SILVERCREST
ASSET MANAGEMENT GROUP

FIXED INCOME TEAM CALL TRANSCRIPT
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Corporate Speakers

- Richard Hough; Silvercrest Asset Management Group LLC; Chairman and CEO
- Robert Teeter; Silvercrest Asset Management Group LLC; Head, Investment Policy and Strategy
- Russell Brown; Silvercrest Asset Management Group LLC; SVP
- Patrick Bittner; Silvercrest Asset Management Group LLC; Partner
- Buck Stevenson; Silvercrest Asset Management Group LLC; Managing Director

Operator: Ladies and gentlemen, thank you for standing by and welcome to the Silvercrest Conference Call.

I would now like to hand the conference over to your speakers for today, Richard Hough, Chairman and CEO; and Robert Teeter, Head of Investment Policy and Strategy Group. You may begin.

Richard Hough: Thank you. Thank you very much for joining us today for a discussion with all of Silvercrest's fixed income portfolio management team. In addition to Robert Teeter, who's joining me, Rob is Head of the Investment Policy and Strategy Group, he's been working with Silvercrest on asset allocation and manager selection as well as macro-economic issues since 2003 and formally joined the firm just about six years ago.

We're also joined by Patrick Bittner. Patrick is a founding member of the firm and a partner. He's been with us since 2002. And he manages exempt fixed income portfolios for both our high net worth and institutional clients. Prior to that, he was at Credit Suisse managing fixed income bonds.

Russell Brown is a Senior Vice President, and he is the overseer of our taxable fixed income accounts. He joined us in 2005. So many of our fixed income team have been with us for well over a decade.

We're also joined by our high yield municipal team. Buck Stevenson is a Managing Director. He's been at the firm since 2005 as well and prior that was nine years as the head trader and manager of the municipal bond department at Maxcor Financial. His partner and colleague, Ed Appel, is the Managing Director on the municipal value strategy of high yield bonds. He also joined us in 2005 when we put that effort together, and he spent nine years as the director of research of the bond department at Maxcor Financial Group as well. Importantly, and we'll get to this later, Ed served as the CFO of a hospital, and we often invest in healthcare, which is certainly of great interest to our investors these days.

And finally, Doug Stevenson, who is also a Managing Director and Partner at the firm who joined us in 2005. And he, too, spent nine years at Maxcor Financial Group as the generalist in the municipal bond market.

So, thanks so much for joining us. Rob, this is an unprecedented in many respects, time for the fixed income markets, perhaps maybe only matched by the great financial crisis 10, 11 years ago. What are we seeing today? And what do we hope to accomplish with this call on behalf of our investors?

Robert Teeter: Yes, it certainly is unprecedented, Rick, and there's been a significant amount of volatility in the fixed income markets. As you pointed out, some of the (debt) levels are similar to what we've seen in the crisis and others. While not quite there, pretty close to it.

So I'll give a very brief background to set some context and then we'd like to very quickly transition to the experts that we have on the call here today and start getting their views as to what they're seeing in their respective markets and what types of securities they're owning and purchasing on behalf of clients.

So, a couple of things to keep in mind, as many of us know, the U.S. 10-year Treasury bond trades at a rate of about 60 basis points now. That's been a pretty significant move and indicative of some of the risk-off nature of what's going on in markets here.

From the economics side, the backdrop has seen two very significant developments—one, on demand destruction from the shutdowns that have taken place in the economy due to the coronavirus; and the second being very significant amounts of stimulus from both the Fed, the Treasury, and Congress as well. And so, the net result of all of this is there are a lot of cross currents, which make things even more confusing than normal. However, as it relates to rates and bonds, I would say that we don't see inflation being imminent here, although we'll talk a little bit about what the TIPS market, or the inflation-protected bonds market, has to say about that.

Overall, we think it's an environment that should very much reward security-specific credit work, and we think that this is something that should be core to what everyone is doing. And that's what our teams here are doing. And that's what we'll begin to talk about shortly.

If you look back to late February, credit spreads began to widen out very quickly. They've since improved somewhat, recovering about half the move, although it varies somewhat by segment.

So with that, we'll begin to turn some questions over to our teams here. One of the first things that we've noticed is that as is typical in many crises, the global financial crisis was one example of this, and we saw it play out in February and March here, is fear of access to funding. And so, while markets have been pretty choppy, there has been a lot of action taken by the Fed and Treasury, and that's been somewhat beneficial in the near term. But, first, I thought we'd turn to Russell Brown, who as you mentioned, Rick, focuses on corporate bonds, and ask Russell to give us an update on how companies are obtaining access to capital here and what types of rates they're paying for it.

So, Russell, perhaps you could start off with an overview of that?

Russell Brown: Okay, good afternoon, everyone. To give you a review of what happened with the credit markets, they went from fairly expensive at the beginning of the year. After all, the stock market was up so spreads were fairly tight. Then as the coronavirus news hit, the fear factor hit.

The primary market, which is the new debt sales market by corporations shut down by the end of February. In early March, you had some of the lower volatility issuers come to market. Those are your household names that everyone knows. However, the tide was pretty much still going out. Anything that you bought seemed to be wider the next day. And that really centered around two main concerns, solvency and the ability to refinance maturing debt.

Now, a few things happened in the timeframe which did have big effects on the market. Now, the first was on the 15th of March the Fed, the Federal Reserve, did an emergency rate cut from 1.25% to the range of 0% to 0.25%, with the statement that they would do whatever it takes to support the Treasury and the agency mortgage market. That was a big move, but it didn't pacify the credit markets.

Over the next couple of weeks, the average spread on corporate bonds almost tripled from 93 basis points on February 21st to 287 on March 23rd. That represents an unrealized loss of almost 10%.

Now, over time, you did see a repricing, and eventually around the 19th of March, issues that were brought to market were really priced to sell and buyers responded. You had cases of good names were issuing debt in the high 200 basis points to mid-300 basis points versus Treasuries. Now, with only a few exceptions the all-in rates that companies were paying to issue debt wasn't onerous. Okay? BAT Capital, the old British American Tobacco company, they issued 30-year debt. They were among one of the highest rates that they had to pay, and it was still under 5.5%.

Now, as the primary market started to generate gains, the secondary market for corporate bonds started to improve a lot as well. There was a lot more trading. It was a lot more efficient. Then there was a big move on April 9th and that was when the Fed instituted their Muni Liquidity Facility, the Main Street Lending Facility, the expansion of Primary and Secondary Market Corp Credit Facilities, and also the term asset-backed program to as much as $850 billion.

Less affected industries then saw their debt sales very well-received, and spreads were progressively tighter on new issues. Now, there are some industries that were considered severely affected, airlines, retailing, and lodging, and they did have to pay a higher price to refinance debt than other companies. The most extreme were Carnival Cruise Lines. They issued a three-year at 11.5%. And Kohl's issued a five-year at 9.5%.

Now, as Rob mentioned earlier, with all these programs being brought and a better appetite, you saw about a 50% retracement in spreads, which currently stand at about 191 basis points. And that's mainly because refinancing risk has largely abated.

Now, where are we now? You've got a case of most BBB issuers, which are still investment grade, are paying well under 4% for issuing 30-year debt. Most A issuers are paying below 3%. And to give you an idea of what kind of move we had, Coca Cola and Pepsi both sold 10-year debt yesterday at a yield to them of 167. For Pepsi, that represented a spread 75 basis points tighter than they issued on March 17th. With Coke, it was 150 basis points tighter than the deal they sold on March 20th.

And to give you an example of where we are today, Norfolk Southern, which is a Baa1, BBB+ railroad, they're going to see 30-year debt just over a yield of 3%. Mondelez, which is also a Baa1 but BBB by S&P, is issuing a five-year and their yield is going to be under 160 and their 10-year is going to be around a 205. I guess people still like Oreo cookies.

Now, what we've been doing here at Silvercrest is we've been buying industries that I consider operating. They may be marginally affected, but they're basically still in business. UPS had come with a five-year deal in March at about a spread of 312 basis points or a yield of 370. Similar situation was with FedEx. They brought a five-year which came with 350 basis points or a 380. Currently, the UPS bond is trading around 110 basis points over Treasuries and the FedEx is trading around 220.

Just over a week and a half ago, I bought a 10-year issue for Sonoco Products, which is rated mid-BBB, which came at 3.125%. That's an issuer that I consider a lower beta BBB, and that even though it has the kind of rating that it does, it's just not going to have the spread volatility of, let's say, one of the auto companies or some industry like that. I've also bought 1.5 to 3-year first mortgage paper of utilities at spreads from anywhere from 150 to 225 basis points versus Treasuries. Most of those are now well inside 100 basis points.

Now, at this point in time, I'm continuing to favor the aforementioned, what I call, marginally affected names. Again, these are companies who may be seeing that their volumes are down, maybe their costs are up, but they're still operating reasonably normal. And the main reason for that is we're still not sure of what kind of a time horizon we're going to have for a recovery and what type of a recovery it is we're going to have. So, don't know necessarily what's going to happen in about two or three months.

I really don't want to own an issue that I would say has bought themselves time for the next few months but still face a substantial business risk. I've been moving more towards shorter issues on the yield curve as all-in yields tend to fall. So, a lot of the issues that I'm buying may be in the 1.25% to 1.5% yield area. I will buy new issues that are of a longer maturity if I feel that they are attractively priced by the market.

Now, earlier there was a question about inflation. Now, the TIPS market, Treasury Inflation

Protected Securities, is currently expecting deflation for the next two years on the order of 0.3%. Five-year TIPS currently say that we're going to have inflation just under 0.8% for the next five years, while 10 years is around 1.12%.

Now, I just want to remind you that the average CPI has been about 1.8% for the last 10 years. So those estimates are substantially under what history has been.

Now, the one thing is, as far as inflation goes, energy is a big component of the CPI. And of course, we've been hearing what's been going on with oil prices and gasoline. And we do expect that there will be a hit to CPI, however, it's really hard to imagine extended pressure on this. And then the other thing is most of the governments around the world, including ours, are going to have large-scale financing needs. It may be very difficult to avoid inflation unless a recovery is really on the sluggish side.

And that's basically all I have. Thanks very much,

Robert Teeter: Thank you, Russell. You covered a lot of ground there. Certainly happy to hear that the companies have access to the capital markets and that it's creating some opportunities for you in terms of the types of things you're buying on the corporate bond side.

Russell Brown: Yes. That was really the big thing that the refinancing risk has largely been put aside for now.

Richard Hough: And I am curious, Russell, that given the massive liquidity being put into the market by both the Fed and the Treasury, the inflation concerns that you briefly mentioned are high on the mind of a lot of investors, especially those with substantial savings in the fixed income market. And you referred to the TIPS market and what we're seeing now. Is that going to be one of your primary indicators looking forward along with assessing the deflationary trends that we're seeing in sectors like energy? Or are there other aspects of the market that will be your guide as we continue to guide our investors for the future?

Russell Brown: It's going to be something I'll be paying a decent amount of attention to. But certainly not only because it will be as much a general economic picture aside from energy. Again, if the recovery is somewhat sluggish, companies may not be able to pass along price increases even if they want to. But, again, if oil stays at a very low level, you could have a domino effect from that, obviously, on, you know, all the big oil producers. That's going to be a concern. And that could have ripple effects through the economy.

Robert Teeter: Thanks. Thanks very much. I appreciate that. I think now we'll move on to Patrick Bittner, who again, focuses on investment-grade municipals, which is an awfully important sector for our taxable clients. And there's certainly no shortage of challenges there. And we've even seen the Fed now introduce a municipal lending facility. I'm curious, Patrick, what you can share about the investment grade municipal bond market and where we're trading.

Patrick Bittner: Well, I'd like to start and just first go back and just remind everybody a month ago, everything was fine. Unemployment rate—two months ago, unemployment rate was low. We were in the middle of the longest economic expansion in history. State and local municipalities were stockpiling reserves, and money was flowing to the mutual funds at a record pace.

And then it all stopped. Stocks started going down 10%, 20% and then people started looking for assets that they could sell and muni bonds are one of the few assets that hadn't been declining. So, people started selling them. And then we had a problem where leveraged mutual funds had a sell. They were forced to liquidate. And this forced selling hit the market at a time there just weren't enough buyers. We saw interest rates rise about 200 basis points, 2%, in less than 10 days.

And I mean, we had a full-blown liquidity crisis. And like Russell said, the Federal Reserve stepped in, the Treasury stepped in and took some actions to reassure markets to unfreeze them. And then now, two months later, here we are, and the muni market has stabilized with interest rates quickly falling 1.5% as buyers recognize a great value corrected by the sell-off.

New issues are being priced at a normal pace. Bonds are trading in the secondary market. The bid-ask spread, which is a difference between where the bond is worth and what a broker is willing to pay for, has widened. But that's what happens during all recessions. Credit spreads, as Russell mentioned, have widened, but that, as usual, happens in a pre-recession period.

All in all, we're in a normal sort of pre-recession, early recession market. But what isn't normal is the speed and depth in which the changes are occurring. Usually a recession unfolds over a one-, two-year period, not one to two months. As in every recession, we're currently hearing headlines are heralding doom and despair.

Now, state revenues will be down. Local revenues will be down. Sales taxes that are falling. Property taxes will be under stress and personal income taxes are falling. Creds will be downgraded, but I really want to point out that there's a long—the big difference between a downgrade in credit quality (inaudible). The good thing about investment municipal bonds is that they're really high on the investment-grade scale, and they're a long distance away from bankruptcies so most credits can take two, three, four, five, six, seven downgrades before they even have—being a threat of being in bankruptcy. So, as I say, we're in pretty much a normal pre-recession, early recession market.

Robert Teeter: So, Patrick, one of the types of questions we've received from (inaudible) specific challenges facing the New York area and other areas (inaudible) if you might comment on that a bit.

Patrick Bittner: Yes, I mean, New York is lucky (inaudible) funded. They had about $5 billion in general reserves in the fund. They had $2 billion, $3 billion in their rainy-day fund, which is extra money they set aside to use in case there is an economic downturn.

And the other nice thing about New York is that they have an April budget period. Most municipalities have a fiscal year that goes from June 30 to June 30. New York is one of the few that starts in April. And the good news was that they passed the budget in April. They cut spending going into this year, this fiscal year, by $6 billion to $7 billion and gave Governor Cuomo the authority to cut spending even more if he sees fit. So, a lot of time—he doesn't have to go back to the legislature and get approval to do it.

So, New York is actually doing really well just because they came into it with their pensions almost fully funded and a good level of reserves, and they have the budget flexibility right now to handle lower revenues.

Richard Hough: And so Patrick, on that point, you know, municipals have seen something like a 10% drop over the past month. And while they're highly rated at AA+ or A quality, there is some concern that if the federal government doesn't supply some aid that you're risking—maybe perhaps not in New York but in a lot of other municipalities or states, defaults or bankruptcies, although that's a question, how is it that you're evaluating the safety of those revenue bonds going forward?

Patrick Bittner: Well, first, I would sort of disagree with you. I think from an investment credits, like the AAA, AA, A bonds, they have enough flexibility in their budgets. The nice thing about municipal bonds versus corporations is they usually tend to have general reserves on their books. Single A credits usually have about 10% reserves, general reserves. AA credits have about 20% reserves and AAAs have more. So, you're looking at maybe revenues dropping 10%. Well, they have that money already as a general reserve. But usually what municipalities will do is what they'll do what they always do. They will cut budgets. They will lay off people. They will fire people. They'll put job freezes on. They'll cut services. You know, this is not the first recession we've been through, right? We had the dotcom bubble bursting, people on the Northeast. We had the 9/11 crisis, and we all went through the Great Recession a couple of years ago.

So, most of the managements of these municipalities have already been through this. Yes, this is a lot faster and deeper than the Great Recession. But the good news, again, is that reserves were at record levels. We went into the Great Recession with reserves about maybe 5% in the municipal market, and now we're averaging about—I think the average reserves were 8% going into this crisis. So (multiple speakers) in good shape.

Richard Hough: (Inaudible) as well between the different [properties]. I mean, it just—looking where a lot of our investors are, they're in 46 states, of course, and you're investing across the country. We have a concentration in the southeast and in the northeast. Are there some particular areas that you're watching especially carefully? And what are you looking for?

Patrick Bittner: Yes, I mean, there definitely is. I mean, you're right. I deal in 50 different states, and each state is different. The good news is, like in the southeast, our Virginia, Maryland and North Carolina clients, those are really good, strong states. New York is strong.

The Tri-State Region you have the good, bad and the ugly, right? The good is New York. The bad is Connecticut. Connecticut has not done a really good job of taking care of their pensions. But their new governor has done some really good financial fiscally things. He cut the amount of debt that he was issuing. He increased the rainy-day fund. I think Connecticut has about a $2 billion rainy day fund. And they think that this year's budget deficit might be about $500 million. So, the good news is that, yes—I mean, the bad news is that revenues are down. The good news is that they have the reserves to cover it. So, he's been doing well.

And then the ugly is New Jersey. I mean, they haven't been funding their pension. But just because the state isn't doing well, a lot of the local municipalities are doing well. So, Jersey is one of those kind of states that we're going to watch very closely. Citibank just did an analysis of the state and said that while there wouldn't be any good positions right now, they don't see any reason to sell Jersey GOs or Jersey appropriated paper. I'm in that camp also. I think we need to wait and see.

Richard Hough: Yes, and then, of course, you've got your selective active management and security selection at the municipal level, as you pointed out.

Patrick Bittner: Right. I mean, one of the ways we're going about it right now is, again, we're dusting off our recession playbook just like the federal government did it. Right? What we're trying to do right now is keep it safe, keep it short, keep it simple. We're buying pre-funded bond, which are muni bonds that are backed by government collateral, like, government securities as collateral. I'm sticking to the AAA names and the AA and the high AA names. I'm not really buying any single A credits.

The idea is that you're waiting for a buying opportunity. You want to keep things safe right now. You want to keep your portfolios liquid. You want to review your credits that you have and make sure that everything is acting the way you think it should. And then hopefully at some point in time you'll get an opportunity to extend portfolios and to buy credits at wider spreads than they are right now.

Robert Teeter: So, Patrick, one of the other shorter-term considerations here has been another unprecedented action, which has been the delay in tax payment deadlines for individuals. How are you helping people navigate the shorter-term liquidity needs between now and July tax payments?

Patrick Bittner: Well, that's an easier one because normally what we try to do is we try to buy bonds maturing in April for most of our clients that have tax liabilities; something that we can immunize. And April is a hard time to find bonds. There aren't that many bonds issued.

But because the fiscal year for most municipalities starts June 30th, there are a lot of bonds that mature June 1st, June 15th, and July 1st. So, what we have been doing for a lot of people is we're just rolling their April 1st money into July 1st bonds.

And right now, munis are cheap. I mean, Treasury bills that are due in July are probably yielding 0.1%, and I can get anywhere from 0.8% to 1.2% in bonds that are maturing 7/1/2020. I mean, two-year munis right now, AAA munis are yielding four times more than Treasury bonds are.

Rick mentioned before 10-year Treasuries are at 60 while 10-year AAA munis are at 150. So, there's—the good news is that I can find the paper to help these clients out. And the better news is that it's a very cheap way of doing it.

Robert Teeter: Great, thank you, Patrick. That's very helpful.

Richard Hough: (Inaudible) in terms of very helpful on how we're helping our clients navigate this for the tax deadline. We hate it, but of course, that's also where revenue for municipals comes from.

Also joining us today, as I mentioned earlier, is the high-yield municipal team, and Buck Stevenson, Doug Stevenson, and Ed Appel specialize in issues, tax free municipals that are supporting essential services in the communities, such as regional hospitals or senior living or educational facilities. And as we've seen lately in this crisis how important healthcare can be, and in many respects how fragile it can be, and often serves single communities. New York City where, of course, we have the center of the current crisis has one of the large health systems in the country. But many of the places we invest in may only have a single regional hospital. And this team does original credit work. And I thought we'd hear from them given the widening of spreads, what they're seeing in the higher yield market to support these institutions. And we'll discuss their strategy in this environment after that. So, I'll turn it over to you, Buck.

Buck Stevenson: Thank you very much, Rick. Thank you everyone for taking the time to join us this afternoon. What I'd like to start with is a little overview of what we do. We focus on two essential aspects of the high-yield market in every community, and that is healthcare and education. Both are critical to each community that we live in.

And with that, in the healthcare sector there's two components that we focus on—hospital bond, acute care hospital bonds; and continuing care retirement facilities, senior living facilities. And both are very different. And what I'd like to do is give you an example of a type of a hospital we like to buy. It's a 200-bed hospital located in Ward County, and it is the only hospital for 100 miles.

So, it is essential. It's critical it exists. It's very—finance has a very strong balance sheet. And so far, they have not been overrun by any of the virus issues. So, when you read some of the articles concerning the New York City hospitals, it doesn't play out like that throughout the hospital sector. There's over 5,000 not-for-profit hospitals throughout the country, and each one is different. Each has different demographics. And so, there isn't one brush that paints the hospital sector, what you tend to get the impression of when you read the articles. So, it's very important to realize that.

Another interesting hospital is in Kentucky. It is designated the sole community provider, acknowledging that it needs to be there. They get better reimbursement from our government because of that designation. It's interesting, middle part of Kentucky. There's over 50 major manufacturing, some top 500—Fortune 500 companies are there. And so, it is very well-financed also by a nice balance sheet.

Both of these credits we see having no problem at the moment. None of them have had the issues of being overwhelmed that many of the urban centers have, which is one of the things I want to point out is what we don't invest in. We really don't invest in the urban centers. We like to have what we view as almost a monopoly. The urban centers have safety net hospitals. These are the ones that tend to get overrun. That is what we avoid. So, it's very important to understand what we do but also what we don't do.

We also don't invest in malls, convention centers, tobacco bonds. Some of these things that are as important as what we do to stay away from the things that may have challenging finances during recessions. Most all of our credits have been in existence, some of them for 100 years. So, they've weathered many economic cycles.

Now, I'd like to go into the senior living, the continuing care retirement facilities. We read many articles about senior living centers, and they all talk about what's going on, which is very hard to read. It's very disturbing. But I want to point out they're really not naming it the right thing. These are nursing homes.

Nursing homes are a sector of our market we do not invest in. It's one of the sectors that is actually dominated by the for-profit and private owners, not by the not-for-profit 501(c)(3)s. So, a lot of the things we all read are very disturbing, but it is not the sector that we invest in.

I'll give you two examples of some senior living centers that we do invest in. One is in Illinois. It's in Bloomington, Illinois. They have about 200 independent living units on a 40-acre campus. They've been in existence since 1979. They also then provide assisted living and then skilled nursing if need be. But those two segments are much smaller than the independent living. They received $1.7 million from the payment protection plan that was enacted here, indicating how important they are. They have over 300 days cash on hand so they're well-financed. And to this date, they've had no COVID-19 patients sick.

So, there's many facilities like this around the country that are not in financial distress, nor do we anticipate them getting into financial stress. We view this as money good. It is one of the first question we ask when we look at a credit. Is the credit money good? Does it need to be there? What role does it play?

Those are important, fundamental questions that we go through on every investment we own. Also, what's—

Richard Hough: Okay, I was just going to ask you—

Buck Stevenson: Go ahead.

Richard Hough: —just roughly to take a moment to give people some insight into the team that you work with and how you've approached that detailed work that you're just starting to talk about.

Buck Stevenson: Our team has been together for about 30 years actually. We have really picked the sectors that we feel grab the most amount of interest with the least amount of risk—interest rate, I should say, the best returns.

And so, Ed Appel, well, we met in 1995 and at the time he was at Lehman Brothers and he focused on hospital bonds. He was actually rated the number one healthcare analyst back then for hospital bonds. So, we're very good at what we do. We really know how to focus on it, and we try to cherry pick those couple hundred hospitals of the 5,000 that meet all of our criteria.

One of the metrics that we use in purchasing bonds is we make sure we're senior secured, that there's nobody in front of us. The collateral, the property, plant and equipment are what help back our bonds if we need it. But we very much hope that that's not going to be the case, and that generally is not the case.

All of our credits (multiple speakers)—

Buck Stevenson: Go ahead.

Richard Hough: Yes, on that point and kind of what you're looking for and the deep experience of your team, you mentioned Ed's role in evaluating healthcare companies and nonprofits. So, our organization, do you (inaudible) with the hospital CFOs as we've discussed. A lot of this work is that kind of bottom-up credit work you're looking at to make sure that there's a wide moat around facilities. That it's essential for the community it serves, that you're first in line, that it's well-collateralized, et cetera. But once you've invested in it and you're facing an environment like this, where you have the widening spread, you have revenue risk, potentially, how is it that you are undertaking an ongoing review of your credit in the portfolios? And what are the risks that currently exist in the portfolio?

Buck Stevenson: A very good question, especially during this period right now. What is misunderstood sometimes is that because we invest in what is generally viewed as smaller 501(c)(3) not-for-profits that it might be hard to get information. It actually isn't. They are run like small businesses. They use GAAP accounting. They report quarterly. You can access on some of the [NRM] servers, which are three datacenters that all of our credits need to report their financial information to.

How they report is part of the covenant of the bond deal when they came to market. So, they are mandated to give us this financial data on a quarterly minimum and then an annual statement. On top of that, we have calls with management. Bondholders will use the bond trustee, reach out to the facility and schedule phone calls frequently, especially during times like this, to get an up to date read on exactly what's going on with the facility.

So, access to information is key, and we have that ability to monitor each of our credits. So that's a very good question.

Robert Teeter: Great. Buck, maybe if you could give us a little bit of an overview of what a typical portfolio might look like in terms of a type of deal or their income that's generating now, recognizing that much of what we and you do is customized. But just give us a sense of what a portfolio might look like in today's environment.

Buck Stevenson: Certainly. With our separately managed accounts, we are able to try to customize to one's own risk, meaning you can have a five-year duration or you can have a 10-year duration depending on what you like. On average we have about a seven-year duration. We can provide someone with approximately a 5% to 5.5% tax exempt rate at this current market. We were struggling to find that prior to this correction. This correction has opened up an opportunity. And an opportunity because when the crisis, the liquidity crisis hit, and it was a liquidity crisis, not a credit crisis, everything got painted with the same brush.

So when one fund, who was leveraged and they had to unwind started selling, a lot of people started to worry about what's going to happen to hospital bonds? What's going to happen to senior living centers? And so, as that fund sold a bond, the evaluators viewed that trade to represent all the bonds in that sector. We all got painted with the same brush. And that really is not how it works. Each credit is different.

We saw this in 2008, and we were able to purchase some really nice—some of the best buys of our career during the fourth quarter of '08. And sure enough, by 2009, as things settled, all of the credits we bought really rebounded sharply. We were able to make all of it back in a short period of time because we had really quality stories.

Richard Hough: And is that—

Buck Stevenson: And so that's the—go ahead.

Richard Hough: Is that [box] affecting the environment you're seeing now? I mean, you discussed how good the credits are, that they're not impaired, that you believe that they're sound and will continue paying at this nice rate. And yet there's been a significant drawdown in the high-yield portfolio recently.

And I—is that primarily due to the sell-off in the market generally and without distinction, as you're saying? And (multiple speakers)—

Buck Stevenson: Rick, that's exactly right. You're exactly right. They did not make any distinction amongst credits. They viewed things as one broad brush with healthcare. And so that is exactly when we like to take advantage of these inefficiencies.

One thing I like to point out is municipals are different than many other fixed income markets. We have 1 million different securities in existence. Over 50,000 different issuers. So, it's inefficient. The evaluators can't possibly get to each bond individually at this point. They will over time.

So, right now, we can purchase what someone may (inaudible) is not a healthy bond and it actually is. We know the bond. We follow it, and we can buy it at these cheaper prices. So, it's exactly when I can take advantage of this inefficiency going on.

Richard Hough: And how long—how often in the portfolio are you holding your issues to maturity?

Buck Stevenson: We try to do that on most every purchase. The only reason we would sell is, number one, we don't like the fundamentals and the credit is not performing; or number two, the credit has been bought out by a better rated entity, we've had price appreciation, and we can reinvest in a better opportunity. Those are the two reasons. Otherwise, we like to hold the bond, clip our coupon, and hold it to maturity.

Richard Hough: Yes. So, in many respects you're holding it to maturity, getting that yield and then using these price dislocations that are indiscriminate to make better purchases?

Buck Stevenson: Exactly.

Richard Hough: Well, I appreciate that, thanks. Rob, do you—

Buck Stevenson: Another—

Richard Hough: Do you have anything else to say?

Buck Stevenson: Go ahead. I wanted to make one other (multiple speakers)—

Buck Stevenson: —point, I'm sorry.

Richard Hough: Go ahead.

Buck Stevenson: You're going to read in the papers about pension obligations. Patrick talked about it for Connecticut. It's also very important to know all of our businesses do not have pension problems. They're either fully funded or almost fully funded. They are on a defined contribution, not a defined benefit. And that's significant, so our credits many times are healthier than sometimes the state that they reside in.

Richard Hough: Yes, that's very interesting. Well, when they were talking about the municipal credit issued directly by states or municipalities or we're talking about your higher yielding bonds that invest in specific essential services, these issues and the money that is obtained by floating these credits supports vital services in our communities.

And I'm just so pleased that we have a team that—both for the municipal and state credits that Patrick specializes in on behalf of our clients. And your team is part of what helps make this country function and will help in many respects pull us through this environment. And it's great to be, in many respects, a part of that story.

Rob, unless you've got something else, I think we might open up the lines to any callers who may have questions.

Robert Teeter: I think that's a great idea. We've covered a lot of ground here.

Richard Hough: Great. Operator, we'll take questions now from anyone on the line.

QUESTIONS AND ANSWERS

Operator: (Operator instructions)

Richard Hough: Thank you. And we'll just give a moment for those questions to come in. While we wait for that, and I was talking about these services, whether they're from the state or municipality, I think you might find it interesting that in this environment, many of the schools we invest in are serving meals, not just to their own students but to students in the community.

And so, in many respects we view these investments, whether it's in healthcare, charter schools, as community assets that are truly social impact investments, which have gotten a lot of attention over the past few years. And in many respects our firm doesn't view investing in the state and municipal-issued bonds any differently given the services those entities provide us and our communities.

Do we have any questions in the queue?

Operator: We have a question from the line of Caller 1.

Caller 1: Thank you so much. I really appreciate your comprehensive presentation, each of you. And my question is to each one of you as well, Buck, Patrick, and Russell. Considering the huge differences in the size of the offerings, for example, expecting smaller size in the terms of the small rural hospital and large size where we're coming—when we're considering the corporate issuers. Can an individual investor actually make a good purchase in the 100 to 500 bond range? Or do we have to pay up to get the kind of quality that we really should be seeking now?

Richard Hough: Oh, thanks. Thanks for that question. It's a really interesting one. We'll start with (inaudible).

Patrick Bittner: Thanks, Rick. In this kind of market with the changing economic—I mean, first of all, I think I realize where we're all coming from, right? My job is in investment-grade portfolios. I play defense. My job is to keep your money safe. My job is to be your anchor windward, your safe, liquid money. So, my answer is going to be a little bit different probably that Buck and Doug.

And my answer is right now is we don't know what's going to happen, so I'm keeping it safe. I'm paying up to buy the higher credit qualities, I think municipal bonds, right now, the investment-grade municipal bonds are cheap enough. I'd rather pay up a little bit and lose a little bit of yield but sleep better at night and then have the opportunity a year, six months, eight months, a year down the road to sell that good credit quality bond and buy something a little bit lower credit quality once I understand what the situation is and what's happening.

Richard Hough: And, Patrick, on that point, what about the distinction for an investor in the block side is you can purchase for them versus going into a fund, for example?

Caller 1: Yes.

Patrick Bittner: I mean, the nice thing about individual portfolios is it's—we can gear it towards wherever you are. We can gear it towards the parent who has, you know, $100 million or $5 million or $10 million, or the grandchild that only has $100,000, $250,000. So nice thing about a mutual fund is you have liquidity you can sell. The bad thing is you can't control the credits that you're buying. You can't control the timing. My guess is a lot of people that own mutual funds and didn't sell them are going to be hit with big tax bills at the end of the year because all the mutual funds had redemptions at the beginning of the year. They had to sell bonds to take capital gains.

So now you're going to be seeing in mutual funds at the end of the year. I think your municipal bond, tax exempt portfolio, you're going to get this big tax bill. So that's one of the advantages of owning individual securities.

Richard Hough: Thanks, Patrick. Buck, do you have anything to add to this? Of course, your capability is in both the fund format as well as separately managed accounts for investors.

Buck Stevenson: Correct. We have both structures separately managed, which is generally made up of better credit with shorter durations. And then we have our fund which focuses on gaining the best total return we can. We generally invest in longer bonds at higher yields. So, they're both unique in their strategies, and we do like both of them. An interesting point to your question is, and I'm not sure if you meant this, but you don't have to pay up when you invest with Silvercrest. When we buy a bond, that's the price you get it at. You don't have to worry about paying up for anything.

(Multiple speakers)

Buck Stevenson: —Patrick, we've got—go ahead. Patrick and I are constantly buying bonds at the bid side. So, we're saving you money on a lot of our purchases generally.

Richard Hough: That's a great point. How many brokers will you go to, Patrick, often when you're looking to purchase an issue?

Patrick Bittner: Currently, since everybody's on electronical platforms, I'm going to 60, 70, 80. You know, back in the old days, when you had to call everybody, we dealt with maybe 10, 15 people. But now that it's—like, I—when Buck was saying, when I go right now, I go onto Bloomberg. I put a search in and I'm seeing the whole universe of people offering bonds, even people I don't deal with.

So, I see a bond that I like, and I can always go with somebody that I do deal with to say, hey, I don't deal with X firm. Can you try to buy that bond for me? But, yes, typically I'm looking at when I put out bonds for the bids, I'm going to 50, 60 people. And when I'm looking for bonds, I'm probably the whole universe.

Richard Hough: Which is helpful also in finding different sized lots, but important (inaudible). I'm glad you mentioned that because Silvercrest, of course, is just on the bid side, and we are not capturing any spread and passing it along to our investors. We're aligned in trying to buy the best price possible.

Do we have other questions in the queue?

Operator: I'm showing no other questions in the queue.

Richard Hough: Okay. Well, thank you, and thank you for that question. I appreciate you joining us this afternoon to hear from all of our fixed income professionals. It's a very important part of the market that often doesn't get quite the same scrutiny that equity markets do. And we appreciate the opportunity to—oh, I'm getting notice here that we've got one more question. So before we close up the call, we're going to take that question. I think it's from Caller 2.

Operator: Your line is open, Caller 2.

Caller 2: Yes, thanks, Rick. One quick question, the Fed has been intervening in all of the markets. One of the areas they've sort of declined to participate in is mortgage servicers and I'm curious to know if any of you have any views on whether or not they're going to get involved because I think those guys tend to be undercapitalized relative to the amount of money that they're going to need, given the number of people who are out of work and not paying, arguably not paying their mortgages?

Richard Hough: Patrick?

Patrick Bittner: Well, I was going to punt it over to Russell since it has more to do with tax (inaudible), so I don't know I really have expertise in that area. So, Russell?

Robert Teeter: I'm wondering if we still have Russell—

Patrick Bittner: Russell left.

Richard Hough: Okay (multiple speakers)—

Russell Brown: Sorry. I hit the button twice. I'm sorry. I'm here. (Multiple speakers) I had hit the button, and I didn't realize I had muted it again. I'm sorry. That's not really something which is our area of expertise, but I mean what you've been hearing, we've been hearing as well. It was really an issue, I'd say, mid-March, okay, because the mortgage market was more of a mess then. Okay. There has been some stability there. A lot of the mortgage REITs were selling. So that was completely throwing off the market and everything.

There's been more stabilization there since then. It's hard to speculate about what will be done now ultimately, if anything. But you're correct in that. You can't have a lot of these servicers just all of a sudden, you know, disappearing.

Robert Teeter: Thanks, Caller 2, appreciate you calling in. I think we also have a question from Caller 3?

Operator: Caller 3, if you'd like to ask a question, please press star then one again. Your line is open.

Caller 3: My question has to do with what are you predicting for the amount of money that's being printed and its effect on bond prices five years out or so? Will the chickens come to roost? And will the value of the bonds drop considerably from where they are today when you purchase them?

Patrick Bittner: Rick, I'll take that. I think that's the $10 million question, right? And will this be inflationary? I think we still need to see what's going to happen. Is the Fed going to monetize this debt? Are the deficit hawks going to start winning in Congress and then really clamp down on future spending? It's truly too early to tell, but I think it is a possibility and a concern that we have to be aware of and watch very carefully in the future that this could finally lead to inflation.

Caller 3: Well, the dollar is going to take a hit evidently because you can't print this type of money and not have a dollar lose its purchasing power, which means the bonds that you get today I would estimate, I'm not an expert on this, would have much less value if you were selling them five years or seven years down the line if they're a 20-year bond. So, while the interest generating may be great, the principals, to retrieve the principal, that's going to have a lot less value. I think it's inevitable with this type of situation we're in. Don't you?

Richard Hough: Well, it could well be. I think—this is Rick—that actually remains to be seen as Patrick was saying, in terms of whether it's actually monetized or printed. You know that the exact same analysis was put forth in the Great Financial Crisis when the Fed opened the floodgates and added massive amounts of credit to their balance sheet in order to buy in (inaudible). And the great fear was that the multiplier effect of banks loaning out against those credit would generate a large amount of money in circulation, which would inevitably lead to inflation. And it didn't come to pass far from it.

Caller 3: Well, it came to pass from the point of view, if you look at the purchasing power of an '08 dollar to the purchasing power of an '08 dollar today, it's considerably chopped. It doesn't have the same—

Richard Hough: Not in comparison to history as inflation was kept quite low, and we continue to be in a deflationary environment. And I'm not saying that what you're suggesting won't come to pass, but it really does remain to be seen, and we'll be watching how the debt and the fiscal stimulus ultimately gets monetized or not. I think that's the primary answer to your question.

We've got a question from Caller 4 as well on the line, if we could open his line?

Operator: Caller 4, your line is open.

Caller 4: Hi, thank you for the presentation. I guess I have two more general questions. One is with the Fed. What are—do you have any indication what they're focused on buying right now in the market and what that outlook looks like going forward? Just tagging on the last question.

And then, more general question is other than the speed, which you mentioned earlier, has there been any other big surprises this time around compared to the previous cycles?

Patrick Bittner: Well, Rick, I'll take the part of that. What the Fed's buying right now is on the muni, investment-grade muni side, they started a facility where they're going to start buying bonds from municipalities. They haven't done anything yet because they're still trying to get the paperwork done. They've got a $500 billion facility where they're going to buy one to three-year debt from municipalities, cities with a population of above 250,000, and counties with more than 500,000 people and all the states can borrow money from the Fed. They're still working out how they're going to do that.

So the answer to your first question is they haven't done anything yet because the Fed wants them first to go to the market then prove they can't get access to the market then go to the bank and prove they can't get access through the bank and then come to the Fed. On the corporate side, I know that there is a buying program. I don't know if they bought anything. They also have programs to support money market funds. They have programs to support commercial paper.

Russell, do you have any idea if they're doing any buying in that?

Russell Brown: Well, I know they've been buying commercial paper. As far as what they've been doing in the corporate market, it's very much unclear. And actually, a story came out the other day is that they—in their program, they said they would buy the bonds of companies which have principally their employees in the United States.

Well, what's principally mean? And apparently BlackRock, who was hired to manage the buying program, is having problems interpreting what to buy, too. So, the one thing I will also mention is they do release what they bought but not breaking it out. So, you don't know how many corporate bonds they bought, and you don't know what names that they bought, if any. So, the thing is that they're there, but they haven't necessarily done that much yet. And sort of like Patrick said with munis in a way the markets have kind of taken care of themselves.

(Multiple speakers)

Patrick Bittner: —at the Fed there is making, is reassuring to the markets. It's not—like Buck said, and I mentioned earlier, too, that was a liquidity crisis we had earlier when interest rates spiked up. And markets now are functioning, so I don't know if people really need to go to the Fed right now. I'm sure that there will be some people doing it, but right now the markets are very—are functioning.

Richard Hough: Thanks, Patrick. Caller 4, thanks for your question, as well as for the compliment. Appreciate that. And I appreciate you and all of our clients and friends joining us for this call. Please stay tuned. Silvercrest will be holding future conferences with other expertise on our team and then perhaps from outside the firm. Thanks again for joining us.

Operator: Ladies and gentlemen, this concludes today's conference. Thank you for your participation. You may now disconnect.