Credit Shines using Breakeven Analysis

Canadian Credit is in a superior position vs. Debt and Equity

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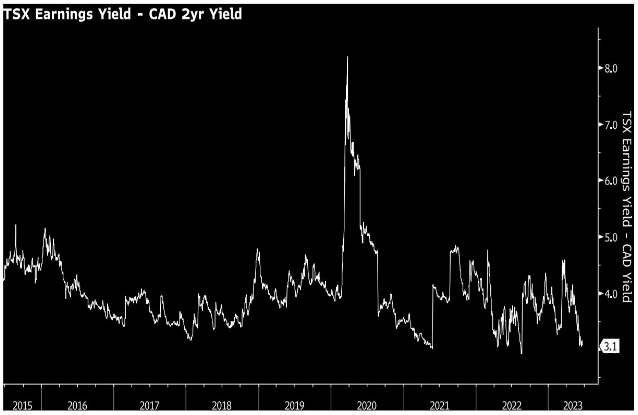
We find the concept of breakeven to be a helpful forward-looking tool, along with the concept of portfolio running yield.

Below we consider the risk premium built into equities and the concept of breakeven for bonds and for YTM Capital Credit Opportunities Fund. What we find is meaningful support from the running yield buffer built into the Fund, historically low levels of equity risk premium, and little room for error in bonds which have less than compelling total return expectations.

Equities

There is not an exact application of breakeven in equities, like an investor can map out for equity options strategies or for bonds. Instead, we can look at equity risk premium, often used in asset allocation modelling. The equity risk premium is a stock's earnings yield minus a risk-free proxy such as short-term yields. In other words, it is a measure of how much premium an equity investor should expect to receive for holding a risky asset.

The equity risk premium is currently small, and likely too small to generate a positive return in any sort of slow or no growth period. Said differently, there is not a lot of protection at current levels for equity investors.



TSX / S&P Composite Index, July 1, 2015 - May 31, 2023. Source: Bloomberg

Bonds

The breakeven level for bonds can be calcauted using the current on-the-run Government of Canada 5 year bond, CAN 3½% 03/01/28.

Carry = +105 bps

Rolldown = -18 bps

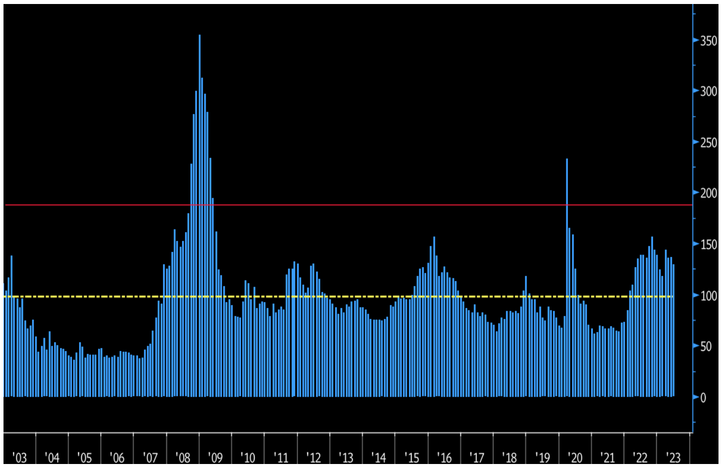
Breakeven = ~+88 bps

Rates could rise by 88 bps before your return is zero.

The Canada 5 year bond has a current yield of 3.65% and breakeven protection of 88 bps, which is better protection than it was one and two years ago. Even with some protection 3.65% doesn't meet most portfolio return targets, especially when Central Banks are signalling higher rates for an extended period of time, likely negating any meaningful capital gains.

YTM Capital Credit Opportunities Fund

The blue bars in the slide below show the level of the short-term Canadian credit spread index. Spreads are currently meaningfully wider than the yellow-line long-term average. The red line shows the breakeven level for the index. The breakeven level for the Fund (not shown) is materially higher than the red line because of the Fund's running yield.



Bloomberg Can Agg Corporate 1 - 5 years OAS, Oct 31, 2002 - May 31, 2023. Source: Bloomberg

We believe that current spreads have built in more pessimism than other asset classes, likely already reflecting most of a mild recession. Spreads have been wider in the past 20 years, but only during the Global Financial Crisis and briefly during COVID, environments that we do not foresee for 2023-24.

We have positioned the Fund defensively, respecting the possibility of wider spreads during a recession, in our pursuit of "better fixed income solutions".

Despite our defensive stance, the Fund is producing a running yield of 10%, creating a breakeven level where spreads could double from current levels to true-crisis levels before the Fund stops generating a positive return. This reality significantly increases the likelihood of a positive and meaningful return for the Fund and comapres favourably to both bonds and equity.