PACIFIC FUNDS

CORPORATE CREDIT HIGHLIGHTS

OCTOBER 31, 2022

	Monthly Return (%)	Year-to-Date Return (%)	Option-Adjusted Spread (BPS)			
	10/31/22	10/31/22	10/31/22	12/31/21	12/31/20	12/31/19
Investment-Grade Corporate Bonds	-1.03	-18.92	147	87	92	90
Single A Bonds	-1.21	-18.85	137	74	74	70
BBB Bonds	-0.75	-19.80	190	115	124	125
1-3 Year Credit	-0.18	-4.79	83	35	30	36
7-10 Year Credit	-0.69	-19.23	180	93	96	98
Long Credit	-2.30	-30.69	184	130	141	139
Bank Loans*	0.85	-2.49	655	439	486	461
BB Loans	1.76	0.85	378	307	305	262
B Loans	0.72	-2.96	705	444	469	470
Over $90	-1.31	-1.15	515	417	422	368
Up to and including $90	-1.12	-19.83	1278	1380	1258	1270
Issues over $1 billion	1.23	-2.76	607	395	414	379
Issues $201 million to $300 million	-0.58	-2.46	883	639	755	685
High Yield	2.60	-12.53	464	283	360	336
BB Bonds	2.35	-12.46	291	194	264	182
CCC Bonds	1.28	-15.64	1082	549	658	869
Intermediate High-Yield Bonds	2.68	-11.80	466	285	363	333
Long High-Yield Bonds	0.30	-25.30	404	252	329	397
Very Liquid High-Yield Bonds	3.05	-13.19	524	309	340	319

Source: Bloomberg, Credit Suisse and Morningstar® as of 10/31/22.
U.S. credit represented by the Bloomberg US Credit Index and index components. Bank loans are represented by the Credit Suisse Leveraged Loan Index and index components. High yield is represented by the Bloomberg US Corporate High Yield Index and index components.
*3-year discount margin shown for bank loans.

Highlights

Investment Grade

- Citi on MBS sales from Fed balance sheet: "Our Agency MBS team no longer expects MBS sales in 2023 due to liquidity concerns. This slows the overall pace of balance sheet reduction, as the MBS runoff cap will not bind in the current interest rate environment. MBS principal paydowns are projected to decline from $23bln in October to around $15bln by December and onwards."[1]
- Morgan Stanley strategy on IG spread expectations: "At 160bp, we see a window for compression back towards our year-end target (150bp), as the economy remains resilient for now. Liquidity considerations into year-end are valid but can cut both ways. The challenge is that the dislocation in index spreads relative to September is driven by 1) the Banks sector amid heavy supply,2) illiquid securities, and 3) the front end. The latter two segments can lag even more in a true downturn and could be value traps. Therefore, we recommend keeping it simple and staying in liquid securities, high quality, and low $ bonds... Our base/bear range of 150-175bp in IG has held this year, and as things stand now, we expect these ranges to continue to hold into year-end."[2]

High-Yield Corporates

- JP Morgan strategy on implied default rate for HY: "The implied default rate for HY spreads (496bp) is 2.8%, or above our 2.25% 2023 default forecast and only slightly below our mild recessionary scenario. Using a historical average excess spread of 330bp and recovery rate of 40%, our 2023 default forecast of 2.25% would imply a HY spread of 465bp by YE22."[3]
- JP Morgan on fallen angels/rising stars in 2023: "We forecast $160bn of debt to be upgraded from HY to HG through 2023 (Rising Stars) while expecting a modest $15bn of debt to fall from HG to HY (fallen angels) over the same time period."[4]

Bank Loans

- Per LCD, a large number of leveraged loan issuers were able to take advantage of the borrower-friendly environment back in 2021 until the first month of this year to refinance term loans and extend maturities. Of the record $614.6 billion of institutional loan issuance in 2021, $178.5 billion (or roughly 29%) of the volume was used to refinance existing debt. As a result, just $110.1 billion of the $1.42 trillion in outstanding loans, or nearly 8% of the market, matures in 2024 or earlier. Another roughly 15% of the index matures in 2025.[5]
- Barclays on loan earnings: "Despite the macro-overhang, it feels like we are seeing some signs of normalization in the loans market. Corporate earnings, which have been widely thought of as a potential catalyst for another leg lower in the loans, have largely come in line, or even better than feared in some cases. The same issues of margin pressures are in focus, but it does feel like the market is getting more comfortable with the current outlook as companies start to look ahead to 2023."[6]
- JP Morgan strategy on default activity or lack thereof: "There were no new defaults or distressed transactions during October, marking the first time since 2018 there was no default/distressed activity. For context, default/distressed volume totaled $23.4bn in 3Q versus $10.4bn in 2Q and $8.6bn in 1Q. Including distressed exchanges, the US high-yield bond and loan default rates increased 1bp and decreased 8bp m/m to 1.59% and 1.58%, respectively. The HY bond and loan default rates compare to the long-term average of 3.2% (HY) and 3.1% (LL)."[7]

Sources

[1] Citi economist Andrew Hollenhorst, Oct. 27, 2022
[2] "Navigating the Flows," Morgan Stanley IG strategy by Vishwas Patkar, Oct. 25, 2022
[3] Jantzen, Nelson, J.P. Morgan Default Monitor, Nov. 1, 2022.
[4] Beinstein, Eric, JPM Daily Credit Strategy & CDS/COX am update, J.P. Morgan, Nov. 2, 2022.
[5] LCD, Nov. 2, 2022
[6] Rogoff, Bradley, et al. Outlook Call. Barclays. November 2022.
[7] Jantzen, Nelson, JPM Daily Credit Strategy & CDS/COX am update. Nov. 2, 2022.

Disclosures

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