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Diversifying Sources of Yield in a Rising Rate Environment

Strategic Asset Alliance – Insurer Investment Forum XXIII

March 30, 2023

Agenda

Private credit should be viewed as an all-weather strategy *that can be expected to perform well in environments of* ***rising rates, high inflation, and even heightened geopolitical risk***

1. Team and Platform

2. Market Opportunity

3. Direct Lending in Times of High Inflation

4. Direct Lending in a Rising Interest Rate Environment

5. Considerations for Insurers

Tom Hall
Co-head
Private Credit

Team and Platform

Dedicated Private Credit Team, Supported By A Powerful Global Asset Management Platform

Private Credit Investment Team[1]

Jens Ernberg
Co-head of Private Credit
RI Committee Member

Thomas Hall, CFA
Co-head of Private Credit

Matthew Bandini
Managing Director

Bryan Chen
Senior Vice President

Zach Crowley
Associate

William Sze Senior Analyst

Private Credit Support Team

Jason Gu
Private Credit
Fund Operations

Yelena Kuznetsova
Private Credit
Marketing & Comms.

Robert Napolitano
Product Development and Strategy

Alyssa Penwell
Head of Legal Funds
Global

Investment Committee ("IC") Members

Andrew Bernstein
Head of
Private Equity

Janusz Heath
Head of Investment
Management

Jens Ernberg
Co-head of
Private Credit

Thomas Hall, CFA
Co-head of
Private Credit

Investment Committee Observers and Responsible Investment ("RI")

Bryn Gostin
IC Observer
Head of
RI Committee

Reid Conway
Global Chief Compliance Officer
IC Observer

Philippe Jost
Head of Risk & Solutions
IC Observer
RI Committee Member

Verena Rossolatos
RI Specialist

Capital Dynamics Overview

USD 13 bn+[2]
AUM/ AUA

14
Offices

150+
Employees

550+ / 950+
Institutional / Private Clients

(1) All information as of December 31, 2022 unless otherwise stated. (2))As of December 31, 2022. Assets Under Management are calculated based on the total commitments as of the final closing date for all funds currently managed by Capital Dynamics, including amounts that have been distributed. Assets Under Advisement includes assets for which Capital Dynamics provides services such as reporting, monitoring and risk management.

Challenging Markets

Challenging Market Dynamics

Investors are being challenged by the current macro environment

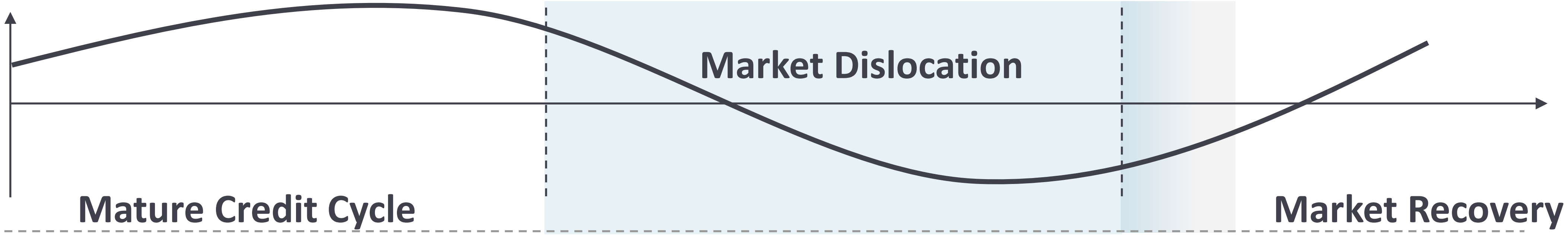
- Inflation
- Rising interest rates
- Geopolitical risk

- Increased volatility
- Pressure on asset prices
- Recessionary fears

Why Private Credit?

"All-Weather" Strategy That Does Not Rely on Market-Timing

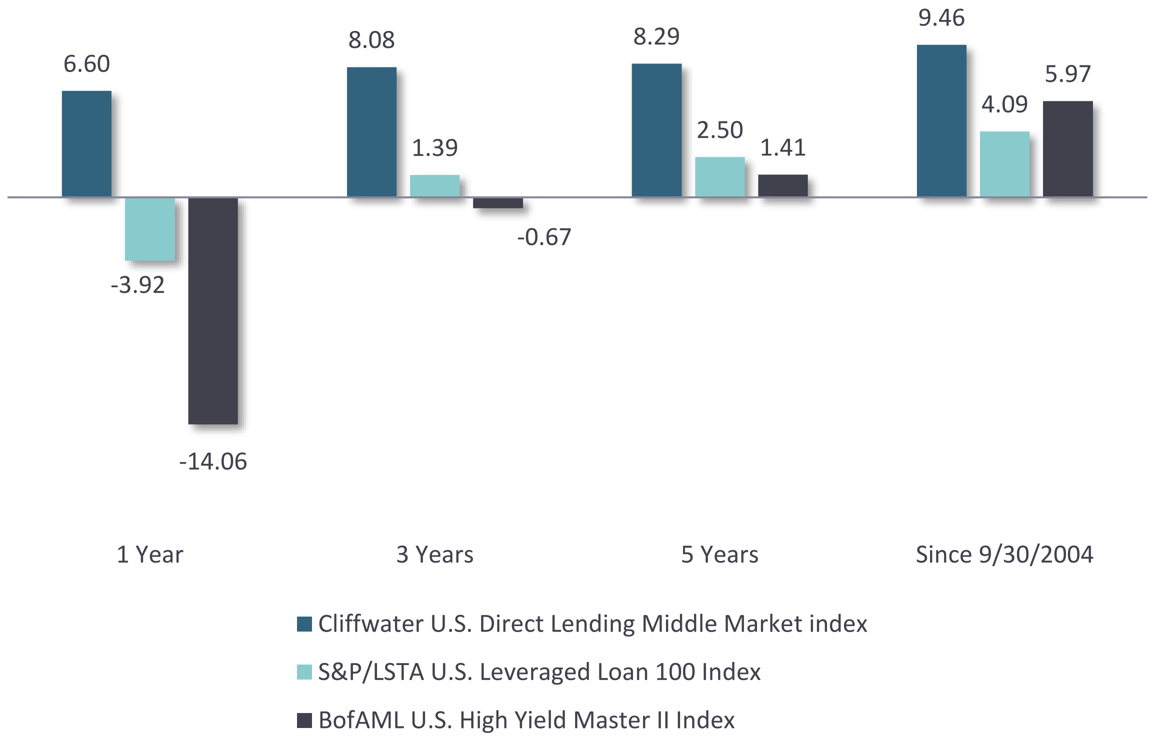
Experienced team capable of adjusting the strategy based on prevailing market conditions



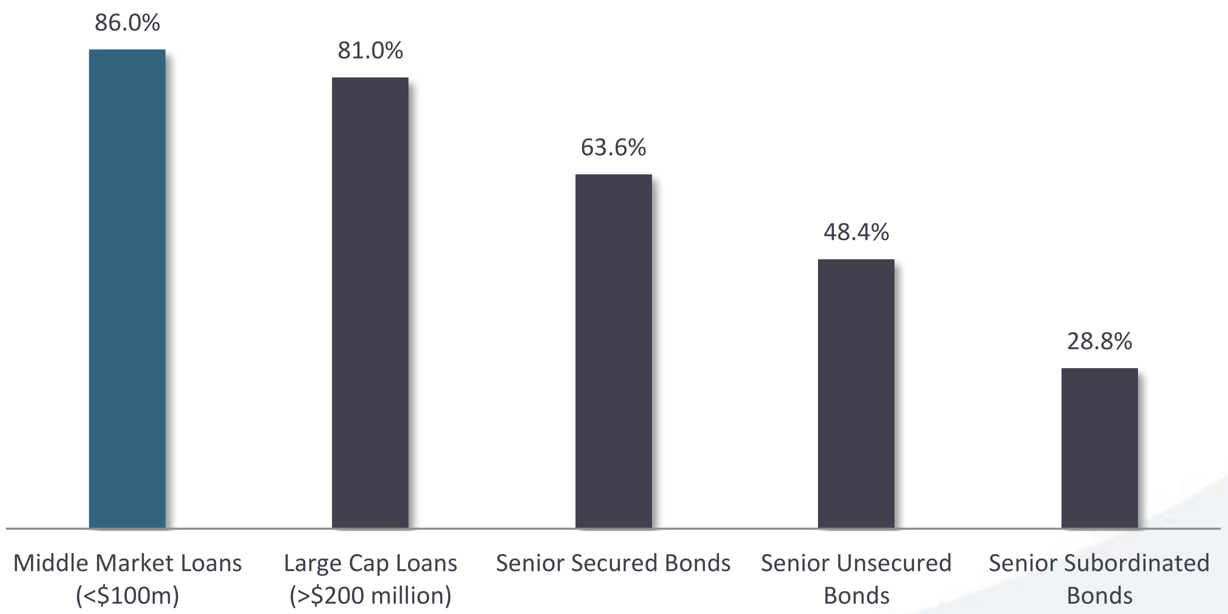
	Mature Credit Cycle	Market Dislocation	Market Recovery
Market Conditions	• Increased risk appetite – "risk-on" • Active M&A market • Low default rates	• Economic indicators turn negative • "Risk-off" • Accelerating defaults	• Improving economy • Muted M&A market • Moderate/high default rates
Lender Implications	• Tightening spreads • Higher liquidity • High competitive intensity	• Spreads gap - liquidity evaporates • Secondary market becomes active • Low competitive intensity	• Supply/demand imbalance • Moderate liquidity • Moderate competitive intensity
Investment Approach	• Borrower profile: recession-resistant businesses; limit exposure to cyclicals • Tranche focus: 1^{st} lien; opportunistic 2^{nd} lien	• Borrower profile: high quality credits/ proven business models • Tranche focus: 1^{st} lien • Other: Provide liquidity solutions	• Borrower profile: broader market participation • Tranche focus: 1st & 2nd lien; opportunistic: subordinated debt

The Asset Class has Consistently Outperformed its Peers…

Credit Benchmark Returns[1] (%)



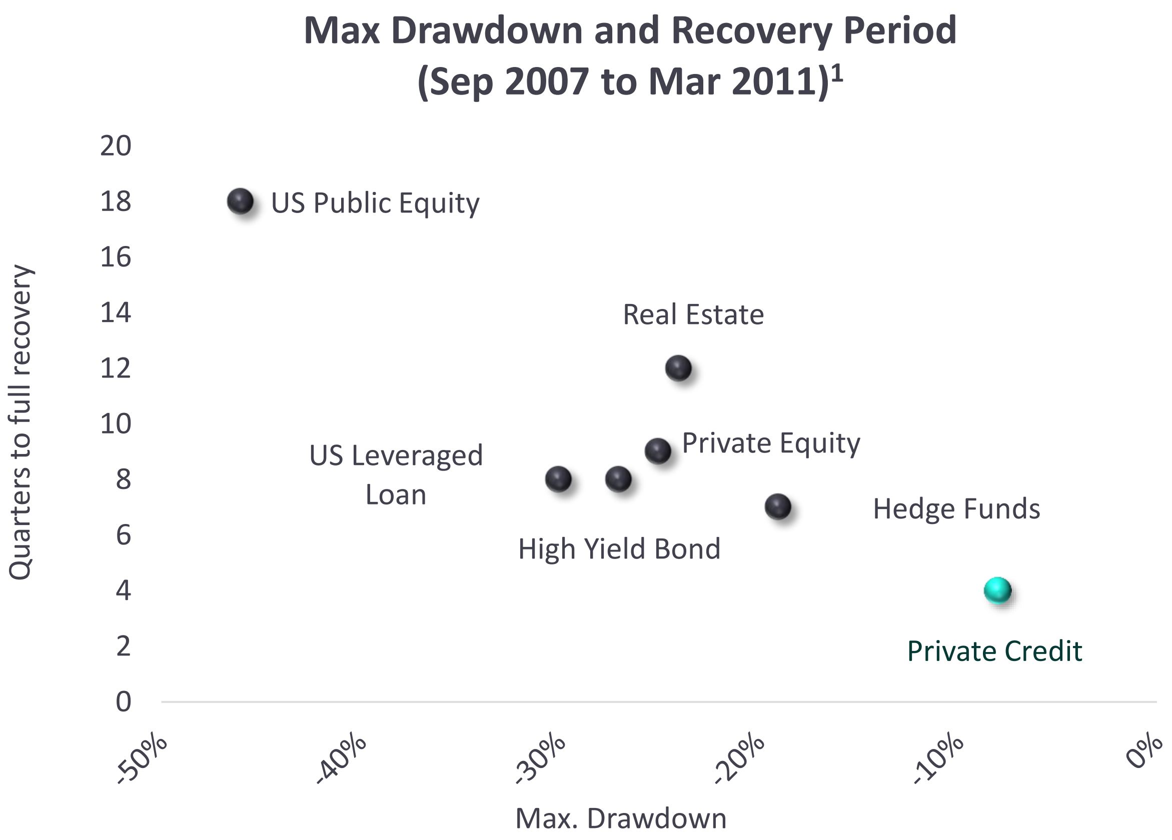
Historical Distribution of Recovery Rates from Defaulted Loans[2]

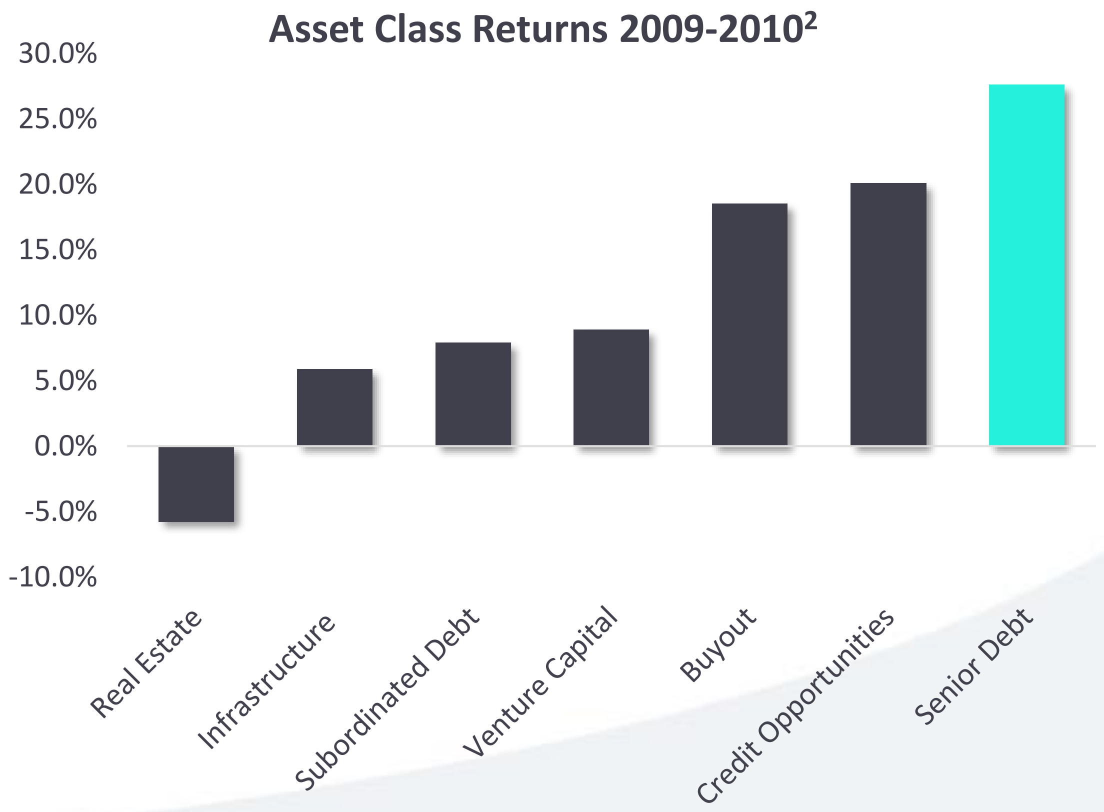


Source: (1) Cliffwater, Bloomberg, Federal Reserve Bank of St. Louis, Total return indices as of September 30, 2022. (2) Source: Moody's/LSTA ultimate recovery rates from 1989 to 2013

…And Provided Investors with Strong Downside Protection

Battle tested asset class - the Global Financial Crisis (“GFC”)





Source: (1) Cliffwater Direct Lending “US Direct Lending: Comparative Performance Through the Financial Crisis” July 30th, 2019. US Public Equity represented by Russell 3000 Index, US Leveraged Loan represented by S&P/LSTA U.S. Leveraged Loan Index, High Yield Bond represented by Bloomberg Barclays High Yield Bond Index, Private Equity represented by Cambridge Private Equity Universe Index, Real Estate represented by NCREIF Property, Hedge Funds represented by HFRI Fund Weighted Index and Private Credit represented by Cliffwater Direct Lending Index. (2) Cambridge Associates Horizon Returns based on net returns to limited partners Index.

Bank Turmoil Has Set the Stage for Continued Opportunities in Private Credit for the Second Time

The First Wave (2008)

Economic Shock

- **Sub-prime lending,** predominantly in the form of CMOs and CDOs, sets the stage for the GFC

Banking Sector Contraction

- **Lehman Brothers and Bear Sterns** collapse due to overleverage, starting the GFC
- **Dodd Frank** imposes limitations on commercial banks using proprietary capital to fund structured credit vehicles, further **decreasing lending capacity**

Benefit to Private Lenders

- **Regional banks consolidate** into bigger banks that are less likely to lend to small to medium size companies, **providing a new and vast opportunity for private lenders**

JPMorganChase WELLS FARGO BANK OF AMERICA TRUIST

The Second Wave (2023)

Economic Shock

- **Low interest rates rapidly increased** as the Federal Reserve attempted to combat **near record inflation with equally high rates**, resulting in a **mismatch between long dated capital and depositor demand**

Banking Sector Contraction

- **Silicon Valley Bank and Signature Bank fail** due to funding pressures brought on by fundamental macro-economic headwinds
- **Credit Suisse is bought by UBS** evidencing further instability in the banking sector

New Opportunities for Private Lenders

?

- "The failure of Silicon Valley Bank and turmoil for other regional lenders have **opened the doors for private credit firms to win lucrative loan deals**"

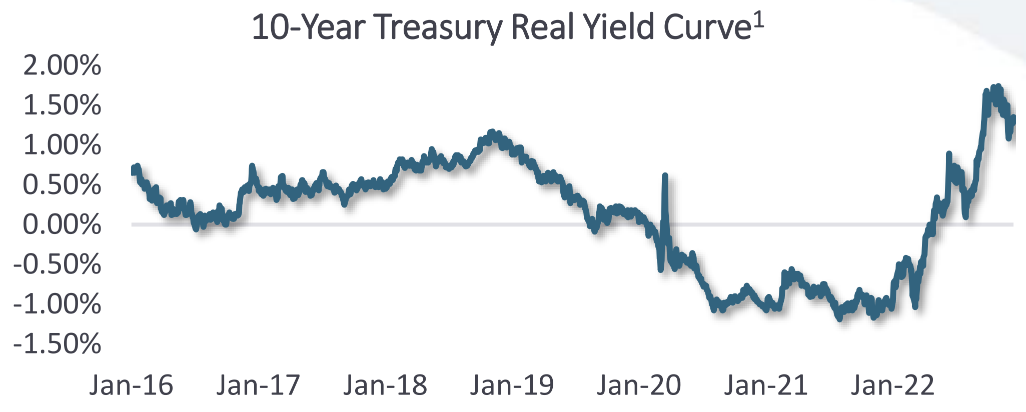
– Bloomberg

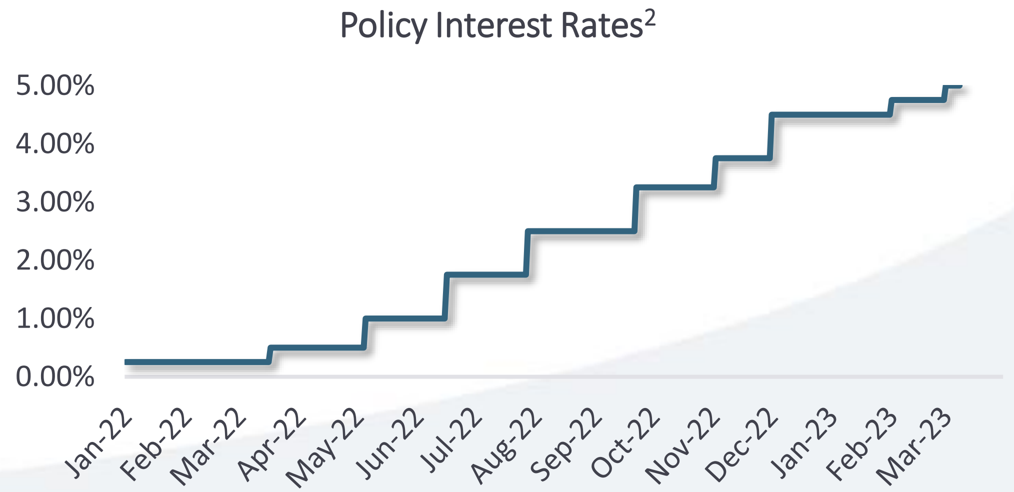
Direct Lending in a Rising Interest Rate Environment

Inflation and Rising Rates are Pressuring Asset Prices and Corporate Margins, While Fueling Market Volatility

Floating rates and conservative structuring in the LMM Offers Risk Mitigation

- With inflation running well above target, central banks are increasing interest rates leading to:
  - Margin compression and diminished cash flows for corporates
  - Increased cost of capital for borrowers
  - Pressure on asset prices and fixed income returns
  - Increased market volatility
- Floating rate loans tend to outperform in rising interest rate environments
- Lower middle market direct lending provides investor protections against the impacts of inflation and increased financing costs

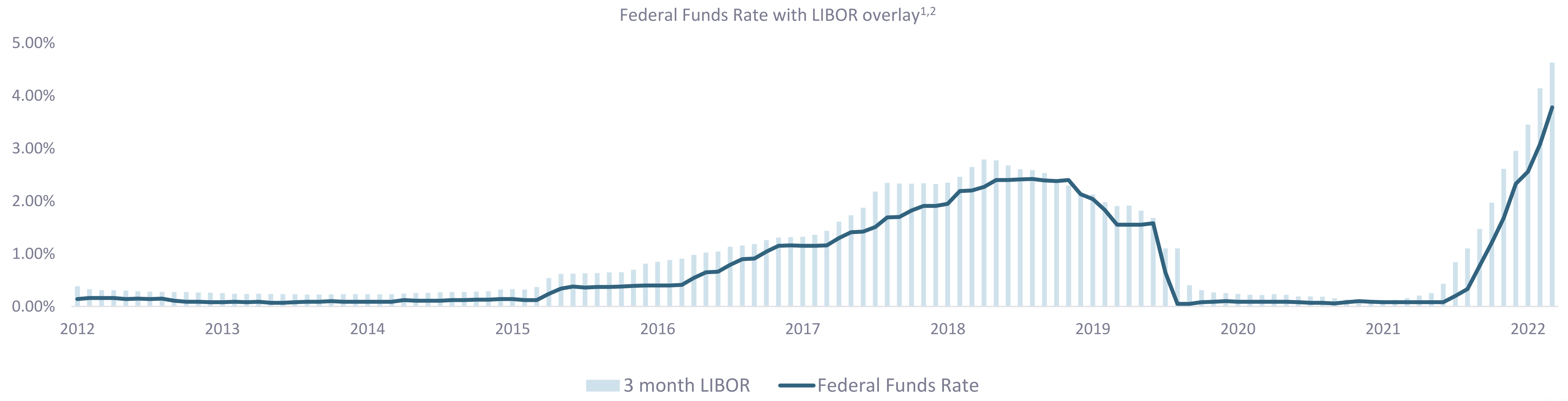




(1) Board of Governors of the Federal Reserve System (US), Market Yield on U.S. Treasury Securities at 10-Year Constant Maturity, Quoted on an Investment Basis, Inflation-Indexed [DFII10], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/DFII10, December 19, 2022. (2) Note: US policy rate shows the upper bound of the Federal Funds Rate. Source: Fitch Ratings.

A Hedge Against Rising Rates

Floating rate loans mean higher all in nominal returns for investors in times of rising rates

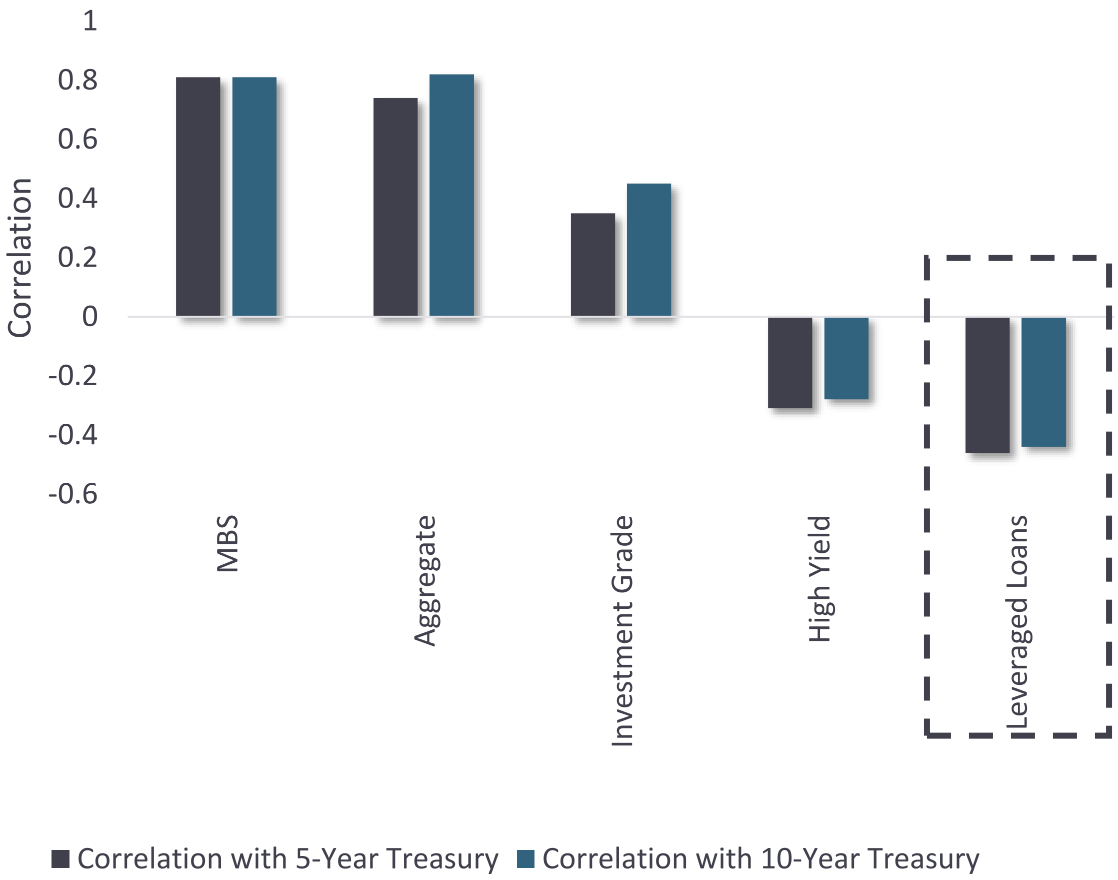


- The Federal Reserve **raised the target range for the federal funds rate** to 4.25%-4.50% while SOFR has reached 3.89%[1]
- Economists predict **the federal funds rate in the US will climb** to 4.50% by year end and 5.25% by the end of 2023[3]
- **Senior secured loans** are priced with a spread over a base rate, **LIBOR** or its replacement **SOFR**, that floats with rising rates, protecting **nominal and real yields** earned by investors

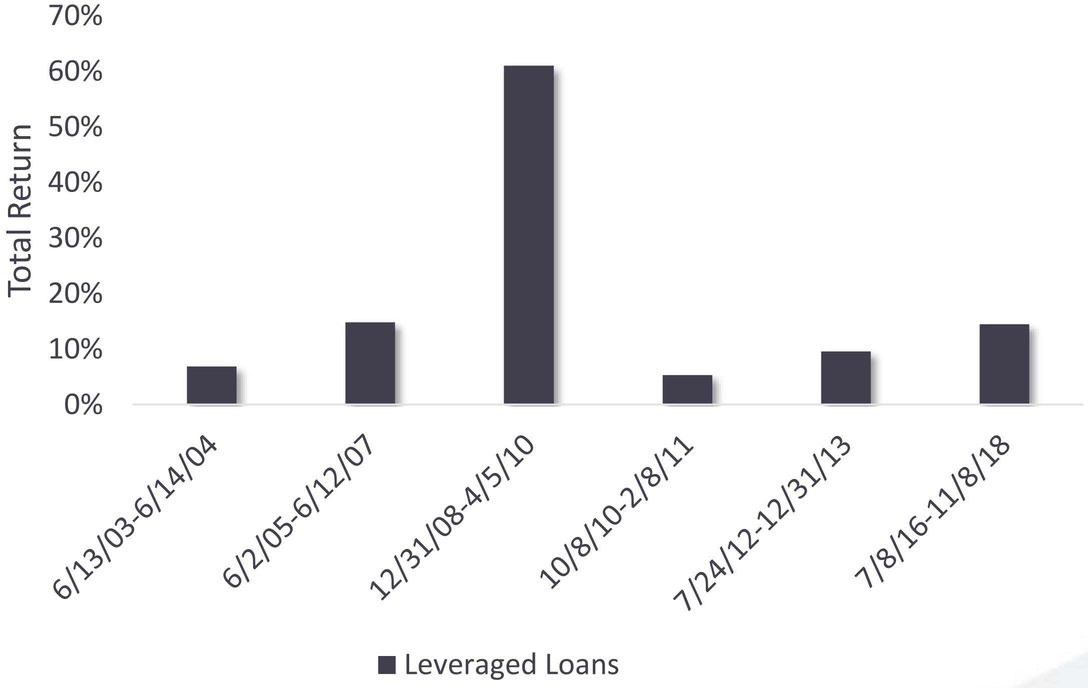
(1) Board of Governors of the Federal Reserve System (US), Federal Funds Effective Rate [FEDFUNDS], retrieved from FRED, Federal Reserve Bank of St. Louis as of December 20, 2022 (2) Fedprimaterate.com: 3-month LIBOR. (3) Federal Reserve; Federal Funds Rate Dotplot

Floating Rate Loans Outperform in Rising Rate Environments

Loans Are Negatively Correlated with Treasuries[1]



Floating-rate Loans Have Generally Fared Well Amid Rising Rates[2]



Increase in 10-yr Treasury Rate	1.80%	1.40%	1.90%	1.30%	1.60%	1.90%
# of Months	12	24	15	4	17	28

(1) JPMorgan, S&P/LCD as of December 31, 2020. MBS is represented by the JP Morgan MBS Bond Index, Aggregate is represented by the Bloomberg Barclays US Aggregate Bond Index, Investment Grade is represented by the JP Morgan US Liquid Index (JULI High-Grade Index), High Yield is represented by the JP Morgan US High Yield Index, and Leveraged Loans is represented by the JP Morgan Leveraged Loan Index. (2) Fidelity Viewpoints, Investing In Loans: Leveraged loans may offer higher yields and inflation protection, published September 13, 2021

Direct Lending in the US Lower Middle Market ("LMM")

Advantages for Lower Middle Market Focused Direct Lenders

Underwriting	• Lenders are intimately involved in directing the diligence process ✓ **Longer underwriting timelines** allow lenders to better identify resilient companies and validate underwriting merits – e.g., pricing power
Yield	• Significant and consistent **yield premium (~250-500 bps)** over core and upper middle market ✓ Yield has been relatively constant over time – uncorrelated return
Structure	• **Conservative leverage** - <50% LTV with average leverage < 4x (vs. 5.5x in core middle market) – and full complement of **maintenance covenants** ✓ Gives companies the flexibility to manage through cycles ✓ Covenants allow for early intervention by lenders if borrowers underperform
Diversification	• U.S. middle market is **vast and diverse** ✓ Deep opportunity set ✓ Provides for diversified portfolio construction with limited correlation across portfolio investments

What are the Driving Factors of Risk Adjusted Returns in the LMM?

Lead Arranger And Syndication

The Team assumes the role of a "lead arranger" for the majority of transactions

Advantages include:

- Advantaged economics
- Risk mitigation
- Enhanced sourcing

Financial Maintenance Covenants

Financial maintenance covenants provide downside protection

Advantages include:

- Early warnings signs
- Course corrections
- Enhanced recoveries

Due Diligence and Structuring

Lower middle market investing allows for direct engagement with teams and sponsors

Advantages include:

- Control documentation
- Validate underwriting assumptions
- Enhanced reporting

Real Yield Premium

Sponsor is typically first institutional capital into entrepreneur-owned businesses

Advantages include:

- Higher yields and relative risk adjusted returns
- Conservative structuring

LMM vs. Core/Upper MM vs. Broadly Syndicated Loans

	LMM	Core/Upper	BSL
Company Size (EBITDA)	USD 5- 30 million	USD 25 – 100 million	> USD 75 million
All-in Yields	11.0 - 13.0 %	8.5 - 11.0%	8.0 - 10.0%
Covenants	Always	Rarely	Almost Never
Leverage	2.5 - 5.0x	3.5 – 6.5x	4.5 – 7.5+x
Geographic Scope	Concentrated	Broad	Broad
Liquidity	Limited	Modest	High
Volatility	Low	Modest	High
Underwriting periods	4-8 weeks	2-4 weeks	1-3 weeks
# of Lenders/Facility	1-4	1 - 10	10 - 50+
Competitive Intensity	Modest	High	High
Control of structure and price	High	Modest	Limited
Reporting / management interaction	Monthly / Frequent	Quarterly / Infrequent	Quarterly / Infrequent

How Have the Markets Informed Our Underwriting?

Underwriting standards and approach are unchanged, but we are armed with powerful lessons learned from the pandemic as well as recent economic headwinds

Company profile

- ☑ Market leadership
- ☑ Predictable demand drivers
- ☑ Favorable industry dynamics
- ☑ Robust cash flow generation
- ☑ Experienced management team
- ☑ Capable sponsor
- ☑ ESG sustainability

Transaction dynamics

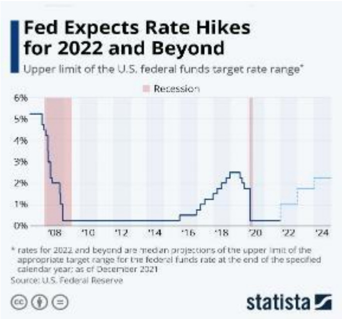
- ☑ Limited competition
- ☑ Strong asset coverage
- ☑ Conservative structuring
- ☑ Powerful investor protections

Market test

- ☑ Demonstrated resiliency
- ☑ Pricing Power
- ☑ Management actions
- ☑ Sponsor support
- ☑ Business continuity

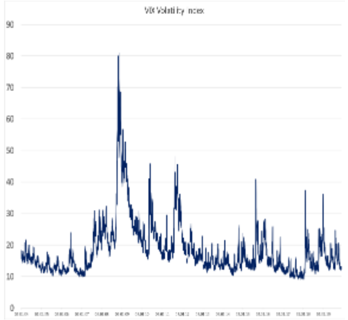
Recap: US LMM Direct Lending Is Well-Positioned to Weather the Current Macro Environment

Macro Factors



Rising Interest Rates

High Inflation



Market Volatility

Geopolitical Risk

Defensive Attributes

Rising Interest Rates

- ✓ **Floating rate loans** provide a hedge against rising interest rates

High Inflation

- ✓ **Conservative structuring**
- ✓ Differentiated sourcing ➡ **Selectivity and diversification**
- ✓ Underwriting market leaders with **pricing power**

Market Volatility

- ✓ **Private markets are less susceptible** than public markets to short-term investor sentiment and expectations

Geopolitical Risk

- ✓ **US-centric strategy** provides **insulation**
- ✓ Tailwinds from **relative strength of the US economy** and **localized demand**
- ✓ Greater **energy and food independence**

Considerations for Insurers

Considerations for Insurers

Private credit can provide insurance investors with:

- **Meaningful Diversification to Public Markets**
- **Attractive Risk-Adjusted Returns**
- **Enhanced Yield**

Various methods to access private credit that provide investors with different benefits:

- **Structured Solutions**
- **Commitments to Funds**
- **Separately Managed Accounts**

Thomas Hall

Managing Director

Co-head of Private Credit

THall@capdyn.com

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