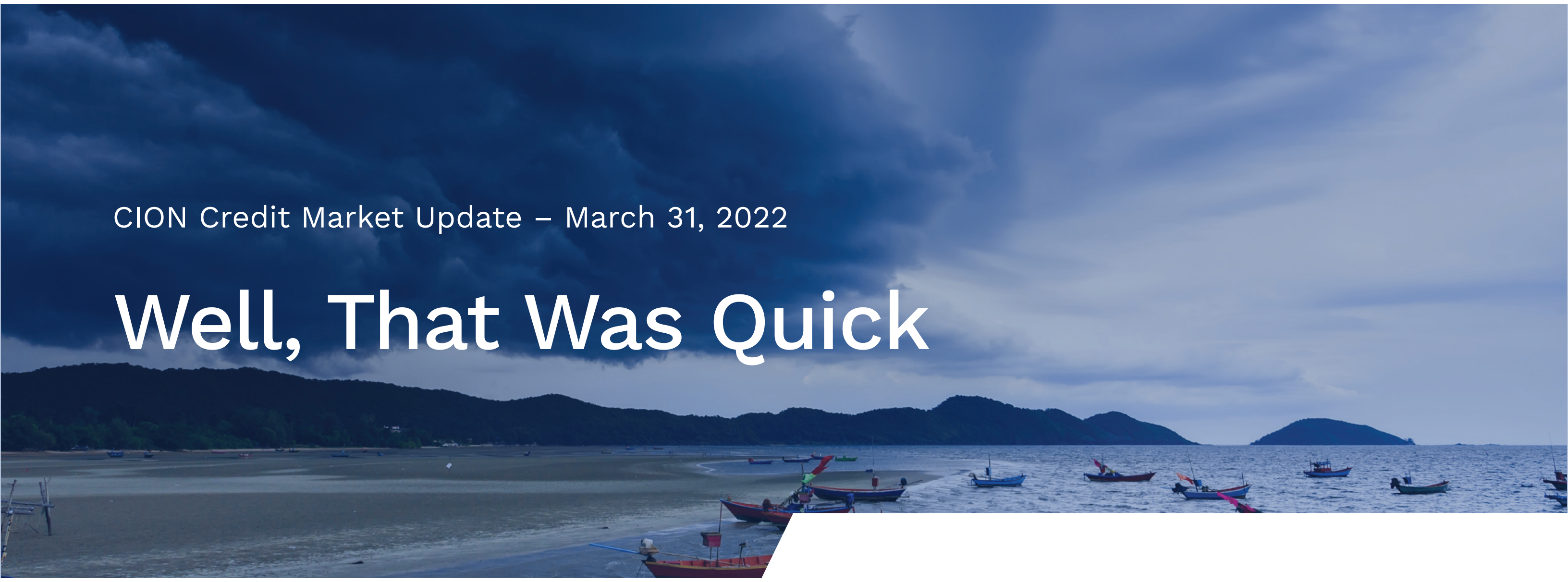


CION Credit Market Update – March 31, 2022

Well, That Was Quick

The fierce resistance of Ukrainians to the Russian invasion was unflagging throughout the month, with the result that Russia was first stalled and then pushed back from the primary target of Kyiv. The unprecedented levels of sanctions against Russia have resulted in further disruption of supply chains and higher energy prices – both of which were already contributing to intransigent inflation.

With inflation at 40 year highs and a strong February jobs number, the FOMC meeting in March was almost anticlimactic. The Fed did as expected and increased the Fed funds rate by 25 basis points. Equity markets began a recovery and ended the month with positive performance, if not enough to overcome the negative year-to-date of January and February.

Bond markets were not similarly inclined. Federal Reserve Chairman Powell, in keeping with his goal of allowing markets time to anticipate and assimilate tightening moves, waited barely a week before making a drastic revision to the standard Fed language around rate increases.

Speaking at a National Association for Business Economics conference, Powell remarked that "The labor market is very strong, and inflation is much too high. There is an obvious need to move expeditiously to return the stance of monetary policy to a more neutral level, and then to move to more restrictive levels if that is what is required to restore price stability."

Powell is attempting to quickly remove the excess liquidity in the system that resulted from two years of stimulus. This in theory will give him more room to maneuver on future rate hikes as he attempts to engineer a soft landing for the economy.

Markets interpreted this to mean that the May FOMC meeting will bring a 50 basis point rate hike, for the first time in 22 years. Anticipating additional 50-basis point increases, markets began to price in a short-term rate of 2.25% - 2.50% by year end. Most Fed policymakers consider this to be the "neutral" level.

Spreads between maturities at various points along the yield curve began to narrow, and the curve ultimately inverted at the end of the month. An inversion is when the shorter-term yield in a pair of U.S. Treasury maturities is higher than the longer-term yield, reversing or inverting the normal relationship. The significance of a yield curve inversion is that inversions have a history of predicting recessions.

A Closer Look: Yield Curve Inversions — Different Part of the Curve, Different Predictive Ability

The points on the curve that bond investors often look to are the two-year U.S. Treasury vs. the ten-year U.S. Treasury. Inversions at this part of the curve have been correct at predicting seven out of the last eight recessions. Recessions aren't imminent, however. They generally follow a two-year/ten-year inversion by one- to-two years.

The Federal Reserve does their own research on yield curve inversions as harbingers of recession, and prefers to look at a different part of the curve. The three-month U.S. Treasury vs. the ten-year U.S. Treasury is the Fed's indicator of choice. This part of the curve has an even better track record at predicting recessions. An inversion here correctly signaled eight of the last eight recessions. Again, recessions follow at some point in the next one-to-two years, usually averaging about 17 months away from the inversion.

There is another wrinkle this time: The Fed's balance sheet. The Federal Reserve is holding close to $8.5 trillion in U.S. Treasury and agency and mortgage-backed securities. It began purchasing them at the beginning of the pandemic in a very successful effort to pump liquidity into the system.

This is called quantitative easing, and the effect of the Fed purchasing these securities was to keep prices up, which lowered yields as bond prices and yields move inversely. Without this Fed action, the yield on the 10-year U.S. Treasury would likely be much higher than it is now. This would mean the curve is not inverted. The Fed has indicated its intention to begin "quantitative tightening" by reducing these assets in the near term.

Performance Among Credit Indices

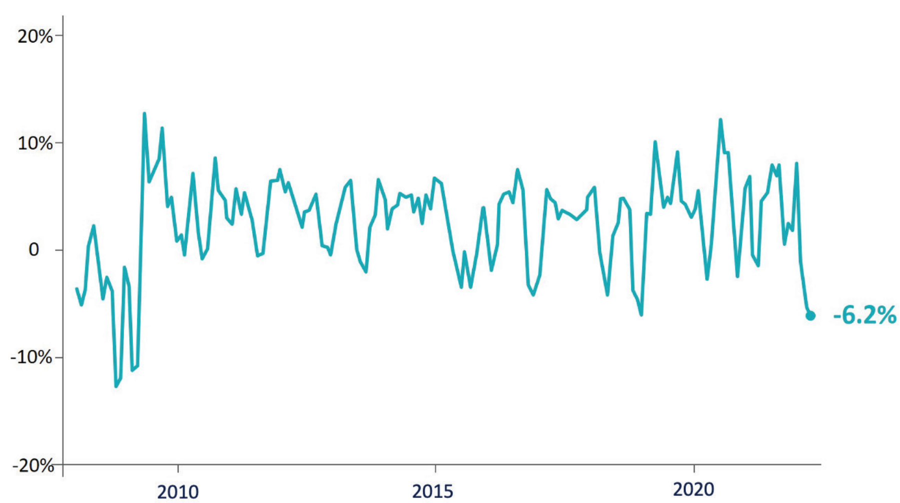
	MTD (2/28/2022 - 3/31/2022)	YTD (as of 3/31/2022)	TRAILING 1 YEAR (2/28/2022 - 3/31/2022)
Credit Suisse Leveraged Loan Total Return Index (CSLLLTOT)	-0.04%	-0.10%	3.22%
Bloomberg US Corporate High Yield Total Return Index (LF98TRUU)	-1.15%	-4.84%	-0.66%
Bloomberg US Aggregate Total Return Index (LBUSTRUU)	-2.78%	-5.93%	-4.15%
Bloomberg Municipal Bond Index (LMBITR)	-3.24%	-6.23%	-4.47%
Palmer Square CLO Debt Index (CLODI)	0.34%	-0.40%	2.81%

Source: Bloomberg as of 4/4/2022

Chart Spotlight: The 60/40 Portfolio is Struggling

A portfolio comprising 60% S&P 500 and 40% Treasurys suffered a return of -6.2% as high inflation, geopolitical uncertainty and rate increases proved difficult to overcome. The allocation is usually viewed as balanced, but the returns in the first quarter are undermining the risk/return trade-off.

Return of a 60/40 portfolio from January 2008 through March 31, 2022



Source: FactSet, Neil Irwin, Axios Visuals S&P500 return represented by an ETF tracking the S&P500 index; Treasury return represented by an ETF containing long-term Treasurys.

Credit Asset Classes

Private Credit	Structured Credit	High Yield
McKinsey & Company recently published a Global Private Markets Review that included an assessment of private debt. "Fundraising growth continued in private debt, the only private asset class to grow fundraising every year since 2011, including through the pandemic. This cyclical resilience is partially driven by the diversity of private debt substrategies: when one zigs, another usually zags. Over the longer term, growth has been driven by a dramatic expansion in direct lending strategies, which have accounted for 73 percent of fundraising growth in the last decade."	S&P Global reports that the lagging indicator of the leveraged loan market's default rate shrunk further toward its all-time low in February. With no new bankruptcy filings or payment misses among S&P/LSTA Leveraged Loan Index loans during the previous three months, the rate sits at a 10-year low of 0.19% by principal amount and is just 4 basis points above the 2007 low watermark of 0.15%. For 1Q 2022, while overshadowed by more-recent global events, the leveraged loan primary market started the new year hot, with $72.7 billion of supply in the first month alone, the second-busiest January on record, according to LCD. That represents 67% of the first quarter's total institutional volume of $108.5 billion (as of March 21). Fervent demand by investors with heaps of cash to put to work led to deal oversubscriptions, and pricing terms that were generally at or tight of talk during this period.	The U.S. High Yield market dropped -0.92% in March, bringing YTD performance to -4.50%, as measured by the ICE BofA US High Yield Constrained Index. High yield spreads tightened by 34 bps on the month, falling to 344 bps. The market's negative return was driven by higher government bond yields, with the 5-year US Treasury yield rising by an eye-popping 74 bps in March, while the 10-year yield was up 51 bps. In this environment, higher quality, more interest rate sensitive bonds lagged, with BB-rated bonds losing -1.1%, vs. a -0.5% decline for Bs and a -1.0% drop in CCCs.

Other Related Asset Classes

Treasuries	Investment Grade Corporates	Municipals
The benchmark ten-year U.S. Treasury bond yield closed at 2.34% (after reaching 2.55%), up from last month's 1.85%. The 30-year U.S. Treasury Bond closed at 2.45%, up from last month's 2.19%. Two- and ten-year Treasury yields inverted as the shorter end of the curve reacted to a 25 bps rate increase in March and Powell's subsequent language on potential 50 bps increases going forward, if necessary to control inflation.	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.	Municipal bonds as represented by the Bloomberg Municipal Index returned -3.24% in March and had a year-to-date return of -6.23% for the first quarter. While bond yields across the spectrum rose on the Fed's revised, more aggressive positioning, due to the inefficiency of the municipal market, yield increases were not as steep. Municipals remain attractive versus Treasuries.

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