AGF PERSPECTIVES

What are you doing after work?®

The Floating-Rate Loan Market

"The floating-rate loan market is entering a phase in which selectivity is especially important."

The following is an excerpt from a recent advisor white paper from Eaton Vance Management (Floating-rate loans: Core value remains as the need for selectivity rises, January 2014)

Floating-rate loans performed well in 2013, being one of only two major fixed-income sectors (along with high-yield bonds) to show a positive return for 2013, as of November 30[1]. Investor demand has been strong generally due to solid credit fundamentals and the prospect of further rising rates – U.S. Treasury yields have risen approximately 100 basis points (bps) after the U.S. Federal Reserve Board's (the Fed's) talk about reducing their bond purchases in the spring. The issuance of new loans in 2013 hit US$455 billion, easily eclipsing the 2007 record of US$387 billion, as issuers have taken advantage of attractive borrowing conditions[2].

The importance of quality

In 2014, we at Eaton Vance believe the loan market is entering a phase in which selectivity is especially important. At this phase in the credit cycle, we see a growing portion of the market that is less creditworthy, which makes issuer selectivity and fundamental credit research especially important for investors.

For those investing in floating-rate loans, there would appear to be no lack of issuers with sound credit profiles and low default risk, as many issuers are buoyed by low financing costs, strong balance sheets and earnings growth. But not all of today's US$600-billion-plus loan market[3] is created equally. Long-term viability and fundamentals vary, emphasizing the importance of thorough research and selective investing. As the largest and most experienced floating-rate fund managers in the U.S., we are first to be offered many of the new issues and we turned down approximately 75% of the new deals we reviewed in 2013. This ensures our fully invested portfolio is made up of what we believe are the highest quality loans.

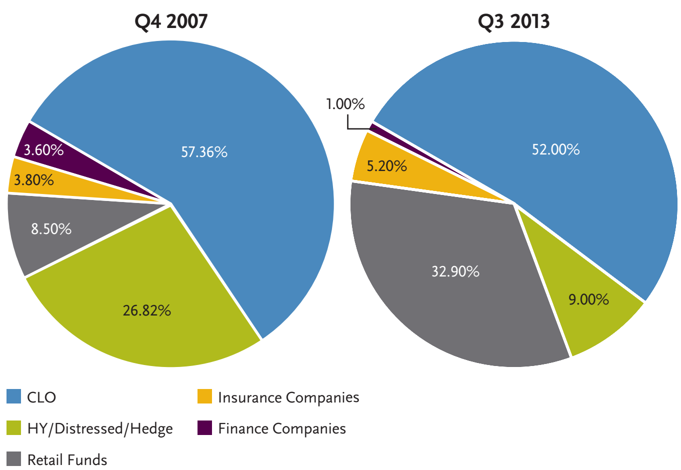
Some other factors are also aligning which may enhance the overall credit quality of the floating-rate loan sector. The financial crisis forced many weaker companies into default and/or bankruptcy, so today's issuers are survivors of that crisis. And many of them have refinanced over the past few years, meaning there are very few near-term maturities pressuring their finances. Finally, the improving overall economic backdrop in the U.S. makes a continuation of positive loan fundamentals likely, in our opinion.

Overall, the loan market has offered what we believe are reasonable spreads, attractive yields relative to other market segments and a healthy supply/demand balance.

Greater retail loan ownership

Over the past six years, retail mutual fund ownership of floating-rate loans has grown to about a third of the market outstanding, from about 8% (Exhibit 1) as of November 30, 2013. As a result, retail cash flows are now a bigger factor in secondary market pricing and a potential source of greater volatility.

EXHIBIT 1: Retail floating-rate loan demand has grown significantly in recent years



We see the broadened investor base as a positive, resulting in greater diversification of demand and improved liquidity. Of course, retail sentiment can change quickly and increasing mutual fund ownership may magnify temporary price swings, which can be disconcerting to investors. However, to the extent such volatility is not reflective of the underlying fundamentals – as is frequently the case – we view such price fluctuations as a potential source of opportunities for longer-term loan investors.

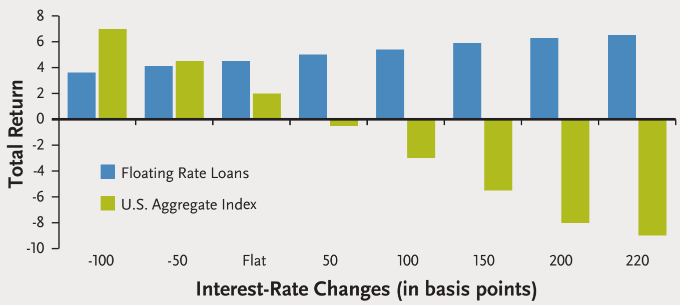
The risk of interest-rate exposure

Taking a step back to look at the relative value of the floating-rate loan sector, we continue to believe that the biggest risk for fixed-income investors today remains interest-rate exposure, which is almost completely absent from loans, due to their short duration.

In our opinion, the prospect of further rate increases underscores the need for investors to protect the value of their fixed-income portfolios. With attractive relative yields and a solid credit foundation, we believe that today's case for floating-rate loans as a strategic portfolio allocation, guided by fundamental credit research, may be as important as ever.

When interest rates go up, bond prices go down.

Loans vs. Bonds: Hypothetical Returns in Various Rate Scenarios



Source: Eaton Vance, December 31, 2013

For more information on how AGF Floating Rate Income Fund can help protect and grow your portfolio in a rising rate environment, visit AGF.com/FloatingRateIncome and speak to your financial advisor.

[1] Bloomberg, November 30, 2013
[2] S&P Capital IQ LCD
[3] S&P Capital IQ as of November 30, 2013

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Commissions, trailing commissions, management fees and expenses all may be associated with mutual fund investments. Please read the prospectus before investing. Mutual funds are not guaranteed; their values change frequently and past performance may not be repeated.

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