

An aerial photograph of a vast vineyard with rows of green grapevines stretching across a hillside. A narrow, misty path or stream cuts through the vines, leading towards the horizon. The lighting is soft, suggesting early morning or late afternoon.

CION Credit Market Update – August 31, 2022

Fed Pivot? Not This Time.

The July and early August question of whether the markets were recovering or if it was a bear market rally was answered, with the bears remaining firmly in charge. The catalyst was Chairman Powell's recent remarks, where he made clear that the Fed is committed to getting inflation under control.

The rally appeared to be the result of market participants' overly-optimistic view that the Fed would potentially begin to reduce the number and/or shrink the size of rate increases, with a likelihood of lowering rates in 2023. The history of the "pivot" is the Fed's backing off rate increases and quantitative tightening during the recovery from the global financial crisis, in response to a market overcorrection.

Positive economic data, including a blockbuster jobs report released in early August, may have pushed the Fed to be very clear on its potential future decisions regarding interest rates. The Fed is also intent on shedding its immense balance sheet as part of normalizing monetary policy.

In his remarks, Powell focused on the inflation of the 1970s, and the need to act decisively on rates. His words were "forceful and rapid," and he acknowledged the economic pain this would cause. Powell's view is the Fed needs to act decisively to bring inflation down quickly, or consumer expectations for higher inflation will become entrenched, and inflation will become intransigent.

This could not be more different from the "transitory" language we saw at this time last year, as inflation declined over the summer, and then bounced back up in the fall and winter. The Fed's citing of the 1970s is a historical

underpinning to the Fed being cautious about curbing the tightening of monetary policy too soon. It could also be interpreted as the Fed taking responsibility for its dilatory approach to rates until May of this year.

The Bureau of Labor Statistics reported on September 13th that the Consumer Price Index (CPI) increased 0.1% for the month of August, seasonally adjusted. CPI rose 8.3% over the last 12 months, not seasonally adjusted. This is a slight decline from the 8.5% increase in July.

How Did the Credit Markets React?

Treasury yields rose, almost hitting the June year-to-date peak. After a mostly positive July, most major credit sectors declined in August. The Bloomberg Barclays U.S. Aggregate turned in its sixth month of negative performance, retracing all the gains from July, which was its best month year-to-date.

A Closer Look: What Does the Fed's Crystal Ball Say?

The Fed doesn't have a crystal ball. Its version of a Palantir is called the "Beige Book." It's published eight times per year, and aggregates anecdotal information on current economic conditions in each of the twelve Fed Districts. It also provides information on the outlook going forward. The current report is from July through the end of August.

- Overall economic activity focused on the shift in consumer spending: "Households continued to trade down and to shift spending away from discretionary goods and toward food and other essential items." The outlook for future

economic growth “remained generally weak, with contacts noting expectations for further softening of demand over the next six to twelve months.”

- Overall labor market conditions highlighted that wages continued to grow, “although reports of a slower pace of increase and moderating salary expectations were

widespread.” The outlook for wages is a little more choppy, with “expectations for the pace of wage growth varied across industries and Districts.”

- Price levels remained highly elevated, and “Most contacts expected price pressures to persist at least through the end of the year.”

Performance Among Credit Indices

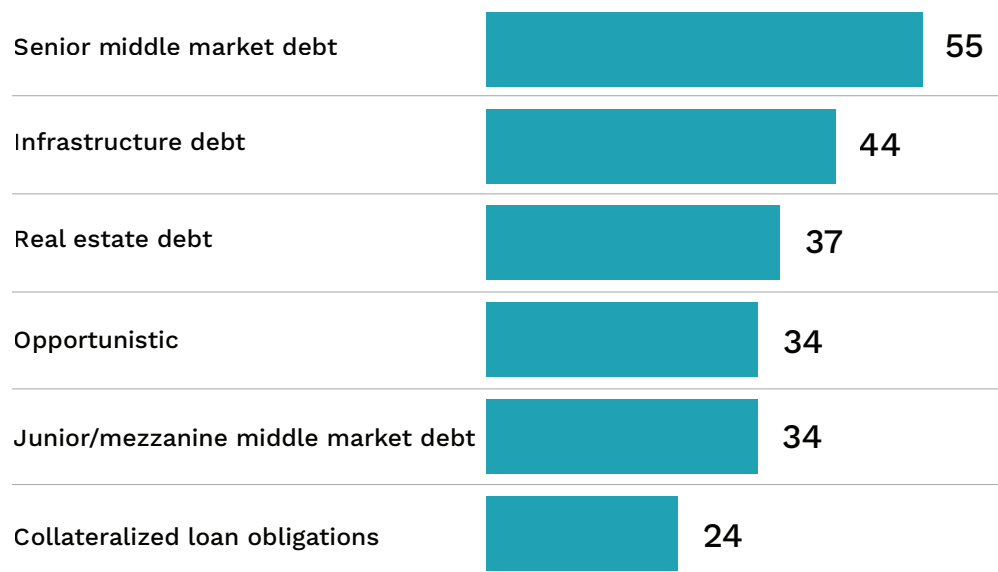
	MTD (7/29/2022-8/31/2022)	YTD (as of 8/31/2022)	TRAILING 1 YEAR (8/31/2021 - 8/31/2022)
Credit Suisse Leveraged Loan Total Return Index (CSLLLTOT)	1.53%	-1.17%	0.18%
Bloomberg U.S. Corporate High Yield Total Return Index (LF98TR.UU)	-2.30%	-11.22%	-10.60%
Bloomberg U.S. Aggregate Total Return Index (LBUSTRUU).	-2.83%	-10.75%	-11.52%
Bloomberg Municipal Bond Index (LMBITR)	-2.19%	-8.62%	-8.63%
Palmer Square CLO Debt Index (CLODI)	2.23%	-3.75%	-2.99%

Source: Bloomberg as of 9/7/2022

Chart Spotlight: Private Credit Continues to See Demand

Institutional investors continue to lead the way in increasing allocations to private credit, with senior middle market debt, which is typically floating rate instruments, leading the way.

Top Picks for Future Private Credit Investment (%)



Source: Nuveen, Think Equilibrium, 2022 Global Institutional Investor Study

Credit Asset Classes

Private Credit	Structured Credit	High Yield
<p>Nuveen's 2022 Equilibrium Survey of 800 institutional investors and consultants showed that the reach for yield is still a priority over the next two years, and the vast majority are looking to alternative credit.</p> <p>"Private credit saw the biggest year-over-year increase in the percentage of asset owners who hold the asset class, making it one of the more commonly held alternatives."</p> <p>The report also focused on the diversification benefits specific to middle market lending: "Senior middle market direct lending brings a high degree of idiosyncratic risk to the portfolio. As a result, senior middle market direct lending has low correlations to other traditional fixed income asset classes, creating meaningful diversification in a multi-asset portfolio."</p>	<p>Leveraged loans bucked the overall trend of credit sectors in August, rallying strongly early in the month and ending up with a positive return of 1.54%.</p> <p>Combined with July's positive return, this marks the strongest two-month period since May and June 2020.</p> <p>The index is down only 1.01% year-to-date, compared to the return of the overall fixed income market, as measured by the Bloomberg Barclays U.S. Aggregate Index, of -10.75%.</p> <p>As recently reported by Barrons, leveraged loans offer an average 7.5% yield, or three to five hundred basis points over LIBOR.</p> <p>Defaults remain a concern, but the loans are generally at the top of a company's capital stack and are secured by the issuer's assets.</p>	<p>The U.S. high yield market declined 2.39% in August, bringing the YTD return down to -11.03%, as measured by the ICE BofA US High Yield Constrained Index (HUC0).</p> <p>Energy and other commodities, capital goods, and leisure were the best performing sectors. Defaults are currently below historical averages.</p>

Other Related Asset Classes

Treasuries	Investment Grade Corporates	Municipals
<p>The benchmark ten-year U.S. Treasury bond yield rose 55 basis points to 3.20%.</p> <p>The 30-year U.S. Treasury Bond rose 29 basis points to close at 3.30%.</p> <p>On the short end of the curve, the three-month Treasury jumped 54 basis points to 2.95%, and the two-year remained inverted against the 10-year U.S. Treasury, with a yield of 3.50%.</p>	<p>Investment grade corporates struggled, returning -2.93%, bringing the year-to-date return to -14.21% for the Bloomberg U.S. Corporate Investment Grade Index</p> <p>Spreads continued to tighten during the month, reaching 131 bps before widening in late August to close at 140 bps, four basis points tighter than July.</p> <p>Credit spreads indicate the credit risk perceived by market participants/investors, and can provide a "real time" take on sectors or issuers. Tighter spreads indicate less risk relative to Treasuries, and wider spreads indicate more risk.</p>	<p>Municipal bonds as represented by the Bloomberg Municipal Index returned -2.19% in August.</p> <p>Tax-exempt yields rose across the curve in August, and the curve flattened. Factors were the inverted U.S. Treasury curve and an overhang of short-term notes from July.</p> <p>Modest spread widening allowed higher-quality sectors to outperform lower-quality issues.</p>

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