CION Credit Market Update – September 30, 2021

Risk-Off Makes a Comeback. Sort Of.

That Sound You Heard Was Equities Screeching to a Halt

The equity market, as measured by the S&P 500, broke its streak and failed to rack up multiple record closes, notching only one early in the month. After that, the combination of the ongoing Delta surge, back and forth on the debt ceiling, negotiations on the Build Back Better Act and the FOMC meeting at the end of the month all took their toll. But the resulting switch to risk-off was not quite a home run for Treasuries.

What Did This Mean for the Bond Markets?

Treasury yields did increase, with the five-year hitting the highest level since February 2020 and the ten-year pushing past 1.50% for the first time since June. All maturities of Treasuries ended September with higher yields. September made up for the decreases in yields we saw over the summer in July and August, but only for maturities of ten years or less. For the quarter, longer-dated maturities finished slightly lower.

The Great and Powerful Fed Has Spoken

At the Fed's September meeting, Chairman Powell indicated his goals on employment and inflation are coming into view. Powell said that "Inflation has achieved… substantial further progress" and that he believes the same test for employment is "all but met." The impact of that was seen in the Fed's "dot plot," which indicated that more members see a rate hike happening in 2022, as opposed to the June meeting when a slight majority of members put the rate increase in 2023.

The other highly anticipated piece of the Fed puzzle is the timing around tapering, which now looks likely to begin after the FOMC's November meeting. The Fed released a new economic outlook, and core inflation is now projected to increase 3.7% this year, compared with the 3% forecast in June.

With the rise in rates, some economists may now be back to the expectation for rates to hit 1.8% by the end of the year and 2% by next year. Which is good for the markets, but what about investors? Let's go back to that inflation number. Even if yields increase, with inflation where it is, real yields will likely still be negative.

Performance Among Credit Indices

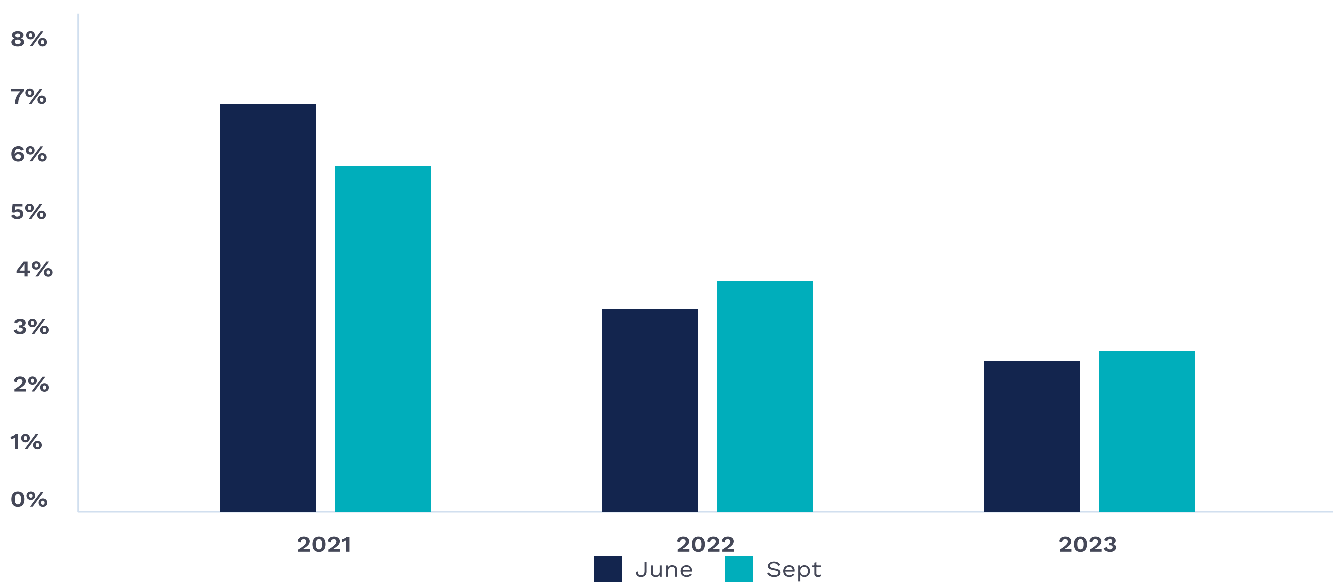
	MTD 8/31/2021 – 9/30/2021	YTD (as of 9/30/2021)	TRAILING 1 YEAR (9/30/2020 - 9/30/2021)
Credit Suisse Leveraged Loan Total Return Index (CSLLLTOT)	0.64%	4.65%	8.45%
Bloomberg Barclays US Corporate High Yield Total Return Index (LF98TRUU)	-0.01%	4.53%	11.27%
Bloomberg Barclays US Aggregate Total Return Index (LBUSTRUU)	-0.86%	-1.55%	-0.89%
Bloomberg Barclays Municipal Bond Index (LMBITR)	-0.72%	0.79%	2.62%
Palmer Square CLO Debt Index (CLODI)	0.15%	4.17%	9.06%

Source: Bloomberg as of 10/6/2021

Chart Spotlight: The Federal Reserve Has an Evolving View on Growth

What a difference a summer makes. While 2021 growth projections fell, looking a little further out is more positive.

FOMC Median GDP Projections, September 2021



Source: The Federal Reserve

Credit Asset Classes

Private Credit	Structured Credit	High Yield
With the Federal Reserve seemingly poised to raise rates in 2022, which is earlier than expected, private debt loans' typical floating rate nature is becoming attractive. Even if rates do increase, however, yields are unlikely to outpace the increase in inflation, which the Fed has recently revised upwards. The enhanced yields of private, middle market loans are another point of attraction. But inflation doesn't just hit consumers and investors – how will middle market companies themselves contend with it? The concern is that while larger companies may have more pricing power, if middle market companies are unable to restructure costs through efficiencies or pass on costs to consumers, inflation could hamper their growth, putting pressure on loans. The National Center for the Middle Market tracked data from 2012 – 2019 and found that mid-size companies grew average revenue by 6.5% and employment by 4.3%. Large businesses had 3.5% average revenue growth and 2.3% employment growth over the same period.	Strong performance in structured credit this year has resulted in record issuance. S&P Global reports that the U.S. leveraged loan market is on a record pace for issuance in 2021. Total institutional loan volume through Sept. 30 is $487 billion, surpassing the prior high for the first three quarters, $405 billion in 2017, and within easy striking distance of the 2017 full-year record of $503 billion. The third quarter was the third consecutive quarter that the market has established a new issuance record, with deal flow at $130 billion in the year to date, topping the yearly volume record of $129 billion in 2018. In the third quarter, the volume of primary CLO issuance was a record $46.7 billion. In the second quarter, the previous high quarterly tally, managers printed $43.4 billion in new-issue CLO paper.	High yield corporates ended the month of September flat after a final week of negative performance. They outperformed similar-duration Treasuries as spreads tightened for the month by 53 basis points and the quarter by 87 basis points. Inflows into the sector remained positive over the last six weeks, totaling $1.9 billion over the entire quarter. This resulted in the first positive quarter of inflows in 2021.

Other Related Asset Classes

Treasuries	Investment Grade Corporates	Municipals
The 10-year U.S. Treasury Bond yield closed at 1.49%, up from last month's 1.32% and compared to 0.92% at year-end 2020. Yields have yet to attain the 1.92% they achieved at year-end 2019. The 30-year U.S. Treasury Bond closed at 2.04%, up from last month's 1.94% Treasuries suffered a negative total return for September, but managed a slightly positive return for the third quarter.	Investment grade corporates posted a -1.05% return for the month of September, and year-to-date return of -1.27%. Technical support in the market remains strong, with investor inflows averaging $4 billion.	Tax-exempt municipals struggled as Treasury yields increased and municipals yields were low on outsize issuance that is priced to sell. As an example, Maryland Department of Transportation (DOT) competitively issued $295 million bonds (rated Aa1/AAA). The deal included 3% bonds due in 2031 priced at a yield of 1.40%, while Treasury yields were trading at 1.50%. Issuance is expected to remain high throughout the end of the year.