CION Credit Market Update – October 30, 2020

A Strong Third Quarter Followed by Growing Uncertainty

Third quarter GDP increased at an annual rate of 33.1%, as the economy got a boost from reopening and fiscal stimulus. Real consumer spending soared in the third quarter, rising 40.7% at an annualized rate, adding 25.3 percentage points to GDP growth. The composition of spending shifted significantly, favoring goods. Real spending on durable goods is 11.9% above its level in the final three months of last year. However, real spending on services is still 8% below that seen in the fourth quarter of last year.

Throughout the third quarter, world trade volumes, global industrial production, and measures of U.S. business and consumer sentiment continued to increase from depressed levels. While still negative, the U.S. Conference Board Leading Economic Index recovered from its recent low on April 30 of negative 13.1 YoY, a level not seen since the Global Financial Crisis, to negative 3.9 YoY as of Sep. 30.

Through the end of September, TIPS outperformed other credit asset classes year to date, largely on the Fed's announcement mid-month that they would allow inflation to rise above 2%. U.S. Treasuries also continued to outperform all other sectors except TIPS. Corporate bond spreads continued to look attractive. Every sector recovered enough by the end of the third quarter to be in positive territory for the year, except for bank loans, which were only down 0.5% year to date.

October charted a volatile course for yields in which news about the growing spread of the pandemic contrasted with positive economic releases of data about the third quarter, resulting in almost weekly selloffs that were then recovered the following week.

As of October 30, the shape of the Treasury curve had steepened considerably, bringing the difference between 30- and the 5-year yields to the highest level since 2016. Speculation about increasing Treasury supply propelled long rates higher.

High yield bond returns were a negative 1.03% in September but remained one of the top-performing asset classes for the quarter as the Bloomberg Barclays US Corporate High Yield Index gained 0.95% in August and 4.69% in July. As of October 23, high yield had returned 1.57% for the month.

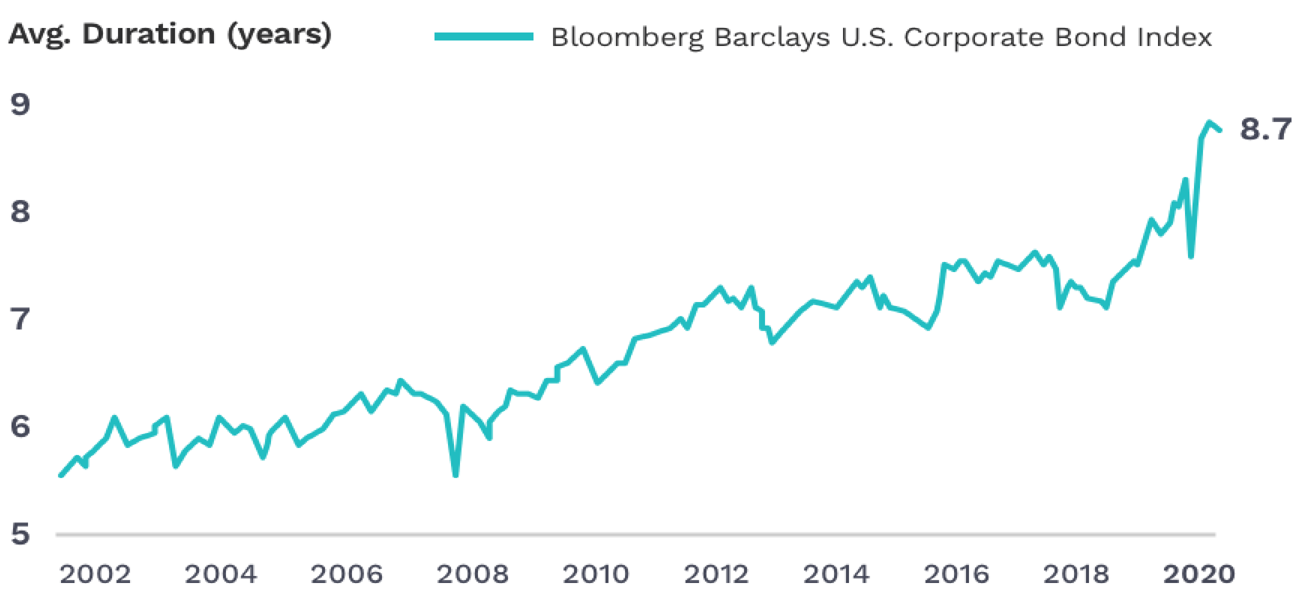
Structured product asset class returns for the third quarter were also positive. The Markit iBoxx Broad US Non-Agency

RMBS Index, which tracks residential mortgage-backed securities (RMBS), returned 6.7%. The Bloomberg Barclays US CMBS Investment Grade BBB Index, which tracks commercial mortgage-backed securities (CMBS) rated BBB, returned 7.7%. The ICE Bank of America (BofA) AA-BBB U.S. Fixed-Rate ABS Index, which tracks asset-backed securities (ABS) rated AA to BBB, returned 3.14%; BBB-rated tranches of collateralized loan obligations (CLOs) returned 3.2%.

Period **BLOOMBERG DATE RANGE** (based on close price)	**October 2020** 9/30/20 - 10/30/20	**YTD (10/30/2020)** 12/31/19-10/30/20	**TTM (10/30/2020)** 10/31/19-10/30/20
Credit Suisse Leveraged Loan Total Return Index (CSLLLTOT)	0.17%	-0.65%	1.50%
Bloomberg Barclays US Corporate High Yield Total Return Index (LF98TRUU)	0.50%	1.13%	3.49%
Bloomberg Barclays US Aggregate Total Return Index (LBUSTRUU)	-0.44%	6.31%	6.18%
Bloomberg Barclays Municipal Bond Index (LMBITR)	-0.30%	3.02%	3.59%
Palmer Square CLO Debt Index (CLODI)	-1.09%	0.91%	4.63%

Source: Bloomberg as of 10/30/2020

Chart Spotlight: : Interest rate risk for corporate bonds near all-time high



Source: Bloomberg, using weekly data as of September 30, 2020. Duration is a measure of interest rate sensitivity. All else being equal, the higher a bond's duration, the more sensitive the bond's price is to a given change in interest rates.

Credit Asset Classes

Private Credit	Structured Credit	High Yield
Preqin reports that for the 3rd quarter, fund managers are seeking record amounts of capital in the private debt market, with an aggregate $295bn targeted. This represents a 54% increase compared to January 2020, when funds on the road were looking to raise $192bn. The average size of funds in market is also increasing, given that the number of funds in market grew by 19% over the same period, from 436 to 521 – also a new record. One of the drivers of fundraising activity across the private debt space is the yield spread over 10-year government bonds. Across many sectors, and for investment-grade issues, yield premiums can be more than 150bps, making these investments attractive on a relative basis.	Fitch reports that market conditions for US and European CLO primary issuance improved during 3Q20, with issuance, average AAA(sf) spread levels, reinvestment periods and weighted average life tests for transactions that priced during the quarter stabilizing or normalizing. Year-over-year comparisons illustrate weakness, however. Issuance for US broadly syndicated loan (BSL), middle market (MM) and European (EU) CLOs were all higher in 3Q than other quarters this year. This comes as most senior spreads tightened for all categories to levels that were much higher than the levels logged at the end of 2019. The market seems to be smoothing over the disruptions it had earlier in the year and adjusting to a new normal. It helps that credit quality in the portfolios is stabilizing, for example there has been a more normalized level of corporate rating actions on issuers of the loans held in the CLOs.	Moody's reports that net credit rating downgrades of U.S. high-yield issuers, or downgrades less upgrades, has plunged from second-quarter 2020's record high of 369 to a final tally for the third quarter that may be no greater than 25. Earlier, net high-yield downgrades ballooned from the 54 of 2019's final quarter to the 194 of 2020's first quarter. The average annual Bloomberg/Barclays high-yield bond spread for 2019 was 387 bp. January-September 2020's prospective 196 high-yield downgrades per quarter were joined by a 573 bp average for the high-yield bond spread. March's 84% year over year plunge has been the only month where high-yield bond issuance suffered from the COVID-19 recession. For the eight months of January-September excluding March, the issuance of US$-denominated high-yield corporate bonds soared 57% year-over-year.

Other Related Asset Classes

Treasuries	Corporate Bonds	Munis
October was marked by yield volatility intra-month but enough positive momentum for an overall increase. The 10-year Treasury note yield rose 18.1 basis points in October, its biggest monthly increase since September 2018. The 2-year note rate was virtually flat at 0.152%, leaving it unchanged for the week and up 2.9 basis points this month. The 30-year bond yield climbed 18.4 basis points in October. Despite sharp declines in U.S. and European equities at the end of the month, Treasuries did not see large rallies, but this was likely related to investors positioning themselves ahead of the Nov. 3 presidential election.	Investment grade corporates were hurt by their long duration as 10- and 30- year Treasury yields have increased. They were still positive MTD as of October 23rd but did not perform as well as other non-Treasury sectors. With two months left this year, gross supply of investment grade credit is already $300bn ahead of the record set in 2017 and more than 65% ahead of last year's pace. Early estimates for gross supply in 2021 are for $800bn-$1tn, which would be the lowest level since 2001.	Municipal demand is being driven by the steeper yield curve. As of October 23rd, fund flows were positive for the third straight week at $607 million. Given the steepness of the yield curve, investors are seeing buying opportunities. The demand for longer maturities should continue for the foreseeable future, as the Federal Reserve (Fed) indicates that rates will remain low until the economy has recovered. New issue municipal supply will likely be outsized through the end of the year, but the steep yield curve should support robust demand.

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