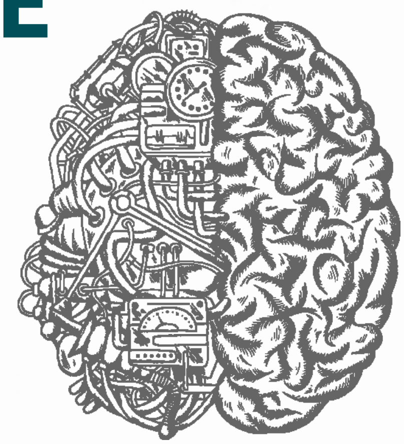
PPMAMERICA

QUARTERLY INSIGHTS - APRIL 2024

THE MARKET WRITES ITS OWN NARRATIVE



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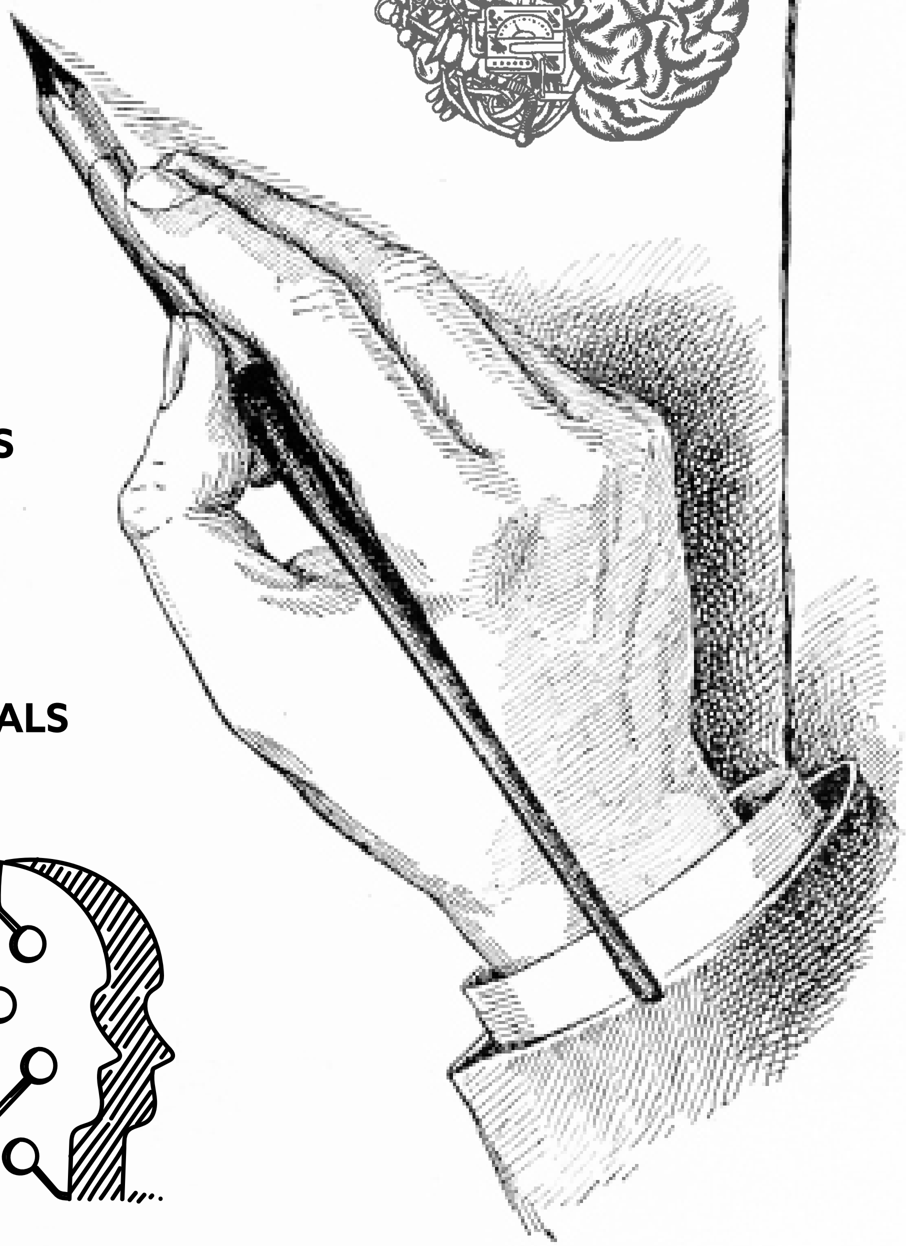
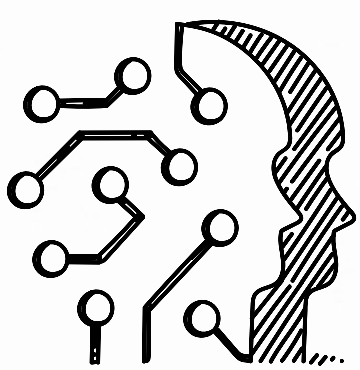




Letter From The CIO

It is only a quarter into the year, but we have already seen market expectations for the Federal Reserve (Fed) cutting rates in 2024 shift in both magnitude and timing due to inflation remaining stubbornly high.[1] The number of rate cuts discounted by Fed Funds Futures has more than halved (from nearly seven in mid-January to two currently), while the timing of the first cut has been pushed back to September from March.[2] Unsurprisingly, US Treasuries have sold off, with the 10-year yield rising 75 bps year-to-date to 4.63%.[3]

In the meantime, US risk markets have continued to strengthen, with equity returns higher even with the April pullback and credit spreads tightening across almost all asset classes.[4] Markets received a further boost in March when the Fed reaffirmed its intention to commence rate cuts at some point this year.

Given history, the repricing of rate cuts should not have been that surprising. As we have noted in previous newsletters, economic circumstances do not always allow the Fed to do what it says it will do nor what the markets anticipate it will do. Another factor that potentially complicates the Fed's flexibility to act is the presidential election taking place this year. Although Chair Powell has insisted that politics will not influence the timing of any potential rate cuts, it is illuminating to examine how the institution has operated in previous election years.[5] The table below distills the course of Fed actions during election years starting in 1992, focusing on any shifts in policy and when they occurred.

Although this represents a small sample size, the table shows that only once has the Fed changed a rate cycle in the time period between July and the election. That occurred in September 1992 when the central bank ended a multi-year easing cycle that began in response to a struggling economy. In all other instances, they either continued an existing cycle or changed policy prior to July or after the election.[6] Given this history, it seems fair to question the viability of the Fed initiating rate cuts in September as the market currently anticipates.

In addition to potentially influencing the Fed's actions, national elections could theoretically also impact the performance of equities, especially in the immediate aftermath of the results. To examine if this is indeed the case, we looked at how the markets have reacted to previous presidential elections in the US. Since 1960, Republicans and Democrats have each won the

Election Year	FOMC Policy Actions[6]
2020	Eased in March only due to the pandemic
2016	Started tightening cycle in December, post election
2012	No policy actions
2008	Continued GFC easing cycle throughout the entire year
2004	Started tightening cycle in June
2000	Continued tightening cycle through May
1996	Eased in January only
1992	Ended easing cycle in September

(1) As of 23 April 2024. Unless otherwise stated, the information presented has been prepared from market observations and other sources believed in good faith to be reliable. Information and opinions expressed by PPM are current as of the date indicated and are subject to change without notice. Past performance is no guarantee of future results. Forward-looking statements are subject to uncertainties that could cause actual developments and results to differ materially from the expectations expressed. (2) Bloomberg. 15 April 2024. (3) FactSet. 16 April 2024. (4) Morningstar, ICE Data Services. 12 April 2024. (5) New York Times. "Fed Chair Awaits More Inflation Cooling as Path Proves 'Bumpy.'" 3 April 2024. (6) Federal Reserve. FOMC's target federal funds rate or range, change (basis points) and level through July 2023. Data prior to 1990 excluded due to shifts in Fed's handling of monetary policy.

presidency eight times. From election night to year-end, stocks have reacted positively to a Republican win six times and negatively twice; for Democrats, those splits are five and three.[7] Again, a small sample size, but history suggests that the equity market does not react to who wins but rather reflects economic circumstances at the time.

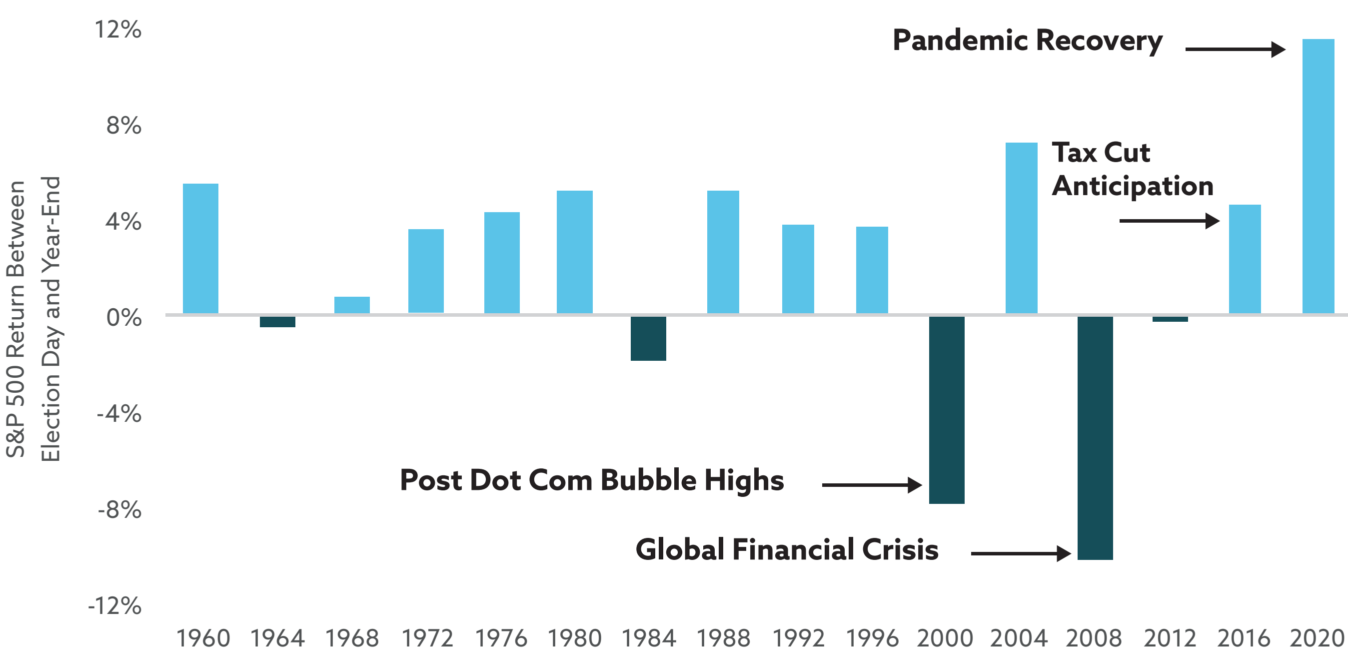
With that in mind, how do market conditions look heading into this year's election season? The S&P 500, Dow Jones and NASDAQ indices all hit new record highs in March led by a concentrated number of companies in the Technology sector, especially Nvidia and Meta. With this run-up in valuations, a number of market observers have commented that stocks may be heading into and could already be in "bubble" territory. While "bubble" concerns cannot be entirely dismissed, our view is that the evidence is far from conclusive. Admittedly, the forward price-to-earnings ratio of 20.95 for the S&P 500 Index at the end of March is elevated.[8] However, this level is still below highs hit during the Internet Boom in 1999-2000 and the post-pandemic recovery in 2021 (see next page). To put these gains into perspective, US equities are only 6% higher than their January 2022 levels, despite nominal GDP increasing more than 13% over the same time frame.[9,10]

One reason that potentially justifies higher equity multiples, especially in the Technology sector, is the likely economic impact of artificial intelligence (AI). Yes, it has been making bold headlines since the launch of ChatGPT in November 2022 and has generated a lot of hype. *But, will its impact live up to expectations and influence markets in the long term?*

A recent study by Goldman Sachs forecasts that AI will lead to an annual increase of 1.5% in developed market labor productivity, resulting in a cumulative increase of 15% by 2034.[11] Set against the historical trend of 1.5% annual productivity growth, an additional 1.5% would be meaningful indeed and result in material wealth creation for developed market economies and the companies that drive AI innovation.[12] AI could lead to an exciting story on productivity over the next 5 to 10 years, which may be reflected in higher equity market valuations today.

At PPM, we understand that markets tend to chart their own path, regardless of the Fed's stated intentions or the outcomes of national elections. We are, at our core, a bottom-up, research-focused fixed income asset manager that relies on our entire investment team (including credit analysts, traders and portfolio

EQUITIES TEND TO FOLLOW ECONOMICS NOT ELECTIONS[7]



(7) J.P. Morgan. Data through 31 December 2020. (8) FactSet. Monthly S&P 500 12-month forward looking price-to-earnings ratio. 1 January 1996 to 31 March 2024. (9) FactSet. S&P 500 prices. 16 April 2024. (10) HSBC Global Research. "Bubblicious?" 22 March 2024. (11) Goldman Sachs. "The AI Transition One Year Later: On Track, but Macro Impact Still Several Years Off." 2 April 2024. (12) US Bureau of Labor Statistics. Average annual percent labor productivity change in the nonfarm business sector for the most recently completed labor cycle (Q4 2007 – Q4 2019).

managers) to find relative value for our clients. For the near to medium term, we see stretched valuation levels, with spreads remaining tight in particular. However, we believe strong demand technicals in investment grade corporate bonds should continue to underpin performance as historically high yields attract investors. For below investment grade bonds, yields equally look attractive as "good enough" corporate earnings and positive economic data buoy lower-rated bonds. CLO issuance has been strong and is driving demand for bank loans, which have continued to generate the steady gains from last year into 2024. Outside of public fixed income, private equity co-investment activity remains robust in contrast to slowdowns in other areas of the asset class.

Given the rally over the past two quarters, our strategies have moved up-in-quality with minimum spread give-up while retaining the ability to be opportunistic in the face of any market volatility. Tight valuations make it even more imperative that we lean into our market-tested investment philosophy of not buying the market indiscriminately, but instead relying on sector and security selection on a credit-by-credit basis to seek alpha.

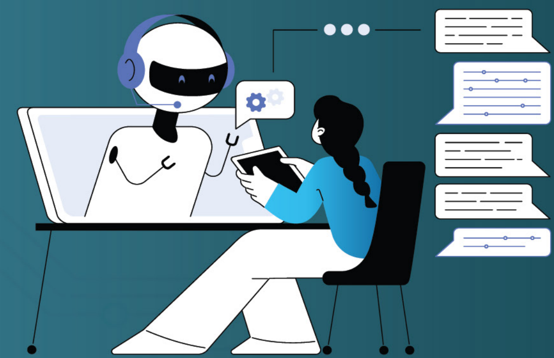
CRAIG SMITH, CFA
President, CEO & CIO

OGECHI NWACHUKWU
Deputy CIO

P/E RATIO ELEVATED BUT BELOW HISTORICAL HIGHS[13]

(13) FactSet. Monthly S&P 500 12-month forward looking price-to-earnings ratio. 1 January 1996 to 31 March 2024.

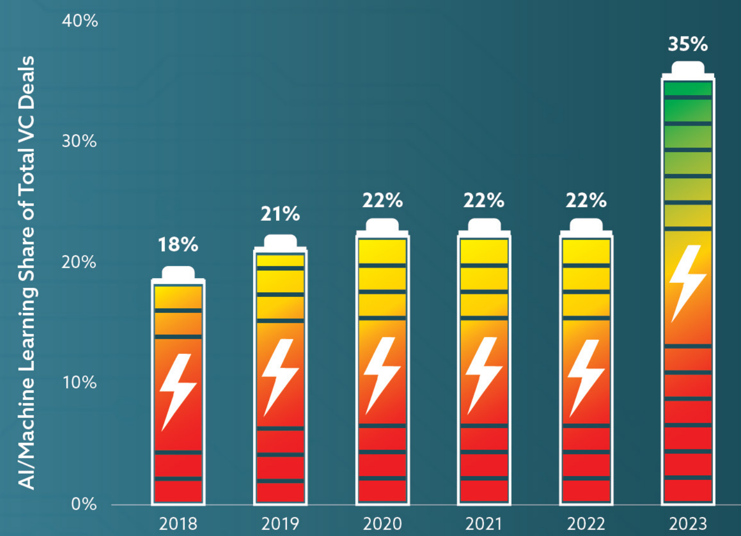
Market, Economic Impacts of AI

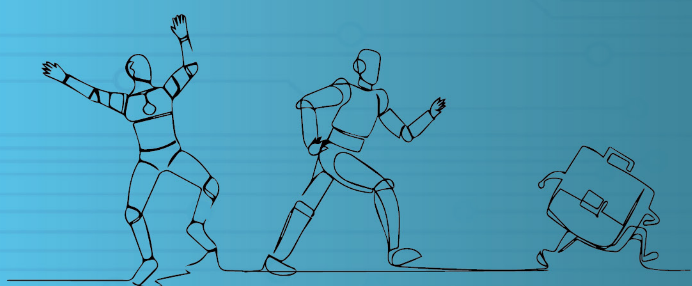


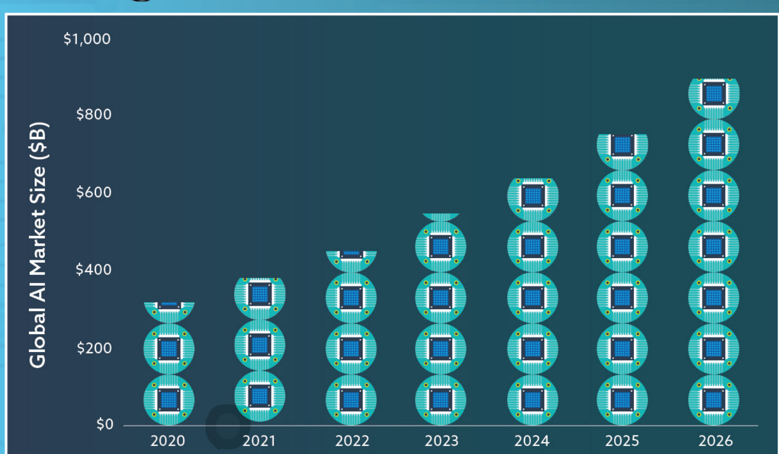
Investors have been inundated with headlines about artificial intelligence (AI) and how these new technologies will reportedly revolutionize everyday life. While financial market impacts can already be seen in the valuations of private companies such as OpenAI and the equity prices of public companies such as Nvidia and Super Micro Computer, how far reaching is the AI boom? While AI is currently only a small percentage of the economy, it is expected to grow quickly and could have meaningful market impacts in the near future.[1]

Venture Capital Investment Has Spiked[2]

On the investment side, it isn't simply mature companies like Nvidia that are getting attention. An increasing share of venture capital (VC) dollars are going to startups that are attempting to become the next OpenAI.





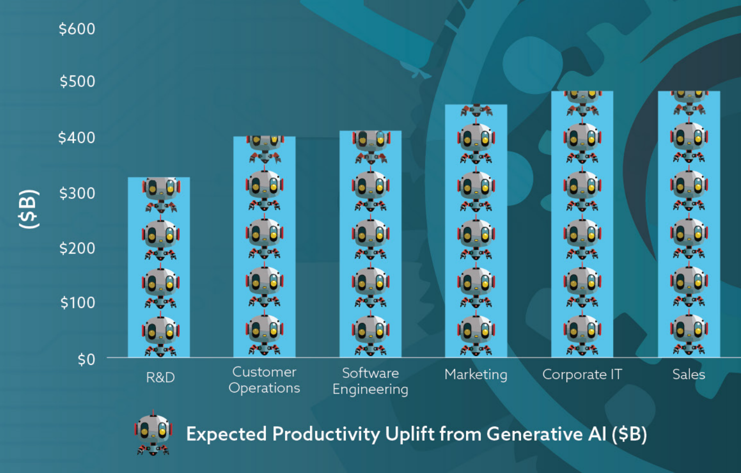


Market Expectating Continued AI Growth[3]

While not yet large in economic terms, AI has kicked off a new investment cycle. The global AI market is expected to show annual growth for many years. It has started with AI chips and hardware to connect to AI data centers, with the ultimate goal of actual software and services that companies can deploy to increase productivity.

AI Could Bring Significant Productivity Growth[4]

Generative AI has been making headlines since the launch of ChatGPT in November 2022, but how will its impact be felt on markets? In our opinion, generative AI could lead to meaningful productivity improvements, benefitting corporate fundamentals. Market forecasts expect productivity gains in not just IT and software, but sales, marketing, operations and research & development.



(1) According to Piper Sandler, AI-related capital expenditures (capex) constitute just 7% of all capex and just 1% of US GDP. "AI: Digitization On Steroids." 5 March 2024. (2) PitchBook. "Quantitative Perspectives: Cleared for Takeoff?" Q1 2024. (3) BofA Global Research. "Me, Myself and AI - Artificial Intelligence Primer." 27 February 2023. (4) Jefferies. "AI Deep Dive: When Will the Software Hype Convert to Revenue Reality?" 31 March 2024.

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KEY TAKEAWAYS

> Investors are grappling with historically tight spreads in US investment grade; however, yields remain elevated and the asset class is experiencing very strong technicals that are supporting current valuation levels

> We also view fundamentals as healthy

> Our focus remains on idiosyncratic investment opportunities (e.g., curve trades, M&A issuance) while maintaining an up-in-quality bias within client portfolios

STRONG TECHNICALS SUPPORTING VALUATIONS

The US investment grade market continued to see spread tightening in Q1 2024, driven by positive economic data and continued demand, even as the market priced out rate cuts amid sticky inflation. The spread of the Bloomberg US Credit Index (Index) tightened 8 bps during the quarter to 85 bps.[1] It hit a low of 83 bps in late March, the tightest level since November 2021.

The other side of the valuation picture is yields. While off the highs, the yield to worst of the Index still closed the first quarter at 5.25%. Historically elevated yields have driven demand into the asset class, which we expect to continue. Further, we expect less net supply as 2024 progresses (see next page).

HIGHER FOR LONGER

We believe interest rates will remain higher for longer, a view that the market has also started to embrace. The Fed could undertake maintenance cuts later in the year (or in 2025), but interest rates should remain historically high.

The economy, specifically the labor market, has held up better than hoped. This has allowed the Fed to push out rate cuts. But higher rates are impactful to corporate fundamentals. Investment grade leverage has started to tick slightly higher, led by AA/A. Leverage among AA/A rated companies has also been impacted by debt-financed M&A. There is bifurcation among sectors, with areas like Technology maintaining low leverage but other sectors seeing leverage creep higher. However, we believe fundamentals are healthy overall.

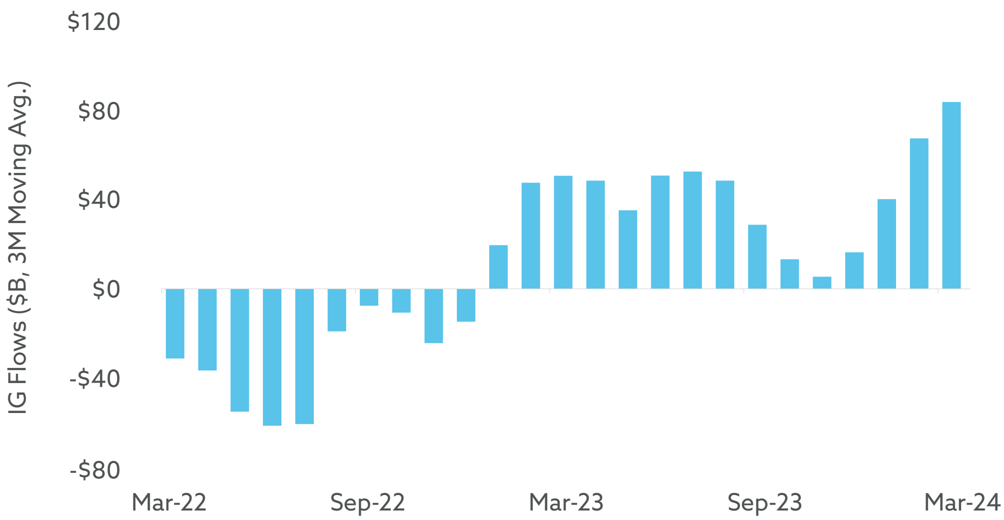
IDIOSYNCRATIC OPPORTUNITIES

Our client portfolios have maintained their up-in-quality bias. Given tight spreads, we looked for idiosyncratic investment opportunities in the first quarter. One example was along the corporate curve, especially the long end which first steepened than flattened in Q1 2024.

Another example was M&A. M&A volume has increased and we believe many companies will issue debt to finance a portion of those transactions. We intend to invest where we see value and believe in the deleveraging story post-acquisition. There were several large new issues to fund recent acquisitions during the first quarter, in particular within Pharmaceuticals, and we invested selectively.

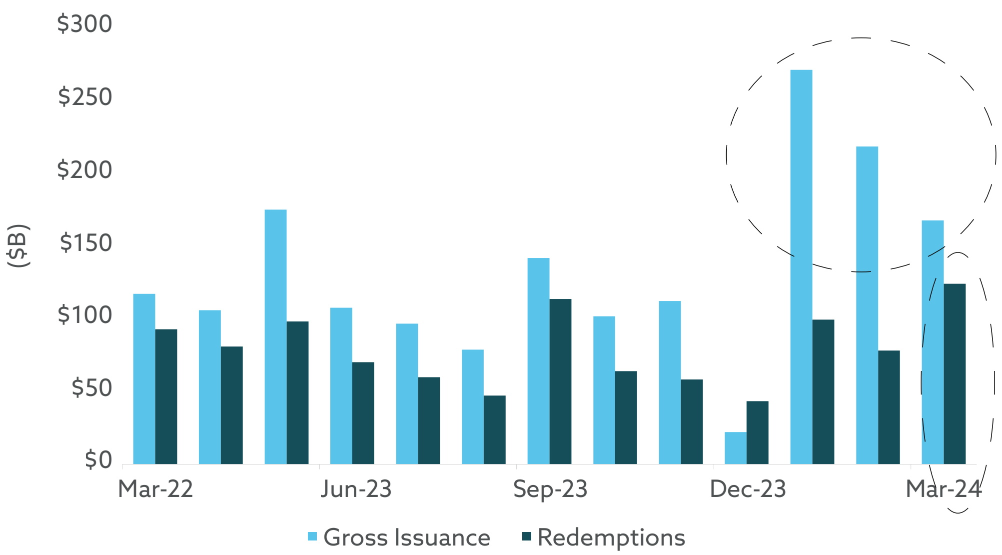
(1) Unless indicated, data sourced from Barclays. 1 April 2024.

DEMAND FOR INVESTMENT GRADE HAS GROWN AMID ELEVATED YIELDS[2]



Investment grade experienced its fifth consecutive quarter of inflows ($83B) in Q1 2024. This follows notable outflows in 2022 amid the Fed's rate hiking cycle. A higher Fed Funds rate increased market yields for investment grade corporate bonds, driving the re-investment into the asset class. Even as yields fluctuate (the yield to worst of the Index peaked in early Q4 2023), we expect them to remain historically high compared to the post-GFC period and to continue to drive inflows. This would be a technical tailwind that could help offset already tight valuations.

AFTER ISSUANCE SPIKE, MATURITIES EXPECTED TO INCREASE[3]



Gross corporate issuance totaled $499B in Q1 2024, up 28% from the year-ago period and a record amount for the first quarter. Issuance grew across sector, rating and maturity. We expect elevated gross issuance could continue in the near term, but taper as the US election nears. Also, the number of maturities increased in March and is expected to remain elevated over the medium term. Taken together, the net issuance outlook looks tighter, which could be another technical tailwind for US investment grade.

(2) Morningstar. Monthly data through 31 March 2024. Aggregated flows for the US OE Corporate Bond, Intermediate Core Bond, Intermediate Core-Plus Bond, Long-Term Bond, Short-Term Bond and Ultrashort Bond categories (including ETFs), shown as a 3-month moving average. (3) Barclays. 2 April 2024.

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KEY TAKEAWAYS

- High yield investors continued to benefit in Q1 2024 from positive economic data and healthy technicals
- The "slow burn" credit cycle continued in the quarter, with a lower distress ratio, small increase in the default rate and more downgrades than upgrades
- When looking for value, we see opportunities across the ratings spectrum and favor core income names with improving credit profiles

The US high yield market rallied in Q1 2024, underpinned by technicals and positive economic data, buoying lower-rated bonds. The ICE BofA US High Yield Constrained Index (Index) posted a quarterly total return of 1.51%, the sixth consecutive quarter of positive returns.[1] All rating categories rallied, but lower-rated bonds led: BB 1.10%, B 1.48%, CCC & Lower 3.22%. Most sectors finished the quarter positive, led by Retail (3.64%) and Energy (2.67%), while Telecommunications (-2.27%) and Media (-1.73%) were the only sectors in negative territory. Finally, the Index spread tightened 14 bps during the quarter to 315 bps. It reached a low of 305 bps in late March, the tightest level since December 2021.

HEALTHY TECHNICALS AMID SLOW BURN CREDIT CYCLE

Demand remained for the asset class in Q1 2024, as high yield experienced a second straight quarter of inflows ($10B).[2] The primary market also reopened, as gross issuance spiked to $87B for the quarter, up significantly from $42B in Q4 2023 (see next page).[3]

Our call for a "slow burn" credit cycle in high yield is playing out, with a lower distress ratio and small increase in the default rate. The Index default rate increased in Q1 2024 for the eighth quarter in a row, rising 30 bps to 3.83%.[4] Conversely, the distress ratio, a predictor of future defaults, decreased for the seventh quarter in a row, falling 36 bps to 5.93%.[4] Separately, the Index saw more bonds downgraded (-$123B) than upgraded ($83B), a trend we expect to continue.

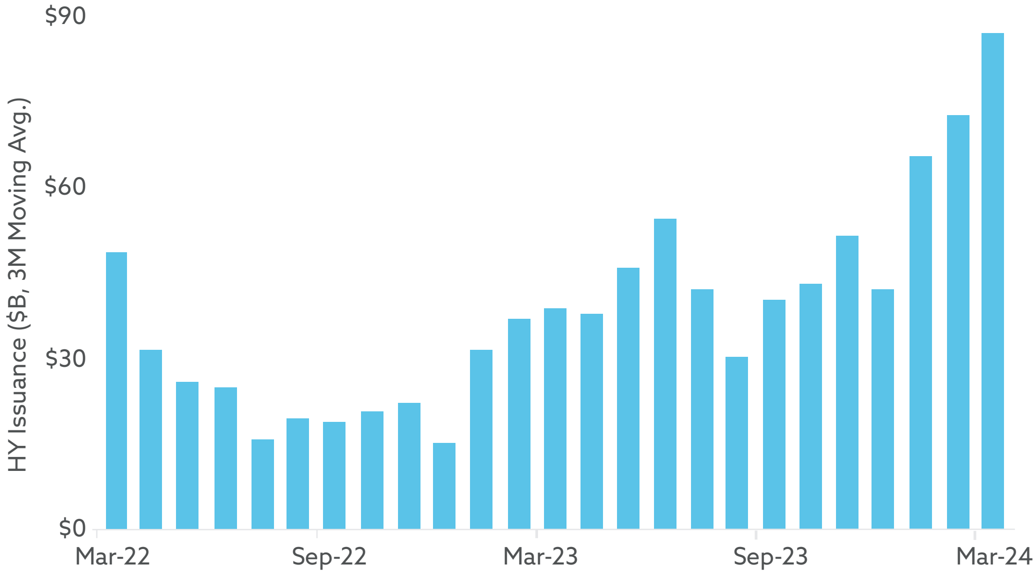
SEARCHING FOR IMPROVING CREDIT PROFILES

We expect economic growth to be good enough in 2024 for most of high yield. The labor market has been resilient, outperforming our expectations. When looking for value, we see opportunities across the ratings spectrum and favor core income names with improving credit profiles.

In Q1 2024, we modestly increased portfolio risk, investing excess cash into opportunities in single B bonds and leveraged loans. Within bonds, we increased exposure to the Financial Services and Technology sectors and reduced exposure to Automotive and Utilities. At quarter-end, Energy and Transportation were the largest overweight sectors while Basic Industry and Real Estate were the largest underweight sectors.

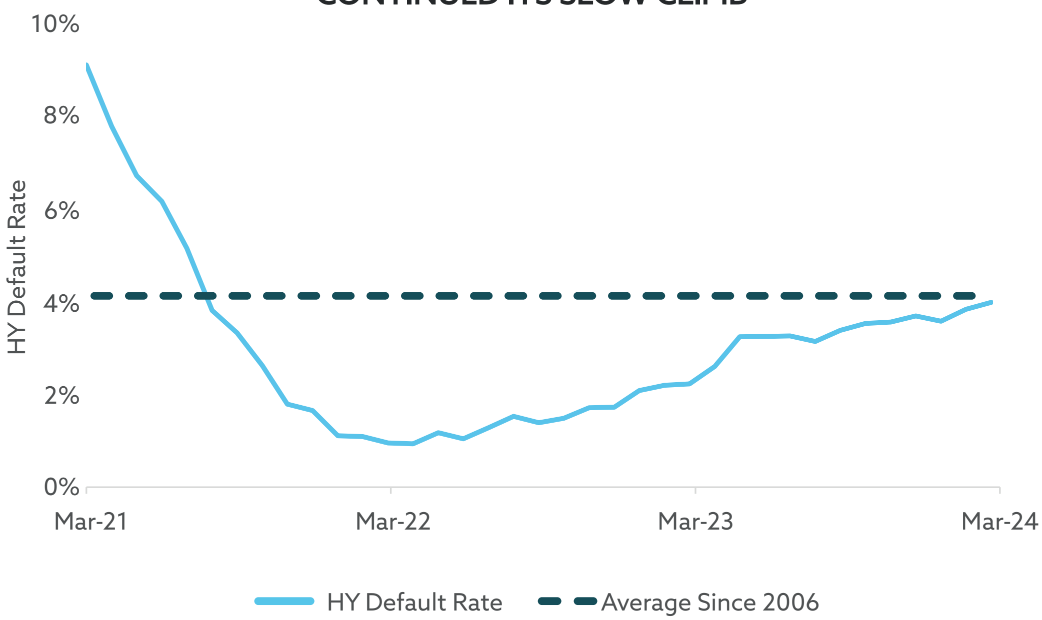
(1) Unless indicated, data sourced from ICE Data Services. 1 April 2024. (2) Morningstar. Monthly flows for the US OE High Yield Bond category (including ETFs) through 31 March 2024. (3) Issuance, default rates and distress ratios, and upgrades/downgrades from BofA Global Research. 1 April 2024. (4) Default rate calculated at the issuer level for the last 12 months. Distress defined as bonds with spreads above 1,000 bps on a par basis.

HIGH YIELD PRIMARY MARKET REOPENED IN Q1 2024[5]



The high yield primary market slowed in 2022 and 2023, but gross issuance spiked in Q1 2024. The increase in supply follows easier financial conditions – tighter spreads, stable rates – and supports leveraged issuers through better opportunities to refinance. We expect continued robust supply since there is still a material amount of refinancing to be done.

HIGH YIELD DEFAULT RATE CONTINUED ITS SLOW CLIMB[6]



The Index default rate rose 30 bps in Q1 2024 to 3.83%, near the average since 2006 of 4.06%. The ascent has been slow, as we expected, unlike the spikes seen in historical periods of stress. While the higher rate environment has weakened interest coverage levels, other credit metrics remain stable. Further, many companies have been able to access the primary market and refinance debt. We believe the default rate can continue to move slowly higher, but could peak in 2024.

(5) BofA Global Research. 1 April 2024. (6) BofA Global Research. 1 April 2024. Default rate calculated at the issuer level for the last 12 months.

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KEY TAKEAWAYS

> The story for investors keeps changing – in Q1 2024, it went from imminent rate cuts to a stronger economy and higher rates for longer

> Higher-for-longer could be a boon for US leveraged loan investors, as the market has been providing historically high coupons and outperforming fixed income asset classes

> Further, the technical picture improved markedly in the first quarter, allowing loan issuers to refinance and improve balance sheet health

The Morningstar LSTA US Leveraged Loan Index (Index) entered 2024 having rallied in 12 of the previous 15 months. It extended that streak by gaining in each month of Q1 2024 (+2.46% for the quarter).[1] Spreads have tightened and prices have risen over that period, but gains have more and more been driven by historically high coupons, including in the first quarter. With the market shifting its focus to higher-for-longer, loans could remain an attractive asset class for investors.

BALANCING TECHNICALS AND VALUATIONS

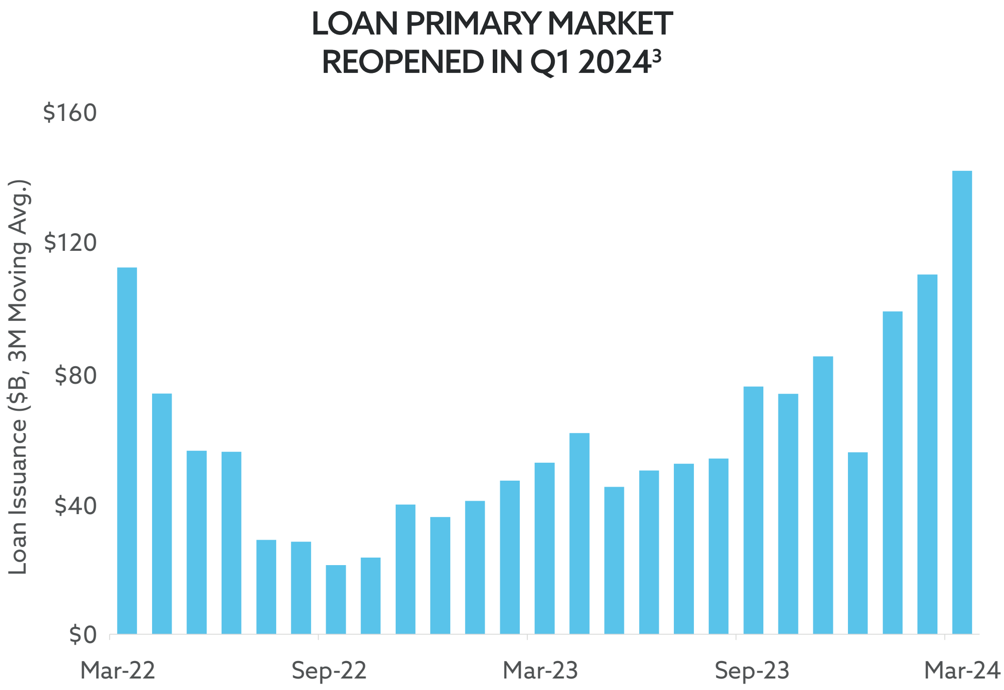
The technical picture improved markedly in Q1 2024. CLO issuance, a large source of demand for leveraged loans, jumped to $49B during the quarter, up from $32B in Q4 2023. Loans also experienced inflows during the quarter ($3B).[2] On the supply side, loan issuance surged to $142B, up from $56B in Q4 2023. The reopening of the primary market is positive for leveraged credits, as it allows names to refinance upcoming maturities (see next page).

Despite improving balance sheets, interest coverage is rising and some industries are still destocking excess inventories. These factors frame our view for the loan market to continue to see net downgrades. And as the market has rallied, loan valuations have become richer. Spreads are tighter and prices are higher, as mentioned, but yields remain historically high and also remain above US high yield bonds. The return outlook for loans is supported by historically high coupon payments and our expectation for "good enough" economic growth in 2024.

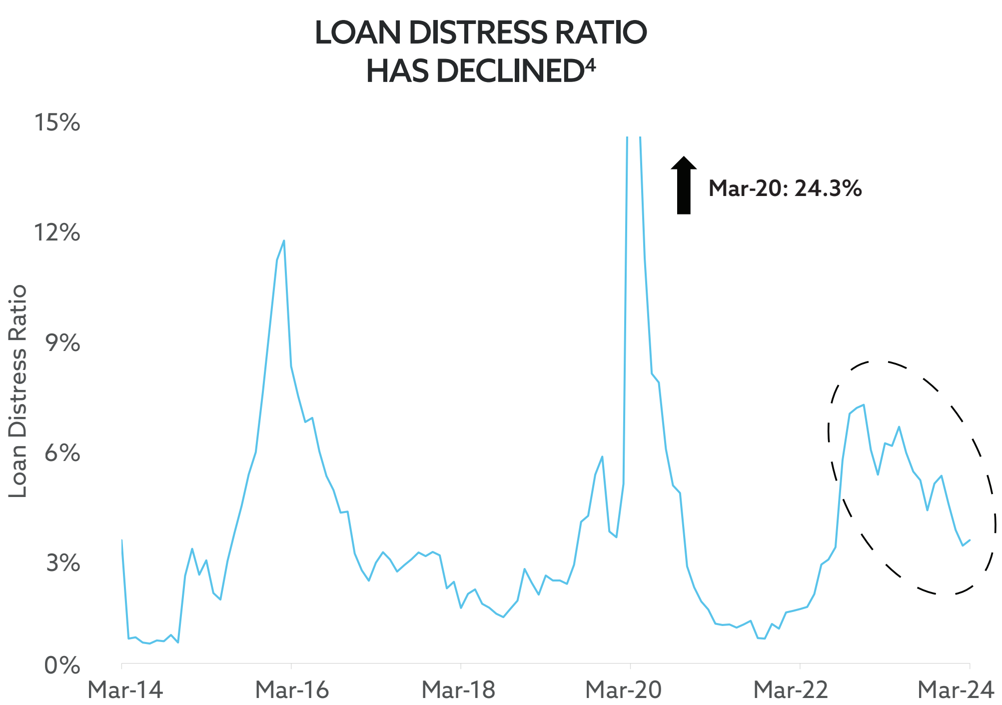
MOVING UP-IN-QUALITY

As the loan market has advanced, we have moved up-in-quality. A stronger economy and an open primary market have most benefitted lower-rated loans, including in the first quarter: BB 2.00%, B 2.45%, CCC & Lower 5.01%. We have used these price movements as an opportunity to take down our exposure in CCC and add exposure in B flat and B-. There is also a demand component here. With prices pushing toward 100 in the higher rated segments, we expect CLOs that still need to buy some loans at discounts to target the B/B- bucket.

(1) Unless indicated, data sourced from Leveraged Commentary & Data. 1 and 2 April 2024. (2) Morningstar. Monthly flows for the US OE Bank Loan category (including ETFs) through 31 March 2024.



As mentioned, loaned issuance surged to $142B during the quarter, up from $56B in Q4 2023. Just last year, it looked like many names would have difficulty refinancing in 2024, but that is no longer the case. However, we have observed the most stressed names still being locked out of the primary market, which is why we continue to expect a slowly increasing default rate within the loan market.



The loan default rate actually decreased 39 bps during the quarter to 1.14%, but we expect it to slowly increase and likely reach its historical average of 2.66% since 1999. We do not expect a spike, due to the economic strength and open primary market already discussed. The lack of pressure can be seen in the distress ratio, which we define as trading under 80 cents on the dollar and view as an indicator of defaults. The percentage of distressed loans has been declining since last year and decreased 103 bps during Q1 2024 to 3.51%. That is well below the average since 1999 of 6.28%, let alone the spikes seen during the 2014-16 energy crisis (peaked at 12.05%) and the 2020 COVID crisis (peaked at 24.25%).

(3) Source: Leveraged Commentary & Data. 2 April 2024. (4) Source: Leveraged Commentary & Data. 1 April 2024. Distress ratio calculated by PPM by adding loans priced less than 80 cents on the dollar.

ABOUT PPM AMERICA

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The **ICE BofA US High Yield Constrained Index** provides a measure of below investment grade bonds, is constructed based on the ICE BofA US High Yield Index and imposes a 2% issuer cap. The ICE BofA 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.

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(1) AUM includes committed but unfunded capital for PPM's private equity and commercial real estate businesses.

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