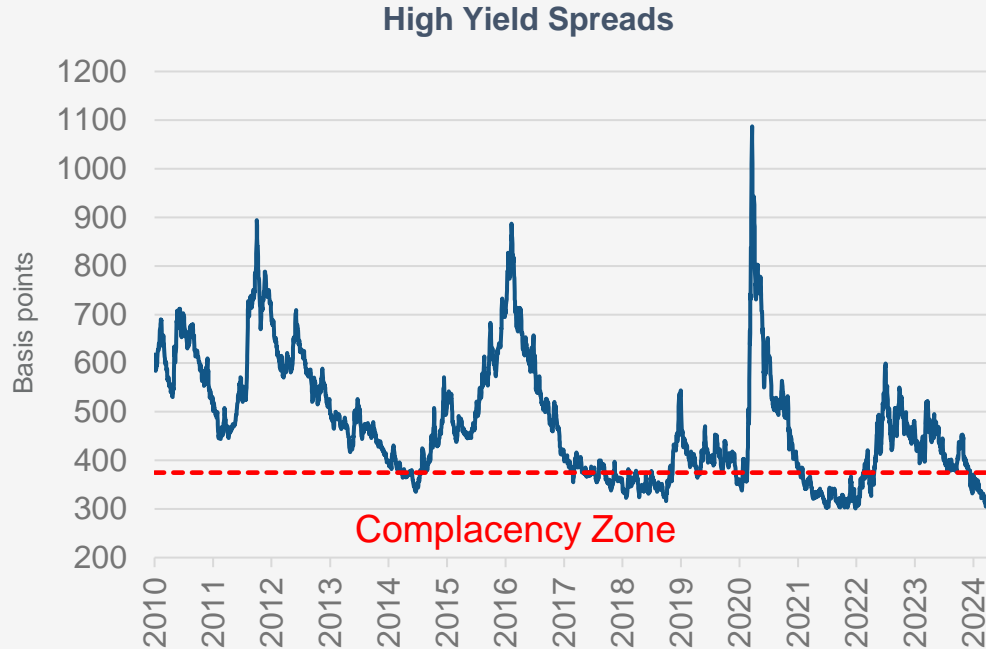
- 14% Index Weight
- 4% DHYBF Weight
- **-4.30% Annualized**

Source: Bloomberg, HY index total return data, total return (%) from 04/08/2021-04/08/2024.

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# Active Hedging Strategies

## Protecting capital through use of flexible hedging tools

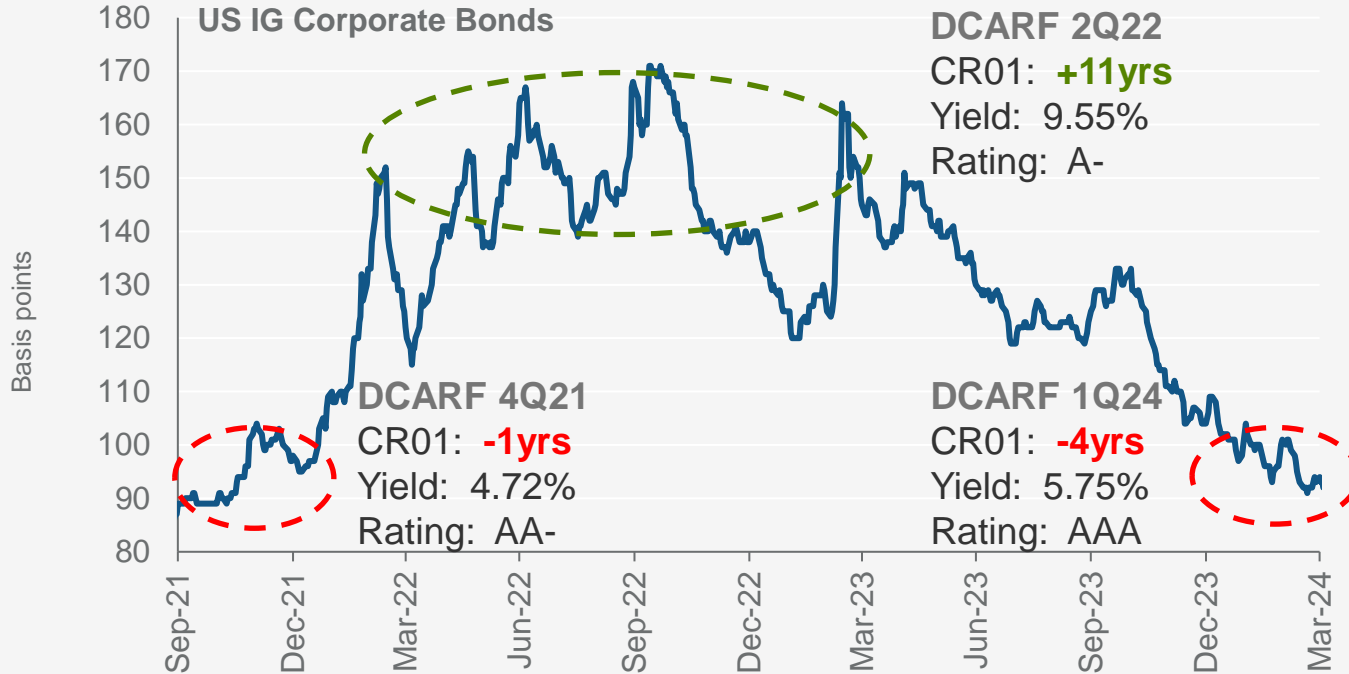


- Unlike equities, the upside in credit is increasingly capped as spreads reach tight levels.
- We actively manage the portfolio's risk/reward profile when spreads are expensive
- **Hedging Tools:**
  - Credit (CDX) / Interest Rate Derivatives
  - Single-Name Credit Default Swaps
  - Option Strategies (Puts, Put Spreads, Collars, etc.)
  - Shorts (Equities, Bonds, ETFs)

Source: Bloomberg, HY Index from 09/30/2021 to 31/03/2024.

# Embracing Flexibility in Credit Alternatives

## Shifting valuations warrant an active approach



### Spreads are Cheap

- Long Positioning
- Increased Leverage
- Broad Quality Skew

### Spreads are Expensive

- Short Positioning
- Lower Leverage
- Higher Quality Skew

Source: Bloomberg, ICE BofAML US Corporate Index from 09/30/2021 to 31/03/2024.

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# Leveraging Credit Alternatives in Your Portfolio

## Flexible liquid alt. mandates to support your client's needs

	Dynamic Credit Absolute Return	Dynamic Credit Opportunities
<b>Investment Objective:</b>	Enhances return profile of Short-Term Investment Grade bonds	Seeks equity-like returns with fixed income volatility
<b>Leverage:</b>	Structural (2-3x)	Opportunistic (1-2x)
<b>Average Rating:</b>	Investment Grade (AAA)	Flexible (BBB+)
<b>Duration:</b>	Hedged	Unhedged, but less rate sensitive
<b>Target Return Profile:</b>	6-8%	8-10%
<b>Correlation (10yrs) FTSE Canada Universe Bond</b>	0.22	n/a
<b>Correlation (10yrs) Bloomberg HY VLI CAD Hedged</b>	0.53	n/a

Source: Bloomberg, 1832 Asset Management LP, data as of 31/03/2024.

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# Conclusion: The Fixed Income World Has Changed

## How will you adjust your client's portfolios?



Corporate bonds provide investors with attractive return profiles rarely seen over the past decade that could potentially exceed equity returns with much less volatility.



Multi-Strategy mandates with flexibility and a proven investment process can improve portfolio diversification and reduce correlations.



Investors should embrace actively managed solutions that can exploit opportunities despite broader market complacency.

# Important information

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