CION Credit Market Update – February 28, 2022

Into the Breach

The month started with market uncertainty around the potential for more aggressive Federal Reserve interest rate increases. This ratcheted up with a strong January employment number early in the month, and the Bureau of Labor Statistics release of CPI for the 12 months ended in January 2022. At 7.5%, the number was well over market expectations and the highest recorded in 40 years.

Expectations that the Fed would increase rates by 50 basis points at the March meeting pushed yields higher, with the front end of the curve seeing the biggest jump. This resulted in a flattening yield curve. Powell and his deputies were very careful to indicate that the Fed would be transparent about upcoming increases and that it would be raising rates by 25 basis point increments.

The Russian invasion of Ukraine led to a decisive "risk-off" move by investors, which brought the yield on the 10-year Treasury back down. It finished out the month only five basis points higher than it started. The impact of sanctions against Russia is likely to be significant and potentially long term. While U.S. growth may be somewhat shielded, globally expectations for growth in 2022 and 2023 may be modified downward.

With the increase in oil prices to well over $100 barrel, controlling inflation will be more difficult. Chairman Powell's testimony to Congress made clear that the Fed is intent on raising rates, but is cautious and committed to remaining flexible as it navigates the increased uncertainty. The advent of Quantitative Tightening, or selling off the assets held on the Fed's balance sheet, is also still in play and may start by mid-year.

A Closer Look: The Impact of the Ukraine Invasion on Growth

On Monday March 7, the price of a barrel of crude oil hit $130 before falling back. Auto club AAA reported that the U.S. national average for a gallon of gasoline has soared 45 cents a gallon in the past week and topped $4.17 on Tuesday, as the ban on imports of Russian oil was announced. Higher oil prices will hit consumer spending.

However, consumer balance sheets remain in good shape. Household debt has increased, but it is largely due to new and refinanced mortgages as the housing boom continues, and to investors anticipating rate increases and locking in financing while rates are lower. Credit card debt remains below where it was pre-pandemic, as consumers used stimulus and higher wages to pay down debt.

The employment picture is solid, with February non-farm employment coming in at a huge 678,000 jobs added. December and January job growth were revised upward, and the unemployment rate fell to 3.8%. While job growth at this level may not be sustainable going forward, it seems clear that the pandemic's impact on the labor markets has faded, removing some uncertainty. Overall, growth may see some slowdown, but is still likely to be above trend.

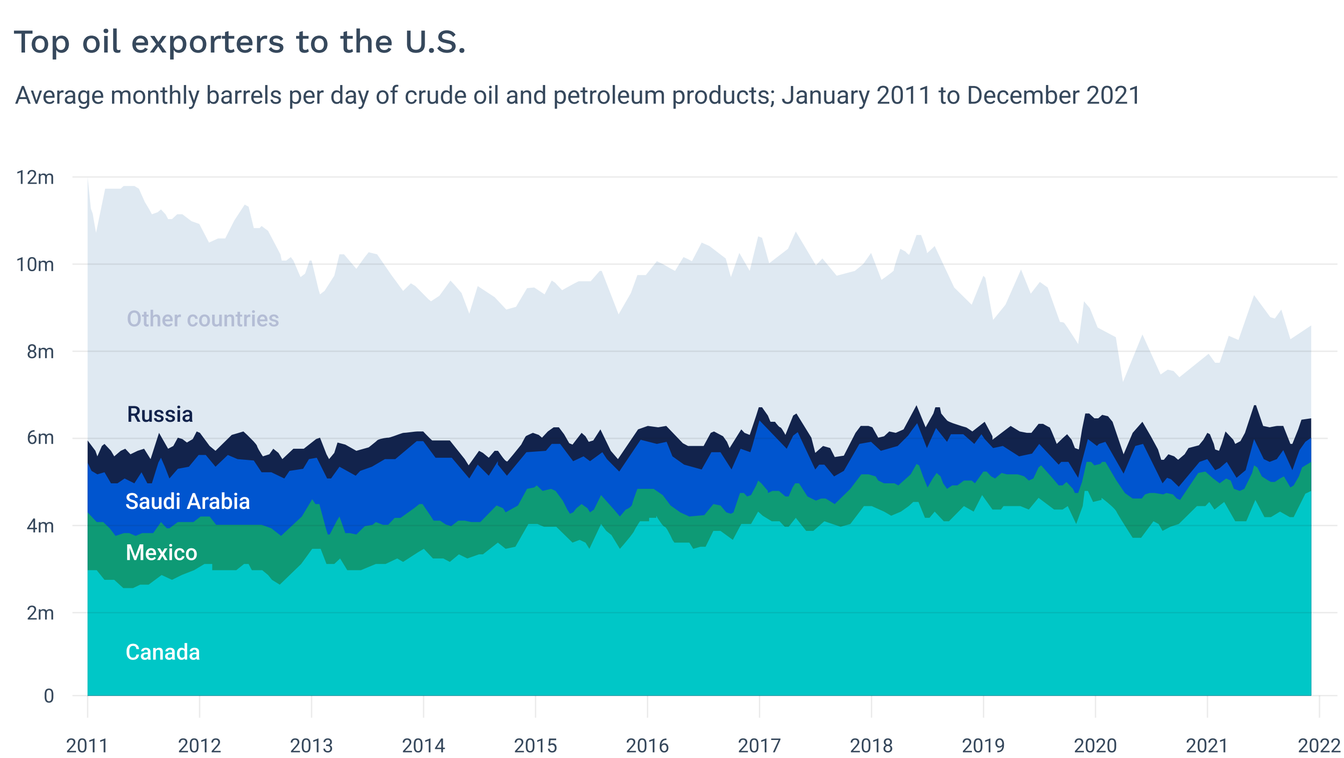
Performance Among Credit Indices

	MTD (1/31/2022 - 2/28/2022)	YTD (as of 2/28/2022)	TRAILING 1 YEAR (2/28/2021 – 2/28/2022)
Credit Suisse Leveraged Loan Total Return Index (CSLLLTOT)	-0.49%	-0.13%	3.24%
Bloomberg US Corporate High Yield Total Return Index (LF98TRUU)	-1.02%	-3.73%	0.64%
Bloomberg US Aggregate Total Return Index (LBUSTRUU)	-1.11%	-3.24%	-2.64%
Bloomberg Municipal Bond Index (LMBITR)	-0.35%	-3.08%	-0.65%
Palmer Square CLO Debt Index (CLODI)	-1.13%	-0.73%	2.38%

Source: Bloomberg as of 3/1/2022

Chart Spotlight: The Ban on Russian Oil

Russian oil comprises about 3% of U.S. crude oil imports..



Data: U.S. Energy Information Administration; Chart: Kavya Beheraj/Axios

Credit Asset Classes

Private Credit	Structured Credit	High Yield
The Economist recently published a special report on private credit in which they explore the growth of the asset class. The piece concluded that “Private credit gives investors more options in the middle ground of risk, between staid bonds or syndicated debt and racy private or growth equity. Expected annual returns range from 4% to the low teens, depending on the product." Additionally, the piece looked at the impact of the pandemic on the asset class and found that the big private-market players were a stabilizing influence: many stayed in the game even as liquid markets briefly seized up. "Private-credit funds and private equity owners did a lot of bespoke rescue financing and other patching up, often in tandem," reports Debevoise & Plimpton.	S&P Global reports that the leveraged loan market volatility over the last three weeks of February left the S&P/LSTA Leveraged Loan Index with a negative return year-to-date, wiping out the solid start for the asset class at the beginning of the year. The year-to-date return is negative (-0.49%). While the loan market has hit a rough patch these past several weeks, money continues to flow into U.S. loan funds, with $912.5 million added in the week ended Feb. 23, bringing the year-to-date total inflow to $13.2 billion. This was the first weekly inflow of less than $1 billion in seven weeks. Loan market volatility has slowed the new-issue market of late, however, with volume down significantly from a robust January.	Rocky conditions persisted for U.S. high-yield bonds as the situation in Ukraine intensified, as investors pulled $17.7 billion from retail funds over the seven consecutive weekly outflows from January 6 to February 23. The ratings categories performed roughly in line with each other for February, but BBs are still notable underperformers for the year-to-date period. The best performing sectors in the market in February included Leisure, Aerospace, and Gaming, while the worst included Building Materials, Consumer Products, and Homebuilding.

Other Related Asset Classes

Treasuries	Investment Grade Corporates	Municipals
The benchmark ten-year Treasury rose to almost to 2% before falling back to end the month only five basis points higher than the start. The return of the index was -0.66%. The differential between 2- and 10-year Treasury yields ended February at approximately 20 bps, an extremely narrow spread that had market observers concerned about the possibility of an inversion.	Corporate bonds suffered a negative (-1.02%) return in February. Corporate spreads widened 16 bps in February, bringing year-to-date spread widening to 30 basis points. Outflows from the asset class were lighter than the previous two months, at $482 million.	For the full month, short-term municipal yields rose 17 bps and long-term yields increased by just 3 basis points, continuing the yield-curve flattening trend that began in the fall of last year. Volatility has resulted in significant municipal fund outflows and total year-to-date redemptions of $8.3B. Tax-exempt supply has been strong, up 14% year-over-year, even with total municipal issuance down 9% year-over-year.