Corporate Bond Investing in Unprecedented Times

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Making You a Better Bond Investor.

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In general, the bond market is volatile, and fixed income securities carry interest rate risk. (As interest rates rise, bond prices usually fall, and vice versa. This effect is usually more pronounced for longer-term securities.) Fixed income securities also carry inflation risk, liquidity risk, call risk, and credit and default risks for both issuers and counterparties. Any fixed income security sold or redeemed prior to maturity may be subject to loss.

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These 15 companies have one thing in common…

- Boeing
- Ford
- Disney
- Macy's
- TJX
- Marriott
- Delta Airlines
- Occidental Petroleum
- Royal Dutch Shell
- Anheuser-Busch
- Freeport-McMoRan
- GM
- Schlumberger
- Las Vegas Sands
- Raytheon

…they have all recently suspended or reduced stock dividend payments…

Dividend stock investors

Corporate CFO

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…and, combined with pausing share buybacks, the savings – and negative shareholder impact – is significant

Dividend & Buyback Summary ($ in millions)*

	12 Months Ending 12/31/19			Announced Through 6/30/20			
Company	Revenue	Dividends	Buybacks	Suspended Dividends	Cut Dividends	Paused Buybacks	12/31/19 Ratings
Royal Dutch Shell	$344,877	$15,198	$10,188	--	66% cut	√	Aa2 / AA-
Boeing	$76,559	$4,630	$2,651	√	--	√	A3 / A-
Disney	$69,570	$2,895	0	√	--	√	A2 / A
Anheuser Busch InBev	$52,329	$5,015	0	--	50% cut	--	Baa1 / A-

* Source: Company SEC filings and public earnings releases

While all 15 companies have reduced or halted both dividends and buybacks, they continue paying bond interest

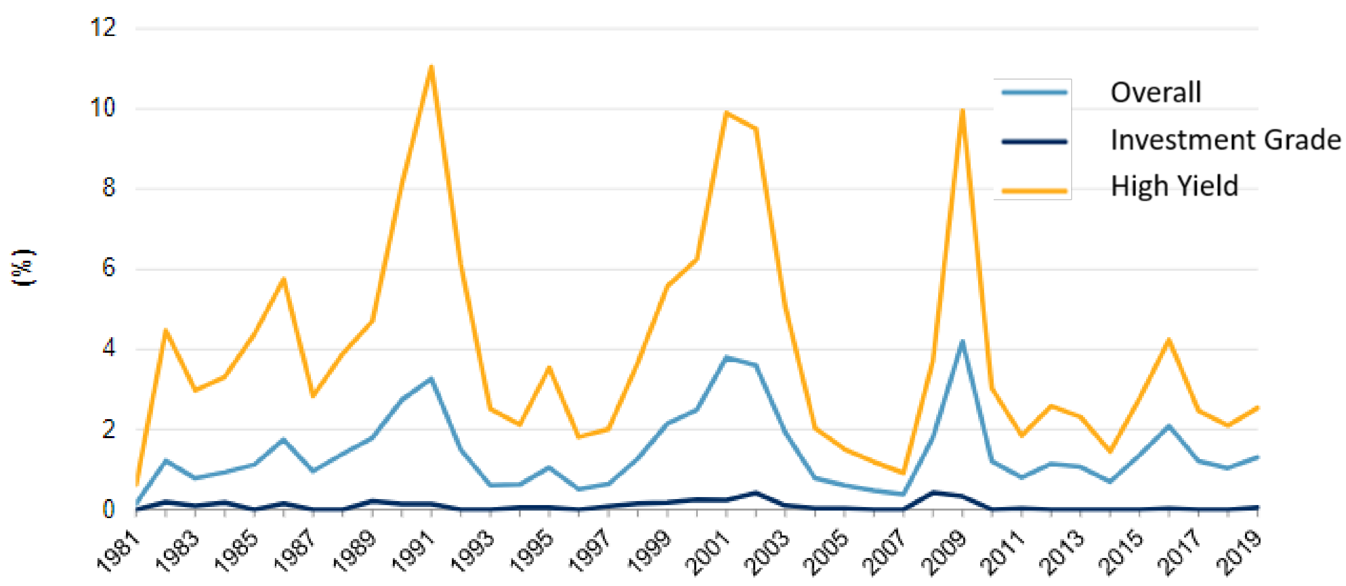
- For many companies, it had been share repurchases – not total earnings growth – which increased EPS and boosted stock performance

- Dividends have proven unreliable for many companies compared to contractual bond interest payments

- Companies can suspend dividends at whim; however, corporate bond defaults are still a very small percentage of the entire corporate bond market

Corporate Bond Default Rates by Rating

Global Corporate Bond Default Rates: 1981-2019



Sources: S&P Global Ratings Research and S&P Global Market Intelligence's CreditPro®

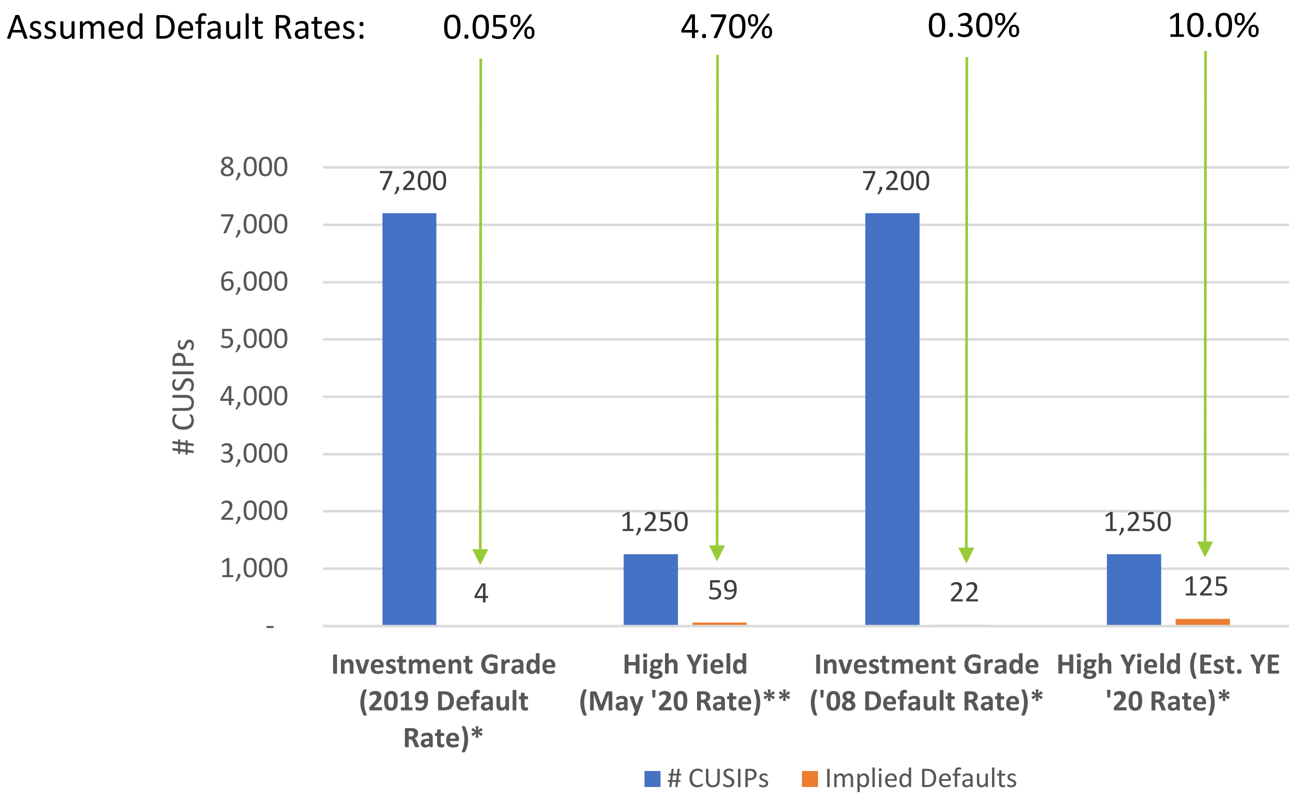
- High-yield corporate bond default rates have hit approximately 10% in the last three recessions
- Moody's said global high-yield default rates hit 4.7% in May 2020. It projected these default rates to peak in Feb '21 at 9.5%
- Per S&P, 2019 defaults comprised 35% distressed exchanges, 33% missed principal or interest payments, and 28% Ch 11 filings

While defaults are generally limited to the lowest-rated bonds, the suspension of dividends by A-rated issuers such as Disney and Boeing provides bondholders a distinct advantage over stockholders for a significant amount of companies

Default Rates in Perspective

Even if high-yield default rates hit 10%, it's still a small percentage of total corporate bond CUSIPs

Implied CUSIPs Going into Default Based on Default Rates



- Bonds rated below investment grade still represent a fairly small portion of the overall corporate bond market
- While we expect the lion's share of the corporate bond market to remain healthy, investors must still be vigilant given how quickly the fortunes of many companies have been turning

* Source: S&P projections and its *2019 Annual Global Corporate Default and Rating Transition Study.* ** Source: Moody's Investor Service

Replacing Lost Dividend Income with Corporate Bonds

- Investors seeking to replace dividend income may need to invest in longer-dated bonds or bonds with higher credit risk
- While longer-term bonds will have greater pricing volatility, they generally rank *pari passu* with other unsecured bonds and are a more reliable income stream than dividend stocks
- Plus, capital appreciation should still be a key objective for corporate bond investors

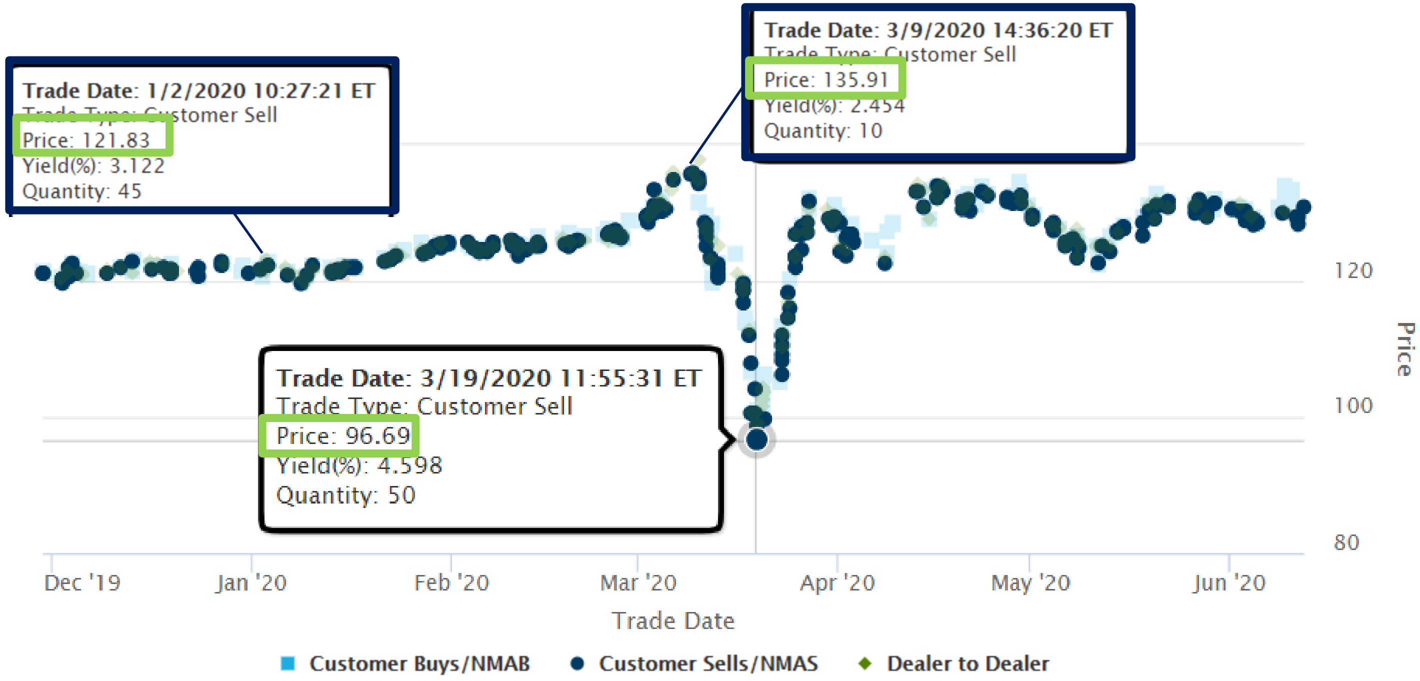
Treasury and Corporate A Yield Curve *

Treasury and Corporate Baa Yield Curve *

* Charts shown on Fidelity.com June 15, 2020 with market data provided by FactSet.

In March, there were scores of investment opportunities across even the most high-credit-quality bonds…but investors had to act quickly

Price Performance of Apple 4.375% 5/13/45*
Nov 29, 2019-June 12, 2020



For illustrative purposes only

- **March 3:** Fed Funds Rate cut by 0.50%
- **March 11:** Dow enters bear territory with 1,400-point drop
- **March 11:** Fed begins increasing balance sheet from $4.3 trillion to $7.2 trillion on June 10
- **March 15:** Fed Funds Rate cut to zero
- **March 23:** Fed announces up to $750 billion in corporate bond buying programs: PMCCF and SMCCF

To do: Have a list of 3-4 high quality bond issuers whose bonds you can buy when the overall market falters

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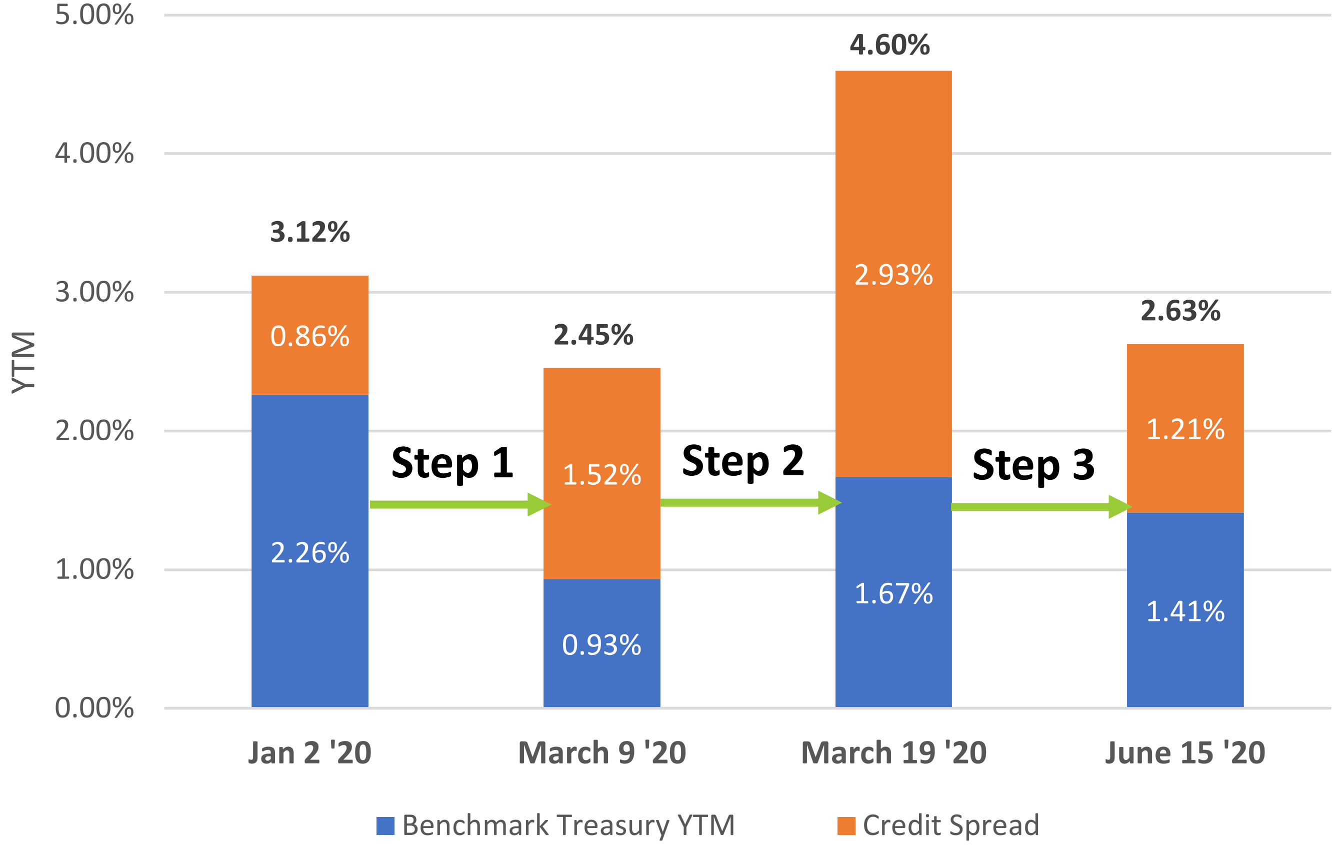
* Pricing data shown on Fidelity.com as reported to the Financial Industry Regulatory Authority (FINRA)’s Trade Reporting and Compliance Engine (TRACE).

Drivers of Changes in Apple ‘45 Bond Price

Building Blocks of Apple 4.375% ‘45 Bond Price in 2020*

Apple ‘45 Price:	121.83	135.91	96.69	131.78



- **Step 1:** Through March 9, the increase in Apple ’45’s price was driven by the Treasury rally, which was offset by an increased credit spread
- **Step 2:** The Apple bond’s credit spread nearly doubles *and* Treasury yields increase, causing a 39-point price decline
- **Step 3:** Treasurys rally *and* spreads normalize causing a 35-point rally in the Apple bond

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* Pricing data shown on Fidelity.com. Spreads provided by either Fidelity.com or calculated using US Treasury historical data.

How the Fed and Treasury Stepped in

- Apart from lowering the Fed Funds Rate and growing its balance sheet, the Fed built two credit facilities to purchase up to $750 billion in corporate bonds, loans, and ETFs
- The impact on credit spreads and issuance has been significant; however, through June 30, the Fed had only invested $8 billion (all in corporate bond ETFs)

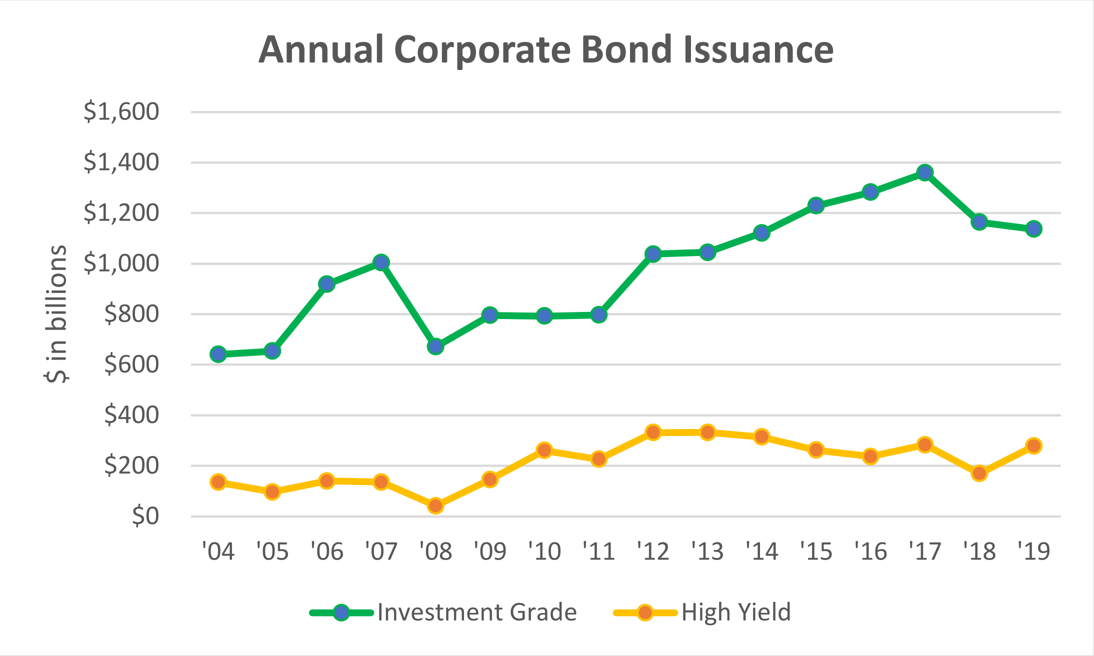
Summary Terms for the PMCCF and SMCCF

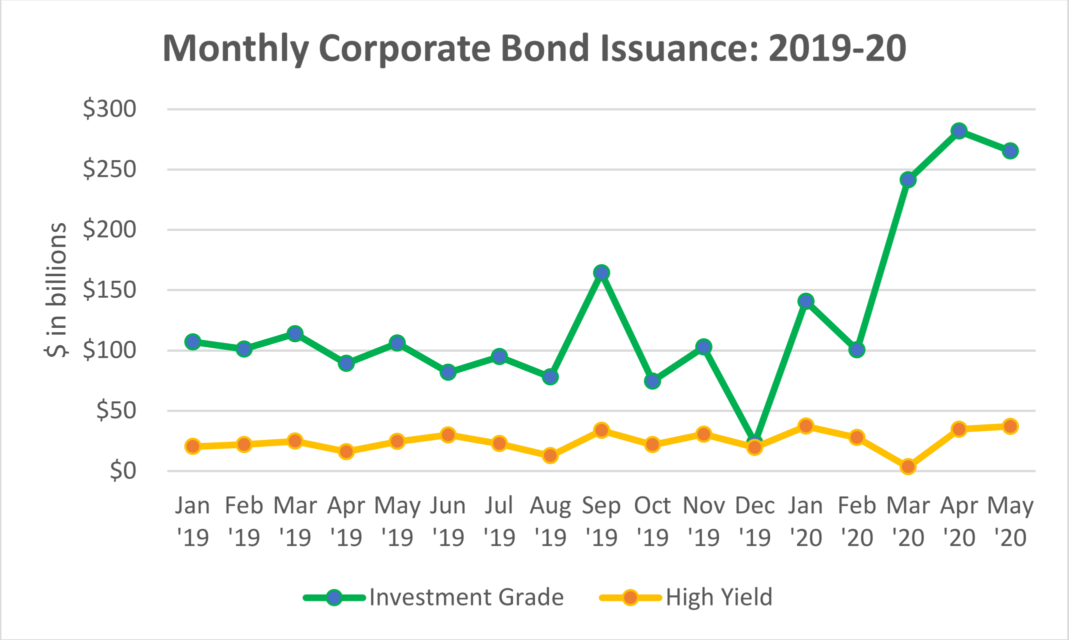
	Primary Market Corporate Credit Facility "PMCCF"	Secondary Market Corporate Credit Facility "SMCCF"
Eligible Securities	New-issue bonds and loans with maturities <= 4 years	Individual corporate bonds trading in secondary market with maturities <= 5 years and corporate bond ETFs
Minimum Rating	Baa3 / BBB- or had these ratings as of March 22 but were then downgraded to no lower than Ba3 / BB-	Same as PMCCF
US Treasury Equity Contribution	$50 billion	$25 billion
Last Date of Purchases	December 31, 2020	December 31, 2020
Status	No transactions through June 30	Purchased $8 billion in corporate bond ETFs and $1.5 billion in corporate bonds through June 30

Source: US Federal Reserve

“If the Fed Builds It, They Will Come”

- The Fed’s actions increased confidence in the credit markets, which has driven lower credit spreads and record corporate bond issuance from March through May 2020
- There was $788 billion of investment-grade US corporate bond issuance from March to May 2020 compared to $1.1 trillion for all of 2019





Source: SIFMA bond issuance data

Good BBB vs. Bad BBB

Many market gurus have warned about lurking trouble in BBB-rated corporate bonds, but it's important to understand that not all BBB bonds are created equal

- Kroger and Anheuser-Busch InBev (AB InBev) have very similar ratings; however, Kroger has much stronger financials
- Kroger represents what an investment-grade issuer should be: a very strong business with leverage less than 3x
- AB InBev has 5.1x leverage* and weak performance in wake of COVID-19
- Investors doing their homework can find opportunities where a bond issuer's credit risk is not aligned with its bond rating

Kroger vs. AB InBev Financials *

$ in millions	**Kroger**	**Anheuser-Busch InBev**
June 15 '20 Rating	Baa1 / BBB	Baa1 / BBB+
Cash	$2,726	$7,169
Total Debt	**$12,603**	**$100,949**
Revenue (Last 12 Months)	$126,584	$51,108
EBITDA (Last 12 Months)	**$6,028**	**$19,903**
Leverage Ratio	2.1x	5.1x
Q1 '20 Growth		
Revenue	11.5%	-10.0%
EBITDA	25.2%	-17.7%
Credit Spread (June 26, 2020)**		
2029 Bond	1.05%	1.49%
2046 Bond	1.78%	2.23%

EBITDA – Earnings before income, tax, depreciation and amortization

* AB InBev balance sheet data are as of 12/31/19 while its income statement figures are through 3/31/20. Kroger's financials are for the period ending 5/23/20
** Credit spread data shown on Fidelity.com.

Why Kroger and AB InBev Have Similar Ratings

- Based on industry, Moody's and S&P weigh different factors to determine a corporate bond's rating
- Since "Leverage and Coverage" only comprise 30% of AB InBev's rating, the other factors inflate its rating, which results, in our view, an undeserving Baa1 Moody's rating for the company

Moody's Weightings: Retail Industry

Factor	Factor Weighting	Sub-Factor	Sub-Factor Weighting
Scale	10%	Revenue	10%
Business Profile	30%	Stability of Product	10%
		Execution and Competitive Position	20%
Leverage and Coverage	45%	EBIT / Interest Expense	15%
		Retained Cash Flow / Net Debt	15%
		Debt/EBITDA	15%
Financial Policy	15%	Financial Policy	15%
Total	**100%**	**Total**	**100%**

Moody's Weightings: Alcoholic Beverage Industry

Factor	Factor Weighting	Sub-factor	Sub-factor Weighting
Scale	15%	Revenue (USD Billion)	15%
Business Profile	32.5%	Diversification and Exposure to Riskier Markets	10%
		Category / Brand Strength and Diversification	7.5%
		Global Industry Position	7.5%
		Innovation, Distribution and Infrastructure	7.5%
Profitability	7.5%	EBITA Margin	7.5%
Leverage and Coverage	30%	RCF / Net Debt	10%
		Debt / EBITDA	12.5%
		EBIT / Interest Expense	7.5%
Financial Policy	15%	--*	15%
Total	**100%**		**100%**

**This factor has no sub-factors.*

Source: Moody's Investors Service

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Macy's: Before and After COVID-19

The Fed's action has kept new debt issuance robust; however, the risk to bondholders has materially increased for many issuers such as Macy's

$ in millions

	Feb 2, 2019	Feb 1, 2020	May 2, 2020
Cash	$1,162	$685	$1,523
Senior Debt			
Total Capacity	$1,500	$1,500	$1,500
Outstanding	-	-	1,500
Bonds	$4,664	$3,601	$4,157
Total Debt	$4,664	$3,601	$5,657
Last 12 Months' EBITDA	$2,877	$2,336	$1,200
Leverage Ratio	1.6x	1.5x	4.7x
Net Leverage Ratio	1.2x	1.2x	3.4x

1 Macy's had paid down $1 billion in debt during fiscal 2019, which enabled it to reduce leverage in spite of weaker operating performance

2 On Feb 1, 2020, there was no debt senior to the $3.6 billion of unsecured bonds

3 Macy's draws down $1.5 billion credit facility, which is senior to unsecured bonds

4 This increase in senior debt and substantial EBITDA decline has vastly increased the risk of owning Macy's unsecured bonds

Source: Macy's SEC filings and earnings releases

A Chapter 11 Case Study: Monitronics

COVID-19 caused many companies to seemingly file for Chapter 11 overnight; however, it often takes longer to play out, as shown in the case of Monitronics' Chapter 11 filing

- Monitronics ("Moni"), a home-security company, had made attempts to improve its business; however, its performance began waning in 2018
- Its $585 million of 9 1/8% 4/1/20 bonds were subject to a 'springing maturity' of the company's senior loans and needed to be refinanced by October 3, 2019
- The company tried effecting restructurings during 2018 but was not successful
- Trading activity increased during Q3 '18, which enabled investors to sell at a reasonable price
- Moni filed for Chapter 11 on July 1, 2019, but, since it had restructuring plan approval from debtholders, it emerged on August 30, 2019

Monitronics 9 1/8% 4/1/20 Price Chart

Sources: FINRA market data, company SEC filings and news releases

Monitronics Debtholder Recoveries

Moni's senior debtholders made out okay; however, this caused the bondholders to be left with minimal recoveries, which were primarily in the form of stock of the new company

Monitronics Chapter 11 Recovery Analysis

$ in millions	As of 7/1/19 Chapter 11 Filing	As of 8/30/19 Emergence from Chapter 11		Recovery
Debtor-in-Possession "DIP" Financing	**$245**			
Successor Senior Debt				
Successor Revolving Facility (Undrawn)		$145		
Successor Term Loans		**$150**	("A")	
Pre-Filing Term Loans	**$1,073**			
Cash		$150		
Fair Value NewCo Shares		$100		
New Term Loans		**$823**	("B")	
TOTAL		$1,073		100%
Pre-Filing Senior Notes	**$585**			
Fair Value NewCo Shares		$75		
Cash		$2		
TOTAL		$77		13.2%
Total Debt	**$1,903**	**$973**	(A+B)	

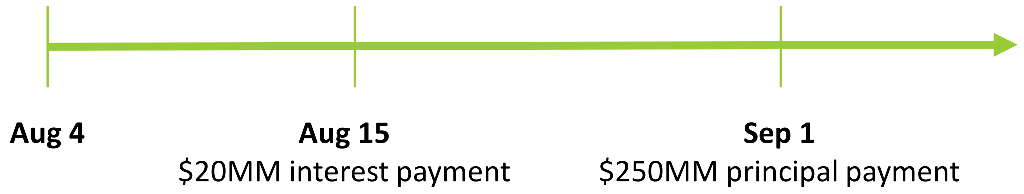
Source: Company SEC filings and news releases

Restructuring 'Reader's Digest' Version:

- Value of company is agreed upon
- Level of post-restructuring debt is agreed upon
- Senior debt gets first claim on keeping debt in the company or receiving cash
- Company will seek to eliminate portions of debt so it has a higher chance of survival
- Junior debt may receive a portion of cash and stock in new company (but not always)

‘Best Practices’ During Unprecedented Times

- Focus on companies with reasonable leverage (ideally 4x and less depending on company)
- Monitor, monitor, monitor, as the fortunes of companies are rapidly changing
- Know what amount of debt is senior to unsecured bondholders
- Have a list of 3-4 bonds with the highest credit quality you can buy more of in the event of a large market correction
- Be extremely disciplined following large run-ups in bond prices
  - “There are no called strikes in investing” – Warren Buffett
- Limit industry concentration
- In hard-hit industries, weigh an issuer’s ‘cash runway’ with how it is turning the corner
- In more speculative investments, lay out the upcoming principal and interest payments and invest *after* these are made



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Thank you and stay well

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