Attractive Yield Opportunities in Illiquid and Liquid Alternative Credit Assets

February 2018

In today's market, where we find richly valued domestic public equities, tight credit spreads and low yields in traditional fixed income, we believe investment opportunities in alternative credit are particularly attractive against the backdrop of a strong and improving economy with the prospect of rising interest rates. In our view, alternative credit, both illiquid and liquid assets, can fulfill the needs of investors searching for high current income and attractive total risk-adjusted returns with downside protection. Unlike many traditional asset classes, various alternative credit asset classes offer the opportunity to earn less volatile total returns of 5% to 15%,[i] depending on the liquidity requirements and leverage requests of the investor. They not only provide high current income as a percentage of total return, but many alternative credit asset classes are also likely to benefit from a rising interest rate environment. As we will show, these alternative credit strategies are typically accessed through a variety of vehicles – commingled funds, separately managed accounts and publicly traded entities.

Alternative Credit Strategies*	Target Return**
Direct Lending Assets – including Business Development Companies / ARCC (NASDAQ)	5–14%
Commercial Real Estate First Mortgage Assets – including Commercial Mortgage REITs / ACRE (NYSE)	4–10%
Bank Loans & High Yield Bonds — including Closed End Funds / ARDC (NYSE)	4–7%
Structured Credit Assets:	
Public Asset-Backed Investing	5–15%
Private Asset-Backed Investing	8–15%

** Represents sample investment products managed by Ares Management LLC and its affiliated manager. These materials neither constitute an offer to sell nor a solicitation to purchase any security of Ares Management L.P. or the referenced funds the purchase or sale of which may only be made by means of definitive offering materials.*
*** Approximate targeted returns for asset classes shown above.[ii] Certain strategies include the use of leverage. There is no assurance that targeted returns can or will be achieved.*

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Asia/Australia Shanghai, Hong Kong, Chengdu, Sydney

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Market Outlook

In 2017, improving economic conditions, rising corporate earnings, highly accommodative monetary policy and modest inflation expectations provided a safe environment for risk assets, resulting in strong inflows and further spread tightening in most credit assets. Today, economic growth is improving, the forward LIBOR curve projects that short-term rates will remain low by historical standards[iii] and default rates will stay below average levels. We also expect an active mergers and acquisition environment, driven by an abundance of capital, tax reform, less regulation and functional capital markets. Taken together, we expect alternative credit products to be well positioned to benefit from these market forces. In fact, most alternative credit products may disproportionately benefit from a rising rate environment compared to other traditional fixed income investments.

> *"The full effects of recent tax reform remain to be seen, but we believe the majority of companies are set to benefit from the new legislation."*

The full effects of recent tax reform remain to be seen, but we believe the majority of companies are set to benefit from the new legislation. Even without taking into account the expected GDP growth from tax reform that should drive top line revenues, the benefits of lower corporate tax rates and immediate expensing of capital expenditures should outweigh the costs of interest expense limitations for most companies.

What key risks are there to our fundamental outlook in 2018? Elevated asset prices, shifting monetary policy, sector earnings divergence, potential for external global shocks or higher than expected inflation headline our list. To that end, we believe manager selection and an appropriate investment strategy will be critical in order to successfully navigate any potential shifts in market dynamics. We expect a significant divergence of returns from manager to manager.

Direct Lending

Direct lending describes a transaction where a lending source *directly* provides a loan to a borrower without the use of an intermediary. This is accomplished by going straight to the private equity sponsors or owner / operators of middle market companies, commercial projects or commercial real estate. Middle market corporate direct lending has emerged as an attractive asset class among institutional and retail investors and generally offers:

- Flexible strategies across the capital structure;
- Greater structural protections;
- Attractive current income;
- Favorable risk-adjusted returns; and
- Insulation from broader market volatility.

The market opportunity for this asset class has evolved over the last several decades as banks have reduced their willingness to originate and hold significant amounts of leveraged loans to middle market companies[iv] due to consolidation, earnings pressure and heightened regulatory challenges.

The ability to directly originate a loan is an important attribute as this active role provides for greater structuring flexibility, influence over terms and post-closing control, while providing investors a strong current yield and illiquidity spread premium relative to other more liquid, traditional investments. A self-origination strategy results in better access to senior management, a more robust due diligence process and can lead to superior portfolio management and credit performance. Moreover, directly originated middle market loans may reduce risk through protective structural terms and maintenance covenants. As a result, these loans to middle market companies can offer attractive relative value, when compared with liquid, tradable credit.

> *"Direct loans can provide relatively high absolute all-in returns of 6%–14% without leverage, with reduced market correlation, lower volatility and lower net credit losses."*

U.S. and European Targeted Middle Market Returns by Product

Note: The below targeted returns are estimated market pricing in the U.S. and Europe.

	United States		Europe	
	Pricing	**Effective Yield***	**Pricing**	**Effective Yield***
Senior 1st Lien	L + 4.00-5.00%	5%-7%	L + 6.00-6.50%	7%-8%
Unitranche	L + 5.00-6.50%	7%-9%	L + 6.75-7.50%	8%-9%
2nd Lien	L + 7.75-9.50%	10%-12%	L + 7.50-8.50%	9%-10%
Subordinated	L + 9.50%-11.50%	12%-14%	L + 10.0%-12.00%	12%-14%
	* Assumes fees of 2-3%, 3 month LIBOR of 1.7% and amortizes fees over three years		* Assumes fees of 3-3.5%, 3 month GBP LIBOR of 0.5% and amortizes fees over three years	

The flexibility to invest across the corporate capital structure – senior loans, unitranche loans, second lien loans, subordinated loans – provides the manager with the ability to capitalize on investments that offer attractive relative value in comparison to their fundamental credit risk profile. In the current rising interest rate environment in the U.S., floating rate senior, unitranche and second lien loans to middle market companies (EBITDA $10 million to $150 million) offer meaningful current income with downside protection. While the default environment is expected to remain benign during 2018 and recent tax reform is viewed as a net positive for most middle market companies, intensive credit selection will continue to be the highest priority.

Alternatively, the European Direct Lending market is less mature when compared to the U.S. market, as alternative lenders began to emerge only in reaction to the 2007/2008 Global Financial Crisis ("GFC"). Bank consolidation and nationalization during the credit cycle resulted in an overall reduction in the supply of leveraged credit to the middle market. This trend has accelerated in the last five years and banks are estimated to account for ~50% of the total market today.[v] We believe that regulatory pressures will continue to impact banks' appetite to participate in the market, while institutional lenders will continue to fill the gap, following the U.S. trend. In addition, the European market has historically been much more dependent on bank lending relative to the U.S., as there are generally no other available European sources of middle market credit such as CLOs, BDCs, etc., which exist in the U.S. market. In our view, the most attractive relative value in the European market is in first and second lien loans.

From an investor's perspective, direct lending can provide relatively high absolute all in returns of 6–14% (without leverage) with reduced market correlation and lower volatility. Direct lending investments produce different sources of returns that can lead to consistent income generation, including upfront origination fees, stated coupons, fees from call protection, LIBOR floors and other return drivers. As an asset class, default rates for middle market direct loans have generally averaged less than 2%,[vi] which implies a net annual credit loss rate of less than 1%.[vii]

There have been numerous new entrants in recent years, which have intensified competition and resulted in modest yield compression. However, many of these new entrants have small funds lacking the scale to compete for the best transactions and offer a fully bought solution. Our indications seem to demonstrate that new entrants are competing to lead deals in the smaller end of the market (e.g., sub-$20mm EBITDA borrowers) and generally participating in larger deals by purchasing loans from scaled, more experienced direct lending managers.

Business Development Companies

The most liquid instrument that provides access to direct lending investing is through a Business Development Company ("BDC"). BDCs are generally public investment companies that trade on exchanges with equity securities that are freely tradeable. With current dividend yields in the 8%-10% range,[viii] BDCs operate as a special type of closed-end fund that typically make direct loans and small equity co-investments to middle market companies and pass through the net income untaxed to shareholders. BDCs use modest leverage (required to maintain a debt to equity of less than 1:1) to earn a return on equity of approximately 8% to 11%[ix] through net interest income and fees less expenses, with such returns being paid to shareholders as cash dividends on a quarterly or monthly basis. Since BDCs predominately make floating rate loans, earnings and dividends

should benefit from rising LIBOR rates and we believe the BDC industry should perform well in a rising rate environment. In addition, BDCs are credit sensitive investments, which should benefit from a low default environment and a healthy, growing economy in the U.S.

Attractive BDC Characteristics & Potential Catalysts:

- *Attractive and Well Supported Dividend Yields:* Currently BDCs offer attractive dividend yields ranging from 8-10%. Many BDCs fully earn their dividends from net investment income or core earnings
- *Current Valuations Support Attractive Entry Point:* Currently, the average BDC trades at 95% of the most recent book value, which is an attractive entry point relative to the historical average price to book valuation of 103%[x]
- *Potential Regulatory Tailwinds:* In November 2017, the House Financial Services Committee approved the Small Business Credit Availability Act by an overwhelming bipartisan majority. In January 2018, the Senate introduced an almost identical bill. The Small Business Credit Availability Act would modestly ease leverage restrictions and streamline BDC reporting and disclosure requirements. If the bill becomes law, it could result in potentially higher profitability for BDCs through the use of higher leverage, and lower portfolio risk as BDCs increasingly focus on higher quality, senior loans.

There are more than 50 publicly traded BDCs in the U.S. with aggregate market capitalization in excess of $30 billion and assets greater than $65 billion.[xi]

Ares Capital Corporation

Ares Management externally manages the largest BDC in the U.S., Ares Capital Corporation (NASDAQ: ARCC), which has a market capitalization of approximately $7.0 billion with assets of approximately $12 billion. Having invested more than $44 billion since inception, ARCC directly originates a variety of direct loans to middle market companies across the U.S. ARCC has a highly diversified investment portfolio predominantly in direct loans to over 300 middle market companies in defensive, cycle-durable industries. It has a dividend yield of 9.3% and trades at 99% of its net asset value based on its closing price on 1/26/2018 of $16.28 per share. Since its IPO in 2004 through 2017, ARCC has paid $19.83 per share in dividends and has generated a 12% average annualized total shareholder return.

Asset Based Lending / Commercial Finance

Asset-based lending ("ABL") is a type of senior secured lending which is supported by collateral (assets). The amount of the loan is typically governed by a borrowing base, which is dependent upon the value of the underlying collateral, not the company or its cash flow. Common asset types that secure an ABL facility include accounts receivable, inventory, machinery and equipment, and real estate. ABL facilities are typically the senior-most position in the capital structure and have several inherent structural protections – the loan amount is dynamic and governed by the value of the underlying assets in the borrowing base (determined by periodic field exams and asset appraisals), and accounts receivable collections are typically remitted directly to the manager via a lockbox, which provides visibility into borrower performance and provides effective risk controls through regular monitoring of cash receipts.

The collateralized nature of ABL allows managers to make high quality loans to companies in transition or that are not easily financed by banking institutions. An asset-based strategy seeks to generate 9-10% asset level returns,[xii] which are generally derived from current income generated from net interest and fee income less expenses. Since these loans are typically made with a loan spread over a floating base rate such as LIBOR, the fund strategy may benefit from rising interest rates. In addition, a strengthening economy may also serve to reduce any credit losses that the strategy may experience.

> *"The collateralized nature of ABL allows managers to make high quality loans to companies in transition or that are not easily financed by banking institutions."*

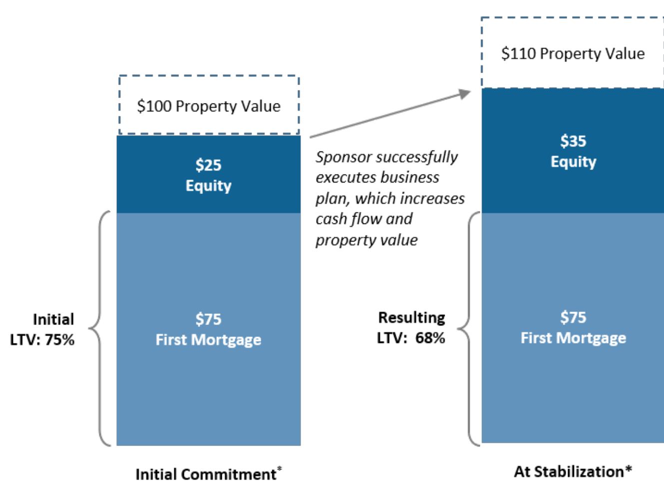
Commercial Real Estate ("CRE") First Mortgage Lending

CRE first mortgage loans are secured by a first lien on commercial property, such as offices, retail, multifamily, industrial and hospitality. First mortgage loans are senior in the capital structure, protected by the borrower's equity, and can be structured to provide further principal and yield protection through loan covenants. We believe that first mortgages are an attractive addition to investor portfolios due to:

- High and predictable current income
- "Hard asset" backing
- Low correlation to public equities

We believe investing in CRE floating-rate first mortgages, in particular, offers attractive relative value. In addition to the attributes highlighted above, the floating-rate nature and often shorter average maturity of 2-3 years of these investments offers a hedge to inflation and rising interest rates. Notably, the attractive risk-adjusted returns for floating-rate CRE first-mortgages can be enhanced by lending to properties whose underlying value and cash flow increases as the borrower executes its property-level business plan. Current prospective loan-level returns range from 4% for a first mortgage secured by a core, stabilized property, and can be structured for returns upward of 10%+ on a first mortgage secured by property requiring transition.[xiii]

The following chart demonstrates how successful execution of a property-level business de-levers a CRE first mortgage position, thereby enhancing risk-adjusted returns.



* For illustrative purposes only. Not intended to represent an actual investment.

The U.S. macroeconomic landscape as well as property and capital market fundamentals are favorable to execute a CRE first mortgage investment strategy. The current economic cycle remains in an expansionary phase with relatively slow but steady growth patterns throughout the recovery. At the same time, U.S. real estate market fundamentals are healthy based on supportive macroeconomic conditions as GDP growth, accommodative monetary policy, and strong labor market conditions are supportive for rental growth. Importantly, demand for U.S. commercial real estate remains strong, the market has seen only moderate levels of supply additions, and the current lender universe is balanced.

Healthy U.S. property market fundamentals support compelling investment opportunities to lend to high-quality commercial real estate. Approximately $1.1 trillion U.S. commercial real estate loans will come due over the next three years and support continued demand for real estate financing.[xiv] In addition, private equity real estate managers are sitting on record amounts of un-called capital which will likely drive acquisitions activity and the need for real estate financing.[xv]

At the same time, traditional lending institutions, such as banks and CMBS participants have pulled back significantly from the $4 trillion[xvi] real estate lending market. Regulatory demands on U.S. and foreign banks (e.g. Basel III and Dodd-Frank Act) have increased required capital charges against certain types of real estate debt investments. As a result, these institutions have become less active in the real estate debt market. In addition, the CMBS market has shrunk 67% from 2007 to 2017 and new issuance is expected to continue to be muted as CMBS lenders grapple with recently implemented risk-retention rules. Consequently, non-traditional lenders such as mortgage REITs and private funds have and will continue to gain market share, expanding the channels through which investors can access this private commercial real estate debt market and gain exposure to the attractive investment attributes offered by commercial real estate first mortgages.

Commercial Mortgage REITs

Commercial mortgage REITs are pass-through vehicles that invest in senior and junior mortgage loans, and in some instances, preferred securities or equity, backed by owners and sponsors of commercial real estate properties. While there is robust demand from borrowers for transitional assets and significant available capital for investment in real estate private equity, traditional lenders have tightened their standards in

response to increased regulations and years of consolidation. As a result, there is a positive supply-demand outlook in the real estate market that is driving demand and a shift in market share toward alternative lenders, many of which operate Commercial Mortgage REITs.

We believe commercial mortgage REITs are an attractive vehicle for investors seeking high current income with the use of modest leverage as the built-in distribution requirements can enhance dividends paid to investors. Commercial mortgage REITs typically generate a return on equity ranging from 8-10% and then distribute most, if not all, of those profits in the form of pass-through dividends to shareholders. Net credit losses for the commercial mortgage REITs that have become public companies since the GFC have been minimal.[xvii] Commercial mortgage REITs are well positioned to benefit from a rising interest rate environment given that the vast majority of the loans in their portfolios are floating rate. As a result, many of the commercial mortgages REITs are expected to experience an increase in earnings per share as LIBOR increases.

In addition, under the recently passed tax legislation, REIT investors are able to deduct 20% of the income received in the form of dividends, with the remainder of the income taxed at the filer's marginal rate. For example, shareholders that pay an income tax rate of 39.6%[xviii] on dividends received would pay 29.6% after the deduction.

Ares Commercial Real Estate Corporation

Externally managed by Ares Management, Ares Commercial Real Estate Corporation (NYSE: ACRE) is a commercial mortgage REIT that directly originates flexible loans to sponsors and owners of commercial real estate. Since its IPO in 2012, the company has invested more than $3.6 billion in loans without any impairments.[xix] With a diversified portfolio of approximately $1.6 billion in loans, ACRE focuses on senior, floating rate loans to institutional quality properties in the top 50 markets in the U.S. ACRE has a market capitalization of approximately $375 million with a current dividend yield of 8.2% based on its closing price on 1/26/18 of $13.08 per share.

Syndicated Floating Rate Bank Loans & High Yield Bonds

Syndicated leveraged loans and high yield bonds are issued by companies that are rated below investment grade, but offer higher potential risk adjusted returns. Syndicated loans and high yield bonds are traded securities in the liquid portion of the alternative credit market.

- *Syndicated bank loans* are typically secured by assets and pay a floating rate coupon of approximately LIBOR plus 3% or more.
- *High yield bonds* are typically unsecured obligations (junior to bank loans in the capital structure) and pay a fixed coupon, generally higher than that of bank loans to reflect the subordination risk.

During 2017, the high yield market returned 7.5%, following a stout 17.5% in 2016.[xx] Investors were again rewarded for an aggressive risk posture, with CCC rated bonds leading the way by delivering 10.6% for 2017.[xxi] In the leveraged loan market, returns have been similarly solid, coming in at 4.3%, led by a 7.4% return from the lower tier part of the market.[xxii] Improving economic conditions, rising earnings, highly accommodative monetary policy and falling inflation expectations provided a near ideal cocktail for fixed income investing.

Looking ahead, we see a favorable market landscape for liquid credit from a fundamental perspective. Economic growth continues to improve with estimates for both corporate earnings growth and global GDP expansion being revised higher. Inflation is relatively benign and the Federal Reserve continues to display patience with respect to its plans for tightening monetary policy. Real interest rates are slightly negative at the front end of the curve and are expected to be slightly positive by the end of 2018. We believe this should sustain a highly accommodative liquidity environment and support another year of solid returns for the liquid credit markets.

Based on our positive outlook for strengthening economic growth against fairly tight current spread levels, we expect all-in returns for high yield bonds to average approximately 5%[xxiii]. Our view is supported by expectations of below average default rates and improving corporate earnings, but balanced against already tight spread levels and the potential for greater volatility in the year ahead. We believe a 5% total return expectation is conservative, but still represents solid relative value given the balanced risks and the relative liquidity provided to investors.

Similarly, we expect leveraged loans to generate returns of approximately 4%+ for 2018.[xxiv] Our return expectations, which factor in rate increases of approximately 75 basis points for LIBOR, are supported by our bias for continued tight credit spreads and a benign default outlook. Importantly, we believe credit selection and active management will be of utmost importance in the upcoming year, and we favor a credit neutral bias with select catalyst driven total return ideas.

Closed End Funds / Ares Dynamic Credit Allocation

Investors can access a dynamically managed strategy in these asset classes through publicly traded closed end funds that use a modest amount of leverage.

Externally managed by Ares Management, Ares Dynamic Credit Allocation Fund (NYSE: ARDC) is a closed end management investment company that seeks to provide an attractive level of total return, primarily through current income and, secondarily, through capital appreciation.[xxv] The Fund invests primarily in a broad, dynamically managed portfolio of senior secured bank loans made primarily to companies whose debt is rated below investment grade, corporate bonds that are primarily high yield issues rated below investment grade, and other fixed-income instruments of a similar nature that may be represented by derivatives and securities of CLOs.

Since inception through December 31, 2017, ARDC has returned 6.39% to investors based on net asset value. The Fund has a distribution rate of 7.88% as of the closing share price on 1/26/2018 and has approximately $600 million in assets under management (based on market values as of 12/31/17 and includes leverage).[xxvi]

Structured Credit[xxvii]

Structured credit offers investors an opportunity defined by high current income, an attractive risk-adjusted return and risk profile, and low performance correlation to traditional asset strategies.[xxviii] There are two different strategies in structured credit to highlight:

- Public asset-backed investing through Collateralized Loan Obligation ("CLO") debt and equity securities
- Self-originated private asset-backed investments

Public Asset-Backed Investing

A CLO is a type of loan fund that provides investors with exposure to actively managed, diversified portfolios of senior secured corporate loans on a leveraged basis. The CLO investing strategy is focused on CLO debt and equity investments in the U.S. and Europe and seeks to deliver investors a high level of current income and realize long term capital gains. The strategy seeks to maximize potential risk-adjusted returns by investing up and down a CLO's capital structure within ratings targets as market opportunities and relative value shift. Target asset level returns for this strategy range from 5% for investments in senior CLO securities to 15%+ for more opportunistic equity and junior debt investments.[xxix]

We believe the backdrop of solid credit fundamentals, rising LIBOR rates, and episodic volatility present opportunities for both CLO debt and equity investors to capture value. Rising LIBOR rates provide CLO debt investors an attractive, long-dated, floating rate investment that offers a yield and coupon premium to comparably-rated corporate bonds and ABS securities. CLO debt spreads (especially AAA CLO spreads) have meaningfully declined, creating an attractive opportunity in the primary CLO equity market to capture and lock in low CLO financing costs. Volatility, primary market supply technicals and other exogenous factors have tended to introduce shifts in relative value and create market inefficiencies, presenting opportunities to capture excess returns.

We anticipate a strong start to the year with a continuation of spread tightening, refinancing activity and an active primary market. We expect to see continued demand for floating rate assets, including CLO securities. We believe owning long-tenor investment grade rated floating rate assets such as investment grade CLO debt securities, is one of the most attractive 'interest rate plays' available in the market today.

> *"Most alternative credit products may disproportionally benefit from a rising rate environment compared to other traditional fixed income investments."*

Private Asset-Backed Investing

As with directly originated investments, these privately negotiated transactions can preserve risk premiums compared to buying broadly syndicated transactions. A private asset-backed investing strategy provides funding solutions to established specialty finance companies across multiple asset classes and select geographies. Private asset-backed investments can offer downside protection, given ample levels of credit enhancement and robust covenant packages, and returns are typically less correlated to the broader credit market. The strategy has a value-based investment orientation with a focus on identifying attractive risk-adjusted returns. Target returns for this strategy range from 8% for senior (1st lien) investments to 15%+ for equity (asset acquisitions).[xxx]

The private asset-backed market has existed for over twenty years. Recent events have created a potentially large and attractive opportunity defined by (a) continued dislocation of capital that began with the GFC and (b) a sweeping set of new regulations that traditional lenders now face that create significant economic and regulatory barriers to entry/re-entry.[xxxi] As a consequence, specialty finance companies began searching for alternative sources of funding. The sector also experienced significant inflows of capital from private equity fund managers as they saw an opportunity to take market share from banks and other traditional lenders. The public asset-backed securities market has contracted post-crisis and is now focused on the largest liquid issuers, providing early mover opportunities to invest with counterparties prior to accessing the public market.

The landscape and market environment we now see is bigger in scope and size than at any previous time. We believe this opportunity will remain attractive largely because it represents a specialization that relatively few investors have. We believe the overall macroeconomic and market outlook continues to be supportive for private asset-backed investing and will continue to generate significant investment opportunities across the capital structure.

Conclusion

Under current economic and market conditions, we believe the alternative credit products outlined are particularly well positioned to generate attractive total return opportunities across the risk spectrum. The alternative credit products in this paper can be accessed through a variety of vehicles — commingled funds, separately managed accounts and publicly traded entities. These investments can provide a high component of current return and may be attractive for investors considering alternatives to traditional fixed income investments.

About Ares Management, L.P.

Ares Management, L.P. is a publicly traded, leading global alternative asset manager with approximately $106 billion of assets under management as of September 30, 2017 and more than 15 offices in the United States, Europe and Asia.[xxxii] Since its inception in 1997, Ares has adhered to a disciplined investment philosophy that focuses on delivering strong risk-adjusted investment returns throughout market cycles. Ares believes each of its three distinct but complementary investment groups in Credit, Private Equity and Real Estate is a market leader based on assets under management and investment performance. Ares was built upon the fundamental principle that each group benefits from being part of the greater whole. For more information, visit **www.aresmgmt.com**.

Ares Credit Group

The Ares Credit Group is a leading manager of credit strategies across the non-investment grade credit universe, with more than $70 billion of assets under management and approximately 140 funds as of September 30, 2017. We offer a range of investment strategies across the liquid and illiquid credit spectrum. We provide investors access to our broad credit capabilities through several vehicles, including commingled funds, separately managed accounts, publicly traded vehicles and sub-advised funds for retail investors.

Direct Lending

With more than $40 billion in direct lending AUM and over 175 investment professionals, Ares is one of the largest (non-bank) global direct lenders, managing a wide variety of direct lending investment vehicles and strategies across the U.S. and European markets. Ares' direct lending team operates out of seven office locations in the U.S. and five office locations across Europe. Since 2004, Ares has invested more than $60 billion in direct lending investments across these two markets.[xxxiii] Ares leverages its flexibility, structuring expertise and self-origination capabilities to invest across capital structures and meet the full spectrum of its clients' financing needs. Ares' broad direct origination strategy allows the team to review a significant portion of the market, resulting in a highly selective closing rate of only about 4% of transactions reviewed.

Ares Capital Corporation

Ares Capital is a leading specialty finance company that provides one-stop debt and equity financing solutions to U.S. middle market companies and power generation projects. Ares Capital originates and invests in senior secured loans, mezzanine debt and, to a lesser extent, equity investments through its national direct origination platform. Ares Capital's investment objective is to generate both current income and capital appreciation through debt and equity investments primarily in private companies. Ares Capital has elected to be regulated as a business development company ("BDC") and as of September 30, 2017, was the largest BDC by total assets and market capitalization. Ares Capital is externally managed by a subsidiary of Ares Management, L.P.

Ares Commercial Finance

Ares Commercial Finance is a strategy within Ares' U.S. Direct Lending platform providing asset-based and cash flow loans to small and middle-market companies, as well as asset-backed facilities to specialty finance companies.

Syndicated Loans and High Yield Bonds

The Ares Credit Group invests in high yield and bank loans through various commingled funds, separately managed accounts and CLO funds. The liquid credit strategies of Ares are supported by more than 37 investment professionals that cover over 1,000 companies across 60 industries.

Ares Dynamic Credit Allocation Fund

Ares Dynamic Credit Allocation Fund (NYSE: "ARDC") is a closed end management investment company that seeks to provide an attractive level of total return, primarily through current income and, secondarily, through capital appreciation.[xxxiv] The Fund invests primarily in a broad, dynamically managed portfolio of (i) senior secured loans ("Senior Loans") made primarily to companies whose debt is rated below investment grade; (ii) corporate bonds ("Corporate Bonds") that are primarily high yield issues rated below investment grade; (iii) other fixed-income instruments of a similar nature that may be represented by derivatives; and (iv) securities of collateralized loan obligations ("CLOs").

Structured Credit

Ares invests across the capital structure of syndicated collateralized loan obligation vehicles and in directly-originated asset-backed investments comprised of diversified portfolios of consumer and commercial assets. Ares' Structured Credit team, comprised of 20 seasoned investment professionals, manages over $5 billion in AUM[xxxv] across dedicated structured credit funds and other strategies.

Ares Real Estate Group

Ares' Real Estate Group manages comprehensive public and private equity and debt strategies, with approximately $10.6 billion of assets under management as of September 30, 2017. Our Real Estate Group's senior leadership averages approximately 30 years of relevant real estate investment experience. We believe our multi-asset class experience, global scale and deep property knowledge differentiate us from other investors in the real estate market.

Real Estate Debt

Our U.S. real estate debt team of approximately 20 professionals directly originates and invests in a wide range of financing opportunities for middle-market owners and operators of commercial real estate. We provide flexible financing solutions across a potential borrower's capital structure, including senior debt, subordinated debt and preferred equity. While we focus on self-originated transactions, we will also selectively pursue secondary market acquisitions and club/syndicated transactions.

Ares Commercial Real Estate Corporation

Ares Commercial Real Estate Corporation is a specialty finance company primarily engaged in originating and investing in commercial real estate loans and related investments. Through its national direct origination platform, the Company provides a broad offering of flexible and reliable financing solutions for commercial real estate owners and operators. The Company originates senior mortgage loans, as well as subordinate financings, mezzanine debt and preferred equity, with an emphasis on providing value added financing on a variety of properties located in liquid markets across the United States. Ares Commercial Real Estate Corporation elected and qualified to be taxed as a real estate investment trust and is externally managed by a subsidiary of Ares Management, L.P.

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Endnotes

[i] No guarantee target returns can be achieved.
[ii] No guarantee target returns can be achieved.
[iii] Sources: Chatham Financial as of January 24, 2018 and Standard and Poor's LCD Q4-17 Leveraged Lending Review.
[iv] In the U.S., the middle market is defined as the economic segment that is made up of companies with annual revenue between $10 million and $1 billion. Source: National Center for the Middle Market 3Q 2017 Middle Market Indicator.
[v] Source: European Banking Federation.
[vi] Source: Fitch U.S. Levered Loan Insights 2007-2016 Annual Default Rate.
[vii] Recovery rates on middle market loans are 68%. Source: Moody's 2017 Annual Default Study for period 2007–2016 for Senior Secured Loans.
[viii] Source: SNL Financial as of 1/31/2018.
[ix] Source: Company filings. Return on equity calculated as net investment income divided by average equity. Stated range inclusive of the first to third quartile return from January 1, 2015 to September 30, 2017. Based on BDCs with a market capitalization over $450 million as of December 31, 2017. Includes: ARCC, PSEC, MAIN, CCT, FSIC, CGBD, AINV, TSLX, HTGC, GBDC, NMFC, TCPC, GSBD, SLRC, OCSL, PFLT, PNNT, BKCC, TCAP.
[x] Source: SNL Financial data as of 12/31/04–12/31/17. Since December 2004, when BDCs traded between 95%-105% of book value, the average subsequent 1 year total return has been 11% and the 3 year annualized total return is nearly 14%.
[xi] Source: SNL Financial. Market capitalization as of December 31, 2017. Total assets as of September 30, 2017.
[xii] No guarantee target returns can be achieved.
[xiii] No guarantee target returns can be achieved.
[xiv] Source: Trepp, Federal Reserve 2016 and JLL Research as of December 2016.
[xv] Source: Preqin.
[xvi] Source: U.S. Federal Reserve, Mortgage Debt Outstanding as of Q3 2017.
[xvii] Source: Public commercial mortgage REIT filings from 2012–Q3 2017. Includes: ARI, ACRE, STWD, and BXMT.
[xviii] Recently enacted tax reform legislation (Public Law No. 115–97).
[xix] As of September 30, 2017.
[xx] Total returns based on the ICE BofAML U.S. High Yield Master II Index. The ICE BAML U.S. High Yield Index tracks the performance of U.S. dollar denominated below investment grade corporate debt publicly issued in the U.S. domestic market. BofA Merrill Lynch, used with permission. ICE BAMIL LICENSING THE ICE BAMIL INDICES AND RELATED DATA "AS IS," MAKES NO WARRANTIES REGARDING SAME, DOES NOT GUARANTEE THE SUITABILITY QUALITY, ACCURACY, TIMELINESS, AND/OR COMPLETENESS OF THE ICE BAML INDICES OR ANY DATA INCLUDED IN, RELATED TO, OR DERIVED THEREFROM, ASSUMES NO LIABILITY IN CONNECTION WITH THEIR USE, AND DOES NOT SPONSOR, ENDORSE, OR RECOMMEND ARES MANAGEMENT, OR ANY OF ITS PRODUCTS OR SERVICES.
[xxi] Total returns based on the ICE BofAML U.S. High Yield Master II Index. The ICE BAML U.S. High Yield Index tracks the performance of U.S. dollar denominated below investment grade corporate debt publicly issued in the U.S. domestic market. BofA Merrill Lynch, used with permission. ICE BAMIL LICENSING THE ICE BAMIL INDICES AND RELATED DATA "AS IS," MAKES NO WARRANTIES REGARDING SAME, DOES NOT GUARANTEE THE SUITABILITY QUALITY, ACCURACY, TIMELINESS, AND/OR COMPLETENESS OF THE ICE BAML INDICES OR ANY DATA INCLUDED IN, RELATED TO, OR DERIVED THEREFROM, ASSUMES NO LIABILITY IN CONNECTION WITH THEIR USE, AND DOES NOT SPONSOR, ENDORSE, OR RECOMMEND ARES MANAGEMENT, OR ANY OF ITS PRODUCTS OR SERVICES.
[xxii] Total returns based on the Credit Suisse Leveraged Loan Index.
[xxiii] There is no guarantee performance returns can be achieved.
[xxiv] There is no guarantee performance returns can be achieved.
[xxv] There can be no assurance ARDC will be able to achieve its investment objective or structure its investment portfolio as anticipated.
[xxvi] There is no guarantee performance returns can be achieved.
[xxvii] For more information on CLO investing, please see detailed whitepaper published on the Ares website.
[xxviii] The Barclays Asset-Backed Securities Index ("ABS Index") had a 0.22 10-Year correlation to the S&P 500 and 0.66 to the Credit Suisse Leveraged Loan Index ("CSLLI") as of December 31, 2017. This information is sourced from Barclay's and Credit Suisse's websites and Ares is not responsible for any historic revision made to the indices. Correlation results have been calculated using the monthly returns of the above referenced indices. The CSLLI (creditsuisse.com/indices) is an index designed to mirror the investable universe of the $US-denominated leveraged loan market. The ABS Index (index.barcap.com) is the ABS component of the Barclays U.S. Aggregate Index and has three subsectors (credit and charge cards, autos, and utility).
[xxix] There is no guarantee performance returns can be achieved.
[xxx] There is no guarantee performance returns can be achieved.
[xxxi] Based on Ares' market observations.
[xxxii] As of September 30, 2017, AUM amounts include funds managed by Ivy Hill Asset Management, L.P., a wholly owned portfolio company of Ares Capital Corporation and a registered investment adviser.
[xxxiii] As of September 30, 2017. Includes capital deployed by ARCC, the Senior Secured Loan Program ("SSLP"), the Senior Direct Lending Program ("SLDP"), funds and SMAs. For investments made through the SSLP and the SDLP, invested capital represents the total facility amount funded by the SSLP and the SDLP. Excludes capital deployed by Ares Commercial Finance and Ivy Hill Asset Management. Excludes $1.8 billion of assets acquired as part of ARCC's acquisition of Allied Capital Corporation on April 1, 2010. Excludes $2.5 billion of assets acquired as part of ARCC's acquisition of American Capital on January 3, 2017. Invested capital represents the book value of investments net of OID and syndications within one year of investment closing and excludes warrants, CLO investments, LP/vehicles and investments inherited from portfolio acquisitions. For investments made through the SSLP, invested capital represents the total facility amount funded by the SSLP. Includes the Ares portion of the ESSLP; excludes the GECFB portion of ESSLP. Converted from EUR to USD using the September 30, 2017 exchange rate.
[xxxiv] There can be no assurance ARDC will be able to achieve its investment objective or structure its investment portfolio as anticipated.
[xxxv] AUM reflects USD amount. Includes ~$4.7bn invested across dedicated structured credit funds and ~$0.9bn invested across other strategies.