GOLUB CAPITAL

We invest where we have deep expertise

Scott Morrison, Head of Broadly Syndicated Loans at Golub Capital, offers his perspective on the BSL market and his outlook for investors in BSL securitizations.

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The Covid-19 pandemic put investment managers to the test in 2020. Looking back, how did Golub Capital's BSL strategy perform?

We believe our strategy performed very well through Covid. We're proud to have been ranked #1 in market value change during the Covid-19 pandemic out of 103 managers tracked by Bank of America research[1], and ranked #3 in par build by JP Morgan research[2].

We didn't do well because we foresaw a global pandemic. We believe we did well because our underwriting, monitoring and trading are designed to preserve par, especially during recessions and market dislocations. We invest in credits and sectors where we believe we have deep expertise and high conviction.

Our intense focus on credit quality has given us a 15+ year history of annual default rates averaging 80% below the BSL Index[3] in aggregate. Our high conviction in our investments reflects the experience of our team; our team has an average of 23 years of credit experience.

When the BSL market sold off in March 2020, we didn't panic. We've been through numerous downturns, both individually and as a team. This experience prepared us to stick to our fundamental convictions while focusing on building par and reducing risk through an active trading strategy.

What lessons have you taken away from the market volatility in 2020?

We think we were served well by being willing to disagree with the rating agencies. The Covid economic dislocation precipitated a rash of downgrades by the rating agencies. This was not surprising; there was a massive increase in uncertainty and ratings need to reflect this. But something else happened, too: we believe the rating agencies painted with a very broad brush. It was "downgrade first and ask questions later."

Managers of BSL securitizations that focus on smaller, sponsor-backed deals, as we do, saw many issuers of this type downgraded early in the Covid dislocation, leading to unusually high levels of CCC-rated assets in their CLOs. Managers in this position could have reduced their CCC exposure by selling CCC-rated assets, which would have meant crystallizing losses.

As an alternative, these managers could have chosen to "look bad" on CCC exposure metrics in the short term because they believed that those ratings did not accurately reflect credit risk. We chose to focus on our assessment of risk rather than rating agency assessments of risk, and we believe this approach enabled us to build par and perform well for our investors.

Where in today's market do you see opportunity for investors in BSL securitizations?

We see a lot of signs of strength in the US economy. At the same time, we believe it's prudent to stay cautious and not to compromise on credit quality.

We think the most significant near-term risk is a resurgence of Covid-19; it's not our base case scenario, but we think investors should be prepared. We're focused on investing at the top of the capital structure of resilient businesses in resilient sectors. This strategy outperformed in 2020 and we would expect it to outperform again in a downside scenario[4].

1. Covid is defined as the period from February 2020 to December 2020 for the purposes of this analysis per Bank of America Research. Based on CLO managers covered in Bank of America Research's "CLO Manager Performance: Hindsight is 2020" presentation as of January 13, 2021. Includes managers with more than one deal. Past performance does not guarantee future results.

2. JP Morgan's "US CLO Manager Analysis." report as of January 27, 2021.

3. The S&P/LSTA Leveraged Loan Index (the "BSL Index") is a market value-weighted index designed to measure the performance of the US broadly syndicated loan market based upon market weightings, spreads and interest payments.

4. Golub Capital BSL outperformed the BSL Index by 182 bps on an unlevered basis in 2020. Golub Capital BSL returns are based on the capital weighted average of monthly unlevered returns gross of fees and expenses of each Golub Capital managed Collateralized Loan Obligations (CLO) containing broadly syndicated loans. Golub Capital BSL returns are defined as (a) the total return of the underlying collateral in a given CLO, multiplied by (b) the size of the CLO and divided by (c) the aggregate size of applicable CLOs. The performance of the Golub Capital BSL composite does not represent the actual return of any investor or fund. The deduction of fees and expenses would lower actual returns. The BSL Index used in this analysis is the S&P/LSTA Leveraged Loan Index. The S&P/LSTA Leveraged Loan Index is a market value-weighted index designed to measure the performance of the U.S. broadly syndicated leveraged loan market. The S&P/LSTA Leveraged Loan Index typically encompasses 90%-95% of the entire broadly syndicated leveraged loan market. Past performance does not guarantee future results.

About Golub Capital

Golub Capital is a market-leading, award-winning direct lender and credit asset manager, with over $40 billion of capital under management.

Founded over 25 years ago, Golub Capital today has lending offices in Chicago, New York, San Francisco and London. For more information, please visit golubcapital.com.