PPM AMERICA

Market Brief

OCTOBER 2018

Entering 2018, large dynamics in the marketplace were changing. The list was led by tighter monetary policy, including the shift from quantitative easing to quantitative tightening in the US, and the potential for higher yields. As the year progressed, participants also began looking forward to lower US GDP growth, as global growth was already slowing, and a deceleration in corporate earnings growth. Some of these risks were being priced into the market, as evidenced by the back-up in investment grade credit spreads. This changed more broadly in October, as an equity-driven decline (S&P 500 -6.84%) brought participants face-to-face with this growing list of risks.[1]

Yields began moving higher at the beginning of the month amid hawkish commentary from Federal Reserve members. Chairman Powell noted the stance of monetary policy remains accommodative, despite the Federal Open Market Committee (FOMC) removing this language from the most recent policy statement. He also said the Fed will not necessarily stop the hiking cycle when the fed funds rate hits neutral, and that the current economic expansion can continue "effectively indefinitely."[2] The 10-year Treasury yield increased 10 bps on the month to 3.15%.

The equity market had experienced narrow leadership year-to-date. The so-called FAANG stocks had driven higher the Consumer Discretionary and Information Technology sectors, while many other sectors lagged, including other cyclical sectors. (Note: Some of the FAANG names moved to the new Communications Services sector in September.) These sectors led the way lower during the October sell-off, aided by weak reactions to earnings, pushing down growth indices (S&P 500 Growth -8.08%). Value indices outperformed on a relative basis (S&P 500 Value -5.33%).

Finally, a handful of companies with large, BBB rated capital structures were under pressure in October, including auto names, health care names and a major conglomerate. Issues began coming to light, including the slowing global economy, a lack of deleveraging following M&A deals and subsequent pressure from ratings agencies. Investment grade bonds declined -80 bps on an excess return basis, as spreads widened 12 bps.[3] High yield declined -1.64% on a total return basis, with spreads widening 53 bps.[4] Bank loans also ended their positive streak, albeit modestly (S&P/LSTA Leveraged Loan Index -0.03%).

FUNDAMENTALS HAVE NOT CHANGED

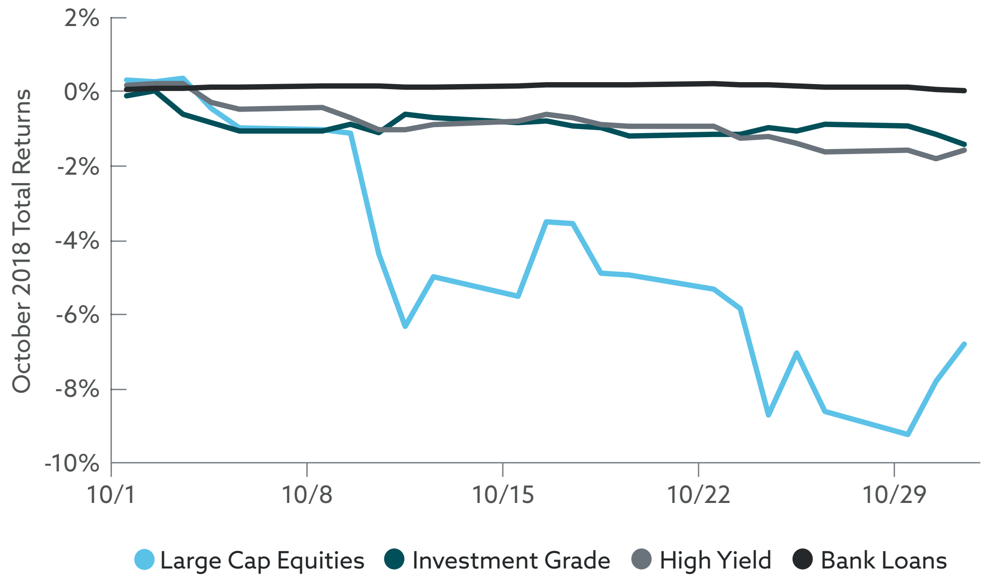
Our biggest takeaway from October is that, in our view, the fundamentals have not changed. Despite weak reactions to select earnings results from the FAANG stocks and industrial names, the expected growth rate for third quarter earnings has increased to 24%.[5] While earnings growth will likely decelerate from here, the fourth quarter is still expected to see 15% growth and 2019 is expected to see 10% growth. On the economic front, US GDP grew 3.5% in the third quarter, with 2.6% expected in the fourth quarter and 2.5% in 2019.[6] Consumer/business surveys also remain at or near highs.[7] Finally, we believe the banking sector remains in relatively good shape. There are risks to this fundamental picture, and we continue to believe the largest comes from trade/tariffs.

However, we remain hesitant to say the October pullback represents a broad buying opportunity. Our longer-term, strategic outlook has been tempered due to historically tight bond valuations and high equity valuations. The pullback did not change our bond market view. The equity correction brought broad market valuations more closely in-line with longer-term averages. We continue to look for relative value opportunities, and believe that, since fundamentals largely stayed steady, we will be able to selectively add risk. An example could be high yield bonds, where the Index spread has widened out near its widest level year-to-date (381 bps) while the yield has reached 7%.[4]

Selectivity is key, as we will continue to use a bottom-up focus for any potential opportunities. On the fixed income side, the risks emanating from heavily-indebted portions of the BBB space are real, and we feel certain names are being re-rated wider due to their idiosyncratic issues. On the equity side, we have been highlighting narrow equity leadership as a concern throughout 2018. Some of these names were due for a pullback, in our opinion, while we still feel there are relative value opportunities elsewhere.

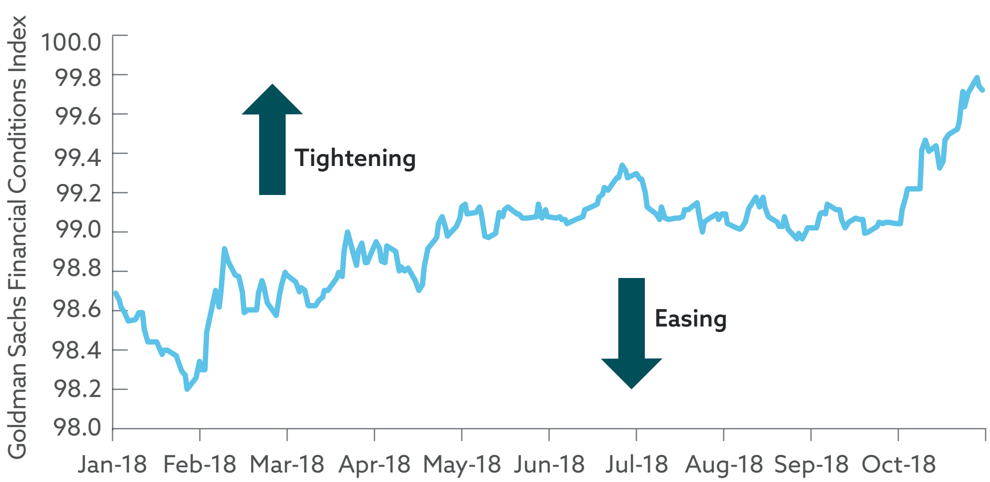
(1) Unless otherwise indicated, market data came from Morningstar and FactSet. 1 November 2018. (2) WSJ. "Fed Chair Powell Sees 'Remarkably Positive Set of Economic Circumstances.'" 3 October 2018. (3) Index is the Bloomberg Barclays US Credit Index. (4) Index is the ICE BofAML US High Yield Constrained Index. (5) FactSet. 1 November 2018. (6) BEA. 26 October 2018. FactSet. 1 November 2018. (7) NFIB. 9 October 2018. University of Michigan. 26 October 2018. The Conference Board. 30 October 2018.
Past performance is no guarantee of future results.

EQUITIES DRIVE THE OCTOBER SELL-OFF[8]



US equities swiftly trended downward in October, impacted by several catalysts including hawkish Fed speak, rising rates, slowing global growth negatively impacting multi-national firms, and disappointing earnings from select companies. We would argue that corporate credit experienced a more orderly pullback in October. Investment grade and high yield markets were impacted by some of the same catalysts, but tended to see less volatility day-to-day. Equities rebounded somewhat to close October, and both markets have seen early strength in November. However, the market will continue to deal with a rising list of risks.

FINANCIAL CONDITIONS TIGHTEN IN OCTOBER[9]



Fed rate hikes to this point – eight in total since December 2015 – have not had a significant impact on overall US financial conditions. Indices have shown easier financial conditions since the hiking cycle began.[9] However, the sell-off in October led to a notable tightening in financial conditions (an increase in the index indicates tightening). If this were to continue, we believe the Fed would take notice and it could impact decision-making at the FOMC regarding future rate hikes.

(8) FactSet, S&P Global Market Intelligence. As represented by the S&P 500, Bloomberg Barclays US Corporate Investment Grade, ICE BofAML US High Yield and S&P/LSTA Leveraged Loan Indices. 2 November 2018. (9) Bloomberg. 2 November 2018.
Past performance is no guarantee of future results.

ABOUT PPM AMERICA

PPM America, Inc. (PPM) is a client-focused investment manager. As part of one of the world's leading financial organizations, PPM has the expertise, global reach and substantial resources to provide our clients with investment solutions across markets, including fixed income, public and private equity, and commercial real estate. However, like a smaller shop, PPM remains nimble, investment-led and responsive to the opportunities that our teams discover together. Our mission is to deliver specific client solutions and service to investors around the world with the goal of meeting investors' unique investment objectives. In addition, PPM employees are committed to building our community and supporting local nonprofits that strengthen families and increase economic opportunities.

Indices are unmanaged and are not available for direct investment. The index returns do not reflect management fees, transaction costs, or other expenses. Performance of any index does not represent actual portfolio performance. A portfolio may differ significantly from the securities included in an index. The index information provided is for comparison purposes only to reflect general market conditions for the period shown.

The **Bloomberg Barclays US Corporate Investment Grade Index** provides a broad measure of US investment grade, USD-denominated fixed rate corporate bonds. It includes SEC-registered industrial, utility and finance bonds issued by both US and non-US corporations.

The **Bloomberg Barclays US Credit Index** provides a broad measure of investment grade, USD-denominated credit securities. It includes publicly-issued US and SEC-registered global corporate securities, foreign debt and secured notes.

The **ICE BofAML US High Yield Index** provides a broad measure of below investment grade, USD-denominated fixed rate corporate debt. It includes corporate bonds with risk exposures to countries that are members of the FX-G10, Western Europe or territories of the US and Western Europe.

The **S&P 500 Growth Index** provides a measure of US large cap growth stocks and is constructed based on the S&P 500 Index. Additionally, the S&P 500 Growth Index includes stocks that exhibit strong growth characteristics based on the evaluation of book value-to-price, earnings-to-price and sales-to-price ratios. The S&P 500 Index provides a broad measure, market capitalization-weighted measure of US large cap stocks.

The **S&P 500 Index** provides a broad, market capitalization-weighted measure of US large cap stocks. It includes approximately 500 publicly-traded stocks of the largest US companies.

The **S&P 500 Value Index** provides a measure of US large cap value stocks and is constructed based on the S&P 500 Index. Additionally, the S&P 500 Value Index includes stocks that exhibit strong value characteristics based on the evaluation of book value-to-price, earnings-to-price and sales-to-price ratios. The S&P 500 Index provides a broad measure, market capitalization-weighted measure of US large cap stocks.

The **S&P/LSTA Leveraged Loan Index** provides a broad, market value-weighted measure of US institutional leveraged loans. It includes the institutional tranches of loans syndicated to US loan investors.

The information presented herein has been prepared solely for informational purposes. Unless otherwise stated, information or views herein contained are as of the date of this presentation. The views expressed herein, as well as forecasts or portfolio strategies, may be changed in the future, reflecting change of various factors, including economic fundamentals. This presentation is not an offer, or a solicitation of an offer, to buy or sell any instrument. Nothing contained herein shall be relied upon as a promise or representation whether as to past or future performance. Past performance is no guarantee of future results.

The information provided in this report should not be considered a recommendation to purchase or sell any particular security. There is no assurance that securities discussed herein are held in any portfolio at the time you receive this report or that securities sold have not been repurchased. Portfolio holdings are subject to change without notice and are not intended as recommendations of individual stocks. It should not be assumed that any of the securities discussed were or will prove to be profitable or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein.

PPMAMERICA