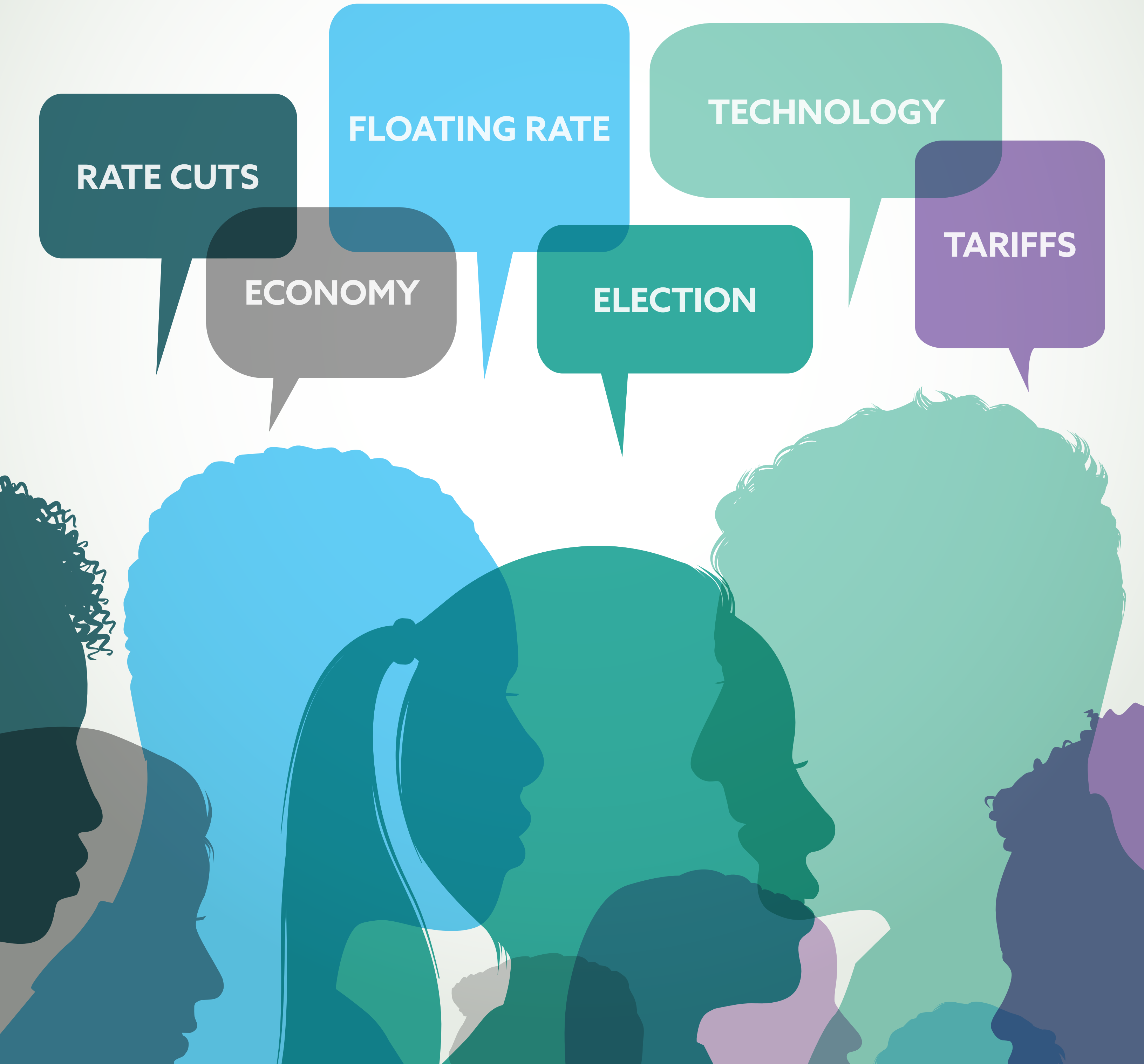
PPMAMERICA

QUARTERLY INSIGHTS – JULY 2024

MARKETS SENDING MIXED MESSAGES



Letter From The CIO

The need to rigorously examine conventional market wisdom appeared clear in the first half of 2024.[1] Early in the year, following a series of hotter-than-expected inflation data points, investors rapidly priced out expectations for interest rate cuts from the Federal Reserve (Fed). Fewer anticipated rate cuts can often lead to weaker performance in risk assets, and this was indeed what many market strategists predicted. However, markets continued to rally, driven by a stronger economy that more bearish strategists had either overlooked or failed to anticipate.

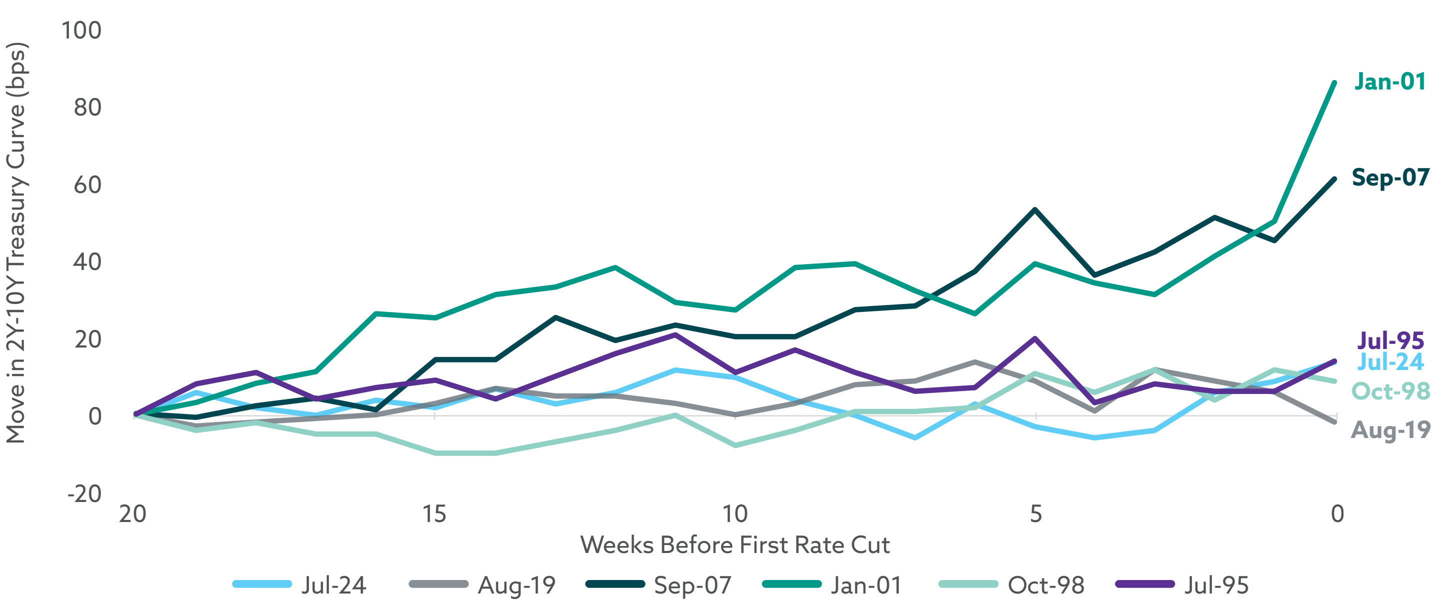
In recent weeks, consensus has emerged that the Fed will soon embark on a significant rate cutting cycle. This view is largely driven by recent, disappointing economic data points. Indeed, the current market-implied probability for the first rate cut happening in September is 100%.[2]

In order to examine the validity of this point of view, we look to the shape of the US Treasury curve and how it has changed prior to the commencement of previous cutting cycles. The spread between the 2-year and 10-year Treasury yields notably steepened in the weeks leading up to the first interest rate cuts in 2007 and 2001, which presaged recessions. However, as seen in chart below, there have been other instances where the Treasury curve stayed flat. In these instances, the easing cycle turned out to be much shallower. Interestingly, the Treasury curve has remained relatively flat year-to-date, suggesting that the coming easing cycle may be similarly shallow.

Such an occurrence would be consistent with our view, articulated in prior newsletters, that rates will generally remain higher-for-longer in the current cycle. We interpret higher-for-longer to mean an easing cycle that is generally more gradual than the one currently built into consensus expectations. We question the need for a first rate cut in September and feel the FOMC may still wish to gain further confidence that rate cuts do not jeopardize the progress that has been made toward their 2% target. We believe recent stock market gains should also serve to temper some of the impulse to cut rates rather than wait a few more months. The Fed's demonstrated history of being reluctant to commence a cycle so close to the presidential election is another dimension to this argument.

If our view that a more gradual and later rate cutting cycle prevails, what then may be the implications for fixed income markets? The instinctive response would

TREASURY CURVE NOT INDICATING IMMINENT RATE CUTS[3]



(1) As of 24 July 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. 16 July 2024. (3) FactSet. 12 July 2024. Weekly data for each period. The last 20 weeks for the curve in 2024 encompass 2/23 through 7/12.

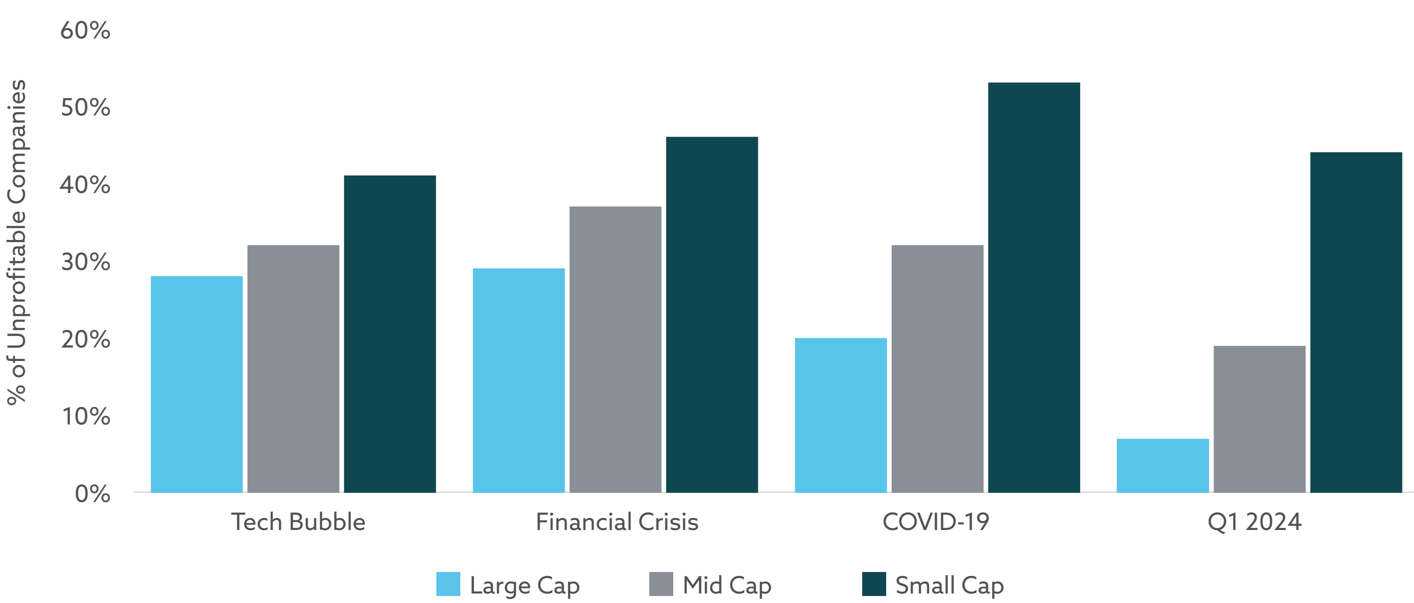
be that the cost of debt would be higher for bonds and loans with floating rate price structures, while the options to refinance for borrowers will narrow. Refinancing risk may not be such a big problem for public companies that issued floating rate loans, as many have used a robust new issue market ($289B in H1 2024) to push out most 2024 maturities and a good portion of 2025 maturities as well.[4] The bigger problem may lie in commercial real estate (CRE), where (re)funding markets have remained largely frozen. In this asset class, elevated rates could eventually lead to distress for overleveraged borrowers (and potential investment opportunities elsewhere). The private credit market may also be of some concern. This is an asset class with a significant amount of floating rate debt, coupled with generally opaque credit quality, a combination that could lead to distress the longer rates stay elevated.

On the other hand, a likely benefit for fixed income investors is more attractive returns, which have historically been positively correlated with starting yields. In other words, today's higher starting yields bring the potential for higher returns compared to the prior decade and the Fed's zero interest rate policy. These potential returns are somewhat offset by the current historically tight spread levels. Regardless, history highlights the importance of rigorous credit analysis as the stress of elevated rates builds across the economy.

At PPM, our credit analysts have been analyzing the ability of companies to manage in a higher pricing environment. Most often this involves trying to determine which companies are agile enough and have a strong enough market position to raise prices and/or cut costs to offset higher interest rates and inflation while maintaining margins. So far, our analysts conclude that companies in differentiated sectors (e.g., technology) and necessities (e.g., insurance, pharmaceuticals) are resilient and have the ability to raise prices, while those in highly competitive sectors (e.g., retail, media) or commodity-related sectors are weaker positioned and have limited pricing power. This type of analysis is an essential input into our security selection process, which compares valuations with fundamental drivers.

The need to dig deeper into specific sectors and companies is even more pertinent, given that headline S&P 500 Index earnings may not be representative of earnings for the broader universe of corporations. The S&P 500 is expected to show double-digit earnings growth in both 2024 and 2025.[5] It would be easy to then conclude that corporate fundamentals are very

CURRENT STRESS CONFINED TO SMALL CAPS[6]



(4) Loan issuance data from LCD, a part of PitchBook. 3 July 2024. Maturity data from BofA Global Research. 1 July 2024. (5) FactSet Earnings Insight. 3 July 2024. (6) J.P. Morgan Asset Management. 30 June 2024. Percentage of unprofitable companies is calculated from pro-forma EPS. The S&P 500 is used for large cap, the Russell Midcap for mid cap and the Russell 2000 for small cap. Tech bubble = 4Q01, financial crisis = 4Q08 and COVID-19 = 1Q20. Data for Q1 2024 is the latest available.

strong. However, the S&P 500 has become more and more weighted to very large technology companies and is becoming less and less representative of the broader corporate universe. As it happens, earnings for the broader universe are also expected to remain healthy, with S&P 500 companies excluding the so-called "magnificent 7" expected to show earnings growth of 7% this year.[7] However, as discussed in the previous paragraph and shown in the chart on the prior page, there are still sectors with negative operating trends that require in-depth analysis to separate the winners and losers.

Finally, the election could be a wild card for US bond markets. They have historically rallied the year after presidential elections, as can be seen in the table below. If this pattern again holds true, it could provide an additional boost to bond returns in 2025. In the interim, we believe US bond markets will benefit from continued demand given historically high yields and healthy overall corporate fundamentals.

CRAIG SMITH, CFA
President, CEO & CIO

OGECHI NWACHUKWU
Deputy CIO

Year Following Presidential Election	Total Returns (%)[8]		
	Investment Grade	High Yield Bonds	Leveraged Loans
1973	1.51	—	—
1977	3.16	—	—
1981	2.95	—	—
1985	24.06	—	—
1989	14.09	2.31	—
1993	12.16	16.69	—
1997	10.23	13.27	7.52
2001	10.40	4.48	4.21
2005	1.96	2.74	5.06
2009	16.04	57.51	51.62
2013	-2.01	7.42	5.29
2017	6.18	7.48	4.12
2021	-1.08	5.36	5.20
Avg.	**7.67**	**13.03**	**11.86**

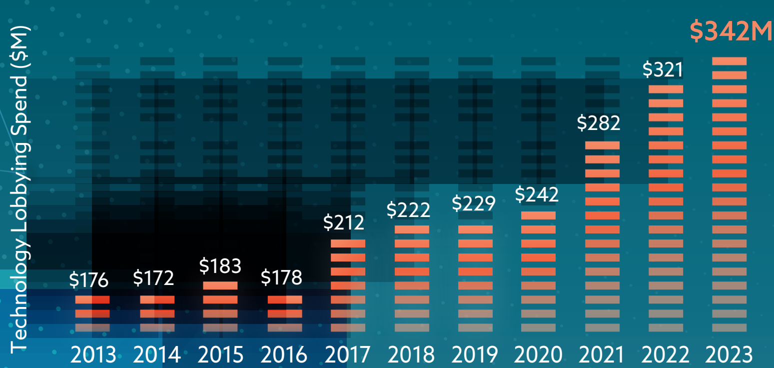
(7) J.P. Morgan Asset Management. 30 June 2024. "Magnificent 7" includes Apple, Amazon, Google, Meta, Microsoft, Nvidia and Tesla. (8) Morningstar. 2 July 2024. Total returns for the Bloomberg US Credit Index, the ICE BofA US High Yield Index and the Morningstar LSTA US Leveraged Loan Index.

The Burgeoning Influence of Technology

It seems as if every other day, investors see equity indexes making new highs led by technology companies. The largest of these technology companies have market values that would rank among the top 10 countries in terms of gross domestic product.[1] After exploring the impact of artificial intelligence (AI) on the economy and financial markets last quarter, let's take a step back and put into perspective the growth of the information technology (IT) sector and reach of technology companies as a whole.

IT NEARLY ONE-THIRD THE SIZE OF S&P 500[2]

Led by behemoths such as Nvidia, Microsoft and Apple, the IT sector comprises 32.4% of the S&P 500 Index (Index) compared to just 21.5% in June 2019. This represents 51% growth as a percentage of the Index over the last five years. This current size dwarfs the next largest sector in the index – Financials at 12.4%.

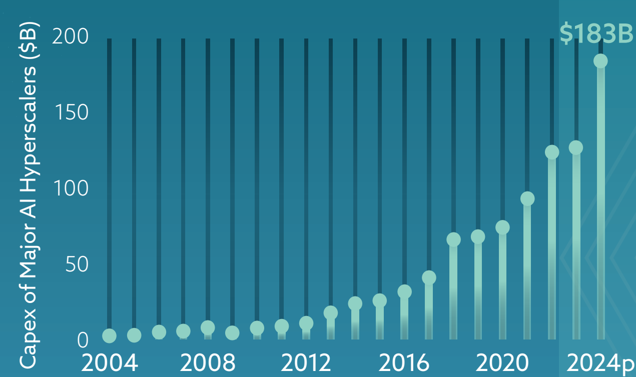


INVESTING IN ADVOCACY[3]

With this increase in size, the IT sector and technology companies broadly now have the means to help shape government policy in areas that will impact their businesses, including AI. The sector has exerted this influence by nearly doubling the amount spent lobbying regulators in Washington, DC since 2013 ($342M vs. $176M).

BUILDING THE INFRASTRUCTURE TO FUEL AI[4]

Why would tech companies spend millions to impact the AI regulatory environment? One reason is to protect the billions of dollars being invested in hyperscale data centers, massive structures that house computers and associated components that will support the potential steep increase in AI-related workloads.[5] In 2024, the major hyperscalers are projected to spend $183B in these facilities, a 45% increase from just the year before.



(1) Finbold. "Nvidia's record market cap surpasses all but five global economies." 24 June 2024. (2) FactSet. Weekly market value of the Information Technology sector and S&P 500. Market value of Financial sector on 28 June 2024. (3) JLL. "Tech in DC: Tech companies come to advocate and stay to grow." May 2024. (4) J.P. Morgan Asset Management. 30 June 2024. Hyperscalers shown are Microsoft (Azure), Meta, Amazon (AWS), Oracle and Alphabet (Google Cloud). (5) DataCenterKnowledge. "Hyperscalers in 2024: Where Next For the World's Biggest Data Center Operators?" 28 February 2024.

MICHAEL KENNEDY, CFA
Senior Managing Director,
Portfolio Manager

MARK REDFEARN, CFA
Senior Managing Director,
Portfolio Manager

JOSH SETTLE, CFA
Senior Managing Director,
Portfolio Manager

CALVIN WALKER
Managing Director,
Portfolio Manager

JON NELSON, CFA
Vice President,
Portfolio Manager

KEY TAKEAWAYS

> Investors continue to grapple with tight spreads in US investment grade; however, yields remain elevated and the asset class is experiencing very strong technicals that are supporting current valuations

> Our focus is on idiosyncratic investment opportunities while maintaining an up-in-quality bias within client portfolios

> If factors such as the economy, Fed or US election create volatility, we expect to be opportunistic

High yields and tight spreads. The story stayed consistent for investors in US investment grade during Q2 2024. There are more drivers when considering today's strong technicals and slowly weakening fundamentals, but the valuation picture can create a conundrum for investors. Our approach is to conduct diligent and disciplined fundamental analysis. We always lean on our experience in security selection, being respectful of today's bond valuations.

HIGH YIELDS, STRONG TECHNICALS

The yield to worst of the Bloomberg US Credit Index (Index) showed little direction overall in Q2 2024, increasing a modest 18 bps to 5.43%.[1] A historically elevated yield continued to drive inflows into the asset class ($21B), its eighth consecutive quarterly inflow.[2] We believe positive demand technicals for corporate bonds will remain in H2 2024, though demand could be more variable if market volatility is realized.

The other side of the technical picture is issuance. Companies have been issuing bonds at a fast pace to meet demand, but we see corporate supply tapering in the second half. Gross corporate issuance totaled $316B during the quarter, a decrease from Q1 2024 ($499B) but modestly above the $298B issued in Q2 2023. Gross issuance could move even lower as many companies may have front-loaded issuance to avoid potentially volatile markets ahead of the US election. With a sizable amount of upcoming maturities, coupled with elevated coupon income, we also see net issuance as being more manageable.

IDIOSYNCRATIC OPPORTUNITIES

Our client portfolios have maintained their up-in-quality bias, given tight spreads. We continued to look for idiosyncratic opportunities in the second quarter.

> Within the Investment Grade Credit strategy, that meant rotating sector exposures. We reduced Banking, which has been a better performer this year and could bear the brunt of any market volatility. We rotated into Energy, but kept our focus on quality by adding integrated energy names, a higher-rated segment within that sector.

> Within Investment Grade Credit Plus, we continue to hold floating rate bonds where client guidelines allow, which we believe would benefit if an elevated rate environment plays out.

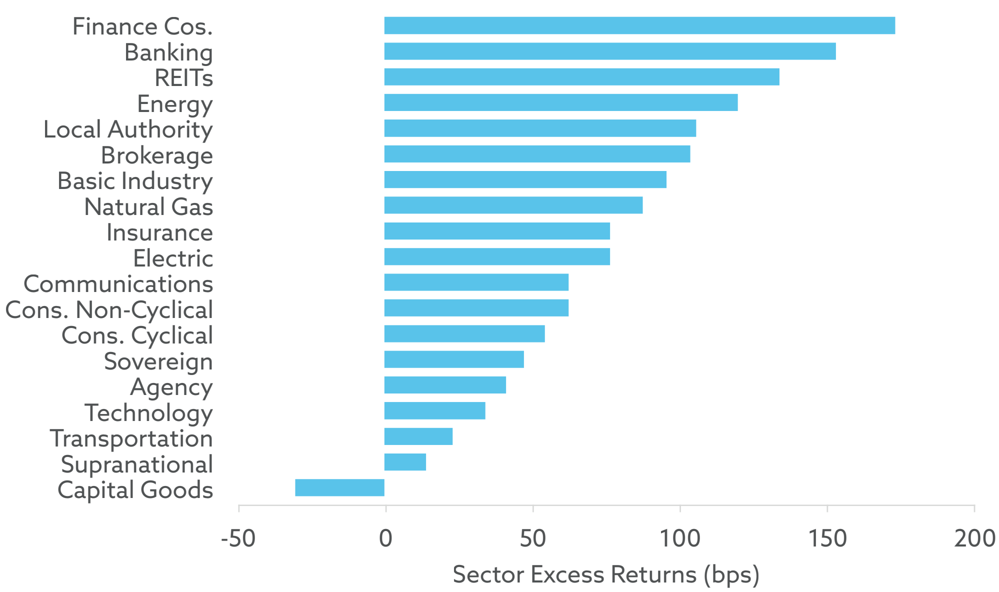
> Finally, within Core Plus Fixed Income, US Treasuries and MBS outperformed on a relative basis during the quarter as yield buyers stepped back from corporate credit. That move could prove temporary, again given the possibility for higher-for-longer rates. Our client portfolios continue to hold underweights in those asset classes, preferring higher-quality corporates and ABS.

(1) Unless indicated, data sourced from Barclays. 1 July 2024. (2) Morningstar. Based on monthly flows for the US OE Intermediate Core Bond category (including ETFs) through 30 June 2024.

INVESTMENT GRADE SPREADS TIGHT, BUT YIELDS ELEVATED[3]

Like yields, investment grade spreads showed little direction overall in Q2 2024. That leaves them historically tight, a notable juxtaposition to today's historically elevated yields. We expect to be opportunistic around any pullback in spreads. However, we would expect spread widening to be more modest and not severe, given corporate fundamentals have not weakened to a great extent and investors can still attain yield in US investment grade.

STRONG EXCESS RETURNS IN H1 2024



The Index produced an excess return of -3 bps in Q2 2024, breaking a streak of seven positive quarters. Still, the Index has gained 80 bps in excess return year-to-date. Strength has been broad-based, led by finance sectors, with only Capital Goods in negative territory. All rating categories have advanced on an excess return basis in 2024, led by lower-rated bonds: AAA/AA 25 bps, A 64 bps, BBB 115 bps. The latter helps explain our preference for up-in-quality.

(3) ICE Data Services. Daily data for the ICE BofA US Corporate Index through 8 July 2024. (4) Barclays. 1 July 2024. Sectors within the Bloomberg US Credit Index that are greater than 0.50% of the MV of the Index.

ADAM SPIELMAN
Senior Managing Director,
Head of Leveraged Credit

JOHN BROZ
Managing Director,
Portfolio Manager

KARL PETROVICH
Managing Director,
Portfolio Manager

KEY TAKEAWAYS

> The US high yield market saw a stable 2nd quarter with spreads close to unchanged and yields modestly higher, as both inflation and growth data were in-line with a soft-landing narrative

> Credit conditions remained supportive – there were more upgrades than downgrades and the default rate declined – while the distress ratio increased but remained below the long-term average

> We saw opportunities to swap into certain lower dollar priced bonds and add leveraged loans where client mandates permit

US high yield spreads were close to unchanged and yields modestly higher as the market focused on growth and inflation data in Q2 2024.[1] Nonfarm payrolls added an average of 177,000 jobs per month over the quarter, while the year-over-year growth rate for core CPI declined 50 bps.[2] The ICE BofA US High Yield Constrained Index (Index) posted a total return of 1.09%, the seventh consecutive quarter of positive returns. Higher-rated bonds led the rally: BB 1.32%, B 1.03%, CCC & Lower 0.18%. Most sectors finished the quarter positive, led by Healthcare (3.17%) and Insurance (1.94%), while Telecommunications (-1.98%) and Media (-1.73%) were the only sectors in negative territory. The Index has gained 2.62% year-to-date. After tightening as much as 12 bps by early May, the Index spread finished the quarter 6 bps wider to 321 bps. The spread is 18 bps tighter year-to-date.

HEALTHY TECHNICALS

Demand remained for the asset class in Q2 2024, as high yield experienced a third straight quarter of inflows ($3B).[3] High yield companies issued $78B in bonds, a modest decrease from Q1 2024 ($87B) but up significantly from Q2 2023 ($54B).[4] Year-to-date issuance has increased 77% to $165B. The elevated level of supply follows easier financial conditions – tighter spreads, stable rates – and supports leveraged issuers through better opportunities to refinance.

Credit conditions remained supportive. The Index default rate decreased for the first time in nine quarters, falling 111 bps to 2.72%, below the average since 2006 of 4.05%.[5] The Index also saw more bonds upgraded ($93B) than downgraded (-$89B) for the first time since Q3 2023. The distress ratio, a predictor of future defaults, increased for the first time in eight quarters, rising 142 bps to 7.35%.

SEARCHING FOR VALUE

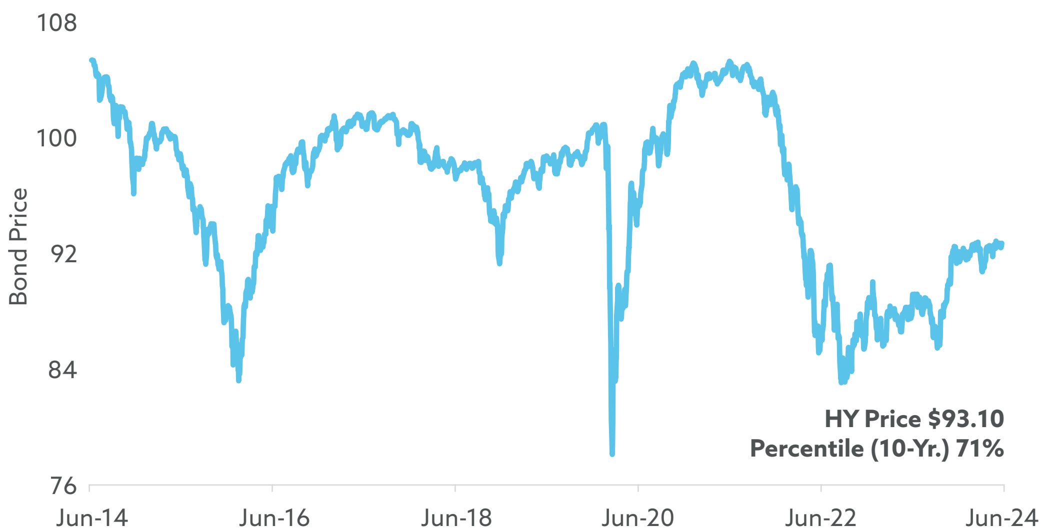
We expect economic growth to be good enough in 2024 for most of high yield. The labor market has been resilient, outperforming our expectations. When looking for value, we see opportunities across the ratings spectrum and favor core income names with improving credit profiles.

In Q2 2024, we reduced risk across client portfolios. We increased exposure to Technology and Utilities and reduced exposure to Capital Goods and Telecommunications. High yield spreads, in our opinion, could move modestly wider from today's compressed levels. Yields near 8% still screen as attractive and position the US high yield market as a liquid source for high current income.

When looking for value, we see opportunities in certain lower dollar priced bonds and leveraged loans. Where client investment guidelines allow, portfolios hold a higher-than-usual position in loans to take advantage of high current income and positive technical demand for the asset class.

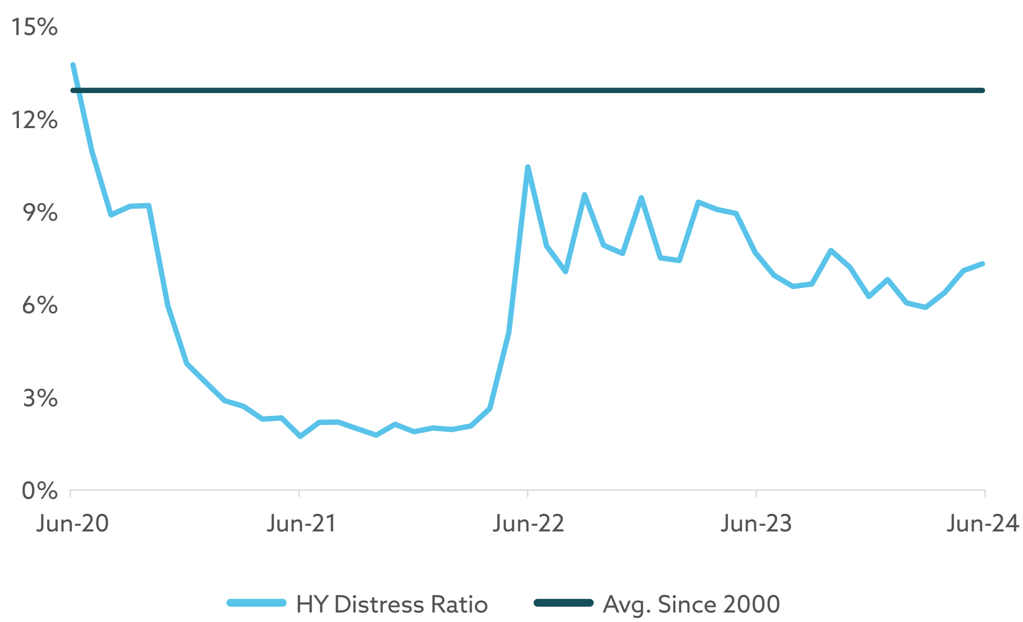
(1) Unless indicated, data sourced from ICE Data Services. 1 July 2024. (2) FactSet. 15 July 2024. (3) Morningstar. Based on monthly flows for the US OE High Yield Bond category (including ETFs) through 30 June 2024. (4) Issuance, default rates and distress ratios, and upgrades/downgrades from BofA Global Research. 1 July 2024. (5) Default rate calculated at the issuer level for the last 12 months. Distress ratio defined as bonds with spreads above 1,000 bps on a par basis.

DOLLAR PRICES HISTORICALLY LOW[6]



We see tactical opportunities to reposition in certain lower dollar priced securities to improve risk-reward profiles. In an effort to improve price convexity in portfolios, we have selectively sold high dollar priced bonds where we see limited upside and have bought low dollar priced bonds. We view this as a hedge against higher volatility, as lower dollar priced bonds could perform better in that environment.

DISTRESS RATIO BELOW HISTORICAL AVERAGE[7]



At the lower end of the quality spectrum, distress has remained below the historical average. Some distressed names have benefitted from an open new issue market – the market has been selectively receptive to issuance from distress names that offer a healthy enough coupon and better legal documentation. The current level of distress supports a below average default outlook.

(6) ICE Data Services. Daily price data for the ICE BofA US High Yield Index through 5 July 2024. Percentiles calculated by PPM. (7) BofA Global Research. 1 July 2024. Distress defined as bonds with spreads above 1,000 bps on a par basis. Average calculated by PPM.

CHRIS KAPPAS
Senior Managing Director,
Portfolio Manager

DAN GREEN, CFA
Vice President,
Portfolio Manager

MICHAEL STERNE, CFA, CPA
Vice President,
Portfolio Manager

KEY TAKEAWAYS

> Floating rate investments have become a more attractive product in the current rate environment, and floating rate CLO debt as well as the underlying collateral consisting of broadly syndicated loans are both currently in demand

> However, the strong bid from CLO issuance has contributed to an elevated bank loan price environment, increasing the difficulty of finding relative value in the current market

> As a result, we are seeking to take advantage of this strong bid by exiting credits where our view has changed and concentrating on names in which we have high conviction, especially well capitalized issuers that have recurring revenues and stable free cash flows

TAKING STOCK OF THE MARKETPLACE

For the broadly syndicated loan market, 2024 so far has been a continuation of the momentum started in 2023.[2] Although the 500 bps in Fed rate hikes put a strain on a portion of borrowers, most loan issuers have been able to recalibrate and sustain under the current higher-for-longer environment, aided by the resiliency of the US economy and consumer. In turn, the broader loan market has returned 4.40% through June driven by elevated coupons and underpinned by strong supply/demand technicals.

The largest source of demand for leveraged loans is the CLO market. The elevated base rate of floating rate products has made investing in AAA/AA tranches of CLOs an attractive alternative to other investment grade products. Additionally, the stable underlying loan market has led to redemptions of older CLOs that has returned cash to investors, leading to increased demand and continued liability spread tightening. As a result, the US CLO market issued over $100B in new CLOs in the first half of 2024, which is a record for a six-month period, and may be on pace to exceed the 2021 record issuance of $187B.

For the second half of 2024, we believe that the strong bid from CLO issuance along with rate protection and stable fundamentals should provide a floor on loan dollar prices and lead to a "coupon clipping return." In our estimation, roughly 90% of the broadly syndicated loan market has run up in price over that last 6-12 months while 10% is still stressed. Within the Morningstar LSTA US Leveraged Loan Index, 44% of loans trade above par. However, this elevated price environment increases the difficulty of finding relative value in the current market.

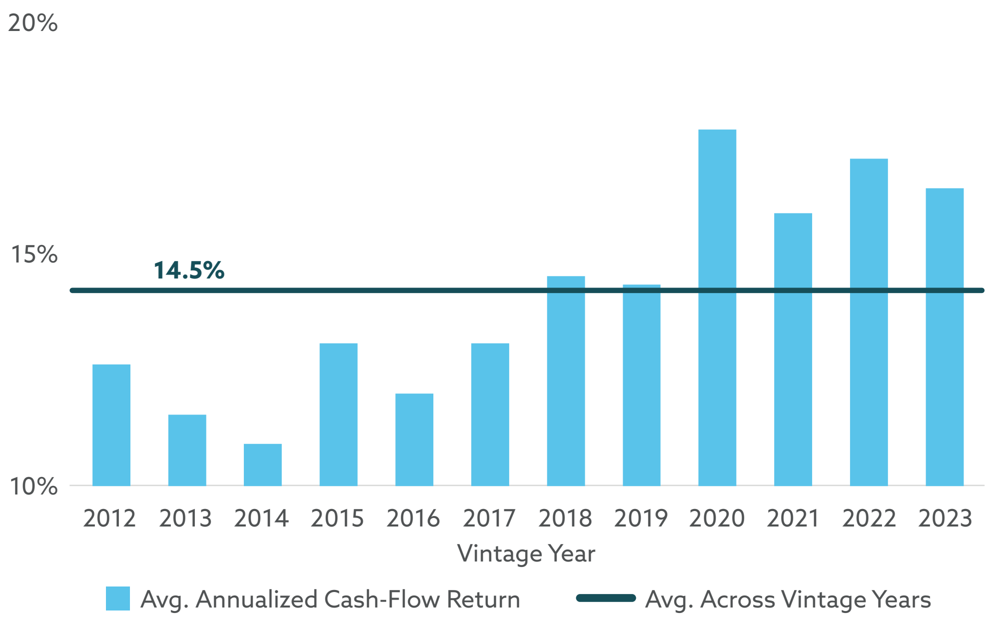
READJUSTING OUR APPROACH

After this prolonged improvement in the loan market, we do not expect to see a significant move upward in already high-priced loans. As an active CLO manager, we are looking to reduce risk by selling names at what we view to be elevated prices where we have a less than neutral outlook and adding to names in which we have high conviction. Although the portfolio remains highly diversified, it has become a bit more concentrated as we take larger positions in loans we like. To put it in perspective, our most recent CLO had 230 loans in it compared to 300+ loans in each of our previous 6 CLOs.

Given our view of the lack of value in the loan market, our focus is on fundamentals. Using our bottom-up, credit research-focused approach, we seek to identify solid performing companies with "sticky" businesses that involve recurring customers and contractual revenue. An example of this would be technology companies whose software becomes essential to the operations of their customers and cannot easily be replaced. On the flip side, we have reduced positions in telecommunications and cable companies as they face secular issues, such as cord-cutting.

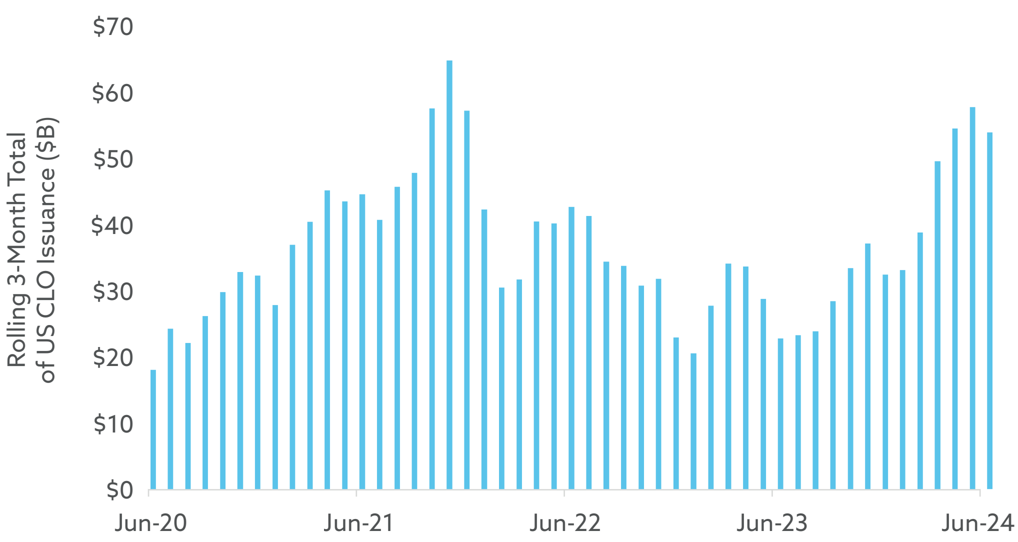
(1) PPM's CLOs are managed by a PPM subsidiary, PPM Loan Management Company 2, LLC, a registered investment adviser. (2) Unless indicated, data sourced from LCD, a part of PitchBook. 1 July 2024.

HEALTHY RECENT CASH-FLOW RETURNS FOR CLO EQUITY[3]



Strong demand for the top end of the stack is compressing potential returns for the AAA and AA tranches in CLOs. As such, now could be a good time for a CLO equity investor to consider coming into the market. For the past four years, CLO equity investors have experienced higher-than-average cash-flow returns. With a favorable "arb" – the difference between the cost of capital paid to bondholders and the coupons received from loan issuers – currently in place, cash-flow returns have averaged 7.6% in the first six months of the year and are on track for an estimated 15% return.[3]

CLO ISSUANCE HIGH BUT DRIVEN BY REFIS[4]



Led by a large number of refinancings, CLO issuance has been robust so far in 2024, up 82% from the year-ago period.[4] However, June saw only $12B of new CLO issuance. This slowdown is due, in part, to the lack of true new money – LBO/M&A-related loans that are essentially the lifeblood of the leveraged finance market and CLO creation. Although analysts project continued new CLO issuance, a record year is less likely without a strong forward LBO loan calendar.

(3) J.P. Morgan. "Global Securitized Products Research: CLO." 3 May 2024. (4) LCD, a part of PitchBook. Monthly US Volume. 3 July 2024.

ABOUT PPM AMERICA

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The **Bloomberg 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 BofA US Corporate Index** provides a broad measure of the USD-denominated investment grade corporate debt securities publicly issued in the US domestic market.

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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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.

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

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