AltScape

Gaining Perspective on Alternative Investments

Tempering Risk in Fixed Income Portfolios

Volatility, interest-rate risk and inflation are formidable threats to any portfolio. Until recently, many investors found refuge in the bond market. But, with traditional fixed-income yields near zero—and the threat of rising interest rates—investors are seeking new strategies for mitigating volatility and balancing portfolio performance. Enter senior secured loans.

Key considerations when investing in debt

Any discussion about investing in corporate debt should consider these three universal concerns:

- **Default Risk:** Will I be first in line to recover my money in case of a default?
- **Recovery Risk:** How will I recover asset value if a borrower declares bankruptcy?
- **Interest-rate Risk:** What if interest rates rise? Will I be locked in at lower rates?

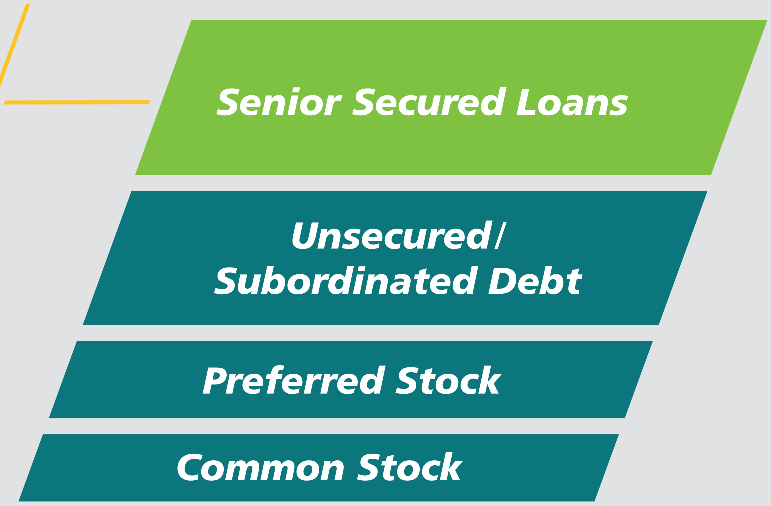
Senior secured loans address each of these issues with characteristics that set them apart from bonds.

The fundamentals of senior secured loans:

1 ***Senior*** *to all other debt and common and preferred stock in a company's capital structure.*

2 ***Secured*** *by first-claim rights to the issuing company's assets after bankruptcy and often contain restrictive covenants that further protect investor interests.*

3 ***Floating rates*** *consisting of a variable base rate (typically LIBOR), plus a fixed rate, help ensure that income adjusts with rising interest rates, generally resetting every 30 or 60 days.*



Low default rates and high recovery rates after default:
Unlike high-yield bonds, senior secured loans are repaid first after a default. Default rates average about 2.5% and recovery rates are more than 80 cents on the dollar as of 12/31/2016.[2]

Annual Default Rate – Senior Secured Loans[3]

Conclusion

Senior secured loans offer an alternative strategy for fixed income portfolios. Default risk is mitigated by their senior priority for repayment and first-claim rights to the borrowing company's assets. Interest-rate risk is tempered through floating rates that typically reset every 30 or 60 days.

Of course there's no way to remove all investment risks—senior secured loans have credit risk, as they are loans to lower-credit quality companies. However, expanding your universe of investments to include senior secured loans may provide an effective strategy for pursuing income and diversification goals.

What is AltScape?

AltScape is an educational resource to help financial advisors and their clients expand their definition of diversification and embrace the role of alternative investments in mitigating risk, enhancing returns and hedging inflation—to target better portfolio outcomes.

For information, contact your financial advisor or visit provasicapital.com

[1]S&P Capital IQ, LCD's Leveraged Lending Review, Q4 2016, *"Par Amount of Outstanding Leveraged Loans–By Industry,"* pg. 172.

[2]Moody's Annual Default Study: *"Corporate Default and Recovery Rates, 1920 -2015,"* February, 2016.

[3]S&P Capital IQ, LCD's Leveraged Lending Review, Q4 2016, *"Lagging 12-month Default Rate by Principal Amount,"* pg. 180.