Investment Grade Market Update

Newfleet ASSET MANAGEMENT
A Virtus Investment Partner

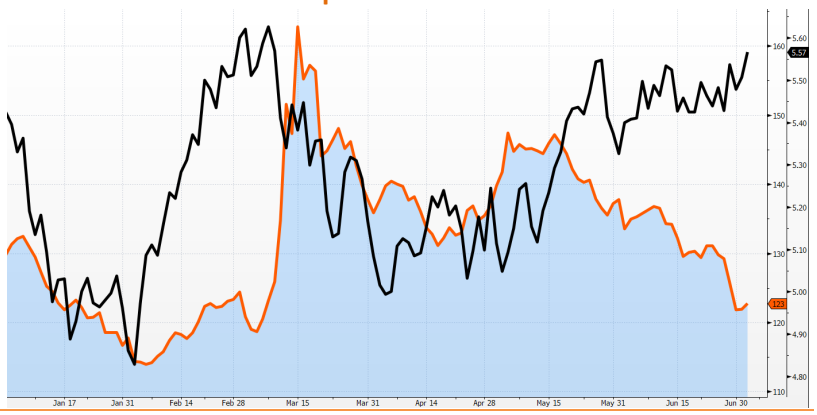
JUNE 2023: OUTLOOK AND IMPLEMENTATION

We were firmly in the consensus last month in noting a technical outlook favorable enough to push spreads tighter, but the speed of this rally has been a surprise. Spreads were sideways through the first week of June as the market absorbed $50 billion of issuance. Once issuance slowed ($12 billion per week average from there), we were off to the races, rallying 15 bps from June 9 to June 30. Spreads are now directly atop their 5-and-10-year averages, which feels tight considering the number of models calling for a 2024 recession. Yet with fundamentals stable and not much to change the technical strength, we would expect this rally to persist into July.

	June - 2023	YTD
Total Returns	0.41%	3.21%
Excess Returns	1.22%	1.56%
Yield Δ	0.11%	0.06%
Spread Δ	-15	-8
Price Δ	+$0.09	+$1.58

Source: Bloomberg U.S. Corporate Investment Grade Bond Index
Past performance is not indicative of future results.

YTD: **Spreads** and **Yields**



Fundamentals – Earnings estimates for the second quarter imply a 7% decline for the S&P 500 constituents – the third consecutive quarter of (likely) earnings declines. These estimates have been stabilizing at these levels and the market expects more flat results in the third quarter, followed by robust growth in the fourth quarter.

In June, the Fed stress tests were released, with all 23 banks tested receiving passing grades. This is another hurdle cleared for the beleaguered industry. Emergency borrowings from the Fed have been stable. Money market inflows have reverted. These are all encouraging signs that stress on regional banks is abating. Commercial real estate exposure remains in focus with less positive news there (see ratings).

Ratings Changes

Steel Dynamics: Both agencies upgraded the mini-mill steel producer from low to mid-BBB ratings in June as key metrics have been above agency thresholds for a multi-year period.

Office REITS: Hudson Pacific Properties ($1.65B outstanding bonds) and Brandywine Realty Trust ($1.5B) were both downgraded by S&P from BBB- to BB+ due to continued weakness in office properties as lease expirations are set to increase.

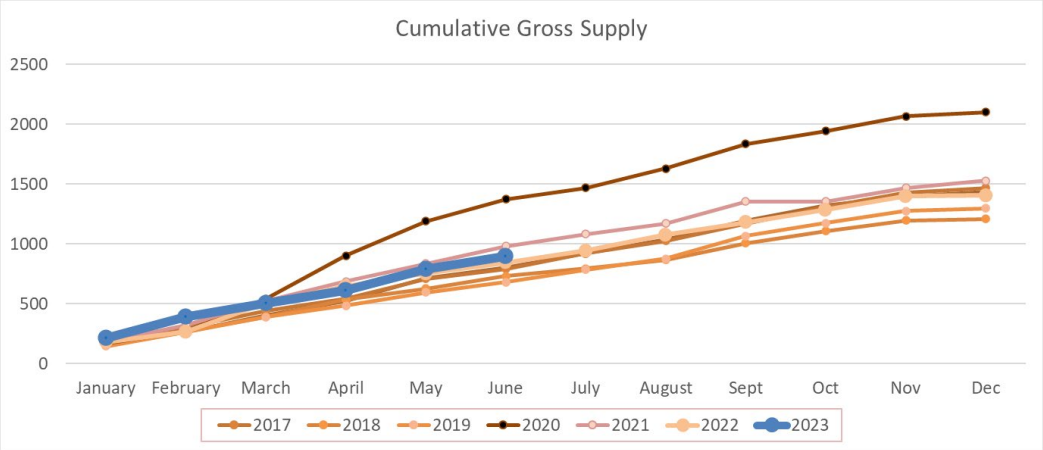
Credit metrics have plateaued at pre-COVID levels, with leverage and interest coverage deteriorating slightly on a sequential basis. Encouragingly, the shareholder payout ratio declined, and the riskiest cohort of high-quality borrowers remained on a positive ratings trajectory. BBB-rated issuers, the lowest tier of investment grade bonds, have declined from 14% of the index to 11.5% over the past 24 months.

Investment Grade Market Update

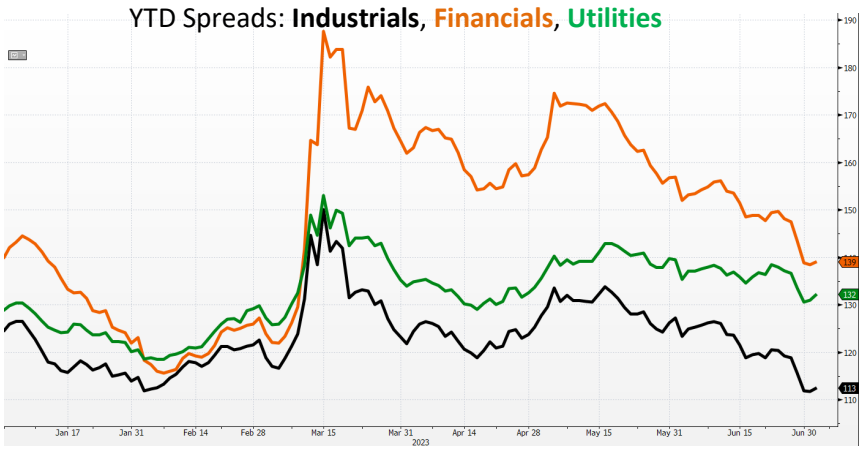
June Supply	
Top Issuers	Size (in MM)
Nasdaq	$4,250
US Bancorp	3500
Capital One	$3,500
PNC	$3,500
Truist	$3,250
60 Others	$71,545
Total Issuance	$89,545

Technicals – The supply numbers themselves did not tell much of a story in June as they were firmly average ($90 billion gross), but what the supply contained was notable. All three super regional banks tapped the market in June after being shut out in the post-Silicon Valley Bank failure. Those deals were well received and mark an important step towards normalization for the financial industry.

Investment grade funds are currently in the midst of a 14-week streak of inflows even as total returns have been disappointing with rates higher. Higher yields continue to attract funds from institutional buyers like pension funds and insurance companies. Forecasts call for a seasonally appropriate July/August, which means supply will remain light for the upcoming weeks.



Valuations – Spreads tightened 15 bps during the month to 122 bps. This is equal to both the 5- and 10-year averages. Meanwhile, yields pushed higher despite the spread rally, ending the month near the YTD highs at 5.5%. Financials continue to claw back performance relative to industrials, with the relationship another 4 bps tighter during June. They remain relatively wide in a historical context, and we view this as an attractive trade to lean into. Utility underperformance also warrants a higher allocation, in our view.



Performance					
Top Industries	Spread	Spread Δ	Bottom Industries	Spread	Spread Δ
Airlines	148	(47)	Independent Energy	163	(5)
Office REITS	259	(45)	Retailers	83	(9)
Finance Companies	204	(35)	Electric Utilities	132	(9)
Gaming	193	(34)	Consumer Products	74	(10)
Media	145	(24)	Construction Mach	46	(10)

Newfleet Asset Management
One Financial Plaza
Hartford, Connecticut 06103
877-332-8172

Past performance is not indicative of future results.

*At S&P, a fallen angel is when a credit is downgraded from Investment Grade (BBB- or higher) to High Yield (BB+ or lower). A rising star is when a credit is upgraded from High Yield (BB+ or lower) to Investment Grade (BBB- or higher). At Moody's, a fallen angel is when a credit is downgraded from Investment Grade (Baa3 or higher) to High Yield (Ba1 or lower). A rising star is when a credit is upgraded from High Yield (Ba1 or lower) to Investment Grade (Baa3 or higher).

The Bloomberg U.S. Aggregate Bond Index is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS, and CMBS. The index is unmanaged, its returns do not reflect any fees, expenses, or sales charges, and is not available for direct investment. **The Bloomberg U.S. Corporate Bond Index** is a component of the U.S. Aggregate Bond Index. It measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by US and non-US industrial, utility, and financial issuers.

Newfleet Asset Management's industry trends and observations are the result of research conducted by the portfolio management / research team. These observations reflect their industry expertise and have been prepared using sources of information generally believed to be reliable; however, their accuracy is not guaranteed. Opinions represented are subject to change and should not be considered investment advice.

Investing is subject to risk, including the risk of possible loss of principal.

AR 2990113 7/2023

For Institutional Investor Use