Quarterly Credit Update

Full Discretion Team Views – 1st Quarter 2022

Key Views

- The credit cycle has advanced to the later stages of the ‘Expansion’ phase characterized by higher expected volatility and a greater risk of a downturn scenario. Risk premiums currently appear attractive relative to history, but catalysts for spread tightening appear limited given concerns over persistent inflation and the current geopolitical landscape.
- Bottom-up fundamentals continue to appear favorable given low leverage and high interest coverage in both IG and HY with spreads technically supported by lower expected issuance relative to previous years.
- Negative impacts of the war in Ukraine have yet to materialize in US fundamental data. However, uncertainty remains high with surging commodity prices, supply-chain challenges, and Russian sanctions.

Credit Cycle/Risk Premiums

Credit Cycle Has Moved to Late-Cycle

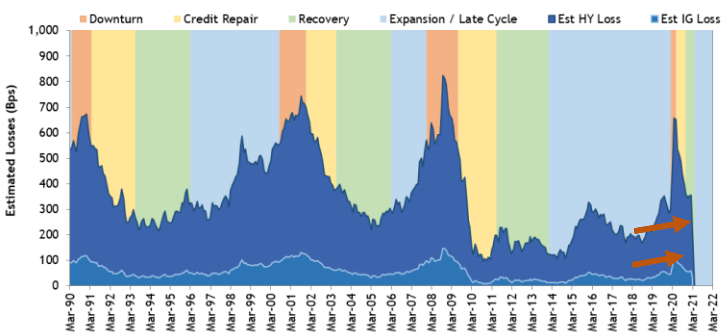
Despite a solid earnings backdrop, we expect recession concerns to increase as inflation persists, commodity prices remain elevated, the Fed hikes into slower global growth and financial conditions gradually tighten.

As of 3/31/22. Chart shown for illustrative purposes only. Some or all of the information on this chart may be dated, and, therefore, should not be the basis to purchase

Steady Rise in Defaults Expected, Still Below Historical Averages

Low loss estimates appear largely driven by healthy macro and bottom-up fundamentals. However, tighter monetary policy and swiftly moving higher rates could begin to pressure corporate health leading to a rise in losses and lower risk premiums.

Estimated IG and HY Losses



Source: Loomis Sayles. As of 3/31/22

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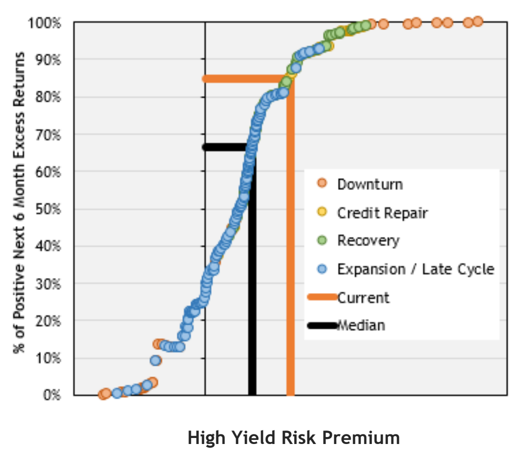
High Yield Risk Premiums Appear Favorable, But Headwinds Have Emerged and Appear Persistent

Risk Premiums have continued to be positive, above historical median, and attractive relative to history primarily driven by low forecasted losses.

However, inflation concerns and a fast moving Fed could be headwinds to meaningful spread tightening as downturn probabilities have grown.

HY Risk Premium & Probability of Positive Excess Return Potential Over Next 6 Months



Source: Loomis Sayles, as of 3/31/22.

Past Performance is no guarantee of future results.

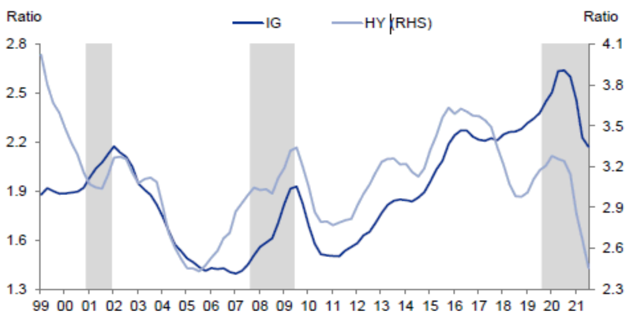
Charts are illustrative for presentation purposes only as a sampling of risk management tool output. *Some or all of this information on these charts may be dated, and, therefore, should not be used as a basis to purchase or sell any securities. The information is not intended to represent any actual portfolio. †*

Technicals/Fundamentals

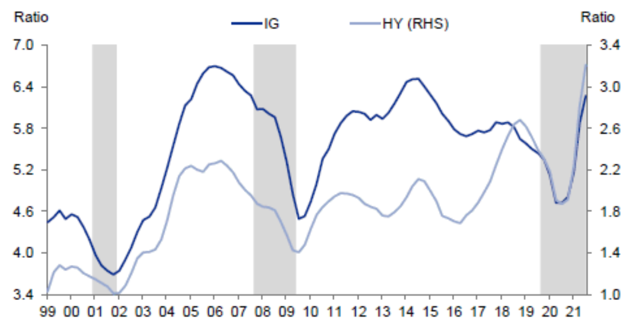
Fundamentals Have Continued to Improve

Leverage in both IG and HY has continued to trend lower with HY leverage back to pre-2008 levels. Interest coverage has remained near peak levels as many companies have taken advantage of historically low rates.

Net Debt to EBITDA for Median IG and HY Rated Company in North America



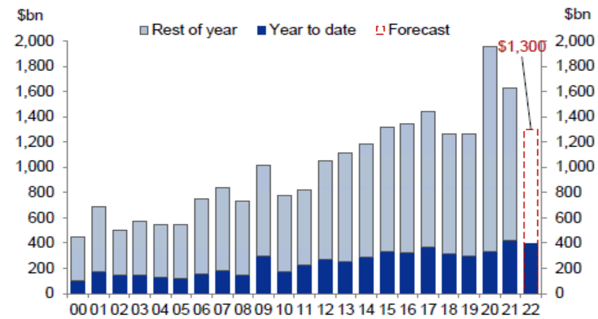
Interest Coverage for Median IG and HY Rated Company in North America



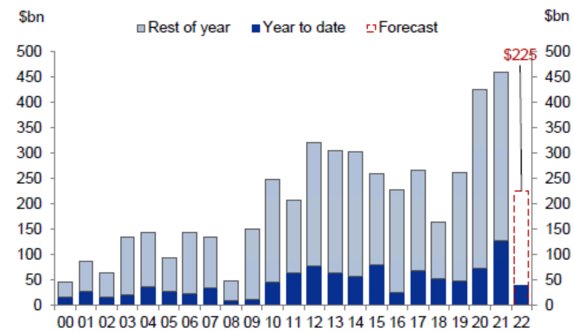
Technicals Appear Favorable

While YTD IG issuance has been tracking just slightly below 2021 levels, HY issuance appears on track to be significantly below recent years, which could benefit secondary market spreads.

Historical USD IG Gross Issuance



Historical USD HY Gross Issuance



Source: Goldman Sachs, Data as of 2/28/2022

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Security Selection

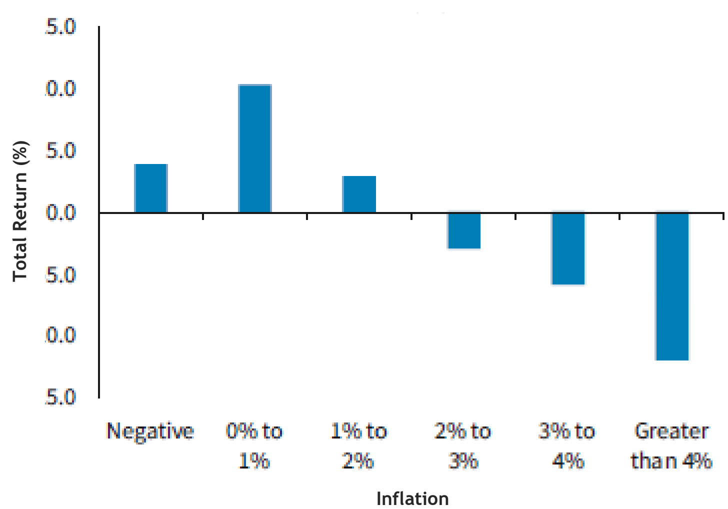
Credit Quality Matters As Inflation Ticks Higher

During periods of higher inflation, lower-rated HY companies have historically fared worse on a total return basis compared to higher quality HY companies.

Highly leveraged/minimal free cash flow companies are typically the most vulnerable as input costs rise, pressuring margins and further eroding cash flows.

Companies that can weather inflationary environments by passing through rising input costs while maintaining demand for their goods/services could stand to perform well in an inflationary environment.

Median Forward 12-Month CCC-BB Total Return (%)



Source: Bloomberg, Barclays Research Data as of 3/31/2022.
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Risk Premium Disclosure

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