

Penn Capital Monthly Credit Insights

Executive Summary

High yield (HY) bonds & Leveraged loans both kicked off 2021 with continued gains as investors grew increasingly optimistic on energy pricing and stimulus lead economic growth. Aided by spread compression, Leveraged loan returns of +1.21% in January bested those of HY bonds which only produced gains of +0.56%.

High Yield Bond Summary & Performance

Source: JP Morgan

The HY bond asset class returned +0.56% in January despite yields and spreads increasing 9 bp and 5 bp, respectively, to end the month at 4.81% and 448 bp. This more modest rate of return versus the past few months occurred against the backdrop of rising equity volatility, an active primary calendar, optimism around further stimulus payments and improving energy prices. New issuance activity totaled ~\$56bn in January. This marks the most active January on record for gross issuance and represents an issuance level well above the \$30bn in volume January has averaged in the recent past. Refinancing deals were once again the main driver of monthly issuance, with ~\$43bn (77% of gross volume) directed to refinancing activities. Including distressed exchanges, the US HY bond default rate decreased 14 bp month-over-month to end the year at 6.63%. Excluding Energy, the US HY default rate ended January at 4.35%.

Best Performing Industries MTD:

- Energy (+2.24%)
- Transportation (+1.71%)
- Retail (+1.07%)

Best Performing Industries YTD:

- Energy (+2.24%)
- Transportation (+1.71%)
- Retail (+1.07%)

Worst Performing Industries MTD:

- Food & Beverage (-0.17%)
- Technology (-0.16%)
- Automotive (-0.13%)

Worst Performing Industries YTD:

- Food & Beverage (-0.17%)
- Technology (-0.16%)
- Automotive (-0.13%)

Performance by Ratings MTD:

- CCC-rated bonds (+1.57%)
- B-rated bonds (+0.36%)
- BB-rated bonds (-0.07%)

Performance by Ratings YTD:

- CCC-rated bonds (+1.57%)
- B-rated bonds (+0.36%)
- BB-rated bonds (-0.07%)

Floating Rate Loan Summary & Performance

Source: JP Morgan

Leveraged loans provided a +1.21% return in January as loan investors also grew more optimistic on the potential for additional stimulus and increasing interest rates. New issue activity, at ~\$96bn, was the 9th highest monthly new issuance total on record and well above average issuance levels of ~\$43bn seen during the recent past in January. Refinancing & repricing deals were the main driver of new issue activity for the month representing ~83% of January volumes. Gross US CLO (collateralized loan obligation) volume of \$19.5b in January marked a nice increase from December levels. Unlike most of 2020 however, refinancings were the main driver of CLO issuance this month by representing 56% of volume. Including distressed exchanges the leveraged loan default rate ended January at 4.11%, down 16bp m/m.

Best Performing Industries MTD:

- Metals & Mining (+3.38%)
- Gaming & Leisure (+2.09%)
- Energy (+2.04%)

Best Performing Industries YTD:

- Metals & Mining (+3.38%)
- Gaming & Leisure (+2.09%)
- Energy (+2.04%)

Worst Performing Industries MTD:

- Broadcasting (+0.60%)
- Cable & Satellite (+0.67%)
- Utility (+0.76%)

Worst Performing Industries YTD:

- Broadcasting (+0.60%)
- Cable & Satellite (+0.67%)
- Utility (+0.76%)

Performance by Ratings MTD:

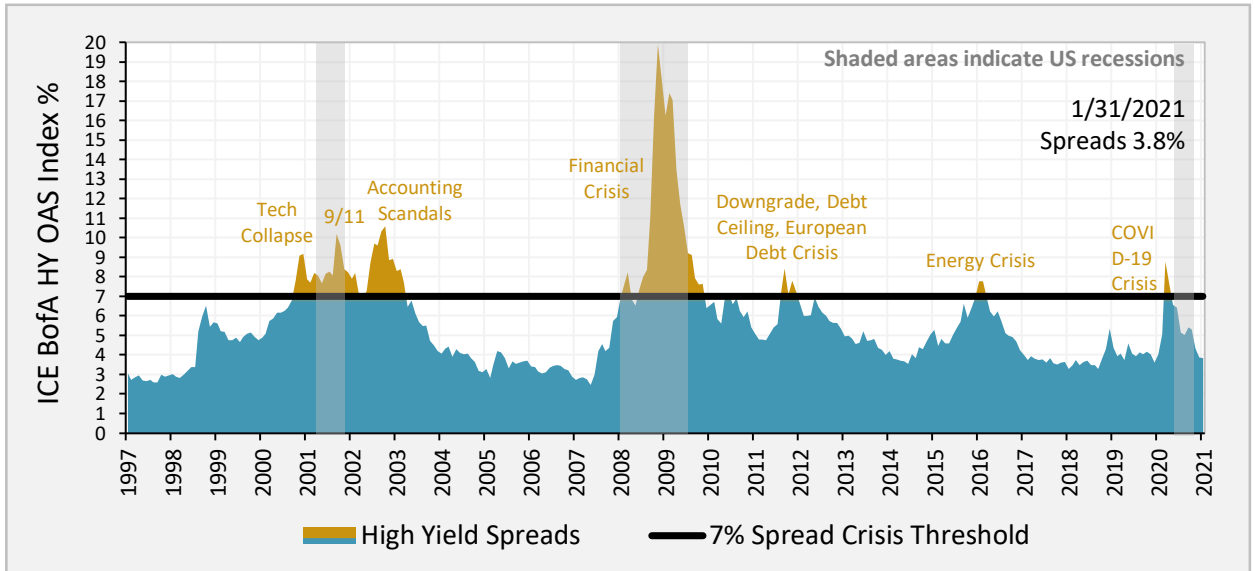
- Split B/CCC-rated loans (+3.61%)
- B-rated loans (+1.04%)
- BB-rated loans (+0.81%)

Performance by Ratings YTD:

- Split B/CCC-rated loans (+3.61%)
- B-rated loans (+1.04%)
- BB-rated loans (+0.81%)

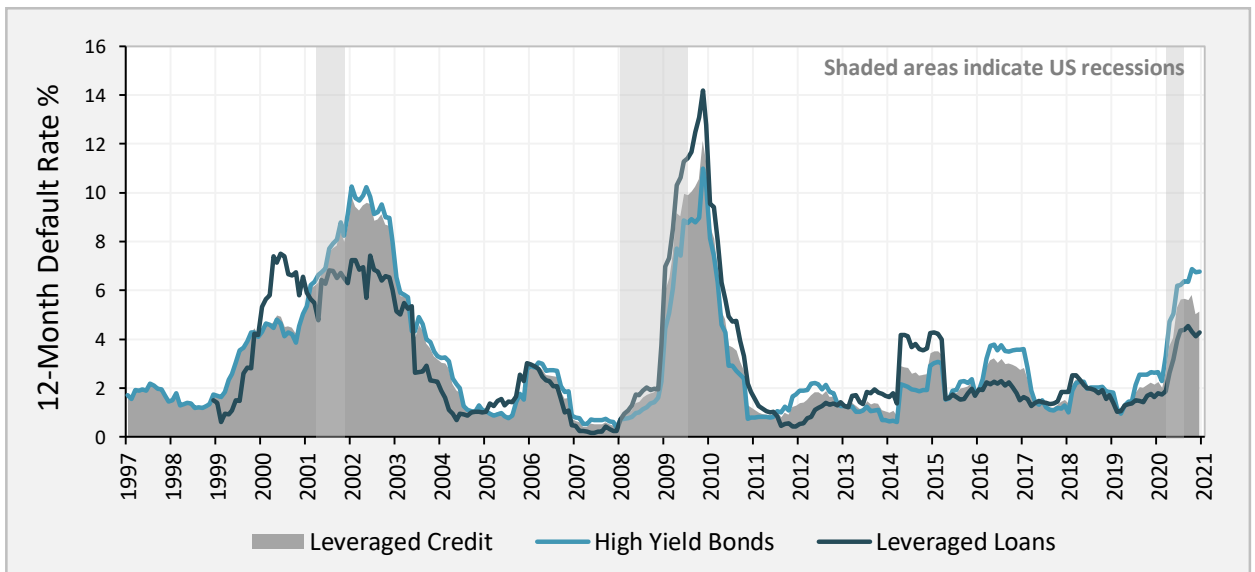
As of January 31, 2021	Performance		Characteristics				
	Month	YTD	Spread	YTD Change	Average Price	Yield to Worst	Yield to Maturity
10-Year US Treasuries	-1.62%	-1.62%	---	---	---	1.09%	1.09%
Bbg Barclays Aggregate Bond Index	-0.78%	-0.78%	38 bp	-4 bp	\$109.47	1.1%	1.1%
JP Morgan BB-B Rated Loan Index	0.96%	-0.96%	393bp	-22 bp	\$99.31	4.2%	---
ICE BofA 1-3 Year BB-B Rated Index	0.34%	0.34%	300bp	-1 bp	\$103.99	3.1%	3.1%
ICE BofA BB-B Rated Non-Distressed Index	0.06%	0.06%	324 bp	+5 bp	\$106.04	3.7%	4.3%
ICE BofA BB-B Rated Index	0.11%	0.11%	334 bp	+6 bp	\$105.66	3.8%	4.4%
ICE BofA High Yield Index	0.38%	0.38%	384 bp	-2 bp	\$104.58	4.3%	4.9%

Credit Risk: Credit Spreads and Crisis Periods



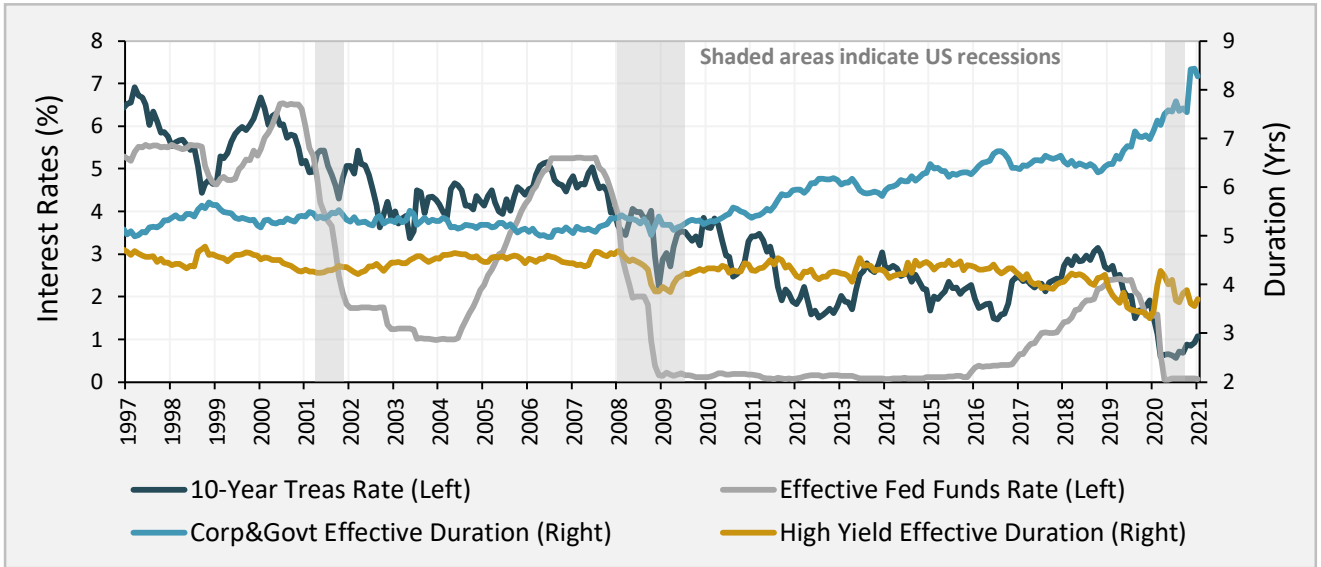
As of 1/31/2021. Source: ICE BofA. Index: ICE BofA High Yield Option Adjusted Spread Index.

Credit Risk: High Yield Bond and Leveraged Loan Default Rates



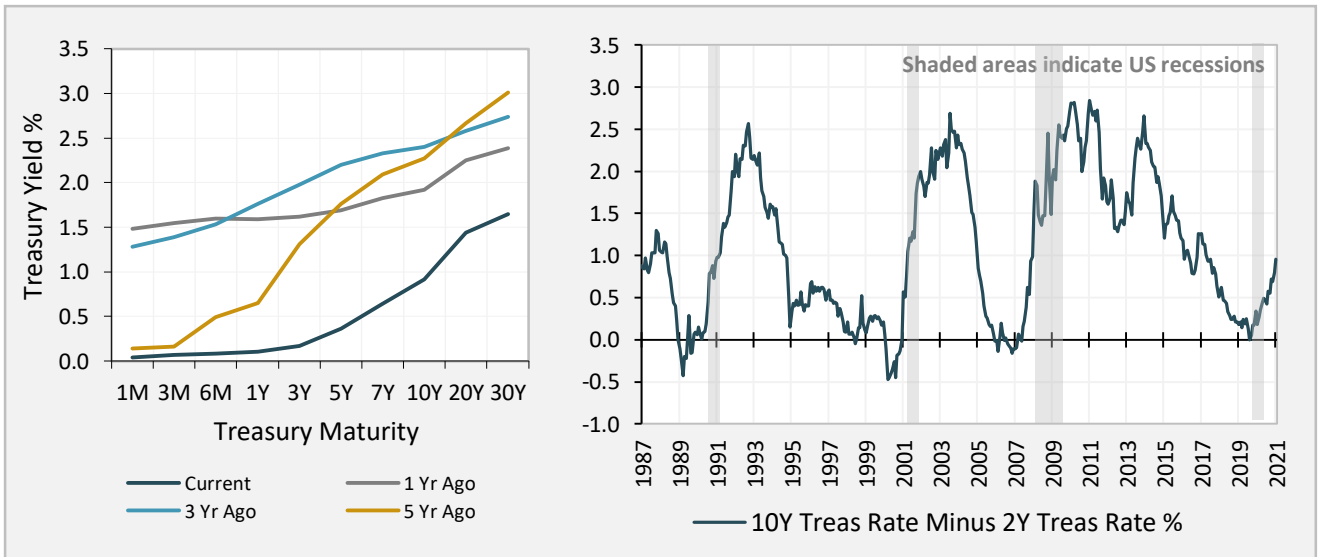
As of 1/31/2021. Source: JP Morgan. 12-month defaults weighted by par.

Interest Rate Risk: Rates and Duration



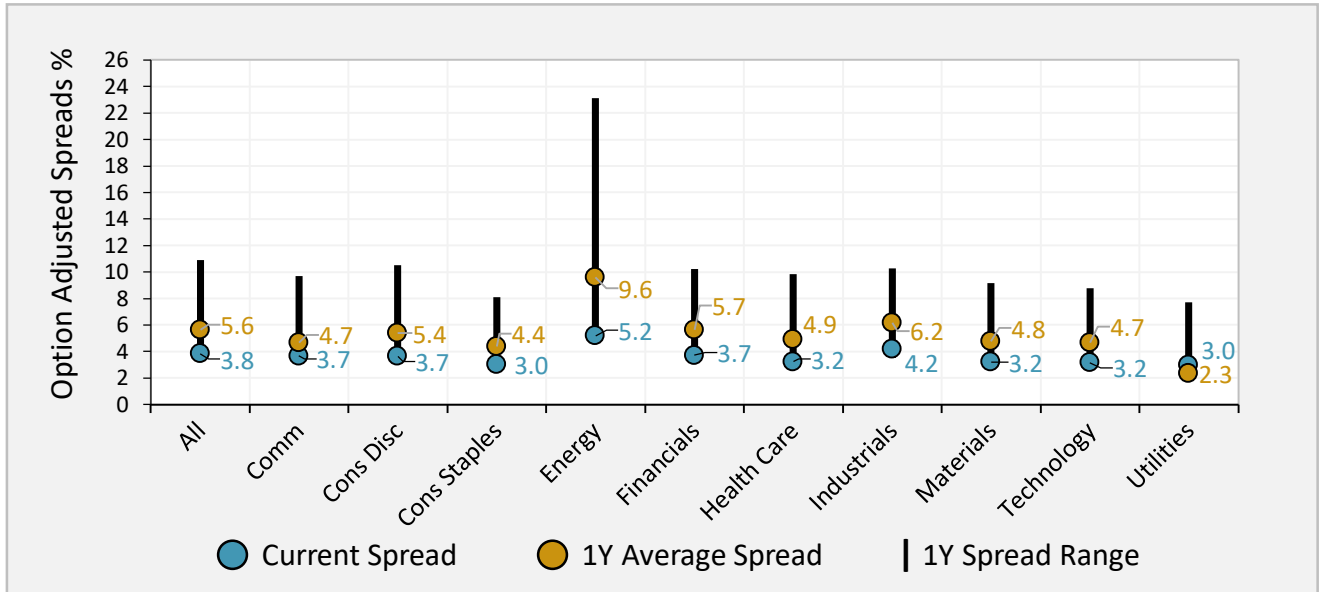
As of 1/31/2021. Source: Federal Reserve, ICE BofA. Indices: ICE BofA Corp & Govt Bond Index, ICE BofA High Yield Bond Index.

Yield Curve: Current and Historical Treasury Curve



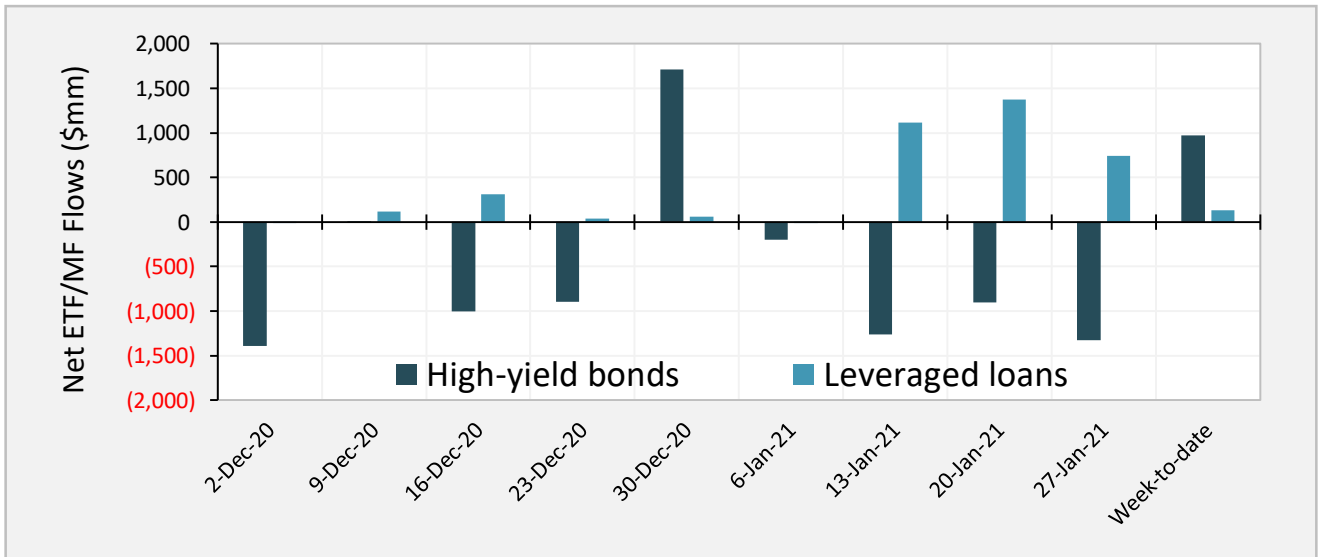
As of 1/31/2021. Source: Federal Reserve.

Sector Risk: High Yield Credit Spreads by Sector



As of 1/31/2021. Source: Bloomberg.

Fund Flows: Weekly High Yield Credit ETF and MF Flows



As of 1/31/2021. Source: JP Morgan.

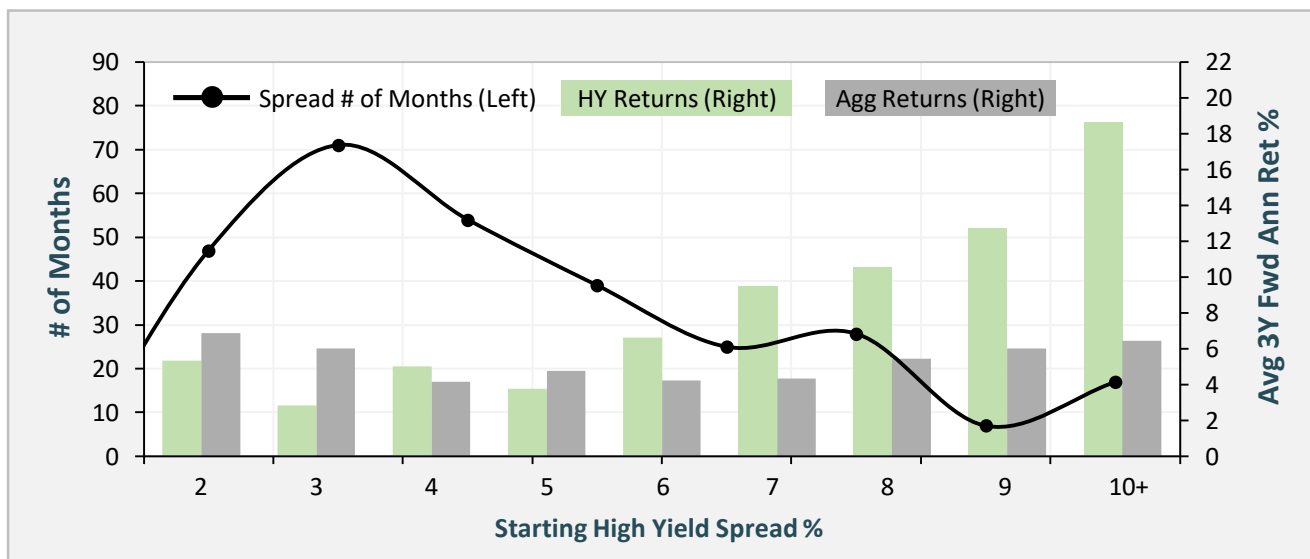
Spreads at Investment Entry: Avg 3-Yr Forward Ann Return by Asset Class

# of Months	Credit Spreads	Small Stocks	Large Stocks	HY Bonds	Lev Loans	BB-B 1-3 Bonds	Corp Bonds	Muni Bonds	MBS Debt	Agg Bonds	Agency Bonds	Treasury Bonds
1	2	-6.6	-8.7	5.3	3.3	8.4	6.2	5.2	7.8	6.9	6.6	7.2
47	3	0.8	4.4	2.8	2.9	5.7	4.8	4.4	6.6	6	6.2	6.6
71	4	6.2	8.2	5	3.2	4.5	4.3	4	4.1	4.2	3.8	4.3
54	5	6.8	5.7	3.8	4	5.7	5.5	5.5	4.6	4.8	4.2	4.4
39	6	10.4	8.1	6.6	5	6.9	5.5	4.8	4.1	4.2	3.7	3.7
25	7	12.8	10.7	9.5	6	7.8	6.3	4.9	3.9	4.3	3.4	3.6
28	8	12.1	6.1	10.5	6.2	9	7.4	6	5.1	5.4	4.6	4.7
7	9	13.9	7.6	12.7	6.8	10.2	8.4	6.9	5.3	6	4.9	5.4
17	>=10	18.4	13.9	18.6	11.6	13.4	10.7	7.5	5.4	6.4	4.2	4.8

Current Spread Level

3Y forward return example: investing in HY bonds 1/31/2016 (spreads at 7), 3Y ann. return of 10% ending 1/31/2019. 12/31/1996 to current month. Source: Bloomberg.

Spreads at Investment Entry: Spread Distribution and HY vs Agg Return



3Y forward return example: investing in HY bonds 1/31/2016 (spreads at 7), 3Y ann. return of 10% ending 1/31/2019. 12/31/1996 to current month. Source: Bloomberg.

Asset Class Statistics: Credit and Equity Performance and Fundamentals

Asset Class	Equity		High Yield Credit			Investment Grade Credit						Term Definition
	Small Stocks	Large Stocks	High Yield	Lev Loans	BB-B 1-3Y	Corp	Muni	MBS	Agg	Agency	Treas	
1 Mth Return (%)	5.03	-0.82	0.38	1.19	0.40	-1.22	0.66	0.13	-0.78	-0.27	-1.12	Cumulative total return over last month.
YTD Return (%)	5.03	-0.82	0.38	1.19	0.40	-1.22	0.66	0.13	-0.78	-0.27	-1.12	Cumulative total return year-to-date.
1 Yr Return (%)	30.17	19.84	6.57	3.77	2.30	5.95	4.09	3.47	4.60	3.83	4.33	Cumulative total return over last 12 months.
3 Yr Return (%)	11.10	12.48	5.79	4.09	4.28	6.92	5.24	4.30	5.55	4.49	5.38	Annualized total return over last 3 years.
Volatility (%)	21.11	15.47	7.86	6.95	5.68	5.90	3.89	2.08	3.24	2.25	4.12	5-year annualized standard deviation of index monthly returns.
Max Drawdown (%)	-41.75	-34.58	-21.54	-20.73	-16.39	-15.14	-11.38	-3.11	-6.35	-3.33	-5.98	Largest downside, measured from peak to trough, over last 5 years, daily return basis.
Eff Yield (%)	1.43	1.20	4.41	3.61	3.22	1.90	1.33	0.90	1.12	0.55	0.69	Coupon/dividend payments divided by market value, annualized. Assumes reinvestment.
YTM (%)	-	-	4.94	4.83	3.67	1.96	2.18	0.90	1.13	0.61	0.69	Total return if bond held to maturity, coupons made/reinvested, principal returned.
YTW (%)	-	-	4.31	4.20	3.16	1.90	1.01	0.90	1.12	0.57	0.69	Adjusts for embedded options. Lowest out of individual Yield to Calls or YTM.
YTML (%)	12.61	12.27	4.63	4.52	3.41	1.93	1.59	0.90	1.13	0.59	0.69	Credit: Yield to Most Likely is avg of YTM and YTW. *Equity: Div yield + Earnings growth.
Opt Adj Spread (%)	-	-	3.84	4.37	3.09	1.03	0.34	0.17	0.38	0.11	0.00	Measure of credit risk. Yield above maturity equivalent treasuries, accounting for options.
Coupon (%)	-	-	5.98	3.47	5.71	3.79	4.49	3.08	2.78	1.80	1.96	Stated coupon payment on a bond, par weighted.
Price (\$)	-	-	104.6	97.4	103.5	113.5	114.0	106.8	109.5	108.1	108.5	Market price of a bond, weighted by par.
Maturity (Yrs)	-	-	6.52	4.65	2.02	11.70	12.78	3.69	8.30	5.40	8.75	# Years until bond matures. Equivalent to Macaulay Duration for zero-coupon bonds.
Macaulay Dur (Yrs)	-	-	5.15	0.25	1.82	8.39	8.92	3.54	6.55	4.60	7.22	Measure of interest rate risk. Weighted avg maturity of cash flows (coupons & principal).
Mod Duration (Yrs)	-	-	5.03	0.25	1.79	8.29	8.79	3.52	6.50	4.58	7.18	Modified Macaulay Dur. +/- 1% rate change effect on price (eg 5 = -5% loss from +1% rate)
Eff Duration (Yrs)	-	-	3.79	0.25	1.44	8.35	6.02	2.44	6.34	4.01	7.35	Duration calc for bonds with options. Equals mod duration if options are non-impactful.
Convexity	-	-	-0.33	0.00	-0.04	1.33	-0.10	-1.71	0.50	-0.62	1.16	Measures change in duration as rates change. Positive if duration rises as rates fall.
Credit Rating	B	BBB	B	B	BB	A	AA	AAA	AA	AAA	AAA	Aggregate composite rating using ICE BofA methodology (S&P, Moody's, Fitch).
# Issues	2,033	1,013	2,030	1,454	212	8,829	59,216	607	17,114	491	262	Number of stocks/bonds within index.
Par Value (\$bn)	-	-	1,455	1,191	142	7,381	1,504	6,710	28,871	384	11,957	\$ value of bonds within index by par.
Market Val (\$bn)	3,100	37,620	1,542	1,160	149	8,448	1,728	7,183	31,775	417	13,046	\$ value of bonds/stocks within index by market price.
% of Total Market	7.61	92.39	4.45	3.35	0.43	24.40	4.99	20.75	91.77	1.20	37.68	Approximation of stock/bond market value relative to its broader respective market.
Return/Vol Ratio	0.60	0.79	0.59	0.65	0.60	0.33	0.41	0.43	0.35	0.26	0.17	Return (YTML) per unit of volatility (5-year standard deviation).
Return/Dur Ratio	-	-	1.22	-	2.36	0.23	0.26	0.37	0.18	0.15	0.09	Return (YTML) per unit of duration (effective duration).
Return/Down Ratio	0.30	0.35	0.21	0.22	0.21	0.13	0.14	0.29	0.18	0.18	0.12	Return (YTML) per unit of downside (maximum drawdown).

Investment Discipline from Credit Data

Credit is the lifeblood of the modern economic system. The analysis of macroeconomic credit fundamentals (liquidity, solvency, interest rates, leverage) can provide equity and credit investors with a disciplined framework for understanding and reacting to market conditions. This is especially true in today's market of record-breaking volatility.

Stock prices are roughly 20x more volatile than their fundamentals, as noted by Robert Shiller, when pointing out the excess volatility could not be explained by the efficient market theory. Excess volatility appears to be derived from behavioral psychology. Credit fundamentals, especially their positive/negative directional momentum, have historically cut through behavioral price noise, offering indication of where we are in the cycle and where we're going.

Credit risk, interest rate risk, and yield curve risk are 3 key components of macroeconomic credit. Penn Capital's Monthly Credit Insights focus on these core factors, seeking to help investors make disciplined and informed decisions. Updates can be found on our [website](#).

High yield credit, bonds and loans of companies rated below BBB, provide especially useful indication (such as high yield credit spread movements). High yield credit has historically exhibited earlier and greater sensitivity, and therefore indication, to changes in macroeconomic credit conditions that we believe truly drive the market. For that reason, we emphasize high yield credit in our analysis.



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The ICE BofA US HY Cash Pay BB-B Rated 1-3 Year Index is a subset of The Bank of America US Cash Pay High Yield Index, which tracks the performance of non-investment-grade corporate bonds with a remaining term to final maturity less than three years and rated BB-B. The ICE BofA US High Yield Index tracks the performance of US dollar denominated below investment grade rated corporate debt publicly issued in the US domestic market. The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed rate taxable bond market. The ICE BofA High Yield OAS (Option-Adjusted Spreads) Index is the calculated spread between a computed OAS index of all bonds in a given rating category and a spot Treasury curve. An OAS index is constructed using each constituent bond weighted by market capitalization. The S&P/LSTA Leveraged Loan Index is a market value-weighted index designed to measure the performance of the US leveraged loan market based upon market weightings, spreads and interest payments. The ICE BofA US Corporate Index tracks the performance of US dollar denominated investment grade corporate debt publicly issued in the US domestic market. The ICE BofA US Treasury Index tracks the performance of the US dollar denominated sovereign debt publicly issued by the US government in its domestic market. The ICE BofA US Municipal Securities Index tracks the performance of U.S. dollar-denominated investment grade tax-exempt debt publicly issued by U.S. states and territories, and their political subdivisions, in the U.S. domestic market. The ICE BofA US Mortgage Backed Securities Index tracks the performance US Mortgage Backed Securities Index. The ICE BofA US Asset Backed Securities & Commercial Mortgage-Backed Securities Index tracks the performance US asset backed securities and commercial mortgage-backed securities. The ICE BofA Agency & Quasi-Government Index tracks the performance of US dollar denominated US agency debt issued in the US domestic market. Qualifying securities must have an investment grade rating (based on an average of Moody's, S&P and Fitch). A copy of Penn Capital's current written disclosure statement discussing our advisory services and fees is available upon request. Investors cannot invest directly in an index.