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2022 Outlook: Finding Attractive Income & Lower Duration

December 2021

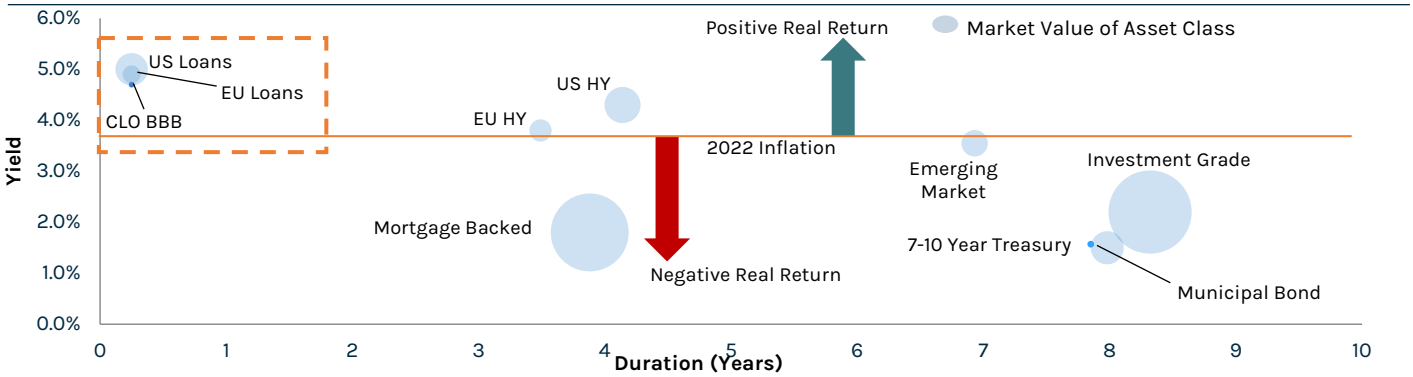
In the current market environment, investors are faced with the challenge of finding attractive current income solutions that offer protection from rising interest rate risk, particularly as many traditional fixed income strategies (proxy: Bloomberg Barclays Global Agg) have suffered negative monthly returns in recent months. Meanwhile, the potential for bouts of volatility is increasing amid rising inflation concerns. To solve for this conundrum, we seek to unearth investment solutions offering higher yields and diversification for Australian investors within the defensive part of their portfolios, and what we view as the more senior, high quality segments of the corporate debt and alternative credit markets; we call it the "sweet spot" of credit. This encompasses a $5.7 trillion[1] opportunity set across U.S. and European loans, corporate bonds, and alternative credit markets.

Importantly, we believe a dynamic, flexible approach to investing in the "sweet spot" of credit offers:

1. **Strong diversification benefits** due to varying risk return profiles and low correlation to traditional fixed income and equities
2. **Opportunity to generate alpha while mitigating risk** by shifting targeted exposures through active portfolio management as value shifts between markets can generate attractive entry points into each asset class

To illustrate the challenges that traditional fixed income investors are facing today, as well as the relative value opportunities available in the corporate debt and alternative credit markets, **Chart 1** plots the current yield against interest rate duration for various fixed income asset classes. The size of the bubbles represents the market value of each asset class.

CHART 1: Bank Loan Opportunity: Attractive Yield Amid Rising Duration Risk



Note: For illustrative purposes only. Sources: ICE BofA High U.S. High Yield Constrained Index (YTW), Credit Suisse Leveraged Loan Index (3yr Yield); ICE BofA European High Yield Constrained Index (YTW); Credit Suisse Western European Leveraged Loan Index (3yr Yield); ICE BofA Emerging Markets Diversified Corporate Index; Barclays U.S. Corporate Index; ICE BofA U.S. Insured Bond Municipal Securities Index; ICE BofA U.S. Mortgage-Backed Securities Index. As of October 31, 2021. The 3.6% projected inflation estimate is represented by Bloomberg's forecasted 2022 CPI YOY Change. Please see endnotes for Index Definitions and an important index disclosure.

[1] As of September 30, 2021. Assumes a 1.16 EUR/USD exchange rate where applicable. Sources: Credit Suisse Leveraged Loan Index, Credit Suisse Western European Leveraged Loan Index, ICE BofA US High Yield Index, ICE BofA European Currency High Yield Constrained Index, Bank of America Research (CMBS Non-Agency), Ares INsight database, and Intex.

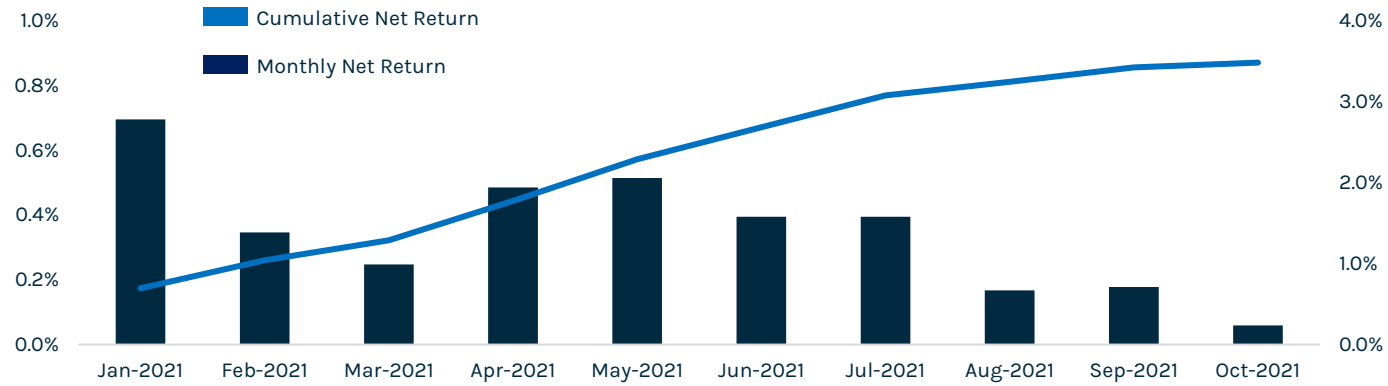
With the outlook of a low default and higher rate environment ahead, we believe certain higher beta, floating rate instruments, specifically bank loans and CLO debt securities, screen attractive from a relative value perspective as they provide high levels of current income and low duration of less than one year. In a rising rate environment, the coupon of floating rate assets adjusts to shifts in short-term interest rates, and as a result, these assets exhibit lower price volatility relative to fixed rated securities.

Looking forward, while we anticipate increased price volatility and dispersion in the credit markets as interest rates and inflation remain at the forefront of policy decision making, we view bank loans and CLO debt securities as attractive allocations within fixed income as we expect retail and institutional demand to remain robust. Additionally, we believe valuations will be supported by strong fundamentals and improving credit metrics, low default expectations and robust capital markets.

Across our multi-asset credit portfolios, including the Ares Global Credit Income Fund ("AGCIF"), we seek to find the most attractive relative value opportunities in the "sweet spot" of credit in order to deliver higher yields with optimal downside protection and lower volatility. Specific to AGCIF, performance has benefited from tactical asset allocation and credit selection, as illustrated by its annualized since inception net return of 9.2%.[2] In addition to weathering varied market environments, we believe AGCIF is particularly well suited to serve a growing appetite for stable incoming-producing strategies among Australian investors as it targets a per annum distribution of 3%-4%. Further, the current ex-ante volatility of AGCIF averages approximately 0.5x[2] the volatility of the broader bank loan and high yield bond universe, illustrating our keen focus on downside protection and volatility management.

Active allocation has proven paramount in successfully navigating the volatile market environment during 2020 and remains critical to unlocking value, particularly as market conditions evolve heading into the end of 2021 and early 2022. Informed by quantitative analysis and fundamental research, our demonstrated ability to express relative value across the credit markets continues to drive strong and stable monthly performance year-to-date, as illustrated in **Chart 2.**

CHART 2: Ares Global Credit Income Fund 2021 Monthly Performance



Past performance is not a reliable indicator of future performance. Performance figures are calculated after fees have been deducted and assume distributions have been reinvested. No allowance is made for tax when calculating these figures. Past performance figures that are less than 12 months are for informational purposes only and are not to be relied upon when considering the likely future performance of the Fund.

In summary, as investors seek attractive income solutions in today's market environment, many may struggle to determine how best to position their credit exposure in order to maximize yield and mitigate risk. By accessing the "sweet spot" of credit, comprised of corporate debt and alternative credit asset classes, we believe investors can overcome these challenges. At Ares, our differentiated approach to capitalizing on the best risk-adjusted return opportunities across the investable universe is rooted in the scale and integration of our Global Liquid and Alternative Credit strategies, which allows us to fully leverage extensive research capabilities, proprietary technologies and longstanding relationships.

[2] As of October 31, 2021. AGCIF's inception date is May 1, 2020.

Index Disclosure & Definitions

Index Disclosure: 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. 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 Credit Suisse Western European Leveraged Loan Index ("CSWELLI") is designed to mirror the investable universe of the leveraged loan market of issues which are denominated in US$ or Western European currencies. The issuer has assets located in or revenues derived from Western Europe, or the loan represents assets in Western Europe, such as a loan denominated in a Western European currency. Loan facilities must be rated "5B" or lower. That is, the highest Moody's/S&P ratings are Baa1/BB+ or Ba1/BBB+. Only fully funded term loan facilities are included and the tenor must be at least one year. Minimum outstanding balance is $100 million and new loans must be priced by a third-party vendor at month-end. The index inception is January 1998.

The Credit Suisse Institutional Leveraged Loan Index ("CSLLI") is designed to mirror the investable universe of the $US-denominated leveraged loan market. The index inception is January 1992. The index frequency is daily, weekly and monthly. New loans are added to the index on their effective date if they qualify according to the following criteria: 1) Loan facilities must be rated "5B" or lower. That is, the highest Moody's/S&P ratings are Baa1/BB+ or Ba1/BBB+. If unrated, the initial spread level must be Libor plus 125 basis points or higher. 2) Only fully-funded term loan facilities are included. 3) The tenor must be at least one year. 4) Issuers must be domiciled in developed countries; issuers from developing countries are excluded.

The BofA US High Yield Master II Constrained Index ("HUCO") tracks the performance of US Dollar denominated below investment grade corporate debt publicly issued in the US domestic market with a maximum issuer exposure of 2%. The returns of the benchmark are provided to represent the investment environment existing during the time period shown. For comparison purposes the index includes the reinvestment of income and other earnings but does not include any transaction costs, management fees or other costs. BANK OF AMERICA IS LICENSING THE ICE BofA INDICES AND RELATED DATA "AS IS," MAKES NO WARRANTIES REGARDING SAME, DOES NOT GUARANTEE THE SUITABILITY, QUALITY, ACCURACY, TIMELINESS, AND/OR COMPLETENESS OF THE ICE BofA INDICES OR ANY DATA INCLUDED IN, RELATED TO, OR DERIVED THEREFROM, ASSUMES NO LIABILITY IN CONNECTION WITH THEIR USE, AND DOES NOT SPONSOR, ENDORSE, OR RECOMMEND ARES MANAGEMENT, OR ANY OF ITS PRODUCTS OR SERVICES.

ICE BofA European Currency High Yield Index ("HP00") tracks the performance of EUR and GBP denominated below investment grade corporate debt publicly issued in the eurobond, sterling domestic or euro domestic markets. Qualifying securities must have a below 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). In addition, qualifying securities must have at least one year remaining term to final maturity, a fixed coupon schedule and a minimum amount outstanding of EUR 100 million or GBP 50 million. Original issue zero coupon bonds, "global" securities (debt issued simultaneously in the eurobond and domestic markets), 144a securities and pay-in-kind securities, including toggle notes, qualify for inclusion in the Index. Callable perpetual securities qualify provided they are at least one year from the first call date. Fixed-to-floating rate securities also qualify provided they are callable within the fixed rate period and are at least one year from the last call prior to the date the bond transitions from a fixed to a floating rate security. Defaulted, warrant-bearing and euro legacy currency securities are excluded from the Index. Inception date: December 31, 1997 The above rules take into account all revisions up to and including December 31, 2010.

The Bloomberg Barclays Capital U.S. Aggregate Bond Index ("Barclays Agg") 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.

ICE BofA U.S. Mortgage Backed Securities Index ("MOA0") tracks the performance of US dollar denominated 30-year, 20-year and 15-year fixed rate residential mortgage pass-through securities publicly issued by US agencies in the US domestic market. Fixed rate mortgage pools are included in the Index provided they have at least one year remaining term to final maturity and a minimum amount outstanding of at least $5 billion per generic coupon. Balloon, mobile home, graduated payment and quarter coupon fixed rate mortgages are excluded from the index, as are all collateralized mortgage obligations.

ICE BofA Emerging Markets Diversified Corporate Index ("EMSD") tracks the performance of US dollar denominated emerging markets corporate senior and secured debt publicly issued in the US domestic and eurobond markets. In order to qualify for inclusion in the Index an issuer must have primary risk exposure to a country other than a member of the FX G10, a Western European country, or a territory of the US or a Western European country. The FX-G10 includes all Euro members, the US, Japan, the UK, Canada, Australia, New Zealand, Switzerland, Norway and Sweden. Individual securities of qualifying issuers must be denominated in US dollars, must be senior or secured debt, must have at least one year remaining term to final maturity a fixed coupon and at least $500 million in outstanding face value. Qualifying securities must have at least 18 months to final maturity at the time of issuance. The index includes corporate debt of qualifying countries, but excludes sovereign, quasi-government, securitized and collateralized debt. Original issue zero coupon bonds 144a securities, both with and without registration rights, and pay-in-kind securities, including toggle notes, qualify for inclusion in the Index.

ICE BofA US Insured Bond Municipal Securities Index ("U0D0") is a subset of ICE BofA US Municipal Securities Index including all insured securities. ICE BofA US Municipal Securities Index tracks the performance of US dollar denominated investment grade tax-exempt debt publicly issued by US states and territories, and their political subdivisions, in the US domestic market. Qualifying securities must have at least one year remaining term to final maturity, at least 18 months to final maturity at the time of issuance, a fixed coupon schedule and an investment grade rating (based on an average of Moody's, S&P and Fitch). Minimum size requirements vary based on the initial term to final maturity at time of issuance. Securities with an initial term to final maturity greater than or equal to one year and less than five years must have a current amount outstanding of at least $10 million. Securities with an initial term to final maturity greater than or equal to five years and less than ten years must have a current amount outstanding of at least $15 million. Securities with an initial term to final maturity of ten years or more must have a current amount outstanding of at least $25 million.

Disclaimer

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