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CREDIT INSIGHTS

January 2022 Market Commentary

Performance Overview

A positive start to the year for credit quickly gave way to weakness as the Fed's increasingly hawkish stance in the face of surging inflation spooked global markets.

Loans were the stand-out performer, trading in relative isolation and shielded by record inflows into loan retail funds. It's a trend we expect to play out over the course of the year as investors seek floating rate assets to hedge against rising rates and persistent inflation.

Market conditions turned increasingly volatile at the prospect of more aggressive central bank monetary policy in both the US and Europe following ongoing record-high CPI. Escalating geopolitical tensions and decelerating Chinese growth added to the pressure, while early signs of the rollback of COVID-19 restrictions provided a welcome positive development.

Investors are now pricing in at least five Fed hikes and one ECB hike in 2022. Both central banks are playing catch up to the BofE, which has hiked its rates twice already.

Treasuries slumped and equities buckled. The VIX climbed 44% to finish the month at 25 and the Nasdaq fell 12%, its worst start to a year in half a century, as tech stocks that are valued on future earnings and growth expectations tumbled.[1]

- **Volatility hits markets ahead of rate hikes**
- **Loans outperform other credit markets amid record retail inflows**
- **Duration, fixed income assets bruised by rising rates**
- **Geopolitical pressures rise as COVID eases**

As interest rates rose the Treasury yield curve flattened and the 10Y widened by nearly 30bp to 1.92% at the end of January. That put pressure on rate sensitive and longer-duration fixed income assets.

US high yield and investment grade experienced outflows and their worst monthly performance since March 2020,[2] although both markets outperformed equities. US high yield was harder hit than European high yield, while US and European loans were the only credit market to stay in positive territory.

Generally upbeat fourth quarter earnings, especially from some tech companies, helped allay concerns about the impact of higher rates on fundamental performance. The default picture also remains benign, and January was the third time in the last 9 months where there were no defaults. The US high-yield bond and loan default rates are 0.32% and 0.66%, respectively. [3]

Market Stats (as of January 31, 2022)[4]

	January	QTD	YTD
S&P / LSTA U.S. Leveraged Loan Index	0.36%	0.36%	0.36%
Bloomberg Barclays U.S. Corporate Investment Grade Index	-3.37%	-3.37%	-3.37%
Bloomberg Barclays U.S. High Yield Index	-2.73%	-2.73%	-2.73%
Credit Suisse Western European Leveraged Loan Index	0.29%	0.29%	0.29%
Credit Suisse Western European High Yield Index	-1.65%	-1.65%	-1.65%
S&P 500	-5.26%	-5.26%	-5.26%
Euro Stoxx 50	-2.88%	-2.88%	-2.88%

[1] Bloomberg, Blackstone Credit
[2] Bloomberg Corporate High Yield Indices, January 31, 2022.
[3] J.P. Morgan, February 1, 2022.
[4] The volatility and risk profile of the indices presented is likely to be materially different from that of a Fund. In addition, the indices employ different investment guidelines and criteria than a Fund and do not employ leverage; as a result, the holdings in a Fund and the liquidity of such holdings may differ significantly from the securities that comprise the indices.

Past performance is not necessarily indicative of future results.

Market Stats (cont'd) (as of January 31, 2022)

	Spread			Yield			Price		
	Level	ΔMTD	ΔYTD	Level	ΔMTD	ΔYTD	Level	ΔMTD	ΔYTD
U.S. Loans	409	(2)	(34)	4.22%	0.01%	-0.49%	$ 98.69	$ 0.05	$ 2.49
U.S. HY	342	59	(18)	5.53%	0.67%	0.56%	$ 100.12	$ (3.44)	$ (4.84)
EU Loans	412	(0)	(47)	3.85%	0.03%	-0.03%	€ 98.69	€ (0.01)	€ 1.34
EU HY	417	57	(7)	4.18%	0.42%	-0.06%	€ 98.22	€ (2.01)	€ (0.37)

US Investment Grade Market

A strong start for US investment grade was quickly erased as interest rate jitters pushed the asset class to its worst performance since March 2020 at -3.4%.[5]

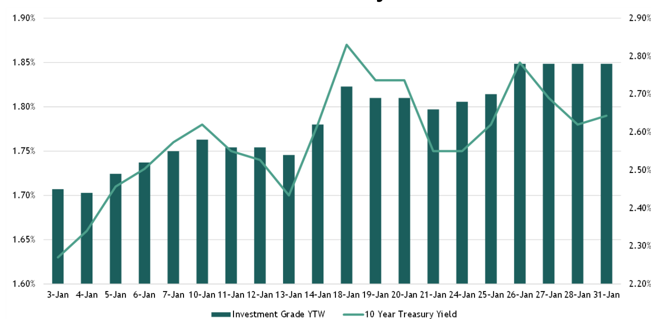
Taking their cue from Treasuries, investment grade yields rose to 2.78%, and spreads widened by 14bp in January.[6] Longer-duration and media and telecom sectors bore the brunt of the volatility, while banks and energy outperformed.[7]

Adding to the pressure was $138 billion of new issuance, making January the second busiest on record, as corporate borrowers tried to price deals ahead of rising rates. Borrowers front-loaded supply paying higher new issue concessions as demand eased during the month. Average new issue yields rose to 2.64% compared with 1.71% in January 2021.[8]

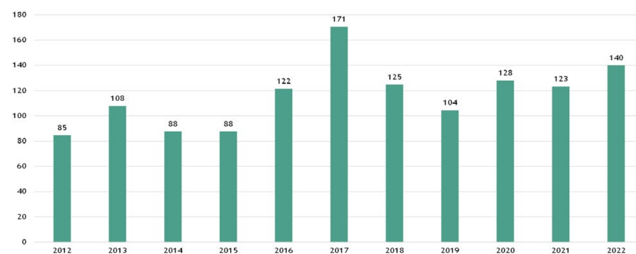
Retail funds experienced outflows for a second consecutive month, after inflows through much of 2021. Asian appetite was weak due in part to the Lunar New Year, although higher rates should draw demand from foreign investors.

Rising stars could impact the technical picture this year; $13 billion of credits were upgraded to investment grade in January, the highest monthly total since 2019.[9]

Investment Grade vs 10Y Treasury Yields[10]



Annual January Investment Grade Issuance ($ in Bn)[11]

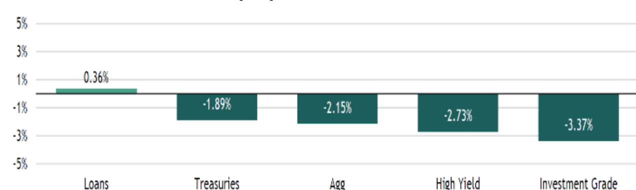


US Loan and High Yield Markets

Record inflows insulated loans from the broader market selloff for much of January, keeping returns in positive territory at 0.36%.[12] In contrast, outflows from the US high yield market contributed to the index falling 2.7% in January, split between the -1.7% credit return and a -1.0% default free return.[13]

Loan mutual funds and ETFs experienced nearly $7 billion of inflows during the month.[14] Average loan prices rose above $99 for the first time in eight years as investors waited for primary allocations.[15] Softer prices amid the broader volatility late month took an anticipated repricing wave off the table as the percentage of loans priced above par fell to 14% from 45% on January 20.[16]

2022 YTD Returns (%) [17]



[5] Bloomberg Corporate Index, January 31, 2022.
[6] Bloomberg as of January 31, 2022.
[77] CS Credit Research Strategy, February 2, 2022.
[8] LCD, February 2, 2022.
[9] CS Credit Research Strategy, February 2, 2022.
[10] Bloomberg as of January 31, 2022.
[11] LCD as of January 31, 2022.
[12] S&P/LSTA Leveraged Loan Index, February 1, 2022.
[13] ICE Data Indices, Bloomberg High Yield Index, January 31, 2022.
[14] Lipper, J.P. Morgan, January 31, 2022.
[15] CS Credit Research, January 19, 2022.
[16] J.P. Morgan, February 1, 2022.
[17] S&P/LSTA Leveraged Loan Index, Bloomberg High Yield Bond Index, Bloomberg US Aggregate Bond Index, S&P 500, Bloomberg Corporate Bond Index, as of January 31, 2022.

Past performance is not necessarily indicative of future results.

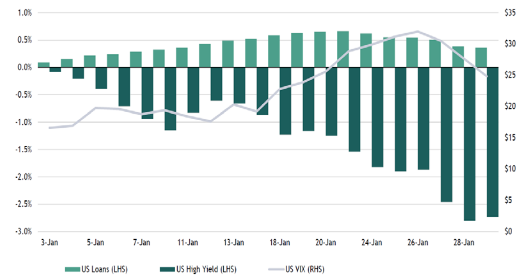
Primary was active and $70 billion of institutional loan transactions priced in January,[18] much of that backing M&A and LBOs. 96% of January's loan supply referenced SOFR, as the market works through the CSA element.[19] Lower-rated recovery sector loans outperformed in the ongoing search for yield.

High yield experienced a reversal of December's inflows and investors pulled more than $6.5 billion from the asset class over the month, predominantly from ETFs.[20] On average high yield bond prices lost over $3 during the month.

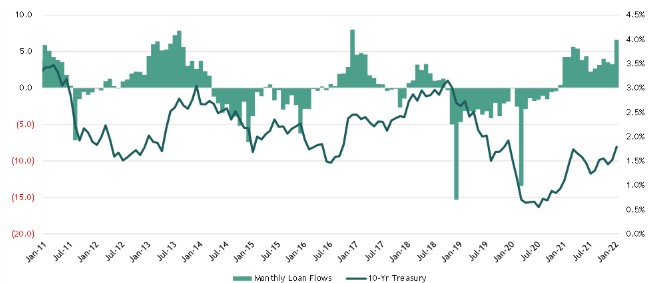
Longer-duration, rate-sensitive BB bonds were worst hit by the rate volatility and spreads widened to 342bp, levels last seen in November 2020.[21] BB valuations looked cheap at these levels and buyers returned towards month end.

Rising yields dampened primary issuance and the month's $24 billion of supply was 55% lower than January 2021.[22] Having worked through much of the known M&A pipeline the forward calendar looks thinner from here. This, together with expected rising star upgrades, should support the technical supply/demand equation.

Cumulative Daily Returns (%) [23]



Loan Flows Follow 10-Yr Rate Moves ($ in Bn)[24]



European Loan and High Yield Markets

Strong demand supported loans through much of the broader market volatility, maintaining returns in positive territory at 0.3%, as modest price falls were outweighed by interest income.[25]

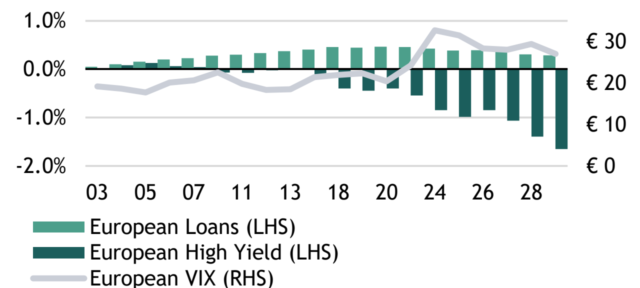
Meanwhile, Europe's high yield market experienced its worst performance since March 2020,[26] down -1.65% in January.[27]

After a quiet December borrowers priced €13.3 billion of new deals, up 16% YoY, propped up by cross-border and M&A transactions.[28] Based on conversations with arrangers the near-term technical picture remains strong with more than 70 CLO warehouses open.

Buyers turned to secondary in the wait for primary allocations, pushing the average loan price above €99 for the first time since November 2018.[29] Month end weakness reduced the percentage of outstanding loans priced above par to 15% from 26% on January 19 reducing any repricing potential.[30]

Lower-coupon, liquid names came under pressure from accounts making room for the additional supply, while higher-margin credits held steady. Travel & Leisure credits outperformed as anticipation of Omicron restrictions being lifted increased.

Cumulative Daily Returns[31]



[18] LCD, January 31, 2022.
[19] J.P. Morgan Research, February 2, 2022.
[20] J.P. Morgan Fund Flows, January 31, 2022.
[21] CS Credit Research, January 31, 2022.
[22] LCD, January 31, 2022.
[23] S&P/LSTA Leveraged Loan Index, Bloomberg High Yield Bond Index, and US VIX index, as of 31 January 2022.
[24] J.P. Morgan, Lipper for loan fund flows, January 31, 2022.
[25] Credit Suisse Leveraged Loan Index, January 2022.
[26] CS Western European HY Index, January 31, 2022.
[27] CS Western European HY Index, January 31, 2022.
[28] LCD, Leveraged Loan Data, February 2, 2022.
[29] Credit Suisse Leveraged Loan Index, January 2022.
[30] Blackstone Credit, February 1, 2022.
[31] Credit Suisse Western European Leveraged Loan, High Yield Bonds Indices, and European VIX index, January 31, 2022.

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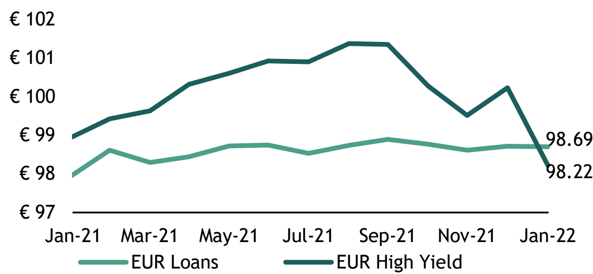
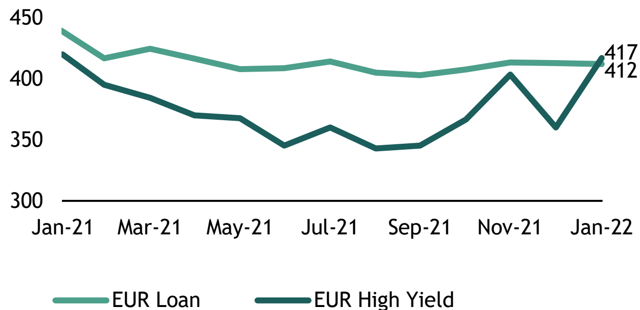
European Loan and High Yield Average Price [32]



European Loan and High Yield Average Spreads [33]

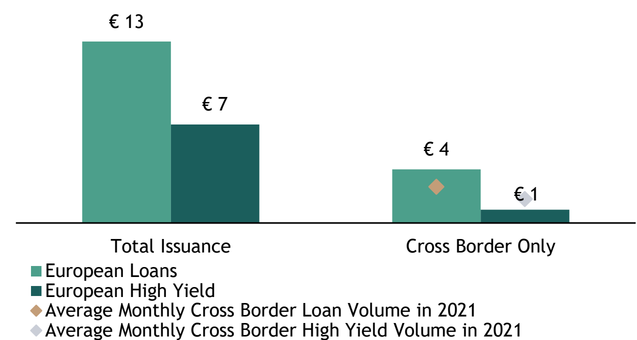


In high yield, average prices fell below par, and spreads widened to 417bp as elevated inflation expectations pushed benchmark 10-year Bund yields into positive territory for the first time since May 2019.[34]

Longer duration BB bonds underperformed lower-rated debt, although CCCs and cyclical risk also came under pressure towards month end. The selloff and impact on relative value motivated some investors to switch out of loans and into cheaper high yield bonds from the same issuer.

Supply at €7.36 billion was 41% lower than January 2021, with a number of deals withdrawn amid the volatility.[35] On the demand side retail funds experienced outflows of €290 million.[36]

European Issuance in January (€ in Bn) [37]



US and European CLO Markets

Global CLOs held steady against the broader market weakness for most of January and CLO prices and spreads softened only towards the end of the month. The CLOIE index returned +0.63% due to price returns while carry and principal returns remained stable, and all original ratings tranches saw positive returns in January.[38]

Primary markets got off to a slow start after the year-end break. In the US just nine new deals for $4.9 billion priced, 50% of December's tally. In Europe no new issues priced with primary activity limited to just €1.69 billion of refinancing activity providing focus.[39]

New issue US CLO tranche spreads have started to price based on SOFR rather than Libor. The resulting increase in US CLO AAA new issue spreads and overall transaction funding costs has pressured the arbitrage available to CLO equity investors.[40] The diminishing value of the Libor floor on loan spreads could further impact equity returns.

CLO equity investors have taken advantage of higher loan prices to redeem existing transactions.

CLO fundamentals and portfolio health continue to improve with the low default environment and run up in loan prices. Less than 3% of assets in US BSL CLOs and European CLOs are trading below $90.[41] For context only 2.54% of US loans were priced below $90 at the end of January.[42] Since the mid- '90s just 40 CLO 1.0 tranches and 5 CLO 2.0 tranches rated by S&P Global Ratings have defaulted.[43]

January 2022 Returns (%) [44]

[32] Credit Suisse Western European LL and High Yield Bonds Indices, as of January 31, 2022.
[33] Credit Suisse Western European LL Loan and High Yield Bond Indices, as of January 31, 2022.
[34] LCD News, January 19, 2022.
[35] LCD, Leveraged Loan Data, February 2, 2022.
[36] J.P. Morgan Fund Flows, February 4, 2022.
[37] S&P LCD and J.P. Morgan, as of January 31, 2022.
[38] J.P. Morgan CLOIE.
[39] LCD, February 1, 2022.
[40] Barclays Credit Research, February 2, 2022.
[41] Barclays Credit Research, February 2, 2022.
[42] S&P/LSTA Loan Index, January 31, 2022.
[43] S&P Global, CLO Spotlight: U.S. CLO Defaults As Of Dec. 28, 2021.
[44] J.P. Morgan, Credit Suisse Leveraged Loan Index, J.P. Morgan High Yield Index, Bloomberg U.S. Aggregate Bond Index, Bloomberg Corporate Bond Index, and Bloomberg U.S. Treasuries Index.

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Market Outlook

If January is any indication, credit markets could be in for a bumpy ride in 2022 as they adjust to monetary policy tightening and rate hikes as central banks move to reign in multi decade-high inflation. The rapidly shifting macro backdrop is unsettling, and markets are likely to remain volatile as they second-guess how both the Federal Reserve, and the ECB might respond to each new economic data release.

January's market swoon was triggered by Fed Chairman Powell's more hawkish stance in response to December's higher-than-expected inflation data. A higher still release in January, showing US CPI surging 7.5% for the month, its highest since February 1982, together with a strong US jobs report, may encourage an even more robust response by the Fed. Just over a month ago our predictions for four Fed rate hikes in 2022 seemed aggressive,[45] but markets have now moved to price in at least five US rate hikes this year. Liftoff is expected in March, but until the rate and the pace of hiking paths become clearer, markets are likely to remain volatile.

Similarly in Europe, record high Eurozone CPI in January at 5.1% (up from 5% in December)[46] may finally convince the more dovish ECB to consider raising rates this year. The central bank will look to subsequent data releases to determine its next move, although ECB president Christine Lagarde continues to highlight the potential to harm the economic recovery if the bank rushes to tighten.[47]

Rising wages and shelter prices will underpin inflationary pressures in the US over the near term, according to Blackstone Private Wealth Solutions Chief Investment Strategist Joe Zidle in his January piece, *Inflation Puts Price Discovery on Fast Track*. He also notes that China's zero-COVID policy could also have negative repercussions for global supply chains and trade, pushing up goods inflation. In addition to rate hikes, the Fed is expected to move towards quantitative tightening through balance sheet reduction this year, which could also pave the way for higher rates.

We think that credit can endure the current increased volatility given that the odds of recession have not gone up, and we recommend credit risk over duration risk going forward. While there's the potential for a deterioration in credit conditions as central banks remove their stimulus, we remain generally constructive on the outlook for leveraged credit given ongoing economic growth, low default rates and the continued need for yield and real returns amid otherwise low fixed income yields and negative real returns.

The heightened uncertainty should also create renewed opportunities for credit differentiation once the market digests this environment. Our dynamic focus on the evolving underlying firm-level credit fundamentals should be well positioned to capitalize as this next phase of the economic recovery plays out.

We think this is an attractive environment for assets with shorter duration, floating rates, and/or the ability to hedge against or benefit from rising prices. The technical backdrop for loans, given ongoing inflows and CLO issuance against a more limited loan pipeline, should support loan outperformance.

On a final note, at approximately the half-way mark for fourth quarter reporting, earnings have generally been in line with expectations. Omicron has had some impact on near term performance in vulnerable sectors, although predictions that the return to normal as COVID-19 enters its endemic phase in 2022, should minimize any medium to long term impact on earnings. In Europe, we are monitoring any potential for the Russian/Ukraine conflict to drive natural gas prices still higher in Europe.

Credit selection will become increasingly important amid increased performance dispersion across industries and companies as 2022 progresses.

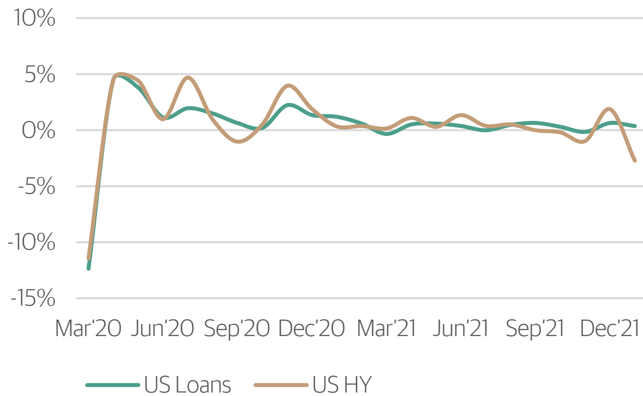
[45] The Ten Surprises of 2022, Joe Zidle and Byron Wien, Blackstone Private Wealth, January 10, 2022.
[46] Bloomberg News, February 2, 2022.
[47] Bloomberg News, February 11, 2022.

Past performance is not necessarily indicative of future results.

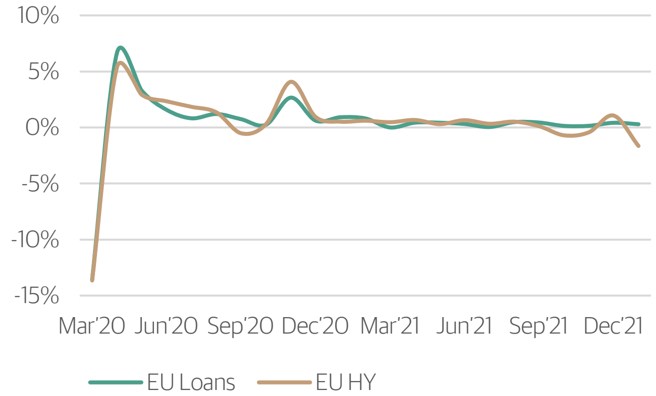
Market Snapshot

(As of January 31, 2022)[48]

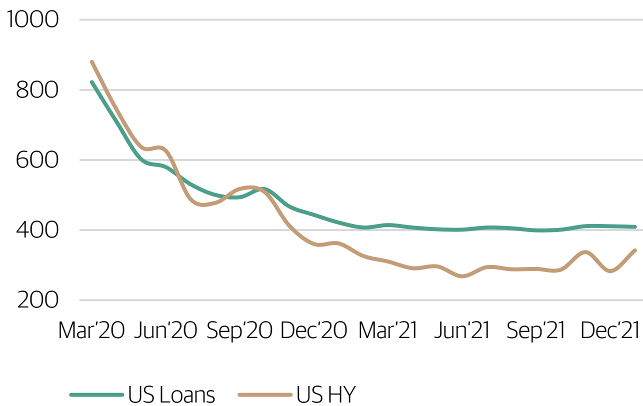
US Credit Monthly Return



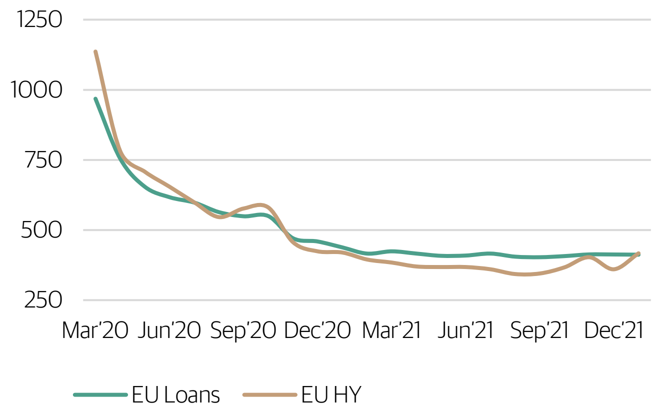
EU Credit Monthly Return



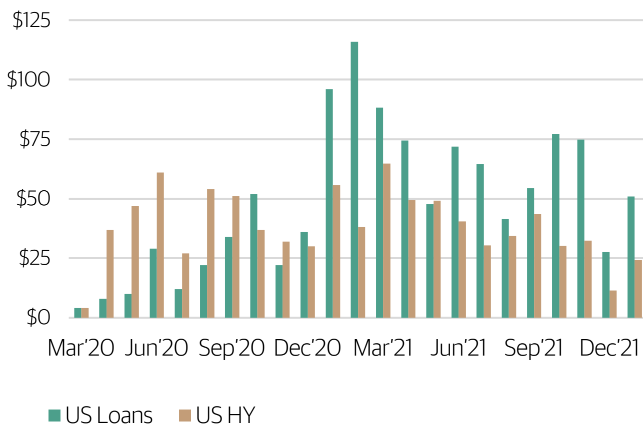
US Credit Spreads (in bp)



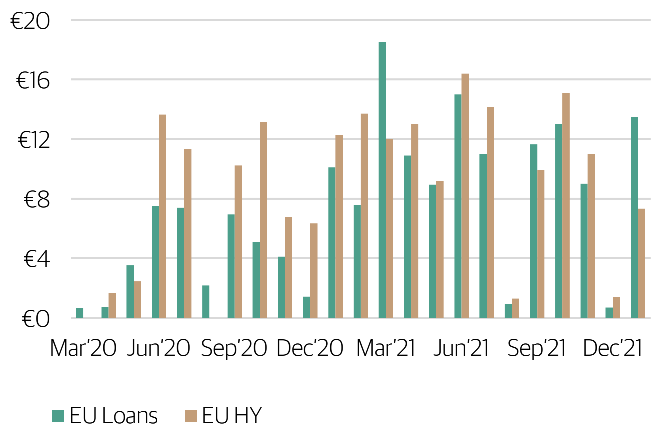
EU Credit Spreads (in bp)



US Credit Issuance ($ in billions)



EU Credit Issuance (€ in billions)



48 S&P/LSTA Leveraged Loan Index (represented by spread to maturity and yield to maturity), Bloomberg 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 January 31, 2022.

Past performance is not necessarily indicative of future results.

Key Risk Factors

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.

Conflicts of Interest. There may be occasions when a Fund's general partner and/or the investment advisor, and their affiliates will encounter potential conflicts of interest in connection with such Fund's activities including, without limitation, the allocation of investment opportunities, relationships with Blackstone's and its affiliates' investment banking and advisory clients, and the diverse interests of such Fund's limited partner group. There can be no assurance that the Sponsor will identify, mitigate, or resolve all conflicts of interest in a manner that is favorable to the Partnership.

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.

Diversification; Potential Lack Thereof. Diversification is not a guarantee of either a return or protection against loss in declining markets. The number of investments which a Fund makes may be limited, which would cause the Fund's investments to be more susceptible to fluctuations in value resulting from adverse economic or business conditions with respect thereto. There is no assurance that any of the Fund's investments will perform well or even return capital; if certain investments perform unfavorably, for the Fund to achieve above-average returns, one or a few of its investments must perform very well. There is no assurance that this will be the case. In addition, certain geographic regions and/or industries in which the Fund is heavily invested may be more adversely affected from economic pressures when compared to other geographic regions and/or industries.

Forward-Looking Statements. Certain information contained in the Materials constitutes "forward-looking statements," which can be identified by the use of forward-looking terminology or the negatives thereof. These may include financial estimates and their underlying assumptions, statements about plans, objectives and expectations with respect to future operations, and statements regarding future performance. Such forward-looking statements are inherently uncertain and there are or may be important factors that could cause actual outcomes or results to differ materially from those indicated in such statements. Blackstone believes these factors include but are not limited to those described under the section entitled "Risk Factors" in its Annual Report on Form 10-K for the fiscal year ended December 31, 2020, and any such updated factors included in its periodic filings with the Securities and Exchange Commission, which are accessible on the SEC's website at www.sec.gov. These factors should not be construed as exhaustive and should be read in conjunction with the other cautionary statements that are included in the Materials and in the filings. Blackstone undertakes no obligation to publicly update or review any forward-looking statement, whether as a result of new information, future developments or otherwise.

Highly Competitive Market for Investment Opportunities. The activity of identifying, completing and realizing attractive investments is highly competitive, and involves a high degree of uncertainty. There can be no assurance that a Fund will be able to locate, consummate and exit investments that satisfy its objectives or realize upon their values or that a Fund will be able to fully invest its committed capital. There is no guarantee that investment opportunities will be allocated to a Fund and/or that the activities of Blackstone's other funds will not adversely affect the interests of such Fund.

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Leverage; Borrowings Under a Subscription Facility. A Fund may use leverage, and a Fund may utilize borrowings from Blackstone Inc. or under its subscription-based credit facility in advance of or in lieu of receiving investors' capital contributions. The use of leverage or borrowings magnifies investment, market and certain other risks and may be significant. A Fund's performance will be affected by the availability and terms of any leverage as such leverage will enhance returns from investments to the extent such returns exceed the costs of borrowings by such Fund. The leveraged capital structure of such assets will increase their exposure to certain factors such as rising interest rates, downturns in the economy, or deterioration in the financial condition of such assets or industry. In the event an investment cannot generate adequate cash flow to meet its debt service, a Fund may suffer a partial or total loss of capital invested in the investment, which may adversely affect the returns of such Fund.

Past performance is not necessarily indicative of future results.

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Reliance on Key Management Personnel. The success of a Fund will depend, in large part, upon the skill and expertise of certain Blackstone professionals. In the event of the death, disability or departure of any key Blackstone professionals, the business and the performance of a Fund may be adversely affected. Some Blackstone professionals may have other responsibilities, including senior management responsibilities, throughout Blackstone and, therefore, conflicts are expected to arise in the allocation of such personnel's time (including as a result of such personnel deriving financial benefit from these other activities, including fees and performance-based compensation).

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