Fixed Income Market Outlook & Trends in High Yield: An Upside Down World

November 2013

13-0316

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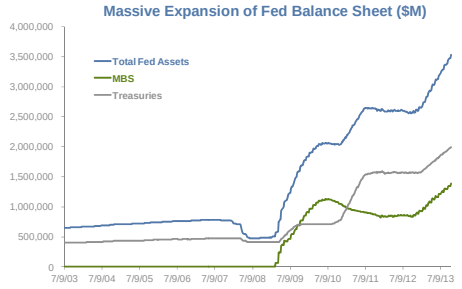
HIMCO

Federal Open Market Committee Policy

Massive Expansion of Fed Balance Sheet



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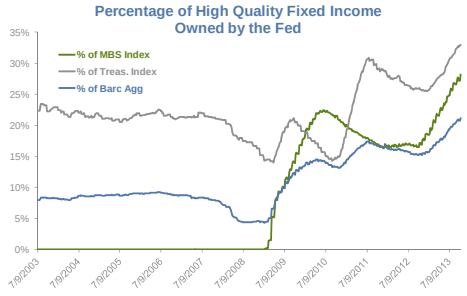
Federal Open Market Committee Policy

Fed Owns Significant Portions of High Quality Assets…



Source: NY Fed, Barclays, HIMCO Calculations. Past performance is no guarantee of future results.

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Federal Open Market Committee Policy

Despite Fed Buying, YTD Fixed Income Returns Negative

	Year to Date Returns
Barclays US Aggregate Index	-1.89%
Barclays US Credit Index	-2.91%
US 10 year Treasury	-5.50%
US 30 Year Treasury	-11.89%
Barclays US Corporate High Yield Index	3.73%
CS Leveraged Loan Index	4.25%
S&P 500 Index	19.79%

As of September 30, 2013. Past performance is no guarantee of future results. An investor cannot invest directly in an index.

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Federal Open Market Committee Policy

QE Exit Delayed, Not Abandoned

Begin Taper:	March 2014 at earliest
End QE:	December 2014 at earliest
Begin Tightening:	End 2015 / Begin 2016
Business Cycle Peak:	End Tightening 2018
2018 Fed Funds Target:	3.5% - 4.0%

Rising interest rate fears gone for the moment, but we will likely be fighting May/June 2013 battle for next several years

The views expressed constitute the portfolio managers' judgment as of September 30, 2013, and are subject to change without notice based on market, economic or other conditions.

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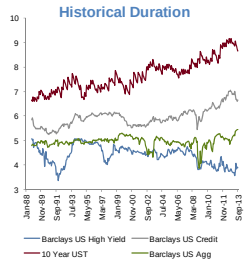
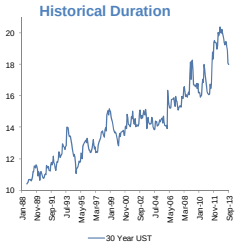
5

Implications of FOMC Policy for High Quality Fixed Income

High Quality Duration Risk At All-Time High





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Implications of FOMC Policy for High Quality Fixed Income

Expect Low Returns for Traditionally "Safe" Asset Classes

	Yield @ 9/30/13	Yield in 5 Yrs	Yield Increase	Duration	Total Price Impact	Avg. Annual Income	Total Income	Total Return	Avg. Annual Return
Barclays US Credit Index	3.19	5.40	2.21	6.63	(14.65)	4.07	20.37	5.72	1.14
Barclays US Aggregate Index	2.34	4.75	2.41	5.50	(13.26)	3.30	16.52	3.27	0.65
10 Yr US Treasury	2.61	5.00	2.39	8.60	(20.54)	3.57	17.83	(2.71)	(0.54)
30 Yr US Treasury	3.69	5.35	1.66	18.00	(29.95)	4.27	21.33	(8.62)	(1.72)

This is a hypothetical example shown for illustrative purposes only. It assumes a normalized interest rate and curve environment by the end of 2018. It does not represent the actual or future performance of any actual investment product and there can be no guarantee as to any projected performance.

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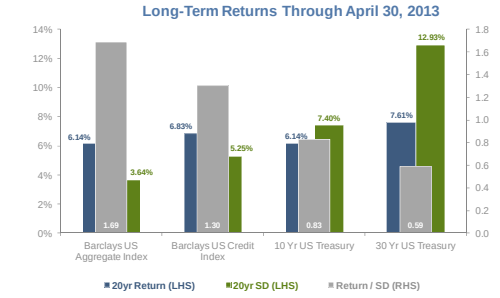
Implications of FOMC Policy for High Quality Fixed Income

Historical Returns & Volatility of High Quality Fixed Income



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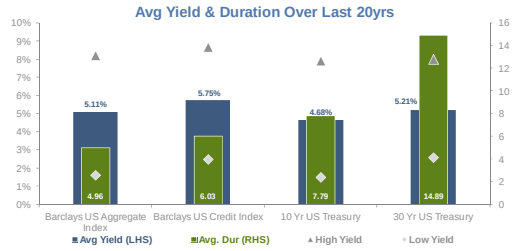
Implications of FOMC Policy for High Quality Fixed Income

Characteristics That Produced Those Returns



As of April 30, 2013. Past performance is no guarantee of future results.

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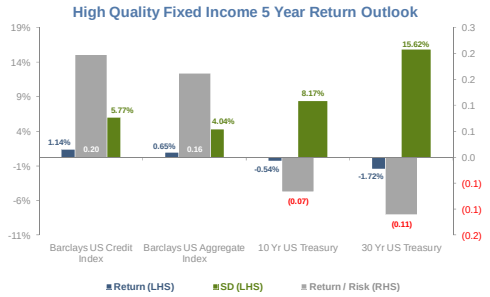
9

Implications of FOMC Policy for High Quality Fixed Income

Not Your Father's Safe Haven – Future Returns & Volatility



As of September 30, 2013.
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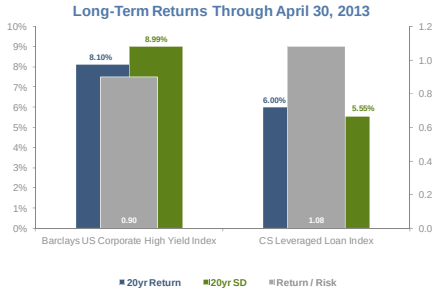
Down in Quality, Down in Duration for Potentially Better Risk Adjusted Returns

High Yield and Bank Loan Historical Returns and Volatility



Past performance is no guarantee of future results.

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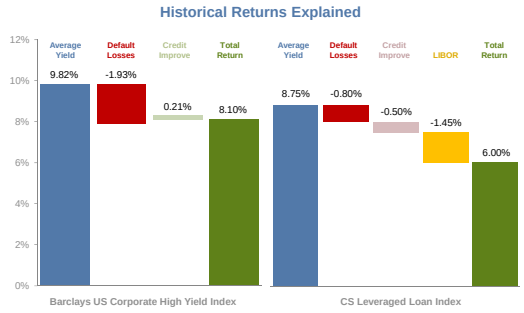
Down in Quality, Down in Duration for Potentially Better Risk Adjusted Returns

Drivers of High Yield and Bank Loan Returns



Source: Barclays, JPMorgan, Credit Suisse, HIMCO. 20 year history ending April 30, 2013. Past performance is no guarantee of future results.

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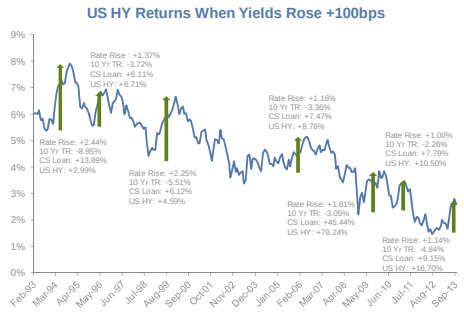
Down in Quality, Down in Duration for Potentially Better Risk Adjusted Returns

As the 10 Year Has Risen… so Have High Yield & Bank Loans



Past performance is no guarantee of future results. US HY is represented by the Barclays U.S. Corporate High Yield Index. CS Loan is represented by the Credit Suisse Leveraged Loan Index

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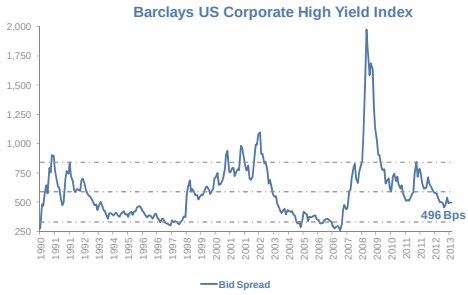
13

Down in Quality, Down in Duration for Potentially Better Risk Adjusted Returns

High Yield Spreads Appear Attractive



As of September 30, 2013. Past performance is no guarantee of future results.

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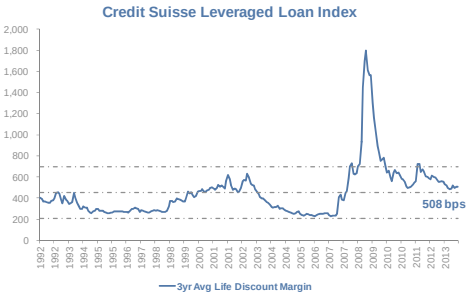
14

Down in Quality, Down in Duration for Potentially Better Risk Adjusted Returns

Bank Loan Spreads Appear Attractive



As of September 30, 2013. Past performance is no guarantee of future results.

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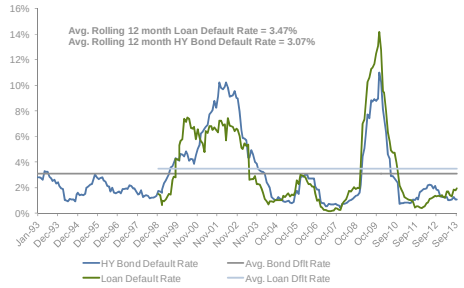
15

Down in Quality, Down in Duration for Potentially Better Risk Adjusted Returns

Benign Default Environment



Source: JP Morgan High Yield and Leveraged Loan Research. As of September 30, 2013. Past performance is no guarantee of future results.

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Down in Quality, Down in Duration for Potentially Better Risk Adjusted Returns

Historical Recovery Rates for High Yield & Bank Loans

Average Recovery Rates

Year	All Bonds	First Lien Loans
1993	43.10%	53.40%
1994	45.60%	67.60%
1995	43.30%	75.40%
1996	41.50%	85.50%
1997	48.80%	78.80%
1998	38.30%	56.70%
1999	33.80%	73.50%
2000	25.30%	68.80%
2001	21.80%	64.90%
2002	29.70%	58.80%
2003	40.40%	73.40%
2004	58.50%	87.70%
2005	56.00%	83.80%
2006	55.00%	83.60%
2007	54.70%	68.60%
2008	27.60%	58.09%
2009	35.47%	62.47%
2010	40.95%	71.18%
2011	48.56%	66.97%
2012	53.23%	55.29%
2013 YTD	50.69%	70.92%
Average	**42.49%**	**69.78%**

Source: JP Morgan High Yield and Leveraged Loan Research, as of September 30, 2013. Past performance is no guarantee of future results.

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Down in Quality, Down in Duration for Potentially Better Risk Adjusted Returns

Default Adjusted Yields Still Appear Attractive

	Yield @ 9/30/13	Default Rate	Loss Rate	Annual Default Losses	Default Adjusted Yield
Bank Loans (Current Default)	5.45	1.94	29%	(0.56)	4.89
Bank Loans (Historical Default)	5.45	3.47	30%	(1.05)	4.40
US High Yield (Current Default)	6.23	1.21	49%	(0.60)	5.63
US High Yield (Historical Default)	6.23	3.07	58%	(1.77)	4.46

Source: Bank Loans Yield is 3yr Avg. Life of CS Leveraged Loan Index; US Corporate High Yield represented by Barclays US High Yield Index; Default Rate and Loss Rate JP Morgan Research; HIMCO Calculations.
Current Default and Loss rates reflect YTD through September 30, 2013. Historical Default and Loss rates reflect 20 year average.

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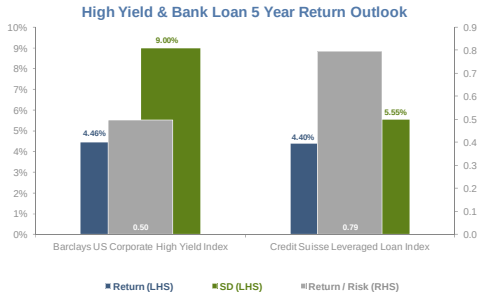
Down in Quality, Down in Duration for Potentially Better Risk Adjusted Returns

Expected Returns & Volatility for High Yield & Bank Loans



This is a hypothetical example shown for illustrative purposes only. It represents the default adjusted yield on slide 18 and historical standard deviation for each asset class. It does not represent the actual or future performance of any actual investment product, and there can be no guarantee as to any projected performance.

19

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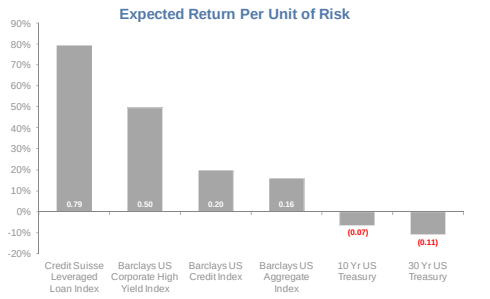
Down in Quality, Down in Duration for Potentially Better Risk Adjusted Returns

Changing of the Guard in Risk Adjusted Returns



This is a hypothetical example shown for illustrative purposes only. It reflects the data shown on slides 20 and 23 for Return per unit of risk. It does not represent the actual or future performance of any actual investment product, and there can be no guarantee as to any projected performance.

20

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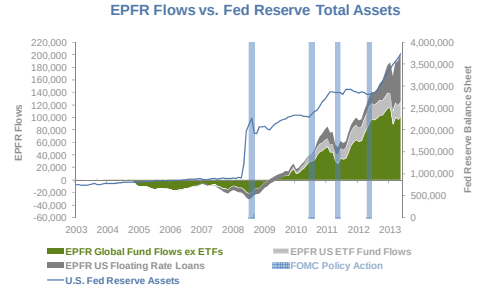
FOMC Policy Implications for Low-Quality Fixed Income

HY & Bank Loan Mutual Fund Flows vs. Fed Balance Sheet



Source: NY Fed and EPFR, as of September 30, 2013

21

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Re-calibrating for a Rising Rate Environment

Maintain Yield, Mitigate Rate Volatility

- As with all fixed income, future returns are likely to be lower and volatility likely to be higher than experienced in the past
- Relative attractiveness of High Yield and Bank Loans may improve prospectively compared to other fixed income alternatives
- As a credit intensive asset class, we believe credit selection through active management may enhance High Yield returns and reduce volatility
- Beware of vehicles susceptible to fund flow volatility
- We think spreads today fairly compensate investors for visible default risk while disciplined underwriting standards put the next default cycle several years away in our view

The opinions expressed herein constitute the Firm's judgment as of October 30, 2013, and are subject to change without notice based on market, economic and other conditions. These opinions are not intended to be a forecast of future events, a guarantee of future results, or investment advice. Securities and sectors referenced should not be construed as a solicitation or recommendation or be used as the sole basis for any investment decision. All data contained in this material is from sources deemed to be reliable, but cannot be guaranteed as to accuracy or completeness.

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Investment Risks

Investment Risks: All investments are subject to risk including possible loss of principal. Fixed income investments are subject to credit and interest rate risk. Investments in high yield securities involve risks beyond those inherent in solely higher rated investments. Bank loans are subject to liquidity risk, prepayment risk, credit and interest rate risk, recovery and call risk.

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