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Q2 2022 Oaktree Specialty Lending Corp Earnings Call

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PRESENTATION

Operator

Welcome, and thank you for joining Oaktree Specialty Lending Corporation's Second Fiscal Quarter 2022 Conference Call. Today's conference call is being recorded. (Operator Instructions)

Now I would like to introduce Michael Mosticchio, Head of Investor Relations, who will host today's conference call. Mr. Mosticchio, you may begin.

Michael Mosticchio ***Oaktree Specialty Lending Corporation - IR***

Thank you, operator, and welcome to Oaktree Specialty Lending Corporation's Second Fiscal Quarter Conference Call. Our earnings release, which we issued this morning, and the accompanying slide presentation can be accessed on the Investors section of our website at oaktreespecialtylending.com. Our speakers today are Armen Panossian, Chief Executive Officer and Chief Investment Officer; Matt Pendo, President; and Chris McKown, Chief Financial Officer and Treasurer. Also joining us on the call today for the question-and-answer session is Matt Stewart, Chief Operating Officer.

Before we begin, I want to remind you that comments on today's call include forward-looking statements reflecting our current views with respect to, among other things, our future operating results and financial performance. Our actual results could differ materially from those implied or expressed in the forward-looking statements. Please refer to our SEC filings for a discussion of these factors in further detail.

We undertake no duty to update or revise any forward-looking statements I'd also like to remind you that nothing on this call constitutes an offer to sell or a solicitation of an offer to purchase any interest in any Oaktree fund. Investors and others should note that Oaktree Specialty Lending uses the Investors section of its corporate website to announce material information. The company encourages investors, the media and others to review the information that it shares on its website.

With that, I would now like to turn the call over to Matt.

Mathew M. Pendo ***Oaktree Capital Group, LLC - President***

Thanks, Mike, and thank you to everyone for joining the call today. OCSL generated solid results in the second quarter. Adjusted net investment income was up, supported by higher prepayment fees, and we increased our dividend for an eighth consecutive quarter. We produced robust origination activity, including several new investments in the attractive life sciences sector while maintaining the portfolio's excellent credit quality.

Adjusted net investment income per share was $0.18 for the quarter, compared with $0.17 for the prior quarter, extending the momentum we steadily built throughout the calendar year 2021. Earnings were supported by the portfolio's improved yield and larger size, higher prepayment fees and OID acceleration related to investment exits, as well as modestly lower professional fees.

Based on the strength and consistency of our earnings, our Board increased the quarterly dividend by 3% to $0.165 per share. Our

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dividend is now up more than 70% from its pre-COVID level.

We reported NAV per share of $7.26, down 1% from the prior quarter. The decrease was primarily driven by the impact of wider credit market spreads and associated mark-to-market price declines. We also experienced a modest decline in the valuation of certain equity investments given the broader stock market volatility.

Now turning to the portfolio. We originated $228 million of new investment commitments in the second quarter. Of these, 72% were first lien loans, consistent with the prior quarter and included $162 million in private transactions and $26 million in the new issue primary market. We also took advantage of some of the volatility in the liquid credit markets by purchasing $40 million of discounted loans and bonds at an average purchase price of 96%.

The weighted average yield on all the new debt originations in the quarter was 8.7%, up from 8.1% in the prior quarter.

Drawing upon the power and reach of the Oaktree platform and our team's deep experience investing across multiple cycles, we expect to continue identifying compelling investment opportunities. As always, we will focus on deals that are structured and priced attractively.

We received $180 million from prepayments, paydown and exits in the second quarter. The average yield of investments that we exited was 8.2%. Our non-core portfolio continued to run off as we were able to monetize $3 million across 3 equity positions at slight gains to their previous fair values. This book represented $86 million at the close of the quarter, or about 3% of the portfolio at fair value.

Credit quality remains a consistent strength. With disciplined underwriting, we invest selectively across a wide range of opportunities. This allows us to identify compelling low-risk opportunities. Underscoring this, we had no investments on nonaccrual at the close of the second quarter.

Importantly, we continue to be rated investment grade by both Moody's and Fitch, and we maintain borrowing flexibility and ample liquidity to meet funding needs.

We finished the quarter with $455 million of undrawn capacity under our credit facilities and $39 million of cash. The weighted average interest rate on debt outstanding was 2.5% in the March quarter, up modestly from 2.3% in the prior quarter due to higher LIBOR.

In February, we entered into an equity distribution agreement for an at-the-market equity program. During the second quarter, we sold 2.6 million shares under this program at a slight premium to NAV, generating net proceeds totaling $19.4 million after giving effect to sales agents' commissions and operating expenses. We believe this program is a cost-efficient way to raise equity capital over time, and will continue to utilize it when market conditions are favorable.

With that, I'll turn the call over to Armen.

Armen Panossian ***Oaktree Specialty Lending Corporation - CEO & CIO***

Thanks, Matt, and hello, everyone. I'll begin with comments on the market environment and continue with some additional highlights from our fiscal second quarter. Overall, credit quality held strong throughout the quarter, supported by broadly favorable conditions, including low unemployment and steady demand for products and services across sectors.

That noted, potential uncertainties remain from the lingering impacts of the pandemic from supply chains to surging costs. The U.S. inflation rate reached a 4-year high in March. The war in Ukraine and Western government sanctions against Russia in protest of the conflict curtailed global oil supply and exacerbated already high gasoline costs. This conflict has also disrupted already fragile supply chains and boosted other commodity prices, putting even more pressure on the Fed to bring down the elevated inflation rate.

At the same time, coronavirus flareups in China and its renewed restrictions on business and travel threaten to further disrupt supply chains, potentially adding to inflationary pressures. Against this backdrop, the Fed started to raise short-term interest rates in March to taper demand and cool the economy. And while markets have widely expected these and future rate hikes, uncertainty surrounding the

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pace of tightening and the economic implications of the war created volatility in the calendar first quarter, adversely impacting credit spreads across all sectors and leading to the modest write-down in our portfolio.

Historically, in periods of Fed tightening, the risk of recession increases given the possibility that policymakers may overreach raising interest rates too much or too quickly.

At Oaktree, we don't invest based on macroeconomic predictions. But we do believe that it is important to pay attention to the major forces impacting securities markets, the economy, industries and individual companies.

If this volatile environment intensifies and causes market dislocation, we are well prepared to act. Oaktree's roots are an opportunistic credit investing, and we have demonstrated over the years our deep expertise in investing in these types of markets.

This environment may also lead to an increase in demand for private credit solutions. Debt issuance in the private markets reached record highs in 2021 and is expected to be robust this year, partly due to the abundance of capital raises to support M&A activity. However, rising interest rates, declining valuation multiples and ongoing inflationary pressures could reduce PE-backed deal flow over the near term.

While issuers may favor private over public funding sources due to the ongoing volatility in public markets, competition to provide private financing may be significant. Compelling opportunities may therefore be found in the non-sponsor-backed market, in situations where the required financing solutions are bespoke, assets are difficult to value and sector-specific expertise is rewarded. In this less crowded segment of the market, we believe that our scale and capacity to make complex loans is a competitive advantage and can lead to superior investment results.

We also remain focused on identifying deal flow of life sciences and technology industries. We expect to see a steady stream of lending opportunities in these sectors as applied sciences and digital commerce continue to gain prominence throughout the global economy.

In summary, we are actively but judiciously investing, working diligently to make sure that we control risk while delivering strong returns for our shareholders.

Now turning to the overall portfolio. At the close of the second quarter, our portfolio was well diversified with more than $2.6 billion of fair value across 146 companies. 86% of the portfolio was invested in senior secured loans, with first lien loans representing 69% of the portfolio. This reflects our emphasis on being at the top of the capital structure. Nearly 90% of our loans are floating rate, positioning us well for rising rates.

As you know, we have been lending to larger, more diversified businesses to lower risk and bolster credit quality. Median portfolio company EBITDA at March 31 was approximately $118 million. The underlying leverage at our portfolio companies was approximately 5x, lower than middle market leverage multiples, which are near historical highs at around 5.6x. The portfolio's weighted average interest coverage is strong at approximately 3x, meaning our borrowers are well positioned for a rising interest rate environment.

Moving on to investment activity. Our $228 million of new investment commitments were spread across 16 new and 9 existing portfolio companies in the second quarter. Of the 24 portfolio companies we invested in during the quarter, 9 were private deals, 3 were primaries and the remaining 12 were secondary purchases, which were generally smaller in size and purchased at a discount to par.

Our ongoing progress in the life sciences sector was particularly pronounced in the March quarter. We invested a total of $62 million to 3 companies that are well positioned for growth in this sector.

These included Innocoll, a provider of health care supply chain and emergency preparedness, infrastructure services to government and commercial customers; Impel, a commercial stage biopharma company focused on developing transformative therapies for people suffering from central nervous system diseases; and SiO2 Material Science, an advanced material sciences company that has invested in new technology for the packaging and containment of biological drugs and molecular diagnostics.

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These are each compelling investments priced attractively with favorable terms that provide meaningful downside protection. Our origination activity remains healthy in this sector and across a wide range of industries, fueling steady momentum as we progress further into 2022.

Now I will turn the call over to Chris to discuss our financial results in more detail.

Christopher McKown ***Oaktree Specialty Lending Corporation - CFO & Treasurer***

Thank you, Armen. OCSL delivered another quarter of solid financial performance, continuing the strong momentum from the first fiscal quarter of 2022 and fiscal year 2021. In the second quarter, we reported adjusted net investment income of $32.3 million or $0.18 per share, up from $31.2 million or $0.17 per share in the first quarter. The increase was primarily the result of higher income from prepayments and lower professional fees. Partially offsetting this was higher interest expense related to the impact of rising LIBOR on our floating rate liabilities.

Net expenses for the second quarter totaled $24.2 million, down $5.1 million sequentially. The decrease was mainly due to lower incentive fees driven by a $5.5 million decrease in accrued capital gains incentive fees resulting from the unrealized losses during the quarter and $0.5 million of lower professional fees. This was partially offset by a $0.5 million increase of higher interest expense due to an increase in borrowings in our larger investment portfolio.

Turning to our credit quality, which continues to be excellent. As Matt mentioned, we had no investments on nonaccrual at quarter-end, as all of our portfolio companies made their scheduled interest payments.

Now moving to the balance sheet. OCSL's net leverage ratio at quarter-end increased moderately from the December quarter to 1.02x. Net leverage continues to be at the high end of our target range of 0.85x to 1x and will tend to fluctuate every quarter depending on the timing of investment fundings and portfolio prepayments.

As of March 31, total debt outstanding was $1.4 billion and had a weighted average interest rate of 2.5% and up from 2.3% at December 31 due to rising LIBOR. Unsecured debt represented 47% of total debt at quarter-end, down slightly from 50% in the prior quarter. At quarter-end, we had total liquidity of approximately $494 million, including $39 million of cash and $455 million of undrawn capacity on our upsized credit facilities. Unfunded commitments, excluding unfunded commitments to the joint ventures were $195 million, with approximately $152 million of this amount eligible to be drawn immediately as the remaining amount is subject to certain milestones that must be met by portfolio companies.

Now turning to our two joint ventures. At quarter-end, the Kemper JV had $390 million of assets invested in senior secured loans to 60 companies, down slightly from last quarter, driven by portfolio payoffs during the second quarter as well as spread widening across the portfolio. The JV generated $1.9 million of cash interest income for OCSL in the quarter, and we also received a $700,000 dividend, up from $450,000 in the prior quarter, as a result of the portfolio's continued strong performance.

Leverage at JV was 1.4x at quarter end, in line with the prior quarter.

The Glick JV had $150 million of assets at March 31. These consisted of senior secured loans to 44 companies. Leverage at the JV was 1.2x at quarter-end. During the quarter, we received $1.1 million of principal and interest payments of OCSL's subordinated notes in the Glick JV.

In summary, we continue to be very pleased with our financial results and believe our diverse portfolio and flexible balance sheet positions us well for the future.

Now I will turn the call back to Matt.

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Mathew M. Pendo ***Oaktree Capital Group, LLC - President***

Thank you, Chris. Our strong financial results for the quarter enabled us to generate an annualized return on equity of 9.7%, slightly higher than the 9.5% we generated last quarter. While we are very pleased with our results this quarter, we believe there are still ways for OCSL's ROE to increase going forward.

First, we remain focused on positioning the portfolio for an improved yield by rotating out of lower-yielding investments and into higher-yielding loans. At quarter end, we had $41 million of loans priced at or below LIBOR plus 4.5%, which we will look to opportunistically exit over time. Our new investments continue to come on the books at attractive yields, which means there is more upside in yield on that portion of the portfolio that we expect to realize over time.

As we discussed before, another ongoing opportunity for us to support our ROE target is to further optimize our joint ventures. We can accomplish this by selectively rotating out of lower-yielding investments into high-yielding ones as well as increasing leverage at the JVs. We've made good progress on this to date as both vehicles are generating ROEs to OCSL of just over 10%. That said, the joint ventures continue to have capacity, and we will selectively rotate and grow these portfolios over time which we believe will be accretive to ROE.

Finally, we believe OCSL is well positioned for a rising rate environment, with 89% of our investment portfolio of in floating rate assets, an increase in base rates over our weighted average interest rate floor of approximately 80 basis points may positively impact our net interest margin.

In conclusion, we are very pleased with our strong second quarter financial results. We are excited about our prospects for the remainder of the year and are optimistic that we will continue to be able to identify new attractive risk-adjusted investment opportunities, allowing us to provide strong returns to our shareholders. Thank you for joining us on today's call and for your continued interest in OCSL.

With that, we're happy to take your questions. Operator, please open the lines.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from Kevin Fultz with JMP Securities.

Kevin Edward Fultz ***JMP Securities LLC, Research Division - VP & Equity Research Analyst***

Clearly, there's been a significant slowdown in deal activity so far in 2022 relative to 2021 parsing out sponsor activity versus non sponsor. It appears that non-sponsor activity levels have been more resilient than on the sponsor side. Just curious if that's what you've seen so far in 2022? And maybe also if you could share your thoughts on why that's been the case.

Armen Panossian ***Oaktree Specialty Lending Corporation - CEO & CIO***

Thanks for the question. This is Armen. I think it's hard to deduce meaningful conclusions from just one quarter. But what I would say is that -- and this is more anecdotal, but on the sponsor side, I think there was a flurry of activity last year. The debt capital markets were pretty open. The private credit markets were quite strong. Valuation multiples were high. And then as we got into November and December of last year, there was a little bit of volatility and then a lot more volatility in January and February.

And what we found was that sponsor activity with new LBOs as well as repricing activity in the broadly syndicated loan market - both of those took a really big step back just given the volatility in the markets. And so very few deals gotten done with leverage by our sponsors in the first 2 months of the year.

And again, anecdotally, it sort of felt like it was coming back in March and April. The last 2 weeks of March were quite strong. And then with April, for the first 2 weeks, it was okay. And so we did see some new LBOs get announced. But as we look forward this year, and if we

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look at the broadly syndicated loan market as an indicator of health, for the sponsor LBO activity, it would suggest that LBO activity is down and that sponsors are taking a little bit of a step back and/or prospective sellers are not interested in transacting at depressed valuation multiples.

So I think it is true that on the sponsor side, things appear slower in comparison to last year. And we would expect that if the current market conditions persist, that they will continue to be slow. On the non-sponsor side, it's hard to gauge the resilience or lack thereof of that part of the market. But the reason it is likely to be resilient relative to the ups and downs or cyclicality of the sponsor market is that, generally speaking, on the non-sponsor side, borrowers are taking on credit for strategic reasons. They're not doing it for a transactions, they're not funding dividends. They're doing it to acquire a competitor to build out a manufacturing plant to onshore what was historically offshore production given some of the supply chain disruptions that have occurred over the last couple of years.

And so those strategic initiatives are typically not really tied to market conditions. They're just tied to the return on investment or the return on equity that that particular borrower assesses with with that initiative and whether they could find a willing private credit or direct lending counterparty to transact with.

So I think the drivers are just different between sponsor and non-sponsor -- but I'd be remiss not to say that the total size or the opportunity set of attractive non-sponsor deal flow is probably still smaller than the sponsor side of the market. So even though it might be resilient, it's still not likely to pick up with such alacrity that it would counter all the reduction in deal flow on the sponsor side.

Kevin Edward Fultz ***JMP Securities LLC, Research Division - VP & Equity Research Analyst***

Okay. That's really helpful color, Armen. And then just one follow-up in regards to portfolio positioning. Are there any pockets or industries that you find particularly attractive in the current climate?

Armen Panossian ***Oaktree Specialty Lending Corporation - CEO & CIO***

I think life sciences is definitely the one that comes to mind, mainly because -- well, it's kind of two things. One is, if you look at the equity index for life sciences companies, it is down over 30% year-to-date, over 50% year-over-year. And that volatility in the equity market and the depressed valuation multiples for some of these life sciences companies makes it such that those borrowers would prefer to finance themselves differently rather than tapping equity, dilutive equity. And so we've seen a meaningful uptick in our pipeline of potential deal volume on the life sciences side.

And the second reason we like it -- so the first was just taking advantage of market volatility, and we like doing that at Oaktree. The second is that life sciences as an industry, I wouldn't say it's entirely this way, but it's substantially this way, it is fairly uncorrelated with global GDP. The reason is the pace of scientific innovation is what drives the profitability and growth and value of these businesses. It isn't like a general industrial or consumer packaged goods or a discretionary item. It is -- generally speaking, the places that we invest in life sciences, these are need to have, must-have life-saving, life-changing therapies and drugs.

And therefore, if a company is successful in innovating in those areas, there is a large unmet need that will buy that product or will need that product irrespective of what's going on in the global economy. So that lack of correlation from a portfolio management perspective is quite attractive so that you don't have an entirely procyclical sponsor-only set of deal flow that will correlate to one in a pandemic type of setting or some other global economic slowdown.

I think we're more focused on the industries that are -- or the companies that are going to be problematic, and that's where we're spending most of our time. It's just avoiding land mines, to be honest with you. We're rather than pivoting towards what's most attractive. I think there's more danger in the market than there is opportunity right now.

Operator

The next question comes from Bryce Rowe with Hovde Group.

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Bryce Wells Rowe ***Hovde Group, LLC, Research Division - Research Analyst***

I wanted to maybe start on balance sheet leverage and prospects going forward. So obviously, you're slightly above your targeted range. Kind of curious how you think about balance sheet leverage at this point? And I mean, do you see -- is there some appetite to go even higher if some of these maybe secondary market opportunities continue to present themselves or do you feel more comfortable trying to push the balance sheet leverage back into that 85 to 100 range?

Mathew M. Pendo ***Oaktree Capital Group, LLC - President***

Bryce, it's Matt. Matt Pendo. I think while we were at 1.02x, I really view that as just 1x. And we had a loan coming back after the quarter-end that we knew of. So that's one of the reasons why we're e slightly above. But I still think of it as we were 0.85 to 1. We have lots of liquidity and capacity across our capital structure. I think we're at the lower range of many of our peers. So I feel like we've got a lot of capacity if there's a great opportunity to invest.

As Armen just said, we're going to be very, very disciplined here, just given some of the volatility in the market. But as you saw last time going into the pandemic, we had a lot of dry powder, a lot of flexibility and we invested pretty aggressively and effectively and took leverage up. So I think it's a little too early to kind of predict that. But I think we've got the flexibility and the capacity to do what makes sense here. I think we're really, really well positioned with our leverage and our capital structure and our liquidity. And so we'll be prepared if an opportunity presents itself. But I think it's too early to kind of call that right now.

Bryce Wells Rowe ***Hovde Group, LLC, Research Division - Research Analyst***

Okay. That's helpful, Matt. I appreciate it. And then maybe one other question just around the dividend and the dividend level. I certainly appreciate the eighth consecutive dividend increase here. Just want to try to understand kind of what the thought process might be against the current macro backdrop with layering in the prospects for higher interest rates having a positive impact on the revenue stream and on NII. Just kind of wondering if we should think about maybe future dividend increases despite a murkier backdrop and just want to understand how much cushion you might want to have for any kind of deterioration or downturn?

Mathew M. Pendo ***Oaktree Capital Group, LLC - President***

Sure. It's Matt again. It's a great question. I think as you pointed out, we have been able to increase the dividend for eight quarters now, and we obviously like doing that. In terms of the future, it's up to the Board, as we've explained previously that the dividend is the output of the earnings of the portfolio.

To your point, as interest rates go up, that's going to be helpful to the portfolio, and we get more specifics on that. That being said, we're kind of in a period now as LIBOR is going up so far and we're kind of transitioning above the floor, some loans above the floor, some below floors. So how that kind of plays out in the dividend is -- and earnings is a little too early to predict.

So I think for now, I just kind of leave you with we felt great about the ability to increase the dividend. We're pretty thoughtful about what we do with the dividend, it's a function of the portfolio. And I don't think you should necessarily model out a bunch of dividend increases just based on interest rates because rates are obviously moving pretty dramatically kind of day to day or week to week. So I just wouldn't do that just yet.

Operator

Our next question comes from Ryan Lynch with KBW.

Ryan Patrick Lynch ***Keefe, Bruyette, & Woods, Inc., Research Division - MD***

First question I had is just looking at your investment activity this quarter. After several quarters of basically staying out of the secondary market, you guys got back into that marketplace with $40 million of fundings this quarter. My question is, can you explain what is the nature of the investment thesis behind those investments?

Obviously, there was some volatility in the marketplace this quarter. Is it the intent that you find good companies there that you can get it at a price that you think will make an attractive return and hold those securities until maturity and discounted price will allow you to generate a sufficient return for OCSL? Or are those more dislocations that you see that are more temporary securities that you can buy

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and what you think at a discounted price and then trade out of them, whether it's a couple of months or a couple of quarters down the road?

Armen Panossian ***Oaktree Specialty Lending Corporation - CEO & CIO***

Thanks for the question. This is Armen. So the first statement I would make is that whatever we do buy, whether it's primary or secondary, is always with the intention of holding it to maturity and feeling comfortable with both that risk and that return.

Now with tradable credit, you may be in a situation where you buy something and it trades up more rapidly than you thought or it trades down because of some sort of change in the picture for the company and you have to reassess because you always need to look at risk-adjusted return, prospective return with any kind of meaningful change in price in those securities. So again, we buy things with an intention to hold them to maturity, but we are happy to trade out of them if they do move the other direction.

The reason you see some elevated activity in secondary purchases is because we're always looking for the best relative value in credit for OCSL and for all of our clients at Oaktree. So when we look at the spectrum of what's available in the market, there's sponsor lending, non- sponsor lending, episodically some sort of opportunistic or rescue lending, and then there's tradable credit, both loan and bond. And when we looked across that spectrum, there really isn't, I would say, a lot of opportunistic or episodic rescue lending right now.

But on the sponsor side, what we saw was that there was muted deal flow. But in terms of terms on the deals that did get done, they were no different than where they were at in most of 2021. Same sort of spread, same sort of return, same sort of legal protections. Meanwhile, the publicly traded market was meaningfully backing up. Spreads were widening in the quarter, they widened maybe 25 to 50 basis points in both bonds and loans. But the dollar price, especially in bonds, moved down a lot because of duration.

And so as we looked at the quality of the issuers in bond and loan land, the publicly traded side, and we compared them against -- generally speaking what are smaller businesses in the private credit side and the opportunities that we were able to source or look at in the quarter. We found that it made a lot more sense on the margin to invest in bigger businesses with bigger capital structures where bonds, especially were trading down -- today, some of these bonds are in the 80s now, and they were issued 2 or 3 years ago and might have been trading at 105 or 110 just 9 months ago.

And so that convexity, the opportunity to earn convexity and NAV appreciation through a combination of good underwriting and solid day-to-day evaluation of prospective returns through our trading desk and through all the other adjacent strategies that we have to direct lending at Oaktree, we thought that we would be able to deliver alpha through that relative value comparison between public and private. And so that's what you see in the activity in the first quarter, and that's why you didn't see it so much in the last 5 or 6 quarters.

Ryan Patrick Lynch ***Keefe, Bruyette, & Woods, Inc., Research Division - MD***

That makes sense. That's helpful color. So I would assume based on how markets have kind of acted so far in the calendar second quarter, based on your kind of outlook for a lot more economic uncertainty, I would assume that you guys are anticipate continuing to be fairly active in that secondary market and that could become more of a consistent component of fundings going forward. Is that a fair assumption?

Armen Panossian ***Oaktree Specialty Lending Corporation - CEO & CIO***

Yes. I wouldn't go that far, but what I would say is that it is a very active area of interest for us and we will always think about the incremental publicly traded opportunity versus the private opportunity we're seeing. And I don't want to make any sort of forward-looking guidance or statement on that.

But it continues to be a very attractive opportunity set right now, but you have to understand that there is likely to be continued volatility this year with inflation, with Fed action and to be measured in pace and approach and always think about what the alternative is. So that's all I'll be able to say about.

Operator

Our next question comes from Melissa Wedel with JPMorgan.

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Melissa Marie Wedel ***JPMorgan Chase & Co, Research Division - Analyst***

I appreciate you taking my questions this morning. The first thing I'm trying to reconcile a little bit is what sounds like a somewhat cautious tone on your part in terms of potential Fed policy. And I know that your general approach is often to keep some dry powder available and yet you're running towards the higher end of your target leverage range. Can you sort of help reconcile that? Are there any larger anticipated repayments coming up that we should be thinking about?

Armen Panossian ***Oaktree Specialty Lending Corporation - CEO & CIO***

I mean we're always getting some repayments. I wouldn't want to give any sort of forward guidance on anticipated repayments. We feel very good about the performance of our portfolio. We also have, as I mentioned, this uncorrelated life sciences book that is both high yielding and performing quite well. So we will always evaluate the proper makeup of our capital structure. We generally run more conservative on leverage than a lot of publicly traded BDCs, and we like doing it that way.

But it's just -- frankly, it's just a blocking and tackling day-to-day decision. We are cautious for sure, about what we're seeing in the market. But we're very comfortable with the portfolio that we have. So we're not looking to generate cash or sit on cash or anything like that. We feel like we have -- if needed, we feel like we do have ample liquidity to take advantage of opportunities. But we're staying cautious and building up our portfolio from bottoms up.

Mathew M. Pendo ***Oaktree Capital Group, LLC - President***

And we do have -- Melissa, it's Matt. We do have, as we've talked a lot of times some very, very high quality, liquid, relatively lower-yielding assets that to the extent we wanted to redeploy that into higher-yielding investments as we've been doing over the quarters. We have that lever as well.

Melissa Marie Wedel ***JPMorgan Chase & Co, Research Division - Analyst***

Sure. I appreciate that. And I guess another question is bigger picture in nature. Given the volatility that we've seen in the forward curve, I think back to a couple of quarters ago when you were talking about potentially investors, there being a greater risk of rate increases or rate hikes that weren't being priced into the forward curve. It seems like we've come full circle on that a little bit with a lot of volatility in the forward curve. So to the extent that you think about sort of policy mistakes, I guess I'm curious about your thoughts if you think that the forward curve is -- has overshot to any extent.

Armen Panossian ***Oaktree Specialty Lending Corporation - CEO & CIO***

That's a tough one to gauge. I would say I don't know. I don't know that it's overshot, but it certainly now reflects the Fed's hawkishness, at least in the short run for rate hikes to combat inflation. If you look at the euro-dollar forward curve, which is effectively short-term rates and the expectation of the rate hikes, it is expected that there will be continued rate hikes this year. I mean we need to pull it up. I think it's probably another 75 or 100 basis points that it assumes for the rest of this year. But it also predicts a rate decline, a short-term rate decline next year.

And so there's this sort of upside down V-shape on the expectation, market expectation on short-term rates, which would indicate that inflation is too high, north of 8%, and the Fed must do something to stop that. But with some of the inherent issues in the economy around inflation but also some of the demand destruction that could be caused by higher rates, the market generally thinks that there can be a recession in 2023. And therefore, the Fed will need to reduce rates in 2023.

So I think that inflection of when rates rise to stop inflation versus when they need to decline to combat some sort of recessionary outcome. I think that's going to create continued volatility. So that's what I'm most focused on in terms of Fed policy and what their tone is.

In terms of long-term rates, the return on the 10-year is north of 3% now, which is, frankly, I mean, if it were to go up to 4% and stay at 4% for an extended period of time, that would be a dangerously high level, which could create significant stress amongst consumers and companies without any sort of Fed or treasury action to counter that.

We would need to stay there for a couple of years rather than a couple of months. But if you were to ask me what keeps you up at night, it

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would be that. It would be high rates for a longer-than-expected period of time on the long end of the curve, which impacts real estate values, impacts other types of lending and could create a need for deleveraging that I don't think very many consumers or corporations are thinking about right now.

Operator

(Operator Instructions)

Showing no further questions. This concludes our question-and-answer session. I would like to turn the conference back over to Mr. Mosticchio for any closing remarks.

Michael Mosticchio ***Oaktree Specialty Lending Corporation - IR***

Great. Thanks, Sarah, and thank you all for joining us on today's earnings conference call. A replay of this call will be available for 30 days on OCSL's website in the Investors section or by dialing 877 344-7529 for U.S. callers or 1 (412) 317-0088 for non-U.S. callers with the replay access code 4588025, beginning approximately 1 hour after this broadcast.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.

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