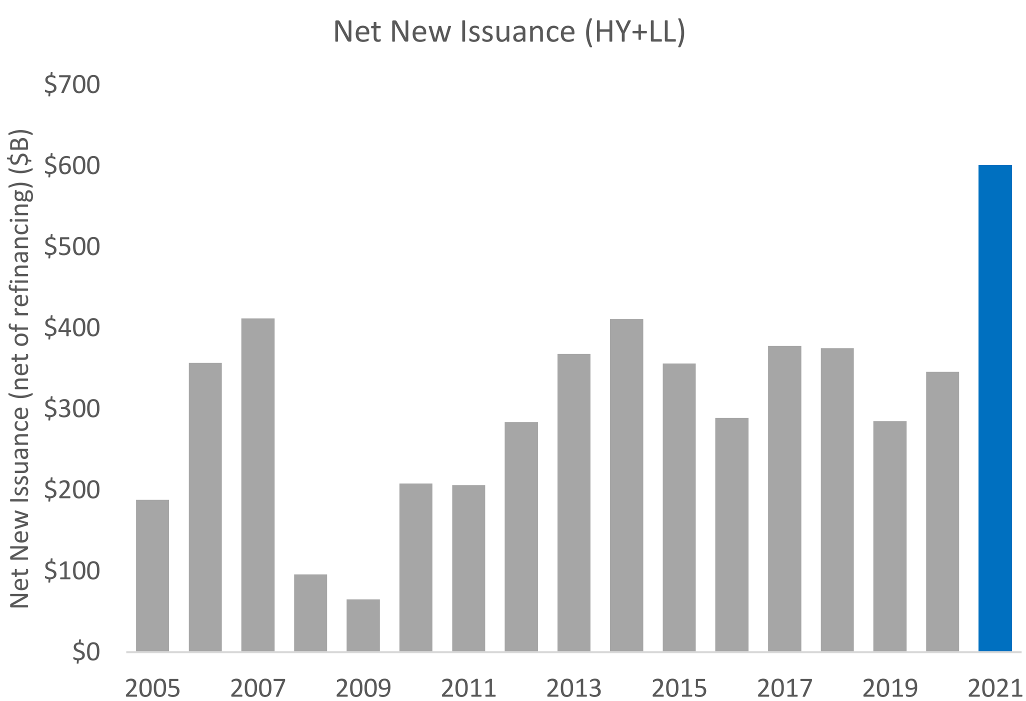
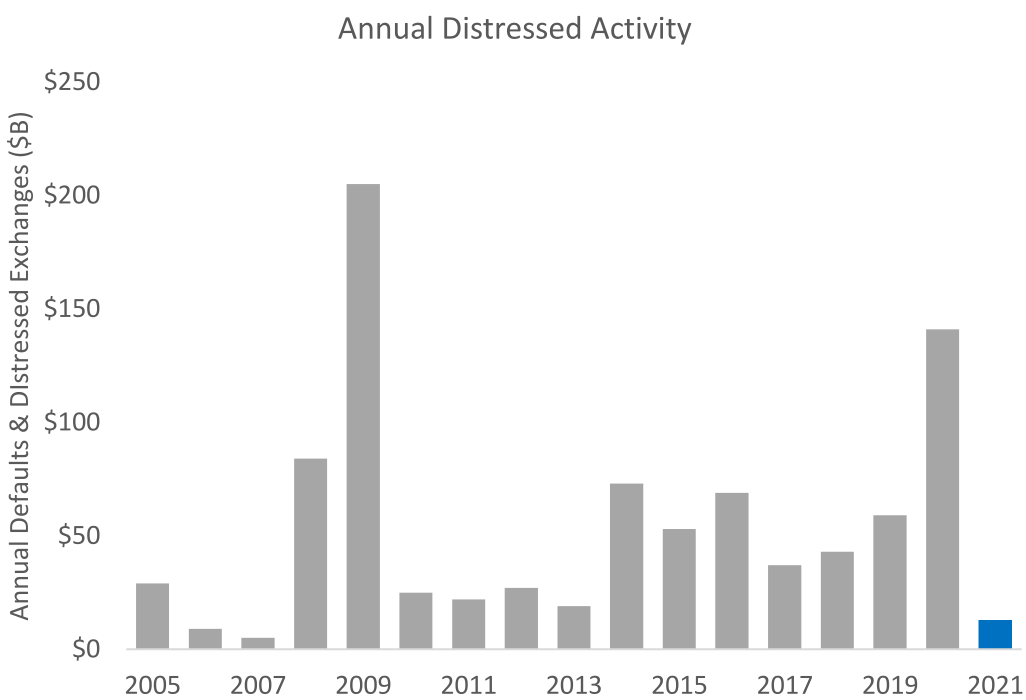
PUBLIC CREDIT

High Yield markets returned 0.7 percent but saw a “tale of two quarters.” Hawkish comments from Chair Powell led to weak October and November returns, but this was completely recouped in December, the strongest one-month gain of the year at 2.0 percent, as the Fed moderated their hawkish tone and evidence emerged of Omicron’s weakened severity. However, in a reversal of previous quarters, it was higher quality bonds within high yield that outperformed. Leveraged loans saw a positive return for the quarter, delivering a 0.8 percent return. Most other areas of the credit markets were weaker, as converts declined 0.4 percent, and structured markets including CMBS, MBS, and ABS finished lower by 0.6 percent, 0.4 percent, and 0.6 percent, respectively. The one structured credit market segment that continued to see strong demand was RMBS, given the supportive residential housing market dynamics.

Issuance moderated during the quarter, to some extent as expected given the holiday seasonality, but issuance has been on a steady decline from record levels set in Q2. Leveraged loans saw moderate issuance during the quarter, with volume reaching its lowest level for 2021 during December. However, for the full year, bonds and loans still surpassed previous calendar year records for net (of refi) issuance.



While markets were characterized by elevated volatility during the quarter, which may have led to some moderation of issuance, in general the capital markets remain wide open for issuers, likely leading to a continuation of limited distressed opportunities. Given the availability of new capital, defaults have reached multi-decade lows, and 2021 as a whole saw the lightest calendar year of defaults since 2007.



Q4 distressed activity was no different, accounting for only $2.5 billion of the $13 billion total for 2021. This level of activity brings default rates at year-end to just 0.3 percent for high yield (a record) and 0.7 percent for leveraged loans. Given the strong growth backdrop and refinanced balance sheets (and given the amount of issuance), it's likely default rates will remain well below average for several more years. But if the Fed is forced to hike rates more quickly than expected, the growth backdrop subsides, and companies face much higher debt servicing costs, a proper distressed environment for the weakest balance sheets may emerge more quickly than expected.