

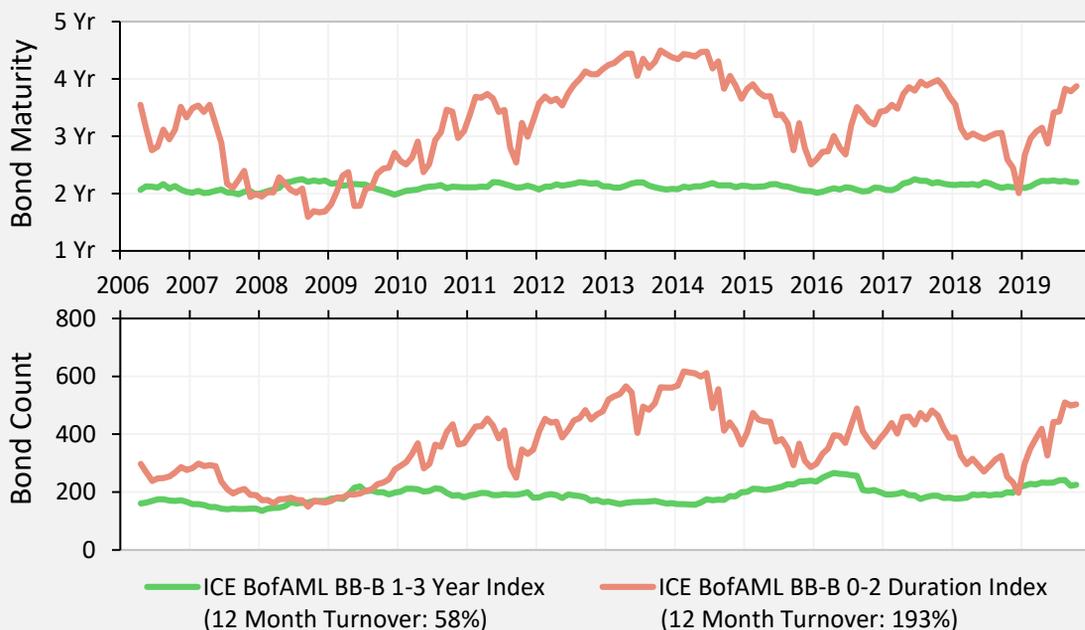
Short Duration's Trojan Horse

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Long maturity bonds often masquerade as short duration. With a minor price change, a short duration bond with a long maturity typically becomes long duration. This reveals far more risk than originally indicated, yet the risk was present all along.

We believe the solution is simple yet almost universally ignored. Define the short duration universe in terms of *maturity*, not *duration*. Price changes do not impact maturities, which are on a fixed horizon. The result is a less volatile group of true short duration bonds, with the potential for more consistent fundamentals and lower turnover.

Short Maturity vs Short Duration High Yield Bond Methodology



As of 10/31/2019. Source: Bloomberg.

For example, Equinix corporate bonds (5.75%, 1/1/2025) recently opened at \$105.25 with a duration of 1.8 years, closing the same day at \$103.78 and 4.2 years. No longer short duration, a duration-based index simply delists the bond. But an actual portfolio would face large transaction costs from such high turnover. More likely, a duration-based strategy would simply hold on to the bond and take excess risk. This scenario is avoidable with a maturity-based strategy, yet few managers utilize such an approach.

Short Duration High Yield Manager Statistics and Returns

Trailing Returns (Net of Fees) as of 9/30/2019



Strategy	% >3Y Maturity	Maturity (Yr)	Duration (Yr)	Yield (%)	3Y Return (%)
eVestment Short Duration High Yield	48.45	3.10	1.38	5.12	4.78
ICE BofAML BB-B 0-2 Duration Index	59.72	3.79	1.29	5.07	4.28
ICE BofAML BB-B 1-3 Year Index	0.00	2.20	1.46	5.14	5.15

As of 9/30/2019. Source: eVestment, Bloomberg. Universe: eVestment Short Duration High Yield SMA (52 Strategies).

Active short duration high yield managers can reduce volatility and improve alpha potential by focusing on true duration risk reduction, not stated duration reduction. However, this requires insight, discipline, and capacity constraint. The BB-B 1-3 year market consists of only 222 bonds (\$148bn*) vs the BB-B 0-2 duration index 499 bonds (\$357bn). Large and/or undisciplined short duration strategies often expand to longer maturities and lower ratings to chase higher yield and target more bonds.

For more info on short duration BB-B bonds, [our research can be found here](#).

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The ICE BofA ML US HY Cash Pay BB-B Rated 1-3 Year Index is a subset of The Bank of America Merrill Lynch US Cash Pay High Yield Index, which tracks the performance of non-investment-grade corporate bonds with a remaining term to final maturity less than three years and rated BB-B. The ICE BofA ML US HY Cash Pay BB-B Rated 0-2 Year Index tracks the performance of non-investment-grade corporate bonds with a duration of less than two years and rated BB-B. A copy of Penn Capital's current written disclosure statement discussing our advisory services and fees is available upon request.

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