



CrossingBridge

David K. Sherman and T. Kirk Whitney

A Disciplined Approach to Capital Preservation
in a Low-Duration Strategy

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As markets provide little certainty, credit investors may seek alternative fixed-income solutions, which both preserve capital and take advantage of opportunities for yield. David Sherman, Founder, CIO and Portfolio Manager at CrossingBridge Advisors LLC, and Kirk Whitney, Assistant Portfolio Manager, share how the team draws upon their robust experience to meet investors' specific needs across a spectrum of risk. Sherman and Whitney describe how the firm's "money good" philosophy informs its bottom-up approach, mitigating risk and seeking to achieve good risk-adjusted returns. Moreover, they explain why this approach allows the firm to offer a low volatility income-oriented product with relatively low duration where the strategy is to produce consistently high income.

To begin, can you outline CrossingBridge's investment philosophy? What areas are of most importance to CrossingBridge and its investors?

David Sherman: Our daily liquid strategy focuses on value investing in high-income, low-duration securities. We take a bottom-up approach, embodying traditional Graham and Dodd value investing principles that when lending money, it is imperative to discern the company's value and identify all potential risks for repayment of the loan. This begins with careful evaluation of the business, its economic model and its risks.

While we look at economic environments and interest rates as part of our portfolio construction, we are not macro or top-down investors. For our strategy, those considerations are not the driving fundamentals the way they may be for other fixed-income products. Our bottom-up approach allows us to be sharply focused on areas of inherent value, rather than conditional concerns about macro fluctuations.

Our strategy is appropriate for investors who may have a need or mandate for low-duration solutions for capital preservation and income.

CrossingBridge has a qualified investment team with an average experience of 20+ years. Can you share with us more about your team and why your collective expertise sets you apart from your peers?

Kirk Whitney: Most of our investment professionals have 20 to 30 years of experience managing portfolios ranging from leveraged loans to private lending and distressed debt. We have an exceptionally experienced and diligent team borne from market segments that have historically attracted bright minds able to creatively identify methods for alpha generation. The critical thinking that informed their training is now part of their DNA, making them extremely adept at bottom-up evaluation and high yield underwriting.

We credit our strength to our discipline and diversity of perspective. Hailing from hedge funds and beyond, we draw upon our collective learnings to implement effective approaches from across the investment landscape.

Investors seeking high yield return typically look for high total returns and long investment horizons. How does CrossingBridge's strategy of focusing on low-duration debt offer investors a more favourable yield?

David Sherman: Investors have bills to pay and other short-term requirements for liquidity. By incorporating our strategies into their overall approach, investors can take a long-term view on some portion of their capital and deploy it for a several-year horizon for total return, while the low-duration offers a ballast to allow them to meet their immediate and ongoing funding needs while earning a high income.



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David K. Sherman



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Our flexible strategy construction allows us to strategically deploy capital where and when we see opportunities in the market to capture value.

T. Kirk Whitney

Our strategies meet investor needs through a balance of income, the return of capital and the safety of a bond portfolio.

Can you explain the meaning of your “money good” philosophy?

David Sherman: “Money good” is the premise that an underlying investment is elaborated, and the quality of credit renders the repayment of principal with all contractual coupons likely.

The concept allows the freedom to decouple the quality of an investment from current market conditions. We are ultimately guided by core business fundamentals, agnostic of market fluctuations.

How does your approach to credit analysis and risk assessment feed into your investment selection?

Kirk Whitney: Thorough analysis and risk assessment are central to our strategy. As we underwrite credit quality and risk, we assess each entity and its ability to pay its obligations, beginning with the basics – the fundamental business model. When determining if we want to lend to a business, we examine its competitive advantage and pricing power.

Additionally, we evaluate qualitative aspects of the business, including individual management teams and broader industry dynamics.

We are looking for good companies with catalysts to pay debt, with positive free cash flow and low leverage. We also monitor holdings, market conditions, liquidity and concentration and relative value spreads in the market. These elements are critical from a risk management standpoint, especially in a fixed-income strategy. In our overall risk assessment, position size is important to us.

Your strategy is comprised of five categories – short-term securities, event-driven securities, interest rate sensitivity, core value and credit opportunities. Can you share with us investment examples in each of these categories?

David Sherman: Short-term securities will mature or be taken out by a call within the next 90 days. These may be short-term investment grade securities or short-term high yield securities that are expected to be refinanced or mature through cash flow from the corporation in a very short period.

Event-driven securities are catalysed by specific events, such as M&A transactions, spin-offs or changes of control. An important differentiator in our investment approach in this category is a belief in the company fundamentals. This means that in the scenario that the loan catalyst event does not come to fruition, we remain steadfast that the bond is “money good” and therefore will come to maturity or be refinanced through another route.

Interest rate sensitivity has become a broader category in our strategy because of the inverted yield curve. In our view, securities impacted by interest rates are advantageous due to the nature of floating rates. These securities are seeing yield pickup in the short end right now, especially in the US as we have seen an additional 75 to 100 basis points. Other securities in this category may be commercial mortgage-backed securities (CMBS).

Core value are bonds that have a one-, two- or three-year maturity. These are securities that may have a catalyst but aren't necessarily an event. If they are being issued in attempts to lower leverage, we may see that the debt is likely to be taken out in a refinancing transaction.

Credit opportunities are situations in which we opportunistically invest at a discount to par and where the value of the business itself covers the price paid for a certain security. There may be the possibility that this is a stressed security, though these are generally a lower percentage of our overall strategy.

How does CrossingBridge weight its investment selection in terms of portfolio construction, and what factors do you identify as drivers for those allocations?

Kirk Whitney: Our flexible strategy construction allows us to strategically deploy capital where and when we see opportunities in the market to capture value.

Typically, our strategy is comprised of 65 percent or less high yield, leaving 35 percent or more for investment grade opportunities. We focus on producing high-quality, risk-adjusted returns and believe that the volume of investment grade does not detract from our total yield.

A substantial 30 percent of our current strategy is floating rate. Our strategy has North American underlying securities, but also a substantial amount of non-US securities, in developed nations where contractual laws and property rights are valued.

Traditionally, between 10 and 30 percent of our strategy is comprised of non-US issuers of debt. Given their current value, we are investing on the higher end of those percentages. This flexibility sets us apart. Rather than adhering to a rigid construction or deployment cadence, we are able to opportunistically take what the market offers.

Particularly within a low-duration portfolio, preservation of capital is prioritised over outsized yield. How does a bottom-up approach mitigate downside risk to capital?

David Sherman: We believe asset management firms can either focus on generating outsized positive returns on the upside or focus on downside protection – it is very difficult to do both well. At our firm, we emphasize downside protection OVER maximising returns.

One of our core differentiators is that in a world of beating benchmarks, we are completely benchmark agnostic. We like to say that our only benchmark is trying to do what is smart for the portfolio. When you take this approach, you are not forced to purchase securities to try and mirror or beat a benchmark, but rather take an extremely disciplined bottom-up, process-driven approach that allows us to thoroughly evaluate risk at the individual debt level. It is this discipline that allows us to preserve capital while increasing the likelihood of returns.

For example, we generally do not invest in typical financial firms (i.e. banks). The reason is that they are typically exposed to the same set of risks that we are as a firm: liquidity risk, market risk, underwriting risk, counterparty risk etc. We are more than happy to give up any additional yield these securities might offer and deploy the capital elsewhere for the sake of risk management.

How do market conditions and interest rate environments inform your selection of effective maturities for investment securities?

Kirk Whitney: The markets are never static – they change constantly. The US has seen one of the longest periods of an inverted yield curve in recent memory. We believe that the curve height makes it such that it pays to be on the shorter part of the curve, understanding that it must come down and reinvestments will be a consideration down the road. Because of this, we believe now is an incredibly advantageous time to focus on low-duration securities in our strategy. Given this dynamic we focus on credit selection in the shorter end of the curve and are comfortable with resultant reinvestments as opposed to taking duration risk at this point in the cycle.

CrossingBridge Low Duration High Income Fund

US asset manager CrossingBridge Advisors LLC, a specialist in credit investments, oversees approximately 3 billion US dollars across all strategies. The company's focus is on investment funds with low durations, high income and low volatility. The Low Duration High Income strategy, launched in 2018 via a US mutual fund, has been available on the Universal Investment platform in a new UCITS fund domiciled in Ireland since October 2023.

The investment focus is on US high yield debt with expected maturities of less than three years. However, unlike existing low-duration high yield funds, CrossingBridge's approach is more flexible, as the fund is not managed against a benchmark and regularly exploits investment opportunities beyond US high yield debt, thereby offering what they believe to be a significantly more attractive risk-return profile.

Investment Process:

As part of a pragmatic value philosophy, the investment process focuses on bottom-up credit analysis to identify bonds with a high probability of repayment and low downside risk. This is achieved through in-depth analysis of the business model (competitive environment, pricing power), qualitative analysis (management team), financial analysis (capital structure) and analysis of the bond structure and covenants. In order to identify so-called "money good" investments, the last basis point of yield is often sacrificed in favour of greater security. The term "money good" is used to describe debt it believes will be paid off in full under current market conditions and on a strict priority basis. Investments can be divided into five categories: short-term securities, event-driven securities, interest rate sensitivity, core value and credit opportunities, with no predetermined limits for each bucket. Instead, investments are made opportunistically in the most attractive bonds based on the current market environment. The fund's portfolio is ultimately made up of 80 to 100 bonds, with weightings based on risk/reward and independent of any benchmark.

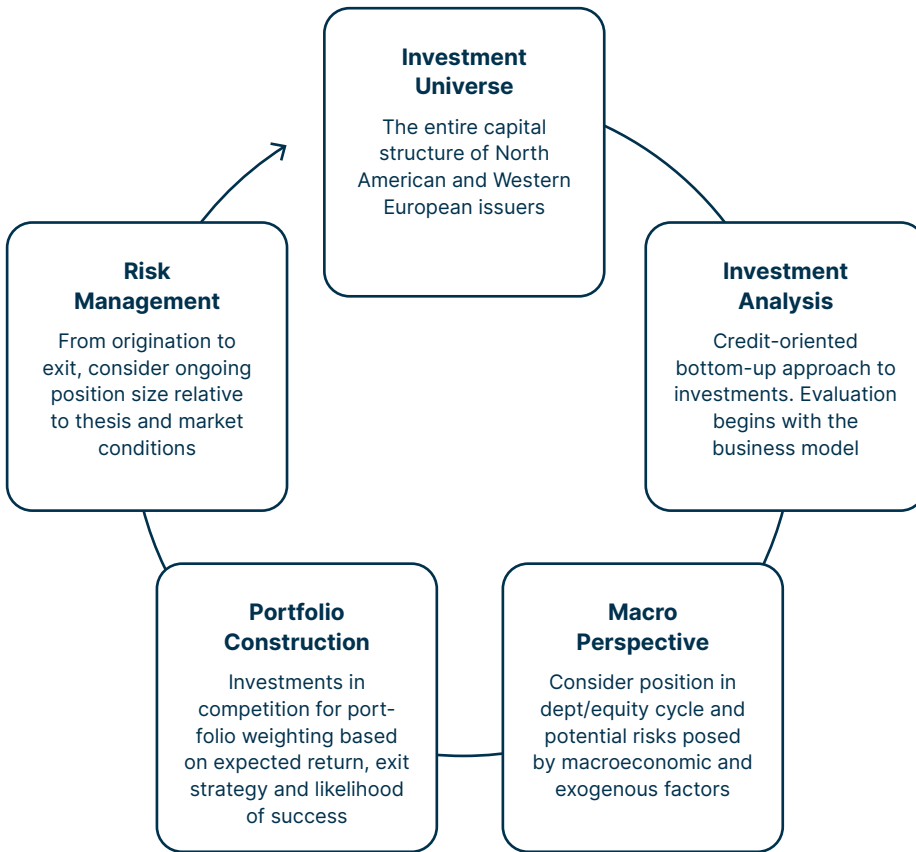
Management:

CrossingBridge's investment team is led by David Sherman, Founder, CIO and Portfolio Manager of CrossingBridge Advisors and currently consists of nine investment professionals. The majority have been with the firm for many years and have extensive investment experience. The team has a diverse background with many members of the team having worked in CLOs, structured credit and hedge funds before joining CrossingBridge. The team is characterised by high continuity and low turnover, which benefits the team approach.

Portfolio:

Given the current inverted yield curve, the fund is focusing its investments on the very short end of the market. Accordingly, approximately 30 percent of the fund's portfolio has a maturity of less than three months. However, should the market environment change, longer maturities may be considered again, provided that the expected remaining maturity of a bond is always less than three years. The fund's investments are primarily made in US issuers, but opportunities outside the USA (approximately 10 to 30 percent) are regularly realised. Currently, these are found mainly in the Nordics. The fund's investment strategy favours high yield bonds, whereby the proportion of investment grade-rated debt is usually greater than 35 percent, which emphasises the conservative orientation of the fund. In addition to bonds with fixed coupons, floaters are currently an important portfolio component. Structured bonds

The Investment Process



Source: CrossingBridge Advisors, LLC, as of 30/8/2024

(ABS/MBS) can also play a certain role in the portfolio and thus ensure diversification, given the right attractiveness and market environment.

Conclusion:

CrossingBridge's investment strategy positions the company to create an impact in the current market environment. In comparison to floater strategies, a higher yield may be achieved. In comparison to low-duration high yield strategies, the more conservatively and more flexibly managed portfolio of the fund offers a significantly more attractive risk profile with comparable long-term return potential. The track record of the US strategy, which has been in existence since 2018, can be transferred to the UCITS fund with minimal adjustments. This is an attractive option for investors seeking to benefit from high yields in the short-maturity segment of corporate bonds, supported by the expertise of a specialised niche provider.

CrossingBridge Low Duration High Income

ISIN: IE000QUK8N90 (more share classes)

Fund category: bonds

Inception date: 23/10/2023

Fund currency: EUR

Volume: 96,313,637.84 USD (all share classes)

Domicile: Ireland

Source: Universal-Investment Ireland Fund Management Limited, as of 30/8/2024

Risk Factors

Investors' attention is drawn to the risk factors set out in the prospectus that will have relevance for the Sub-Fund, including, but not limited to, risk factors relating to equities, currency risk, currency hedging, derivative risk. Investors' attention is also drawn to more general risk factors set out in the prospectus, including, but not limited to, leverage risk, broker credit risk, liquidity risk, transaction timing risk, valuation risk and title/custody risk.

Please refer to the prospectus for a detailed list of the risk information for this product.

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