Blackstone Credit

CREDIT INSIGHTS

May 2021 Market Commentary

- U.S. and European credit markets continued their positive momentum in May despite mixed economic data with U.S. loans outperforming year-to-date
- U.S. investment-grade bonds posted the second consecutive month of positive returns this year as spreads tightened and rates further stabilized
- Default and distressed activity in the global credit markets continues to decline and default rates are likely to end the year meaningfully lower than initially forecasted

Performance Overview

Performance of U.S. below investment-grade corporate credit continued to climb higher in May, ending the month with solid returns despite mixed economic data casting uncertainty over the persistence of the economic recovery. U.S. loans in particular continue to outperform relative to other fixed income assets with returns of 2.90% year-to-date. Despite oil prices climbing to their highest levels since 2018, Treasury yields continued their decline reinforcing the view that inflationary pressures would prove to be transitory resulting in a more measured pace of expected rate rises from the Federal Reserve.[1]

U.S. investment grade bonds, represented by the Bloomberg Barclays US Corporate Investment Grade Index, posted positive monthly returns for the second consecutive month this year as spreads tightened and rates declined.

In Europe, credit performance also ticked higher amid increasing consumer demand and confidence. Eurozone retail sales increased by 12.3% year-over-year in May, while the Eurozone Manufacturing PMI reached 63.5, up from 62.9 in April. The Euro Area Consumer Confidence Index reached -5.1 in May, up for the fourth month in a row and the highest level since October 2018.[2]

Retail demand for U.S. loans and investment-grade bonds remained strong in May, with net retail inflows of $3.8 billion and $8.0 billion, respectively. Retail flows for U.S. high-yield funds remained negative with outflows of $4.6 billion over the month. European high yield funds experienced net outflows of €362 million in May.[3] U.S. default activity has remained minimal. Zero companies defaulted in May, bringing the par-weighted U.S. high yield last-twelve-month ("LTM") default rate down 62bp to 3.07% and the loan par-weighted default rate down 67bp to 1.96%.[4] Both bond and loan default rates are currently less than half of what they were at their peaks last year. Of note, J.P. Morgan sharply lowered its U.S. loan and high yield default forecasts from 2.0% each for 2021 and 2022 to 0.65% each for 2021 and 1.25% each for 2022.

There were no new defaults recorded for European loan or high yield issuers in May. As a result, the LTM par-weighted default rate remained at 1.10% for European loans and the default rate for European high yield bonds fell to 1.4% from 3.3% in April.[5]

Market Stats (as of May 31, 2021)

	May	QTD	YTD
S&P / LSTA U.S. Leveraged Loan Index	0.58%	1.10%	2.90%
Bloomberg Barclays U.S. Corporate Investment Grade Index	0.77%	1.25%	-2.85%
Bloomberg Barclays U.S. High Yield Index	0.30%	1.21%	2.25%
Credit Suisse Western European Leveraged Loan Index	0.42%	0.85%	2.59%
Credit Suisse Western European High Yield Index	0.30%	0.97%	2.59%
S&P 500	0.70%	6.07%	12.62%
Euro Stoxx 50	1.63%	3.07%	13.70%

	Spread			Yield			Price		
	Level	ΔMTD	ΔYTD	Level	ΔMTD	ΔYTD	Level	ΔMTD	ΔYTD
U.S. Loans	402	-5	-40	4.26%	-0.06%	-0.44%	$98.08	$0.29	$1.88
U.S. HY	296	5	-64	4.78%	-0.01%	-0.19%	$104.46	-$0.28	-$0.50
EU Loans	408	-8	-51	3.75%	-0.02%	-0.13%	$98.72	$0.28	$1.37
EU HY	368	-2	-56	3.78%	-0.04%	-0.46%	$100.60	$0.28	$2.01

1 Bloomberg
2 Credit Suisse European Credit Views: Our World in Pictures June 2, 2021
3 J.P. Morgan for loans and high yield bonds and Credit Suisse for investment grade bonds, as of May 31, 2021
4 J.P. Morgan Default Monitor, June 1, 2021
5 Credit Suisse Default Report June 7, 2021

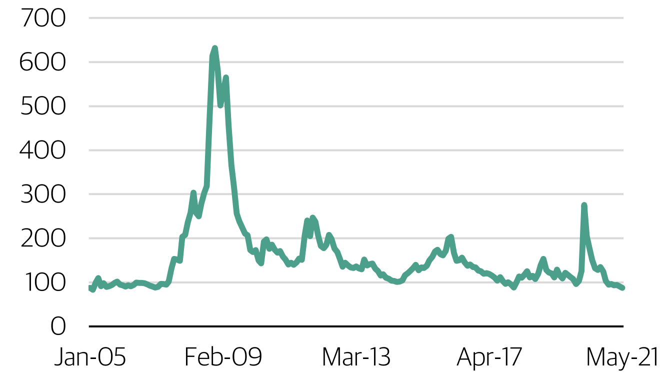
U.S. Investment Grade Market

U.S. investment grade bonds posted positive returns for the second consecutive month in May totaling 0.80% as spreads tightened to their lowest levels since the Global Financial Crisis and rates remained relatively stable. Retail investor sentiment remained supportive with an inflow of $8.0 billion during the month, bringing the year-to-date total to $74 billion.[6]

New issue supply totaled $138 billion in May, bringing total issuance for the year to $723 billion. While this is trending higher than most recent years, it remains well below the record pace of issuance in 2020. By this time last year, investment grade issuance had already totaled more than $1 trillion.[6]

We expect supply to continue to moderate, while demand should remain strong as evidenced by further retail inflows due to expectations for a range-bound rates environment. Valuations, however, are historically tight, and anticipation of the Fed's tapering announcement later in the summer or fall could lead to pockets of volatility.

Historical U.S. Investment Grade Spreads (bp)[7]

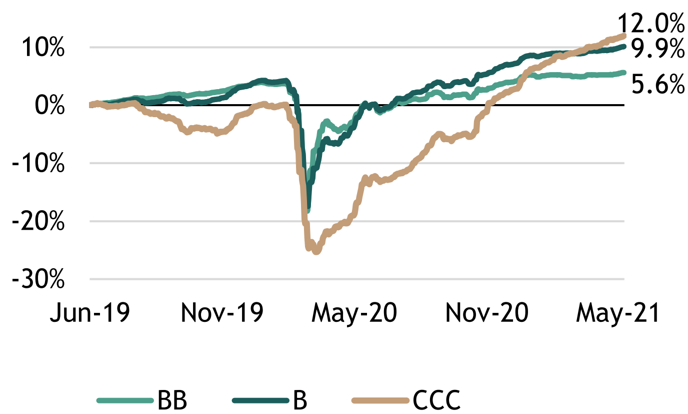


U.S. Loan and High Yield Markets

U.S. loans continued their positive momentum in May, returning 0.58%, as lower rated loans continued to rally. The outperformance of U.S. loans relative to other fixed income is a trend we expect to continue for the remainder of the year. New issue volumes slowed to $35 billion while demand increased alongside the 21st consecutive week of positive retail inflows.[6] We expect loan prices to grind higher in the secondary market in the coming weeks as the new issue calendar remains muted and CLO formation continues at a rapid pace.

U.S. high-yield bonds posted a 0.30% gain in May despite heavy supply volume and retail outflows. Credit spreads were largely unchanged, but interest rates fell slightly, which boosted total return. Momentum of CCC-rated bonds continued, as the rebound of that segment continued to outpace the broader market.[8] Lower supply volumes are anticipated during an expected summer slowdown, which should be supportive of secondary prices until refinancing activity reaccelerates this fall.

U.S. Loan Returns by Quality (%)[9]

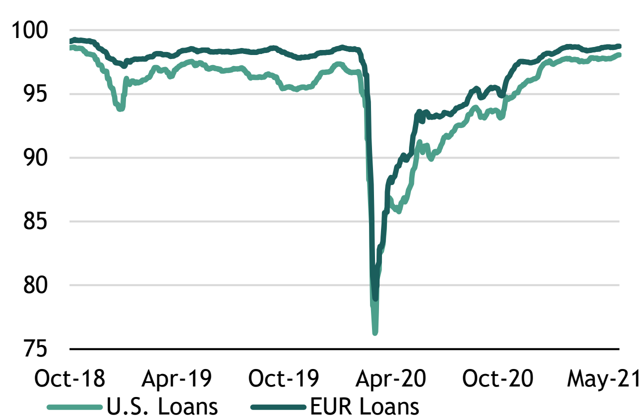


European Loan and High-Yield Markets

The European loan market recorded another strong month of performance returning 0.42% in May and stretching the positive return record to 14 straight months as prices gained in the secondary market. The reopening theme continued to bolster performance with retail sales and manufacturing recovering strongly alongside increasing consumer demand and confidence.[10]

European high yield continued its slow and steady performance returning 0.30% in May as the compression theme continued alongside the rally in CCC-rated bonds. Spreads continued to march slowly tighter as investors deployed cash into the primary market and fixed income investors migrated down in rating in the secondary market given the attractiveness of BB-rated spreads relative to investment grade. Sector dispersion remains as TMT lagged and energy delivered strong returns.[11]

Average U.S. and EUR Loan Prices ($/€)[12]



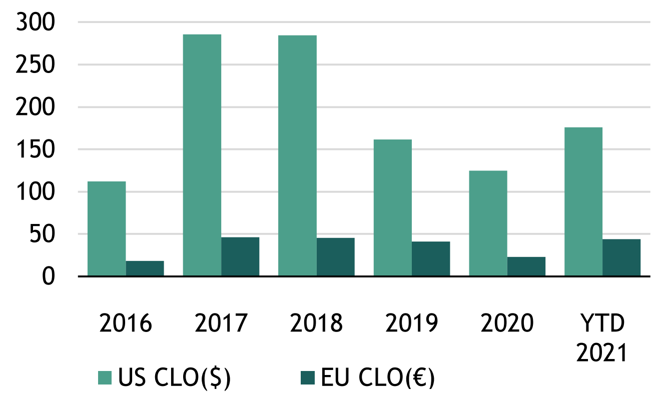
6 Credit Suisse Strategy Daily, June 2, 2021
7 Bloomberg Barclays Corporate Index, May 31, 2021
8 J.P. Morgan High Yield Bond and Leveraged Loan Market Monitor, as of June 1, 2021
9 LCD, as of May 31, 2021
10 Credit Suisse European Credit Views: Our World in Pictures June 2, 2021
11 Credit Suisse, June 4, 2021
12 LCD, as of May 31, 2021

U.S. and European CLO Markets

The pace of new CLO creation remains well ahead of previous years. Year-to-date issuance now totals $176 billion in the US, of which 62% has been from refinancing and resets. In Europe, year-to-date issuance through May totals €44 billion, nearly double the whole of 2020, with 72% of this accounted for by CLO refinancing and resets.[13]

Despite the heavy issuance volumes, spreads for new issue US CLO tranches were mostly tighter in May whereas European CLO tranche spreads have begun to widen under the pressure of the heavy supply. In the secondary market, spreads contracted across all tranches in May, with most of the tightening occurring in the mezzanine tranches. Spreads on US CLO tranches rated A and BB contracted by 10bp each during the month while spreads on European CLO tranches rated AA and BBB contracted by 12bp each. European CLO tranches rated A narrowed the most with spreads lowering 22bp on average during May.[14]

U.S. and EUR CLO Historical issuance ($/€ in billions)[13]



Market Outlook

Our optimistic outlook remains largely unchanged from last month, as economic and company-specific data released in the interim has been largely confirmatory of our view. Although we are closely monitoring the COVID-19 Delta variant, among others, we believe it is unlikely to cause further widespread shutdowns. Moreover, the United States announced donation of 500 million vaccines to low-income countries should significantly reduce the spread of future mutations globally. We continue to expect consumer spending on travel, out-of-home entertainment and commuting to sharply recover over the next few months.

Much of the U.S. yield curve has remained relatively range-bound for the last few months, though we expect some dynamics that have applied downward pressure on rates may abate in coming months. These include the significant amount of quantitative easing ($120 billion per month), higher rates on sovereign debt in Europe, and the increase in personal savings held at banks that has driven their demand for treasuries. Notably, the Fed's June 16 announcement that they may hike as soon as 2023 (from 2024 previously) in response to higher expected inflation drove volatility across both fixed income and equities. As such, we believe investors should consider assets with shorter durations to hedge against inflation risk and higher long-term interest rates.

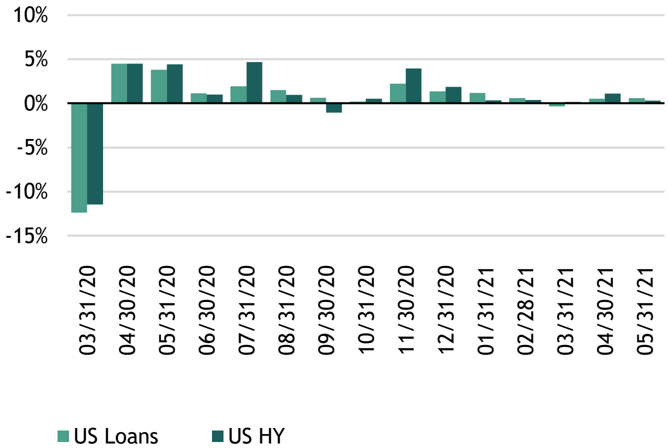
We expect both the supply and demand side of the loan market to remain robust in the near-term based on our indications from underwriting banks and our institutional investors. We expect continued supply from LBO financings, including jumbo LBOs, based on the significant amount of dry powder among private equity funds.

Default rates in U.S. credit continue to track even lower than initial forecasts and, as previously mentioned, J.P. Morgan has again revised downward its 2021 default forecast to 0.65% for both loans and high yield and their 2022 default forecasts were revised downward to 1.25% apiece. Many long-term stressed credits in secularly declining sectors were restructured during the summer 2020 flurry, so many of the remaining potential defaults will likely be those impacted by social distancing restrictions. Given the rebound in travel, leisure, and dining, driven by unprecedented pent-up demand and generous stimulus payments, we believe default risk for many of these companies has fallen significantly and, as such, expect default rates to remain below 1% for the near-term.

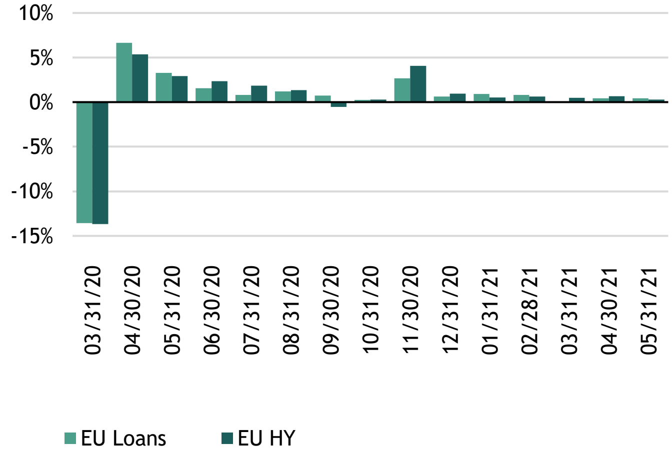
[13] LCD Global Databank, as of May 31, 2021
[14] Bank of America Global Research, Citibank, May 31, 2021

Market Snapshot (as of May 31, 2021)[15]

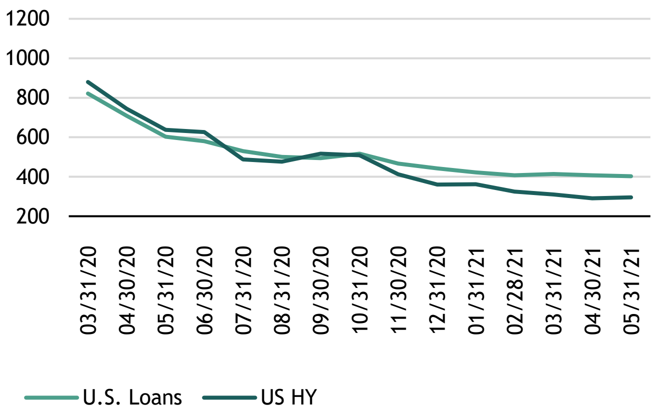
U.S. Credit Monthly Returns



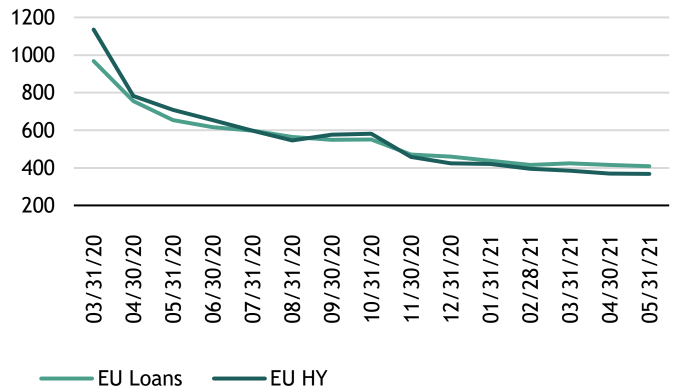
EU Credit Monthly Returns



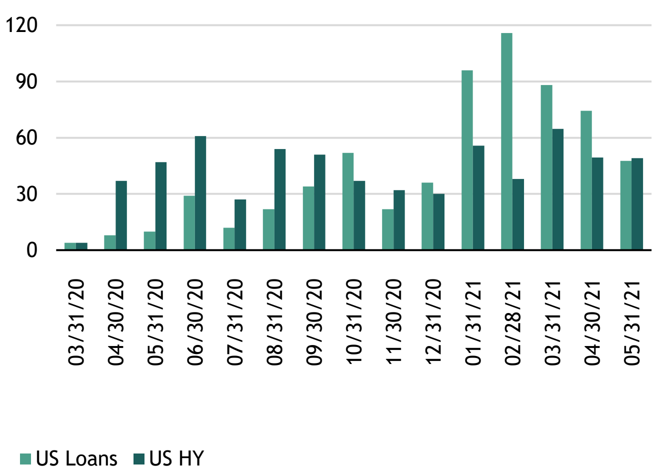
U.S. Credit Spreads (in bp)



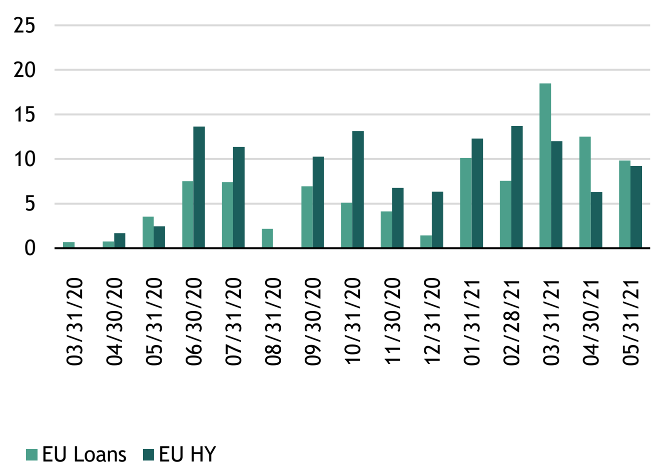
EU Credit Spreads (in bp)



U.S. Credit Issuance ($ in billions)



EU Credit Issuance (€ in billions)



[15] S&P/LSTA Leveraged Loan Index (represented by spread to maturity and yield to maturity), Bloomberg Barclays U.S. High Yield Index (represented by OAS and yield to maturity), Credit Suisse Western European Leveraged Loan Index (represented by 3-year discount margin and current yield), and Credit Suisse Western European High Yield Index (represented by spread to worst and yield to worst), as of May 31, 2021.

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