

Penn Capital Credit Month in Review

Executive Summary

Leveraged loans provided investors with slightly positive returns in February while high yield (HY) bond returns turned negative. Rising treasury yields, an equity sell-off and investor outflows all weighed on bond prices.

Bonds

The HY bond asset class returned -0.83% in February as yields and spreads increased 34 bp and 17 bp, respectively. Rising treasury yields, a significant equity sell-off, and investor outflows from the asset class all influenced returns. At 6.39% and 389 bp, yields and spreads eventually ended the month of February 21 bp and 29 bp lower than their respective intra-month highs. Broadcasting (+0.02%), Retail (-0.13%), and Cable/Satellite (-0.33%) were the best performing industries during the month while Energy and Metals/Mining were the largest underperformers, returning -1.82% and -1.25%, respectively. By rating, single Bs (-0.49%) were the top performers in February, beating the -0.57% and -1.12% returns posted by CCC-rated and BB-rated bonds during the month. Year-to-date (YTD), Retail (+1.71%) is the best performing industry while Food & Beverages (-1.17%) is the worst. CCC-rated bonds remain top performers YTD with +1.77% return. This beats returns offered by B-rated (+0.42%) and BB-rated (-1.14%) bonds. Given the market volatility during the month, gross new issue activity reached only ~\$13b in February, a two-year low. Issuance remained heavily skewed toward refinancing transactions (~\$11b) over net issuance (~\$3b). YTD, gross HY new issue volume reached \$44b; this volume level is 13% below the gross issuance of ~\$51b we saw by this point last year. Including distressed exchanges, the US HY bond default rate increased 83 bp to 2.02%, mostly due to the default of one large radio broadcasting company. Despite this increase the default rate is still down 142 bp over last year.

Loans

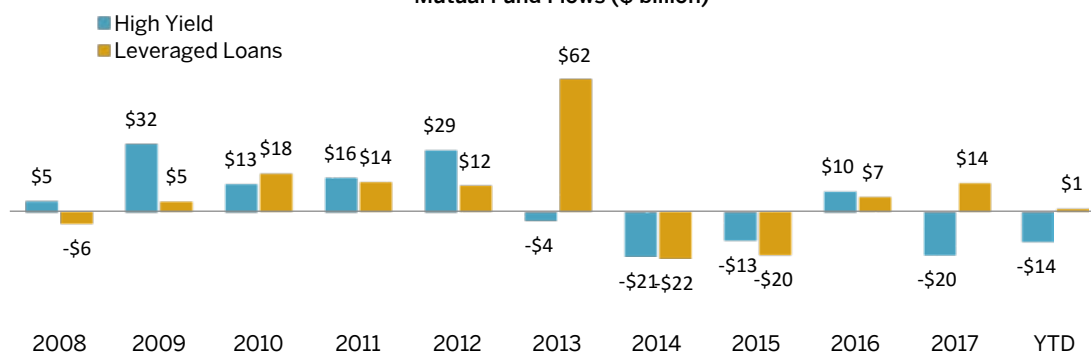
Leveraged loans returned +0.15% in February as loan prices proved to be better protected from the volatility we saw across other asset classes. This marks the fifth consecutive month loans outperformed HY bonds. Energy (+0.55%) and Telecom (+0.30%) were the best performing industries for the month while Metals/Mining and Consumer Products were the largest laggards returning -0.51% and -0.32%, respectively. During the month, CCC-rated loan returns of +0.45% bested the returns offered by B-rated (+0.20%) and BB-rated (+0.03%) loans. Energy (+2.86%) is the best performing industry YTD while Paper & Packaging remains the largest laggard with returns of 0.75% through February. CCC-rated loans (+4.06%) remain the top performers YTD as B-rated and BB-rated loans returned a lesser +1.24% and +0.85%, respectively. New issue activity totaled ~\$83b in February, up 72% month-over-month but down 19% year-over-year. Most of this volume, ~\$53b (or ~64%), continues to be related to refinancings/repricings. YTD repricings and refinancings remain a significant ~66% of total new institutional loan volume but this is down from the ~80% they represented YTD February 2017. Gross US collateralized loan obligations (CLO) volume of ~\$23b in February was the sixth highest monthly total on record. This brings YTD US CLO volumes to ~\$43b. Of that total, ~\$22b or 52% of US CLO volume was used for refinancing/reset deals. The US Leveraged loan default rate is now at 2.52%, this is largely due to the default of the same aforementioned large radio broadcasting company. That being said, February marks the highest monthly default rate we have seen since March 2015 when the default rate hit 3.99%.

Source: JP Morgan

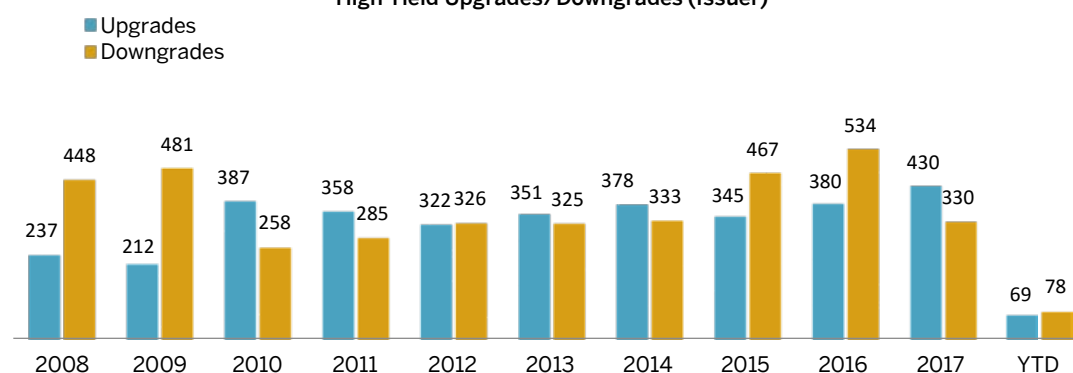
As of February 28, 2018	Performance			Characteristics			
	Month	YTD	Spread	YTD Change	Average Price	YTW	YTM
10-Year Treasury	-1.24%	-3.67%	---	---	---	2.9%	2.9%
Bloomberg Barclays US Aggregate Bond Index	-0.95%	-2.09%	48 bp	-1 bp	\$100.38	3.2%	3.2%
JP Morgan BB/B Loan Index	0.08%	0.95%	317 bp	-18 bp	\$99.81	5.9%	---
ICE BofA Merrill Lynch 1-3 Year BB-B Rated US Cash Pay High Yield Index	-0.10%	0.38%	212 bp	-7 bp	\$102.52	4.3%	4.8%
ICE BofA Merrill Lynch BB-B Rated Non-Distressed High Yield Index	-1.00%	-0.63%	280 bp	-4 bp	\$101.24	5.4%	5.7%
ICE BofA Merrill Lynch BB-B Rated US High Yield Constrained Index	-0.98%	-0.56%	291 bp	-6 bp	\$100.87	5.5%	5.8%
ICE BofA Merrill Lynch US High Yield Constrained Index	-0.93%	-0.30%	360 bp	-13 bp	\$99.36	6.2%	6.4%

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

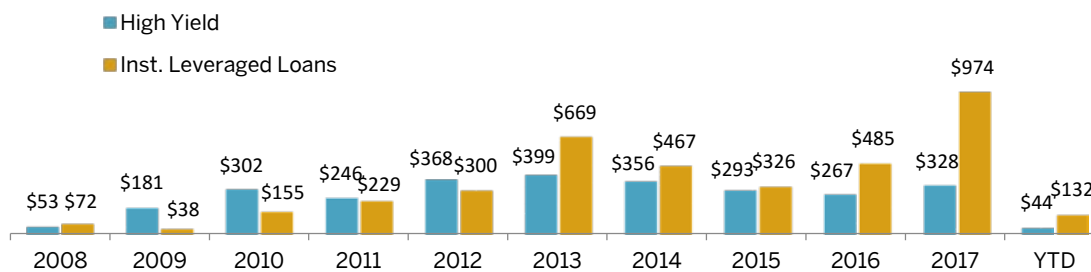
Mutual Fund Flows (\$ billion)



High Yield Upgrades/Downgrades (Issuer)



New Issuance Volume (\$ billion)



Source for Charts: JP Morgan

Specialists in capital structure investing

At Penn Capital, we believe that understanding a company's entire capital structure is the best way to identify investment opportunities with the most value. In fact, we've found that managing credit portfolios makes us better equity managers, and vice versa. Employing a fully integrated credit and equity research process, we focus on non-investment grade companies in the micro to mid-capitalization range, where we can take advantage of inefficient security pricing. We are an independent, employee-owned boutique investment management firm based in Philadelphia. We forge our own ideas, we respect hard work, and we are committed to our clients, our staff and our community.

The subject matter contained herein has been derived from several sources believed to be reliable and accurate at the time of compilation, but no representation or warranty (express or implied) is made as to the accuracy or completeness of any of this information. Under no circumstances should this information be construed as a recommendation or advice. The views expressed herein reflect the professional opinions of the portfolio managers and are subject to change. Penn Capital does not accept any liability for losses either direct or consequential caused by the use of this information.

Historical Spreads / Default Rates	2009	2010	2011	2012	2013	2014	2015	2016	2017	YTD
ICE BofA Merrill Lynch US BB-B Rated High Yield Index	521 bp	485 bp	612 bp	443 bp	344 bp	434 bp	558 bp	348 bp	297 bp	291 bp
ICE BofA Merrill Lynch US BB Rated High Yield Index	445 bp	399 bp	503 bp	357 bp	281 bp	336 bp	427 bp	286 bp	228 bp	231 bp
ICE BofA Merrill Lynch US B Rated High Yield Index	613 bp	573 bp	736 bp	524 bp	417 bp	549 bp	722 bp	432 bp	381 bp	363 bp
ICE BofA Merrill Lynch US CCC Rated High Yield Index	980 bp	874 bp	1,262 bp	943 bp	766 bp	976 bp	1,648 bp	977 bp	843 bp	784 bp
Moody's 12-Month Default Rate (US)	13.2%	3.5%	1.8%	3.2%	2.2%	1.9%	3.2%	5.7%	3.3%	3.2%*
Moody's 12-Month Default Rate (Global)	12.5%	3.3%	1.7%	2.6%	2.6%	2.1%	3.4%	4.4%	2.9%	2.8%*

Sources: BofA Merrill Lynch, Moody's.

* As of 01/31/2018. Past performance is no guarantee of future results.

For use with institutional investors and financial intermediaries only. Not for distribution to, or for use with, individual investors.

© 2018 Penn Capital, Inc. All rights reserved. • 1200 Intrepid Avenue, Suite 400, Philadelphia, PA 19112 • www.penncapital.com