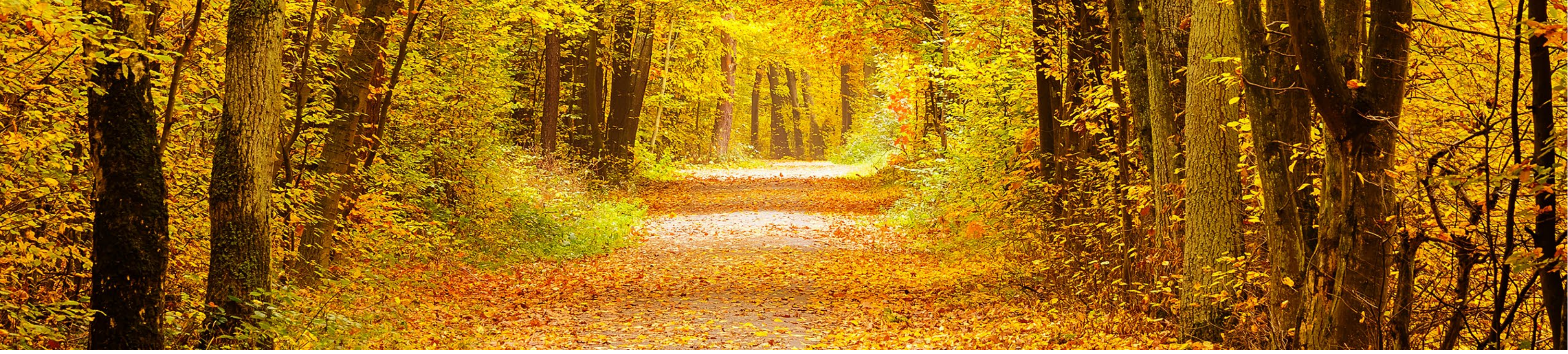


Alternative Credit – The Road Less Traveled

Spring 2020

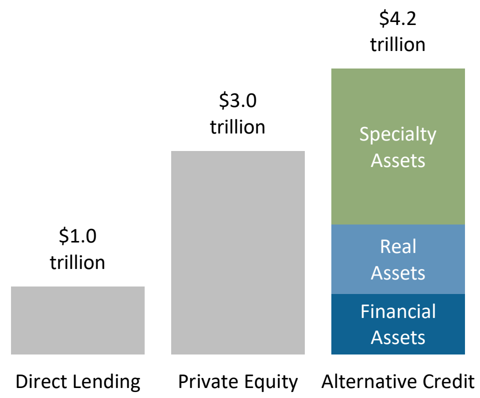
Alternative Credit has long described the spectrum of investments and sectors that exist outside of traditional markets. The development and expansion of markets can lead to the formation of new, Alternative Credit sectors. Likewise, market stresses and economic cycles can create mismatches in the supply and demand for capital thus creating opportunities for Alternative Credit investors.

Whatever the root cause, Alternative Credit investments are often aimed at filling gaps created by market inefficiencies. By providing capital solutions that traditional markets do not or cannot, Alternative Credit managers can create value and deliver attractive returns to investors – often in excess of 10%[2] – despite a credit profile that is protective of principal.

The sectors that comprise this market evolve over time. Some become large and established. Occasionally, a sector may become so well established and conventional that it 'graduates' into the realm of traditional markets where investors benefit from greater market liquidity, transparency, standardization and scalability (albeit at a lower yield premium). In fact, several credit-oriented asset classes with which investors today are very familiar initially began as newly-formed, niche Alternative Credit sectors (think: high yield corporate bonds and leveraged loans).

However, for the large majority of Alternative Credit sectors, there are inherent limits to liquidity, transparency, standardization or scale. Most sectors never institutionalize and never become efficient. Consequently, we find that the already-large Alternative Credit universe is ever expanding in size and scope.

Ares estimates that the various sectors comprising this market represent an overall investible universe of over $4 trillion in size today. To put that in context, Alternative Credit presents an investible market roughly equal in size to direct lending and private equity markets *combined* (illustrated below).[3]



Despite the large market size and potential for attractive risk-adjusted returns, we find that Alternative Credit is often underrepresented in many investors' portfolios. It thus represents a road less traveled.

In this paper we will explore the key reasons for this underrepresentation and the opportunity cost it signifies, including: greater diversification, higher returns, current income, and a profile that can increase the risk-return efficiency of credit-focused portfolios.[4]

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Please see the Endnotes and Legal Notice and Disclaimers beginning on page 8.

A CASE STUDY IN ALTERNATIVE CREDIT MARKET DEVELOPMENT

The history of Corporate Direct Lending is illustrative of the several factors that, especially in combination, can create large gaps in traditional markets. These factors have played, and continue to play, a central role in creating new sectors and sustaining today's $4+ trillion Alternative Credit market.

> *Two roads diverged in a yellow wood,*
> *And sorry I could not travel both*
> *And be one traveler, long I stood*
> *And looked down one as far as I could*
> *To where it bent in the undergrowth…*

The U.S. Corporate Direct Lending market started as a niche, Alternative Credit opportunity. It has since become so established and institutionalized that many investors today no longer refer to it as 'alternative.' It began as most Alternative Credit sectors do – a capital solution to address a gap in the credit market. In this case, the gap was first created by the wave of bank consolidations between 1990 and 2005 that consumed nearly 500 banks per year.[5]

Historically, small to mid-sized companies relied largely on regional banks for financing as they were too small to access the public debt markets. As large banks consolidated smaller banks, they turned their resources and attention toward large, public debt transactions, leaving smaller borrowers with shrinking access to financing and waning attention. The middle market became famously overlooked and underbanked… until an Alternative Credit solution was developed by non-bank institutional investors: *Corporate Direct Lending*.

The few non-bank lenders in this early market were niche operators often with industry or product specialization. They offered middle market companies an alternative source of debt capital that either complemented their bank loan or offered terms or scale they could not obtain from a small bank syndicate.

As Alternative Credit managers organized themselves around this emerging market opportunity, most investors viewed investing in middle market loans as a 'trade' rather than an asset class. That view did not last long, however. Through the mid-2000s, middle market lending activity in the U.S. steadily shifted into the hands of non-bank, Alternative Credit managers.[4,6] That shift changed the Corporate Direct Lending landscape as it became an opportunity that could attract scale capital from large institutional investors.

Following the Great Financial Crisis ('GFC')[7], banks were further displaced as they faced new, punitive capital charges and regulatory barriers that inhibited middle market lending. With the writing on the wall, talented originators and underwriters left their seats at commercial banks to join non-bank lenders. The transition was complete at the point Alternative Credit managers had accumulated sufficient scale and product flexibility to attract capital from large institutional investors.

Corporate Direct Lending investors have reaped the benefits of this mismatch of supply and demand for finance – not only in the form of excess returns, but also in access to an opportunity set that simply did not exist until it was created and offered as an Alternative Credit sector.

FACTORS THAT CREATE GAPS IN TRADITIONAL MARKETS

GAPS AND BOXES: THE ROLE OF ALTERNATIVE CREDIT

Gaps and *boxes* are useful motifs for thinking about Alternative Credit. Where gaps exist in between markets, we tend to find sectors that are overlooked or misunderstood. This is often due to lack of market visibility, access or perceived complexity.

Many of today's Alternative Credit sectors are well established and familiar to most investors, including:

- asset-backed securities
- collateralized loan obligations
- inventory finance
- equipment finance
- credit tenant leases
- trade finance

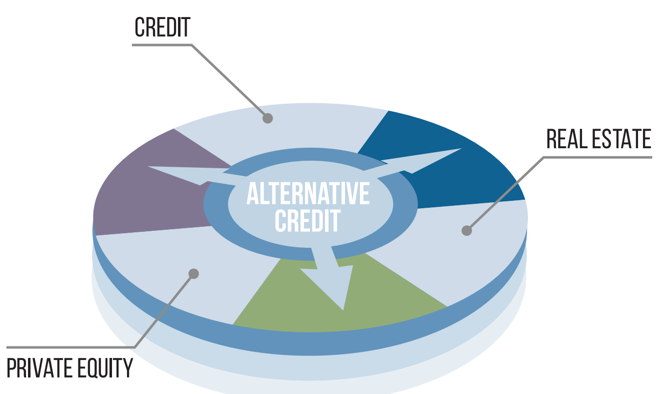
Other Alternative Credit sectors are also well established but have remained small and niche and may therefore be less familiar. They include:

- royalty finance
- tax lien securities
- media finance
- intellectual property finance
- agriculture finance
- insurance-linked securities
- transportation equipment
- franchise lending
- regulatory capital finance
- structured settlements

Irrespective of the sector, Alternative Credit investments share important features and characteristics. For example, each is secured by real or financial assets that generate cash flows upon which the investment relies for repayment. That feature, in combination with other features, contributes to an investment profile (described below) that has historically exhibited significant resiliency to stress while generating excess returns and attractive levels of current yield.[3,8]

Perhaps the most commonly-shared characteristic is that Alternative Credit sectors exist outside of – or in between – traditional, well-defined markets. Ironically, perhaps, the traditional markets' quest for efficiencies very often creates the gaps that Alternative Credit seeks to fill.

ALTERNATIVE CREDIT EXISTS IN THE GAPS BETWEEN TRADITIONAL MARKETS



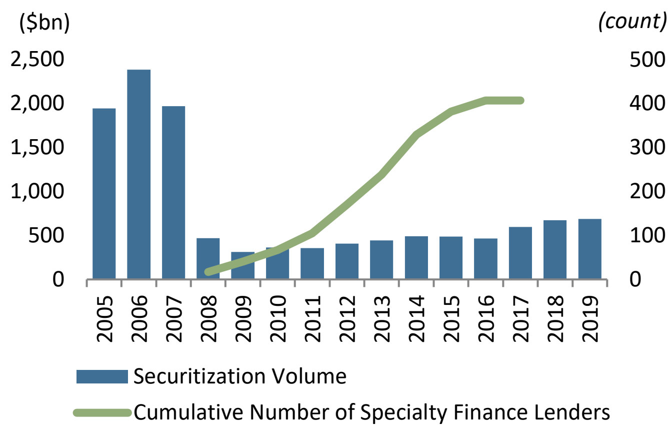
For example, markets find efficiency in standardization. By creating 'one-size-fits-all' transactions, or by defining a sector narrowly and strictly, efficiencies are created for bankers, issuers and investors alike. Standardization is also driven by other factors including regulations, tax and accounting rules, rating agency criteria, and even benchmarking criteria.

By design, Alternative Credit seeks to provide a *non-standard* solution in an effort to address those opportunities and financing needs that 'one-size-fits-all' approaches leave behind. At scale, we believe an Alternative Credit solution can go a long way toward filling large gaps in the market.

ALTERNATIVE CREDIT AND THE SPECIALTY FINANCE GAP

In the years leading up to the GFC, the public securitization (non-mortgage) market produced roughly $2 trillion of new investment opportunities each year.[9] In the GFC, and despite solid credit performance across ABS sectors[7], most banks and other traditional investors in this market exited – many involuntarily. The result was a massive capital dislocation that caused primary issuance volumes in the public securitization markets to contract from over $2 trillion per year to less than $500 billion per year…*and never recover* (see chart below).[9]

YEARLY PUBLIC SECURITIZATION VOLUMES VS. CREATION OF NEW U.S. SPECIALTY FINANCE COMPANIES



Did the consumers and small businesses represented by the pre-GFC securitization markets disappear or stop borrowing? Of course not. They simply turned to a different set of lenders.

Coincident with the contraction in public securitization volumes was a dramatic expansion in the number of specialty finance companies operating in North America following the GFC[10] (also plotted in the chart).

Recent estimates point to more than 1,000 specialty finance companies operating across the U.S. and Canada, and hundreds more in Western Europe.[11] More than half of these have been formed since the GFC. The specialty finance market has never been bigger, busier… or more fragmented.

Who finances these new lenders and lends against the assets they are originating? Alternative Credit investors like Ares. FinCo lending, structured lending and asset-backed lending by Alternative Credit institutions have continued to displace traditional investors and public securitization markets – filling the massive gap left in the wake of the GFC.

In this fragmented landscape, we believe Alternative Credit managers who have invested heavily in origination capabilities can create significant competitive advantages. Managers who have raised dedicated capital in scale can have significant competitive advantages when vying to work with specialty finance companies who want a capital partner who can grow with them. Managers whose scale capital is also flexible have significant competitive advantages in developing creative solutions across a broader spectrum of opportunities.

Specialty finance companies likewise face a fragmented market of potential capital providers. Consequently, we find that they favor Alternative Credit managers who can differentiate themselves in five key areas:

1. Reputation and Experience
2. Compatibility of Capital
3. Scale of Capital
4. Flexibility of Capital
5. Execution Speed and Certainty

Few Alternative Credit managers can deliver in every area. Those who do can develop strong, long-term relationships with counterparties and enjoy the benefits of incumbency. Furthermore, specialty finance companies are often willing to pay a premium to access Alternative Credit capital due to its greater flexibility and independence from public securitization markets.

WORKING OUTSIDE THE BOX

Wall Street excels at syndicating risk that fits neatly inside the demarcations of traditional capital markets activity. Regulations, market structure, liquidity constraints, rating agency criteria, and many other factors together create 'the box' into which borrowers must fit if they want to enjoy the benefits of efficient, capital markets execution of their debt.

However, borrowers often find capital markets execution overly restrictive or misaligned with their businesses. They are increasingly looking for capital solutions that are outside the capital markets box; they are often willing to pay a premium for a solution that is a better overall fit or that acts as an 'insurance policy' against the risk that their access to traditional markets is interrupted due to market dislocation or volatility.

ALTERNATIVE CREDIT CASE STUDY

Counterparty: Large U.S. insurance company

Situation: A large subset of its asset portfolio was disproportionally affecting their regulatory capital and operational overhead.

'In the Box' Options Considered: Asset disposition or reinsurance. Asset disposition was rejected due to its negative impact on portfolio yield. Reinsurance was rejected as it did not alleviate the operational burden and reduced portfolio yield.

'Outside the Box' Solution: Ares provided financing using securitization technology to reformat and transform the assets into (mostly) investment-grade rated securities.

Value Creation for Counterparty: Greater yield preservation, significantly better regulatory capital treatment, and significantly reduced operational burdens.

Value Creation for Ares Investors: Origination of a large, unique investment opportunity having an attractive risk and return profile.

In many cases, borrowers are not seeking to displace traditional sources of capital but rather use Alternative Credit solutions as a complement. They will exploit the benefits of traditional, efficient markets for the 'vanilla' portion of their financing needs but will then partner with an Alternative Credit manager to create customized, 'out of the box' solutions that address specific needs.

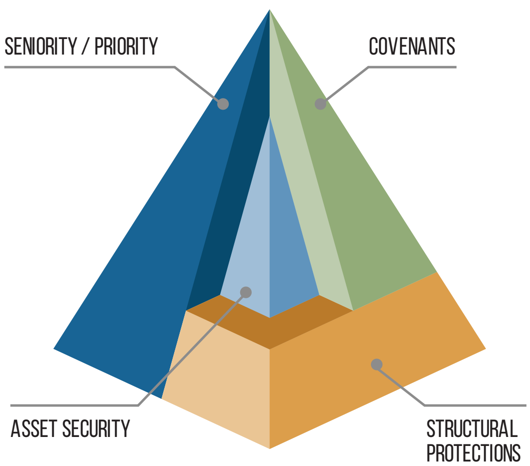
Increasingly, we are finding that many counterparties' needs extend beyond trying to simply minimize financing costs. As regulatory and operational burdens have increased, more companies are looking at their business models and capital holistically. Many are turning to Alternative Credit managers for solutions.

By providing unique solutions to *borrowers*, Alternative Credit managers can, in turn, provide unique solutions and opportunities to *investors*. That nexus lays at the heart of value creation and value capture in Alternative Credit.

THE DIFFERENCE IT MAKES

While Alternative Credit presents investors access to investments across a range of asset types and formats, the investments share certain attributes that together contribute to an overall outcome that many investors are seeking today.

COMMON INVESTMENT ATTRIBUTES OF ALTERNATIVE CREDIT INVESTMENTS



Above are four key attributes[12] that we find in virtually every Alternative Credit investment. In combination, these features contribute to an overall profile that can be highly resilient to stress and protective of value while still offering attractive returns (with yields often in excess of 10%).[1]

For example, *asset security* is protective of value in three different ways.

- First, the assets – not the counterparty – generate the cash flows that repay principal and interest on our investment. This minimizes (and can eliminate) counterparty credit risk.
- Second, in most cases there are hundreds or even thousands of individual assets forming the security for a single investment. This inherent granularity contributes to stable performance and cash yield.
- Third, historically, various types of discrete asset portfolios have shown very low performance correlation, creating an attractive complement to Corporate Direct Lending and other fixed income. [13]

Similar observations can be made with respect to structural protections, covenants and seniority features of Alternative Credit investments. Taken together, these features create investments that typically have durable cash flows, downside protection, shorter duration and low performance correlation.

As a long-standing Alternative Credit manager, we would highlight a few other features that are admittedly more qualitative in nature but are nonetheless top of mind for many CIOs, portfolio managers, risk managers and consultants.

Diversification. Cycle-tested investors understand that traditional conceptions of diversification do not go far enough to attenuate risk in high correlation environments. Such investors seek opportunities to create *risk firewalls* that serve to reduce portfolio contagion risk. Alternative Credit can offer such an opportunity as it provides investors access to discrete risks with assets and capital structures that are typically independent of markets.

Direct origination. One of the laments one hears quite frequently today is the 'race to the bottom' as issuers and their advisors seek to exploit excess demand, investor competition and market liquidity. Alternative Credit managers, like Ares, can side-step such markets by orienting our sourcing efforts toward proprietary investments that are originated outside of a competitive environment and with a different objective in mind than 'optimized execution' for the issuer.

Pro-cyclical expansion. When disruption impacts traditional markets, issuers and their bank advisors face increased execution risks. IPOs may get pulled or postponed; debt offerings may get hung; warehouse or aggregation facilities may get shut down. Thus, we find that both the opportunity set and potential value capture can expand – sometimes dramatically – in volatile markets.

Complementary duration profile. In times of stress, many Alternative Credit investments are designed with protections that can result in shortened tenors, creating a complementary cash flow profile vs. other asset classes (e.g. corporate debt) that can experience extension risk.

WE SEE STRONG SIMILARITIES BETWEEN TODAY'S ALTERNATIVE CREDIT MARKET AND THE CORPORATE DIRECT LENDING MARKET FIFTEEN YEARS AGO

A common challenge investors face is how to enhance returns without simply adding risk. We believe Alternative Credit investments and strategies provides a real solution to that challenge. The attributes that we typically find in Alternative Credit investments contribute to performance stability and resiliency to stress. By providing capital solutions that traditional markets do not or cannot, Alternative Credit managers can create and capture value, and deliver that excess value to investors. That risk-return profile can make a big difference to the risk-return efficiency of most investors' portfolios.

WHY DOESN'T EVERYONE DO THIS?

All of these apparent benefits beg the question: *why doesn't everyone do this*? In many cases, the answer is as obvious as it is ironic: investors have gaps and boxes of their own!

Has the following scenario ever happened to you, or in your firm? You have a meeting with an asset manager who presents a market opportunity or strategy where you currently have no exposure. It is interesting, compelling, diversifying – everything you could hope for. But you have a dilemma: where do you put it and which team at your firm will evaluate it?

One of the reasons Corporate Direct Lending took many years to become an established sector among institutional investors is because investors struggled for so long to resolve this exact dilemma. Fixed income investment teams struggled to identify an appropriate benchmark and were not always sure that Corporate Direct Lending did not belong in Private Equity buckets due to its liquidity profile. Private Equity investment teams, in many cases, did not know what to do with a corporate debt strategy that presented lower returns despite illiquidity.

Some investors face a similar dilemma today with Alternative Credit. Although there are many more investors these days who have addressed such gaps in their strategies and in the capabilities of their investment teams, it remains a work-in-progress for a host of others. This has kept the investor base for Alternative Credit somewhat concentrated among very large, sophisticated institutions and otherwise fragmented among a number of smaller, focused investors.

We see strong similarities between today's Alternative Credit market and the Corporate Direct Lending market *circa* 2005. Early adopters of Corporate Direct Lending have reaped a significantly greater reward than those who only discovered the sector last week. We believe the same may be said one day of early mover investors who can address today's opportunities in Alternative Credit.

BY PROVIDING UNIQUE SOLUTIONS TO BORROWERS, ALTERNATIVE CREDIT MANAGERS CAN, IN TURN, PROVIDE UNIQUE VALUE AND SOLUTIONS TO INVESTORS

THE CHALLENGES OF A DIVERSIFIED APPROACH

The other tendency we encounter with institutional investors is that where they do access Alternative Credit, it is typically within a fairly narrow band of sectors. Investors identify a market opportunity in a particular niche or specialty, find a manager who focuses in that sector, and design an investment mandate that represents a 'pure play' in that specialty.

Consultants and other advisors have built entire businesses around supporting this approach to investing: creating diversified portfolios by collecting many discrete strategies and managers. While it is a fairly popular approach, most investors recognize the inherent challenges and complications it creates. Those we hear most frequently are:

- Identifying and evaluating managers is time consuming and costly – and there is often a limit to the total number of managers and strategies that investors want to have in their portfolios
- Specialist managers tend to advocate for their niche, thereby placing the burden of objectively assessing the sector's relative value and risk back on the investor
- Reporting standards and transparency can vary widely from manager to manager, strategy to strategy… creating difficulties downstream for risk management and stakeholder reporting
- Many specialist managers are very small and sub-scale, making it difficult for larger institutional investors to access certain opportunities or to deploy capital in sufficient size to move their needle

These challenges in particular have tended to hinder investors from taking a diversified, relative value approach to investing in Alternative Credit. Consequently, we find most investors accessing only the larger sectors and in strictly-defined, pure-play formats. Some of the sectors receiving recent focus and capital allocations include: CLOs; ABS; marketplace loans; transportation equipment leases (e.g. commercial aircraft and railcars, especially); regulatory capital trades; and NPLs.

In our view, the main deficit of this limited focus and pure-play approach is that it barely scratches the surface of the Alternative

Credit market opportunity and is rarely executed with a relative value discipline.

It is one (non-trivial) matter to determine all that is on the Alternative Credit menu; it is another matter entirely to subject each opportunity to a relative value standard and then allocate capital on that basis. The approaches we typically see generally fail to resolve either matter, which is one reason why gaps and boxes in investors' portfolios persist.

TAKING THE ROAD LESS TRAVELED

The key question for many investors is: have I defined my businesses or organized my resources such that I have inhibited access to strategies and investment opportunities to which my stakeholders would want exposure? The answer to this question presents both a challenge and a potential reward.

The challenge lays first in identifying where gaps may exist. In a conversation with a large pension fund, the new CIO observed that his investment teams were organized well for strategies designed to achieve 4% to 7% returns, and other strategies designed to achieve returns of 12% or greater. Their performance was solid and by all appearances they felt they were delivering on these mandates as defined. But, he confessed, they had no natural home for strategies seeking 8% to 12% returns – a common range for Alternative Credit strategies. In this case there were multiple reasons why this gap in their capital had formed and persisted, some of which stemmed from guidelines and investment opportunities designed many years ago in a different market environment.

Addressing this particular gap was this new CIO's top priority. His fresh perspective on the matter is starting to make a big difference. He is opening up his portfolio to more diversity, creating greater operational flexibility for his investment teams and engaging his portfolio managers in a more objective evaluation of risk and relative value across their portfolios.

IT IS ONE MATTER TO DETERMINE ALL THAT IS ON THE ALTERNATIVE CREDIT MENU; IT IS ANOTHER MATTER ENTIRELY TO SUBJECT EACH OPPORTUNITY TO A RELATIVE VALUE STANDARD, AND THEN ALLOCATE CAPITAL ON THAT BASIS

This particular pension fund is hardly alone. This is a story we have heard countless times from nearly every corner of the world, and from all types of investors. The good news is that these issues are getting attention. As investors, we have a duty to regularly step back, elevate our perspective to see the big picture and challenge our assumptions. Very often we will discover gaps and boxes of our own creation.

That is where the potential rewards may be found. Increasingly investors are discovering such rewards in their evaluation of Alternative Credit. Because Alternative Credit sectors and investments sit between or adjacent to traditional markets, the territory is often not only familiar but also complementary. With that foundation, investors can focus on how best to capture or create value using Alternative Credit strategies.

… I shall be telling this with a sigh
Somewhere ages and ages hence:
Two roads diverged in a wood, and I—
I took the one less traveled by,
And that has made all the difference.

When Robert Frost penned his famous poem, '*The Road Not Taken*,' it was a provocation to consider one's alternatives. That which is commonplace and familiar remains so because it requires little explanation or new effort. Nothing is inherently wrong with efficient and economical. Its deficiency, as Frost saw it, is that it also lacks impact. It is in taking the road less traveled that makes all the difference.

Endnotes

1 Ares has a presence in Sydney, Australia through its joint venture, Ares Australia Management Pty Ltd (AAM), with Fidante Partners Limited, a wholly owned subsidiary of Challenger Limited.

2 Based on Ares Alternative Credit team's observations. There is no assurance that target returns can or will be achieved.

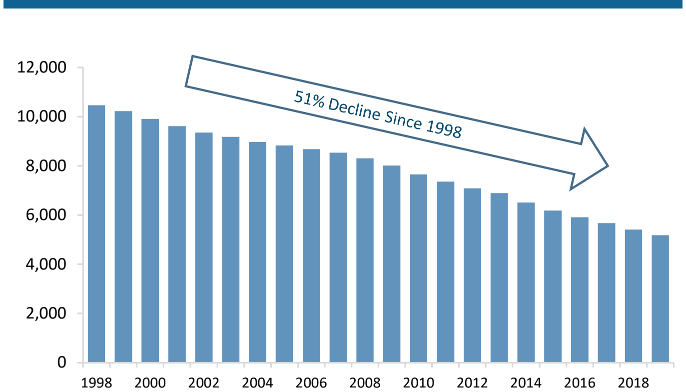
3 For additional insights into the Corporate Direct Lending market, please refer to Ares' *Opportunities in Global Direct Lending* whitepaper. Source: Bain and Company, Market Watch, Wall Street Journal, Houlihan Lokey, Coral Capital Solutions, Equipment Leasing and Finance Foundation, Real Capital Analytics, Commercial Finance Association, J.P. Morgan, AIMA, S&P Capital IQ, Credit Suisse, Bloomberg, SIFMA, Cambridge Centre for Alternative Finance and Ares' market observations.

4 Ares has organized all Alternative Credit sectors into five general categories: asset-backed securities ('ABS'), collateralized loan obligations ('CLO'), specialty assets, real assets and finance company lending & solutions ('FINCO'). The table below provides Ares' general view and our assessment of each category, based on our investment experience, which is intended to be illustrative and indicative only. A specific investment in any category may have a materially different profile or set of characteristics.

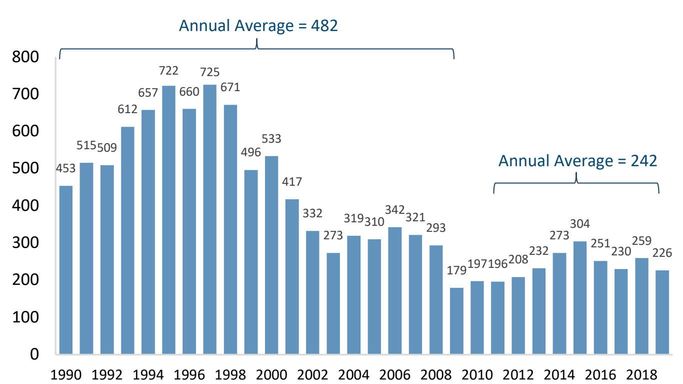
	ABS	CLO	SPECIALTY ASSETS	REAL ASSETS	FINCO
ASSET SECURED	✓	✓	✓	✓	✓
YIELD PREMIUM	MED TO HIGH	MED TO HIGH	HIGH	MED TO HIGH	HIGH
CURRENT INCOME	✓	✓	✓	✓	✓
TENOR / FEATURE	SHORT AMORTIZING	MED NON-AMORTIZING	MOSTLY SHORT AMORTIZING	SHORT TO MED SOME AMORTIZING	SHORT TO MED AMORTIZING
CORRELATION	LOW TO MED	MED	VERY LOW	LOW	VERY LOW
VOLATILITY	VERY LOW	MED TO HIGH	VERY LOW	LOW	LOW TO MED
DIVERSIFICATION	VERY HIGH	HIGH	MED TO HIGH	MED TO HIGH	MED TO HIGH

5 Source: Federal Deposit Insurance Corporation, 'Quarterly Banking Profile,' December 31, 2019. The charts below show the overall change in the number of bank institutions operating in the U.S., and the number of mergers that have occurred, with the highest consolidation rates occurring between the mid-1990s and mid-2000s.

Total Number of U.S. Banks Continues to Decline

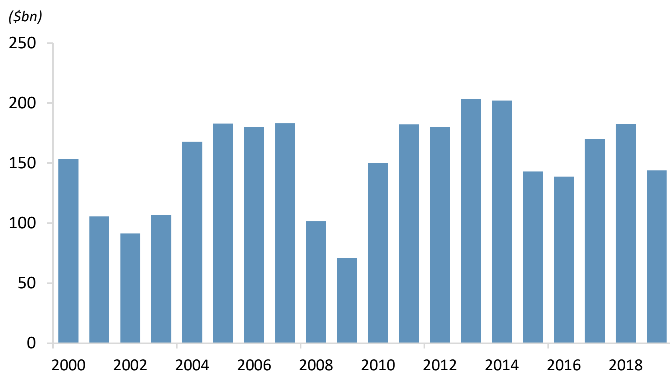


Total Number of U.S. Bank Mergers

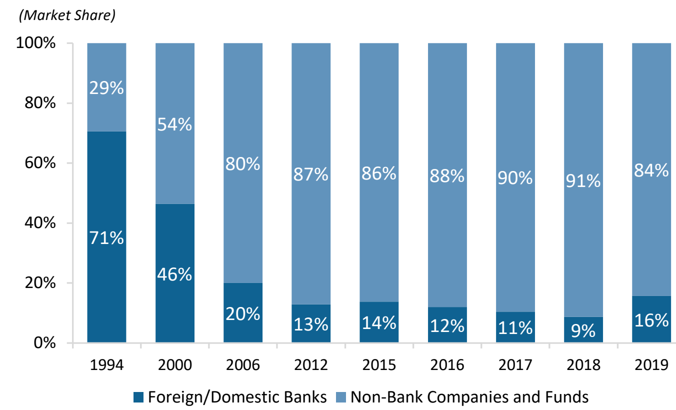


6 Source: Refinitiv, 'Middle Market Review Q4-19,' December 31, 2019.
S&P LCD, 'Leveraged Lending Review Q4-19,' December 31, 2019. Excludes left and right agent commitments (including administrative, syndication and documentation agent as well as arranger).

Annual Middle Market Issuance



Leveraged Loan Market Fundings by Entity Issuance



7 Note: Great Financial Crisis ('GFC') is defined as the period just prior to and following the credit market dislocation of 2008.

8 Source:

- **Ratings performance:** Moody's Investors Service. 'Structured Finance Rating Transitions: 2009 – 2019H1,' September 30, 2019; 'Annual Default Study: Defaults Will Edge Higher in 2020,' January 30, 2020.
  J.P. Morgan ABS Research. Historical rating actions as of December 31, 2019. Tracked since 1999 for credit cards, student loans, and equipment leases. Tracked since 2002 for autos.

- **Default performance:**
  SIFMA, 'U.S. ABS Outstanding,' June 30, 2019.
  Asset-Backed Alert, 'ABS Database,' September 30, 2019. Transaction count per sector and rating agency as characterized by Asset-Backed Alert.

9 Source: Asset-Backed Alert, 'ABS Database,' December 31, 2019. Deloitte, 'Fintech by the Numbers,' September 2017. Reflects cumulative number of specialty finance lenders since 2008.

10 Source: Securitization Volumes from Asset-Backed Alert, 'ABS Database,' December 31, 2019.
New specialty finance company formation data from Deloitte, 'Fintech by the Numbers,' September 2017. Chart reflects the cumulative number of new specialty finance lenders entering the market since 2008.

11 Source: The Americas Alternative Finance Industry Report. 'Expanding Horizons,' 2018; 'Hitting Stride,' 2017; 'Breaking New Ground,' 2016.

12 Source: Based on Ares Alternative Credit team's observations. Ares expects that virtually all Alternative Credit investments it pursues will feature the four following attributes.

STRUCTURE	We design our investments with structural protections against downside risks. These can enhance performance stability, especially in times of stress.
COVENANTS	Covenants are designed to give us rights, protections and dominion over the assets and a priority claim over the cash flows that support our investments.
ASSET SECURITY	Our investments are always secured by assets. When combined with proper structure and covenants, asset security greatly mitigates downside risks.
SENIORITY	As credit investors, we know that seniority and other forms of priority or control over cash flows and assets can lead to better outcomes in times of stress.

13 Estimates of market correlation are not available for many Alternative Credit sectors due to lack of independent, publicly available data. However, where data is available, correlations with traditional markets have historically been quite low. The table below shows 10-year correlation statistics across a number of asset classes, with Asset-Backed Securities representative of a major sector within Alternative Credit. Observations by senior members of Ares Alternative Credit Team from over decades of investment experience also support the general view that cash flow performance, default rates and loss rates in most Alternative Credit sectors are generally not correlated with markets but tend to be idiosyncratic and specific to individual transactions.

CORRELATION MATRIX

	U.S. Equities	Global Equities	U.S. High Yield	U.S. Leveraged Loans	European High Yield	European Leveraged Loans	U.S. IG Corporate Debt	U.S. Fixed Income	Asset-Backed Securities	Direct Lending
U.S. Equities[1]	1.00									
Global Equities[2]	0.97	1.00								
U.S. High Yield[3]	0.72	0.75	1.00							
U.S. Leveraged Loan[4]	0.61	0.65	0.81	1.00						
European High Yield[5]	0.64	0.72	0.85	0.67	1.00					
European Leveraged Loan[6]	0.52	0.58	0.73	0.91	0.69	1.00				
U.S. IG Corporate Debt[7]	0.14	0.15	0.43	0.12	0.46	0.13	1.00			
U.S. Fixed Income[8]	(0.17)	(0.17)	0.09	(0.20)	0.12	(0.18)	0.91	1.00		
Asset-Backed Securities[9]	(0.37)	(0.37)	(0.09)	(0.27)	(0.12)	(0.25)	0.70	0.88	1.00	
Direct Lending[10]	(0.07)	(0.08)	(0.03)	(0.06)	(0.07)	(0.15)	0.11	0.09	0.04	1.00

Note: As of December 31, 2019. The information related to the various indices is sourced from the providers' websites. Ares is not responsible for any historic revision made to the indices. The indices include the reinvestment of dividends, interest and other earnings and have not been adjusted for management fees or expenses. Any indices that are not denominated in U.S. Dollars are hedged back to the U.S. Dollar currency for comparison purposes.

Indices are provided for illustrative purposes only and not indicative of any investment. They have not been selected to represent appropriate benchmarks or targets for the strategy. Rather, the indices shown are provided solely to illustrate the performance of well-known and widely recognized indices. Any comparisons herein of the investment performance of a strategy to an index are qualified as follows: (i) the volatility of such index will likely be materially different from that of the strategy; (ii) such index will, in many cases, employ different investment guidelines and criteria than the strategy and, therefore, holdings in such strategy will differ significantly from holdings of the securities that comprise such index and such strategy may invest in different asset classes altogether from the illustrative index, which may materially impact the performance of the strategy relative to the index; and (iii) the performance of such index is disclosed solely to allow for comparison on the referenced strategy's performance to that of a well-known index. Comparisons to indices have limitations because indices have risk profiles, volatility, asset composition and other material characteristics that will differ from the strategy. The indices do not reflect the deduction of fees or expenses. You cannot invest directly in an index. No representation is being made as to the risk profile of any benchmark or index relative to the risk profile of the strategy presented herein. There can be no assurance that the future performance of any specific investment, investment strategy, or product will be profitable, equal any corresponding indicated historical performance, or be suitable for a portfolio.

Correlation results have been calculated using the monthly returns of the below reference indices:

1. "U.S. Equities" is represented by the S&P 500 index. The S&P 500 index is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.
2. "Global Equities" is represented by the MSCI World Index. The MSCI World Index captures large and mid-cap representation across 23 Developed Markets (DM) countries. With 1,649 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. DM countries include: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the UK and the US.

3. “U.S. High Yield” is represented by the ICE BofA High Yield Master II Index (“H0A0”). The H0A0) consists of below investment grade U.S. dollar denominated corporate bonds that are publicly issued in the US domestic and yankee bonds (issues included in the index have maturities of one year or more and have a credit rating lower than BBB-/Baa3, but are not in default).
4. “U.S. Leveraged Loans” is represented by the Credit Suisse Leveraged Loan Index (“CSLLI”). The CSLLI is an index designed to mirror the investable universe of the $US-denominated leveraged loan market.
5. “European High Yield” is represented by the ICE BofA European High Yield Index (“HE00”). The HE00) tracks the performance of EUR denominated below investment grade corporate debt publicly issued in the euro domestic or eurobond markets.
6. “European Leveraged Loans” is represented by the Western European Leveraged Loan Index (“WELLI”). The WELLI is designed to mirror the investible universe of the Western European leveraged loan market, with loans denominated in $US and Western European currencies.
7. “US IG Corporate Debt” is represented by the ICE BofA US Corporate Master Index (“C0A0”). The C0A0 tracks the performance of US dollar denominated investment grade rated corporate debt publicly issued in the US domestic market. To qualify for inclusion in the index, securities must have an investment grade rating (based on an average of Moody's, S&P, and Fitch) and an investment grade rated country of risk (based on an average of Moody's, S&P, and Fitch foreign currency long term sovereign debt ratings). Each security must have greater than 1 year of remaining maturity, a fixed coupon schedule, and a minimum amount outstanding of $250 million.
8. “U.S. Fixed Income” is represented by Bloomberg Barclays U.S. Aggregate Bond Index. The Barclays Capital U.S. Aggregate Bond Index measures the performance of the U.S. investment grade bond market. The index invests in a wide spectrum of public, investment-grade, taxable, fixed income securities in the United States – including government, corporate, and international dollar-denominated bonds, as well as mortgage-backed and asset-backed securities, all with maturities of more than 1 year. To be included in the index, bonds must be rated investment grade (at least Baa3/BBB) by Moody’s and S&P. Inception date: January 1, 1976.
9. “Asset-Backed Securities” is represented by the Bloomberg Barclays Asset-Backed Securities Index. The Bloomberg Barclays Asset-Backed Securities Index is the ABS component of the Bloomberg Barclays U.S. Aggregate Bond Index and has three subsectors (credit and charge cards, autos, and utility).
10. “Direct Lending” is represented by the NAV returns of Ares Capital Corporation (“ARCC”). Direct Lending is shown for illustrative purposes only and represents the change in net asset value (NAV) plus the value of dividends paid by Ares Capital Corporation (ARCC), a publicly traded business development company (BDC). ARCC invests primarily in directly originated debt; however, it also invests in some equity and other asset classes. ARCC performance is shown as representative of Ares’ track record in direct lending, as ARCC is Ares' only direct lending fund that has been investing for over ten years. ARCC NAV and dividends are calculated on a quarterly basis, so for non-quarter end months, we assume 0% returns in order to create a monthly time series. As ARCC is a publicly traded BDC with the ability to invest in asset classes other than direct lending, its returns may be materially different than what an investor may achieve in a private fund invested solely in direct lending assets. In addition, ARCC NAV is calculated based on the fair value of ARCCs investments. Due to the illiquid nature of direct lending assets, the ability to liquidate them at their fair value cannot be assured.

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