Leveraged Finance Asset Allocation Insights

PineBridge® INVESTMENTS

1Q **2024**

Bank Loans Have the Edge Over High Yield

The US economic outlook appears more promising than most had expected a year ago, with a resilient consumer, tight labor market, and moderating inflation bolstering conditions. Issuer fundamentals remain solid, but we expect some deterioration as the lagged effects of restrictive monetary policy take hold. The narrative from the late-January Federal Reserve meeting led investors to anticipate an initial rate cut in mid-2024. Despite the upward surprise in January's CPI reading, the broader downward trend is still intact, as core goods dipped into year-on-year deflation for the first time since 2020. With the January number held up by only a few sticky services components, inflation is still expected to trend toward 2% by the end of the year.

The picture outside the US looks weaker. Europe stagnated at the end of 2023, avoiding a recession by the slimmest of margins as stronger growth in Italy and Spain offset a downturn in Germany. In China, despite accelerating fiscal support, a 50-basis-point (bp) cut in reserve ratio requirements, and a substantial equity market rescue package, the chronic declines in stock values and property prices attest to more dominant forces at work. Real rates in China are too high and keep rising as deflation outpaces policy rate cuts.

Credit spreads continue to grind tighter despite the pullback in Treasuries as the market adjusts to more realistic expectations about the timing and magnitude of Fed easing. Strong technical demand for yield is easily absorbing any supply, and valuations are tight by most historical measures, particularly in the fixed rate portions of credit markets. We view some parts of the credit curve as more fairly priced and see idiosyncratic opportunities at the issuer level in all markets; however, broad beta is trading through fair value despite expectations for a stable economic environment.

The fundamental outlook calls for an extension of the current cycle, and we see signs that more cyclical industrial segments may have bottomed. We are still in earnings season and do not yet see a clear trend with respect to concerns about near-term declines. Overall, spreads are unlikely to rally further from here and could potentially normalize wider, though the timing and catalysts for such normalization remain highly uncertain.

In the meantime, the relative value opportunity has shifted toward areas of the market that have not rallied as strongly, including geographies outside the US. Spreads on floating-rate fixed income segments are generally cheap relative to fixed-rate segments (see chart), although we are finding attractive total return opportunities at the issuer level in both markets and do not favor underweight positioning with respect to overall duration, given the backup in Treasury yields. We had favored neutralizing the high yield underweight for the past few months, but the sharp rally now calls for a reversal of that trend. Absent a massive Treasury rally, bank loans are likely to outperform high yield. In CLOs, we favor positioning higher in the capital stack overall but see select opportunities at the BBB level in US portfolios, and we continue to seek compelling entry points lower in the capital stack in both the US and Europe.

About This Report

This is a quarterly publication which encapsulates insights of PineBridge Investments' Leveraged Finance Team. Our global team of investment professionals convenes in a live forum to evaluate, debate and establish top-down guidance for the leveraged finance investment universe. Using our independent analysis and research, driven by our Fundamentals, Valuations and Technicals framework, we assess the pulse of high yield, leveraged loans and CLOs.

Contributors:

Steven Oh, CFA
Global Head of Credit and Fixed Income and Head of Leveraged Finance

John Yovanovic, CFA
Head of High Yield Portfolio Management

Kevin Wolfson
Portfolio Manager, US Leveraged Loans

Laila Kollmorgen, CFA
Portfolio Manager, CLO Tranche

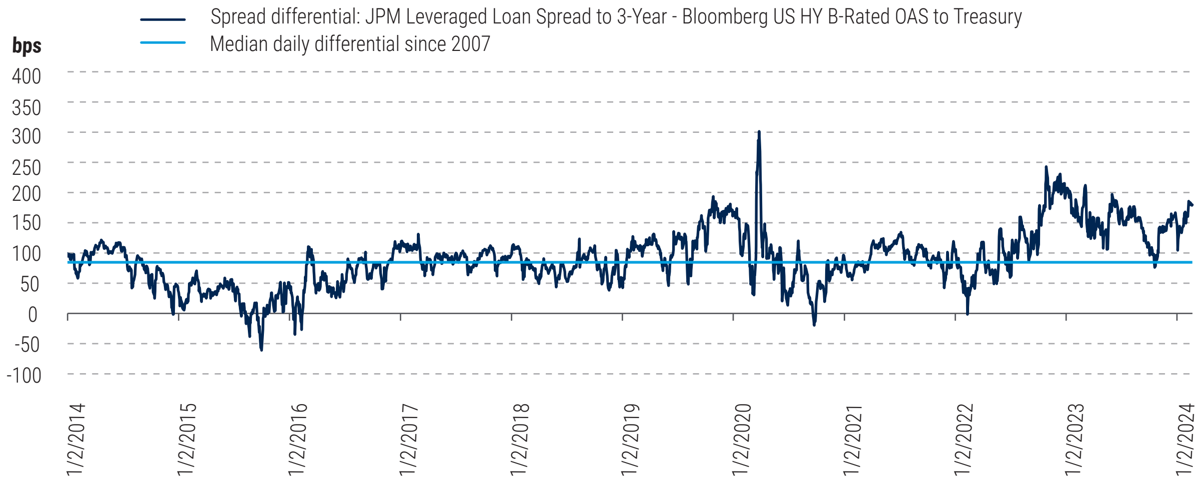
Andrew Karlsberg, CFA
Portfolio Risk Manager and Investment Strategist, Leveraged Finance

Jonathan Kramer, CFA
Fixed Income Product Specialist, Leveraged Finance

Evan Burke
Assistant Portfolio Manager, US Leveraged Loans

Current Spread Differentials Give the Edge to Loans Over High Yield

The spread differential between single-B loans and single-B high yield bonds is currently 180 bps, compared with a longer-term median of 85 bps.



Source: JP Morgan and Bloomberg as of 21 February 2024.

Key Data

		Spread (bps)				Yield (%)			
		Current	3-year median	5-year median	10-year median	Current	3-year median	5-year median	10-year median
High yield	Index	319	376	386	390	7.89	7.81	6.20	6.22
	BB	197	252	253	260	6.63	6.48	4.79	4.78
	B	291	385	391	392	7.66	7.94	6.35	6.24
	CCC	799	817	822	745	12.68	12.59	10.81	10.10
Leveraged loans	Index	495	504	483	458	9.00	8.47	6.09	5.90
	BB	315	324	321	326	7.19	6.78	4.59	4.96
	B	478	503	474	464	8.78	8.36	6.05	5.92
	CCC	1210	1291	1294	1210	16.84	16.65	16.14	13.46
CLOs	Index	289	269	258	252	7.21	6.12	4.01	4.17
	AAA	144	161	137	147	5.93	5.14	3.01	3.00
	AA	203	224	195	209	6.26	5.81	3.63	3.88
	A	258	290	264	285	6.72	6.35	4.34	4.83
	BBB	400	443	402	410	8.16	7.85	5.69	6.04
	BB	825	869	814	707	12.51	12.18	9.85	8.93
	B	1328	1308	1203	998	17.75	16.69	14.29	11.70

Source: Bloomberg as of 14 February 2024. High yield represented by the Bloomberg US Corporate High Yield Index, spread is OAS and yield is yield-to-worst. Leveraged loans represented by the Credit Suisse Leveraged Loan Index, spread is discount margin 3-year and yield is yield-to-maturity. CLO represented by the JPM Post-Crisis CLOIE, spread is discount margin to worst and yield is yield-to-worst.

High Yield Bonds

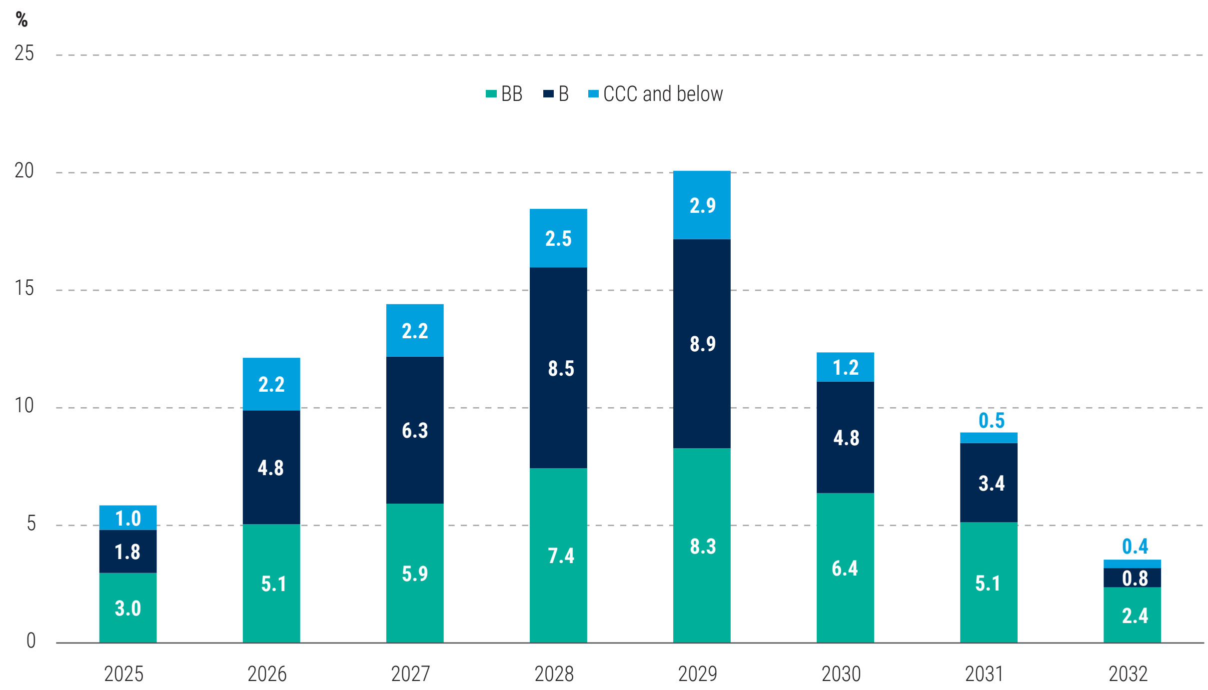
High yield credit spreads are fair, but higher all-in yields remain attractive relative to historical levels. The market has generally priced in our anticipated increase in default rates to 3%, and the resilient macro outlook continues to support our "modest increase/no spike" default outlook. Fundamental indicators suggest a solid employment picture, rising but still low consumer credit stress, and normalization of supply chains. Strength in issuer credit metrics appears to have peaked, but from a high starting level. Public earnings estimates for 2024 indicate that the first quarter will be the earnings trough, with moderate sequential improvement from there.

Much of the issuer base refinanced debt maturities when spreads and Treasury rates were trading much lower, which has resulted in a maturity wall that is further out, in 2028-2029 (see chart below). We believe we're entering a multi-year process of repricing capital structures higher into a decent macro economy, which will result only in a range of pricing outcomes for higher-quality issuers but could lead to defaults in lower-quality issuers. We are most wary of the distressed segments of retail, pharmaceuticals, healthcare, wirelines, and media/entertainment, and we expect defaults to be concentrated in these areas. We continue to find attractive idiosyncratic opportunities within finance, cable and satellite, technology, and supermarket names.

From a credit rating standpoint, we favor being underweight the most interest-rate-sensitive BB rating tier, overweight single-B credits, and remain highly selective among credits rated CCC and below. While we acknowledge that aggressive central bank actions will create a more challenging environment for issuers generally, we believe investors can mitigate that risk by avoiding or minimizing exposure to the lowest-quality segments of the high yield market. Against the current macro and credit backdrop, we believe defaults will remain rare for higher-rated high yield debt. With its compelling yields, the upper portion of the high yield market – BB and B rated bonds – is a sweet spot for investors. Valuations, with index level spreads at 300-350, are toward the tighter end of our fair valuation range. Spreads have tightened materially since October 2023, with all-in yields close to 8% and option-adjusted spread duration of 3.3 – very low versus other fixed income asset classes (see table above). That said, we believe that high yield is well positioned for mid- to high-single-digit total returns over the next few years.

A High Yield Maturity Wall Is Several Years Away

Percent of Bloomberg US Corporate High Yield Index maturing by calendar year



Source: Bloomberg as of 21 February 2024.

Leveraged Loans

The outlook for the leveraged loan market overall looks benign over the next six to 12 months, albeit with elevated performance dispersion for lower-quality borrowers, while all-in yields remain at attractive levels. The fourth-quarter 2023 earnings season is underway, and while we are seeing increased volatility in results, issuers in general continue to post positive top- and bottom-line gains. Leverage has held steady over the past few quarters, while fixed-charge coverage ratios and free cash flow have declined as a result of elevated interest burdens.

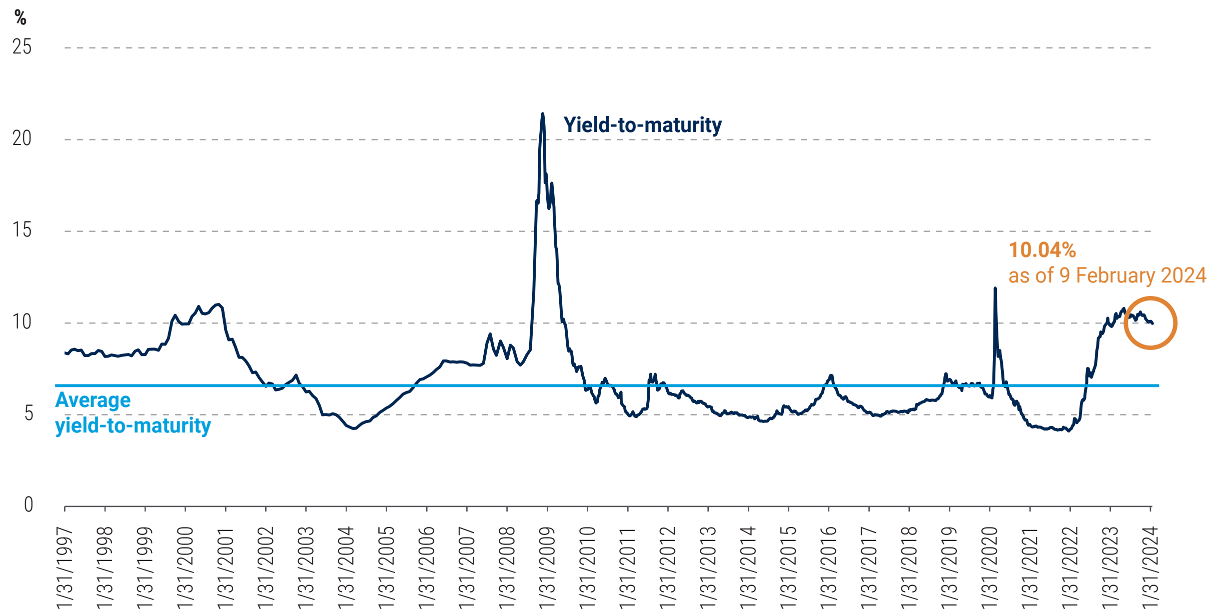
We expect the default rate (by par amount outstanding) to reach the 3% area, slightly above the historical average, with new filings and distressed exchanges primarily concentrated among loans rated B- and below. Technicals should be supportive of loan prices over the next several quarters due to both healthy CLO issuance (the largest source of demand for leveraged loans) and limited net loan supply. The robust pace of CLO issuance to start the year appears likely to persist for now and could outstrip net loan supply unless we see a meaningful increase in M&A and leveraged buyouts, which remain suppressed amid elevated financing costs.

We believe bottom-up credit selection based on a credit research-intensive process will be the primary source of alpha in the loan market in the current environment. From a ratings perspective, single-B loans offer more value on a risk-adjusted basis relative to BB loans. Our positioning is skewed toward the B-flat and B+ rating segments. We favor being underweight loans rated below B- in the current macro environment, in part because elevated interest burdens continue to strain overleveraged capital structures. Sectors that warrant additional scrutiny include media and healthcare, where defaults have been the highest over the past 12 months. We are also vigilant on software and services, where we see pockets of risk following greater LBO issuance in recent years. We are positive on consumer services, including hotels and casinos, which continue to benefit from resilient consumer spending.

While high interest rates are a headwind for leveraged loan issuers, they are a positive for investors. All-in yields in the 9%-10% range for the asset class (see chart) are several points above the historical average, even as the rally for loans has tightened discount margins and repricing activity has pressured nominal spreads since the start of the year. In addition, markets have priced out roughly three rate cuts since the beginning of the year in response to solid economic data and hawkish commentary from Fed officials. If the current forward curve holds, short-term rates will remain north of 4% by year-end and keep loan yields at attractive levels on a historical basis.

Leveraged Loan Yields Are Above Historical Averages

Morningstar LSTA US Leveraged Loan Index yield to maturity



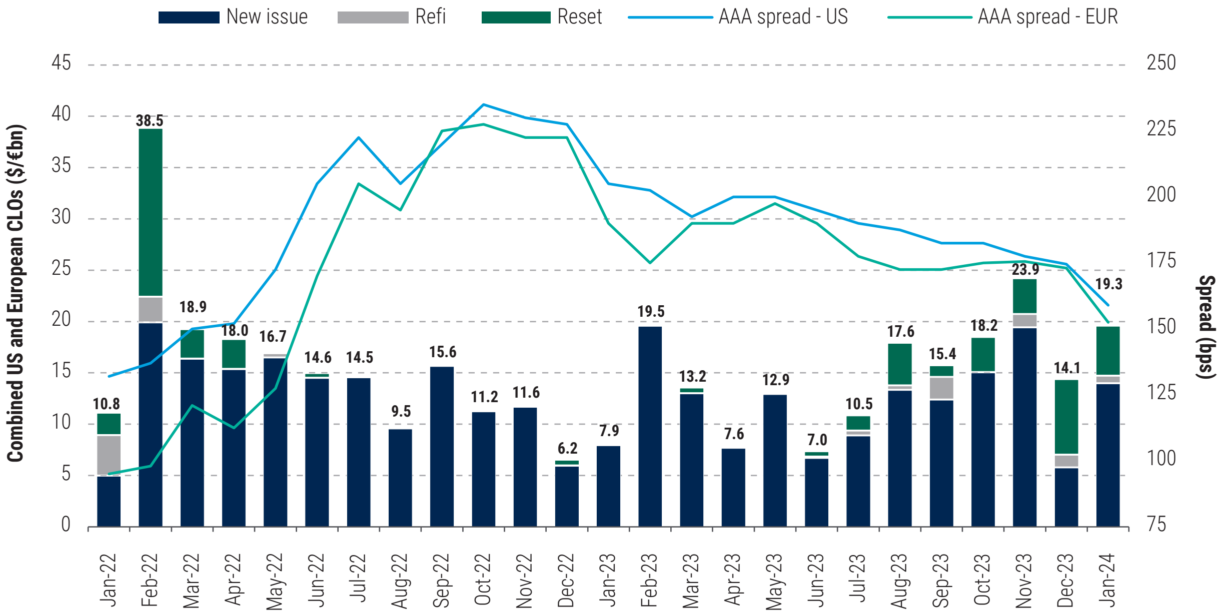
Source: Pitchbook/LCD as of 16 February 2024.

CLOs

CLO new issuance has picked up significantly in the last few months as managers looked to take advantage of tightening liability spreads. This trend may continue in the near term given that current AAA spreads are at the tightest levels since early 2022, though the current pace may be unsustainable given the lack of net new loan issuance, unless M&A and LBO activity picks up. Despite the higher-than-expected supply, CLOs continue to see strong demand given high all-in yields, which we expect to remain at attractive levels given more muted rate-cut expectations. We have also seen elevated refinancing and reset activity in recent months as portfolios constructed with purchases in the secondary market took advantage of the rally in the loan market and tighter CLO spreads.

Tightening Liability Spreads Have Led to Robust YTD CLO Issuance

US and European CLO issuance ($/€bn) and spreads (bps)



Sources: As of 31 January 2024. CLO issuance data from Finsight, OpenFIGI, LCD, Barclays. Spread data from JPMorgan.

Should the loan and CLO markets continue to rally, we would expect to see more portfolios benefit from the significant redemption optionality in CLOs. However, given current dispersion in the loan market, certain CLO portfolios holding weaker credits may eventually experience impairments to the lowest-rated debt tranches, even if the majority of the loan market continues to rally. As a result, we believe CLO vintage, portfolio, and manager selection remain key.

We anticipate CLO spreads to trade in a range for the next three to six months and view spreads and yields as attractive under most market scenarios over the next 12 months. We also expect the technical backdrop to remain supportive. Notwithstanding the deluge of new issuance to start the year, we expect issuance to be somewhat lower than in the past few years, which should limit the potential for extreme spread widening in the near term.

Given tighter valuations and risks tilted to the downside, we favor positioning higher in the capital stack overall. However, we have seen select opportunities at the BBB level in US portfolios and continue to look for attractive entry points lower in the capital stack in both the US and Europe. Should the backdrop begin to improve within the next six months, as we currently expect, we would favor shifting lower in the cap stack and looking to add below-investment-grade classes to portfolios. In addition, while portfolios in Europe continue to look stronger than in the US, the value proposition for newer-issue deals has begun to shift back toward the US given the significant spread tightening in European CLOs.

About PineBridge Investments

PineBridge Investments is a private, global asset manager focused on active, high-conviction investing. We draw on the collective power of our experts in each discipline, market, and region of the world through an open culture of collaboration designed to identify the best ideas. Our mission is to exceed clients' expectations on every level, every day. As of 31 December 2023, the firm managed US$157.1 billion across global asset classes for sophisticated investors around the world.

pinebridge.com

MULTI-ASSET | FIXED INCOME | EQUITIES | ALTERNATIVES

Investing involves risk, including possible loss of principal. The information presented herein is for illustrative purposes only and should not be considered reflective of any particular security, strategy, or investment product. It represents a general assessment of the markets at a specific time and is not a guarantee of future performance results or market movement. This material does not constitute investment, financial, legal, tax, or other advice; investment research or a product of any research department; an offer to sell, or the solicitation of an offer to purchase any security or interest in a fund; or a recommendation for any investment product or strategy. PineBridge Investments is not soliciting or recommending any action based on information in this document. Any opinions, projections, or forward-looking statements expressed herein are solely those of the author, may differ from the views or opinions expressed by other areas of PineBridge Investments, and are only for general informational purposes as of the date indicated. Views may be based on third-party data that has not been independently verified. PineBridge Investments does not approve of or endorse any republication of this material. You are solely responsible for deciding whether any investment product or strategy is appropriate for you based upon your investment goals, financial situation and tolerance for risk.

Disclosure Statement

PineBridge Investments is a group of international companies that provides investment advice and markets asset management products and services to clients around the world. PineBridge Investments is a registered trademark proprietary to PineBridge Investments IP Holding Company Limited.

Readership: This document is intended solely for the addressee(s) and may not be redistributed without the prior permission of PineBridge Investments. Its content may be confidential, proprietary, and/or trade secret information. PineBridge Investments and its subsidiaries are not responsible for any unlawful distribution of this document to any third parties, in whole or in part.

Opinions: Any opinions expressed in this document represent the views of the manager, are valid only as of the date indicated, and are subject to change without notice. There can be no guarantee that any of the opinions expressed in this document or any underlying position will be maintained at the time of this presentation or thereafter. We are not soliciting or recommending any action based on this material.

Risk Warning: All investments involve risk, including possible loss of principal. If applicable, the offering document should be read for further details including the risk factors. Our investment management services relate to a variety of investments, each of which can fluctuate in value. The investment risks vary between different types of instruments. In making an investment decision, prospective investors must rely on their own examination of the merits and risks involved.

Performance Notes: Past performance is not indicative of future results. There can be no assurance that any investment objective will be met. No investment strategy or risk management technique can guarantee returns or eliminate risk in any market environment. PineBridge Investments often uses benchmarks for the purpose of comparison of results. Benchmarks are used for illustrative purposes only, and any such references should not be understood to mean there would necessarily be a correlation between investment returns of any investment and any benchmark. Any referenced benchmark does not reflect fees and expenses associated with the active management of an investment. PineBridge Investments may, from time to time, show the efficacy of its strategies or communicate general industry views via modeling. Such methods are intended to show only an expected range of possible investment outcomes, and should not be viewed as a guide to future performance. There is no assurance that any returns can be achieved, that the strategy will be successful or profitable for any investor, or that any industry views will come to pass. Actual investors may experience different results.

Information is unaudited unless otherwise indicated, and any information from third-party sources is believed to be reliable, but PineBridge Investments cannot guarantee its accuracy or completeness. All information is sourced from PineBridge Investments unless otherwise noted.

This document and the information contained herein does not constitute and is not intended to constitute an offer of securities or provision of financial advice and accordingly should not be construed as such.

The securities and any other products or services referenced in this document may not be licensed in all jurisdictions, and unless otherwise indicated, no regulator or government authority has reviewed this document or the merits of the products and services referenced herein. This document and the information contained herein has been made available in accordance with the restrictions and/or limitations implemented by any applicable laws and regulations. This document is directed at and intended for institutional and qualified investors (as such term is defined in each jurisdiction in which the security is marketed). Before acting on any information in this document, prospective investors should inform themselves of and observe all applicable laws, rules and regulations of any relevant jurisdictions and obtain independent advice if required.

Where applicable, the Manager may determine to terminate any arrangements made for marketing the Shares in one or more jurisdictions in accordance with the AIFM Directive and UCITS Directive respectively, as may be amended from time to time. Investors and potential investors can obtain a summary of investor rights and information on access to collective redress mechanisms at www.pinebridge.com/investorrights.

Certain Geographic Disclosures:

Australia: PineBridge Investments LLC is exempt from the requirement to hold an Australian financial services license under the Corporations Act 2001 (Cth) in respect of the financial services it provides to wholesale clients, and is not licensed to provide financial services to individual investors or retail clients. Nothing herein constitutes an offer or solicitation to anyone in or outside Australia where such offer or solicitation is not authorised or to whom it is unlawful. This information is not directed to any person to whom its publication or availability is restricted.

Bermuda: PineBridge Investments Asia Limited is registered as a Class A Registered Person with the Bermuda Monetary Authority pursuant to the Investment Business Act 2003 (as amended).

Hong Kong: The issuer of this document is PineBridge Investments Asia Limited, a company incorporated in Bermuda with limited liability, licensed and regulated by the Securities and Futures Commission (SFC). This document has not been reviewed by the SFC.

Malaysia: PineBridge Investments Malaysia Sdn Bhd is licensed and regulated by Securities Commission of Malaysia (SC). This material is not reviewed or endorsed by the SC.

Singapore: PineBridge Investments Singapore Limited is licensed and regulated by the Monetary Authority of Singapore (MAS). In Singapore, this material may not be suitable to a retail investor. This advertisement or publication has not been reviewed by the MAS.

Taiwan: PineBridge Investments Management Taiwan Ltd. Is licensed and regulated by Securities and Futures Bureau of Taiwan (SFB). In Taiwan, this material may not be suitable to investors and is not reviewed or endorsed by the SFB.

Last updated 7 February 2024. For additional legal and regulatory disclosures including other cross border information, please refer to https://www.pinebridge.com/en/regulatory-disclosure.