Blackstone Credit

CREDIT INSIGHTS

October 2020 Market Commentary

Performance Overview

- Recovery in global credit continued despite volatility from the contentious US election and additional European shutdowns and restrictions
- Default expectations remain predicated on the timing of a COVID-19 vaccine

Credit markets in the US and Europe continued their recovery during October despite a bout of volatility likely related to the November US election and an increase in COVID-19 cases globally. In Europe, additional shutdowns and restrictions were announced across the continent and may be followed by similar measures in the US. However, expectations for further stimulus from the European Central Bank ("ECB"), in addition to the US government, should help further support credit markets. Promising developments have also emerged in the race for an effective COVID-19 vaccine; however, questions about vaccine distribution and adoption remain.

In October, the US loan default rate decreased on a last-twelve-month ("LTM") basis while the US high yield bond default rate increased. Similarly in Europe, only the high yield default rate increased in October while the European loan default rate declined to pre-COVID-19 levels. Future default rates are expected to decline further in 2021 but remain heavily predicated on the timing of a successful COVID-19 vaccine and whether the magnitude of new virus cases will lead to another economic setback.[1]

Alongside a further abatement of rating agency downgrades on loans globally, CLO fundamentals improved month-over-month and exposure to CCC-rated loans decreased in both the US and Europe. This improvement in CLO fundamentals has allowed most deals that paused equity distributions to resume payment in October.[2]

Market Returns (as of October 31, 2020)

	October	QTD	YTD
S&P / LSTA U.S. Leveraged Loan Index	0.20%	0.20%	-0.46%
Bloomberg Barclays U.S. High Yield Index	0.51%	0.51%	1.13%
Credit Suisse Western European Leveraged Loan Index	0.25%	0.25%	-0.88%
Credit Suisse Western European High Yield Index	0.29%	0.29%	-2.95%
S&P 500	-2.66%	-2.66%	2.77%
Euro Stoxx 50	-7.29%	-7.29%	-18.96%

Market Outlook

With former Vice President Joe Biden's victory in the US presidential election and Republicans likely to retain the Senate majority, markets are welcoming the split government outcome despite the realization that a "blue wave" sized stimulus package may no longer come to fruition and monetary policy will likely fill the void. Based on our sector specific views across the credit markets, we see this as supportive to healthcare and housing sectors, but a near-term headwind for infrastructure.

The split government outcome is a positive development for healthcare, which had been bracing for substantial policy changes that now seem less likely. Additionally, while drug pricing reform has been a bipartisan focus area, we believe the most negative policy proposals for the industry are now unlikely in a split government with potential for more moderate reforms. There is also less of a political imperative to enact stronger regulations on drug companies when the country – and the global community – is depending on them to help stem the tide of COVID-19 infections and return the world to normalcy. We also expect the continuation of a strong housing sector; however, infrastructure is expected to be challenged in the near term by projected spending declines in 2021 and a lack of federal aid. In the longer term, higher taxes, a focus on renewable energy, and an openness to aiding state and local governments could provide needed support.

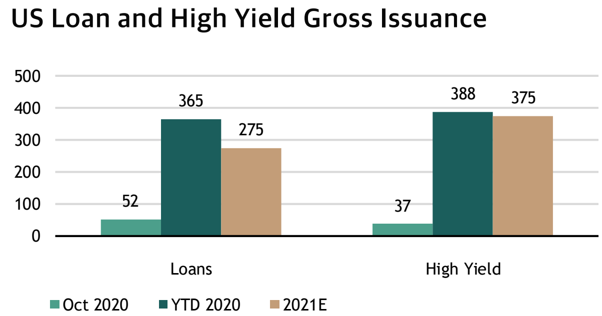
Signs of continued economic recovery, such as a rebound in consumer spending to pre-COVID levels (excluding travel and some leisure categories), are promising, but fiscal stimulus and, more importantly, a COVID-19 vaccine, are paramount for economies to fully recover.[3] Sectors most directly impacted by COVID-19 have experienced tailwinds due to Pfizer's announcement of a high efficacy vaccine alongside other positive developments from Moderna, but we do not expect full vaccine availability until spring or summer of 2021. Ultimately, the Federal Reserve and the ECB remain the backstop and the latter has committed to keep the bank's pandemic emergency bond-buying program running through mid-2021. We remain focused on rates and whether the Fed will likewise extend their bond buying program.

We remain constructive on US and European loans and high yield bonds given the expectation for further economic recovery should continue to support risk assets broadly.

[1] JP Morgan Default Monitor, November 2, 2020; Credit Suisse Default Report, November 4, 2020.
[2] Barclays CLO Monthly, November 3, 2020.
[3] JP Morgan credit card data, November 2, 2020.

US Loan and High Yield Markets

US loans and high yield bonds continued to recover in October, despite volatility leading up to the US presidential and congressional elections. Loans returned 0.20%, bringing the year-to-date return to -0.46%, and high yield bonds returned 0.51%, bringing year-to-date performance to 1.13%.[4]



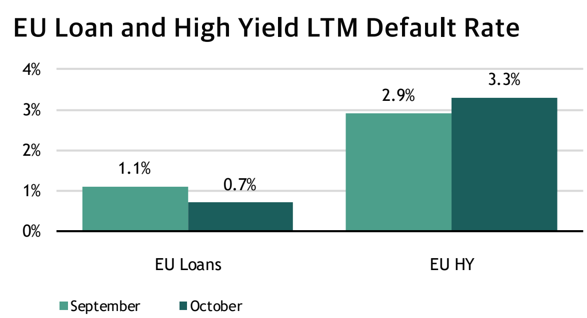
US loan gross issuance increased 54% month over month to $52 billion, representing the highest monthly issuance total since February. Meanwhile, high yield bond issuance slowed 27% to $37 billion but stands higher than the October monthly average, since 2010, of $24 billion.[5] Looking forward, JP Morgan forecasts modest declines in 2021 gross and net issuance for loans and high yield bonds; however, they expect 2021 volumes to be among the heaviest for gross high yield bond issuance and refinancing activity.

The LTM par-weighted US loan default rate decreased month over month to 3.99% despite the increase in overall loan and high yield default volume to $11.5 billion, well above the modest totals in August and September. The LTM default rate for high yield bonds, on the other hand, increased to 6.34%. Excluding energy, which accounts for 30% of year-to-date defaults, the default rates for loans and high yield drop to 3.64% and 4.58%, respectively. This sector has also experienced low recovery rates, significantly impacting unsecured high yield bond recoveries which currently stand at just 16.3% on average. Excluding energy, the unsecured high yield recovery rate increases to 21.3%. For loans, although the current LTM recovery rate of 46.3% sits nearly 20% lower than the long-term average, it is just 2% lower than the recovery rate experienced in 2009. And because default rates are much lower than the 12.8% experienced in 2009, average principal loss rates are much improved this default cycle (2.1%) than during the financial crisis (6.6%).[6]

Retail demand for US loans remained tepid as investors withdrew another $0.5 billion from loan retail funds in October. Now accounting for approximately 5% of the loan investor base, we expect loan retail investors to have less capacity to drive volatility moving forward. In comparison, investor demand for high yield bonds has been strong with $4.4 billion of total inflows to retail funds in October. Loans remain an important asset class for institutional investors and US CLO issuance totaled $12.7 billion in October, now accounting for 57% of the loan investor base and more than offsetting lackluster demand from retail investors.[7]

European Loan and High Yield Markets

Despite the surge of COVID-19 cases across Europe and the incremental shutdowns and restrictions that followed, loans and high yield bonds continued to recover in October, returning 0.25% and 0.29%, respectively.[8] With the ECB committed to keep the bank's pandemic emergency bond-buying program running through mid-2021, we believe the recovery will continue. However, the pace of return to economic health will depend on the continent's ability to contain new outbreaks regionally and the timing of an effective vaccine.



European loan prices continued to be supported in the secondary market by an increase in CLO issuance, with October's volumes representing the highest monthly total year-to-date. European loan issuance also decreased month over month to €5.8 billion from €6.9 billion, further supporting loan technicals.[9]

European high yield bonds, on the other hand, experienced headwinds from high yield retail investors, who withdrew €729 million, and an increase in supply with €13.2 billion of issuance in October compared to €10.2 billion in September.[10] Performance in October was driven largely by higher quality bonds as volatility encouraged investors to move up in quality.

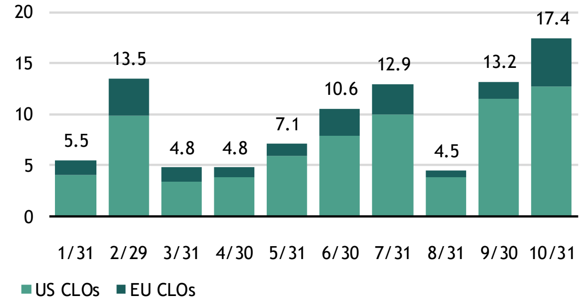
Given no European loan issuers defaulted in October, the LTM default rate declined to 0.7%, a level not seen since before March. The European high yield LTM default rate increased to 3.3% but remains manageable and notably lower than the US high yield default rate.[11] European loan and high yield defaults have remained concentrated in the small issuers that encompass the retail, restaurants, travel, and leisure sectors. The largest issuers in Europe are concentrated in the telecom, auto, and bank sectors, which have seen very few defaults.[12]

[4] S&P/LSTA Leveraged Loan Index, Bloomberg Barclays US High Yield Index, as of October 31, 2020.
[5] JP Morgan High Yield Bond and Leveraged Loan Market Monitor, November 2, 2020.
[6] JP Morgan Default Monitor, November 2, 2020.
[7] LCD, as of October 31, 2020. JP Morgan, Lipper, as of October 31, 2020. Includes all weekly and monthly reporting funds if reported by November 4, 2020.
[8] Credit Suisse European Leveraged Loan and High Yield Bond Indices, as of September 30, 2020.
[9] LCD as of October 31, 2020.
[10] JP Morgan Lipper, as of October 31, 2020.
[11] Credit Suisse Default Monitor, November 4, 2020.
[12] Credit Suisse European Credit Trades & Themes: HY Default Deep Dive, October 27, 2020.

US and European CLO Markets

CLO equity distributions rebounded sharply in October, approaching 2019 levels, driven by improving collateral quality and healthier CLO fundamentals. CCC levels, in particular, appear to have peaked with exposure within US CLOs declining -0.6% month over month and European CLOs by -0.4%, consistent with decreases in CCC-rated exposure in both the US and European loan indices.[13]

US and European CLO Issuance



October marked the busiest month year-to-date for CLO primary market activity globally as CLO managers and CLO arrangers printed deals to lock in CLO liabilities ahead of the US election. In the US, 32 deals priced for $12.7 billion, representing an 11% increase month-over-month. Four managers priced their first US CLO of 2020 during the month, and the new-issue manager count now totals 82. In Europe, 12 CLOs priced for €4.0 billion with just one manager issuing its first CLO of the year.[14] CLO activity in 2020 has proven resilient with year-to-date US supply of $75 billion beating JP Morgan's downside case of $50-70 billion in issuance. US and European CLO issuance for 2021 is forecasted to increase to $85-95 billion and €25 billion, respectively.[15]

In the US, CLO reinvestment periods experienced a reemergence of pre-pandemic five-year lengths in October. These longer reinvestment periods provide more opportunity to take advantage of an elongated period of loan spread widening with term funding and also allow for more time to work out distressed assets if needed. In Europe, CLO reinvestment periods largely remain three-years in length with one-year non-call term structures.

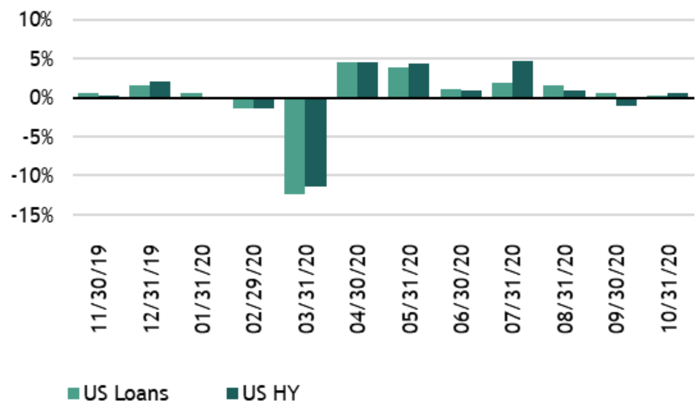
Heading into the US election, volatility in the global markets spilled into the CLO market late in October, and CLO liability spreads widened in the secondary market across the capital stack. Lower rated tranches experienced the most widening; US CLO tranches rated BB widened by 30bp while AAA-BBB-rated tranches widened by 5-20bp. European CLO tranches rated BB experienced 63bp of spread widening while investment grade tranches widened by 8-30bp.[16] Bifurcation in secondary pricing remains evident between CLOs with lower quality portfolios and lower market value overcollateralization ratios relative to other CLOs that were less impacted by the recent volatility. Secondary trading volumes remained healthy in October, with BWIC volumes of $3.5 billion in the US and €1.0 billion in Europe, but showed a slight decrease month over month from $4.5 billion and €1.4 billion, respectively.

In the CLO primary market, tiering of new issue AAA spread levels was elevated in the US as smaller managers returned to the new issue market at wider spreads and investors expressed preference for manager strategy amid the strong demand for AAA-rated tranches. The differential between the 10th and 90th percentile of US AAA new issue discount margins averaged 34bp in October, almost three times the median 2019 level. If AAA spreads continue to tighten, this gap may compress slightly in the coming weeks. In Europe, tiering of new issue CLO AAA spreads has subsided, with spread differentials between AAA new issue discount margins having narrowed back near historical averages where they are likely to remain for the near term.[17]

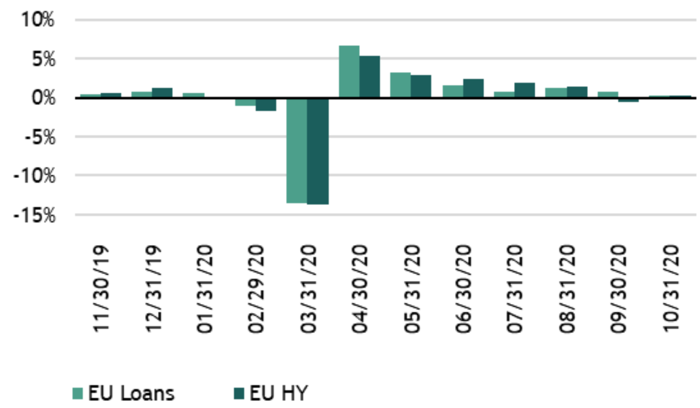
[13] Barclays CLO Monthly, November 3, 2020.
[14] LCD, as of October 31, 2020.
[15] JP Morgan Preliminary 2021 CLO Supply Forecast November 6, 2020.
[16] BofA Global Research for US CLO spreads, as of October 31, 2020. Citi for European CLO spreads, as of October 31, 2020.
[17] Barclays CLOs: Tiering at the Top October 23, 2020.

Market Snapshot (as of October 31, 2020)[18]

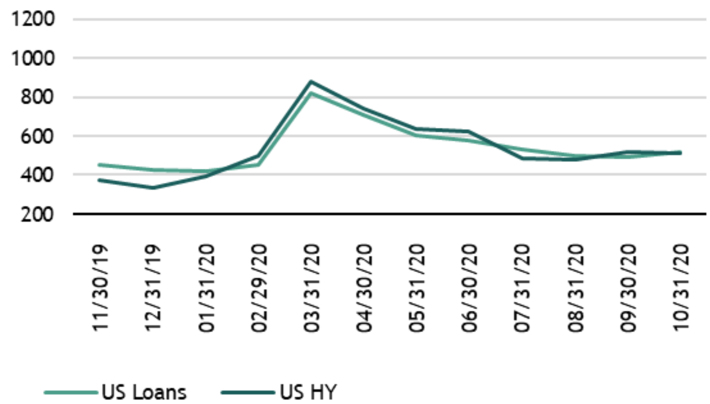
US Credit Monthly Returns



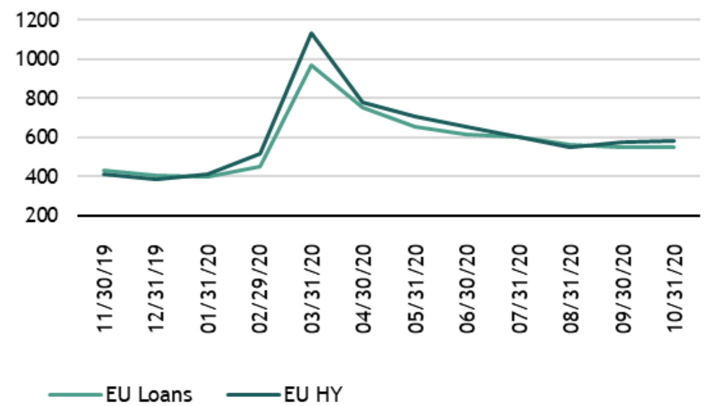
EU Credit Monthly Returns



US Credit Spreads (bp)



EU Credit Spreads (bp)



	Spread			Yield			Price		
	Level	ΔMTD	ΔYTD	Level	ΔMTD	ΔYTD	Level	ΔMTD	ΔYTD
U.S. Loans	517	23	94	5.45%	-0.28%	-0.68%	$93.17	-$0.01	-$3.55
U.S. HY	509	-9	172	6.10%	-0.02%	0.12%	$99.74	$0.17	-$1.49
EU Loans	550	1	144	3.97%	0.01%	-0.18%	€94.73	€0.14	-€ 3.59
EU HY	580	4	200	5.28%	-0.15%	0.86%	€93.49	€ 0.15	-€ 5.94

	Level	MTD Return	YTD Return
Dow Jones Industrials	26502	-4.52%	-5.38%
S&P 500	3270	-2.66%	2.77%
Russell 2000	1538	2.09%	-6.77%
Euro Stoxx 50	2958	-7.29%	-18.96%
DAX	11556	-0.36%	-12.77%
MSCI Emerging Markets	1103	2.08%	1.15%
MSCI World	2293	-3.04%	-0.98%

	Level	ΔMTD	ΔYTD
1-Month Libor	0.14%	-1 bp	-162 bp
3-Month Libor	0.22%	-2 bp	-169 bp
10-Year Treasury	0.87%	19 bp	-105 bp
3-Month Euribor	-0.52%	-3 bp	-14 bp
6-Month Euribor	-0.52%	-4 bp	-20 bp
10-Year German Bund	-0.63%	-11 bp	-44 bp

[18] S&P/LSTA Leveraged Loan Index (represented by spread to maturity and yield to maturity), Bloomberg Barclays US 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 October 31, 2020. Equities, LIBOR, Euribor, US Treasury, and German bund sourced from JP Morgan daily updates.

Important Disclosure Information

This document has been prepared for informational purposes only about Blackstone's credit focused business group (together with its affiliates, "Blackstone Credit") and it does not constitute an offer to sell, or a solicitation of an offer to buy, any investment in, or to participate in any trading strategy with Blackstone Credit or any fund or account managed, advised or sponsored by Blackstone Credit (each, a "Fund"). Any offering would only be made to qualifying investors through a separate investment management agreement for a Fund as it may be amended or supplemented from time to time and the governing and operating documents for a Fund (together, the "Operative Documents"). The Operative Documents contain material information (including a discussion of potential conflicts of interest) not contained in this document, and supersedes and qualifies in its entirety the information set forth herein. Any decision to invest in, or withdraw from, a Fund should be made after reviewing the appropriate Operative Documents, conducting such investigations as the investor deems necessary and consulting the investor's own legal, accounting and tax advisors in order to make an independent determination of the suitability and consequences of the investment. Risks associated with investment in a Fund include, without limitation, illiquidity of an investment, risk of default of the underlying debt instrument and risk of loss of principal.

This document is based on information which is otherwise publicly available and, whilst Blackstone Credit uses reasonable efforts to ensure the information is accurate and up to date, no representations or warranties are given as to the reliability, accuracy or completeness of the information. While such information is believed to be reliable for the purpose used herein, Blackstone Credit does not accept any liability for any loss or damage which may arise directly or indirectly from any use of or reliance on such information. The information presented herein is as of the date of preparation unless otherwise indicated and Blackstone Credit is under no obligation to, and shall not, provide updates to the information contained herein.

Certain information contained in this document constitutes "forward-looking statements," which can be identified by the use of forward-looking terminology such as "may," "will," "should," "expect," "anticipate," "target," "intend," "continue" or "believe," or the negatives thereof or other variations thereon or comparable terminology. Due to various risks and uncertainties, actual events or results described herein may differ materially from those reflected or contemplated in such forward-looking statements.

This document is for informational purposes only and does not constitute a financial promotion, investment advice or an inducement or incitement to participate in any product, offering or investment. It does not constitute or form part of any offer to issue or sell, or any solicitation of any offer to subscribe or purchase any investment nor shall it or the fact of its distribution form the basis of, or be relied on in connection with, any contract. No representation, warranty or undertaking, express or implied, is given as to the accuracy or completeness of the information or opinions contained in this document by Blackstone Credit, Blackstone, any Fund, or any of their respective directors, officers, managers, shareholders, partners, members or employees and no liability is accepted by such persons for the accuracy or completeness of any such information or opinions. Tax considerations, margin requirements, commissions and other transaction costs may significantly affect the economic consequences of any transaction concepts referenced in this commentary and should be reviewed carefully with one's investment and tax advisors. Blackstone and others associated with it may have positions in and effect transactions in securities of companies mentioned or indirectly referenced in this commentary and may also perform or seek to perform services for those companies. Investment concepts mentioned in this commentary may be unsuitable for investors depending on their specific investment objectives and financial position.

IN MAKING AN INVESTMENT DECISION, INVESTORS MUST RELY SOLELY ON THEIR OWN EXAMINATION OF THE RELEVANT FUND AND THE TERMS OF THE APPLICABLE OPERATIVE DOCUMENTS, INCLUDING THE MERITS AND RISKS INVOLVED, AND NOT ON ANY INFORMATION OR REPRESENTATION MADE OR ALLEDGED TO HAVE BEEN MADE HEREIN OR OTHERWISE.

To the extent that this document contains third party data or information (including, without limitation S&P Credit Ratings) (collectively "Content"), neither Blackstone nor the applicable third party content provider(s) ("Blackstone Parties") guarantee the accuracy, completeness, timeliness or availability of any Content, and are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, or for the results obtained from the access or use of such Content. In no event shall the Blackstone Parties be liable for any damages, costs, expenses, legal fees or losses (including lost income or lost profit and opportunity costs) in connection with any use of the Content. Please read the complete disclaimer with respect to S&P Credit Ratings: http://www.standardandpoors.com/en_US/web/guest/regulatory/legal-disclaimers.

The views expressed herein are the personal views of the authors, and do not necessarily reflect the views of Blackstone (as herein defined) or Blackstone Credit (as herein defined). The views expressed reflect the current views of the authors as of the date hereof and the authors Blackstone, and Blackstone Credit each undertake no responsibility to advise you of any changes in the views expressed herein.

ERISA Fiduciary Disclosure. The foregoing information has not been provided in a fiduciary capacity under ERISA, and it is not intended to be, and should not be considered as, impartial investment advice.

For more information about how Blackstone collects, uses, stores and processes your personal information, please see our Privacy Policy here: http://go.pardot.com/e/213192/privacy/68f9x/182811975?h=L3PDlTnbE2h0R6yw-jpiXWquHwiOdKAOzy99H3DK9f8.

Certain countries have been susceptible to epidemics, most recently COVID-19, which may be designated as pandemics by world health authorities. The outbreak of such epidemics, together with any resulting restrictions on travel or quarantines imposed, has had and will continue to have a negative impact on the economy and business activity globally (including in the countries in which the Funds invest), and thereby is expected to adversely affect the performance of the Funds' Investments. Furthermore, the rapid development of epidemics could preclude prediction as to their ultimate adverse impact on economic and market conditions, and, as a result, presents material uncertainty and risk with respect to the Funds and the performance of their Investments.

Blackstone Securities Partners L.P. ("BSP") is a broker-dealer whose purpose is to distribute Blackstone managed or affiliated products. BSP provides services to its Blackstone affiliates, not to investors in its funds, strategies or other products. BSP does not make any recommendation regarding, and will not monitor, any investment. As such, when BSP presents an investment strategy or product to an investor, BSP does not collect the information necessary to determine—and BSP does not engage in a determination regarding—whether an investment in the strategy or product is in the best interests of, or is suitable for, the investor. You should exercise your own judgment and/or consult with a professional advisor to determine whether it is advisable for you to invest in any Blackstone strategy or product. Please note that BSP may not provide the kinds of financial services that you might expect from another financial intermediary, such as overseeing any brokerage or similar account. For financial advice relating to an investment in any Blackstone strategy or product, contact your own professional advisor.