

# Penn Capital Credit Month in Review

## Executive Summary

Leveraged loan returns outpaced those of high yield (HY) bonds in September. This breaks the recent streak of HY outperformance vs. loans the past few months. Year-to-date (YTD) loan returns still remain above that of HY (now by +186 bp). Light new issuance volume continued to be a major theme this month.

### Bonds

The HY bond asset class returned +0.53% in September. Yields decreased 2 bp while spreads decreased 22 bp to end the month at 6.53% and +365 bp, respectively. Returns were positively impacted by positive trade developments, stronger oil prices and a new issue calendar that remained lighter than normal. Gross new issue activity totaled \$18.2b in September, well below the \$34b of new issuance the month has averaged over the past eight years. Of this new issuance, refinancing transactions accounted for 55% (~\$10b) of the volume. YTD, gross HY new-issue volume now stands at ~\$168.3b, down 34% year-over-year. Refinancings continue to represent a majority (~\$105b) of this volume with net new issuance only representing 38% of YTD new-issue volume. Including distressed exchanges, the US HY bond default rate was down 1 bp to 2.04%.

### Loans

Leveraged loans produced continued gains in September with a +0.71% return. The percentage of loans trading above par in the market is now at a four month high of 64.9%. New issue activity remained restrained in September as issuance only hit \$35b, down 33% year-over-year. Only ~21% of September's volume was related to refi/repricings but YTD refi/repricings still comprise 60% of loan new issue volume. Gross US collateralized loan obligation (CLO) volume of ~\$17b in September was the lowest monthly total recorded since September '17. This brings YTD US CLO volumes to ~\$219b. Of that total, ~\$104b or 47% of US CLO volume was used for refi/reset deals. Including distressed exchanges, the leveraged loan default rate ended September at 1.82% (-15 bp).

Source: JP Morgan

### Bonds

#### Best performing Industries during the month:

- Telecommunications (+1.12%)
- Cable/Satellite (+0.92%)
- Energy (+0.81%)

#### Largest underperformers during the month:

- Automotive (-0.20%)
- Chemicals (-0.05%)
- Food/Beverages (+0.11%)

#### Best performing Industries YTD:

- Telecommunications (+5.68%)
- Retail (+5.02%)
- Healthcare (+4.96%)

#### Largest underperformers YTD:

- Automotive (-4.05%)
- Housing (-0.46%)
- Media (+0.10%)

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

- CCC-rated bonds (+0.98%)
- B-rated bonds (+0.57%)
- BB-rated bonds (+0.27%)

#### Performance ranked by ratings for YTD:

- CCC-rated bonds (+6.06%)
- B-rated bonds (+3.58%)
- BB-rated bonds (+0.76%)

### Loans

#### Best performing Industries during the month:

- Consumer Products (+1.18%)
- Retail (+1.17%)
- Cable & Satellite (+0.91%)

#### Largest underperformers during the month:

- Metals & Mining (+0.34%)
- Diversified Media (+0.52%)
- Gaming/Lodging (+0.55%)

#### Best performing Industries YTD:

- Retail (+8.63%)
- Metals & Mining (+7.26%)
- Energy (+7.18%)

#### Largest underperformers YTD:

- Media (+2.64%)
- Automotive (+3.20%)
- Paper & Packaging (+3.32%)

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

- Split B/CCC loans (+1.82%)
- B-rated loans (+0.76%)
- BB-rated loans (+0.51%)

#### Performance ranked by ratings for YTD:

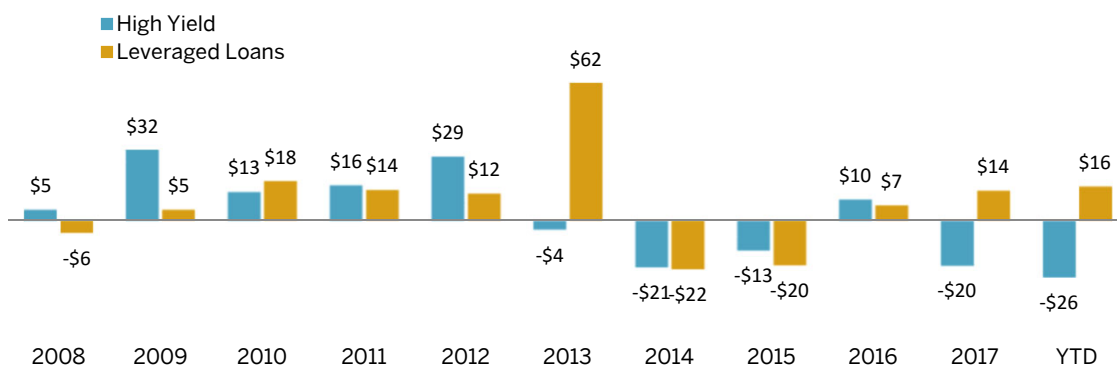
- Split B/CCC loans (+11.55%)
- B-rated loans (+4.53%)
- BB-rated loans (+3.50%)

Source: JP Morgan

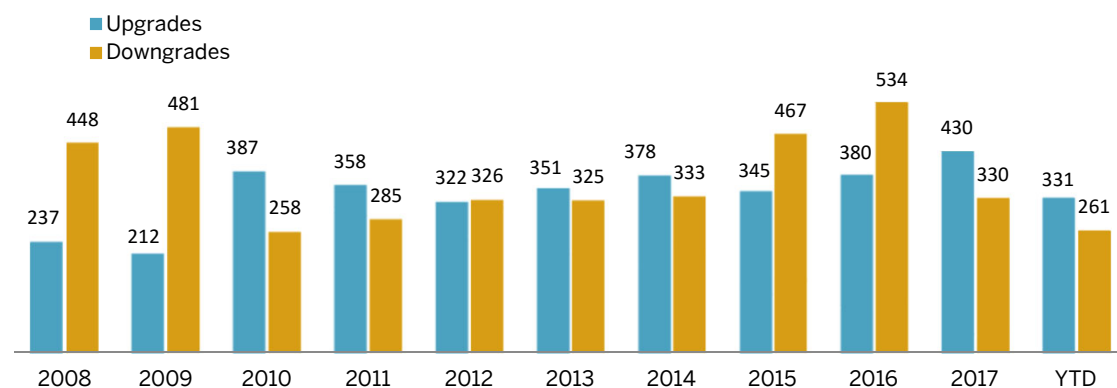
| As of September 30, 2018  | Performance |        | Characteristics |            |               |      |      |
|---|-------------|--------|-----------------|------------|---------------|------|------|
|   | Month       | YTD    | Spread          | YTD Change | Average Price | YTW  | YTM  |
| 10-Year Treasury  | -1.50%      | -3.75% | ---             | ---        | ---           | 3.1% | 3.1% |
| Bloomberg Barclays US Aggregate Bond Index                              | -0.10%      | -1.69% | 49 bp           | 0 bp       | \$99.09       | 3.5% | 3.5% |
| JP Morgan BB/B Loan Index   | 0.67%       | 3.66%  | 319 bp          | -15 bp     | \$99.69       | 6.2% | ---  |
| ICE BofA Merrill Lynch 1-3 Year BB-B Rated US Cash Pay High Yield Index | 0.48%       | 3.30%  | 192 bp          | -27 bp     | \$101.80      | 4.6% | 5.1% |
| ICE BofA Merrill Lynch BB-B Rated Non-Distressed High Yield Index       | 0.49%       | 1.80%  | 276 bp          | -8 bp      | \$99.90       | 5.7% | 5.9% |
| ICE BofA Merrill Lynch BB-B Rated US High Yield Constrained Index       | 0.50%       | 1.90%  | 288 bp          | -9 bp      | \$99.53       | 5.8% | 6.0% |
| ICE BofA Merrill Lynch US High Yield Constrained Index                  | 0.58%       | 2.52%  | 339 bp          | -34 bp     | \$98.52       | 6.3% | 6.5% |

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

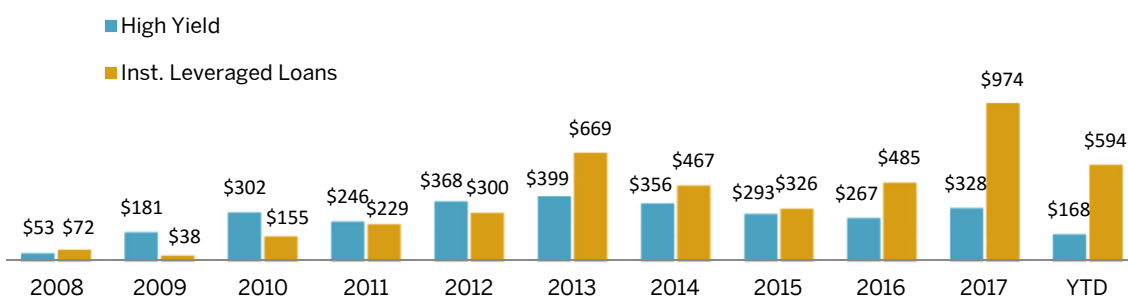
Mutual Fund Flows (\$ billion)



High Yield Upgrades/Downgrades (Issuer)



New Issuance Volume (\$ billion)



Source for Charts: JP Morgan



PETER DUFFY, CFA  
Senior Portfolio Manager,  
Senior Partner



DAVID JACKSON, CFA  
Senior Portfolio Manager,  
Senior Partner

The subject matter contained herein has been derived from several sources believed to be reliable and accurate at the time of compilation, but no representation or warranty (express or implied) is made as to the accuracy or completeness of any of this information. Under no circumstances should this information be construed as a recommendation or advice. The views expressed herein reflect the professional opinions of the portfolio managers and are subject to change. Penn Capital does not accept any liability for losses either direct or consequential caused by the use of this information.

| Historical Spreads / Default Rates                    | 2009   | 2010   | 2011     | 2012   | 2013   | 2014   | 2015     | 2016   | 2017   | 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 | 287 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 | 224 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 | 358 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 | 680 bp |
| J.P. Morgan's 12-Month Default Rate                   | 10.3%  | 0.8%   | 1.7%     | 1.3%   | 0.7%   | 2.9%   | 1.8%     | 3.6%   | 1.3%   | 2.0%   |

Sources: BofA Merrill Lynch. J.P. Morgan. Past performance is no guarantee of future results.

For use with institutional investors and financial intermediaries only. Not for distribution to, or for use with, individual investors.

© 2018 Penn Capital. All rights reserved. • 1200 Intrepid Avenue, Suite 400, Philadelphia, PA 19112 • [www.penncapital.com](http://www.penncapital.com)