Blackstone Credit

CREDIT INSIGHTS

December 2021 Market Commentary

Performance Overview

- High yield rebounds, top credit performer
- Demand pushes up prices despite Omicron
- Hawkish central banks embark on rate hikes
- Credit supply set for strong start to 2022

Despite ongoing volatility in December, global credit markets rallied into year-end carving out positive returns almost across the board. High yield rebounded to outperform other credit markets for the month and full year even as global equity markets whipsawed on surging COVID-19 infections and central bank hawkishness.

A rally to begin the month was quickly replaced with renewed volatility as European governments intensified lockdowns and travel restrictions to curb the spread of Omicron. Crude oil prices fell on demand concerns and investors hurried back to the safe haven of Treasuries and core currency sovereign debt.

The month was filled with central bank meetings and ensuing hawkish statements. The Fed outlined plans for three rate increases in 2022, while the Bank of England's surprise 15bp rate hike drove a selloff in Gilts. The ECB signaled zero rate hikes in 2022, but revised headline inflation expectations up to 3.2% for current year. The stalling of the roughly $2 trillion Build Back Better bill added to the uncertainty.

Despite the monetary and fiscal concerns, equities and credit rallied into year-end on growing confidence that the latest variant would be mild and potentially a pathway to greater immunity. From daily swings of more than 1% earlier in the month, the S&P 500 rallied to end December up 4.4% and the year up 26.9%.[1] Treasury yields rose steadily into month end with the 10-year ending at 1.51%.

Despite reluctance to add risk late in the year, seasonally low levels of liquidity, limited primary in the second half of the month, as well as inflows from retail funds helped loan and high yield prices grind higher.

Annual returns across all sub-investment grade credit markets ended well ahead of 2020. The Santa rally helped the US high yield market deliver a 5.28% annual return for 2021, the best performance among credit asset classes.[2] US loans came a close second at 5.20%, as persistent demand provided immunity to the late year volatility.

Healthy credit fundamentals set the scene for a strong start to the new year, with the potential for loan and bond prices to edge higher in early January before new issue supply becomes available. Overall issuance forecasts are for another busy year across credit, although not quite at the same record pace as 2021.

Capital structures are in good shape in terms of near-term maturities and improving cash flows and the stressed universe of US bonds/loans totaled just $32 billion at year-end compared to $549 billion in March 2020.[3] Just one US issuer defaulted in December, leaving overall default rates well below 1%, while the number of US loan and bond companies defaulting in 2021 is the lowest since 2007.[4]

Market Stats (as of December 31, 2021)

	December	QTD	YTD
S&P / LSTA U.S. Leveraged Loan Index	0.64%	0.75%	5.20%
Bloomberg Barclays U.S. Corporate Investment Grade Index	-0.08%	0.23%	-1.04%
Bloomberg Barclays U.S. High Yield Index	1.87%	-1.15%	5.28%
Credit Suisse Western European Leveraged Loan Index	0.42%	0.70%	4.63%
Credit Suisse Western European High Yield Index	1.06%	-0.05%	4.04%
S&P 500	4.36%	10.65%	26.89%
Euro Stoxx 50	5.79%	6.18%	20.99%

[1] Bloomberg, December 31, 2021.
[2] Bloomberg, December 28, 2021.
[3] J.P. Morgan Research, January 3, 2022.
[4] J.P. Morgan Default Report, January 2021.

Past performance is not necessarily indicative of future results.

Market Stats (cont'd) (as of December 31, 2021)

	Spread			Yield			Price		
	Level	ΔMTD	ΔYTD	Level	ΔMTD	ΔYTD	Level	ΔMTD	ΔYTD
U.S. Loans	411	(0)	(32)	4.20%	-0.12%	-0.50%	$98.64	$0.49	$2.44
U.S. HY	283	(54)	(77)	4.86%	-0.28%	-0.11%	$103.56	$1.43	($1.40)
EU Loans	413	(0)	(46)	3.82%	0.05%	-0.06%	€98.71	€0.10	€1.36
EU HY	360	(43)	(64)	3.76%	-0.19%	-0.48%	€100.23	€0.72	€1.64

US Investment Grade Market

Investment grade bonds ebbed with equities and Treasuries in the final month of the year as sentiment switched between risk off and risk on. Heavy supply also weighed on the market, which returned -0.08% in December and -1.04% for the year.[5] Energy was a modest outperformer while the longer duration utility sector lagged the broader market.

Interest rates in the U.S. reversed course over the month, rising across the curve. The 2-year Treasury rose 17bp to yield 0.73% while the 10-year rose 7bp to 1.51% as the yield curve continued to flatten in response to the Fed quickening its taper plans and pulling forward the projected lift-off date for raising their policy rate.

Having widened to an annual high of 103bp at the start of the month, investment grade spreads tightened to 92bp by month end, inside their year-end 2020 closing level of 96bp, but off the year's tights.[6]

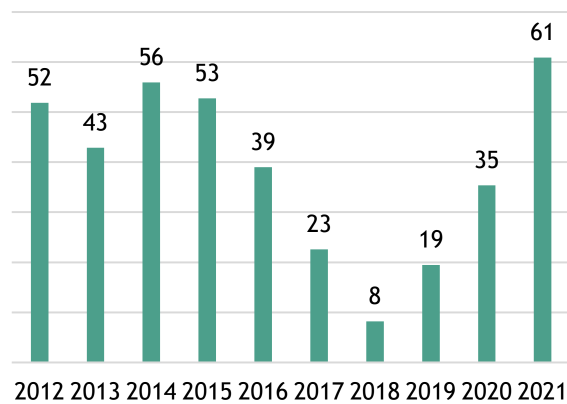
After an initial delay, borrowers stepped up issuance as sentiment improved and a record $61 billion of new deals priced in December, surpassing the previous high of $56 billion issued in December 2014. All told 2021 issuance finished at $1.37 trillion, inside last year's record total, but more than 10% ahead of the pre-pandemic annual peak in 2017.[7]

High-grade corporates sought to lock in funds ahead of rising rates. On average issuers paid 2.59% at issuance in December, a high since July 2020, and up from the pandemic-era low at 1.71% in January 2021.[8]

Despite some predictions that the busy December could precede a quieter January,[9] issuers got straight back to business during the first week of 2022. Early forecasts, based on conversations with arrangers, are for $140 billion of new deals in January and this tally could rise higher if rate concerns pull forward issuance plans.[10] Overall supply in 2022 is expected to decrease slightly from 2021.

December saw the largest monthly retail outflow since March 2020, while Asian buyers, an active part of the investment grade buyer base in 2021, returned after some initial selling at the start of the month. Investment grade funds netted robust retail inflows of $132 billion in 2021.[11]

Investment grade recorded highest December issuance in a decade[12]
Annual December Issuance ($ in billions)



US Loan and High Yield Markets

The US high yield market staged a strong recovery in December as concerns about the severity of the Omicron variant receded. Returns ended at 1.87% for the month, the highest in 2021 by a significant amount.[13]

As rates stabilized, high yield retail inflows turned positive to the tune of roughly $4 billion,[14] fueling a risk-on rally in the absence of primary supply. Buying was evident across the risk spectrum driving prices higher, spreads lower and helping the market recoup losses incurred in October and November. The relief rally also offered the opportunity to

[5] Bloomberg US Corporate Investment Grade Index.
[6] Bloomberg US Corporate Investment Grade Index.
[7] LCD, December 2021.
[8] LCD, January 4, 2022.
[9] Barclays Investment Grade Credit Research, December 17, 2021.
[10] Blackstone Credit
[11] CS Credit Strategy Daily, January 4, 2022.
[12] LCD, December 2021.
[13] Bloomberg Barclays Index.
[14] J.P. Morgan Fund Flows.

Past performance is not necessarily indicative of future results.

take some risk off the table ahead of year end and investors pivoted to higher-rated assets.

After some initial weakness COVID-recovery credits recovered in the final two weeks of the year amid muted primary volumes. CCC credits in both high yield and loans rounded out the year as the top performer within fixed income in 2021.[15]

High yield borrowers wrapped up issuance quickly amid the more volatile first half making December's $9.5 billion of deals the lowest monthly tally of the year.[16] Arrangers are guiding for roughly $30 billion of new deals in January.

The loan market also finished the year in strong form, and loan prices retraced from the late November volatility to deliver a return of 0.64% for the month and an impressive 5.20% for 2021.[17]

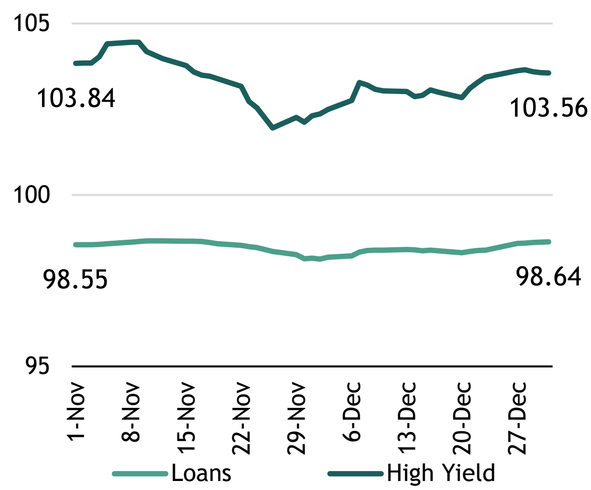
Average loan prices ended the year at $98.64, not quite back to the pre-Thanksgiving annual high of $98.67, but well above the $96.22 mark where they started the year.[18]

Accounts used the last bit of liquidity to tweak portfolios and adjust cash before the holidays. There was ongoing appetite from CLO buyers, which stepped in to buy loans with coupons above 400bp. Retail flows resumed into mutual funds and some ETFs, amounting to roughly $2 billion.

Loan issuers stayed active into December pricing $13.4 billion of mostly smaller add-ons, taking overall issuance in 2021 to a record $615 billion.[19] Based on our discussions with the market, the visible forward calendar for January includes $40-50 billion of deals,[20] including some sizeable transactions following the run up in secondary prices.

Credit metrics for both high yield and leveraged loans improved again in the third quarter and are expected to improve further in the final quarter on the back of GDP growth. High yield bond upgrades continue to outpace downgrades leaving the LTM upgrade-to-downgrade ratio at a record 2:1.[21]

Prices of loans and high yield rebounded in December[22]



European Loan and High Yield Markets

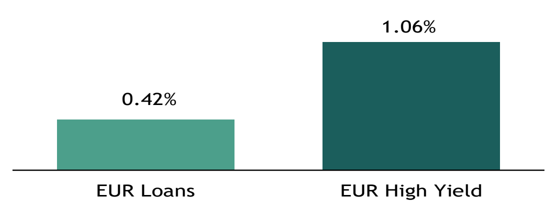
In Europe, high yield and loans recorded their strongest return of the quarter, with high yield performing particularly well following two negative prior months. These returns were more notable given the rapid spread of COVID-19 cases across Europe during the month, which led to a more risk-off sentiment compared to the US.

High yield initially moved in tandem with global risk assets, and, after an initial recovery, succumbed to renewed concern as COVID cases and lockdown measures increased. Technicals then came into play as limited primary and elevated cash levels supported secondary prices and the market retraced the October/November weakness. Returns rounded out the month at 1.06% and at 4.04% for the year.[23]

Liquidity became increasingly challenging as the month progressed as dealers looked to reduce balance sheet risk, and investors parked cash in higher quality credits. Reopening names recovered as fears of the need for full-blown lockdowns dissipated.

Primary market activity was muted after a handful of borrowers pulled deals amid the volatility, leaving T-Mobile Netherlands BV the focal point of the month's €1.4 billion volume. That didn't detract from 2021's record €125 billion of high yield issuance,[24] and our estimates point to a visible pipeline of €12 to 15 billion.

December MTD Performance[25]



The very limited primary calendar and ongoing demand from ramping CLOs provided technical support for European loans. Average prices recovered to 98.71, which, although still below the annual high set in September, bolstered returns to 0.42% for December and to 4.63% for the year.[26]

[15] Bloomberg Barclays Index, S&P/LSTA Index.
[16] LCD, December 2021.
[17] S&P/LSTA Index.
[18] S&P/LSTA Index.
[19] LCD, December 2021.
[20] Blackstone Credit
[21] J.P. Morgan Research.
[22] Barclays Live and LCD, November 30, 2021.
[23] Credit Suisse Western European High Yield Index, December 31, 2021.
[24] LCD, December 2021.
[25] Credit Suisse Western European Leveraged Loan Index and Credit Suisse Western European High Yield Index, December 31, 2021.
[26] Credit Suisse Western European Leveraged Loan Index, December 31, 2021.

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Year-end fatigue set in earlier than usual in European loans and after a bumper year of loan issuance, just €710 million of loan paper priced over the month. Despite this drop off, annual supply reached a post-Global Financial Market crisis high of €130 billion. [27]

Secondary market activity was confined mostly to dealer clean ups and cash parks in high quality paper. Renewed COVID restrictions and idiosyncratic developments within the cinema sector weighed on high beta reopening names during the first half, despite some expected upgrades in theme park credits.

Gaming also came under pressure as ESG headwinds weigh on the sector, as did the more inflation exposed credits after November's record high Eurozone CPI reading of 4.9%. Nonetheless, CCC credits remain the standout performer for 2021 with returns above 11%.[28]

US and European CLO Markets

The CLO new issue market proved more immune to the broader Omicron volatility given many managers had already locked in pricing levels for new deals prior to the weakness.

Some softness across mezzanine tranches emerged as the month progressed and accounts stepped back. 2021 was a strong year for US CLO returns, especially further down the rated bond stack with BB-rated CLO bonds returning 9-11% and CLO equity returning 20-30%.[29]

Issuers front-loaded pricing plans in December ahead of a well-attended and upbeat industry conference, and before the window to price and close deals in 2021 closed. Primary market supply in the US was comprised mostly of opportunistic first-time issuers and lower-tier managers, with just a handful of top-tier deals in the mix. That exacerbated the manager pricing tiering which was also evident for much of November.

All told, another $10.3 billion of new deals priced in the US in December, pushing the market to a new quarterly record and leaving the year's total at $187 billion, double 2020's tally.[30]

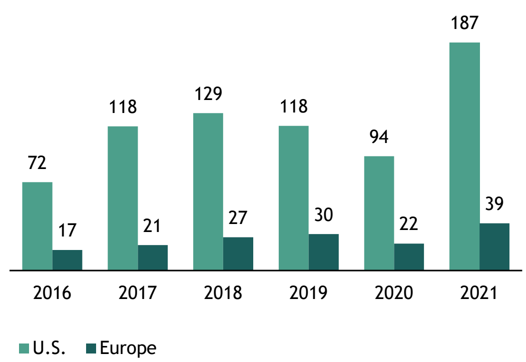
Arrangers guided towards a busy January with nearly twice the warehouse count outstanding compared to a year ago. Estimates among bank analysts are for between $135 to 165 billion of issuance in 2022.[31] A number of 2019/2020 vintage deals with high funding costs will be incentivized to refinance this year.

New transactions will price using the SOFR base rate, and while we do not expect much technical disruption around the transition away from LIBOR, the market will need to agree on an adjusted credit spread with SOFR.

In Europe, the year ended with a firm tone in secondary and spreads squeezed tighter over the month as primary and trading activity dried up, retracing the previous widening caused by the late November softness. Just three new issue transactions priced in December, taking 2021's full year total to a record €38.62 billion, versus €22.11 billion in 2020.[32]

Our conversations with arrangers point to a healthy pipeline of between 45-55 open warehouses setting the scene for another strong year of issuance. Forecasts from bank analysts are for between €30-40 billion of new issuance in 2022.

Global CLO Historical New Issuance ($/€ in billions)[33]



Market Outlook

The year ended in similar fashion to how it began, with renewed restrictions aimed at combating the latest and highly transmissible Omicron variant which has caused cases to rise at record speed across key economies. As ever, predicting what lies ahead with this constantly mutating virus remains challenging, although we have been encouraged by both the mounting evidence that this new strain causes less severe illness than previous variants, particularly in vaccinated people, as well as the approval of anti-viral pills and other treatments. Amid a growing intolerance among populations for curbs on lifestyle, governments are trying to balance the need to protect people and health services while trying to minimize the impact of restrictions on the economic recovery.

[27] LCD, December 2021.
[28] Credit Suisse Western European Leveraged Loan Index, December 31, 2021.
[29] J.P. Morgan CLOIE.
[30] LCD, December 17, 2021.
[31] J.P. Morgan and Citi US CLO 2022 forecasts.
[32] LCD, December 22, 2021.
[33] LCD, December 30, 2021: reflects new issuance excluding refis and resets.

Past performance is not necessarily indicative of future results.

Data from our analysts shows that KPIs in the travel and hospitality sectors have worsened over the near term. especially in Europe, where restrictions were implemented much earlier. However, so far Omicron hasn't yet had a material impact on medium to long-term booking patterns, although the full extent of repercussions may not be known for some time yet.

We are mindful that this latest wave could delay the anticipated improvement in supply-chain issues, as well as intensify short-term staffing shortages. For now, we remain optimistic that the long-term economic recovery remains on track, and that an anticipated return to normal conditions, at least in the US, by the end of the year, should support economic growth, and in turn credit markets.[34]

Aside from Omicron, the new year brings with it decreasing central bank stimulus and elevated inflation stoked by COVID and supply-chain bottlenecks, as well as questions over how much impetus is left in the equity bull market and whether Treasury yields will push higher.

We expect monetary policy will tighten this year as central banks move to combat rising prices. Already the Fed is out in front of the ECB, and we think and there is the potential for a multi-speed global economy in 2022 based on the strength of each country's response to higher inflation as well as COVID.

We think that the US economy is better supported by strong consumer spending and is also more insulated against rising energy prices and against decelerating Chinese growth compared to Europe. In Europe, growth slowed in the second half of 2021, with Eurozone Manufacturing PMI at 58 in December 2021, its lowest level since February.[35] Manufacturing output growth was unchanged in December from November, which registered the second-weakest pace of expansion since July 2020. With Omicron expected to remain a disruptor to supply chains over the near term, and natural gas prices ending the year at all-time highs, we see the possibility for a volatile first half for longer duration assets and company margins in Europe.

Despite some near-term headwinds, overall, we think sub-investment grade credit will perform well during 2022, as demand for higher-yielding assets, particularly those that float, underpins loan and high yield markets amid still negative real yields in investment grade fixed income. Anticipated strong inflows into institutional accounts in January should provide support for secondary prices as investors look to put money to work before the flow of new issues begins.

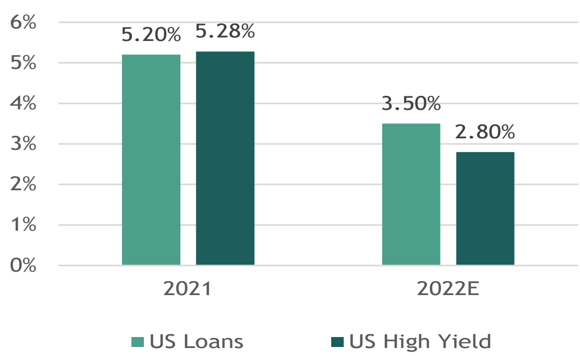
Rising rates due to strong economic growth are positive for all credit markets, and healthy corporate balance sheets should support an ongoing robust carry environment over the coming year.

A final note on the Treasury market as we move into 2022. Having ended 2021 at ~1.50%, which is still at the lows historically speaking, the trend for the 10-year treasury could be higher from here based on previous inflationary upturns, defined as more than 12 consecutive months of CPI growth above the average of the prior two years.

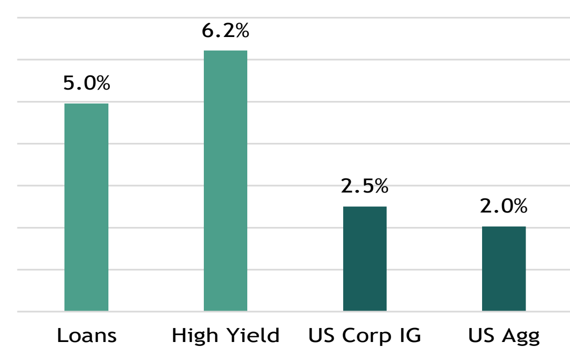
November's four-decade US inflation rate high of 6.8% puts the US into an inflationary upturn starting this month. As the bond market begins to respond to rising inflation and tapering by the Federal Reserve, the yield on the 10-year Treasury could rise to 2.75%, according to Joe Zidle, Chief Investment Strategist and Byron Wien, Vice Chairman of Private Wealth Solutions in their The 10 Surprises of 2022 webcast[36]. They also note that the Fed could raise rates four times in 2022. Already in early January the 10-year rate had crossed the 1.70% mark after minutes from the Fed's December meeting showed officials' increasing preference for a faster path of rate hikes and tapering.

As before, we recommend targeting assets with positive real yields (credit), shorter durations (high yield), and floating-rate coupons, (loans and CLO debt/equity), to counter higher rates and benefit from a strong economy.

US Loans and HY posted strong returns in 2021, despite several new COVID variants



US Loan and HY performance during Fed rate hikes



[34] Joe Zidle, Chief Investment Strategist and Byron Wien, Vice Chairman, Private Wealth Solutions, Blackstone Investment Strategy.
[35] IHS Markit.
[36] Joe Zidle, Chief Investment Strategist and Byron Wien, Vice Chairman, Private Wealth Solutions, Blackstone Investment Strategy.

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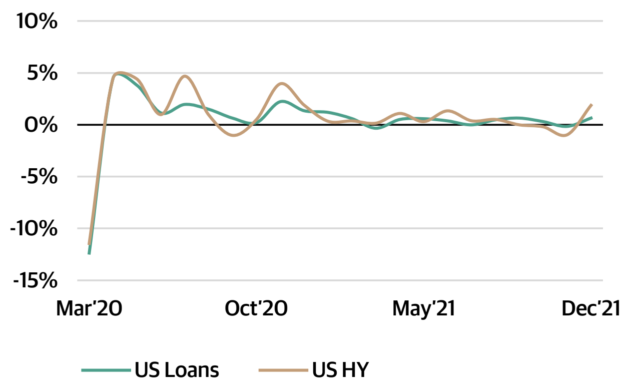
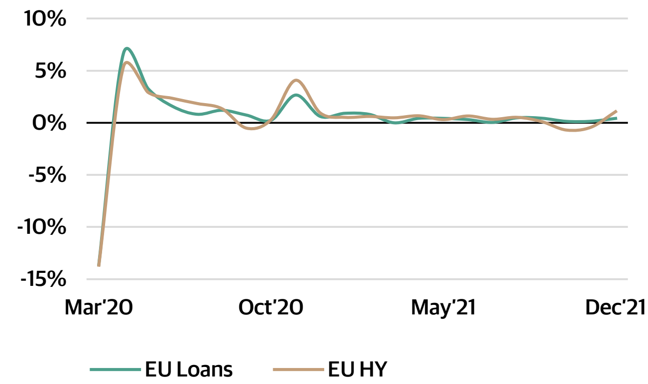
Market Snapshot

(As of December 31, 2021)[37]

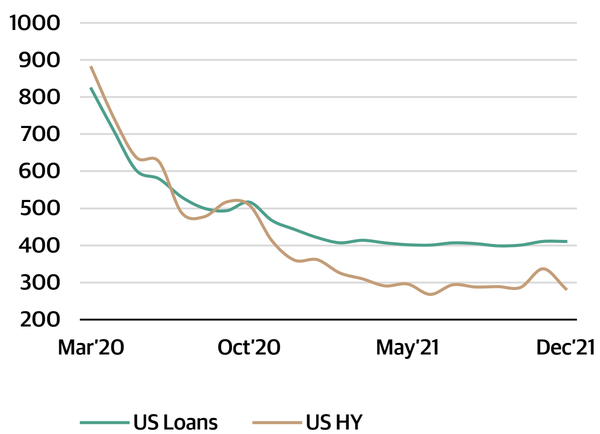
US Credit Monthly Return



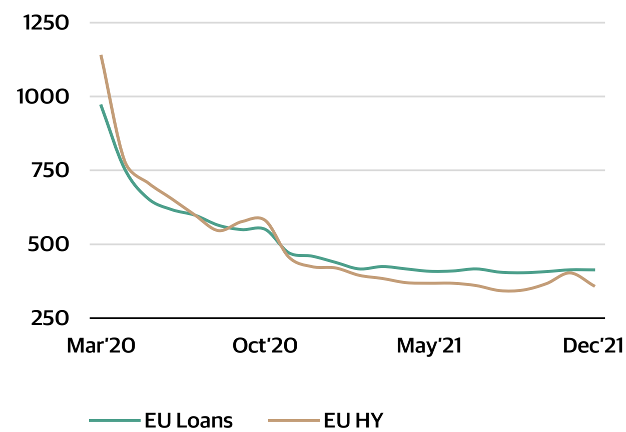
EU Credit Monthly Return



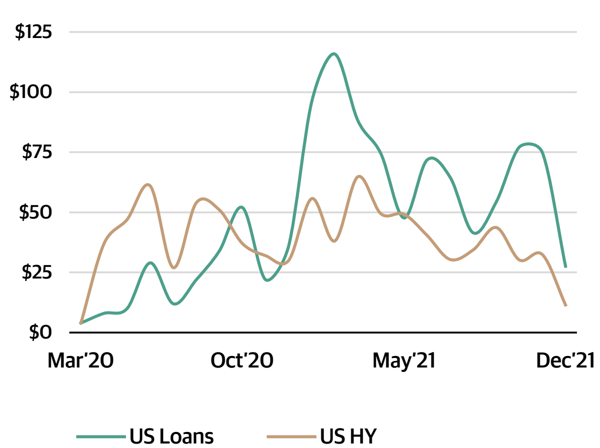
US Credit Spreads (in bps)



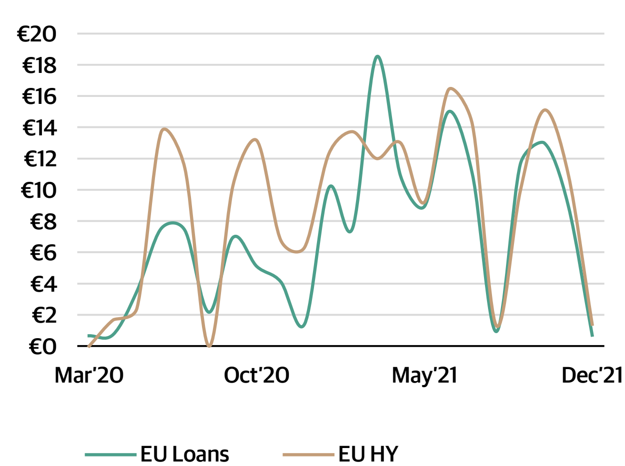
EU Credit Spreads (in bps)



US Credit Issuance ($ in billions)



EU Credit Issuance (€ in billions)



[37] 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 December 31, 2021.

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In considering any investment performance information contained in the Materials, **prospective investors should bear in mind that past or estimated performance is not necessarily indicative of future results** and there can be no assurance that a Fund will achieve comparable results, implement its investment strategy, achieve its objectives or avoid substantial losses or that any expected returns will be met.

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COVID-19. Certain countries have been susceptible to epidemics which may be designated as pandemics by world health authorities, most recently COVID-19. 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.

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Past performance is not necessarily indicative of future results.

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