Read the transcript from the panel session discussion titled: "Deep Analysis of the 70+ Active UITs Focused on CEFs/BDCs: Which Sponsors Have More Success for Various Investment Goals?"

Wednesday, November 6, 2019

David Sachs, Partner & Co-founder at Ares Management, Barry Sloane, President and CEO of Newtek Business Services, Kim Flynn, Managing Director of Alternative Investments at XA Investments, and Tony Huang, Associate Portfolio Manager at Advent Capital, were panelists at the AICA Boot Camp and Round Table held on November 6th in New York City. The moderator of the panel was Dan Silver, CEF/BDC Analyst at AICA and Portfolio Manager at Zoso Capital. Read the transcript from the discussion below to hear the insight from the panelists.

David Sachs

Barry Sloane

Kim Flynn

Tony Huang

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Dan Silver: My name is Dan Silver, and I've known John Cole Scott who started the Alliance for about five years. I run a tiny hedge fund in New York; long, short, mostly closed-end funds. And since I know him and I've been a client, used his data for a long time, he asked me to help moderate the panel, so that's

where we're at. And since we have a disparate panel, it's not just three guys that all run an interval fund, I'm going to ask each of the panelists if they could tell us who they are, what firm they're from, and give us a little bit of background. So I'll tell you what, why don't we go from my right to left? Mr. Sachs?

David Sachs: Good afternoon everyone. David Sachs, I'm a partner at Ares Management and have been there since we began the firm. Was our liquid credit portfolio manager for the first 10 or so years of Ares, and now sit on most of the investment committees. And specific to this conference, I am the chairman of Ares Dynamic Credit Allocation Fund; ARDC.

Barry Sloane: Hi, I'm Barry Sloane, president and CEO, and founder in Newtek Business Service Corp, we're an internally managed BDC. We're coming up on our fifth year anniversary of converting from an operating company to a business-development corporation. We are headquartered in New York and Florida. Fairly unique BDC, we trade at about 1.45 to NAV. It's an interesting story in and of itself, and I appreciate the opportunity to present in front of everybody.

Kim Flynn: Kimberly Flynn, I'm the founder of XA Investments. I spent many years at Nuveen Investments and left about three years ago to found an asset manage business to focus on alternatives, and also focused on closed-end funds. We have both listed and non-listed funds, and we partner with independent managers who have long track records in this space. And we help them access individual investor markets. Most of these managers are institutional and don't have the resources, and sometimes they don't have the inclination to pursue registered funds, which is what we're here to talk about today.

Tony Huang: Hi, I'm Tony Huang. I'm an associate portfolio manager at Advent Capital, and we're a manager of about nine billion dollars of publicly traded securities, mostly convertible bonds but also high-yield and equities as well. Advent has one closed-end fund that trades on the New York Exchange, its ticker is AVK, that has about a billion of assets. And I'm here to talk about AVK, as well as the convertible bond asset class.

Dan Silver: Okay, so I probably should have mentioned this at the outset. So this panel is about alternative credit and alternative income. So with that kind of out of the way, I was thinking maybe we could go down the line, why don't we see if we can't come to some type of a joint definition about what exactly that means? I think there are probably a bunch of ways that we can skin the cat. So in any order, I'll tell you what, if you want to start on the far end and maybe a couple of factors that you would use to define alternative credit or alternative income?

Tony Huang: Sure. So in creating an income for your clients, of course there are the typical high-yield bond, treasury, mortgage bond areas to create a lot of cash income. And of course equities, and dividends, and covered calls. I think everybody on this panel has a different way that is not in one of these standard areas. For Advent, it would be in the convertible bond asset class, which is a bond plus the option to turn that bond into equity if the stock that it converts into trades very well. And so this gets into a combination of corporate credit as well as equities, but also the fact that you own an equity option. Which gets into the pricing of volatility, which is considered by many institutional investors to be a separate asset class. And so the volatility of pricing and the fact that the option is at the choice of the investor, is a very good way of generating overall income or overall returns. Because when the stock market is sloshy and there's difficult times, then you have a bond that you can default into that will return your maturity and your coupon. But if the markets are very strong, then your option can turn into equity. And so when markets are down, the bond element creates some cushion downside, protection for the investors. And so over long periods of time, the convertible markets, you generally think because they're part bond and part equity, would have returns in between the two asset classes. Over time, the convertible asset classes actually return very close to the equity markets with actually less risk, less standard deviation, less volatility than the equity asset class. And so the Sharpe ratio has been actually superior compared to equities, and so that has been a very powerful argument for pensions and other players that are looking to match their liabilities. And so as a way of creating income but also reducing risk, the convertible bond asset class is one that I think investors should take a look at.

Kim Flynn: Just generally speaking, we think about alternative assets being less liquid assets. We're focused on alternatives that don't otherwise fit into ETFs and mutual funds, and I think that's really important. The ability to earn additional return or alpha is coming to the fact that many of these assets have liquidity premiums that are driving returns. And so sure there are some highly liquid alternatives that you might be able to buy in an ETF, but that's not what fits best into the BDC or the closed-end fund structure. And then there's also I think another way to think about alternatives. There's alternative assets, there's alternative structures, and there's a wide variety of alternative product structures that can deliver income. Sometimes it's from ordinary income investments, and sometimes it's from a managed distribution or an endowment-like payout. But it too can deliver cash-flow or income, and so you can think a little bit more broadly about alternative income when you include those types of structures.

Barry Sloane: This is a diverse panel, so I guess you're going to get four different definitions of what alternative investments are to each of us. I think from my perspective when I think of someone saying, "I want to put money into alternatives," it's not equity, it's not debt, it could be a lot of other things. We're an interesting business-development corp., in that we actually have operating businesses underneath the BDC. So there's certain aspects of our returns to investors that incorporate fixed-income. There's certain aspects to investing in our BDC that are operationally based. And a good portion of our BDC is invested actually in business services entities that we own a hundred percent of. So from an alternative investment, our returns of NAWT over the last five years has been in excess of two hundred percent, 130% over three. And this year we're on target to be in excess of 20%. So we've clearly beaten the market indices, which you couldn't get from just owning the S&P Index or bonds. People invest in alternatives to get a return beyond what you can get from a bond index or the stock market index.

David Sachs: Well, first of all, I agree with everything the other panelists has said. But the interesting thing about alternatives is what constitutes alternative asset or alternative structure has evolved so much over the 40 years I've been in the investing business. In the early 1980's, Ginnie Mae, and Fannie Mae, and mortgage back securities were not in the institutional fixed-income index. So the New York State

pension plan wouldn't buy those because they were benchmarking. So things have evolved, and things like high-yield certainly weren't. I think that, as was said by one of the other panelists, the trick about alternative assets is they may be able to allow a portfolio manager, or investor, or investor manager, to match a particular characteristic of investment with the needs of an investor, such that they can take illiquidity for example. Now for the retail investor or smaller institution, it's tough to access a lot of these investment assets and you need specialized teams to originate the assets or they're complicated. If you can take for example, illiquidity was mentioned earlier, and you'll earn that illiquidity premium or something's complicated, you'll earn that if you pick a structure, whether it's a closed-end fund, a BDC that offers access to that. So to me, alternative asset is something that's not a stock and not a bond.

Dan Silver: Okay, so we heard a lot of interesting factors there. Whether it's the market return, the overall S&P. Whether it's volatility. Whether it's an interesting model, investor specific returns. We heard reference to Sharpe ratio. There are a lot of ways that I think we can define it, but David, if I can follow-up with you, Ares obviously has a number of different funds, different structures, and you play in numerous different areas. How do you see addressing these market opportunities, because they're obviously not all the same?

David Sachs: Yeah, we have at the present time, besides our management company which is public and trades on the New York Stock Exchange, we have three publicly traded vehicles, four registered vehicles. And really, Ares started out as entirely an institutional manager, and each of these is designed to allow individuals or smaller institutions access in a more liquid fashion, some of these strategies that we offer to institutions. So it really depends on whether someone is looking for only income, or if someone wants diversification beyond the United States, if someone wants access to commercial real estate mortgages. So the way we look at it is, we want to do a good job in each of these strategies. And just like a family that may have several children, we love all our children but it's about the investor or the investment manager matching what characteristics they're looking for, against what we have out there in the public market. And of course, the thing all of us know with public companies, and Barry made reference in his

introduction, is that sometimes a given strategy irrespective of the performance of the company, whether it be an operating company or a closed-end fund or BDC will trade at a premium to book. And sometimes unfortunately, and we've had that experience, traded at a discount to book. Even though the underlying performance of that strategy or company might be better than the benchmark.

Dan Silver: So there are two points there, I think, that I'd like to follow-up with real quick. And the first is you guys provide access to investors to asset classes, types of investments that they previously might not have. But at the same time, there are asset classes that have historically been mostly institutional and now you guys are enabling retail, the mass-market to be able to get access easily; whether it's through a publicly traded vehicle, or through an interval, etcetera. Would you like to comment on those two dynamics of new versus old?

David Sachs: Sure. You have something like Ares Commercial Real Estate as a commercial real estate REIT. Historically most commercial mortgages have been originated or held by either insurance companies, banks, entities like that. So this is a way for investors who want income to access that market. On the other hand, you look at something like the fund I'm chairman of, Ares Dynamic Credit Allocation Fund. There we have high-yield bonds and loans, which retail or individuals investors, small institutions can certainly access through a number of vehicles, whether it be ETFs, other closed-end funds, high-yield, and bank loan mutual funds. But what we've added to that is structured credit, in particular collateralized loan obligations, debt and equity of those. Which is another way to invest in the loan market, and at times, a cheaper way with different characteristics. The net result is in that fund, we pay a much more significant dividend than a typical closed-end fund loan fund. But the interest rate duration of the fund is only slightly over one, so it's not a high-yield fund with a duration of four.

Dan Silver: I think Kim, maybe we follow-up with that. Obviously with the XFLT that you guys have experienced, in not only the CLO aspect of it, but the fact that the income, the yields are higher here, the structures are different. So it's not the plain vanilla traditional, whether it's fixed income that your average

retail investor might think when they think, whether it's the AGG, or treasuries. Perhaps you can comment on the alternative aspect to the income that you guys offer.

Kim Flynn: I think it's a good point. I want to remind you what we heard this morning about the factors that go into building and launching a new listed closed-end fund IPO. And I was at Nuveen Investments for 12 years, and what I'll tell you is we got to the end of the road with traditional investments. Meaning there are plenty of great senior loan funds, preferred funds, muni funds, and we differentiated the heck of the new ones that we brought to market. But the reality was, the market did not need another one of those products, even though they were well managed and whatnot. But yet there was this untapped universe of really compelling investment strategies, largely institutional. And so one of the things that's exciting about what Ares is doing, and what the fellow panelists are doing, is that they're bringing these true institutional strategies to market. Sometimes it's through an interval fund or a non-listed fund. The listed market, which is really the best structure. I built about 45 listed funds in my career, Nuveen is the leader in that market for a reason. But the way these funds are brought to market, there's a reason we're not seeing more alternative listed closed-end fund IPOs. I would like that to change, because it's really an optimal structure for illiquid assets. Even better than an interval fund that provides quarterly tenders. So we have a ways to go in terms of broadening out the opportunities. It's exciting because we're just now seeing really high-caliber managers with long track records and fantastic active managements. And so we're really just on the cusp of seeing a lot of new things. And I think the BDCs, and I know we looked really very closely at the success of the growth of the BDC market, which had followed the success of the REIT market. And so I think the closed-end fund is really in its infancy in terms of that structure broadening out and adapting to many of these new alternative income opportunities.

Dan Silver: Barry has an interesting story to tell, because not all BDCs are the same. It's a pretty generic term, and obviously Newtek is unique in a variety of ways. Do you think maybe you can explain to everyone, not only how it's unique, the fact that it's internally managed, and the valuation and what that reflects?

Barry Sloane: Sure. Newtek basically is a BDC, so we do take advantage of the tax-advantaged nature of BDCs, which is valuable to us and valuable to our shareholders. In the lending space, which obviously gives us our BDC pedigree, to be able to have assets and income that mean the requirements of the SEC. We make loans and given the programs that we're in, either we securitize them, which is a financing vehicle, or we're able to sell them for a capital gain. So actually when you look at our NII, which is the gap term for a BDCs income, it's negative. So we've had to deal with the fact for over the course of our history, that we report these negative numbers. We just show up as this weird line item in a lot of research analysts reports. Well, that's because we make loans, we sell them, we get a capital gain, which doesn't count as gap NII, so we report it as adjusted NII. We're able to do by the utilization of that, is to get a much higher return on our equity. So in that particular segment, that what we do in the BDC, we're generating equity returns on capital that are north of 30% risk-adjusted. When you look at the other business that fit under the umbrella, we own several different vehicles, but there's primarily four other silos. There's payment processing, technology solutions, insurance agency, and payroll. Well, they're all operating business and we own a hundred percent of them. Because we own a hundred percent of them, they fall under the 70% test. Which means that we qualify, and the dividends get dividended up. We do pay tax on those particular entities. So an investment in Newtek is basically an investment in a tax advantaged structure that does benefit from operating returns. Which from my perspective, given that we've owned and operated these business for over ten years, have an attractive risk-return tradeoff. In other words, in order for us to generate our higher than average returns, we don't have to use excessive leverage. We're not investing in meds, we're not investing in sub-debt, we're not putting leverage on that, we don't have SBIC debt. It's just a simple operating structure underneath the BDC that's tax-advantaged, and that's how we've been able to generate these returns. But when the analysts look at us and we're releasing earnings in about 10 minutes, and I'll have my call in the morning. They have a hard time figuring out what we're doing. Fortunately we have a lot of loyal investors that have held the stock for a period of time, and they keep accumulating it. And the dividend has grown from $1.50 in year one, to $2.15 this year. So people say, "Why do you trade at a premium to NAV?" It was pretty simple, we're just

increasing our earnings every year. We're increasing our cash-flow. And I have analysts that say from a NAV perspective, there's sort of this ceiling that you can't pierce. And I say, "Well, I guess they didn't go to school."

Dan Silver: I think at the end of the day we have to follow the cash, right?

Barry Sloane: Follow the cash, exactly. That's what they're buying, future stream of earnings. If it keeps increasing, they're going to keep paying a better price for it.

Dan Silver: I'd like to think that 30% returns on equity are something that almost everyone would be willing to pay for.

Barry Sloane: Hopefully it'll continue.

Dan Silver: Hopefully.

Barry Sloane: Where's my disclaimer?

Dan Silver: Knocked on loose-leaf. Especially in advance of earnings. So Tony, how do you feel about following the 30% returns? Obviously the convertible market has some interesting dynamics. One of the things that you and I had chatted a little bit about, and hopefully you can explain to the audience, is the interplay between the volatility and the value of the option that's imbedded in a convert, and how that plays into the return both on the upside and the downside?

Tony Huang: Yeah. So we have our own set of powerfully nice returns, especially this year, to talk about. AVK, the NAV is up around 18% this year. And because the discount has lessened, the total return to investors since the start of this year has been about 25%. And that's because of its participation in the equity markets, as well as a time period when interest rates have been falling. And a lot of the reason that the returns have been better in the convertible universe so far this year, is because volatility has been rising. If you recall the markets in 2016 and 2017, they were essentially going up monotonically. And volatility was falling, I believe the VIX hit around 10 in late 2017. Well, markets got slushier in 2018.

There's obviously been a lot of geopolitical angst, not just here in the U.S., but of course abroad in Britain, and Hong Kong, and Saudi Arabia, and even down in Latin American Chile. And so all of those events that make investors nervous raise volatility. When you're a convertible bond investor, you own an option, and the value of that option is based on the volatility of the underlying stocks and of the equity markets overall. And so that is on the things that cushions the return. You do get higher volatility mostly when markets fall, and so you'll lose some equity value in that case. But the increase in the valuation of the volatility of the option element, is something that gets return back to convertible investors. And that's one of the ways that the return gets enhanced, so the downside is more protected. Now looking at how Advent does it, and also just to push the Active Investment Company Alliance here, convertible bonds are an area where active management is really, really helpful. Not only are we bringing an institutional market with availability for retail investors, but you're bringing the ability not to invest in just any convertible bond. There is one ETF in convertible bonds that's large, but it invests in all kinds of convertible bonds, regardless of whether they're attractive or not. And so there are many convertible bonds out there, where the option doesn't really mean much because the stock price is not near the strike price. You could have a stock price of a company that's around $30, but your convertible bond, if the strike price is $50 or if the strike price is $15, well, your option is very much out of the money, or it's very much in the money. And your resulting convertible bond is going to act a lot like a regular bond or an equity. And so what Advent focuses on, and what AVK focuses on, are bonds where the option's close to the money, and you get a lot of gamma in that option. Where if the stock goes up, then you'll participate in that. If the stock goes down, the option goes out of the money, you have a bond and you're protected on your downside much more so than a regular equity holder would. And so AVK investing in the bonds that are in the middle of the universe, they're not way out of the money, they're not way in the money. That's very beneficial to create the downside protection while still participating in the upside appreciation. So looking at AVK, which also trades by the way at a 10% discount, and is one of the wider convertible closed-end funds in terms of its valuation. With an 8.5% yield on NAV and a 9.5% yield on the market

price, it's a very, very interesting investment to participate in, in an asset class that can provide a lot of good Sharpe ratio benefits to investors.

Dan Silver: A nice hint, hint. Might be something that you should take a look at and do your own due diligence. David, I'd like to follow-up on that, because one of the things, again, we're talking about volatility. And obviously as investors thinking about their returns, sophisticated investors will think about volatility, the volatility of their returns, risk-adjusted returns. Now we're really coming back to the concept of alternatives and where they fit in. My question for you is, obviously we know alternative investments are here to stay. I think the last 20-something years has born that out. How do you think about the near term and medium term outlook for alternative credit? Are they here to stay, or this more just a definitional, transitional change?

David Sachs: Well, I do think it is here to stay, and it's because of the evolution that's gone on first here frankly in the United States, and now across the developed markets. Of what regulated financial institutions do and don't do. So the reason alternative credit really exists is because through a variety of cycles, banks and other financial institutions have decided, "Okay, there's certain things we used to do for our own balance sheet that we used to do ourselves, that maybe others who are focused only on credit will do better." If you think about a bank, banks have a variety of credit businesses, and they have a variety of fee-based businesses. And unfortunately, sometimes those two things get confused within the bank, about why they should renew a credit line or not. And whereas a BDC, or for that matter a closed-end fund manager like Tony or us, buys the credits that we want to buy in the market. So I think alternative credit is here to stay, and it really allows an investor to pick both the market they want to be involved in, to some degree the geography, the type of credit; secured or unsecured. And with more and more players, the BDC market was very small 20 years ago, 15 years ago. Now you can see the differences in how different management teams execute that strategy. We worked very hard, started with 156 million dollars or something like that, 15 years ago in October of 2004. Today we have, I believe, the largest publicly traded BDC market cap, never missed a dividend. That didn't happen by accident, and I think you can

look at different management styles. And that doesn't mean there's only one way to make money in a BDC, or only one way to make money in a closed-end fund, it's just about doing a valuation. Does the risks that a management team's going to take, the way they allocate their capital, match up with what you are comfortable with? And do they have the capabilities to do it properly?

Dan Silver: I think that dovetails in with a very interesting concept, and that is active versus passive management. So I would submit, this is one of the interesting areas, one of the few areas in the fixed-income universe, research has certainly born this out, that it's easier to generate alpha and possible to generate alpha relative to a benchmark, in fixed-income. And I would suggest that when it comes to alternative credit, this is one of those areas. Because whether it's banks are less involved and using their balance sheet less for regulatory reasons certainly. That the value of research, the amount of due diligence involved, the fact that the market in many cases, private credit, direct lending, is in bespoke. I guess, I'd like to poll the panel whether or not you think this is sustainably an area where active management actually has an edge? Any feel for it?

Barry Sloane: I'll jump in on that one. I think that in areas where there is less research, which is the key, there's more opportunity. So when you look at the equity market, there's a lot of dollars, a lot of eyeballs, a lot of research on all these companies. And it's very hard because of that, to actually find the anomalies. But I do believe it's extremely hard to measure risk. So when you look at all these different alternative asset classes, whether it's mezz, sub, convertibles, real estate, etcetera, and the supermarket keeps getting bigger and bigger. There's just not a ton of research out there to the average investor to be able to make decisions. Which is why companies like Ares has done a tremendous job in having a supermarket of different opportunities and different classes, and different risk profiles to make those investments in. So I think in the fixed-income side of the business, there is really a tremendous opportunity still to make above average returns. Because the areas that we're in and that we're investing in, they're not trading on markets, there's no research to follow them, the bid ask spreads are pretty wide. And through these leverage you

can actually offer above average rates of return, which is why I think the BDC market does have a lot of room to grow.

Dan Silver: Sure. And there's also issues with collateral, right? Underlying assets that requires actual analysis.

Barry Sloane: It requires an analysis, but I think importantly they're not typically sold or created in an auctioned-off market. The minute someone says, "I've got a bid in an auction," I'm out. Which unfortunately sometimes causes a problem, because they never bought keywords or competed in digital marketing. But I'm not a real big fan of auctions.

Dan Silver: But it is an important point. That these are markets where the value of research is important, and it's not completely public, it's not completely transparent. So let's follow-up with that. For investors as alternative credit options, the number are increasing, and it's increasingly available to retail. How do people assess whether or not management is talented? How do they find good managers?

David Sachs: Well, I think one way is to look how a firm or the funds have performed on a fundamental basis through past cycles. I'm a big believer in the Chicago School of efficient markets in terms of stock prices and security prices. But that's over time, that's not over short periods. But if you look at the fundamental performance of Tony's fund, or each of the funds here, to the extent they were in that strategy or the fund existed through the great financial crisis before, you can differentiate whether what someone says they're doing is really what they're doing. Because right now due to the central banks around the world, there's a lot of liquidity sloshing around and there haven't been a lot of closed-end funds recently. There's a lot of other types of vehicles been formed, a lot of new people in business. Some of them are going to do a great job, some don't have the capabilities of the people on this panel who have organizations that have been through it before.

Barry Sloane: Yeah. I think the issue of being able to survive tough markets; when I go into meetings, one of my badges of courage is we survived '08/09, we didn't get a government bailout. All of our bank lenders got paid off and we moved on. We've been around for 20 years. There were very few risk takers that survived '08/09, except the very few that were on the right side of that trade. I mean, the reason why that trade caused so much dislocation, was everyone was piled into one side of the trade. I think it's extremely important in the businesses we're in, to be able to measure the risk. Meaning that if what you're doing goes against you, can you survive it? Can you manage it? Do you have enough liquidity to move on in the transaction? And that's the difference between people that are in and out of businesses real quickly. I think returns are really easy to measure on a relative basis, to the talent of actually figuring out how much risk you're taking to get that return.

Kim Flynn: I think the question is about how to you analyze or assess active managers? And there's really a gap in the market right now, and that's why certain publications or newsletters like *Seeking Alpha* have become popular, particularly with independent investors. Because there's fewer and fewer research analysts covering active management BDCs or closed-end funds. And the ones that do provide research oftentimes are tasked with ETF research as well. We got to hear this morning from Amy Charles from Raymond James, and she's one of the leading research analysts on the street for closed-end funds, but she also has ETF coverage, and so that's been a real pull. Fewer and fewer resources are really available, and so I think it's really an opportunity for financial advisors because they are needed in terms of being able to provide the necessary explanation to investors and clients. Because there's complexity at the fund level. There's complexity within the portfolio. And so we heard from Chuck Jaffe this morning, saying that type of complexity will scare people away. So all the more reason that a financial advisor is needed for helping investors understand these opportunities. I don't think that people can it on their own as well as we'd like right now. And the alternatives are not mainstream the way ETFs have become, but they are part and parcel to what institutional investors have long done in endowments and pension funds. So eventually we'll get to a place where investors are more comfortable, but I think that individual investors are still

very risk-adverse, and they view a lot of these alternative strategies as being more risky. It surprising because these strategies are not more risky than the S&P 500, but they underestimate the risk and the volatility that they take in what is largely a U.S. equity weighted portfolio.

Tony Huang: My answer for the question, how do you find value in a manager, would be to look at the internal research commitment. My colleagues here on the panel who are doing private credit, are already selling a very interesting asset class that has a certain uniqueness to investors. But you can make some serious mistakes in the credit underwriting. You can make one mistake and have a default, and that's very problematic for returns of the fund. And the same occurs in the convertible bond universe as well. The way you figure out if a manager has a good sense of quality, is their internal research commitment. In my world, in the convertible bond universe, our investors, our firms often sell to pensions and say, "Hey, look. Look at the structure and the benefits of owning an option for converts." You can get away with just selling that, and that occurs. But what you can also do is say that stock picking actually matters too. And so a lot of convertible firms actually don't have internal research analysts, they may have one or two analysts that are generalists. At Advent, we actually have seven analysts who are sector analysts. I was their technology analyst for many years. And we have a healthcare analyst who has an MD, we have an energy analyst who was a high-yield analyst on the sell side before this. And so we can sell that and it shows up in our returns too, that our stock picking has been better than the average market. And that's very important because a convertible bond, any company that has a convertible bond is by definition, levered. And they tend to be growth investments. They tend to be companies that don't mind equity if equity's issued, and so you see technology companies, healthcare companies, consumer discretionary companies tend to be the kinds of companies that issue convertibles. You don't see Coke or utilities being big issuers of convertible bonds, and so you have some volatile companies, volatile stocks that issue converts. There were number of cannabis companies that came to market selling convertible bonds about a year ago. And it took some very, very careful consideration of what were essentially private companies, to determine if we would participate in that kind of market. And so what Advent is able to do by having a

commitment to spending internal resources on research, is the ability to say that our ability to stock pick, as well as wade our way through some complicated structural elements of convertible bonds, is really a competitive advantage.

David Sachs: If I can add. I think you've touched on two points that have come through here. One is the capabilities and commitment to your own due diligence research of a firm; what their experience is, how many people? There's no substitute for information in doing investment work. So if you have more people, more experienced people, they're covering fewer companies per analyst, etcetera. Everyone here has that. I know the Octagon folks, etcetera. The other is, that's why these assets do not lend themselves as much to ETFs, or index, or passive investing. So if you buy the ETF for loans, or convertibles, or high-yield bonds, you own the whole universe. Well, believe it or not, just because Wall Street will issue a high-yield bond for a shipping company, doesn't mean that's an industry that really should have that much leverage on it. So I'm pretty sure everyone up here has rules about certain industries they just never do. But if you as an investor buy the ETF, you have exposure to that, because if a bond got issued, it's in the index. And that's the reason that unlike say owning the S&P 500 index, these markets in credit and alternatives are very different. It doesn't mean there isn't a place if you're trying to just make a bet on the overall liquidity. Because what drives up ETFs and high-yield and loans, is money flowing in and out, not fundamental credit research.

Dan Silver: Yeah. I think that's an interesting point. You touch on two points there that are absolutely noteworthy. The first is again, the value of active management. And my follow-up to you would be, do you think that we get to a situation where it's a case of the big get better? Because they've got access to deal flow, they have tremendous resources. You guys are obviously global, you have a foreign component. Do you think that the big get bigger and there's consolidation, or would you expect?

David Sachs: That's very tough to predict. If you look at the market the two of us are involved in here, CLOs. After each of the downturns, meaning '01/03 and '07/09, there was some consolidation of managers. First of all, after '07/08, early '09, there was, "Oh, gee, another CLO I'll never get done." And

then firms like Ares, we bought up management contracts from people who had two or three deals. It was three people and, no offence, a Bloomberg, and they thought they'd build a business. They really didn't have a business with three deals. I do think next downturn, to paraphrase what Warren Buffett says, you will see consolidation. But no, I don't think it'll be two, three firms. There are things, as good as an Ares is, as good as Octagon in CLOs, there are things that a smaller manager may be able to focus on that we don't. It's not better or worse, there are different investment styles, so personally I don't think it'll consolidate into a smaller number of managers in our field.

Dan Silver: And certainly the rise in the number of firms, the number of funds, the number of offerings, these are positive when it comes to expending mass market adoption. So whether it's marketing dollars being spent, overall awareness, fund flows, people need to know or they're not going to be able to access it. All right, well moving on. Before we head into Q&A, I was hoping that maybe each of you could maybe try to come up with one message or takeaway that you'd like to impart with the audience. That they should remember or keep in mind as it relates to any aspect of alternative credit that you can think of, that perhaps we have not yet touched on yet? I'll tell you what, you want to start at the end?

Tony Huang: I'll ponder for now.

Dan Silver: Okay, fair enough.

Kim Flynn: I was just going to mention that it's tangent to what we're talking about, but the SEC is looking now at making alternatives more accessible. So private funds, private equity was specifically the focus; they asked for leaders in the industry to comment on what could be done to make these types of alternatives more accessible. Part of the reason why they were focused on private equity, venture capital, was because they know that ordinary investors don't really have access points. The beauty of alternative credit is there are a lot of good ways already, with BDCs, with closed-end funds, with REITs, to get entry points into alternative income types of strategies. So in some ways, the SEC doesn't need to change anything to make those opportunities. We're going to see more and more issues develop funds of this

nature. And just like with listed closed-end funds, the performance and the yield will bear out over time. And the best BDCs trade at premiums. What we're seeing is really interesting, is that the alternative listed closed-end funds that trade at premiums, are distinguishing themselves from traditional closed-end funds. As you would expect, because they have more yield and they have higher total return. So I think it's exciting. I think that the SEC is going to open up some ability for registered closed-end funds to provide access to all sorts of different types of private funds, because they know that ordinary investors are missing these elements. With the defined benefit programs going away, the onus has shifted to the individual, and it's not fair because they don't have the tools that institutions have. So what's good is we're going to see a lot more in terms of alternative managers know that the growth is on the individual investors side, and so you're going to see really high-quality alternative managers pursue a number of these registered structures. So it's really exciting because I think this is terrific asset management. It's a shift that we're seeing right now. So it's exciting to see that, and I think we'll see a lot more of that in the years to come.

Dan Silver: Win-win for the industry. Win-win for investors. Hopefully. Barry?

Barry Sloane: I guess the one thing that we try to impart, which I hit upon earlier, would be to try to focus on what is underneath that return that you're being showed? Because I think the biggest mistake people make is, they look at that return and it's extremely enticing. It's above the bond market, it's above the equity market, but people need to have an understanding of, what's it going to be with one or two standard deviations, or three standard deviations? As a lender, we're extremely cautious. Most of the businesses that we invest in are no growth or slow growth. We like that. Because if we win, we get our coupon and that's all we're playing for. If we lose, we get a nice haircut. So we try to invest in businesses that have been around, that have been steady, that have been stable. Like for example, you're investing in business in oil and gas; extremely volatile. So you try to stay away from businesses that have a lot of volatility if you're a debt investor. Because if they win and they win big, it's great for them, but really

you're just getting a coupon. So try to do the best that you can to see behind what you're being professed as a yield, what are the volatility of those returns in different markets? What can cause those returns to change and change significantly? And try to look at the inherent risk or leverage in the assets themselves. Try to invest in as low leverage as you can to get a reasonable coupon. On that basis, you win. That's where I think the big arbitrage is in the market.

David Sachs: I would just say, an alternative is not an alternative, is not an alternative. It's very broad, and so think about what you're trying to achieve for your portfolio, your client's portfolios, and match that up with the segment that makes sense. Because just buying on yield will not be the right answer.

Tony Huang: So the convertible asset class could actually become a very good investment next year if certain things happen in the marketplace. And the theme that's quite possible is that interest rates start heading up again, and that's certainly possible because the Federal Reserve looks like it's on hold and the U.S. economy has hung in there. Now typically you wouldn't say that if you know that interest rates are headed up, that you want to be in some sort of fixed-income asset class like converts.

But the duration of convertible bonds is actually quite low, most convertible bonds that are issued are three or five or seven years in length. You don't tend to see 15 year convertibles sold because it's very difficult to value 15 years of optionality in the Black Shawls model. And so with interest rates possibly on the rise, and certainly the Federal Reserve looks like it's not going to be cutting at least over the short-term, it indicates that the economy is reasonable healthy. That helps of course, a lot of risk investments. But it also really helps convertible bonds because you don't get hurt by the duration of the risk, and of course growth companies really rely on at least a stable economy to help them going. And so in past periods of rising interest rates, the convertible bonds have been probably the best among the fixed-income universe of asset class in terms of performance. So, we'll just leave you with that.

Dan Silver: Well said, all right. Well, I'd like to open it to the audience to see if there are any questions that the panel can field for you. Anyone care to venture a question? Anyone have something they'd like to ask of our panelists? Anyone? Don't be shy. No? Okay, well - oh, sir?

Audience: What do you think about the new regulations that came in last year for BDCs? Maybe not the convertibles. Do you think it's a good thing that the government has allowed the leverage to increase for BDCs?

Barry Sloane: I think the big issue again depends upon [inaudible] 2:1, and the BDC. I would think just in extreme cases just invested in CEO equity, that probably a risky proposition. And I don't think there was a tremendous amount of thought per se, [inaudible]. I could recall having a conversation with one of my analysts two or three years ago. We got into, "Well, with 0.82 in leverage, don't you think that's kind of high?" "Versus what? A 0.77?" [inaudible] And frankly, we're still having the conversation. If I'm at 1.3 versus 1.5, do you really think that's a wild term? I have analysts that just have a mind for that number in their head. Forget what I'm invested in, [inaudible]. By the way, rating agencies aren't far from that either. I probably just said something I shouldn't have said. This is what we're dealing with, which is what I [inaudible]. You've got to look at the assets. So speaking selfishly, that was a great thing for us. Because we're not invested in a highly levered -- we have very little leverage inherent in the structure. We're able to get the excess in returns because it's operating business. [inaudible]. We're repatriating the cash. If that trend continues, there's ways to get leverage in a BDC structure. That can be problematic.

David Sachs: Yeah. I think we felt it was a good thing, but it's not a good thing for everyone. And just following-up, it depends on what strategy is the business-development company; their resources, what kind of discipline they have? So just to take an example from real world, something in the area of, as we went from late '05 into '06, Ares Capital Corp. had a significant amount of its portfolio in junior capital; mezzanine or second-lien kind of assets. As we saw, and I was on the investment committee then, as the management of it -- it wasn't forced by the investment committee, but we agreed with it -- saw what was going on in the leverage finance market as we went later into '06 into '07. By the time we got to June 30,

'07, the portfolio went from -- I'm using -- don't hold me -- approximately called 60% stretched senior or junior capital, and 40% true first lien. It went to the converse. So when you talk about leverage, it depends on what you're leveraging, how the management treats that leverage. If you owned all credits, where you were lending one time against liquid collateral, then maybe two times leverage makes sense. If on the other hand, as Barry said, someone in their BDC buys a lot of subordinated debt, or equity in CLOs, or some other more volatile underlying asset, then more leverage on the BDC balance sheet maybe be problematic. Because let's not forget, whether it was the old way or now the new rule, if you go over that, it has all kinds of implications for your ability to pay dividends. It has implications for your debt covenants, never mind your rating. So I think overall it's a good thig, but you have to look at the management and the strategy of the individual BDC.

Tony Huang: Yes, if I could jump in on that actually. AVK is actually an investor in convertible debt that are issued by BDCs, and so the fund has investments in convertible debt issued by Ares. And so we've been monitoring this situation as a debt holder, and we've actually been really quite pleased. The industry overall, twelve months into these new regulations, there have been very few firms that have gone past the 1:1 leverage ratio. And so that really goes to the point of David there, it depends on the kind of debt that you're going into. The type of junior mezzanine debt that have high-yields is not really appropriate to go beyond a hundred percent leverage. And so credit quality matters a lot, and the concept that it's just not right for all the companies to do so. So you would have all kinds of unintended consequences if the entire industry went after, and essentially that threw more money at a situation. It would bid interest rates down. Credit quality you would undoubtably reduce. And we've actually been quite happy that very few firms have actually gone after that trend, that ability.

David Sachs: I just want to add though, there's so many articles these days about private credit, direct lending, CLOs. Politicians have mentioned it, financial market observers, certainly journalists. It's sort of the thing to write about the last six months. Let's keep in mind, this is very different than City Bank and Chase Manhattan lending money to Argentina like they did in the late 70's or 80's, where the party at risk

ultimately is the tax payers because there's government insured deposits. We don't want Tony's fund to buy a convertible bond of some BDC and lose money on it because the BDC blows up, but that is what the capital markets are about. It's about pricing risk, and some people will evaluate right and some won't. By congress doing what they did, they did not in my view expose the financial system, or the federal government, or tax payers to any additional risk.

Audience: So Barry, I'm a shareholder as you know, for years. Thank you for the great work. You mentioned something about packaging your loans and maybe selling the profit at the end. Why aren't other people copying that? Does it have any relationship with SBA?

Barry Sloane: Well, this sort of bodes into the conversation about being only big or small. On a comparative basis, we're small. And we decided to take a niche and position in the market, and really focus on small and medium sized independent business owners. And we positioned ourselves in one of the programs, the SBA 7(a) program. By the benefit of how the program is structed, it enables us to make a loan, sell off a [inaudible] interest, which is not senior. It's [inaudible] to what you hold in the books. Get a gain and really repatriate our capital. So we were able to figure out a marketplace that we can compete in. We build a mousetrap on how to acquire credits without using brokers, or BDOs, or bankers, which is useful. We actually reject about 97.5% of the referrals that come to us, so we're able to select the cream of the crop. Then we also have these seven other operating businesses that are providing significant cash-flow in the dividend. I think that the marketplace is still open for always new entrants that can bring technology in, or find certain niches. But looking at why others aren't making loans and selling them, they could do it through CDOs, which is effectively a financing. I think that's important to know. Back in the old days, securitization, you got a sale. Which today, you can't, it's viewed as a financing. The reality happens to be based upon the liquidity of the assets. The assets that are made in this class are deemed to be illiquid. But if I could make an apple for a buck, and sell it for a $1.05 a day later, I'm selling.

Audience: [inaudible].

Barry Sloane: Just keep doing it.

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