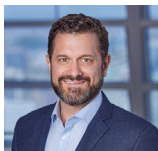




The Active Investor: Exploring the Opportunistic Credit Spectrum



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In this podcast, Lord Abbett Portfolio Manager Adam Castle discusses what he's watching in credit markets, how opportunities are evolving across structured securities, and how his team is thinking about risk in the current environment.

BRIAN FOERSTER: Once again, we are in a period of volatility. War in Iran and the disruption that [artificial intelligence] AI is causing across areas like software have both made markets considerably more volatile over the past couple of months. And that volatility has driven some anxiety and selling, as we're seeing in risk assets.

For investors, these can be periods of opportunity, as well, even while others are running for the exits. This is Brian Foerster, and welcome to *The Active Investor* podcast. Today, to discuss our outlook on the credit markets, I'm joined by Lord Abbett partner and portfolio manager, Adam Castle. Adam, great to have you here.

ADAM CASTLE: Hey, Brian. Thank you. Great to be here on the podcast.

FOERSTER: Thanks for being here. So, in addition to being a portfolio manager, Adam is also our head of securitized products. And we'll touch on that in a few minutes, but I thought we'd first cover what's going on in the markets right now, specifically within credit.

You know, just kind of what is your overall macro view? And I'll just say, we're recording this on March 20th, so things may have changed by the time this recording [is available] around the world. But, you know, what are your thoughts right now, just on the credit markets?

CASTLE: Absolutely, Brian. And I think it is fair to say it is one of those periods of time where things do change on a daily basis. So, [it is] important to mention the date. There are a variety of cyclical, structural, and then day-to-day tactical things that are happening.

So, some items are the sort of thing that would change on a daily basis. But then there are parts of our portfolio management and construction right now that are more structural and taking more of an intermediate- to longer-term view. And I can talk about both of those.

But by and large, the market is valuing, simple, cleaner stories at the moment. Credits that are cuspy, or have any complexity to

them, you know, there's a great deal of execution risk that we face. And that is just leading to a great deal of dispersion and rotation across sectors, and even within sectors, by company, looking at much more nuances related to [capitalization] cap structure, related to maturity walls, related to management teams, related to ownership structures than we had in the last few years. So much more is happening below the surface.

You know, why is execution risk high? I'd say there are a few things. First, there is low momentum in the labor force, right? So, we're in this low-hire/low-fire situation right now. We certainly had a negative print very recently with payrolls. It is a low momentum sort of thing that should raise some concerns. You know, it's certainly the case that there's a low supply of labor, which helps in terms of joblessness. But the low momentum creates some unease, I'd say, in the market.

And then second, you have a big rapid shift in technology and technological capability through AI. There's a variety of opinions regarding the speed with which it will infiltrate and impact dynamics, in regards to demand for labor, regards to productivity. It could have immense upside; it could have immense downside. There's a great deal of [capital expenditure] capex being spent and leveraging activity taking place related to this. Then you've got the coming [U.S. Federal Reserve] Fed chair. You know, Fed policy is likely to change. Unclear, though, as far as how and the timing of that, especially with some uncertainty that [U.S. Federal Reserve Chairman] Powell introduced last week, as it relates to when he plans on vacating his seat.

And then lastly, we have a pretty big military conflict taking place in the Middle East. There are clear ramifications for commodities markets, and then the downstream effects that would have as an input to other goods and services. So, you know, all in all, four pretty big variables that would impact execution risk, the ability for companies and households to navigate these times. It's just a higher bar for success right now.



FOERSTER: Yeah, so a lot going on. So, given all that, where are you and your team seeing opportunity right now? And then maybe also what are you staying away from?

CASTLE: Yeah, that's a great point. So as a team, we think in terms of scenarios. And, you can think, right now four major scenarios come to mind. One is an outright recession. One is a stagflationary environment where we have tepid growth, combined with inflation that's elevated above target. There could be a high nominal growth environment, where real growth is not great but still positive. And then there could be an outright high, real-growth environment, which, you know, all of these things are possible right now. And there are, in fact, companies that are living one of those four things at the moment. So, there are companies that feel like they're in recession right now, and then there are companies that are exhibiting incredible real growth, right? And that is a winner and loser type of economy, this K-shaped economy has been referenced. You can apply that K to numerous things, from high income to low income, to those who own homes to those who don't own homes, to companies that are on the right side of AI and the companies that are on the wrong side of AI, to bank loan borrowers versus fixed-rate corporate borrowers. There's all different ways of drawing that. But the bottom line is that these different scenarios apply, and we're really taking that approach to how we think about credits right now. You know, there are a few things to see, I'd say, below the surface.

But by and large, there's a lot of thematic things to do. So, we're thinking about, chemicals and commodities, especially in the U.S., as being a winner, temporarily, at least from the geopolitical conflicts and commodities disruptions that we're having in the Middle East. The U.S. is typically the number-one or number-two producer of a number of commodities that can substitute for what production comes from the Middle East, and there's a lot of winners that potentially could emerge there. You have utilities, telecom, and less cyclical areas of the market, which we like as well.

Thematically, the areas that are less attractive in today's market, when it comes to pricing, would be cyclical consumer, and then levered financials. So, financials, by and large, are positioned fine, especially banks, when it comes to their capital base, and just how heavily regulated and safe they are now. But there's a variety of financials. You have the non-banks, you have insurance companies, life insurance companies, you have specialty finance firms. Away from banks, things have become a bit more risk prone in the last few years, and there's going to be the need for some caution around certain financials. And then, as it relates to consumer cyclicals, it's again going to be about the strength of households, how they navigate a hand-off to a lower job-creation environment, the onset of AI, higher gasoline prices, and now we're seeing higher interest rates, which could affect the cost of borrowing, as well. So, those issues lead to headwinds for those sectors. It doesn't mean that we can't do anything in those sectors, but it's going to be a bit more idiosyncratic there.

FOERSTER: Got it. Okay, so then maybe digging a little bit more, and maybe this is more of a philosophical question. But thinking about it in more opportunistic credit strategies, in a period of

volatility like this, are you thinking that we want to put dry powder to work? Are you thinking more like preservation of capital? Are you trading more? How do you think about, within an opportunistic credit portfolio, is there something that you do differently in a period of volatility like this, where you're looking to maybe pounce? Or is more pulling back? Or is it more just idiosyncratic? Or all of the above?

CASTLE: Yeah, no, that's a great question. So, there's a mix of things going on. Headline levels of risk premium are still relatively tight, given the complexity of this backdrop that we are in. The added piece, though, is that when you have volatility like you have right now, even when spreads are tight on an index level, you do have situations where sentiment and fundamentals are out of sync with one another. So what I mean by that is, there are companies where sentiment, or credit opportunities, you could say, where sentiment is significantly more volatile than the fundamental picture, where you can look at real data, whether that's the company's financial position, their input costs, and their positioning in the market, their pricing power, and you compare that to the way the sentiment is moving, the pricing of the bonds, the pricing of the equity in the company, what have you, and opportunities can emerge.

And we see that right now. We saw that last year. You know, speaking about last year, after tariff uncertainty really entered a fever pitch in April of 2025, energy prices cratered to very low levels on fears about no global trade, or a complete deterioration of global trade activity. And energy became a de facto way of trading that situation. So, energy companies across the board saw their valuations plummet. Most energy companies in the U.S., or not most, but enough for us to be interested, had effectively hedged their oil pricing out to 2028. So, you end up in a situation where the company's asset, or their bonds are trading along with spot oil, but their revenues are actually tied to a string of hedges that are in place. So that would be a situation where fundamentals are actually going to be much more stable than sentiment, and an area where we were able to put a great deal of risk on during that period of time.

And that is happening right now in other areas. So obviously energy is now a beneficiary of the Iran situation. Consumers are not, right? So, consumers would be another example where sentiment will likely swing or swoon lower than fundamentals. So, we are watching that, and there are some opportunities where we have taken some risk, but we're being extremely picky about that. You know, right now, if you're a lender, if you're a consumer lender, you write loans, whether that's auto or consumer loans, what have you. When sentiment is at its worst, it's typically when you can write some of the best loans.

So right now, having that deterioration in sentiment and tightening in financial conditions is a good thing for putting on attractive risk, well-priced risk. So that's starting to trickle into consumer financial conditions, and that tightness will have some negative impacts from a cyclical perspective. I wouldn't want to be a hotel operator right now. But I think being a lender to consumers right now, you're going to enter an environment where there's some good risk to put on.



FOERSTER: Okay. And that takes us into your field of expertise there, and that is securitized. So, we're talking about [asset-backed securities] ABS, [commercial mortgage-backed securities] CMBS, [collateralized loan obligations] CLOs. As the head of that team, what do you think of, and again, this may be more a philosophical question, but what are the essentials to having an investment edge in running securitized credit?

CASTLE: That's a great question, Brian. I mean, it is important to think about structural advantage, especially at the scale that we're operating at. You know, we are a large team. We have a significant amount of assets to manage. You know, about \$40 billion across a wide range of mandates from very high-quality portfolios to more opportunistic and leveraged portfolios and alternatives, as well.

And when you have that wide range of mandates, when you have larger scale, you need to be thinking about what are the ways to create repeatable edge, right? You can't be just thinking about small idiosyncratic risks only. You sometimes have to be able to buy large swaths of the market, but understand that the way you lean or tilt, or the segments that you avoid, are going to be as much a driver of return as those small idiosyncratic wins that you might have.

So, there are really four key components to how we create our edge. The first is we have very innovative tools. So, we care very much about cutting-edge technology. We spend a great deal of time and money on tech, both in-house proprietary, as well as third-party. Investors exist on our team, but as well as in quantitative research and in technology to augment our research process. And that is really a crucial piece. You know, getting the data in our hands, manipulating it quickly in real time is what really can make the difference in speed and agility.

And the second would be our cross-asset platform. So, we are securitized as a team, sure. However, we exist within a multi-asset platform here at Lord Abbett. And, you know, a lot of the fixed-income markets are becoming connected, more so today than they were a decade ago. And it's important as investors that we are aware of the relative value differentials that exist across different types of borrowing instruments. So, if you're a company management team, you are typically now going to be thinking about how to borrow in the bank loan market, how to borrow in high-yield, how to borrow in the private credit markets, how to potentially borrow in the asset-backed markets. Theoretically, all four of these markets are open to nearly every company now, in some way, shape, or form. It might not be quite the traditional ways that we're used to, but all of these markets are expanding and evolving. And so having a multi-asset platform to compare relative value is key. And we see differentiation where there's some very obvious trades to make sometimes between different components of a company's capital structure, and that is another key advantage for us. The last, because of our scale, we have access to markets that others do not.

We're repeatedly in these markets, collecting color every day. We transact in these markets daily, multiple trades a day. Due to our mix of funds that we manage with flows, due to our institutional accounts, due to our strategic asset allocation changes, we're

really collecting color, and these are over-the-counter markets where you don't necessarily have index data, or public reporting of security-level pricing data. So, the activity that we're generating internally, and the pricing information and color that we collect, is a differentiating factor. It gives us an edge. It gets us into the information mix, and into the top of the funnel when it comes to sourcing opportunities. All of that is of course also very important.

And then the last thing is domain expertise. So, we don't really participate in parts of the market where the domain expertise isn't immense. We want to have an advantage over our peers. And the key there is really to help us avoid the moral hazards that might exist when an asset is securitized into the market as kind of a hobby or an opportunistic trade. You know, our team will invest time and resources into becoming expert on a particular segment of the securitized markets. And only then would we then be a participant in that market. So, there's a one-off transaction of kind of an esoteric group of assets, or something that's sort of experimental, we have to really ask ourselves, are we getting sucked into something because bankers are trying to sort of pitch us on something? Or are we actual experts in this? Can we get smart on this in some way that leads to a variant perception? And can we see value that other people cannot? Or is it the opposite? Are we not seeing something that other people are? And that's a dangerous place to be.

So, we think about domain expertise as a crucial aspect of our positioning. And we tend to evolve over time by evaluating, you know, if new segments of the market emerge, what kind of tools, what kind of pieces of information, what kind of market structure has developed, and is it the sort of thing that we like? And if it does pass certain standards, we then might start to resource around it.

FOERSTER: You mentioned earlier in your comments that we manage securitized across many different strategies. And I do tend to notice that we tend to be higher in terms of our allocation to securitized than the broader category, in many asset classes. So, is that because there's more relative value there? Or just why is it that we tend to run higher than the category?

CASTLE: Sure. Yeah, it's a very important question. So, I think there are a few ways to tackle it. Where you do see that elevated allocation, it's going to be in multi-sector portfolios, right, typically. That's why it looks elevated. And multi-sector portfolio management, it's a combination of, of course, understanding multiple different asset classes, the relationships that exist, the correlations that exist between multiple asset classes. How to create alpha and diversification, improve Sharpe ratio. All of these things are crucial to a successful multi-asset or multi-sector management franchise. And one of the key ways you could do that is by de-pressurizing any one area of the team, or any one asset class, from being a forced buyer.

So, these markets, they're correlated, but they're not perfectly correlated. So, you have situations where one asset class is maybe rising in value faster than another, or falling in value faster than another, and that creates dispersion, right? If we're maintaining, in real time, an opinion about the relative value of these asset classes, we can use that to our advantage, and that could mean the



difference between one asset class being a forced buyer, or a forced seller, at inopportune times.

So, for example, if you have a circumstance where you have inflows, and look, 2024 and 2025 were years of historic inflows into bond funds, right? So, you had inflows coming in, you had rates rather stable to slightly lower over that time. You had credit spreads compressing, right? So, you are putting bond funds in a position where they are buyers, whether they like it or not, right? So, the more assets you have to choose from, the better off you are going to be. And there's going to be a great deal of issuance, and there was last couple years.

So, thinking about what's the bar that you're going to have for making a position an overweight versus an index. In a portfolio, the more things you have to choose from, the higher that bar can be. If you have a more constrained opportunity set, you actually have to have a lower bar for your overweights because you have less things out there. So securitized is a tool. Just like [investment grade] IG corporates, just like [U.S.] Treasuries, it is a tool where we can go mine alpha, and it is an opportunity set that we are better off having than not having.

Now, I think the next key is the resourcing around any tool, or any opportunity set that you have in your tool kit. You need to have the resourcing to support it. So, securitized product is a complex environment. It's typically 144A, meaning it's not [Securities and Exchange Commission] SEC registered. There's a very wide array of instruments out there to buy. There's not as much homogeneity, so to speak. So, you need the depth. You don't want to be a tourist. And I think to answer your question another way of why we might have more of an expression there than some of our peers would be also just the depth that is required. If you're going to go into these markets, you've got to go in with a pretty large budget. And I think what you would notice is, if you look at some of the larger peers in our opportunity set, they have a comparable amount of securitized. And I think that's what you really see is some of the resourcing constraints, you know, that we have invested in for our clients are really only possible if you're operating at a certain scale.

FOERSTER: One last question, and I think I have to ask it, because it's just constantly in the news every day, and that's around private credit. And it's in the news for a lot of different reasons, but more and more, with this whole idea of convergence, it's more just becoming credit, like public and private. So as a broad-based credit investor, how are you thinking about that space?

CASTLE: Yeah, it's very important. I mean, I think private credit is an important piece of the bond or fixed-income universe right now. You have to have an opinion on it, not necessarily as a practitioner, but as a market participant, writ large.

You know, it's over \$1 trillion market right now, so it's a key area that will contribute to loosening or tightening financial conditions. So, our exposure to private credit can be seen through a few lenses. One is the middle-market [collateralized loan obligation] CLO space. Middle-market CLOs are CLOs backed by private credit or direct lending. We are not involved in that asset class at Lord Abbett very much. We have only sporadically purchased, but that's mainly because of pricing. Pricing had been pretty tight.

When we think about the standards that we look for in an asset-backed or securitized transaction, there are really a few standards that we hold to. And one of those is a tight feedback loop, or a feedback loop that exists between the extension of credit, and then the performance of that credit, and then the pricing of that credit. So, if you're going to lend to someone, or lend to a company, and do that programmatically, the rate that you charge, or the level of interest that is borne by that credit risk, should begin to reflect the level of risk being taken. And if you don't have a feedback loop in place to prove that out, then pricing can sometimes go adrift and be pushed around by other market forces. And the tighter that feedback loop is the better. And I think one of the challenges with private credit has been such a strong sort of escalator of growth, right, where assets have come in, attracted to the Sharpe ratio.

And due to the very appealing liability structures in place, there's been rare instances of forced selling. There's the ability to extend, to amend terms, and really avoid realization of loss. So, you're at a point now, over a decade into the growth of private credit, where Sharpe ratios, on a backward-looking basis, look phenomenal, right? You have had very little price volatility, but you also have had an accumulation of non-performing assets, or of PIKing [payment in kind] assets, so to speak. And this does indicate that that feedback loop is starting, finally, in a very extended process of turning back around and feeding back into the input of how risk is written.

And I think that's very healthy, and it's important. And every real market should go through these types of cycles. I don't think this is the end of private credit, by any means. I think this is part of the growth of private credit. And in fact, going through cycles like this, and culling out under-performers, and proving out the value of the top lenders is a very healthy thing. And I think that that will be important here, you know, a clearing event, so to speak.

You know, there are some lenders who have been doing private credit for 20 or 30 years, and they probably are looking forward to a situation like this, because there's been more than 100 entrants in the last few years who might be unproven. So, I think it's just part of a normal cycle. And again, establishing a feedback loop for performance and pricing is something that the private credit markets are really due for. And I think if that starts to occur, we might get more involved in middle-market or private credit CLO. But at the moment, we're on the sidelines waiting for that pricing to start reacting.

FOERSTER: Okay, great. A lot of great content. I know I learned a few things today and got to hear the word "homogeneity." But we'll leave it there, and thanks for joining us, Adam. We'd love to have you back again some time.

CASTLE: Excellent. Can't wait. Thanks, Brian.

FOERSTER: So, we will leave it there. And for investors wanting to learn more about Lord Abbett's views on the markets, please visit the insights section of lordabbett.com. And you can follow us on LinkedIn, Instagram, and YouTube for more perspectives from across the firm. And if you have any comments on today's episode, or ideas for future episodes, email podcasts@lordabbett.com.

This has been Brian Foerster with *The Active Investor* podcast. Thanks for listening.



GLOSSARY OF TERMS USED IN THIS BROADCAST

Alpha measures an investment's performance relative to a benchmark, showing the return generated above (or below) what would be expected given the market's performance and risk.

Asset-backed security (ABS) is a security whose income payments, and hence value, are derived from and collateralized by a specified pool of underlying assets.

Asset-based lending is the business of loaning money in an agreement that is secured by collateral. An asset-based loan or line of credit may be secured by inventory, accounts receivable, equipment, or other property owned by the borrower.

A **basis point** is equal to one one-hundredth of a percentage point.

Base rate: Variable interest rates fluctuate in line with a base rate which, typically, shifts in reaction to market factors.

Bank loans are debt instruments in which a bank or banks lend money to a borrower with scheduled interest and principal payments, usually a floating rate, and either a secured or unsecured structure.

Beta measures how sensitive a portfolio's returns are to movements in its benchmark or a broad market index. Beta shows how much the portfolio tends to move when the market moves.

Broadly syndicated loans are floating-rate loans made to corporate borrowers with generally greater than \$50 million in EBITDA and in most cases, at least \$100 million. They are senior in the capital structure and have a first claim on the assets of the borrower. They are a subset of bank loans with multiple lenders participating in the same loan facility.

Capital expenditures (CapEx) refers to the funds that a company uses to acquire, upgrade, and maintain physical assets such as property, plants, buildings, technology, or equipment. These expenditures are considered investments in the company's future operations and growth.

The **capital stack, or capital structure**, refers to the layers of debt and equity capital used by companies to finance operations. Within the capital structure, segments called tranches represent different risk classes that are available to investors.

Carry refers to the return or cost from holding an asset over time. It is the income earned minus the cost incurred.

A **Collateralized Loan Obligation (CLO)** is a special purpose vehicle (SPV) that purchases a diversified pool of senior secured bank loans—often leveraged loans—and then issues tranches of securities backed by the cash flows from those loans.

A **commercial mortgage-backed security (CMBS)** is a type of mortgage-backed security backed by commercial and multifamily real estate loans, rather than residential mortgages. The underlying loans are pooled together and securitized, and investors receive payments derived from the cash flows of those commercial mortgages.

Credit ratings or ratings are independent assessments of the creditworthiness of a borrower, such as a corporation, government, or specific debt instrument. They are issued by credit rating agencies, most commonly S&P Global Ratings, Moody's Investors Service, and Fitch Ratings. They indicate how likely it is for the borrower to repay its debt on time and in full and are considered a measure of credit risk.

Cuspy refers to something that is on the edge, boundary, or threshold between two states or categories.

Direct lending is a type of private credit strategy that makes direct, illiquid loans to middle market companies outside of the traditional banking system.

Dry powder refers to capital that has been raised or committed but not yet invested, and is therefore readily available for deployment when opportunities arise.

Duration is a measure of how sensitive a bond or fixed-income portfolio is to changes in interest rates.

Idiosyncratic risk is the risk that is unique to a particular company, asset, or sector, rather than affecting the whole market. It arises from issuer-specific factors such as management decisions, balance-sheet strength, business model, regulation, or operational events.

K-shaped economy describes an economic environment where different parts of the economy recover or grow at very different rates with some segments improving more than others.

A **leveraged loan** is a loan made to a company with a relatively high level of debt or below-investment-grade credit quality, typically rated BB+ or lower. These loans are most often used to finance leveraged buyouts (LBOs), acquisitions, or refinancings.

Liquidity: Daily liquidity vehicles, like mutual funds, allow investors to buy or redeem shares at the end of each day's net asset value (NAV). A quarterly liquidity vehicle refers to an investment structure that offers investors the opportunity to redeem their shares on a quarterly basis. Highly illiquid investments, such as Limited Partnerships (LPs) or private funds, may require investors to wait for a specific event or a longer period to exit their investment.

Maturity wall refers to a large concentration of debt coming due within a relatively short period of time, creating a "wall" of refinancing or repayment needs for borrowers. This concept is commonly used in high yield, leveraged loans, and private credit discussions.

Nominal Gross Domestic Product (GDP) growth measures how fast an economy is growing in current dollars, including the effects of inflation. It reflects changes in both economic output and prices.

PIK (Payment-in-Kind) refers to a form of interest payment in which a borrower does not pay interest in cash but instead adds the interest to the outstanding loan balance, increasing the principal owed.

Private credit refers to privately negotiated loans between a borrower and a non-bank lender.

Private equity refers to capital investments made in companies that are not publicly traded.

Real Gross Domestic Product (GDP) growth measures economic growth after adjusting for inflation, showing the true increase in the volume of goods and services produced. It reflects actual economic activity, not price changes.

Residential mortgage-backed security (RMBS) is a type of mortgage-backed security backed by residential mortgage loans, such as those on single-family homes or residential properties. The underlying residential mortgages are pooled together, and bonds are issued that pass through the cash flows from homeowners to investors.

Rule 144A securities are privately placed securities that may be offered and traded in the U.S. without SEC registration, provided they are sold only to Qualified Institutional Buyers (QIBs), as defined under Rule 144A of the Securities Act of 1933.

Securitized products broadly refer to pools of financial assets that are brought together to create a new security, which is then divided and sold to investors. The value and cash flows of the new asset are based on its underlying securities.



Sharpe ratio is a measure of risk-adjusted return. It shows how much excess return an investment or portfolio has generated for each unit of risk taken.

Spot oil refers to the current market price for crude oil to be bought or sold for immediate delivery, as opposed to delivery at a future date.

Spread is the percentage difference in current yields of various classes of fixed-income securities versus Treasury bonds or another benchmark bond measure. A bond spread is often expressed as a difference in percentage points or basis points (which equal one-one hundredth of a percentage point). The option-adjusted spread (OAS) is the measurement of the spread of a fixed-income security rate and the risk-free rate of return, which is adjusted to take into account an embedded option. Typically, an analyst uses the Treasury securities yield for the risk-free rate.

Stagflation is an economic condition where high inflation, slow or negative economic growth, and high unemployment happen at the same time.

Yield is the income returned on an investment, such as the interest received from holding a security. The yield is usually expressed as an annual percentage rate based on the investment's cost, current market value, or face value.

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