

# HIGH YIELD STRATEGY

## *The Opportunity*

The high yield market offers equity-like returns with less volatility. The asset class also has much less interest rate sensitivity than most other fixed rate segments of the bond market. In addition to this compensation for default and liquidity risk, market segmentation among investors and a traditional focus on bottom-up fundamental analysis introduces alpha opportunities for those with a differentiated, macro view of the asset class.

## *The GMO Solution*

The GMO High Yield Strategy seeks to outperform its benchmark, the Markit iBoxx USD Liquid High Yield Index, by applying a factor-based approach to portfolio construction. It is designed to capture alpha from top-down sources of risk premia, taking advantage of structural market inefficiencies, while maintaining a liquid portfolio. Our top-down/data-driven approach (in what is still largely a fundamentally managed asset class) brings a unique perspective that allows us to allocate capital across a range of high yield instruments in order to seek the best possible risk-adjusted returns over a full market cycle.

## STRATEGY PILLARS

*Top-down factors capture well-established sources of high yield risk premia*

### CARRY



- Return earned if market conditions remain unchanged, except for the passage of time
- Strategy compares the potential carry return across cash and synthetic instruments to determine the optimal carry allocation

### QUALITY



- Harvests premium in high quality, i.e., BB bonds
- Factor provides better risk-adjusted returns through lower default rate and less volatility

### FALLEN ANGELS



- Recently downgraded bonds tend to get over sold as they transition from IG to high yield
- Screen for downgraded names that trade cheap to peers and that have potential to tighten

### SHORT DURATION, LOW QUALITY



- Lower rated, short maturity bonds are often overlooked, given asymmetrical risk profile and illiquidity
- Default risk mitigated through diversification and in-house credit team screening for imminent jump risk

### VOLATILITY



- Demand-supply imbalance in the credit options market keeps implied volatility elevated versus realized
- Strategy sells delta-hedged put options to harvest this premium systematically

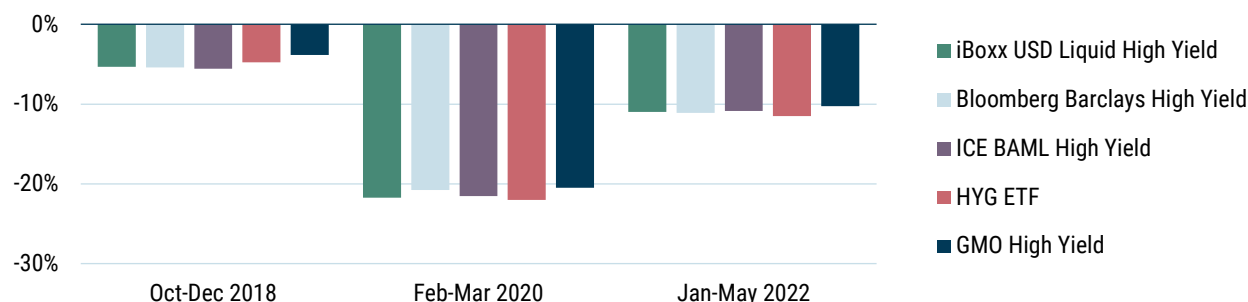
### BENCHMARK ARBITRAGE



- Liquid, low-cost source of beta that helps minimize tracking error
- Alpha generative when sourced at a discount to NAV

The correlation between the active returns of the different factor sleeves has been low, providing diversification that helps to enhance portfolio performance. A strong risk management process that monitors exposure across a range of factors helps to ensure a risk profile that is not materially different from the broad high yield market. We hedge out the duration risk to match the benchmark and seek to outperform through credit returns. Our choice of alpha factors lends a defensive tilt to the portfolio, helping us outperform during severe market drawdowns, as illustrated in the chart below.

## PERFORMANCE DURING MAJOR MARKET DRAWDOWNS



## The Client Fit

- We believe the High Yield Strategy is an ideal fit for clients seeking a thoughtful implementation of high yield exposure, either on a stand-alone basis or as part of a multi-manager solution.
- It can be employed as a diversifier to a fundamental high yield or distressed allocation, given its low active correlation to other managers.
- Its defensive characteristics relative to the benchmark during market drawdowns makes it an attractive alternative to passive high yield exposure.
- Exposure to high yield through GMO's strategy can be used to enhance a broad fixed income allocation or a traditional 60-40 blend by improving risk-adjusted characteristics.

## Who We Are

Founded in 1977, GMO is a private partnership whose sole business is investment management. The firm manages global portfolios with offices and clients around the world. Investment offerings include equity, fixed income, multi-asset class, and alternative strategies. GMO is known for blended fundamental and quantitative investment research expertise and a long-term fundamental orientation toward investing.

The GMO High Yield Strategy is managed by the High Yield team, led by Head of Developed Fixed Income Joe Auth and portfolio manager Rachna Ramachandran. The team has a broad range of credit market experience across research, trading, and investing and works collaboratively in managing the portfolio. Colleagues from GMO's fixed income division provide support for cash and duration management, and default risk screening.

<i>Annualized Returns as of 12/31/2022 (Net, USD)</i>	<i>Inception</i>	<i>1-Year</i>	<i>3-Year</i>	<i>5-Year</i>	<i>ITD</i>
<b>GMO High Yield Strategy</b>	01/31/2017	-8.05	0.61	2.97	3.54
<b>Markit iBoxx USD Liquid High Yield</b>		-10.74	-0.80	1.97	2.53

**Performance data quoted represents past performance and is not predictive of future performance.** Net returns are presented after the deduction of a model advisory fee and incentive fee if applicable. These returns include transaction costs, commissions and withholding taxes on foreign income and capital gains and include the reinvestment of dividends and other income, as applicable. Fees paid by accounts within the composite may be higher or lower than the model fees used. **A Global Investment Performance Standards (GIPS®) Composite Report is included in the Important Information section at the back of this presentation. GIPS® is a registered trademark owned by CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. Actual fees are disclosed in Part 2 of GMO's Form ADV and are also available in each strategy's Composite Report.** The Markit iBoxx USD Liquid High Yield Index is an independently maintained index consisting of liquid USD high yield bonds, selected to provide a balanced representation of the broad USD high yield corporate bond universe.

## RISK

Risks associated with investing in the Strategy may include Management and Operational Risk, Market Risk - Fixed Income, Credit Risk, Illiquidity Risk, and Derivatives and Short Sales Risk.