CION Credit Market Update – November 30, 2020

Risk-Off, Risk-On. Was November a Turning Point or a Sticking Point?

Fixed income markets in November were driven by investors' perception of when the recovery would become firmly established. Investors initially favored higher-quality assets with longer durations, but by the last week of the month, investors began to overlook short-term uncertainty and move back into riskier assets. In the end, Treasury rates ended up about where they started, despite some jumps mid-month.

Uncertainty about the near-term outlook was paramount in the first three weeks of November, as the potential for a divided Congress clouded the outlook for a new stimulus. Headlines on the seasonal upswing of the coronavirus and the resulting slowing of the recovery weighed on investors' view of the short-term, while positive news on vaccines boosted the outlook for the mid- and long-term view of the economy.

With the short-term economic outlook uncertain, duration was the driver of returns across both Treasuries and Corporates. For the week ending November 20th, the longer-term components of the Bloomberg Barclays U.S. Aggregate index returned more than 2%, while the short end was up a mere 10 basis points.

By the last week of the month, which was shortened by the Thanksgiving holiday, investors began to be more optimistic. Formal preparations for a transition of presidential power commenced, and announcements of multiple vaccines potentially being available over the next several months boosted the positive market risk sentiment. In addition, Treasury issuance of $193 billion (which included a record $56 billion 7-year note auction) pushed Treasury yields higher before the holiday, as increased supply resulted in falling prices (the price and yield of a bond move inversely to one another). A return of uncertainty at the end of the month pushed yields back down, and they ended essentially flat.

From a total return perspective, high yield corporates were the standout for the last week of the month at 0.63%, along with senior loans at 0.36%. Investment grade corporates could not sustain momentum from earlier in the month when they outperformed all other fixed income sectors, returning 0.13%. No other domestic sectors cracked returns above 0.10% and returns on the Bloomberg Barclays U.S. Aggregate Bond, along with Treasuries and mortgage-backed securities, were negative.

Given the return to risk sentiment that generated the rally in the equity markets, the best performer for the month was high yield. While still lagging higher-quality assets, the Bloomberg Barclays U.S. High Yield Index is now up 4.99% for the year, with a duration of 3.62 years. In comparison, the U.S. Aggregate returned 7.28%, but with a duration of 6.24 years.

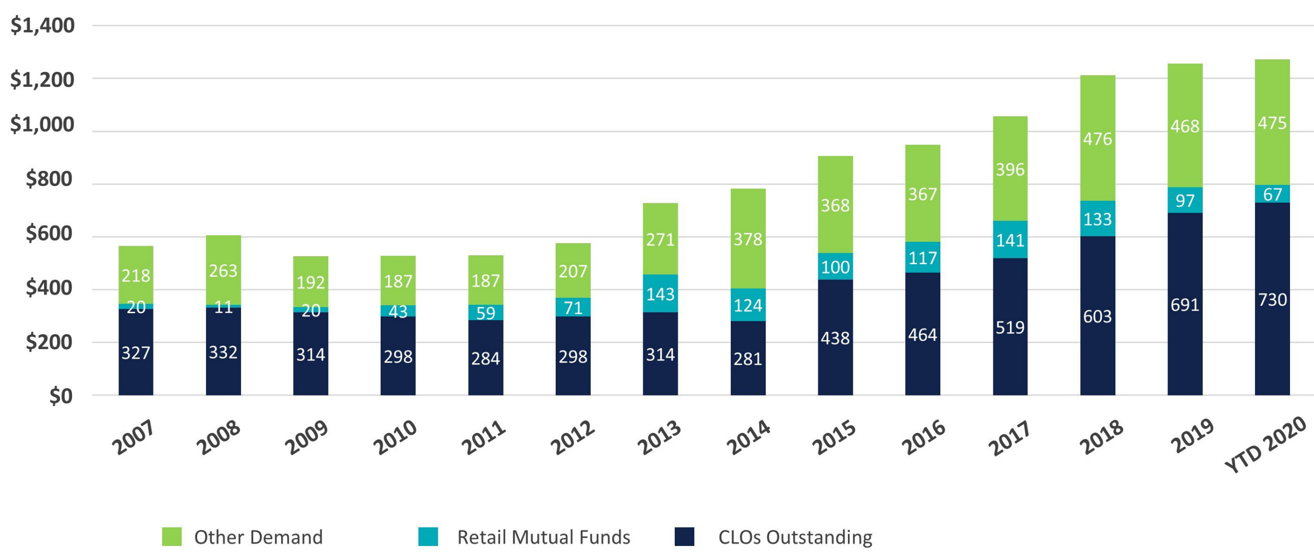
Performance Among Credit Indices

	10/30/2020 -11/30/2020	YTD (as of 11/30/2020)	TRAILING 1 YEAR (12/02/2019 - 11/30/2020)
Credit Suisse Leveraged Loan Total Return Index (CSLLLTOT)	2.12%	1.46%	3.04%
Bloomberg Barclays US Corporate High Yield Total Return Index (LF98TRUU)	3.95%	5.13%	7.34%
Bloomberg Barclays US Aggregate Total Return Index (LBUSTRUU)	0.98%	7.35%	7.64%
Bloomberg Barclays Municipal Bond Index (LMBITR)	1.50%	4.57%	5.03%
Palmer Square CLO Debt Index (CLODI)	4.24%	5.20%	7.90%

Source: Bloomberg as of 11/30/2020

Chart Spotlight: Leveraged Loan Holder Base

Leveraged loan issuance has more than doubled since 2012. In the last two years, the base has shifted out of retail mutual funds and into CLOs. Because CLOs are locked up, long-term capital they tend to make the market less volatile.



Source: S&P Global

Credit Asset Classes

Private Credit	Structured Credit	High Yield
Private credit continues to play an important role in the economy and in investor portfolios. eVestment reports that year to date, despite the pandemic, private debt funds are outpacing 2019 fundraising totals for the same period by 11%. The Alternative Credit Council has published their annual survey of the private credit markets and finds that private credit funds are on track to loan ~ $100 billion dollars in 2020, and that 50% of managers surveyed think that the peak in distressed debt lending has not yet been reached. Looking to the future, Preqin projects an annual increase in total private debt assets of 11.4%, to $1.46 trillion at the end of 2025, from $848 billion at the end of 2020. Institutional investors responding to the Preqin survey reported that 58% expect to increase allocations to private debt over the coming five years.	In early November, S&P Global Ratings published their forecast for the projected default rate on the S&P/LSTA Leveraged Loan index. The forecast was 8.0% by June of 2021. They also published an 'optimistic scenario' default rate of 2.5%, which is essentially in line with historical norms. The CLO markets continued to steady in October, Fitch says in its latest Monthly U.S. CLO Index. The average weighted average spread (WAS) for CLOs in the Index moved higher for the fifth month in a row, leading to fewer than 2.0% of CLOs in the Index failing their WAS tests in October.	Overall spreads narrowed 11 basis points in the last week of the month to412 bps, which is the lowest level since February and 115 bps tighter than the long-term average. Positive returns in the last four weeks and eight of the last nine puts high-yield on top for November and in the lead for Q4.

Other Related Asset Classes

Treasuries	Corporate Bonds	Munis
Short-duration U.S. Treasury yields (less than 5 years) were largely unchanged from their levels at the end of October. Thirty-year Treasuries were also largely flat, moving to 1.58% from 1.55%, after being up 10 basis points just before Thanksgiving. The yield on ten-year Treasuries also ended the month flat at 0.85% - but only after prescribing a parabola that saw it reach 0.975%, its highest point since March. Positive news on vaccines and a resolved election saw investors in safe-harbor Treasury assets jumping back into risk, but only temporarily.	Investment grade corporates have benefitted from a bias towards higher quality assets and have strong year to date performance. However, they also have the longest duration, at 8.84 years, creating significant interest rate risk. Spreads tightened by 4 bps over the month, to 106 bps — their narrowest level in nine months. The average investment grade yield dipped to 1.82%, matching its all-time low.	Continuing low interest rates are supportive of municipal bonds, and they continue to gain. The short holiday week at the end of the month resulted in a reduced new issue calendar, but December should be greater supply, particularly in the first two weeks. Taxable municipal bonds could continue to be a significant portion of the new supply, which would continue the growth of taxable issuance we've seen so far in 2020. Taxable municipal new issue volume through November was $170 billion, nearly double the level from 2019.