

SOURCES OF INCOME

RISING TIDES

FINDING INCOME IN A
POST-PANDEMIC WORLD



BRIGHT MINDS CAPTURING OPPORTUNITIES OTHERS MAY LEAVE BEHIND



GEORGE CIPOLLONI
PORTFOLIO MANAGER
PENN MUTUAL AM 1847 INCOME FUND



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George Cipolloni and Mark Heppenstall, of Penn Mutual Asset Management, discuss hidden influences in income investing, the importance of being humble and how to protect against human error.

WHAT SETS THE PENN MUTUAL AM 1847 INCOME FUND (PMEFX) APART FROM OTHER INCOME STRATEGIES?

George Cipolloni: Our strategy is unique from a few different standpoints. First, the asset allocation is driven primarily from the bottom-up versus the top-down. We clearly stand out from our competitors by using our bottom-up research as generalists and sourcing the universe of income-producing securities to add long-term total returns.

Second, our allocation is not fixed — it's flexible over time. Many other income funds will consistently have 40% in stocks and 60% in fixed income. Instead, we allow our bottom-up research to guide us toward the sectors of the market that we believe have the best and most favorable balance of risk and reward.

ARE THERE MOMENTS WHEN YOU WOULD PREFER A MORE RIGID APPROACH THAT DOESN'T ALLOW FOR THAT LEVEL OF FLEXIBILITY?

Cipolloni: Frankly, we think of it more as an opportunity. We can be patient and see through near-term volatility, while also recognizing short-term overvalued conditions in the market. We believe that's a clear advantage of our established value-drive investment process.

WHAT ELSE MAKES THE FUND STAND OUT FROM ITS PEERS?

Cipolloni: Simply put, the team. Each of us is an expert in the income universe with depth, breadth and experience to create a collaborative investment culture. Our combined skill set enables us to provide as much value as possible, while also limiting risk. It isn't difficult to just add the highest-yielding securities to your fund. The challenge is in adding income relative to protecting downside risk. That's where we excel.

Another advantage of our team is that we are not strictly segmented into stock-versus-bond experts. Most allocation funds have separate teams responsible for various segments of the fund. For example, the equity team will drive equity decisions while the fixed income team drives high-yield decisions. We don't do that, which allows us to view a company across the capital structure and capture potential alpha opportunities.

HOW EXACTLY DO YOU GO ABOUT IDENTIFYING OPPORTUNITIES?

Cipolloni: We combine objective and subjective factors in our analysis. On the equity side, we start by looking at the 15-year history of a company and breaking down the components of return on capital. We want to tie everything back to a company's income statement, balance sheet and free cash flow statement. The process on the fixed income side is very similar. We want to know if a company has the ability to pay off its debt using internally generated funds versus having access to capital markets, which can be volatile over time. That's the objective part.

WHAT ABOUT THE SUBJECTIVE PART?

Cipolloni: That's a key differentiator for us. Among other measures, we analyze proxy statements to identify the quality of the management teams and decide if we want to invest with them. Are they quality executives? Do they do right by their shareholders and bondholders? Do they make

good capital allocation decisions over time? We spend an extensive amount of time on those softer, subjective factors.

WHAT DOES YOUR RISK MANAGEMENT PROCESS LOOK LIKE?

Cipolloni: Risk is inherently built into our research process and assessed on a case-by-case basis. We aim to protect the downside for every investment we add to the Fund. Additionally, we layer a level of risk control into our portfolio management process. Over the years, we've seen many managers focus solely on one particular stock, just to watch it blow up. Humility is important. You have to realize that no matter how good your research is, there is always more to learn. There's a human element to managing these companies. People are making decisions, and circumstances change.

HOW DO YOU PROTECT YOURSELVES AGAINST HUMAN ERROR?

Cipolloni: Through weightings. For example, we won't buy more than 3% of any individual company, because we want to limit that overconcentration risk. Similarly, we don't want to add value through sector bets. Even if we think health care is the greatest sector in the world, we're not going to own 60% of it. We only allocate 20% of the Fund to a specific industry. Although it's not a mandatory figure, we've used that limit for over 20 years and it makes a lot of sense, providing plenty of flexibility to add value but also protecting us and our investors from unforeseen circumstances.

DO YOU SEE THE SHORT TRACK RECORD OF THE FUND AS A CHALLENGE?

Mark Heppenstall: While the track record is relatively short, it's important to keep in mind the long-tenured investment team has over 20 years of experience in managing balanced income strategies.

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GEORGE CIPOLLONI

THE FUND IS STILL RELATIVELY SMALL. WOULD YOU SAY THAT'S ACTUALLY A BLESSING IN DISGUISE?

Cipolloni: We strongly believe that our smaller size is a real advantage because the team is able to build meaningful positions without moving the market. Securing sustainable income without exposing shareholders to negative returns requires patience, a flexible and nimble asset allocation and a willingness to move away from the crowd.

HOW DOES THE FUND COMPLEMENT YOUR EXISTING SUITE OF FIXED INCOME OFFERINGS?

Heppenstall: In the face of economic uncertainty and volatile markets, investors are looking for solutions that could offer consistent income, while attempting to mitigate risk. The Fund is designed to meet the evolving needs of institutional investors and it complements our existing suite of fixed income offerings. Our team's opportunistic approach to managing fixed income assets across all of our strategies has helped deliver consistent, value-added results for our investors. We look forward to building on our long-term track record of success.

For more information, please visit www.pennmutualam.com or contact Chris Fanelli at Fanelli.chris@pennmutualam.com

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