Blackstone Credit

CREDIT INSIGHTS

November 2021 Market Commentary

Performance Overview

- **COVID-19 variant roils global credit markets**
- **High yield retreats on rates, Omicron, supply**
- **Fed mulls faster taper on persistent inflation**
- **Issuance ramps up in loans, investment grade bonds**

COVID-19 again rattled global credit markets in November as the emergence of a new variant, Omicron, sparked a sharper financial market selloff than the Delta variant in July.

Uncertainty over the potential severity and repercussions of the new variant impacted equities and debt alike and on November 26 the Dow posted its worst day this year[1]. Oil prices also tumbled on renewed concerns over demand.[2] The subsequent rush to safe havens caused Treasuries to rally and the yield on the 10-year fell to 1.44% by month end.[3]

The impact on credit was exacerbated by the news hitting over the sparsely staffed Thanksgiving holiday period and, after an otherwise strong year, returns took a temporary hit across the board. High yield was most affected as retail investors withdrew funds and performance suffered, knocking a full percentage point off year-to-date returns.

Investment grade bonds benefitted from the rate rally, while loans, although not immune from volatility or retail outflows from ETFs, were generally supported by the deep bid from ramping CLOs who stepped in to buy at the lower prices.

Energy and COVID impacted sectors, including travel and leisure, bore the brunt of the risk off sentiment. Specifically, airlines traded lower as travel restrictions were rolled out in Europe. Work-from-home sectors and pandemic beneficiaries such as online grocers and vaccine makers rallied.

The late month turmoil capped off what had already been a volatile month for credit. An initial rally on the back of a strong US jobs numbers and initially more dovish messaging from central banks was cut short by rising COVID-19 cases and the return of lockdown restrictions in Europe.

Strong monthly CPI statistics across the US, the UK and Europe reignited rate hike expectations and rate volatility intensified into month-end on Federal Reserve chair Jerome Powell's statements citing elevated and persistent inflation bringing an earlier end to tapering.

Issuance was another key theme in November as borrowers took advantage of ongoing demand for higher yielding assets to issue debt ahead of the Thanksgiving break.

Defaults remain low. One borrower defaulted on $1.92 billion of bonds and loans in November leaving the US high yield bond and loan last-twelve-month default rates at 0.38% and 0.83%, respectively.[4]

Markets rebounded at the start of December but may remain skittish until more is known about the physical and economic impact of the new Omicron strain.

Market Stats (as of November 30, 2021)

	November	QTD	YTD
S&P / LSTA U.S. Leveraged Loan Index	-0.16%	0.11%	4.53%
Bloomberg Barclays U.S. Corporate Investment Grade Index	0.06%	0.31%	-0.96%
Bloomberg Barclays U.S. High Yield Index	-0.97%	-1.14%	3.34%
Credit Suisse Western European Leveraged Loan Index	0.15%	0.28%	4.20%
Credit Suisse Western European High Yield Index	-0.43%	-1.10%	2.94%
S&P 500	-0.83%	6.02%	21.59%
Euro Stoxx 50	-4.41%	0.37%	14.37%

[1] CNBC, November 26, 2021
[2] Financial Times, November 26, 2001.
[3] CS Credit Strategy Daily Comment, December 1, 2021.
[4] J.P. Morgan Default Monitor, December 1, 2021.

Past performance is not necessarily indicative of future results.

Market Stats (cont'd) (as of November 30, 2021)

	Spread			Yield			Price		
	Level	ΔMTD	ΔYTD	Level	ΔMTD	ΔYTD	Level	ΔMTD	ΔYTD
U.S. Loans	411	10	(32)	4.32%	0.13%	-0.38%	$98.14	($0.41)	$1.95
U.S. HY	337	50	(23)	5.14%	0.35%	0.18%	$102.13	($1.78)	($2.83)
EU Loans	413	6	(46)	3.77%	0.02%	-0.11%	€98.61	-€0.15	€1.26
EU HY	403	36	(21)	3.95%	0.21%	-0.29%	€99.51	-€0.77	€0.92

US Investment Grade Market

Rates, supply and Omicron were the key themes in credit markets. Investment grade bonds eked out a slightly positive 0.06% return for the month,[5] boosted by declining longer-term rates which helped offset wider spreads.

The US yield curve flattened as markets brought forward their expectations for rate hikes after Fed monetary policy commentary turned more hawkish. Interest rates fell across most of the spectrum aside from the 2-year which rose 7bp. The 30-year fell another 14bp to end the month at 1.79%.

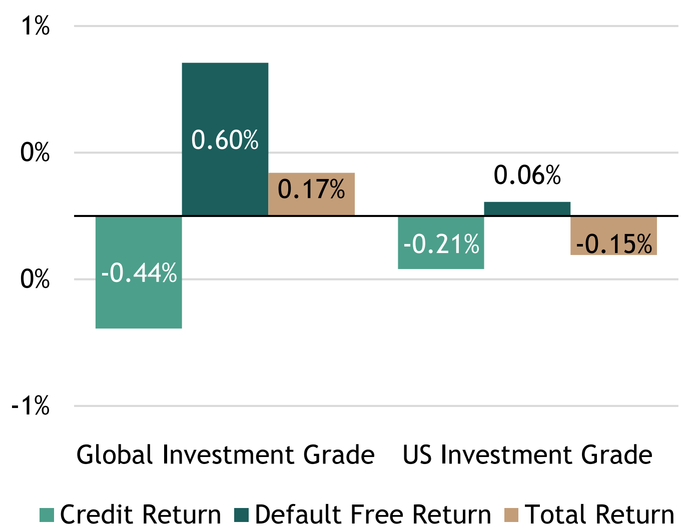
It was a different story for cash spreads, which increased to 99bp month-over-month to their widest level since March.[6] Heavy primary market issuance and bloated dealer balance sheets drove the initial widening and then spreads gapped higher again following the Omicron news.

Issuers priced $107 billion of new deals in November in a bid to get ahead of the Thanksgiving break and anticipated higher borrowing costs amid increased expectations for rate hikes. That takes issuance to $1.31 trillion through the end of November, the second-highest annual amount on record.[7] Borrowers were expected to stay busy into December with $55 billion forecast to price during the month, conditions allowing.

The oversupply and investor fatigue meant borrowers had to pay higher new issue premiums as the month progressed. The average yield at issuance for November's deals rose to 2.52% from 2.12% in September, and from a cycle low of 1.71% in January this year.[8]

On the demand front, rate volatility reduced appetite from Asian buyers and retail demand for IG cash was also weak in November, with funds experiencing their lowest monthly inflow total of the year. Year-to-date, however, IG funds have seen over $140 billion of inflows, well above other credit asset classes.[9]

Drivers of Investment Grade Return in November [10]



US Loan and High Yield Markets

The US loan market held up relatively well amid the uncertainty, supported by the ongoing bid for loan assets. November returns dipped into the red for just the third time since March 2020,[11] while year-to-date performance remains strong at 4.53%.

Traders initially marked loans a quarter to a half point lower following the COVID headlines, but sellers were met with buyers and good two-way flow helped to keep the market orderly. As in other parts of the credit market, reopening sectors, particularly airline and leisure, were hardest hit.

The deep bid for loans from CLOs who took advantage of the cheaper prices to ramp new deals provided a boost for higher coupon names. Even so, by month end the selloff

[5] Bloomberg Barclays US Corporate Investment Grade Index.
[6] Bloomberg, November 29, 2021.
[7] LCD, December 1, 2021.
[8] LCD, December 2, 2021.
[9] CS Credit Strategy Daily, December 3, 2021.
[10] US Department of Treasury, October 31, 2021.
[11] S&P/LSTA US Leveraged Loan Index.

Past performance is not necessarily indicative of future results.

erased the early month rally and average loan prices fell to $98.10 at the end of November from a pandemic era high of $98.67 mid-month.[12] That took the anticipated flow of year end repricings temporarily off the table.

Prior to the late month volatility, elevated supply was the main theme in November as borrowers crammed in $49.3 billion of deals into the month taking year to date issuance to $385.7 billion, up 119% year over year.[13]

Smaller add-ons for dividends and acquisitions dominated supply and secondary trading was active as the market processed the slew of allocations. Nine SOFR-linked loan deals priced in November, taking the year-to-date total to 14 and representing 6.1% of total volume in October and November.[14]

The month-end volatility brought the first weekly outflow from loan funds since July, including some selling out of loan ETFs. CLO issuance remained strong however and heavy retail inflows earlier in the month kept November's monthly total positive at $3.73 billion.[15] Year-to-date inflows now total $42.6 billion.

The US high yield market experienced a volatile month on the back of inflation concerns and omicron. Spreads widened and yields increased to 12-month highs at month-end[16] causing the high yield index to lose -0.97% over the month and reducing year-to-date returns to 3.34%.[17]

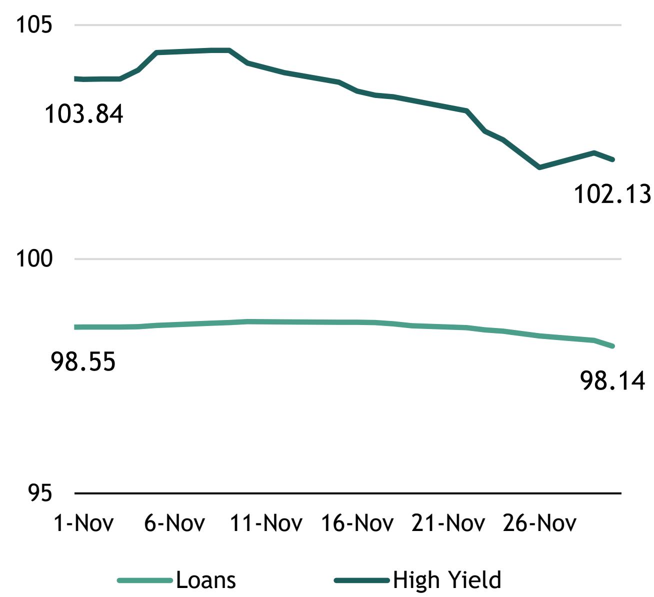
Performance had already come under pressure mid-month due to rate volatility and elevated supply but weakened further as the Omicron headlines hit. Energy names and lower-rated credits led the decline as the Bloomberg Barclays US High Yield Caa Index returned -1.13%. Yields across many credits in reopening sectors pushed to 6-month wides.[18]

Ahead of the Thanksgiving slowdown, borrowers printed $31.4 billion of new high yield deals in November to set a new annual supply record of $455 billion. That's up 13% from one year earlier and tops 2020's $435 billion record.[19]

On the demand side, high yield mutual funds and ETFs experienced month-to-date outflows of $2.8 billion taking the year-to-date total to $13.3billion.[20]

On a more positive note, opportunistic buyers moved in at the lower prices and technicals remain supportive given lighter new issuance volumes, $18.5 billion in rising stars[21] and high levels of calls, tenders and maturities.

Prices of loans and high yield fell in November caused by renewed COVID concerns[22]



European Loan and High-Yield Markets

Positive gains across European sub-investment grade credit at the start of November were quickly erased as sentiment soured on rising COVID cases and restrictions across Europe. The emergence of the new COVID variant compounded the risk-off mood pushing prices lower and spreads wider across loans and bonds.

Loans are typically more orderly in the face of market shocks and ongoing demand, particularly from CLOs, provided some support against the uncertainty, holding returns in positive territory once again in November. Prices still came under pressure however, declining to €98.61, similar to levels reached in July in the wake of the Delta variant.

Borrowers issued €8.8 billion of institutional loans in November, albeit to a slightly pickier buyer base, taking volume for the year to €128.6 billion in total. The monthly tally was boosted by the largest single buyout term loan in more than three years from T-Mobile Netherlands.[23]

High yield came under additional pressure from rate and equity volatility in November and the asset class recorded a second consecutive month of negative returns.

Issuers retreated amid the risk-off environment leading to two high yield deals being cancelled. Ahead of the selloff, high-yield corporates printed €11.1 billion of new deals pushing year to date supply to €123.7 billion at the end of November.[24]

Again, loans and bonds issued by companies in the travel and leisure sectors sold off the most. With COVID-19 restrictions already in place in Austria, Germany and the Netherlands, there has been some decline in flight

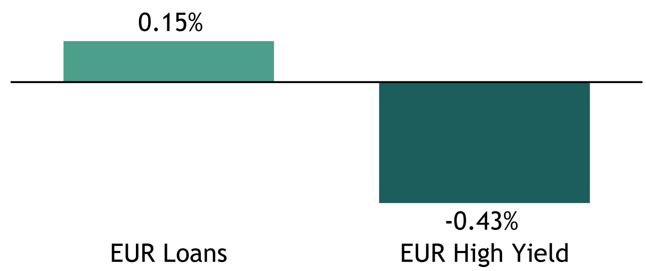
[12] LCD/S&P LSTA Index.
[13] J.P. Morgan Research, December 2, 2021.
[14] J.P. Morgan Research, November 29, 2021.
[15] Morningstar.
[16] CS Credit Strategy Daily, December 1, 2021.
[17] Bloomberg Barclays US High Yield Index.
[18] CS Credit Strategy Daily, December 1, 2021.
[19] LCD News, November 16, 2021.
[20] Barclays US High Yield Corporate Update, December 1, 2021.
[21] Barclays US High Yield Corporate Update, December 1, 2021.
[22] Barclays Live and LCD, November 30, 2021.
[23] LCD News, December 1, 2021.
[24] LCD News, December 1, 2021.

Past performance is not necessarily indicative of future results.

bookings and hotel occupancy rates, according to Blackstone analysts.

Average high yield prices moved inside €100, and the reduction of secondary market liquidity intensified the weakness as traders and investors de-risked ahead of year end. Idiosyncratic names and earnings results drove much of the secondary market action earlier in the month.

November MTD Performance[25]



US and European CLO Markets

The CLO markets were not immune from eroding sentiment at month-end but still managed to rack up more issuance records.

US CLO issuers priced another $26.4 billion of new deals, the highest monthly tally to date, as managers rushed to print deals ahead of the Thanksgiving holiday. In Europe, new CLO creation ran to €6.3 billion from 15 deals, this year's highest monthly tally. Issuers also set a new annual record of €36.6 billion, as well as a new quarterly peak of €10.95 billion.[26]

Managers pricing recent deals have been able to ramp portfolios with lower priced loans post selloff, which could benefit CLO equity returns. Conversely the average price of portfolio assets for existing CLOs fell in both regions in November reducing equity NAVs.[27]

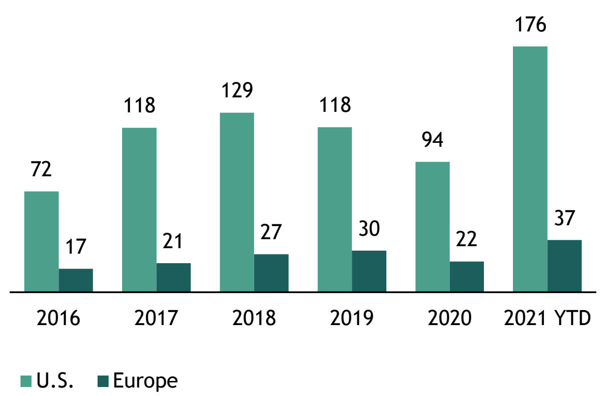
Ahead of the Omicron volatility, ongoing demand for US AAA-rated CLO paper pushed new issue spreads for top tier managers to a five-month low of L+110bp in November.[28] New issue spreads held steady for a while amid the more skittish sentiment post-Omicron as managers had previously locked in levels, but as December got underway there was softness in the lower-rated BBB and BB CLO debt tranches and among lower-tier managers.

In Europe, the selloff pushed spreads on new issue CLO AAA paper from a 95bp area mid-month to 96–99bp in early December, and on the secondary side there was also widening across the capital stack.[29]

Refinancing activity eased in both regions in November and new issue supply is expected to ease into December.

CLO health continues to recover from the pandemic shock as Weighted Average Rating Factor ("WARF") scores improved and Caa/CCC buckets fell further in October across US CLOs. WARF has now fully reversed its pandemic induced deterioration and sits 28 points below pre-pandemic levels. Caa/CCC buckets are still 0.8/1.0% above pre-COVID levels but have recovered from the 4%/6% points of excess experienced at the record highs of last year.[30]

US CLO Historical New Issuance ($/€ in billions)[31]



Market Outlook

The emergence of Omicron adds an element of uncertainty to financial markets as we move into the final weeks of the year. European governments have already responded to rising cases with greater restrictions, and we expect a more defensive stance among risk assets until more is known about how virulent the new strain is, how effective existing vaccines will be in protecting the population, and the extent of further lockdowns and travel bans.

[25] Credit Suisse Western European Leveraged Loan Index and Credit Suisse Western European High Yield Index, October 31, 2021.
[26] LCD News, November 9, 2021.
[27] Morgan Stanley, CLO Market Flash, December 6, 2021.
[28] LCD, November 18, 2021.
[29] DB Asset Backed Barometer, December 3, 2021.
[30] Deutsche Bank US CLO Manager Barometer, November 29, 2021.
[31] LCD, November 30, 2021: reflects new issuance excluding refis and resets.

Past performance is not necessarily indicative of future results.

We are mindful that countries with low vaccination rates and less access to boosters/therapeutics will be more vulnerable to rolling lockdowns, and countries like China retain zero-tolerance COVID policies. That said, new variants are an expected part of the pandemic, and our current view is that this latest development is unlikely to derail the long-term economic recovery. For a start we believe the global community is much better positioned to effectively respond to new variants given increased and ongoing vaccination uptake, including boosters, along with the development of anti-viral pills.

In addition, the Delta variant experience this summer has provided traders and investment professionals with a playbook to help navigate this latest strain. Sectors in the reopening trade were among those that sold off after the emergence of Delta in July, but they quickly recovered again as markets stabilized. These lower-rated credits were again among the hardest hit in late November, especially those in the airlines and hospitality sectors, but we are already seeing a rebound in early December.

There is a risk that these sectors lose revenue during the key holiday season as more restrictions are rolled out, but we continue to focus on the long-term enterprise value as supported by fundamentals. Airlines, for example, are sitting on significant piles of cash and most have ample liquidity to navigate through turbulence in the reopening due to new strains.

Barring any domestic lockdowns or attendance restrictions there should be limited long-term impact to attendance of live events, theme parks and outdoor leisure sectors, including skiing. We expect these sectors to also benefit from robust liquidity positions, and a strong event pipeline through 2022 underpins the recovery through any short-term impact. The natural social distancing of outdoor theme parks should also help protect revenues.

High yield suffered the most in November, but in our view the recent widening actually sets accounts up nicely to add risk at lower prices in December to reposition portfolios to provide convexity in returns beyond just coupon clipping and trying to navigate moves in the Treasury curve.

The heightened uncertainty could create renewed opportunities for exploiting price inefficiencies. Our dynamic focus on the evolving underlying firm-level credit fundamentals could position us well to capitalize as this next phase of the virus as the recovery continues to play out.

Even with this latest COVID setback our conviction in the US market remains strong. Blackstone Private Wealth Solutions Chief Investment Strategist, Joe Zidle, notes in his latest Market Insights piece, A Year-End Look Around the World[32], that both fiscal and monetary policy position the US economy well for continued growth in 2022 and beyond.

He writes that the combination of immunity and improved treatments should further normalize daily life and cause spending to rotate away from durable goods back toward services, alleviating supply chain bottlenecks. The recently passed $1 trillion US infrastructure bill should also benefit supply chains given the additional support laid out for upgrades to bridges, roads, tunnels and other transport systems, as well as $178 billion in funding for ports.[33] And there's further stimulus potentially forthcoming in the Build Back Better Act.

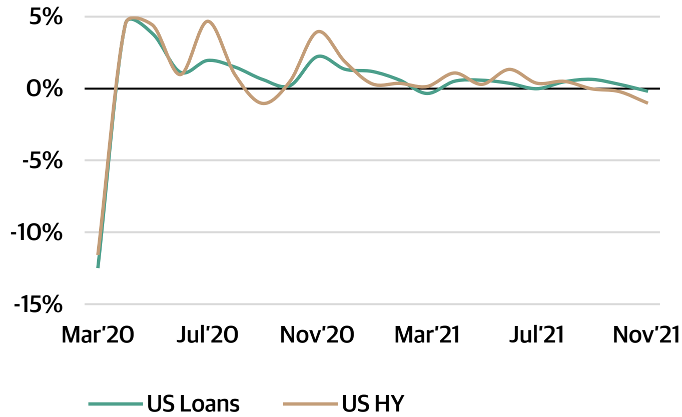
On a final note, renominated Fed Chairman Powell has now acknowledged the more persistent nature of inflation and in December announced that the Fed will speed up the wind down of its asset-purchase program and begin to raise interest rates, starting with three in 2022. Rising rates as a reaction to economic growth is good sign of strong credit fundamentals and performance. To position for potentially persistent inflation, we continue to support floating-rate assets, which can benefit from higher growth and rates.[34]

[32] Joe Zidle, A Year-End Look Around the World, December 6, 2021.
[33] FT, Biden's Landmark Spending Bill Faces Next Battle in Senate, November 20, 2021.
[34] Joe Zidle, Transitory" Inflation Is Proving Costly, November 18, 2021.

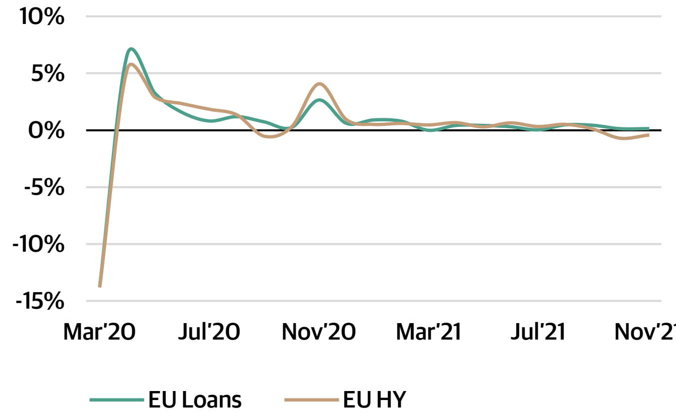
Market Snapshot

(As of November 30, 2021)[35]

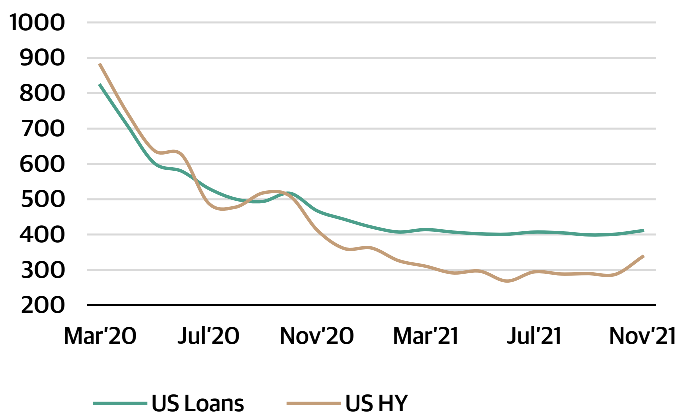
US Credit Monthly Return



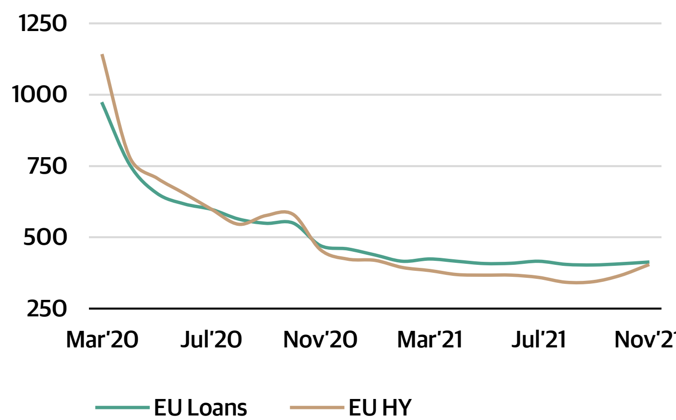
EU Credit Monthly Return



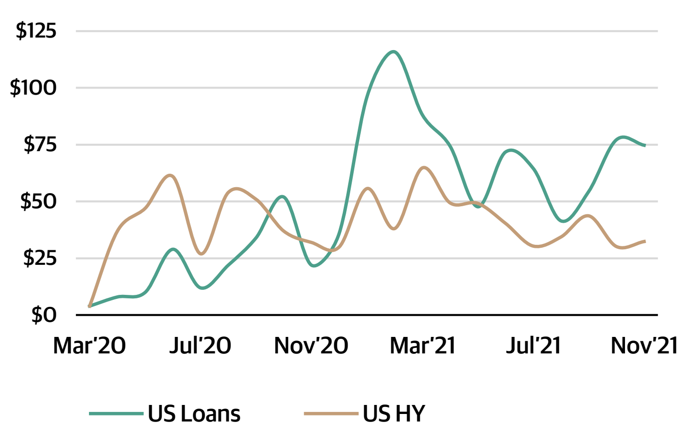
US Credit Spreads (in bps)



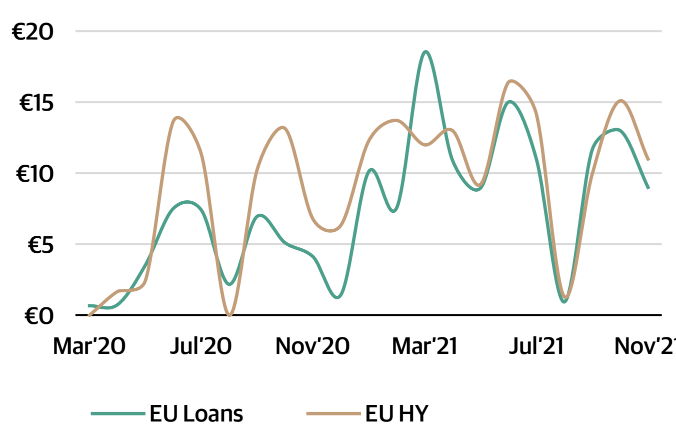
EU Credit Spreads (in bps)



US Credit Issuance ($ in billions)



EU Credit Issuance (€ in billions)



[35] 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 November 30, 2021.

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