

October's Good Oil

Welcome to the inaugural edition of Penn Capital's monthly update produced specifically for the Australian and New Zealand markets.

US Credit Market Update

- Money Market reform effective October 14th
- Liquidity in investment grade commercial paper has decreased significantly as assets invested in Institutional Prime Money Market Funds (MMF) dropped by \$1tn.
- FUM of Institutional US Gov't MMF have seen inflows of \$974bn since January 2016.

- Most analysts expect FOMC (Federal Reserve Open Market Committee) to delay any rate increase until December 2016.
- Yield curve on US Corporate bonds (5 years and under) flattened in September, due to Money Market reform, high relative value of the US Dollar & continuation of the static rate policy's of FOMC and Bank of Japan.

As of 9/30/2016
Sources: BofA ML & JPMorgan

High Yield (HY) Market Update

Performance

- HY bonds provided their 8th consecutive monthly gain, up 77bps in September. By sectors, Metals/Mining were +2.8%, Energy +1.65% & CCC bonds +1.88%.
- Leveraged Loans (LL) were up 83bps during the month; trading above par at 16-month high 58.49%.
- The LL Index has YTD gains of +7.45%. (Split BBB +4.47%; BB +6.02%; Split BB +6.73%; B 7.81%; CCC +17.78%)

Issuance

- HY bond issuance in September totaled \$35bn. 2nd highest YTD after May's \$41.8bn. Most HY bond new issuance for refinancing (70%), with true new issuance \$10.7bn
- LL issuance in September totaled \$57.3bn, also 2nd highest YTD. Most LL volume was for repricing (18%), refinancing (46%), with true new issuance \$20.5bn

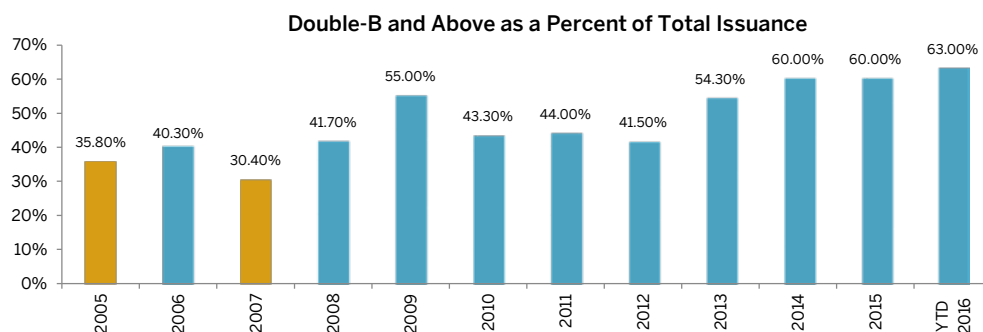
- YTD HY bond volume \$233.0bn (\$100.2bn net of repricing/refi) down from \$250.9bn & \$141.9bn YTD15
- LL volume is \$291.7bn YTD (\$117.9bn net of repricing/refi vs. \$266.2bn & \$137.9bn YTD15)

Defaults

- September defaults were US \$2.7bn (3 companies); light compared to January - May average of US\$8.5bn (7 companies per month)
- YTD defaults US \$53.5bn (\$42.2bn in bonds & \$11.3bn in loans). 42% higher volume than all of 2015 (\$23.6bn bonds & \$14.1bn loans).
- Par weighted HY default rate decreased 3bps from August to 3.54%. Energy and Metals/Mining have markedly increased defaults in trailing 12 months. Excluding Energy & Metals/Mining, default rate is 0.49%.
- Par weighted defaults up 15bps from August to 2.24%; up from 1.55% one year ago.

As of 9/30/2016
Source: JP Morgan

Chart of the Month



As of 9/30/2016
Source: JP Morgan

Monthly Penn Capital Strategy in Focus: Micro-Cap Equity

Focuses on minimizing the inherent volatility of micro cap stocks without sacrificing the significant upside potential

- ✓ Well diversified portfolio of small companies
- ✓ Conducting in-depth fundamental bottom-up research
- ✓ Seeks value metrics with growth catalysts
- ✓ Credit markets provide early identification

Guidelines

- Max Number of Securities 150
- Max Security Weighting 5%
- Max Sector Weighting 40%
- Max Cash 10%
- Min Market Cap at Purchase N/A or the smallest market cap of each respective index, whichever is smaller
- Max Market Cap at Purchase \$1 billion or the maximum market cap of each respective index, whichever is greater
- Benchmark Russell Microcap Index [Please see performance chart on next page](#)

September 30, 2016
US \$5.4bn FUM



- Equity US\$1.6bn
- High Yield US\$3.8bn

Specialists in capital structure investing

- **Experience:** Over 25 years managing high yield credit and equity strategies
- **Continuity:** Ownership, team, process, and culture
- **Process:** Integrated credit and equity research process and proprietary credit rating system (Penn Risk Rating)
- **Liquidity:** Capacity constraints provide liquidity advantage and strategy integrity
- **Firm structure:** Independent Institutional Focused Firm

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Gary is a senior business development associate focusing on global markets and is spearheading Penn Capital's Australian marketing and client service initiative.

Prior to joining Penn Capital, Gary spent 11 years at JP Morgan Asset Management most recently leading the Financial Intermediary Client Service team focusing on banks, insurance companies, hedge funds, and electronic trading platforms.

Gary grew up in Adelaide and now resides in Pennsylvania. In addition to enjoying time with his wife and four children, Gary is an active member of the Philadelphia cricket community where he brings his medium pace swing bowling to the attack line-up in season matches as well as the annual Philadelphia International Cricket Festival.

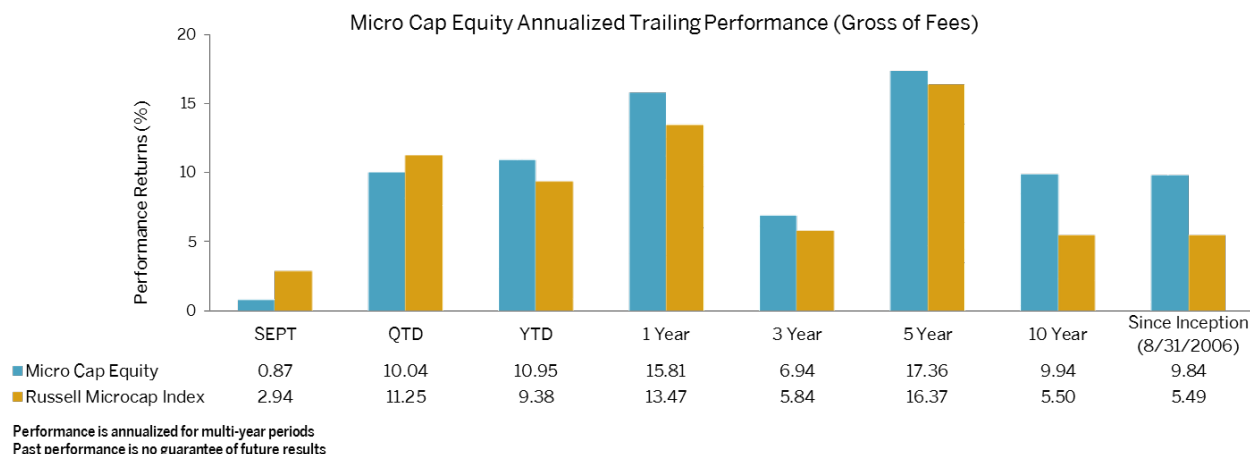
Gary also tries, in vain, to get Americans to like Vegemite.



Gary enjoying a chat with pace bowling legend Dennis Lillee.



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Strategy Performance (Inception) Performance presented is gross of fees in USD	QTD	YTD	1 Yr.	3 Yr.	5 Yr.	10 Yr.	Since Inception
Micro Cap Equity (8/31/2006)	10.04	10.95	15.81	6.94	17.36	9.94	9.84
Russell Microcap Index	11.25	9.38	13.47	5.84	16.37	5.50	5.49
Small Cap Equity (12/31/1993)	7.99	8.12	10.85	1.78	16.43	6.70	13.53
Russell 2000 Index	9.05	11.46	15.47	6.71	15.82	7.07	8.64
Small Cap Value (3/31/2016)	8.92	---	---	---	---	---	16.02
Russell 2000 Value Index	8.69	---	---	---	---	---	13.55
Senior Floating Rate Loans (6/30/2013)	2.26	5.27	4.84	---	---	---	4.04
Credit Suisse Institutional Leveraged Loan Index	2.47	5.83	5.03	---	---	---	4.29
Short Duration (1/31/2013)	2.55	5.90	6.66	4.11	---	---	4.18
BofA ML US HY Cash Pay BB-B Rated, 1-3 Yrs. Index	2.94	8.96	8.61	4.32	---	---	4.48
Defensive High Yield (12/31/1993)*	4.82	9.94	8.84	4.34	6.74	6.62	7.89
BofA ML HY BB/B Non-Distressed Index**	4.81	11.35	11.25	5.75	7.97	6.56	- -

*Penn Capital's earliest GIPS verified Defensive High Yield performance date is 12/31/1993.

**Benchmark inception to date information not available as benchmark inception date is 12/31/1996.

DISCLOSURE

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The Micro Cap Equity Composite is defined to include separately managed accounts with assets over \$500,000.00. These accounts solely invest in equities of U.S. companies at initial purchase with market capitalizations less than \$1.0 billion. The Micro Cap Equity strategy seeks superior investment returns that are attainable on a consistent basis by applying a disciplined value-driven investment approach, which capitalizes on fundamental and technical opportunities in the market. The benchmark is the Russell Microcap Index.

The Small Cap Equity Composite is defined to include separately managed accounts with assets over \$1,000,000.00. These accounts solely invest in equities of U.S. companies at initial purchase with market capitalizations less than \$2.5 billion or the maximum market capitalization of the Russell 2000 Index, whichever is greater. The Small Cap Equity strategy seeks superior investment returns that are attainable on a consistent basis by applying a disciplined value-driven investment approach, which capitalizes on fundamental and technical opportunities in the market. The benchmark is the Russell 2000 Index.

The Small Cap Value Equity Composite is defined to include separately managed accounts with assets over \$250,000.00. These accounts solely invest in equities of U.S. companies with market capitalizations less than \$4 billion at initial purchase or the maximum market capitalization of the Russell 2000 Value Index, whichever is greater. The Small Cap Value Equity strategy seeks superior investment returns that are attainable on a consistent basis by applying a disciplined value-driven investment approach. The benchmark is the Russell 2000 Value Index.

The Senior Floating Rate Loan Composite is defined to include separately managed accounts with assets over \$5,000,000. These accounts invest in a variety of non-investment grade bank loans, primarily those with short to intermediate term maturities. The portfolios will consist of Double-B and Single-B rated issuers with a preference for senior debt in a corporation's capital structure. The Senior Floating Rate Loan strategy seeks to preserve capital and generate high levels of income from US dollar denominated loans made by syndicate banks to corporations. The benchmark is the Credit Suisse Institutional Leveraged Loan Index.

The Short Duration High Yield Composite is defined to include separately managed accounts with assets over \$1,000,000. These accounts solely invest in cash paying fixed income securities of U.S. based companies, with an average portfolio maturity of 3 years and minimum bond credit rating of Split-B Rated. The Short Duration High Yield strategy seeks to preserve investors' capital while managing duration and generating current income. The benchmark is the B of A Merrill Lynch 1-3 Year BB/B Cash Pay High Yield Index.

The Defensive High Yield Composite is defined to include separately managed accounts with assets over \$5,000,000. These accounts solely invest in cash paying fixed income securities of U.S. based companies, with Single-B yield/spread characteristics. The Defensive High Yield strategy seeks to preserve investors' principal, while providing a high level of current income. The benchmark is the B of A Merrill Lynch BB-B Rated Non-Distressed Index.