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NCRAM Update: US Elections, Vaccine News, and Market Outlook*November 9, 2020*

Just as the high yield market was digesting the US election last week, Pfizer and its partner BioNTech announced major Covid-19 vaccine news today, providing two major drivers for the high yield market this month. The US high yield market was up 2.1% last week on the election results, and today we estimate the market is up an additional 1.0% on the vaccine news, as measured by the ICE BofA US High Yield Constrained Index (HUC0).

With regard to the Covid-19 vaccine, Pfizer (with BioNTech) announced a 90% efficacy rate, with no significant safety problems, in their study of over 43,000 patients. The efficacy rate is at the high end of expectations, which ranged from 50% to 90%. Furthermore, this development bodes well for the Moderna vaccine which is based on the same RNA technology. FDA approval should come later this month with vaccines beginning to ship by year-end. There are still some unanswered questions, such as how long the vaccine lasts and how it affects different groups of people. Nevertheless, the news caused a substantial rally in both high yield bonds and equities in the sectors hurt most by Covid-19: travel (airlines, cruise lines, lodging), leisure (gaming, theaters), restaurants, and energy. Other sectors such as healthcare and autos rallied as well, looking ahead to a post-Covid environment.

The vaccine will not be widely available until at least Q2 2021. In the meantime, we expect the continued economic recovery to face some headwinds from rising Covid-19 cases. So far, the economy has continued to recover steadily, led by consumer spending, housing, and growth in China. The October employment report, which showed unemployment dropping to 6.9% and rising hourly earnings, was the latest evidence of this recovery. At the same time, the US is seeing a record number of new Covid-19 cases in recent days and weeks. The rising cases will affect mobility, and we expect states and localities to tighten social distancing rules for the winter months. This may curtail the economic recovery for Q1, but we believe the markets will remain focused on the "light at the end of the tunnel" provided by the vaccine. Assuming the vaccine proceeds on schedule, the economic recovery could be turbo-charged in the second half of 2021 as sectors like travel, restaurants, and leisure come back.

With regard to the election, Joe Biden was declared the winner over the weekend, and Trump's legal challenges seem to have a slim chance of success. The Senate appears likely to have narrow Republican control (75% chance according to the betting odds) which will be determined after run-offs in Georgia in January, and the House of Representatives will have narrow Democratic control. As President, Biden will have the power to set the tone and agenda for the country, appoint leaders of regulatory agencies, handle foreign and trade policy, and issue executive orders, while any legislation will need to pass the relatively evenly divided Congress. We are hopeful the parties will work together to pass some legislation, though the more sweeping ideas from the campaign will probably not come to fruition in the next two years. We believe fiscal stimulus in the \$1.5 trillion area will be agreed either before or soon after Biden's inauguration. Beyond that, in the following pages we have assembled some of the implications of the election on important high yield sectors.

Aerospace/Defense

The Trump presidency has been fairly supportive of defense spending as well as selling aerospace weapons overseas. Trade wars, however, have drawn threats to limit commercial aviation sales to the Chinese. A Biden presidency is likely to have mixed impacts. On one hand, staying in the WTO and supporting free trade (as well as a relaxed China tone) would support commercial aerospace in general. However, any decreased spending in defense, in order to fund other government needs, or composition away from weapons hardware would be a negative. Biden has also historically not been too outspoken about space exploration, while Trump has been generally supportive and established a US Space Force in 2019.

Airlines

We continue to believe that stimulus will be reached in some form, and there continues to be bipartisan support for airline employment. Any stimulus will likely include payroll support for airlines, similar to the CARES Act.

Automotive

A Biden presidency tempered by a Republican Senate majority is unlikely to have a major impact on the automotive industry, although we are likely to see a renewed effort to restore the \$7,500 tax credit for electrified vehicles, which could further stimulate those sales, and there will probably be a renewed effort to implement more stringent tailpipe emission requirements. However, the original equipment manufacturers (OEMs) are well-positioned to address these potential issues by producing more hybrid vehicles. In fact, both GM and Ford are expected to offer electrified versions of their best-selling vehicles in 2021. In terms of the automotive suppliers, they will follow the OEMs and will benefit from more production of electrified hybrid vehicles, because those vehicles (which have both an internal combustion engine and a battery) require more content. In any event, several high yield OEM suppliers like Goodyear (tires), Superior (wheels), Adient, and Lear (seating and interiors) are agnostic when it comes to the type of engine in a given vehicle.

Banking and Financials

We generally expect a Biden presidency to result in heavier scrutiny of financial companies' interactions with consumers and small businesses, by regulatory entities including the Department of Justice and the CFPB. In general, we see this outcome as basically neutral for large-cap banks (where increased sector-wide regulatory burden has tended provide competitive advantages) and negative for non-bank financial companies. Banks are among the largest corporate cash taxpayers and may be negatively impacted if corporate tax rates move higher.

Energy

We believe the biggest negative issue for the energy sector would be on the foreign policy side, with potentially a new Iran deal, which would likely bring additional barrels of oil to the already oversupplied market. With regard to new regulations for drilling and well completions, we believe the focus will be on limiting fracking on public lands and generally tighter regulations, such as a more rigorous permitting process for offshore drilling. An outright ban on fracking is not expected, especially given that most fracking is conducted on private lands. It is also unlikely that the drilling on existing offshore leases can be halted; however, it is possible that there could be no new leases allocated. We believe that new pipeline projects could face more difficulties getting approved. Those issues matter less for the oil sector given that supply is not growing, but are still topical for the natural gas sector. We don't envision any tax reform that would include disallowing oil and gas companies to deduct drilling intangibles, given the immediate negative impact that such a move would have on the current cash flow of the oil and gas companies. We believe the new administration's push for renewables, electric vehicles, and higher fuel efficiency standards will contribute to declining rate of oil demand long-term.

Equipment Rentals

We expect equipment rental companies to benefit from Biden's proposed infrastructure plan. Historically, infrastructure work has made up roughly 10% of overall revenue for some of the general equipment rental companies. There are other specialty equipment rental companies that could benefit more given higher exposure to specific types of projects currently included in Biden's infrastructure plan.

Gaming, Lodging, and Leisure

An increase to the federal minimum wage could be a headwind for many companies in these sectors. However, as in the example of regional gaming, companies have analyzed costs in an entirely new way during the pandemic, and many of the cost savings implemented are expected to be permanent. Thus, we expect margins to be higher than prior to Covid for many of these companies despite any increase in the federal minimum wage. An improved relationship with China under a Biden presidency could benefit the renewal process of Macau gaming concessions for US companies, which are set to expire in 2022.

Healthcare

We see a Biden presidency, coupled with a Republican or split Senate, as a relatively positive outcome for healthcare. A divided Congress will likely inhibit some of the more sweeping Democratic legislative efforts, including a move toward a public option. The Biden administration is likely to roll back Trump executive orders and actions that decreased insurance coverage. We would also expect Biden to boost Medicaid expansion and enrollment, which is positive for providers as it reduces bad debt and increases utilization. Further, we expect the incoming administration to focus on pandemic relief and stimulus. A Biden administration is likely to have a positive impact on the ACA Supreme Court case, as the DOJ is likely to withdraw its support of the case, and we expect that great efforts would be made to preserve the ACA in the event of an adverse court ruling.

Housing

Assuming a Biden presidency with a split Congress, we don't expect any significant direct changes for the housing market. Given historically low interest rates, low inventory, and a clear shift in preferences from multi-family to single-family dwellings, housing demand is very strong and has been disconnected from employment fundamentals. The health of the overall economy, the labor market, taxes, and interest rates will be more crucial for housing going forward, and having a divided government should be supportive.

Machinery and Construction Services/Products

Biden is likely to support renewables development and other green initiatives, which would benefit manufacturing and services companies exposed to wind, solar, EV, and other products related to energy efficiency or pollution control. A rollback of trade tariffs could help lower costs for manufacturers that source raw materials or components from abroad. Another indirect positive for manufacturers from lower trade barriers is an increase in overall economic activity and trade. An infrastructure deal could boost demand for infrastructure-related construction products and equipment, particularly if there are high "Buy American" requirements.

Media Content

Historically, Democratic media regulation policy has been viewed as more restrictive for operators of TV stations, radio stations, and so on. However, the Trump administration wound up accomplishing very little of the deregulation sought by the industry, and the existing regulatory regime is fairly antiquated and unlikely to get any tougher. Moreover, most key regulatory issues are currently tied up in court battles, not in the hands of the executive branch. Therefore, we expect the change of administration to have a negligible impact on this sector.

Metals/Mining and Chemicals

In terms of environmental regulation, if the Obama administration was on the heavy side of regulation and the Trump administration was on the light side, then the Biden administration will likely bring a return to the heavy side. Some air standards that were loosened, or set to go into effect but never did, will be back on the table. Possibly inspection will be more frequent, and permitting new plants and mines might take longer, which could result in higher compliance costs and perhaps some capital expenditures so that plants can meet higher standards.

With regard to coal, Trump couldn't save the industry due to competition from cheap natural gas and the closure of coal-fired generation. Utilities tend to have longer time frames than presidential terms and largely have already made their decisions on how they would comply with tighter pollution controls. We believe the coal industry is dying, and Biden's policies could quicken its demise.

A compressed timeline for higher fuel standards and greater adoption of electric vehicles (EVs) could be an opportunity for steel makers who sell high-strength light-weight (HSLW) steel and for aluminum rollers who make auto body sheet metal (all of which happen to be high yield issuers). Similarly, EVs need the same lightweight materials. Additionally, EVs will increase demand for mined materials: lithium, nickel, cobalt, and copper. Lithium supply has gotten ahead of demand, and projects are getting postponed, but the impact for the other metals should be quicker.

Trade protectionism for the steel industry, particularly from China imports, is very popular among steel producers (steel buyers may disagree), and we think Biden may let it persist. He will likely seek to end the trade spats and duties with Canada (the US imports a lot aluminum from Canada), Mexico, and Europe. Many companies suffered in 2019 due to the uncertainty that Trump's trade war created and have looking forward to 2020 as tensions seemed to be easing. Then the Covid-19 pandemic occurred, and 2019 became a distant memory. In any event, easing of trade tensions will help the chemical companies who compete in the international markets. In addition, any domestic infrastructure deal will also benefit the steel and chemical industries, especially with "Buy American" requirements.

Restaurants and Supermarkets

Potential federal minimum wage increases are a concern for restaurants and supermarkets. Florida passed a \$15 per hour minimum wage on election day, to take effect by 2026, and Biden is likely to push ahead with trying to raise the federal minimum wage to \$15 by 2025 (from \$7.25 per hour currently), although the timeline hasn't

been laid out yet. The combination of a Biden presidency and Republican Senate would likely slow down or thwart such an attempt (versus a “blue wave” scenario), as Republicans generally oppose increasing the federal minimum wage.

Retail and Consumer Products

Select credits within the retail and consumer products spaces have been negatively impacted by trade policy and tariffs. The potential for rollbacks here could have a modest benefit for these credits, but while Biden has long been a proponent of free trade, he may maintain some tariffs on Chinese-made products, limiting this benefit. Fiscal stimulus over and above what likely would have occurred under Trump (though below what probably would have occurred with a Democratic sweep) also has the potential to benefit retailers and certain consumer products companies, as any new stimulus or enhanced unemployment checks get spent. An increase to the federal minimum wage could be a headwind for many retailers.

Shipping and Logistics

There are not as many concrete lines drawn between the election and the shipping sector, but stimulus spending has helped to keep volumes and rates inflated from more depressed levels through the pandemic. Any reduction/reversal in protectionist China trade policies would also increase shipping demand in general. While Trump has pulled back from environmental policies, Biden is likely to support regulation on an international level, which includes lowering carbon emissions from ocean vessels and other forms of transportation.

Technology

While there were some favorable tax policies that helped tech companies under the Trump administration, our general view is that a Biden presidency will provide a more stable environment with fewer uncertainties. A less antagonistic stance on China could include backing off trade wars, while less onerous visa restrictions would allow for increased hiring of skilled foreign workers. Trump has targeted “Big Tech” with lawsuits regarding censorship, antitrust issues, and ideological bias, whereas Biden is more likely to rework existing language regarding immunities on misinformation (Section 230). Both candidates support the build-out of 5G infrastructure, while Biden has strongly supported rural broadband and may look to restore net neutrality in tandem with appointing a new FCC Chair. Lastly, Biden is likely to take a tempered approach in promoting manufacturing of technology in the US.

Theaters and Entertainment

The main factor currently impacting the theater and live entertainment space is Covid-19. Even as theaters have reopened in many areas, attendance remains extremely low due to concerns about the virus and an unwillingness of many studios to release content in this environment. While an administration change will not eliminate the virus, to the extent that Biden’s Covid-19 policies are more effective at controlling the virus, or that eventual vaccine acceptance is higher than it would have been under Trump, this has the potential to positively impact the sector relative to what would otherwise have occurred. Conversely, a possible increase in the federal minimum wage could be a headwind for theater operators. Separately, Netflix is a strong proponent of net neutrality, which could return with a new FCC chair.

Trucking

A Biden administration will likely seek to implement more stringent tailpipe emissions standards and to accelerate the movement of the industry toward battery-powered vehicles, but it is unlikely that any dramatic changes in that area will occur over the next four years. In fact, truck manufacturers overall are already seeking to improve gas mileage, because it stimulates sales of new trucks, given that fuel is a major cost component for the trucking companies. A rollback of tariffs and Biden’s free trade approach might be a modest positive for freight volumes and rates. However, any benefit on the trade and tariff front could be offset by a higher corporate tax rate that might curtail trucking company investments in new trucks. However, a Republican-controlled Senate is less likely to pass legislation to increase the corporate tax rate, so this possibility is unlikely to be a major issue. Additionally, the number of high yield issuers in the truck manufacturing space is dwindling in light of the acquisition of Navistar, so the overall impact of this space on the US high yield market is not that significant.

Utilities

A Biden administration would most likely revive many of the environmental rules that were put aside over the last four years. While this might accelerate the retirement of coal assets, this will not have a major impact on

high yield independent power producers (IPPs) as many already have retirement plans ready for these plants, given both low natural gas prices and state regulations. The biggest beneficiary would be renewable power generation. We believe that subsidies for wind and solar will be extended, and we could see an acceleration of offshore wind projects as well, which would be positive for the renewable yieldco companies.

Wireless Telecom

Prior to the election, we spoke to a leading company in the Wireless Telecom sector about what a Biden presidency would mean for the overall sector, and they believed corporate tax rate increases could be the main change, but that they would be well-positioned due to net operating loss carryforwards. Given the likelihood of a Republican Senate, we are not expecting large tax changes, and therefore only a minimal impact on the wireless space. A return to stronger net neutrality is possible with a new FCC chair, though we would anticipate little or no impact on high yield wireless issuers from such a change. We believe 5G rollouts enjoy bipartisan support, and would not anticipate material changes under the new administration.

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