

CIION Credit Market Update – February 28, 2021

Too Much of a Good Thing?

Credit Markets Responded to Positive News

For a short month, February was packed with headlines: The third stimulus package became clearer and moved forward, a third vaccine was approved, and rapidly improving consumer sentiment was captured by a record-breaking surprise to the upside on retail sales data.

Finally, it seemed like all the highs and lows we've been accustomed to hearing about in headlines were on the right side of progress. While we all enjoyed lower gas prices, rising oil prices are sign of increases in global demand and a recovering economy. Crude oil hit the highest level since May 2019. Initial jobless claims also began to retreat, falling to the lowest weekly level since late November. The Atlanta Fed's GDP Now tracker, which estimates real GDP growth, more than doubled over the month to end at 10% for the first quarter.

The yield curve steepened all month on the news, and ultimately both the 10-year and the 30-year U.S. Treasury rose above levels last seen in 2020, before the pandemic. It appeared that the market is pricing in a Fed rate hike somewhat closer than the Fed's official guidance of the end of 2023. The Fed maintains that its priority is full

employment and that it is not concerned about inflation. This was also reiterated by Treasury Secretary Janet Yellen, who when asked about the potential for the stimulus to trigger higher inflation, referenced having "the tools to deal with that risk if it materializes."

Since bond prices move inversely to yields, the rise in yields was coupled with an almost complete sell-off across asset classes and durations, with the exception of high yield and floating rate senior loans. Longer duration assets felt the most pressure from the risk-on stance of the markets.

The Oracle of Omaha Has a Point of View

Warren Buffet's annual Berkshire Hathaway Shareholder Letter is always a good read. This year, Buffet focused on the positive, highlighting some of the companies he has invested in and their stories. There was one area where he didn't shy away from a dark outlook, though. Here he is on the fixed income markets: "And bonds are not the place to be these days. Can you believe that the income recently available from a 10-year U.S. Treasury bond – the yield was 0.93% at year end – had fallen 94% from the 15.8% yield available in September 1981? Fixed-income

investors worldwide – whether pension funds, insurance companies or retirees – face a bleak future.”

Performance Among Credit Indices

	1/29/2021 - 2/26/2021	YTD (as of 2/26/2021)	TRAILING 1 YEAR (2/28/2020 - 2/26/2021)
Credit Suisse Leveraged Loan Total Return Index (CSLLLTOT)	0.67%	1.94%	5.65%
Bloomberg Barclays US Corporate High Yield Total Return Index (LF98TRUU)	0.36%	0.69%	9.37%
Bloomberg Barclays US Aggregate Total Return Index (LBUSTRUU)	-1.44%	-2.15%	1.38%
Bloomberg Barclays Municipal Bond Index (LMBITR)	-1.58%	-0.96%	1.05%
Palmer Square CLO Debt Index (CLODI)	0.52%	1.90%	7.83%

Source: Bloomberg as of March 5, 2021

Chart Spotlight: M2 Money Supply

Money supply remains high, and this elevated liquidity suggests yield compression will persist in liquid credit markets.

M2 Money Supply (Seasonally adjusted) (SBN)



Source: Federal Reserve economic data as of January 31, 2021

Credit Asset Classes

Private Credit	Structured Credit	High Yield
<p>Over the five years prior to the pandemic, private credit has delivered average annual returns of 8.75%, and over the last 20 years delivered 10.42% annually, according to Cambridge Associates. What will the pandemic do to this track record?</p> <p>As things have shaken out over the last year, lenders whose strategy is to be defensive by investing in good companies and avoiding cyclical industries were better able to get through the nadir of the crisis last March. Many of them are now deploying capital with long-term outlooks.</p> <p>RIA Intel (Institutional Investor) reports that the quality of deals in the market now appears to be higher, with lower leverage levels, tighter documentation and better pricing.</p> <p>This potential for good entry points into solid businesses along with the illiquidity premium of private credit, may bode well for the future. With over 80% of the world's sovereign and corporate debt trading below a 2% yield, investors continue to search for assets that offer an attractive yield.</p>	<p>The Credit Suisse Leveraged Loan Index returned 0.67% in February, bringing the year-to-date return to 1.95%.</p> <p>U.S. leveraged loan investors in February faced the highest monthly supply shortage on record.</p> <p>By the end of February, the weighted average bid of the S&P/LSTA Leveraged Loan Index was 97.79, the highest reading since November 2018, 159 basis points higher than at the end of 2020 and 103 bps higher than Feb. 23, 2020.</p> <p>Both individual and institutional investors sought out floating rate assets in an attempt to manage interest rate risk.</p> <p>S&P Global reports that the "impressive gains in the last two months came about despite the highest ever issuance volume of new leveraged loans for January and February. There has been some \$110 billion issued so far this year, edging the prior record of \$109 billion for the first two months of 2017, a year that featured a record \$502 billion of institutional loan issuance. No other year has had \$100 billion in the first two months."</p>	<p>High yield managed to stay positive with the Bloomberg Barclays High Yield 2% Issuer Capped Index returning 0.37% for the month, despite a drop of 0.59% in the last week as the longer-duration segments of the market suffered.</p> <p>The risk-on stance of the market supported the asset class as investors anticipated that positive economic factors would benefit these companies and their debt investors.</p>

Other Related Asset Classes

Treasuries	Investment Grade Corporates	Municipals
<p>U.S. Treasury yields rose sharply, the fourth consecutive weekly increase and the longest streak since 2018. The U.S. Treasury 10-year ended the month with a yield of 1.41%, the highest the last 12 months.</p> <p>The Bloomberg Barclays U.S. Treasury Index ended the month with negative performance. For the month the index was -1.81% and year-to-date the index return is -2.75%.</p>	<p>Both the Bloomberg Barclays U.S. Aggregate Index and the U.S. Corporate Index turned in negative performance for the second straight month. The Aggregate is down 2.15% year to date and the U.S. Corporate index has declined 2.98%.</p> <p>Inflows into investment grade credit moderated to \$2.4 billion, below the nearly \$4 billion average over the last few weeks. Lower-quality sectors continued to tighten, with the BBB-to-single A spread at a six-year low of 45 bps.</p>	<p>Municipal prices, which had been holding solid, finally succumbed with the 10-year maturity selling off 27 basis points in the last week of the month, as investors began to demand higher interest rates to compensate for potential inflation.</p> <p>In a sign of what may be to come, the state of Maryland competitively issued \$217 million general obligation bonds (rated Aaa/AAA). The dealer was forced to sell bonds at a slight discount due to market weakness.</p>

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