LORD ABBETT®

July 2020

Rethinking Liquidity in Today's Market

We believe the dislocation in credit markets that occurred in March shows the need for a more flexible approach to portfolio liquidity. One potential response: a multi-sector bond strategy.

by Andrew Fox, CFA, CIMA®

In our view, the regulatory shifts that occurred after the Global Financial Crisis (GFC) of 2008–09 have placed the U.S. financial ecosystem on firmer ground. That's all to the good, given the recent disruptions caused by the COVID-19 pandemic. As we have discussed elsewhere, elected and appointed officials both recognized quickly that the burden of the economic shutdown targeted at slowing the spread of the virus would fall on Main Street, not Wall Street.

But this is not to say that the impact of this nearly decade-old regulation has been uniformly positive. One need look no further than the virtual disappearance of liquidity in U.S. credit markets during the market tumult in March.

Liquidity: What's changed since the Global Financial Crisis?

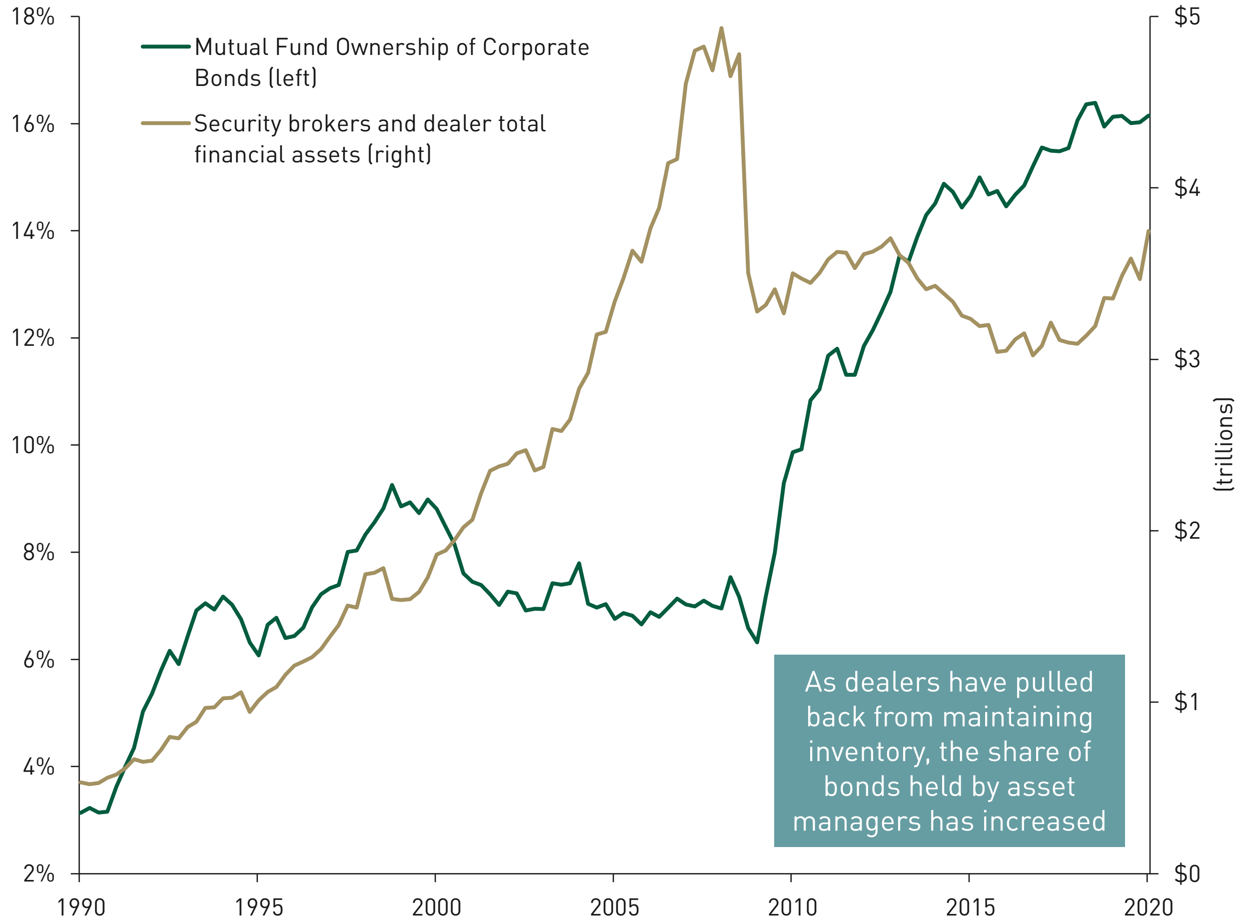
- Central bank policy & market/issuance composition
- Regulation
- Market participants' roles

Since the close of the GFC, central banks have utilized extraordinary measures to stabilize markets and foster economic growth. Zero interest-rate policy (ZIRP), coupled with the now familiar quantitative easing have become the norm rather than the exception. While the aggregate goals of these efforts are well understood, they also have had the effect of increasing borrowing, driving outstanding debt levels to all-time highs.

Regulatory forces are also at work amid moves to limit certain types of risk taking and prohibit others. Dealer capital committed to market making and trading has decreased markedly as a result, along with banks' and insurance companies' appetite for assets defined as less liquid, even as bond markets have increased dramatically in size.

As market roles have shifted, some investor types have assumed more prominent roles in certain markets. As dealers have reduced balance sheets and stepped back from providing liquidity to the fixed income market, many asset managers have filled the void. Both active and passive strategies have seen meaningful growth post GFC, pushing them to a point of greater market influence.

Figure 1. Normal Fixed-Income Liquidity Mechanisms Have Changed in Recent Years



Source: Financial Accounts of the United States, Board of Governors of the Federal Reserve System. Data as of 03/31/2020. **Past performance is not a reliable indicator or guarantee of future results**. For illustrative purposes only and does not represent any specific portfolio managed by Lord Abbett or any particular investment.

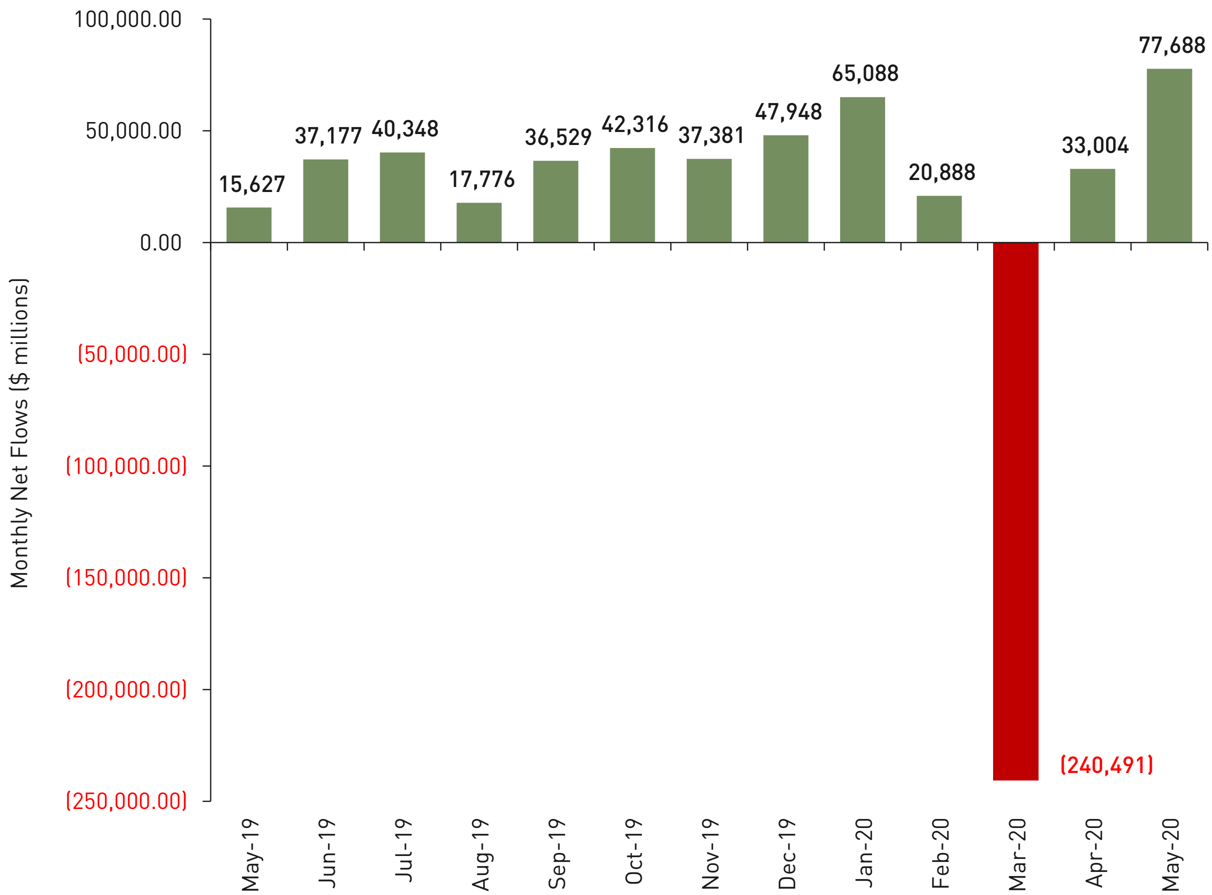
But asset managers have their own reasons for valuing liquidity highly. Because of the structural mismatch of offering short-term redemption options while holding longer term obligations, managers place a premium on liquidity. As investors tend to redeem during periods of market volatility, managers must maintain a high level of liquidity in anticipation of abrupt changes in sentiment.

When markets began to sell off in March 2020, dealers were unable to fulfill their historical buffer role. In the past, when markets became dislocated, market makers, proprietary (prop) trading desks and other entities acted as the primary conduit for risk; if their view was that a market shock would be transient, we assume they would bid for assets, expanding their balance sheets pro-cyclically to match their view of opportunity. But because of changes in the way banks carry assets on their balance sheets to comply with the current regulatory regime, they were limited or unable to do so during the late March liquidity event.

Without that robust intermediary buffer, trading instead occurred "end account to end account," with dealers acting as agents rather than principals, attempting to match buyers with sellers rather than absorbing risk themselves. But because many end accounts had liquidity issues of their own, pricing continuity was far from orderly.

LORD ABBETT®

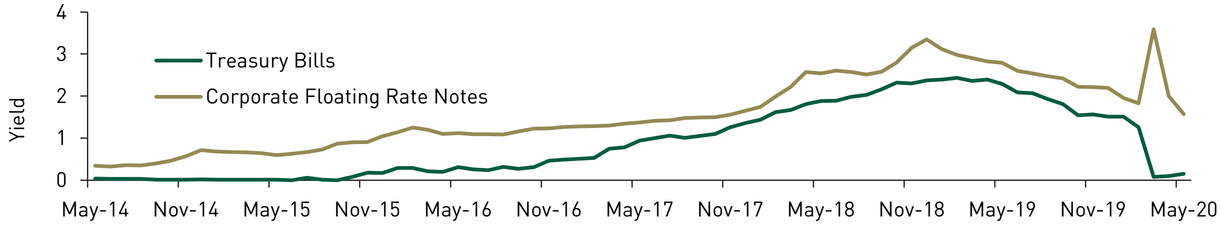
Figures 2 & 3. Taxable Fixed Income Markets Experienced Extreme Outflows in March 2020 …



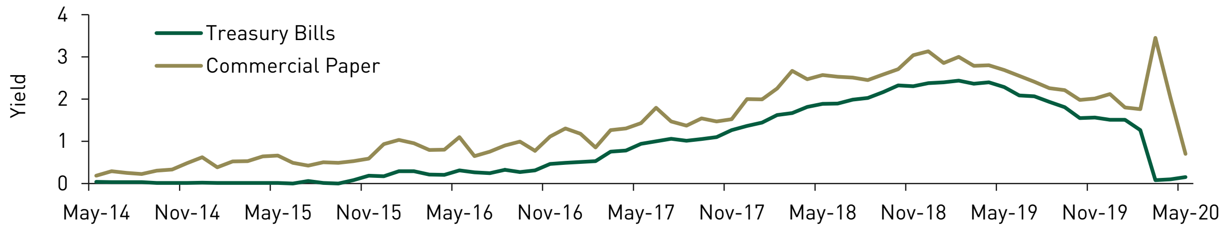
Source: Simfund. Monthly net flows into Morningstar Taxable Bond Categories, as of 05/31/2020. Taxable bond funds are those with at least 70% of assets held in taxable fixed-income securities.

... while Credit Spreads Widened Considerably Before Subsequently Moderating

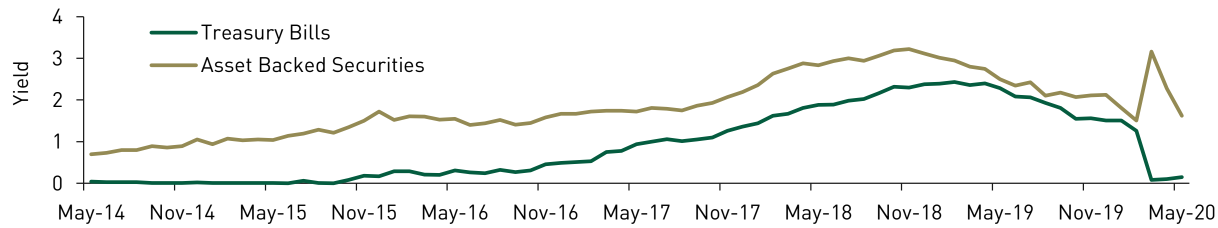
INVESTMENT GRADE CORPORATE FLOATING RATE NOTES[1] VS. TREASURY BILLS[2]



COMMERCIAL PAPER VS. TREASURY BILLS[2]



ASSET-BACKED SECURITIES[3] vs. TREASURY BILLS[2]



Source: Bloomberg Barclays & ICE Data Indices, LLC. Data from 05/01/2014–5/31/2020.

[1]Bloomberg Barclays U.S. Floating Rate Note Index (maturities less than 18 months).

[2]Bloomberg Barclays 3-Month U.S. Treasury Bill Index.

[3]ICE BofAML ABS Fixed Rate 0-3 Year Index.

Past performance is not a reliable indicator or guarantee of future results. For illustrative purposes only and does not represent any specific portfolio managed by Lord Abbett or any particular investment. Indexes are unmanaged, do not reflect the deduction of fees or expenses, and are not available for direct investment.

For investors who had "paid up" for liquidity, purchasing more readily saleable securities with the hope they would be able to transact more easily in an increasingly volatile market, this was a most unwelcome shock. While many asset classes did provide liquidity, it was available in the narrowest sense: these assets could be converted to cash quickly. However, that conversion came at a price far below the market values of just one month earlier.

Liquidity Considerations in Today's Market

There is no "quick fix" to the current structural liquidty challenges, in our view. Policy makers have been aware of the problem, having been reminded in a far gentler fashion back in September-October 2019 when repo rates climbed due to liquidty, and not solvency, concerns.[1] For investors, we believe several partial solutions exist, which, when used in conjunction, may potentially mitigate a fair portion of the risk of episodes of reduced market liquidity and position portfolios to benefit from the volatility.

The first is to consider multi-sector approaches. While most fixed income asset classes suffered to one degree or another during the market disruption in March, the pain was not spread equally; the subsequent recovery has been similarly uneven. Managers' ability to rotate among asset classes may help them better navigate through a tough situation (assuming the manager is sufficiently skilled), trimming assets that have held up well in relative terms to take advantage of dislocated prices in assets that have not.

Figure 4. A Look at Fixed Income Performance Before, and After, the Height of the March Volatility

Returns (%) for the indicated periods

Index Performance	YTD through 03/23/20	03/24 – 05/31/20
U.S. Treasuries	**7.81**	**0.74**
CMBS	**-1.98**	**4.57**
Investment Grade Corporate	**-9.95**	**14.39**
Investment Grade Corporate – BBB	-13.13	16.30
High Yield Corporate	**-20.56**	**18.71**
High Yield Corporate – BB	-18.09	19.17
High Yield Corporate – CCC	-27.74	14.25
Bank Loans	**-19.76**	**17.11**
Bank Loans – BB	-19.46	18.54
Bank Loans – Split B/CCC	-24.91	11.07
EM Sovereign	**-17.07**	**14.99**

Sources: Bloomberg Barclays U.S. Treasury, CMBS and Investment Grade Corporate Indexes; ICE BAML U.S. High Yield Index; Credit Suisse Leveraged Loan Index; and J.P. Morgan Emerging Markets Bond Index Global.

Past performance is not a reliable indicator or guarantee of future results. For illustrative purposes only and does not represent any specific portfolio managed by Lord Abbett or any particular investment. Indexes are unmanaged, do not reflect the deduction of fees or expenses, and are not available for direct investment.

Another potential solution may be to invest through a vehicle that limits account withdrawals. By preventing investors from pulling capital in the face of economic turbulence, strategies may be able to prevent "mark to market" losses from becoming realized losses through forced sales. As an additional benefit, managers investing in such a vehicle may be able to invest in a "steady state" for the long term, without concern that redemptions will pop up and force them to liquidate.

Private credit type investments may seem at first to be an ideal approach in this regard. With their long lockups, they do satisfy on at least one count- investors are barred from pulling their capital at will. Indeed, they are barred from doing so at any time before the end of the lockup period. But private debt generally fails to provide a multi-sector opportunity, with most such portfolios concentrated in one area of the market, limiting the ability to take advantage of conditions across multiple markets.

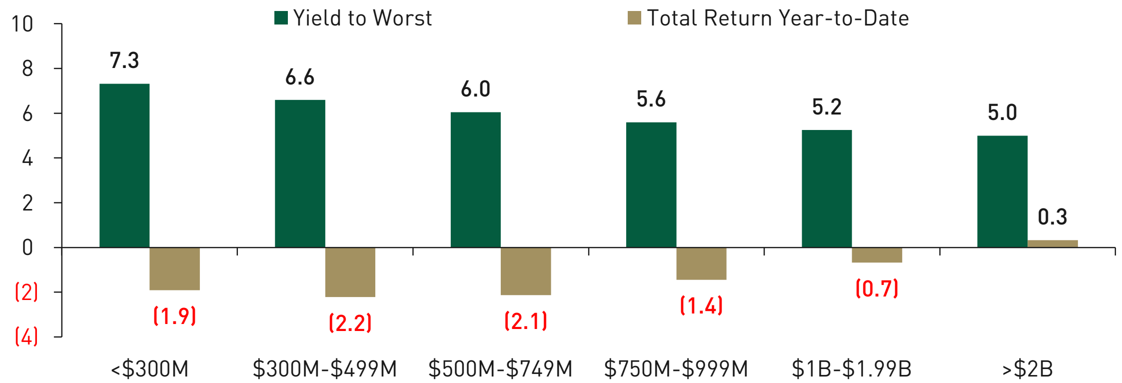
We have found that opportunities exist in public markets that offer return potential similar to those found in private markets, with the difference that these investments may still be managed actively post-investment.

For example, even within otherwise liquid markets, tiering does occur. Despite a benign environment for risk, lower rated CCC bonds lagged the broader high yield market in 2019—the first time since 2001—in an environment of narrowing credit spreads. Why? Higher ratings generally mean larger deal sizes, which can mean greater liquidity, an attractive characteristic for investors.

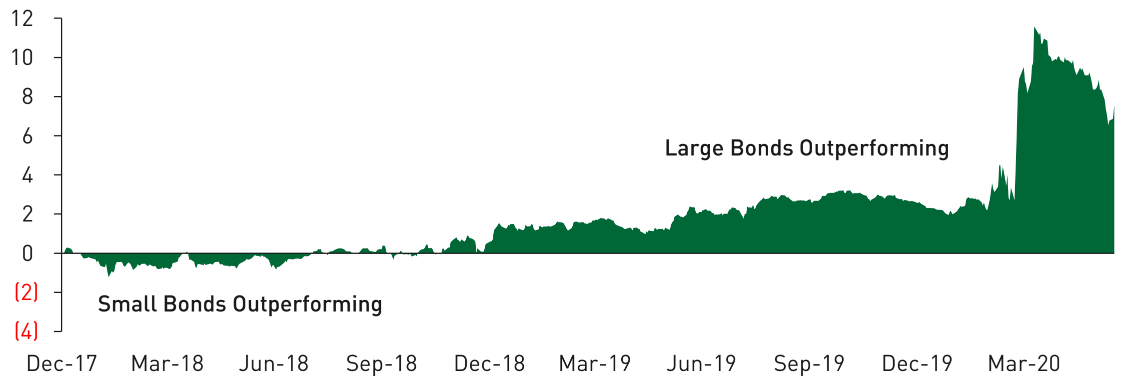
Figure 5. As High Yield Investors Emphasize Liquidity, Small Bonds Have Underperformed Thus Far in 2020

Year-to-date data for June 16, 2020

YEAR-TO-DATE RETURN AND YIELD TO WORST OF DIFFERENT SIZE TRANCHES OF HIGH YIELD



HIGH YIELD: LARGE VS SMALL BOND RELATIVE TOTAL RETURNS



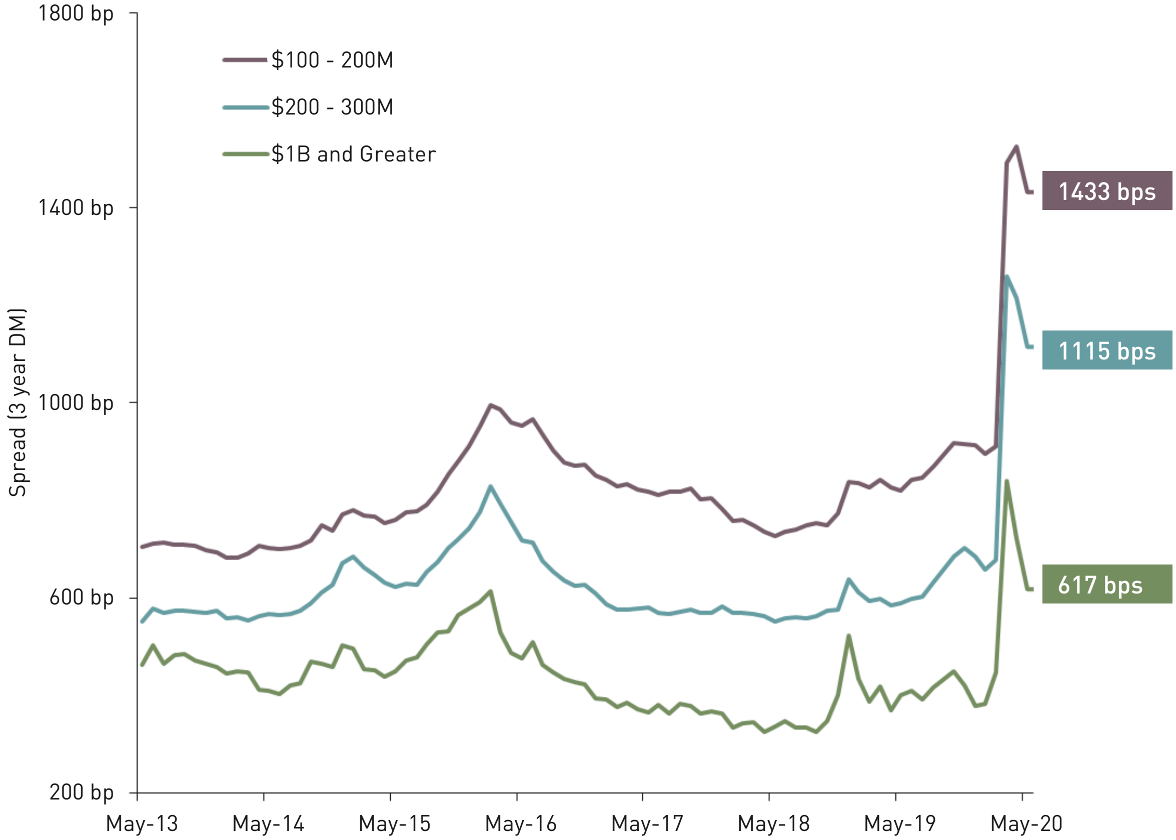
Source: Bloomberg. Data as of 06/16/2020. Based on large- and small-bond datasets within the ICE BofA US High Yield Index.

Past performance is not a reliable indicator or guarantee of future results. For illustrative purposes only and does not represent any specific portfolio managed by Lord Abbett or any particular investment. Indexes are unmanaged, do not reflect the deduction of fees or expenses, and are not available for direct investment.

Similarly, senior loans have shown a tremendous variance in yield by size. Large issues, $1 billion in size or above, yield on average 300 basis points less than those sized between $200-$300 million. While large and small loans share some buyers, such as institutional separate accounts, they do not share others, such as loan mutual funds and many CLO[2] sponsors.

We believe other opportunities lie within the securitization market, notable among them commercial mortgage-backed securities (CMBS). This market never recovered to the size it reached pre-GFC and also has not reached the level of parity in pricing relative to comparable credit it enjoyed during that period. This is despite the fact that CMBS structures are much more robust than they were prior to the crisis, in our view, and despite the fact that the vast majority of the more aggressively structured deals of that period performed relatively well. The opportunity spread pickup versus comparably rated corporate credit exists across the tiered capital "stack" of CMBS and has tended to grow as one goes out on the credit curve.

Figure 6. Smaller Deal Size Bank Loans Have Carried Wider Spreads



Sources: Spread data based on Credit Suisse Leveraged Loan Index, as of 05/31/2020. Indexes are unmanaged, do not reflect the deduction of fees or expenses, and are not available for direct investment. Past performance is not a reliable indicator or guarantee of future results. For illustrative purposes only and does not represent any specific portfolio managed by Lord Abbett or any particular investment.

Figure 7. Spread Comparison: CMBS versus Corporate Credit

Spread (in basis points) by rating and investment category

	Spread (bps)	
Rating (05/31/2020)	U.S. Corporate	CMBS
A	131	721
BBB	228	1,283
BB	452	1,331*
B	627	-

Sources: Bloomberg Barclays US Corporate and Non-Agency CMBS Index (option-adjusted spread basis) unless otherwise noted. Data as of 05/31/2020. Basis points (bps): Each basis point represents one one-hundredth of a percentage point.

*BB CMBS spread is based on CMBX index data.

Past performance is not a reliable indicator or guarantee of future results. Data are for illustrative purposes only and are not meant to represent the characteristics of an actual portfolio managed by Lord Abbett.

CLOs are another area which offers opportunity, in our opinion. While CLOs possess many historical virtues–good credit performance on balance through the GFC, higher yields than comparably rated corporates, and limited interest rate risk due to their floating-rate nature–they do not count liquidity among them. As a result of this, and the level of analysis they demand for success, CLOs trade notably wider than comparable rated corporate credit.

Summing Up

So how might investors approach liquidity in today's market? We have a few suggestions. First, investors should be clear about their actual liquidity needs. If they are reasonably high, investors should be mindful of the costs of that liquidity "insurance premium," which comes in the form of lower compensation for similar credit risks. They should also be aware of what that premium actually pays for–generally speaking, the ability to convert assets to cash quickly, but not necessarily at a given price point, particularly in periods of stress. Investors may wish to consider a multi-sector strategy that invests across a number of different markets to limit the impact of sharp moves in one or several markets.

Second, for those with lower liquidity needs, be aware that their ability to provide liquidity to markets has a value, and that by committing capital for a longer period of time, they may potentially gain the opportunity to monetize that higher category of risk tolerance.

Figure 8. Spread Comparison: CLOs versus Corporate Credit

Spreads and default rates by rating and investment category as of May 31, 2020

Rating (05/31/2020)	Spreads (bps)		Cumulative Default Rates	
	U.S. CLO	U.S. Corporate	U.S. CLO	U.S. Corporate
A	324	131	0.5%	2.1%
BBB	516	228	0.3%	5.3%
BB	1131	452	1.7%	16.7%
B	2054	627	2.6%	29.9%

Sources: Spread data from JP Morgan and Barclays, as of 05/31/2020. Default data from Standard & Poor's over 20 years 1994-2013 (latest data available from a historical study). Basis points (bps): Each basis point represents one one-hundredth of a percentage point.

Past performance is not a reliable indicator or guarantee of future results. . Data are for illustrative purposes only and are not meant to represent the characteristics of an actual portfolio managed by Lord Abbett.

LORD ABBETT®

[1]The so-called "repo" market—a segment of of U.S. fixed income that provides overnight funding for financial institutions–saw a spike in short-term borrowing costs on September 17, 2019.

[2]Collateralized loan obligations.

A Note about Risk: The value of an investment in fixed-income securities will change as interest rates fluctuate and in response to market movements. As interest rates fall, the prices of debt securities tend to rise. As interest rates rise, the prices of debt securities tend to fall. High-yield securities, sometimes called junk bonds, carry increased risks of price volatility, illiquidity, and the possibility of default in the timely payment of interest and principal. Bonds may also be subject to other types of risk, such as call, credit, liquidity, interest-rate, and general market risks. Lower-rated bonds carry greater risks than higher-rated bonds. The principal risks associated with bank loans are credit quality, market liquidity, default risk and price volatility. While bank loans are secured by collateral and considered senior in the capital structure, the issuing companies are often rated below investment grade and may carry higher risk of default. Moreover, the specific collateral used to secure a loan may decline in value or become illiquid, which would adversely affect the loan's value. Longer-term debt securities are usually more sensitive to interest-rate changes; the longer maturity of a security, the greater the effect a change in interest rates is likely to have on its price. No investing strategy can overcome all market volatility or guarantee future results.

Neither diversification nor asset allocation can guarantee a profit or protect against loss in declining markets.

There is no guarantee that the floating-rate loan market will perform in a similar manner under similar conditions in the future.

Forecasts and projections are based on current market conditions and are subject to change without notice. Projections should not be considered a guarantee.

This commentary may contain assumptions that are "forward-looking statements," which are based on certain assumptions of future events. Actual events are difficult to predict and may differ from those assumed. There can be no assurance that forward-looking statements will materialize or that actual returns or results will not be materially different from those described above.

Treasuries are debt securities issued by the U.S. government and secured by its full faith and credit. Income from Treasury securities is exempt from state and local taxes.

Glossary

The **capital structure** is the composition of a company's debt and equity such as bank debt, bonds of all seniority rankings, preferred stock, and common equity. Various debt obligations can have different seniority rankings, which means different priority of payment. Most senior or highest-ranking debts have the first claim on the assets in the event of default.

Collateralized loan obligations (CLOs) are a form of securitization where payments from multiple middle sized and large business loans are pooled together and passed on to different classes of owners in various tranches. A CLO is a type of collateralized debt obligation.

The **Bloomberg Barclays U.S. Floating Rate Note Index** measures the performance of U.S. dollar-denominated, investment-grade floating-rate notes.

The **Bloomberg Barclays U.S. Treasury Index** is the U.S. Treasury component of the U.S. Government Index. The index includes public obligations of the U.S. Treasury with a remaining maturity of one year or more.

The **Bloomberg Barclays U.S. CMBS Investment Grade Index** measures the market of U.S. agency and U.S. non-agency conduit and fusion CMBS deals with a minimum current deal size of $300 million. The Bloomberg Barclays US Corporate and Non-Agency CMBS Index is a subset of the index.

The **Bloomberg Barclays 3-Month U.S. Treasury Bill Index** is designed to measure the performance of public obligations of the U.S. Treasury that have a remaining maturity of three months.

Bloomberg Barclays Index Information:
Source: Bloomberg Index Services Limited. BLOOMBERG® is a trademark and service mark of Bloomberg Finance L.P. and its affiliates (collectively "Bloomberg"). BARCLAYS® is a trademark and service mark of Barclays Bank Plc (collectively with its affiliates, "Barclays"), used under license. Bloomberg or Bloomberg's licensors, including Barclays, own all proprietary rights in the Bloomberg Barclays Indices. Neither Bloomberg nor Barclays approves or endorses this material, or guarantees the accuracy or completeness of any information herein, or makes any warranty, express or implied, as to the results to be obtained therefrom and, to the maximum extent allowed by law, neither shall have any liability or responsibility for injury or damages arising in connection therewith.

The Credit Suisse Leveraged Loan Index is designed to mirror the investable universe of the U.S. dollar-denominated leveraged loan market.

The ICE BofAML ABS Fixed Rate 0-3 Year Index is a rate- and maturity-specific subset of the ICE BofAML US Fixed & Floating Rate Asset Backed Securities Index.

The ICE BofAML U.S. High Yield Index tracks the performance of US dollar denominated below investment grade corporate debt publicly issued in the US domestic market.

Source: ICE Data Indices, LLC ("ICE"), used with permission. ICE PERMITS USE OF THE ICE BofAML INDICES AND RELATED DATA ON AN "AS IS" BASIS, MAKES NO WARRANTIES REGARDING SAME, DOES NOT GUARANTEE THE SUITABILITY, QUALITY, ACCURACY, TIMELINESS, AND/OR COMPLETENESS OF THE ICE BofAML INDICES OR ANY DATA INCLUDED IN, RELATED TO, OR DERIVED THEREFROM, ASSUMES NO LIABILITY IN CONNECTION WITH THE USE OF THE FOREGOING, AND DOES NOT SPONSOR, ENDORSE, OR RECOMMEND LORD ABBETT, OR ANY OF ITS PRODUCTS OR SERVICES.

Indexes are unmanaged, do not reflect the deduction of fees or expenses, and are not available for direct investment.

The credit quality of the securities are assigned by a nationally recognized statistical rating organization (NRSRO), such as Standard & Poor's, Moody's, or Fitch, as an indication of an issuer's creditworthiness. Ratings range from 'AAA' (highest) to 'D' (lowest). Bonds rated 'BBB' or above are considered investment grade. Credit ratings 'BB' and below are lower-rated securities (junk bonds). High-yielding, non-investment-grade bonds (junk bonds) involve higher risks than investment-grade bonds. Adverse conditions may affect the issuer's ability to pay interest and principle on these securities.

The information provided is not directed at any investor or category of investors and is provided solely as general information about Lord Abbett's products and services and to otherwise provide general investment education. None of the information provided should be regarded as a suggestion to engage in or refrain from any investment-related course of action as neither Lord Abbett nor its affiliates are undertaking to provide impartial investment advice, act as an impartial adviser, or give advice in a fiduciary capacity. If you are an individual retirement investor, contact your financial advisor or other fiduciary about whether any given investment idea, strategy, product or service may be appropriate for your circumstances.

The opinions in this commentary are as of the date of publication, are subject to change based on subsequent developments, and may not reflect the views of the firm as a whole. The material is not intended to be relied upon as a forecast, research, or investment advice, is not a recommendation or offer to buy or sell any securities or to adopt any investment strategy and is not intended to predict or depict the performance of any investment. Readers should not assume that investments in companies, securities, sectors, and/or markets described were or will be profitable. Investing involves risk, including possible loss of principal. This document is prepared based on the information Lord Abbett deems reliable; however, Lord Abbett does not warrant the accuracy and completeness of the information. Investors should consult with a financial advisor prior to making an investment decision.

Lord, Abbett & Co. LLC | 90 Hudson Street | Jersey City, NJ 07302-3973 | T 1.888.522.2388 | lordabbett.com