CION Credit Market Update – October 31, 2021

The Tangled Knot.

The Data Said a Lot of Things, and All of Them Translated to Inflation

Economic releases over the course of the month were largely positive and supportive of long-term growth. The Fed's Beige Book, prepared in advance of the November Fed meeting, detailed that most districts reported "significantly elevated prices for materials as supply chain disruptions continued." These increases were often passed along to consumers in the form of raised selling prices, indicating no reduction in the strong demand for goods in most sectors of the economy.

The U.S. Bureau of Labor Statistics data on average weekly earnings found that wages were up 4.5% year-over-year through September. This was echoed by the findings of the National Association for Business Economics (NABE) Business Conditions Survey, which found that 58% of respondents increased wages in the 3rd quarter, up from 51% in the July survey.

The NABE survey found that businesses are also reporting increasing sales. Sixty-five percent of respondents to the survey reported that sales at their firms increased in the third quarter (Q3) of 2021. This appears to translate into confidence in the economy long-term, as businesses continue to invest in themselves despite higher wage and price costs. The U.S. Department of Commerce reported that core capital goods orders rose 0.8% in September, beating economist expectations for growth of around 0.4%.

What Did This Mean for the Bond Markets?

As inflation expectations continued to increase, the markets began to see potential for a quicker start to interest rate hikes than projected. This resulted in a flattening of the yield curve, as short-term yields ascended while long-term yields fell. The market priced in the potential that a steeper front-end to rate increases will stifle inflation, resulting in lower rates overall if the Fed can go back to supporting a growth outlook once the threat of runaway inflation is tamed.

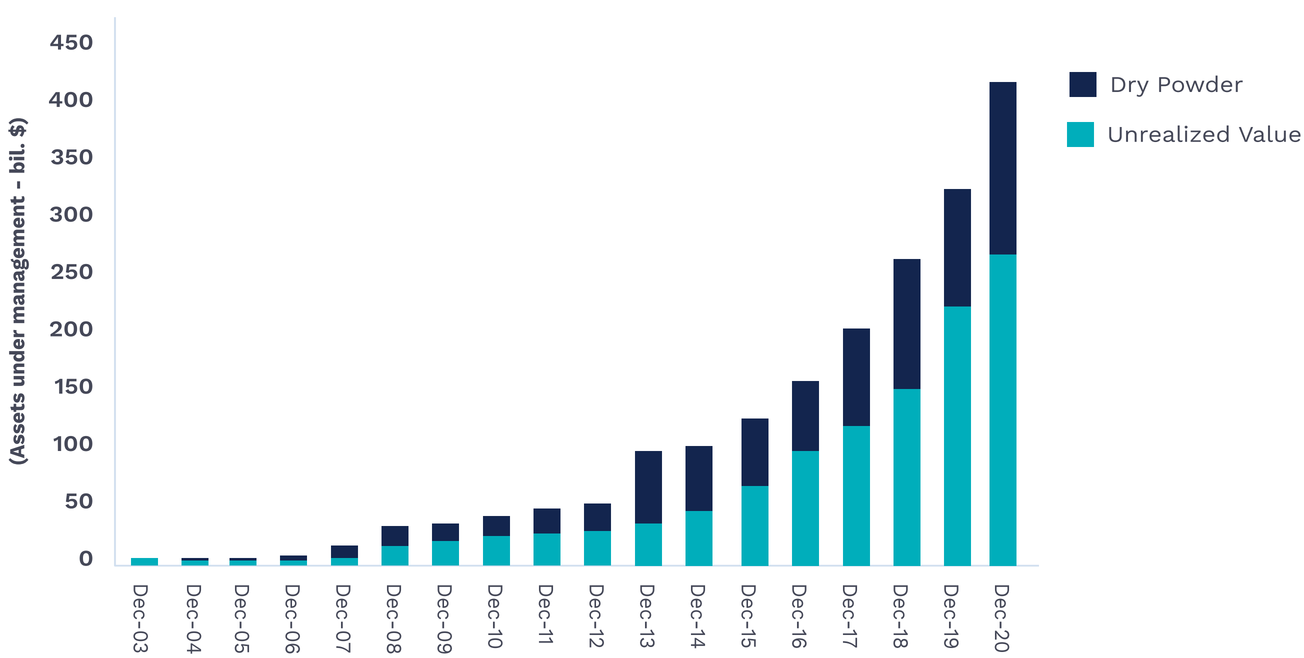
Performance Among Credit Indices

	MTD (9/30/2021 –10/29/2021)	YTD (as of 10/29/2021)	TRAILING 1 YEAR (10/29/2020 – 10/29/2021)
Credit Suisse Leveraged Loan Total Return Index (CSLLLTOT)	0.23%	4.90%	8.44%
Bloomberg Barclays US Corporate High Yield Total Return Index (LF98TRUU)	-0.17%	4.35%	10.46%
Bloomberg Barclays US Aggregate Total Return Index (LBUSTRUU)	-0.02%	-1.58%	-0.54%
Bloomberg Barclays Municipal Bond Index (LMBITR)	-0.29%	0.49%	2.62%
Palmer Square CLO Debt Index (CLODI)	0.38%	4.57%	10.73%

Source: Bloomberg as of 11/1/2021

Chart Spotlight: Private Debt Direct Lending Grew Ten-Fold in Ten Years

Private debt investments have seen tremendous activity as a changing landscape paired with investors seeking yield has resulted in more investment opportunities. Given the amount of "dry powder" funds have at their disposal, it seems likely this volume of activity could continue.



Source: S&P Global Ratings Research, Preqin

Credit Asset Classes

Private Credit	Structured Credit	High Yield
S&P Global has taken a close look at private debt with a recent report on the asset class. The report compared the growing asset class to syndicated loans and found several key differences. Private debt deals see borrowers working more directly with lenders, which allows for quicker turnaround (about two months from inception to execution), and borrowers have more clarity on pricing. From creditors' perspective, private debt loans tend to carry covenants. A significant portion of the companies for which S&P Global Ratings conducts credit estimates have financial-maintenance covenants, which require borrowers to maintain leverage ratios or other indicators of creditworthiness. Because of this and other factors, recovery rates for private debt often are higher on average than those for broadly syndicated loans.	October notched another strong month in CLO issuance, with 39 deals totaling $19.15 billion, a hair behind August's record $19.22 billion primary-market issuance. Annual new-issue volume of $149.37 billion through October 29th reflects the record-setting pace of deals this year. The CLO market also saw a milestone in October as the first U.S. CLO issuer priced a note tranche tied to the Federal Reserve-published secured overnight financing rate, SOFR, the replacement for LIBOR.	The U.S. high-yield bond default rate declined for the eighth consecutive month to finish the third quarter at 1%, according to a new Fitch Ratings report. Fitch projected that the default rate is expected to fall to 0.8% by the end of the month, a level last reached in February 2014. There have been no U.S. defaults since the end of July, the longest stretch without a default since 2010-2011.

Other Related Asset Classes

Treasuries	Investment Grade Corporates	Municipals
The yield curve flattened in October, and the closely- watched gap between two- and 10-year notes narrowed to as much as 97.7 basis points, the flattest it has been since August. The five-year note to 30-year bond curve hit its flattest since March 2020 when it narrowed to 73.4 basis points. While the 20-year yield briefly rose above the 30-year yield, the slight inversion was not seen as a harbinger of growing recession potential.	Investment grade corporates posted a positive return of 0.25% for the month of October, but the year-to-date return remained in the red at -1.02%. Attention on interest rate volatility in the last week of the month resulted in lighter trading flows. October saw approximately $108 billion of new issuance, slightly more than expected.	Long municipal yields ended the month slightly lower. The market is expected to remain range-bound, as new issue supply is likely to be substantial. High yield municipal new issuance also remains active, with multiple deals expected in the near future. Of note, the Puerto Rico Fiscal Oversight Board announced it accepted recently passed legislation clearing the way to finish restructuring roughly $17 billion of debt.

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