

# Penn Capital Credit Month in Review

## Executive Summary

High yield (HY) bonds and leveraged loans both posted positive returns in July against the backdrop of continued dovish Fed sentiment and decent economic data. Year-to-date (YTD), HY returns (+10.32%) continued to best those of loans (+6.47%).

### Bonds

The HY bond asset class returned +0.40% in July as yields and spreads decreased 4bp and 9bp, respectively, to end the month at 6.42% and 452bp. Returns were driven primarily by dovish Fed sentiment, decent domestic economic data & continued mutual fund inflows. Gross new issue activity of ~\$25.4b in July is down slightly month-over-month (m/m) but is well above the \$20.5b in volume that July has averaged in the recent past. Refinancings continue to represent a significant portion of the new issue market with July refi volumes equaling 60% of total issuance. YTD, refinancing activity totaled ~\$109b, or 66%, of total issuance. Including distressed exchanges, the US HY bond default rate stands at 2.35% at the end of July, up 68bp m/m.

### Loans

Leveraged loans gained 0.84% in July against the backdrop of steady CLO demand and lighter outflows. New issue activity totaled ~\$28b in July, down m/m, but above typical July volumes of ~\$24b. Acquisition financing deals led the way in July by representing ~65% of new issuance volume. YTD, acquisition financing now represents 55% of total volume and remains the largest driver of the new issue market. Gross US collateralized loan obligation (CLO) volume of ~\$15b in July was roughly equivalent to volumes witnessed during the past two months but remains well below the \$21b of monthly CLO issuance the market has averaged over the last two years. Of that ~\$15b in July volume, 36% was used for refi/reset deals. Including distressed exchanges, the leveraged loan default rate ended July at 1.83%.

Source: JP Morgan

### Bonds

#### Best performing Industries during the month:

- Financials (+1.40%)
- Broadcasting (+1.22%)
- Transportation (+1.16%)

#### Largest Industry underperformers during the month:

- Energy (-1.57%)
- Media (-0.36%)
- Utility (-0.26%)

#### Best performing Industries YTD:

- Consumer Products (+13.41%)
- Retail (+13.24%)
- Cable & Satellite (+13.06%)

#### Largest Industry underperformers YTD:

- Energy (+5.77%)
- Media (+7.49%)
- Paper & Packaging (+8.61%)

#### Performance ranked by ratings during the month:

- B-rated bonds (+0.54%)
- BB-rated bonds (+0.51%)
- CCC-rated bonds (+0.32%)

#### Performance ranked by ratings YTD:

- BB-rated bonds (+11.08%)
- B-rated bonds (+10.56%)
- CCC-rated bonds (+9.14%)

### Loans

#### Best performing Industries during the month:

- Telecommunications (+1.42%)
- Cable & Satellite (+1.24%)
- Paper & Packaging (+1.21%)

#### Largest Industry underperformers during the month:

- Metals & Mining (-0.13%)
- Energy (+0.08%)
- Media (+0.41%)

#### Best performing Industries YTD:

- Broadcasting (+8.24%)
- Cable & Satellite (+7.96%)
- Retail (+7.80%)

#### Largest Industry underperformers YTD:

- Metals & Mining (+1.97%)
- Consumer Products (+4.99%)
- Auto (+5.05%)

#### Performance ranked by ratings during the month:

- B-rated loans (+0.84%)
- BB-rated loans (+0.82%)
- Split B/CCC-rated loans (+0.27%)

#### Performance ranked by ratings YTD:

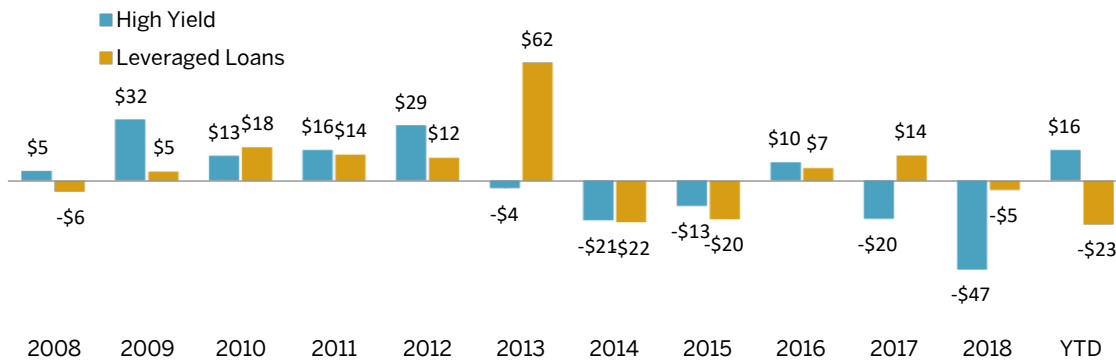
- BB-rated loans (+7.14%)
- B-rated loans (+6.20%)
- Split B/CCC-rated loans (+4.27%)

Source: JP Morgan

| As of July 31, 2019   | Performance |        | Characteristics |            |               |      |      |
|---|-------------|--------|-----------------|------------|---------------|------|------|
|   | Month       | YTD    | Spread          | YTD Change | Average Price | YTW  | YTM  |
| 10-Year Treasuries  | -0.01%      | 7.49%  | ---             | ---        | ---           | 2.0% | 2.0% |
| Bloomberg Barclays US Aggregate Bond Index                              | 0.22%       | 6.35%  | 55 bp           | -11 bp     | \$104.66      | 2.4% | 2.4% |
| JP Morgan BB/B Loan Index   | 0.90%       | 6.94%  | 406 bp          | 132 bp     | \$98.23       | 5.2% | ---  |
| ICE BofA Merrill Lynch 1-3 Year BB-B Rated US Cash Pay High Yield Index | 0.47%       | 6.26%  | 259 bp          | -125 bp    | \$101.80      | 4.6% | 5.0% |
| ICE BofA Merrill Lynch BB-B Rated Non-Distressed High Yield Index       | 0.62%       | 11.06% | 313 bp          | -119 bp    | \$102.16      | 5.1% | 5.5% |
| ICE BofA Merrill Lynch BB-B Rated US High Yield Cons. Index             | 0.58%       | 11.01% | 334 bp          | -129 bp    | \$101.43      | 5.3% | 5.7% |
| ICE BofA Merrill Lynch US High Yield Constrained Index                  | 0.51%       | 10.72% | 407 bp          | -132 bp    | \$99.17       | 6.0% | 6.4% |

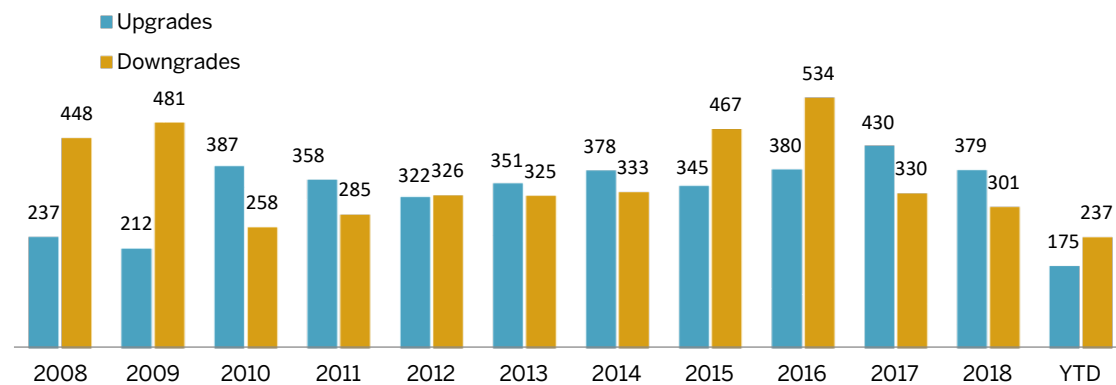
Sources: Barclays, BofA Merrill Lynch, JP Morgan. Past performance is no guarantee of future results.

Mutual Fund Flows (\$ billion)



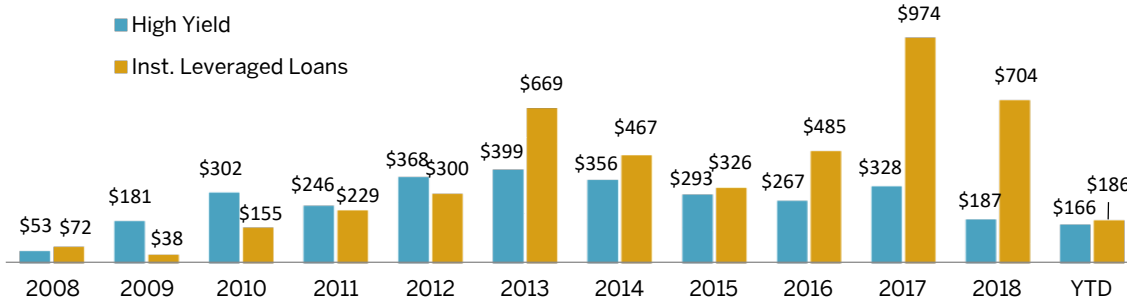
PETER DUFFY, CFA  
Senior Portfolio Manager,  
Senior Partner

High Yield Upgrades/Downgrades (Issuer)



DAVID JACKSON, CFA  
Senior Portfolio Manager,  
Senior Partner

Gross New Issuance Volume (\$ billion)



Source for Charts: JP Morgan

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| Historical Spreads / Default Rates                             | 2009   | 2010   | 2011     | 2012   | 2013   | 2014   | 2015     | 2016   | 2017   | 2018    | YTD    |
|--|--------|--------|----------|--------|--------|--------|----------|--------|--------|---------|--------|
| ICE BofA Merrill Lynch US BB-B Rated High Yield Index          | 521 bp | 485 bp | 612 bp   | 443 bp | 344 bp | 434 bp | 558 bp   | 348 bp | 297 bp | 462 bp  | 334 bp |
| ICE BofA Merrill Lynch US BB Rated High Yield Index            | 445 bp | 399 bp | 503 bp   | 357 bp | 281 bp | 336 bp | 427 bp   | 286 bp | 228 bp | 365 bp  | 249 bp |
| ICE BofA Merrill Lynch US B Rated High Yield Index             | 613 bp | 573 bp | 736 bp   | 524 bp | 417 bp | 549 bp | 722 bp   | 432 bp | 381 bp | 578 bp  | 437 bp |
| ICE BofA Merrill Lynch US CCC Rated High Yield Index           | 980 bp | 874 bp | 1,262 bp | 943 bp | 766 bp | 976 bp | 1,648 bp | 977 bp | 843 bp | 1102 bp | 968 bp |
| J.P. Morgan's HY 12-Month Default Rate (based on # of issuers) | 10.3%  | 0.8%   | 1.7%     | 1.3%   | 0.7%   | 2.9%   | 1.8%     | 3.6%   | 1.3%   | 1.8%    | 2.1%   |