OCTOBER 2023

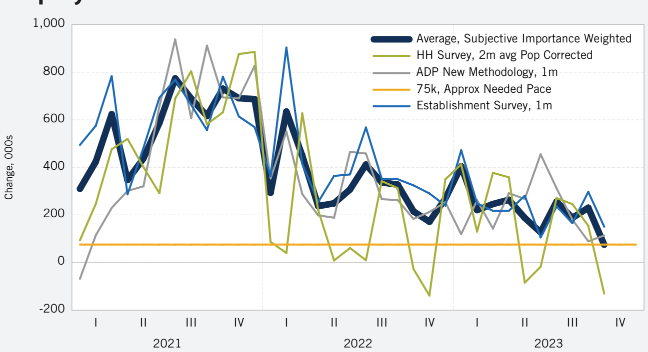
Spotlight on Global Credit

Newfleet
ASSET MANAGEMENT
A Virtus Investment Partner

MACRO VIEWS

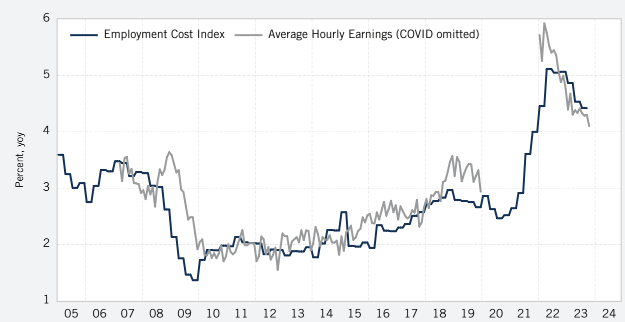
- The employment report for October showed a softening in job growth which had previously looked "too strong" in the context of the current inflationary environment. The establishment report showed a more moderate pace of 150k along with just over 100k of downward revisions to the prior two months. 150k remains well above our estimates of the pace of employment growth that would stabilize the unemployment rate over time. That said, relatively strong labor force participation (LFP), especially female LFP, might be allowing more rapid employment growth than our baseline, something we're watching closely.
- The report also showed unemployment rates continuing to creep higher over the course of the year, with both the standard u3 and broad u6 rates now up noticeably on a 3-month moving average basis compared to late-22 and early-23. The total amount of increase so far has been manageable, but the potential for a more rapid—and more concerning—increase in unemployment remains live.
- The Employment Cost Index (ECI) didn't show as much moderation in October as 3Q's 4.3% pace increased from 4.1% in 2Q. Concern was attenuated somewhat by a relatively soft reading for average hourly earnings—under a 3% annual rate and a 3-month annualized pace of just over 3% through October.
- After a relentless move higher, yields gave back some of their increase around the employment report, government refunding, and softer Institute of Supply Management data. As shown below, that modestly eased financial conditions, though they are well tighter than earlier in the year. Going forward, we will watch to see if looser financial conditions engender any Federal Reserve (Fed) pushback, as tighter financial conditions were one of the reasons given for the more balanced tone at the November Federal Open Market Committee.

Employment Growth Continues to Trend Down



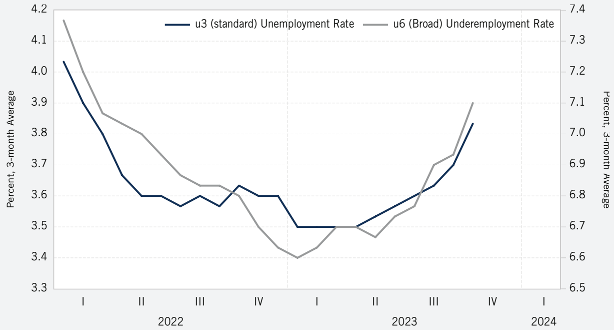
As of November 6, 2023. Source: Bureau of Labor Statistics, ADP, Haver Analytics and author's calculations.

ECI for Q3 Drops Only Modestly But AHE Continue to Trend Down



As of November 6, 2023. Source: Bureau of Labor Statistics, Haver Analytics and author's calculations.

Unemployment Drifting Higher, on Both Standard and Broad Metrics



As of November 6, 2023. Source: Bureau of Labor Statistics, Haver Analytics and author's calculations.

Financial Conditions Tightened Through October, But Have Given Back a Chunk

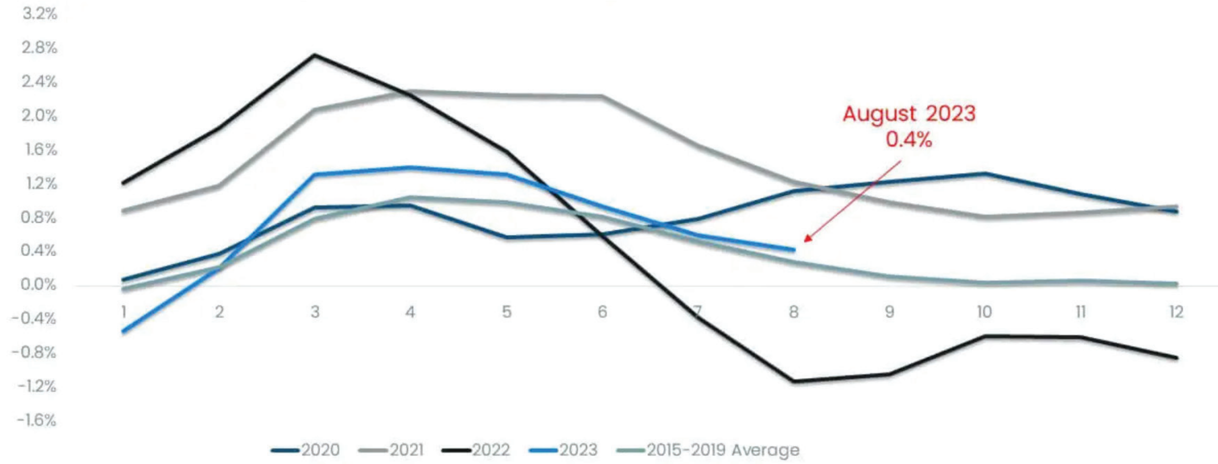
As of November 6, 2023. Source: Goldman Sachs and Bloomberg.

SECTOR UPDATES

Securitized Debt

- Though the securitized sector saw negative returns across the board due to rising rates and widening spreads, fundamentals within the housing and consumer sectors are still relatively solid. Within asset-backed securities, originators have scaled back production and tightened underwriting standards, which should translate into better consumer performance. Meanwhile, housing prices produced another positive month-over-month gain as limited supply keeps prices elevated. Given that consumer and housing fundamentals are still positive, we continue to run an overweight to both sectors.

August Month-Over-Month Average (2015-2019) was 0.3%, while August 2023 Month-Over-Month was 0.4%

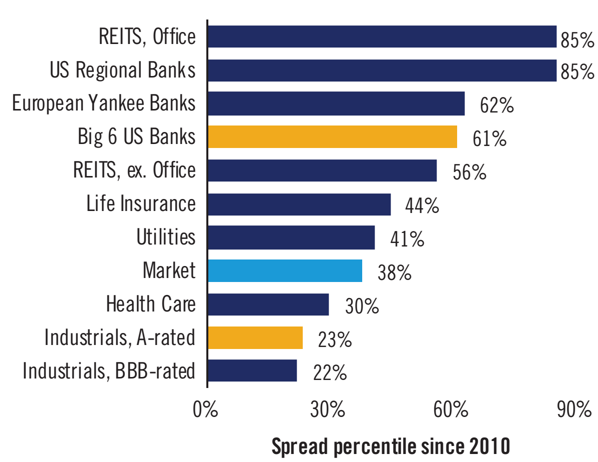


Source: CoreLogic S&P Case-Shiller Index, not seasonally adjusted. Data as of October 31, 2023.

Investment Grade Corporates

- Investment grade spreads widened for a third straight month, though performance was strong on a relative basis as other asset classes struggled. Total returns for the year squeaked into positive territory with rates on a downward trajectory by the end of the month (and into early November). Earnings were good enough to maintain metrics, while technicals were favorable as supply fell short of expectations. Financial industries continued to underperform and are back to their relative wides versus industrials.

Bank Spreads are Cheap Relative to History



Source: BofA Global Research, ICE Data Indices, LLC. Data as of October 31, 2023.

Municipal Bonds

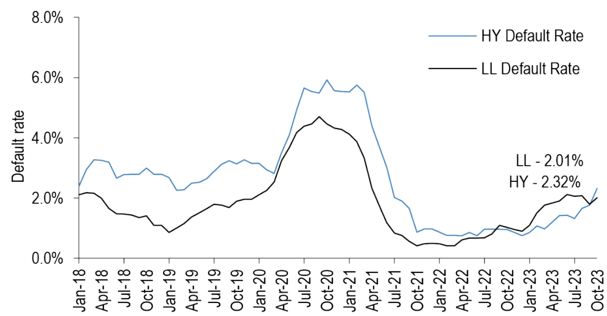
- Lipper reported combined weekly and monthly outflows of $8.7 billion for October. YTD outflows now total $14.4 billion.
- The Bloomberg Municipal Index posted a total return of -0.85% for the month. The high yield municipal index generated a monthly return of -1.6%. Year-to-date, municipals returned -2.22% while high yield munis returned -1.6%.
- For October, issuance was at $39 billion; year-to-date total issuance is $307 billion, down 7% year-over-year.

High Yield Corporate Bonds

- The high yield index posted -1.17% for the month, while the excess return was -0.93%. The Fed's commentary on interest rates, geopolitical volatility, mixed technicals, and some negative credit headlines stemming from third quarter earnings season were all drivers behind the negative return. Fundamentals also worsened for the month, with the default rate increasing through October to 2.32%, up from 1.76% in September. While distressed exchanges are helping to keep companies out of bankruptcy, distressed exchanges reduce recovery values.

For more on high yield bonds, read Newfleet's **High Yield Market Update**.

LTM Default Rate by Number of Issuers



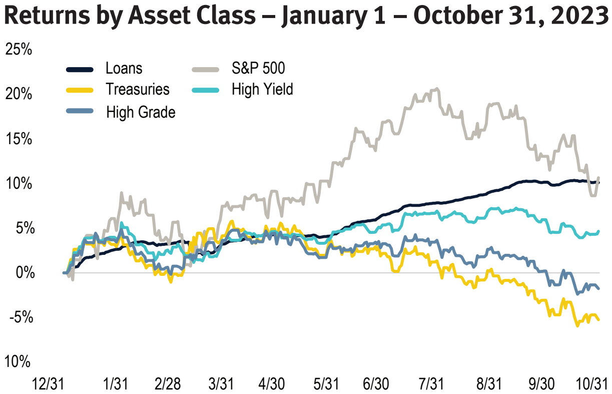
Source: JP Morgan; PitchBook Data; Bloomberg Finance LP; S&P/IHS Markit. Data as of October 31, 2023. Note: Excludes distressed exchanges.

Bank Loans

- October's risk-off tone resulted in loans posting a near-flat return. Loans priced at par or higher declined to 5%, down from as much as 25% in mid-September, and loan market prices were down -0.81% in October. However, the coupon generated 0.79% of return, allowing for outperformance compared with high yield, investment grade corporates, equities, and 10-year Treasuries. Even assuming a return to historical long-term default rates, lower principal recovery rates, and rate cuts, the current jumping-off yield appears adequate to result in a net positive outcome over the next twelve months.

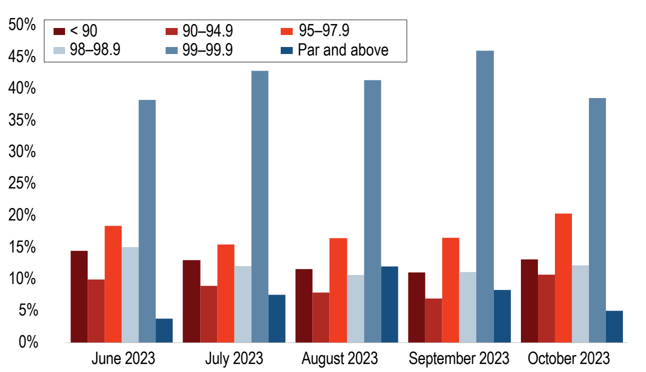
For more on bank loans, read Newfleet's **Bank Loan Market Update**.

Returns by Asset Class – January 1 – October 31, 2023



Source: Pitchbook LCD; Morningstar; S&P Dow Jones Indices. Data as of October 31, 2023 .

Share of Outstanding U.S. Leveraged Loans Priced 90 or Above

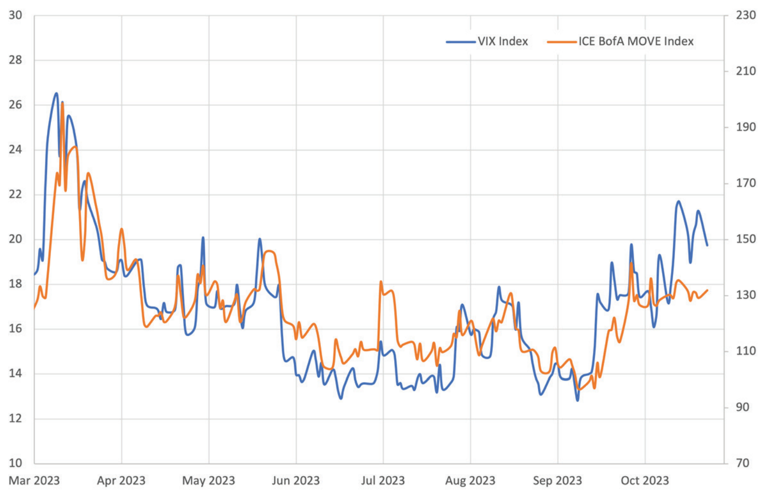


Source: Pitchbook LCD; Morningstar LSTA US Leveraged Loan Index. Data as of October 31, 2023.

Developed Markets

- October saw the Fed, the European Central Bank (ECB) and the Bank of England (BoE) all hold policy steady. Market pricing for Fed Funds held broadly stable, but, reflecting weaker data, markets increased expectations for rate cuts from the ECB and BoE in 2024.
- Conversely, the Bank of Japan removed its upper limit of 1% for 10-year Japanese Government Bond yields as it raised its inflation forecasts for the next three years.
- 10-year U.S. Treasuries ended the month at 4.93%, while 10-year German bunds and UK gilts ended at 2.81% and 4.51%, respectively. All yield curves steepened.
- As shown below, the increase in equity volatility in the latter half of the month demonstrated a divergence from bond volatility trends, hinting at a potential risk transfer in credit and equity markets.

Divergence in Volatility



Source: Bloomberg LP; Newfleet Asset Management. Data as of October 31, 2023.

Emerging Markets Debt

- Emerging markets (EM) debt was down for the third consecutive month at -1.45%, bringing the year-to-date return below zero to -0.38%. EM investment grade bonds returned -2.05% for the month, while EM high yield returned -0.60%. Relative performance was mixed, with EM high yield outperforming U.S. high yield and U.S. investment grade outperforming EM investment grade.

SECTOR ALLOCATION AND STRATEGY

- We increased exposure slightly to agency MBS over the month.
- We continue to have higher allocations to U.S. Treasuries.
- We maintain below long-term historical average exposures to below-investment grade and emerging markets debt.

Positive
Constructive
Neutral
Cautious
Negative

	Structured				Municipals		Credit			Non-U.S.		
	ABS	MBS	RMBS	CMBS	TAX-EX	TAXABLE	IG CORP	HY CORP	BANK LOANS	EM HY	YANKEE GOV	NON USD
Fundamentals	Neutral	Neutral	Neutral	Negative	Neutral	Neutral	Constructive	Neutral	Cautious	Neutral	Neutral	Neutral
Technicals	Neutral	Neutral	Constructive	Positive	Cautious	Neutral	Constructive	Constructive	Positive	Constructive	Constructive	Neutral
Valuations	Constructive	Constructive	Neutral	Neutral	Neutral	Neutral	Neutral	Cautious	Neutral	Neutral	Cautious	Neutral

Newfleet's assessments of non-government spread sectors as of October 31, 2023. Assessments are determined by analyzing a sector's fundamental data, technical indicators, and relative valuations. Sectors (l to r): **Credit:** Investment Grade (IG) Corporate Bonds, High Yield (HY) Corporate Bonds, Bank Loans. **Securitized Product:** Asset-Backed Securities (ABS), Agency Mortgage-Backed Securities (MBS), Non-Agency Residential MBS (RMBS), Non-Agency Commercial MBS (CMBS). **Non-U.S.:** Emerging Markets HY, Yankee Government, Non-U.S. Dollar. **Municipals:** Tax-Exempt, Taxable.

CREDIT MARKET INDEXES

	Performance (%)				Analytics				
Index Name	MTD	QTD	YTD	12M	OAS (BPS)	YTW %	YTM %	Eff. Duration (YRS)	Spread Dur (YRS)
Bloomberg U.S. Aggregate Index	-1.58	-1.58	-2.77	0.36	57	5.65	5.65	6.04	5.93
Bloomberg Intermediate Aggregate Index	-0.98	-0.98	-1.28	1.23	53	5.59	5.59	4.59	4.49
Bloomberg U.S. Securitized Index	-1.97	-1.97	-3.98	-0.59	79	5.96	5.96	6.25	5.85
Bloomberg U.S. Aggregate Corporate Index	-1.87	-1.87	-1.86	2.77	129	6.35	6.35	6.56	6.65
ICE BofA U.S. Corporate & Government 1-5 Year Index	0.05	0.05	1.55	3.03	34	5.39	5.39	2.55	2.61
ICE BofA 3 Mo Libor	0.46	0.46	4.16	4.81	-	5.34	5.34	-	-
Bloomberg U.S. HY 2% Issuer Capped Index	-1.17	-1.17	4.63	6.23	439	9.51	9.53	3.55	3.61
ICE BofA 1-3Y BB U.S. Cash Pay High Yield Index	-0.14	-0.14	4.52	5.55	263	7.88	7.90	1.77	1.88
Credit Suisse Leveraged Loan Index	0.03	0.03	9.94	11.56	600	10.17	10.17	-0.08	2.63
JPM EMBI G D	-1.35	-1.35	0.39	8.36	320	8.07	8.08	6.17	6.16
JPM GBI EM G D	-0.53	-0.53	3.73	13.50	-	7.22	7.22	4.97	4.90
JPM CEMBI B D	-1.22	-1.22	2.12	9.18	334	8.42	8.44	3.97	4.19

Data as of October 31, 2023. Source: Bloomberg, Newfleet Asset Management. For illustrative purposes only. See disclosures at end of material for additional information.

Authored by:

Newfleet Asset Management

Newfleet leverages the knowledge and skill of a team of investment professionals with expertise in every sector of the bond market, including evolving, specialized, and out-of-favor sectors. The team employs active sector rotation and disciplined risk management to portfolio construction.

Bonds may offer a relatively stable level of income, although bond prices will fluctuate providing the potential for principal gain or loss. Intermediate-term, higher-quality bonds generally offer less risk than longer-term bonds and a lower rate of return. Generally, a portfolio's fixed income securities will decrease in value if interest rates rise and vice versa.

Bank loans may be unsecured or not fully collateralized, may be subject to restrictions on resale, may be less liquid, and may trade infrequently on the secondary market. Bank loans settle on a delayed basis; thus, sale proceeds may not be available to meet redemptions for a substantial period of time after the sale of the loan.

Emerging markets securities may be more volatile, or more greatly affected by negative conditions, than those of their counterparts in more established foreign markets. Such securities may also be subject to Sanctions Risk.

Bloomberg U.S. Aggregate Bond Index measures the U.S. investment grade fixed rate bond market. Bloomberg Municipal Bond Index is a market capitalization-weighted index that measures the long-term tax-exempt bond market. **Bloomberg U.S. Intermediate Aggregate Bond Index** measures securities in the intermediate maturity range of the U.S. investment grade fixed rate bond market. **Bloomberg U.S. Securitized Index** is a subset of the Bloomberg U.S. and includes mortgage-backed-securities (MBS), asset-backed securities (ABS), commercial mortgage-backed securities (CMBS) and covered assets. **Bloomberg U.S. Aggregate Corporate Index** is a broad-based benchmark that tracks the investment-grade, U.S. dollar-denominated, fixed-rate, taxable corporate bond market. The **CBOE Volatility Index**, known by its ticker symbol VIX, is a popular measure of the stock market's expectation of volatility implied by S&P 500 index options. **ICE BofA 1-5 Year U.S. Corporate & Government Index Government Index** tracks the performance of U.S. dollar-denominated investment grade debt publicly issued in the U.S. domestic market, including U.S. Treasury, U.S. agency, foreign government, supranational and corporate securities. **J.P. Morgan GBI-EMGD** tracks total returns for local currency debt instruments issued by emerging markets sovereign and quasisovereign entities to which international investors can gain exposure. **J.P. Morgan CEMBI Index** tracks U.S. dollar-denominated debt issued by emerging market corporations. **J.P. Morgan EMBI Global Index** tracks the total return for the U.S. dollar-denominated emerging markets debt, including Brady bonds, Eurobonds, and loans. The **U.S. 3-Month LIBOR Index** represents the performance of the 3 Month London Interbank Offered Rate (LIBOR) Fixing for U.S. Dollar. The rate is an average derived from the quotations provided by the banks determined by the Intercontinental Exchange (ICE) Benchmark Administration. USD LIBOR is calculated on an ACT/360 basis. The **Credit Suisse Leveraged Loan Index** is a market-weighted index that tracks the investable universe of the U.S. dollar denominated leveraged loans. The **Bloomberg U.S. High-Yield 2% Issuer Capped Bond Index** is a market capitalization-weighted index that measures fixed rate non-investment grade debt securities of U.S. and non-U.S. corporations. No single issuer accounts for more than 2% of market cap. The **ICE BofA US Cash Pay High Yield Index** tracks the performance of U.S. dollar-denominated below investment grade corporate debt, currently in a coupon paying period, that is publicly issued in the U.S. domestic market. The **ICE BofA 1-3 Year BB US Cash Pay High Yield Index** is a subset of the ICE BofA US Cash Pay High Yield Index including all securities with a remaining term to final maturity less than 3 years and rated BB1 through BB3, inclusive. The **Bloomberg Pan-European High Yield Index** measures the market of non-investment grade, fixed-rate corporate bonds denominated in the following currencies: euro, pounds sterling, Danish krone, Norwegian krone, Swedish krona, and Swiss franc. Inclusion is based on the currency of issue, and not the domicile of the issuer. The indexes are calculated on a total return basis. The indexes are unmanaged, returns do not reflect any fees, expenses, or sales charges, and are not available for direct investment. The commentary is the opinion of Newfleet Asset Management. This material has been prepared using sources of information generally believed to be reliable; however, its accuracy is not guaranteed. Opinions represented are subject to change and should not be considered investment advice or an offer of securities.

Investing is subject to risk, including the risk of possible loss of principal. Past performance is no guarantee of future results.