

Penn Capital Credit Month in Review

Executive Summary

High yield (HY) bonds and leveraged loans ended the year with positive returns in December as markets digested the passage of a US tax bill, a continued rally in oil, a Fed rate hike, and a new issue calendar heavily skewed toward refinancings and repricings.

Bonds

The HY bond asset class returned +0.38% in December as yields ended unchanged at 6.10%, while spreads decreased 7 bp to 404 bp. Passage of a US tax bill, the continued rally in oil, a Fed rate hike, and the typical seasonal slowdown in HY activity all influenced returns. Energy (+1.13%), Media (+1.00%), and Transportation (+0.74%) were the biggest industry outperformers during the month while Utilities and Telecom were the largest underperformers, returning -0.93% and -0.21%, respectively. By rating, CCCs (+1.10%) were the top performers in December, beating the +0.30% and +0.08% returns posted by B-rated and BB-rated bonds during the month. For 2017, Utilities (+11.40%) and Chemicals (+11.24%) were the best performing industries while Retail (-2.12%) and Telecom (+1.57%) were the worst. CCC-rated bonds, +9.17% in 2017, were the top-performers by rating for the second year in a row. BBs were the second-best performers for the year as their +7.26% returns bested the +6.70% returns offered by B-rated bonds. Gross new issue activity reached ~\$21b in December but remained heavily skewed toward refinancing transactions (\$14.7b) over net issuance (\$6b). In 2017, gross HY new issue volume reached \$328.1b; this volume surpasses the gross issuance of \$286.2b witnessed in 2016. Net of refinancings, 2017 net new volume of \$120.4b was the lowest issuance amount since 2011. Including distressed exchanges, the US HY bond default rate increased ~13 bp to 1.45%, down 283 bp from the start of the year and 344 bp from 2016's May peak rate of 4.89%.

Loans

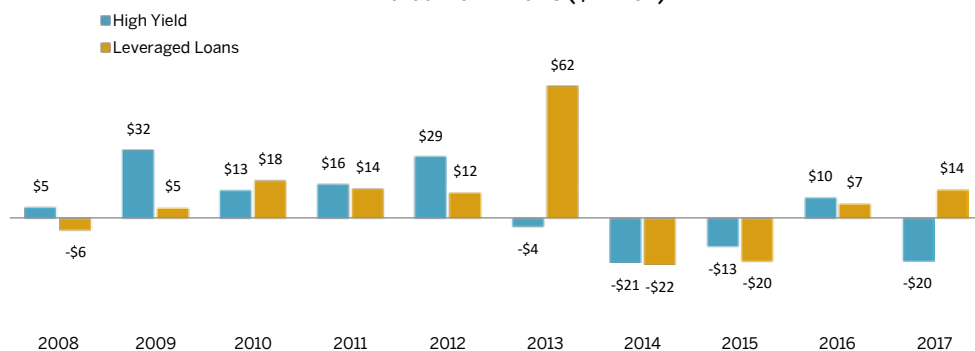
Leveraged loans returned +0.41% in December despite the ongoing wave of re-pricings. Energy (+1.22%) and Media (+0.69%) were the best performing industries for the month while Consumer Products and Retail were the largest laggards returning -0.09% and +0.05%, respectively. During the month, CCC-rated loan returns of +1.02% bested the returns offered by B-rated (+0.45%) and BB-rated (+0.39%) loans. For 2017, Energy (+8.32%) was the best performing industry while Retail was the clear laggard, with returns of -0.32%. CCC-rated loans (+8.98%) were the top performers in 2017 as B-rated and BB-rated loans returned a lesser +4.67% and +3.58%, respectively. New issue activity totaled ~\$72b in December but most of this volume continues to be related to refinancings/repricings. Specifically, ~\$50b, or ~70% of this new issuance, was related to refinancings and repricings. For 2017, repricings and refinancings were a significant 73% of total new institutional loan volume. Gross US collateralized loan obligations (CLO) volume of ~\$20b in December was the ninth highest monthly total on record. This brings 2017 US CLO volumes to \$282.2b vs \$111.8b in 2016. Of the 2017 total, \$165.1b, or 59%, of US CLO volume was used for refinancing/reset deals. The US leveraged loan default rate remained unchanged in December, ending the year at 1.84%. This is a higher level than at the start of the year but still well below long-term averages.

Source: JP Morgan

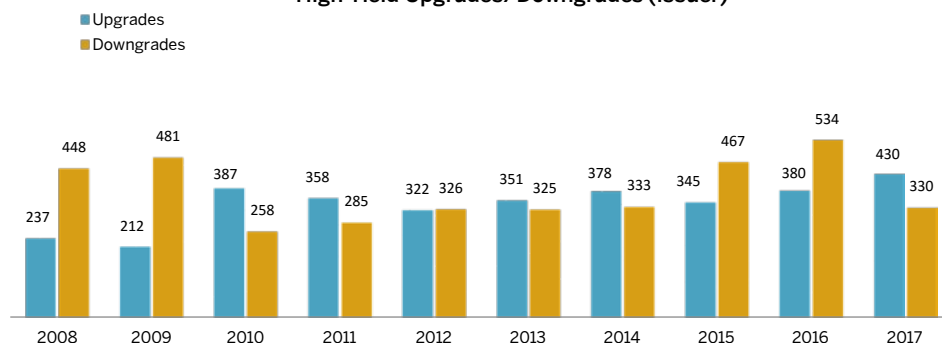
As of December 31, 2017	Performance			Characteristics			
	Month	YTD	Spread	YTD Change	Average Price	YTW	YTM
10-Year Treasury	0.26%	2.10%	---	---	---	2.4%	2.4%
Bloomberg Barclays US Aggregate Bond Index	0.46%	3.54%	49 bp	-2 bp	\$103.07	2.7%	2.7%
JP Morgan BB/B Loan Index	0.22%	3.23%	334 bp	-43 bp	\$99.49	4.9%	---
ICE BofA Merrill Lynch 1-3 Year BB-B US Cash Pay High Yield Index	0.16%	4.71%	219 bp	-91 bp	\$103.03	4.0%	4.4%
ICE BofA Merrill Lynch BB-B Non-Distressed High Yield Index	0.23%	7.03%	284 bp	-55 bp	\$103.06	5.0%	5.3%
ICE BofA Merrill Lynch BB-B US High Yield Constrained Index	0.20%	6.98%	297 bp	-52 bp	\$102.57	5.1%	5.5%
ICE BofA Merrill Lynch US High Yield Constrained Index	0.29%	7.48%	373 bp	-66 bp	\$100.59	5.8%	6.2%

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

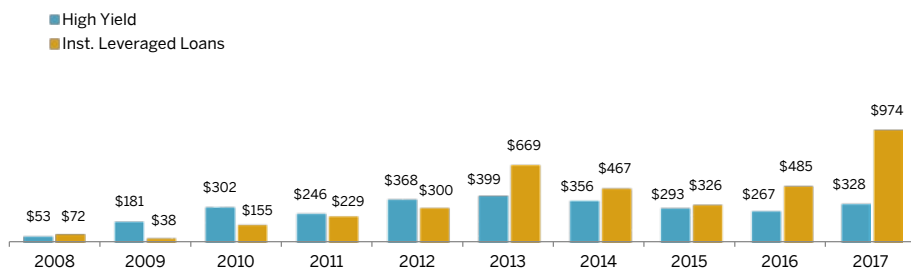
Mutual Fund Flows (\$ billion)



High Yield Upgrades/Downgrades (Issuer)



New Issuance Volume (\$ billion)



Source for Charts: JP Morgan

Historical Spreads/Default Rates	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
ICE BofA Merrill Lynch US BB-B High Yield Index	1,430 bp	521 bp	485 bp	612 bp	443 bp	344 bp	434 bp	558 bp	348 bp	297 bp
ICE BofA Merrill Lynch US BB High Yield Index	1,257 bp	445 bp	399 bp	503 bp	357 bp	281 bp	336 bp	427 bp	286 bp	228 bp
ICE BofA Merrill Lynch US B High Yield Index	1,640 bp	613 bp	573 bp	736 bp	524 bp	417 bp	549 bp	722 bp	432 bp	381 bp
ICE BofA Merrill Lynch US CCC High Yield Index	2,948 bp	980 bp	874 bp	1,262 bp	943 bp	766 bp	976 bp	1,648 bp	977 bp	843 bp
Moody's 12-Month Default Rate (US)	4.4%	13.2%	3.5%	1.8%	3.2%	2.2%	1.9%	3.2%	5.7%	3.4%*
Moody's 12-Month Default Rate (Global)	4.0%	12.5%	3.3%	1.7%	2.6%	2.6%	2.1%	3.4%	4.4%	3.0%*

Sources: BofA Merrill Lynch, Moody's.

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* As of 11/30/2017. Past performance is no guarantee of future results.

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