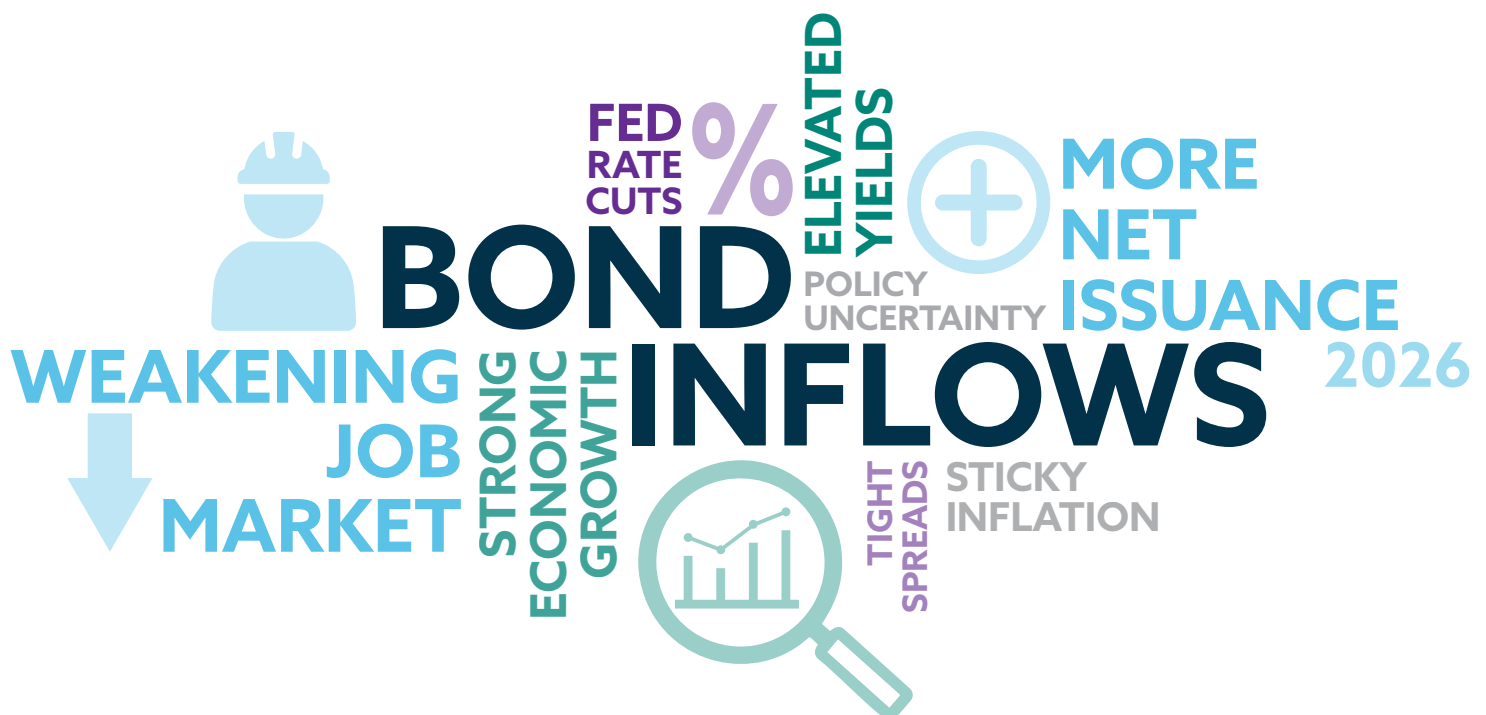


2025 vs. 2026: Spot the Differences



Letter From The CIO

Despite sticky inflation and significant policy uncertainty out of Washington, US markets are trading at elevated valuations, supported by a growing US economy and a Federal Reserve (Fed) that is expected to cut rates further in 2026. High valuations raise the question of how markets [are likely to perform in 2026](#). Valuations were also elevated at the beginning of 2025, but that did not prevent markets from generating generally positive returns. The S&P 500 gained 17.9%, the Bloomberg US Corporate Bond Index generated 119 bps of excess return on its way to a 7.8% total return, and the ICE BofA US High Yield Index returned 8.5%.¹

Consensus expectations we have observed call for another relatively benign year for risk assets. If markets performed strongly in 2025 despite valuations, can they do so again in 2026? The answer to that question may come down to how well the market handles what's different between the two years.

To begin with, the US labor market is weaker. Even though firings are currently low, as evidenced by historically low initial jobless claims, nonfarm payroll growth showed negative prints toward the end of 2025 and job openings are 40% below their post-COVID peak.² Positively, the so-called “low fire, low hire” environment brings some advantages to corporations. It allows them to keep labor costs in check, which translates to continued support for margins, in our experience. However, it also brings risks. Labor income provides the source of demand for goods and services, so at some point a weak hiring environment and rising

unemployment will likely translate to less consumer spending, which is the bedrock of the US economy.

The table below shows historical periods where nonfarm payroll growth, using the 3-month moving average, turned negative, as it did in October 2025. Since 1960, there has been only one period where nonfarm payrolls turned negative and the US avoided a recession. While a recession is not our base case today, the analysis below suggests that continued weak employment growth poses a risk for consumer demand and, by derivation, economic growth and market valuations. Put differently, at some point the contradiction between strong economic growth and weak employment growth needs to be resolved, either by the labor market strengthening, or by the economy weakening.

Another difference we note between 2026 and 2025 is the technical backdrop. Supportive technicals were one of the drivers of strong returns in US fixed income markets in 2025, with elevated yields spurring continued inflows into the asset class. In addition, rising maturities in the investment grade bond universe more than offset a modest increase in gross issuance, resulting in lower net issuance.

However, this positive technical backdrop is expected to reverse in 2026. Technology companies have indicated they will continue spending on data centers, and the market believes they will increasingly finance these expenditures with bond issues. Another expected source of increased issuance is the pick-up in M&A activity, driven

DATE NONFARM PAYROLLS TURNED NEGATIVE ³	MONTHS UNTIL FULLY OUT OF NEGATIVE TERRITORY	CORRESPOND WITH A RECESSION?
Mar-20	4	Yes
Aug-10	2	No
Mar-08	24	Yes
Apr-01	21	Yes
Aug-90	17	Yes
Sep-81	16	Yes
May-80	4	Yes
Oct-74	9	Yes
May-70	8	Yes
May-60	12	Yes

As of 26 January 2026. 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.

(1) Morningstar, Barclays, ICE Data Services. 2 January 2026. (2) US Bureau of Labor Statistics. 7 January 2026. (3) FactSet, National Bureau of Economic Research. 7 January 2026. Dates shown correspond to months where the 3-month moving average of nonfarm payrolls turned negative. For number of months shown, the figure could include months where the average briefly turned positive, only to return to negative territory.

by a more friendly regulatory environment, earnings and balance sheet strength, and equities near all-time highs. There is typically a lag between M&A announcements and the associated bond issues to pay for the acquisitions, so we expect more supply in 2026, likely continuing into 2027. While inflows into fixed income markets should continue, they will likely not be enough to offset increased supply, at least not to the extent they did in 2025.

Note that this less favorable backdrop to 2026 could be magnified by potential headlines emanating on any number of issues, including policy announcements, geopolitical risk and the changing makeup of the Fed. The direction of interest rates is also a risk. Having already cut by 175 bps since September 2024 and with the trajectory of inflation uncertain, there is no guarantee the Fed will cut again in 2026, let alone by approximately 50 bps as currently priced in by markets.⁴

Even with all of these year-over-year differences, like the consensus we are still modestly constructive on fixed income markets and our base case is for positive total returns in 2026. Unless the fundamental economic picture turns, macro and corporate strength should underpin the market, aided by an accommodative (or at least a non-restrictive) Fed.

Where we differ from consensus is that we view negative excess returns as more likely in 2026. In order to reach this conclusion, we examined the historical importance of starting valuations in determining *ex post* annual excess

returns. During 2025, starting spreads were tight and stayed relatively unchanged in both investment grade and high yield, but excess returns were positive. Is that likely to repeat in 2026? As the table below shows, when spreads have historically started a year this tight, excess returns generally skew to the downside, especially in the investment grade market, suggesting that downside risks to excess returns could be assigned more weight.

In conclusion, with the current economic backdrop and given tight spreads and attractive yields, we are constructive on total returns in the fixed income markets in 2026, but less so on excess returns. However, as we demonstrated in 2025, PPM's core investment approach is highly suited to this market environment. Using credit research to find relative value and a bottom-up analysis to build client portfolios does not depend on significant tightening of market spreads to generate returns. Given that markets are priced near perfection, we have prudently moved up-in-quality in our clients' portfolios, especially with the cost of doing so currently being low. This positioning also provides our strategies with the optionality to be tactical, remaining patient and awaiting opportunities to selectively invest into weakness.



OGECHI NWACHUKWU
Chief Investment Officer

INVESTMENT GRADE⁵

YEARS WHEN IG SPREADS BEGAN BELOW 100 BPS	STARTING OAS (BPS)	SUBSEQUENT ANNUAL EXCESS RETURN (%)
1997	60	-0.31
1998	70	-2.22
2004	94	1.73
2005	83	-0.81
2006	92	1.27
2007	91	-5.03
2018	99	-2.84
2022	98	-1.37
2025	82	1.34

HIGH YIELD⁶

YEARS WHEN HY SPREADS BEGAN BELOW 350 BPS	STARTING OAS (BPS)	SUBSEQUENT ANNUAL EXCESS RETURN (%)
1997	313	5.75
1998	296	-5.02
2005	309	0.61
2007	289	-7.32
2022	310	-3.04
2024	339	5.10
2025	281	2.36

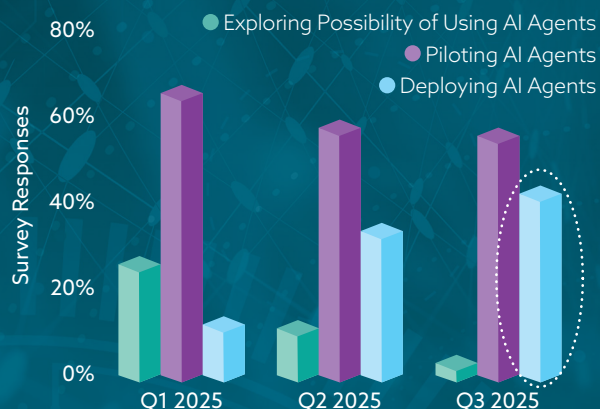
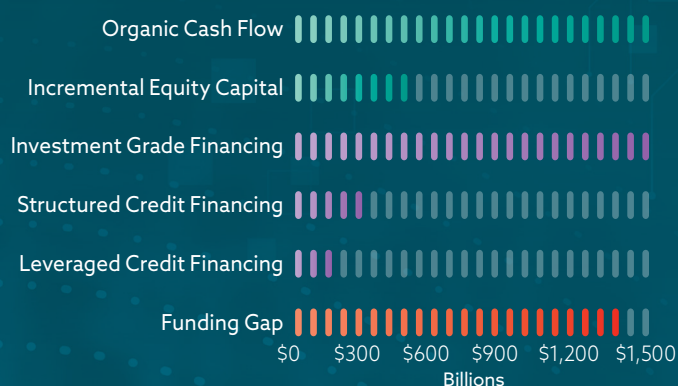
(4) Bloomberg. 16 January 2026. (5) ICE Data Services. Data for the ICE BofA US Corporate Index. 7 January 2026. (6) ICE Data Services. Data for the ICE BofA US High Yield Bond Index. 7 January 2026.

The Plunge into AI Investing

Our near-term concern around AI is how it may impact fixed income investing in 2026. The sheer numbers could require more financing than perhaps available. What financing there is, especially for large investment grade-rated deals, could eat up demand, perhaps pulling it from other IG deals or other asset classes. Let's dive into the numbers.

YOU KNOW WHAT'S COOL? FIVE TRILLION DOLLARS¹

J.P. Morgan recently estimated that AI data centers will require \$5.4T in financing over the next five years. Today's large technology companies generate significant free cash flow, but J.P. Morgan still "only" expects them to cover \$2.0T. The IG market is expected to finance \$1.5T, with leveraged and structured credit adding \$0.5T. That leaves a potential funding gap of \$1.4T!

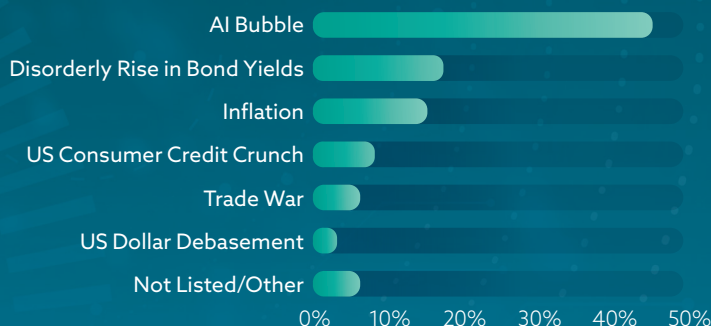


TRACKING INTEGRATION²

Longer-term, the question is if companies can monetize AI to cover such significant investments. A recent survey indicated 42% of businesses are deploying AI agents in the office. However, that survey only includes businesses with annual revenue above \$1B. Another recent survey for all businesses, including small firms, showed a lower figure at 17%.³ These surveys do not reflect how consumers adopt the technology at home (and choose to pay for it), which is also crucial.

AI IDENTIFIED AS TOP RISK⁴

AI is generally considered the most significant economic and market tailwind today, due to potential integration and productivity gains. At the same time, a recent survey noted the market also views AI as the largest risk. This caution likely reflects the data above – funding gaps and the uncertainty around realizing revenue.



(1) J.P. Morgan via PitchBook Data, Inc. 19 November 2025. (2) KPMG. Accessed on 8 January 2026. "The KPMG Quarterly Pulse Survey captures perspectives from 130 U.S.-based C-suite and business leaders representing organizations with annual revenue of \$1 billion or more." (3) Census Business Trends and Outlook Survey via J.P. Morgan. As of 31 December 2025. Percentage of firms reporting use of AI applications in any business function. (4) BofA via PitchBook Data, Inc. 19 November 2025.



MARK REDFEARN, CFA
Portfolio Manager



JOSH SETTLE, CFA
Portfolio Manager



ANDREW BRUNKS, CFA
Portfolio Manager



CALVIN WALKER
Portfolio Manager



JON NELSON, CFA
Portfolio Manager

KEY TAKEAWAYS

- > With credit spreads near multi-decade tights, security selection and tactical reallocation will likely be paramount in 2026
- > We expect technicals to become less positive this year; inflows should continue but AI and M&A funding could significantly increase net issuance
- > Despite overall positive fundamentals, the underlying picture is likely to include slowing or declining job growth, sticky inflation and continued policy uncertainty (tariffs, Fed appointees, etc.)

US investment grade spreads widened modestly in Q4 2025 on account of AI jitters and continued demand not being enough to offset increased issuance. After widening out to 80 bps in November, the spread of the Bloomberg US Credit Index (Index) reversed course to finish the quarter only 3 bps wider to 73 bps.¹ Overall, the spread tightened 4 bps in 2025. The Index posted a positive total return of 0.87% during the quarter due to coupon payments and a modest rally in short-end US Treasuries, improving the year-end total return to 7.83%.

SHIFTING TECHNICALS

A very positive technical environment has driven the market, including inflows and lower net issuance in 2025. However, we expect net issuance to increase in 2026, perhaps significantly. Given the capital expenditures technology companies are expecting to spend on data centers, AI issuance will likely increase. In our view,

M&A activity should continue with a more friendly regulatory environment and equities near all-time highs, which should lead to increased bond issuance to pay for acquisitions. While we expect inflows to persist given elevated yields (~4.75% entering 2026), they will likely not be enough to offset increased supply.

Some of our preferred sectors are those expecting to see less growth in issuance, such as Banks. That sector is also currently benefitting from deregulation. Beyond corporates, we favor select areas of structured credit such as ABS that provide both yield pickup and shorter duration.

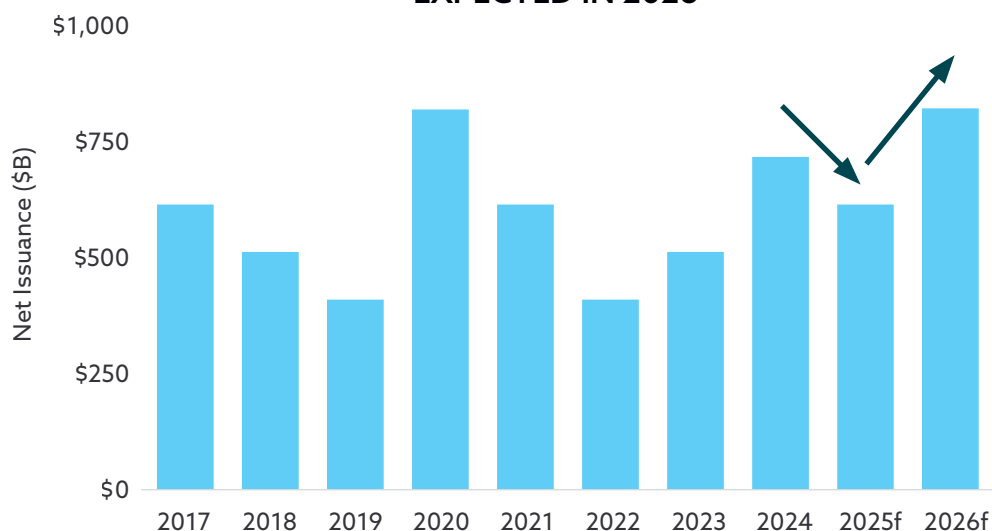
KEEPING AN EYE ON FUNDAMENTALS

Fundamentals remain positive, with resilient macro growth and still strong corporate earnings. However, companies must continue to carefully navigate a changing tariff picture, especially as we await the Supreme Court's decision, and other policy uncertainty. An example of the latter is Fed nominations, including the new Chair.

The Fed may also have to toe the line between sticky inflation and a slowing labor market. We would note that the central bank has already cut rates 175 bps since late 2024. Even if President Trump nominates a dovish Fed Chair, future rate cuts could be limited.

Despite our overall positive fundamental outlook, we are selectively investing in cyclical sectors. Our investment grade portfolios are currently neutral to underweight risk given valuations and the potential hazards discussed above. We believe a better approach is remaining tactical. We would rather be patient and await bouts of volatility, allowing us to invest into weakness.

AFTER 2025 REPRIEVE, HIGHER NET ISSUANCE EXPECTED IN 2026²



Even with an increase in gross issuance in 2025, net issuance fell approximately 10% as a significant amount of the aggressive pandemic supply matured in size. However, with the expectation for AI funding to come to market and M&A activity to increase, forecasts call for around a 30% rise in net issuance in 2026. This supply increase will strain demand, in our view, especially if yields decrease from currently elevated levels.

SPREAD SPIKES MAY PROVIDE OPPORTUNITY³



As investment grade spreads sit near multi-decade tight levels, we believe fixed income investors would be best served to remain tactical. In the past two years, significant spread widening events (e.g., unwinding of the Japanese carry trade and a poor US employment report in August 2024, as well as the reciprocal tariff announcement in April 2025) provided opportunities to buy into a weakened market that ultimately bounced back quickly. With 2026 bringing another year of policy uncertainty, periods of volatility may present more favorable entry points for investors.

**ADAM SPIELMAN**

Head of Leveraged Credit

**JOHN BROZ**

Portfolio Manager

**KARL PETROVICH**

Portfolio Manager

KEY TAKEAWAYS

- > In our view, a resilient US economy, healthy corporate profit growth and benign defaults underpin a supportive fundamental backdrop for high yield
- > Valuations are mixed with tight credit spreads while yields are still attractive
- > Against this backdrop, we favor the Financial Services, Technology and Leisure sectors and are cautious on cyclical areas in Basic Industry and Capital Goods
- > Thematically, we expect increased M&A activity to benefit high yield companies

ANOTHER POSITIVE QUARTER

The US high yield market rallied once again in Q4 2025, gaining 1.35% to take the year-end return to 8.50%.¹ A resilient US economy, Fed rate cuts, healthy corporate profit growth and benign defaults underpinned a supportive backdrop. Higher-rated bonds outperformed during the quarter: BB 1.57%, B 1.55%, CCC & Lower -0.52%. They also outperformed in 2025: BB 8.93%, B 8.38%, CCC & Lower 6.49%.

Technicals were mixed in Q4 2025. Despite modest outflows, high yield bond issuance totaled \$66B, an increase from Q4 2024 (\$50B). Refinancing accounted for 58% of gross supply, but new money also picked up during the quarter (\$28B) relative to total issuance. Supply increased 16% in 2025 to \$335B.² An open primary market is positive for leveraged credit as it allows names to refinance.

High yield fundamentals continued to be supportive in Q4 2025. In addition to continued low defaults (see next page), the asset class saw more bonds upgraded (\$91B) than downgraded (-\$62B) during

the quarter. It experienced net upgrades of \$46B in 2025.

SUPPORTIVE HIGH YIELD BACKDROP

Our expectation is for the supportive fundamental backdrop discussed earlier to continue in 2026. Importantly, investors should note that the high yield market currently has a much better rating composition than during past cycles.² Valuations remain mixed with tight credit spreads, but attractive yields given the overall credit quality and below average default rates. Additionally, the technical picture is positive with overall inflows to the asset class and moderate net supply.

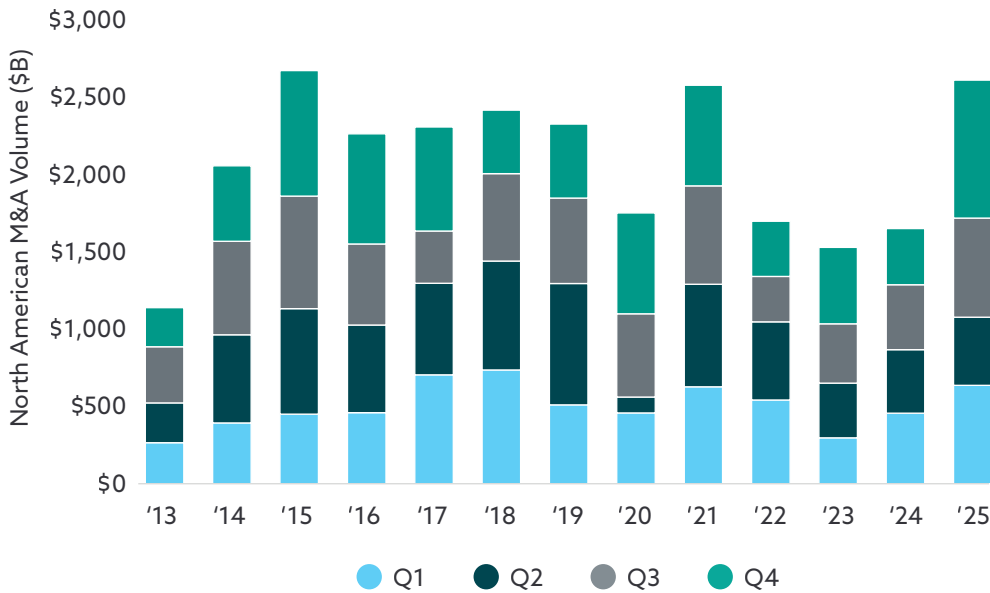
Against this backdrop, our focus in 2026 is on sector and security selection to seek to take advantage of divergent fortunes among corporate sectors and consumer spending. We are favorable on Financial Services, Technology and Leisure. We believe Financial Services can perform well under a range of economic outcomes. Technology and Leisure tend to benefit from certain parts of the economy doing well – demand for technology products and robust consumer spending among middle- and upper-income cohorts for leisure activities. Cyclical areas in the Basic Industry and Capital Goods sectors require caution in our view, as price competition and weaker end-market demand have depressed profits without visibility into a recovery.

Our outlook within the Energy sector is mixed. We are overweight the fee-based Gas Distribution sub-sector and underweight the more commodity sensitive sub-sectors of Exploration & Production and Oilfield Services.

In terms of spread buckets, we favor core income names in the 200-400 bps range to provide attractive income with limited downside, in our view. Thematically, our expectation is for M&A activity to increase and to benefit the high yield market (see next page).

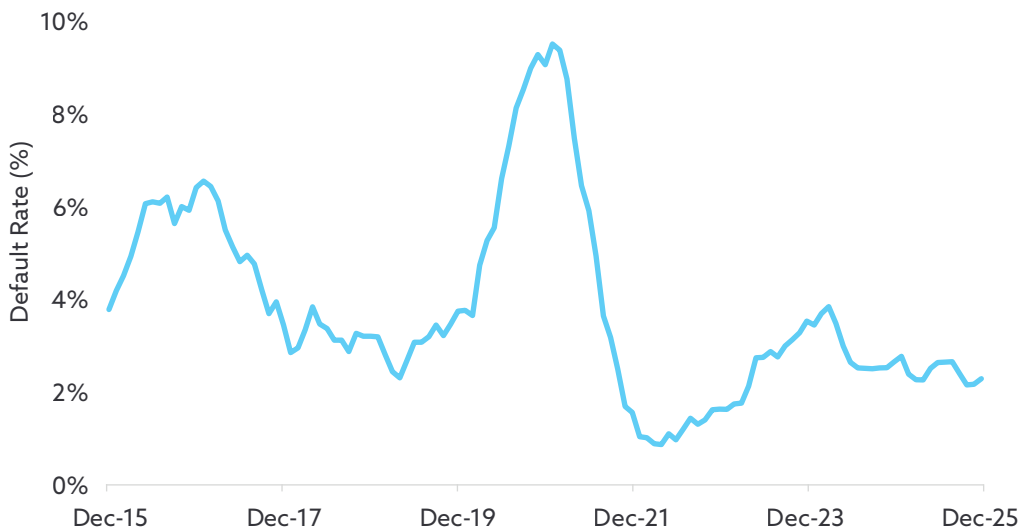
(1) Unless indicated, data sourced from ICE Data Services. 2 January 2026. Data for the ICE BofA US High Yield Constrained Index. (2) Data for issuance, upgrades/downgrades and ratings composition sourced from BofA Global Research. 2 January 2026.

HEIGHTENED M&A ACTIVITY SHOULD CONTINUE IN 2026³



M&A activity spiked in 2025, is expected to remain elevated or even increase further in 2026, and continues to impact credit markets broadly. In general, M&A activity is favorable for high yield companies since they can be acquired by investment grade companies or improve credit quality by gaining scale from mergers or even targeted acquisitions. We seek pockets of capital appreciation through sectors and names that participate in M&A activity and also from shorter maturity bonds that could be refinanced ahead of market expectations.

DEFAULTS COULD REMAIN BENIGN IN 2026⁴



The default rate decreased 12 bps in Q4 2025 to 2.25%, remaining below the average since 2006 of 3.91%.⁴ We do not currently expect a spike in defaults in 2026. The distress ratio, a predictor of future defaults, did increase 56 bps in the fourth quarter to 4.92% but remained well below the average since 2006 of 10.58%.

(3) Bloomberg. 13 January 2026. Quarterly North American M&A volume including pending, completed, terminated, proposed and withdrawn deals.
 (4) BofA Global Research. 2 January 2026. Default rate calculated at the issuer level for the last 12 months.



CHAMP RAJU
Head of Private Equity



CRAIG RADIS
Senior Partner



MARK STAUB
Senior Partner



RAY ZHANG, CFA
Partner

KEY TAKEAWAYS

- > 2026 is shaping up to be a good year for PE, in our view, as falling interest rates and M&A resurgence support overall activity
- > We believe deal flow will remain robust, while exits experience an uptick and fundraising improves especially for GPs with healthy track records
- > One impediment to dealmaking is the potential of price misalignment between buyers and sellers to continue into the new year

BALANCING DEAL/EXIT ACTIVITY WITH VALUATIONS

With the Fed cutting interest rates and M&A activity surging, 2026 is shaping up to be a good year for US private equity (PE). However, understanding which parts of the market are poised to benefit more than others could be key to PE investor success.

From a macro perspective, falling interest rates are supportive of PE activity overall. Lower borrowing costs and improved valuations should be a boon to general partners (GPs), leading to the continuation of the robust deal flow seen in 2025. This should be especially true for co-investment and continuation vehicle (CV) deals. In addition, this favorable environment also drives exits and liquidity, which strengthens limited partners' (LPs) commitment to established GPs, facilitating smoother capital raising for new primary funds and enhancing the overall ecosystem.

PE exit value picked up in 2025. We anticipate this trend to continue in 2026, driven by CVs, the uptick in M&A activity and an IPO market showing signs of life (see next page).

As for fundraising, we observe that GPs with healthy track records and clean histories are hitting their target goals and time frames. Others are taking longer to raise money and close their funds. Additionally, we believe public stocks seem overvalued to many investors, which could lead to more money flowing into PE. An uptick in exit activity would only enhance this as LPs could then redeploy that money back into PE, especially into safer, high-quality investments. Lastly, larger firms gaining traction offering PE funds to retail investors could provide another avenue for fundraising.

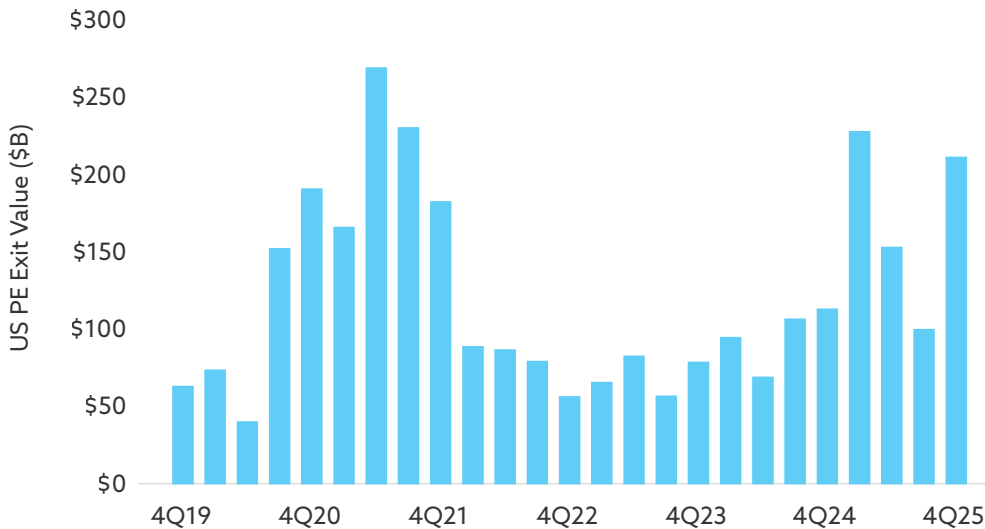
TECH REMAINS AT THE FOREFRONT

After sterling returns in 2025, the Technology sector should remain a focal point for PE investors next year. AI investments including data centers will most likely continue at a historic pace, offering ample opportunities for PE investors. However, caution is in order as any potential AI bubble could have massive repercussions and lead to losses.

DON'T LOSE SIGHT OF THE RISKS

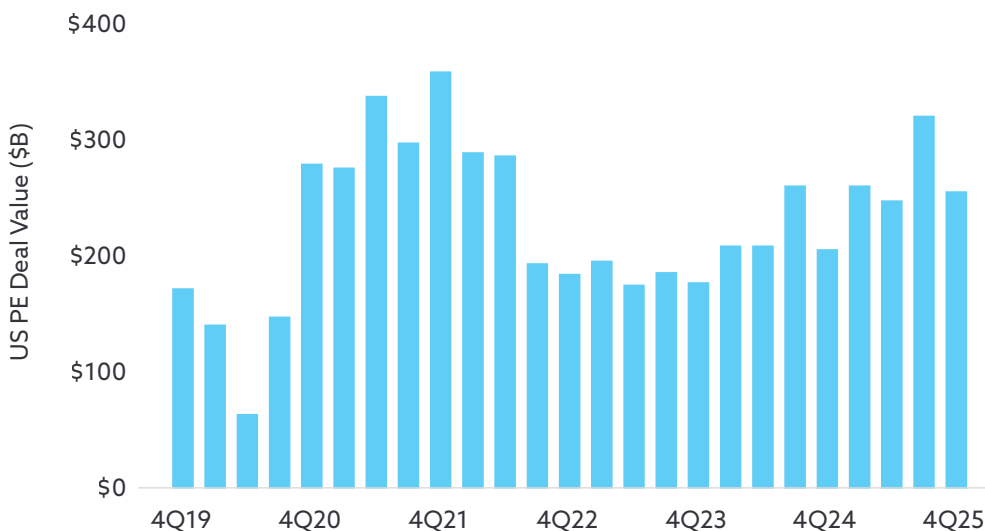
Although optimism reigns for PE in the new year, a few areas of concern are worth noting. At a macro level, a softening job market could impede economic growth. From a policy perspective, federal regulatory scrutiny may continue to impact certain sectors adversely, especially Healthcare. Tariffs have mostly been managed by portfolio companies, but pockets of sectors, namely Industrial, may remain challenged. Interest rate uncertainty also lingers. The Fed may take a pause on further cuts, although a change in Fed leadership or political pressure could impact that decision, which will in turn impact LBO debt costs and M&A activity. When it comes to deal making, one hindrance to both flow and exit activity may be continued price misalignment between buyers and sellers.

PE EXIT MARKET REBOUNDED IN 2025¹



PE exit value picked up in 2025, a trend we anticipate continuing in 2026, led by three main drivers. First, for middle-market PE, GPs have solidified CVs as one of the four main paths of exit (including IPOs, strategic and financial) and their use will likely increase in the coming year. Second, the uptick in M&A activity (which has been aided by lower interest rates) should help not only performance but also spur additional exits. Third, the IPO market is showing signs of life, providing an exit pathway for larger companies.

WE EXPECT DEAL FLOW TO REMAIN ROBUST IN 2026²



We have witnessed robust deal flow in recent years, including 2025, and expect it to remain elevated in 2026. The lending environment remains open and continues to be favorable for PE deals. Interest rates could be a tailwind here if market yields come down. Exit activity could be another driver. Distributions back to LPs can increase their capacity to commit fresh capital, and GPs can use that capital to drive continued deal volume.

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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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