

Penn Capital Credit Month in Review

Executive Summary

Leveraged loans provided small positive returns in May while high yield (HY) bond returns were flat. Volatility in equity, treasury, and oil markets all impacted returns.

Bonds

HY bond returns were flat in May as yields and spreads increased 10 bp and 16 bp, respectively, to 6.64% and +403 bp. Returns were pressured by volatile oil prices and trade war fears while the light primary calendar helped support secondary pricing. Utilities (+0.77%), Healthcare (+0.76%), and Metals/Mining (+0.28%) were the best performing industries during the month while Housing and Automotive were the largest underperformers, returning -0.76% and -0.63%, respectively. By rating, CCCs (+0.57%) were the top performers in May, beating the +0.12% and -0.12% returns posted by B-rated and BB-rated bonds during the month. Year-to-date (YTD), Retail (+2.17%) is now the best performing industry while Automotive (-4.54%) remains the worst. CCC-rated bonds remain top performers YTD with +2.24% returns so far. This beats returns offered by B-rated (+0.85%) and BB-rated (-1.70%) bonds. Gross new issue activity totaled a meager ~\$17b in May, well below historical averages for the month. Refinancing transactions accounted for ~62% (~\$10b) of May's new issuance volume. This is almost equal to the 63% of new issuance volume refinancing transactions accounted for in 2017. YTD, gross HY new issue volume reached ~\$110b; this volume level is 26% lower than the gross issuance amount we saw by this point last year. Including distressed exchanges, the US HY bond default rate decreased 5 bp to 2.34%.

Loans

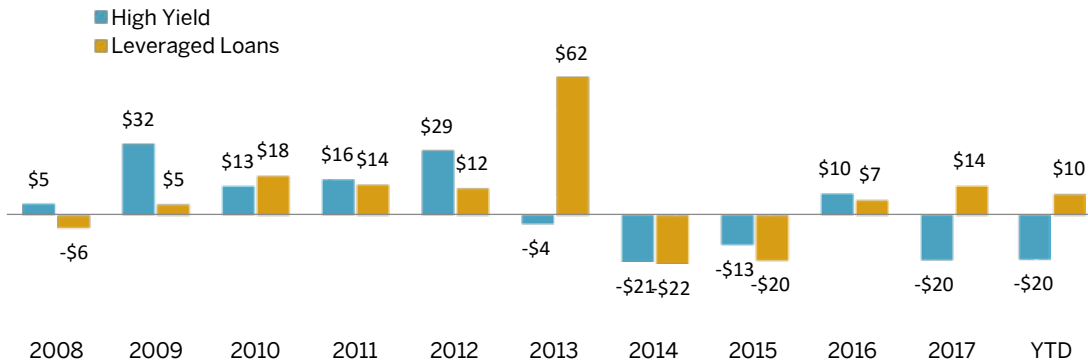
Leveraged loans were able to eke out a +0.21% return in May despite volatile markets. Metals & Mining (+1.07%) and Transportation (+0.80%) were the best performing industries for the month while Broadcasting and Gaming/Leisure were the largest laggards returning -0.30% and +0.07%, respectively. During the month, CCC-rated loan returns of +1.23% bested the returns offered by B-rated (+0.24) and BB-rated (+0.07%) loans. Metals & Mining (+4.65%) is the best performing industry YTD while Media remains the worst performer through May with returns of +1.47%. CCC-rated loans (+5.94%) remain the top performers YTD as B-rated and BB-rated loans returned a lesser +2.32% and +1.74%, respectively. New issue activity totaled ~\$102b in May, +47% month-over-month and +40% year-over-year. Most of this volume, ~\$72b (or ~71%), continues to be related to refinancings/repricings. Gross US collateralized loan obligations (CLO) volume of \$27.5b in May was the seventh highest monthly total on record. This brings YTD US CLO volumes to ~\$120b. Of that total, ~\$48b or 40% of US CLO volume was used for refinancing/reset deals. The US Leveraged Loan default rate ended May down 23 bp to 2.12%.

Source: JP Morgan

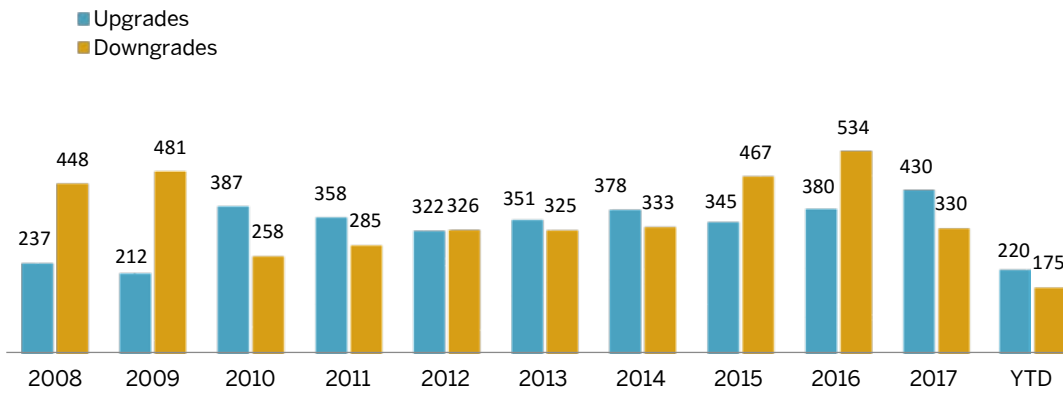
As of May 31, 2018	Performance			Characteristics			
	Month	YTD	Spread	YTD Change	Average Price	YTW	YTM
10-Year Treasury	1.12%	-2.69%	---	---	---	2.9%	2.9%
Bloomberg Barclays US Aggregate Bond Index	0.71%	-1.50%	54 bp	5 bp	\$100.25	3.2%	3.2%
JP Morgan BB/B Loan Index	0.06%	1.81%	338 bp	3 bp	\$99.53	6.1%	---
ICE BofA Merrill Lynch 1-3 Year BB-B Rated US Cash Pay High Yield Index	0.31%	1.26%	230 bp	11 bp	\$101.96	4.7%	5.0%
ICE BofA Merrill Lynch BB-B Rated Non-Distressed High Yield Index	-0.17%	-0.82%	317 bp	33 bp	\$99.46	5.8%	6.0%
ICE BofA Merrill Lynch BB-B Rated US High Yield Constrained Index	-0.13%	-0.69%	326 bp	29 bp	\$99.14	5.9%	6.1%
ICE BofA Merrill Lynch US High Yield Constrained Index	-0.01%	-0.27%	374 bp	1 bp	\$98.23	6.4%	6.6%

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

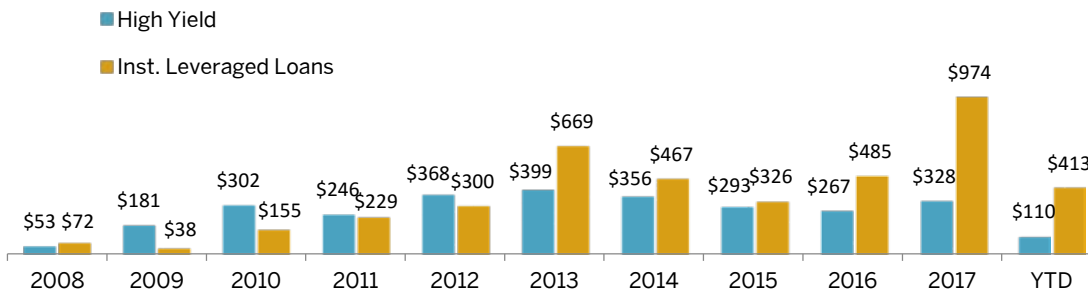
Mutual Fund Flows (\$ billion)



High Yield Upgrades/Downgrades (Issuer)



New Issuance Volume (\$ billion)



Source for Charts: JP Morgan

Specialists in capital structure investing

At Penn Capital, we believe that understanding a company's entire capital structure is the best way to identify investment opportunities with the most value. In fact, we've found that managing credit portfolios makes us better equity managers, and vice versa. Employing a fully integrated credit and equity research process, we focus on non-investment grade companies in the micro to mid-capitalization range, where we can take advantage of inefficient security pricing. We are an independent, employee-owned boutique investment management firm based in Philadelphia. We forge our own ideas, we respect hard work, and we are committed to our clients, our staff and our community.

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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	326 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	263 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	397 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	726 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%	2.3%

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

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