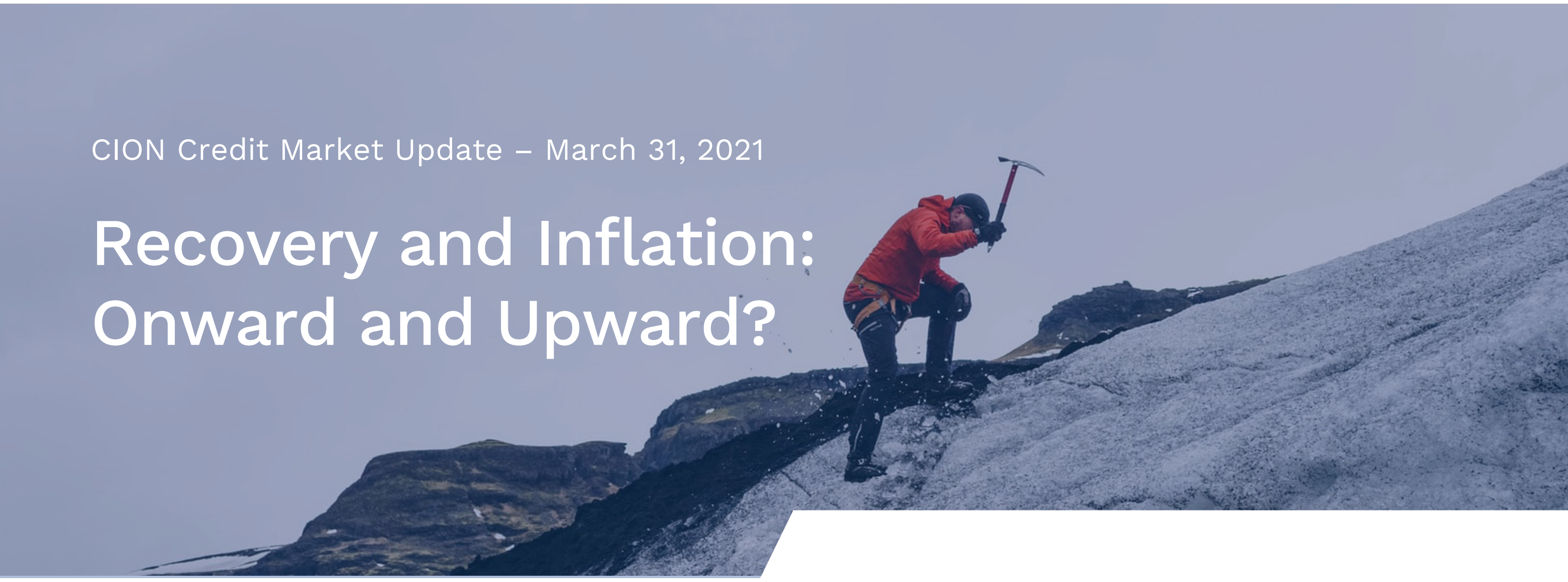
CION INVESTMENTS

CION Credit Market Update – March 31, 2021

Recovery and Inflation: Onward and Upward?



The Recovery Is Here – But it Brought Unwanted Friends

The first quarter started out as a scary movie with fears that the recovery had stalled and COVID had accelerated, and ended up as a feel-good musical with everyone on stage singing and dancing. The happy cast included COVID vaccinations ahead of schedule, economic growth projections that were drastically revised upward, a slew of positive data releases, and a $1.9 trillion stimulus that started to hit bank accounts within days of passing. All along the way, the Federal Reserve reinforced its commitment to low rates at every opportunity.

All this support for a rapid recovery brought a steepening U.S. Treasury yield curve, with the 10-year U.S. Treasury yield rising to 1.74% from 0.83% over the quarter. This level was not predicted to be seen until closer to year end. Along with this, projections for higher inflation increased. Since actual inflation is sensitive to the perception that there will be inflation, fixed income in general and especially longer-duration assets suffered. The first quarter saw largely negative bond performance, particularly in higher-quality sectors. High yield corporates ended the quarter up, in keeping with the demand for both yield and risk assets, and variable rate senior loans benefited from their potential to mitigate against interest rate risk.

It's All About the Fed

Inflation is sometimes thought of as being caused by either a "cost push" or a "demand pull." The cost is wages and raw materials costs rising, which are ultimately passed along to consumers. The pull is consumer demand driving up the price of goods. We've already seen rising inflation in the manufacturing cost of goods that has bled through to prices. The Institute for Supply Management reports that the Services PMI registered an all-time high of 63.7 % in March, 8.4 percentage points higher than February, so it appears to only a matter of time before inflation hits the services sector. The March jobs report, released April 1, showed that the U.S. added 916,000 net jobs last month, beating expectations for 660,000. And even before the third stimulus, consumers had an excess of $1.8 trillion over normal savings levels – and all indications are that they are ready to spend it.

Fed Chairman Powell continues to insist that inflation pressures are a 2021 thing that will resolve as the economy works through stimulus and recovery and returns to normal. For now, that means rates will stay low, and with risk assets booming, bond markets aren't poised to resume the tandem relationship they enjoyed with the equity markets last year.

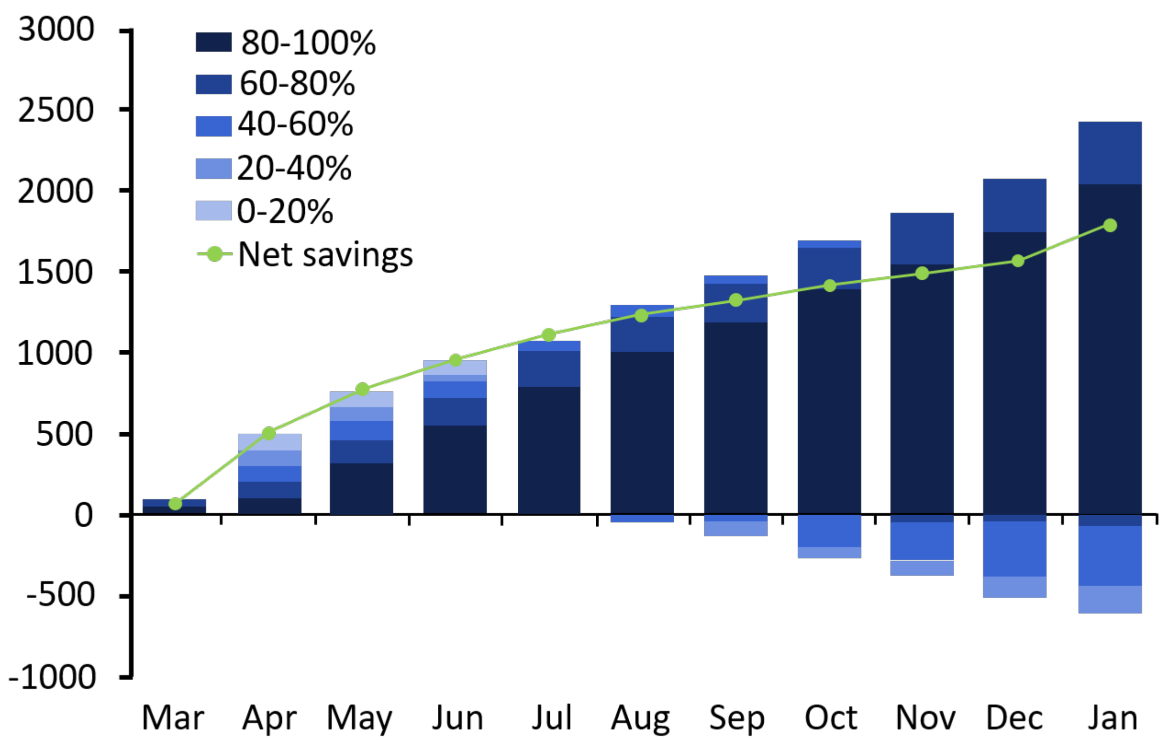
Performance Among Credit Indices

	MTD 2/28/2021-3/31/2021	YTD As of 3/31/2021	TRAILING 1 YEAR 3/31/2020- 3/31/2021
Credit Suisse Leveraged Loan Total Return Index (CSLLLTOT)	0.05%	2.00%	20.77%
Bloomberg Barclays US Corporate High Yield Total Return Index (LF98TRUU)	0.14%	0.84%	23.71%
Bloomberg Barclays US Aggregate Total Return Index (LBUSTRUU)	-1.24%	-3.37%	0.71%
Bloomberg Barclays Municipal Bond Index (LMBITR)	0.61%	-0.35%	5.50%
Palmer Square CLO Debt Index (CLODI)	0.07%	1.82%	35.64%

Source: Bloomberg as of April 1, 2021

US: Uneven Savings Across Income Quintiles

All of the $1.8 trillion of extra savings through January 2021 is owned by the top two income quintiles The effect of the third stimulus should boost the incomes of the lower three quintiles, leaving consumers with an avalanche of money to unleash on the economy, adding to rising inflation.



Source: Oxford Economics

Credit Asset Classes

Private Credit	Structured Credit	High Yield
Cliffwater has released an analysis of the fourth quarter and full year 2020, using the Cliffwater Direct Lending Index (CDLI), which tracks one of the largest segments of private debt, U.S. middle market corporate lending. CDLI rebounded for the third consecutive quarter, producing a 3.67% total return in the fourth quarter; and together with strong second and third quarter returns, the calendar year CDLI ended with a respectable 5.45% total return. Interest income increased during the quarter to 2.39% (9.56% annualized) largely from increased repayment and commitment fees as deal flow surged. Unrealized gains were 2.22% for the quarter, following gains in the prior two quarters. 2020's first quarter unrealized losses of -6.80% have now been almost completely reversed.	Lipper reports that retail investors have been flowing back into leveraged loans in the first quarter. While funds flowed out of U.S. loans through calendar year 2020, 2021's first quarter saw a $10 billion inflow. The asset class is benefiting from both rising rates and higher inflation. S&P Global reports that year-to-date 2021 through March, rating upgrades among U.S. broadly syndicated loan (BSL) CLO portfolio obligors have outnumbered downgrades by a ratio of 1.76-to-one. In addition, a handful of issuers in CLO collateral pools with non-performing ratings ('CC', 'SD', or 'D') had their ratings raised back into the 'CCC' category in February, resulting in a slight increase in CLO 'CCC' buckets.	High yield was one of the only positive sectors in the first quarter, as it benefitted from investor appetite for additional yield and risk assets. Despite the positive performance, inflation remained a concern and S&P Global reports that three consecutive quarters of inflows were followed by an $11 billion outflow in the first quarter. However, even if inflation does increase more than expected, high yield corporates are likely to benefit than investment grade corporates due to lower duration and greater spread "cushion" as they historically have higher spreads than investment grade corporates.

Other Related Asset Classes

Treasuries	Investment Grade Corporates	Municipals
The Georgia run-off election that handed Biden control of the Senate proved to be the start of the runway for unexpectedly rising rates and a steepened yield curve. With prospects for another stimulus as well as a potential infrastructure package, the U.S. Treasury 10-year yield rose all quarter, and with the stimulus signed into law and infrastructure on the horizon, the yield ended the quarter up double its starting point. The Fed's commitment to anchoring the short-term rate at zero meant the curve steepened drastically as well. The Bloomberg Barclays U.S. Treasury Index ended the quarter at -4.20%.	The Bloomberg Barclays U.S. Aggregate Bond Index returned -3.37%, its worst quarterly result on record. All U.S. aggregate sectors recorded losses, ranging from -4.32% for investment grade corporate bonds to -0.20% for asset-backed securities. Inflation and duration were the culprits, with the Corporate Index having the longest duration of all sectors at 8.55 years. Credit spreads are near record lows, which is unusual for where the economy currently is. The exit path is potentially uncertain and volatile for credit markets, even if the broad direction for the economy is positive.	For the first quarter of 2021, municipal bond new issuance totaled $102 billion and was the largest first quarter issuance since 2015's $108 billion. Approximately 26% of this year's volume has been taxable, down from 30% for all of last year, as Treasury yields have risen back to pre-pandemic levels amid an improving economic growth outlook. Munis yields have risen this year, but they've outperformed similar maturity Treasuries as the demand for tax-exempt municipal bonds has remained strong, as evidenced by positive net flows into muni bonds funds. The Bloomberg Barclays Municipal Index, with a relatively short duration of 5.26 years returned -0.27% and the Bloomberg Barclays Taxable Municipal Index suffered for its longer duration of 9.83 years, returning -3.29%.

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