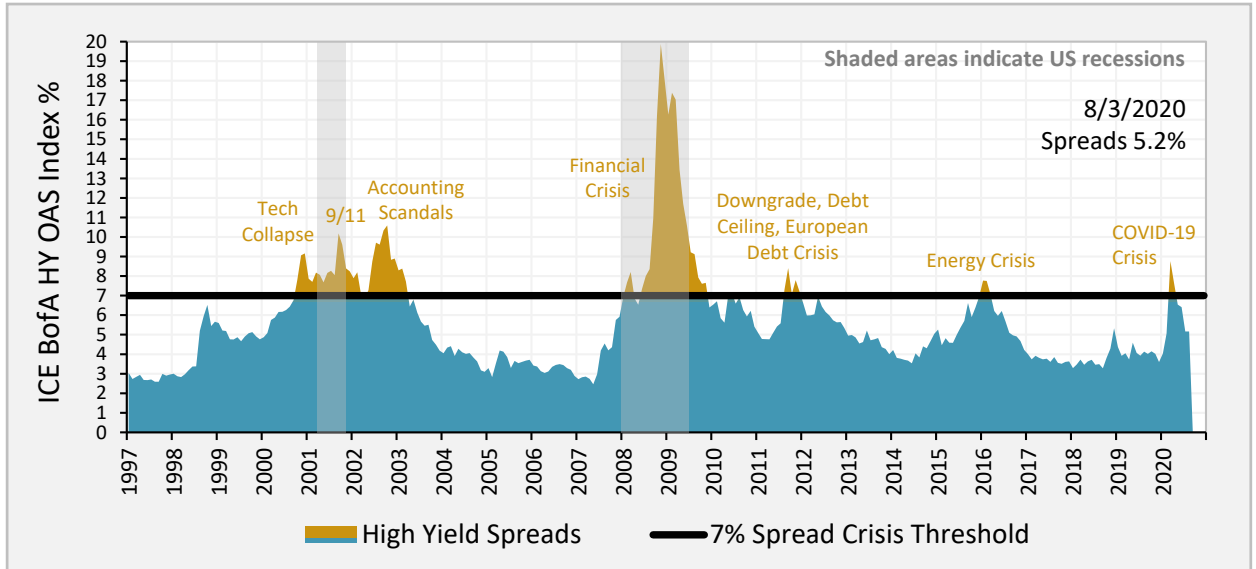


Penn Capital Weekly Credit Insights

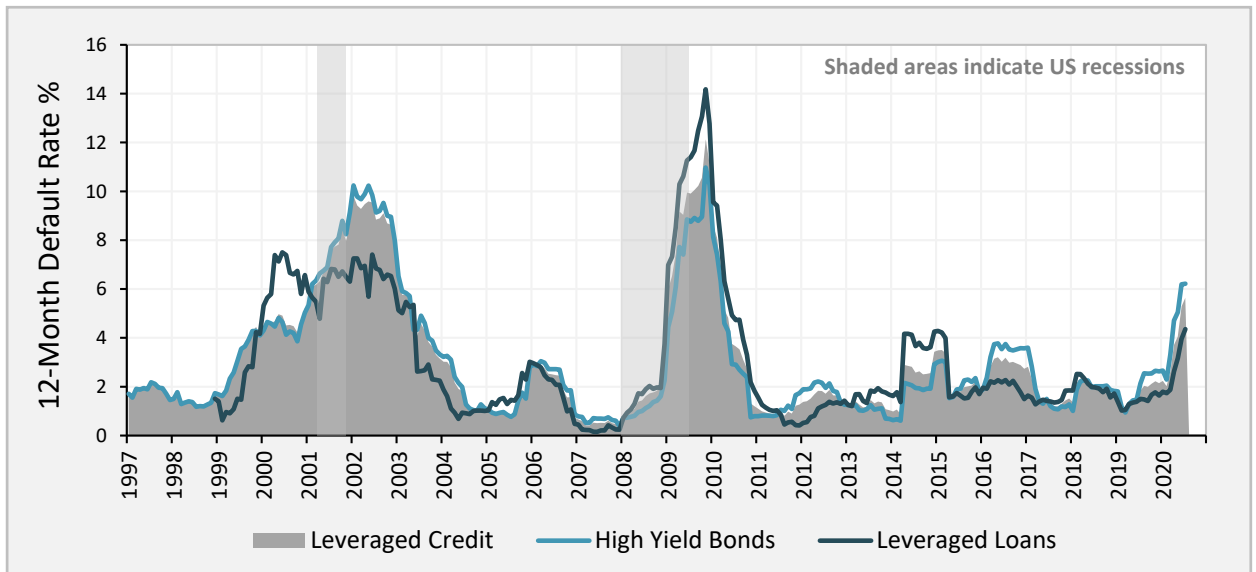
Peter Duffy, CFA and David Jackson, CFA

Credit Risk: Credit Spreads and Crisis Periods



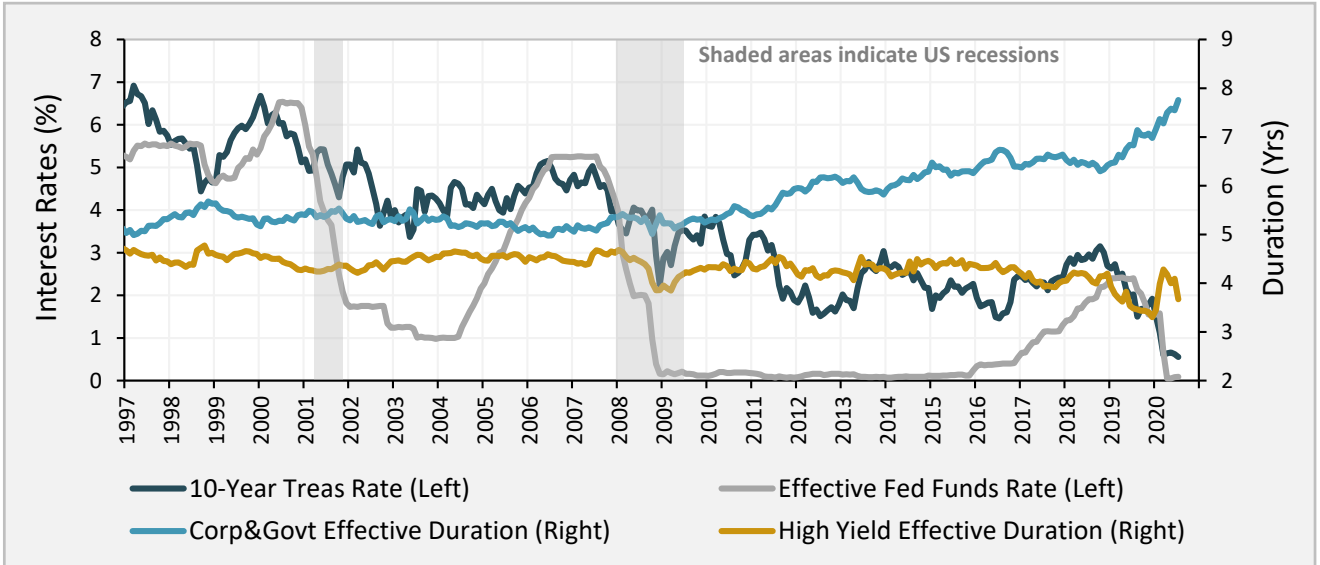
As of 8/3/2020. Source: ICE BofA. Index: ICE BofA High Yield Option Adjusted Spread Index.

Credit Risk: High Yield Bond and Leveraged Loan Default Rates



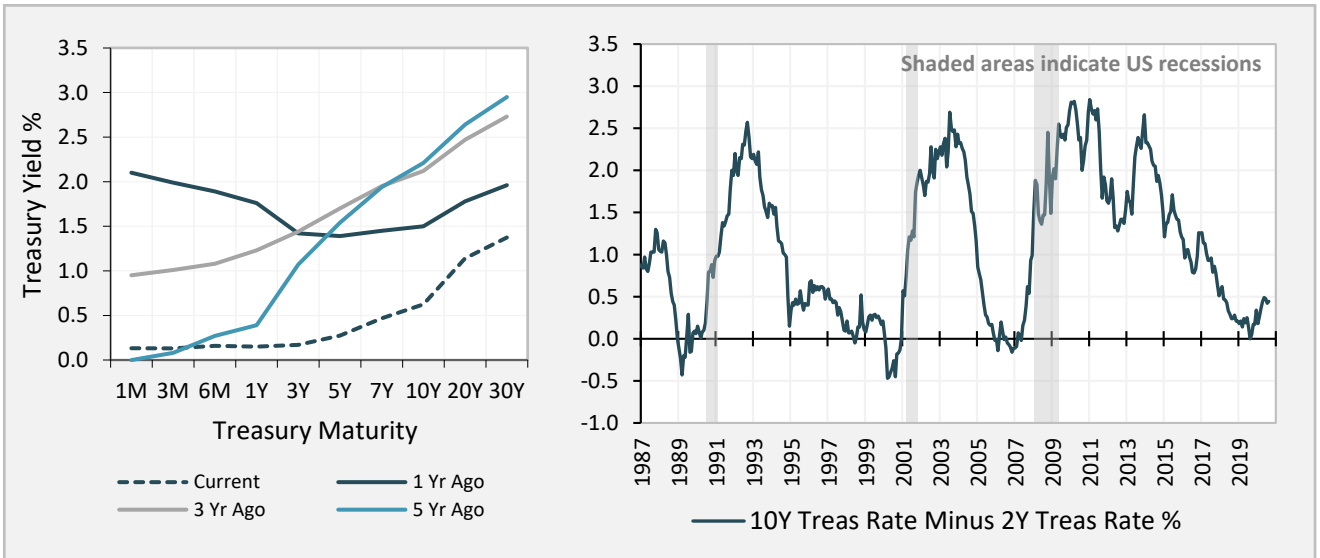
As of 7/31/2020. Source: JP Morgan. 12-month defaults weighted by par.

Interest Rate Risk: Rates and Duration



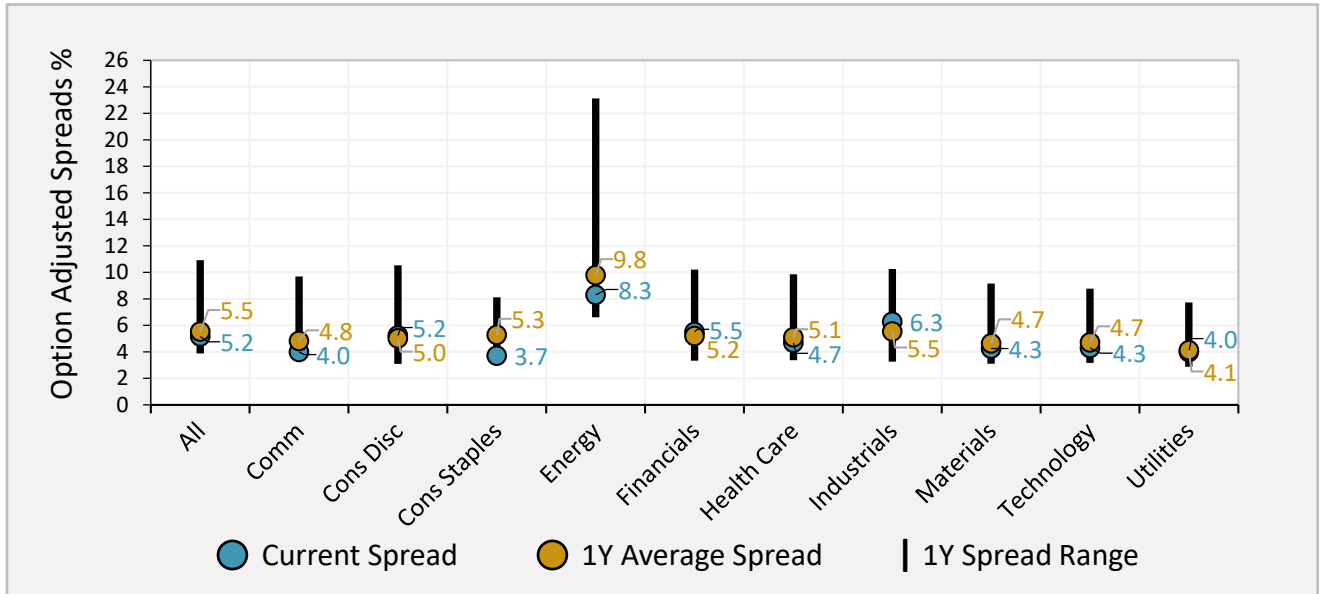
As of 8/3/2020. Source: Federal Reserve, ICE BofA. Indices: ICE BofA Corp & Govt Bond Index, ICE BofA High Yield Bond Index.

Yield Curve: Current and Historical Treasury Curve



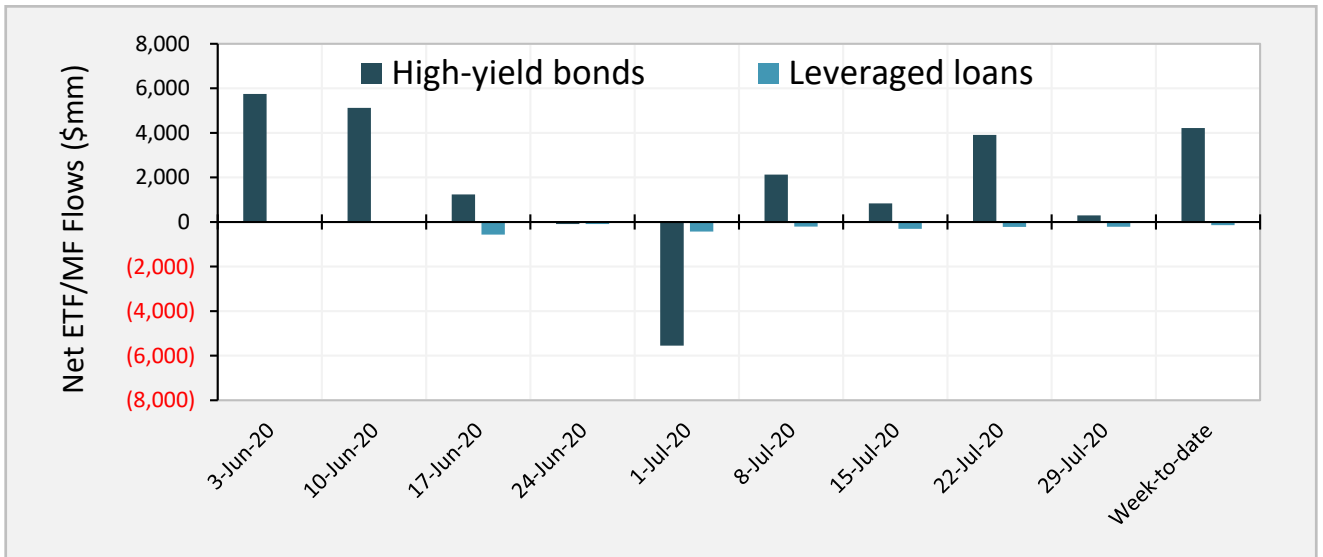
As of 8/3/2020. Source: Federal Reserve.

Sector Risk: High Yield Credit Spreads by Sector



As of 8/3/2020. Source: Bloomberg.

Fund Flows: Weekly High Yield Credit ETF and MF Flows



As of 8/3/2020. Source: JP Morgan.

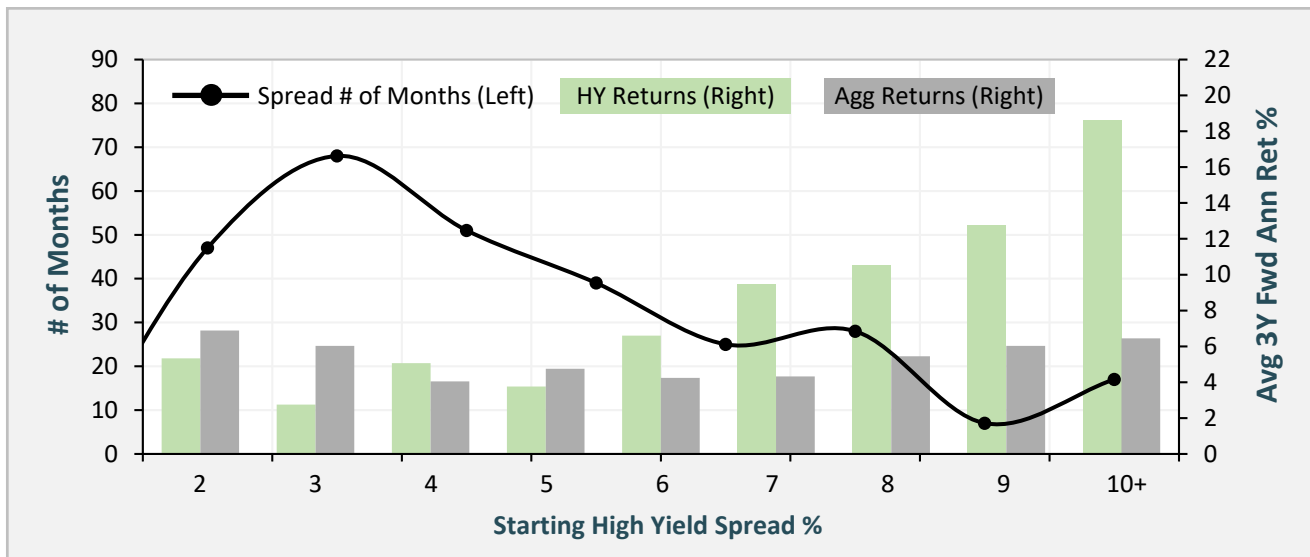
Spreads at Investment Entry: Avg 3-Yr Forward Ann Return by Asset Class

# of Months	Credit Spreads	Small Stocks	Large Stocks	HY Bonds	Lev Loans	BB-B 1-3 Bonds	Corp Bonds	Muni Bonds	MBS Debt	Agg Bonds	Agency Bonds	Treasury Bonds
1	2	-6.6	-8.7	5.3	3.3	8.4	6.2	5.2	7.8	6.9	6.6	7.2
47	3	0.5	4.2	2.8	2.9	5.8	4.7	4.4	6.6	6.0	6.2	6.6
68	4	6.3	7.7	5.1	3.2	4.6	4.0	4.0	4.2	4.0	3.7	4.1
51	5	6.8	5.7	3.8	4.0	5.7	5.5	5.5	4.6	4.8	4.2	4.4
39	6	10.4	8.1	6.6	5.0	6.9	5.5	4.8	4.1	4.2	3.7	3.7
25	7	12.8	10.7	9.5	6.0	7.8	6.3	4.9	3.9	4.3	3.4	3.6
28	8	12.1	6.1	10.5	6.2	9.0	7.4	6.0	5.1	5.4	4.6	4.7
7	9	13.9	7.6	12.7	6.8	10.2	8.4	6.9	5.3	6.0	4.9	5.4
17	>=10	18.4	13.9	18.6	11.6	13.4	10.7	7.5	5.4	6.4	4.2	4.8

Current Spread Level

3Y forward return example: investing in HY bonds 1/31/2016 (spreads at 7), 3Y ann. return of 10% ending 1/31/2019. 12/31/1996 to current month. Source: Bloomberg.

Spreads at Investment Entry: Spread Distribution and HY vs Agg Return



3Y forward return example: investing in HY bonds 1/31/2016 (spreads at 7), 3Y ann. return of 10% ending 1/31/2019. 12/31/1996 to current month. Source: Bloomberg.

High Yield Commentary: June 30, 2020

The HY bond asset class returned +0.92% in June as yields and spreads decreased 5 bp and 1 bp, respectively, to end the month at 7.57% and 722 bp. This slow down in the pace of spread tightening comes amidst the backdrop of accelerating COVID-19 infections in certain states which could hamper the nascent economic recovery that was starting to take hold across the country. Issuers took advantage of the continued market stability in June to issue a record \$61.5b of debt. This all-time high amount of monthly issuance is well above historical averages for the month and well past the previous record of -\$55.5b in issuance set back in September 2013. Refinancing transactions led the way in June by representing 60% of gross volume. YTD, refinancings also remain the main driver of issuance by representing 57% of total volume. Including distressed exchanges, the US HY bond default rate stands at 6.61%, up 129 bp month-over-month due in large part to continued weakness in the Energy sector.

MTD Return % YTD Return %

Best Industries:

- Transportation (+6.49%)
- Retail (+3.08%)
- Automotive (+2.81%)

Best Industries:

- Technology(+0.77%)
- Utility (+0.54%)
- Paper & Packaging (+0.43%)

Worst Industries:

- Broadcasting (-1.58%)
- Food & Beverages (-0.69%)
- Healthcare (-0.40%)

Worst Industries:

- Energy (-22.57%)
- Transportation (-18.71%)
- Broadcasting (-10.78%)

By Ratings:

- CCC-rated (+3.09%)
- B-rated (+0.67%)
- BB-rated (+0.35%)

By Ratings:

- BB-rated (-3.25%)
- B-rated (-6.14%)
- CCC-rated (-7.63%)

Source: JP Morgan.

Leveraged Loan Commentary: June 30, 2020

Leveraged loans returned +1.22% in June as lower quality loans recovered more lost ground despite increasing COVID-19 infection fears. Gross new loan issuance also continued to gain steam in June with -\$28m in volume pricing during the month. This marks a four-month high for loan issuance but is well below typical June volumes of \$45b as issuers continue to favor the HY bond market for raising debt. Refinancing activity was the main driver of issuance for the month at 47% of total volume. Given heavy repricing activity at the start of the year and strong refinancing activity during June, refinancing and repricing deals continue to remain the main driver of issuance YTD by representing 69% of total issuance. Gross US CLO ("collateralized loan obligation") issuance of -\$8b in June showed continued gains from May but remains below normal volumes for the month in the recent past. Net new issue activity, at 60% of total issuance YTD, remains the largest driver of CLO volumes. Including distressed exchanges, the leveraged loan default rate stands at 4.18%.

MTD Return % YTD Return %

Best Industries:

- Energy (+4.38%)
- Retail (+3.89%)
- Transportation (+3.11%)

Best Industries:

- Telecom (-1.25%)
- Utility (-1.60%)
- Chemicals (-1.99%)

Worst Industries:

- Cable & Satellite (-1.00%)
- Broadcasting (-0.27%)
- Food & Beverage (+0.16%)

Worst Industries:

- Energy (-16.07%)
- Transportation (-11.72%)
- Consumer Products (-10.16%)

By Ratings:

- Split B/CCC-rated (+4.58%)
- B-rated (+1.19%)
- BB-rated (+0.14%)

By Ratings:

- B-rated loans (-4.06%)
- BB-rated loans (-4.25%)
- Split B/CCC-rated loans (-16.73%)

Source: JP Morgan.

Asset Class Statistics: Credit and Equity Performance and Fundamentals

Asset Class	Equity		High Yield Credit			Investment Grade Credit						Term Definition
	Small Stocks	Large Stocks	High Yield	Lev Loans	BB-B 1-3Y	Corp	Muni	MBS	Agg	Agency	Treas	
1 Mth Return (%)	5.28	5.62	4.15	1.78	2.65	2.54	1.59	0.24	1.32	0.40	1.09	Cumulative total return over last month.
YTD Return (%)	-8.97	3.73	-0.01	-2.66	-2.21	7.98	3.63	3.86	7.70	5.69	10.11	Cumulative total return year-to-date.
1 Yr Return (%)	-0.31	14.92	3.72	-0.77	0.25	10.98	4.78	5.29	9.27	6.66	10.81	Cumulative total return over last 12 months.
3 Yrs Return (%)	3.77	12.31	4.21	2.51	3.16	6.88	4.42	3.89	5.62	4.27	5.86	Annualized total return over last 3 years.
Volatility (%)	20.28	15.26	8.21	6.97	5.75	5.76	3.85	2.13	3.19	2.31	4.08	5-year annualized standard deviation of index monthly returns.
Max Drawdown (%)	-41.75	-34.58	-21.54	-20.73	-16.39	-15.14	-11.38	-3.11	-6.35	-3.33	-5.98	Largest downside, measured from peak to trough, over last 5 years, daily return basis.
Eff Yield (%)	2.17	1.62	5.39	5.13	4.86	1.93	1.38	1.45	1.16	0.54	0.44	Coupon/dividend payments divided by market value, annualized. Assumes reinvestment.
YTM (%)	-	-	5.98	5.82	5.33	1.98	2.31	1.45	1.18	0.66	0.44	Total return if bond held to maturity, coupons made/reinvested, principal returned.
YTW (%)	-	-	5.38	5.22	4.86	1.93	1.21	1.45	1.16	0.55	0.44	Adjusts for embedded options. Lowest out of individual Yield to Calls or YTM.
YTML (%)	12.79	11.10	5.68	5.52	5.10	1.96	1.76	1.45	1.17	0.60	0.44	Credit: Yield to Most Likely is avg of YTM and YTW. *Equity: Div yield + Earnings growth.
Opt Adj Spread (%)	-	-	5.16	5.56	4.75	1.40	0.43	0.87	0.68	0.28	0.00	Measure of credit risk. Yield above maturity equivalent treasuries, accounting for options.
Coupon (%)	-	-	6.09	4.62	5.70	3.94	4.52	3.41	3.04	2.28	2.22	Stated coupon payment on a bond, par weighted.
Price (\$)	-	-	99.7	91.8	99.6	115.7	113.1	107.5	112.5	110.7	113.8	Market price of a bond, weighted by par.
Maturity (Yrs)	-	-	6.41	4.75	2.21	11.83	12.91	4.41	8.64	5.57	9.00	# Years until bond matures. Equivalent to Macaulay Duration for zero-coupon bonds.
Macaulay Dur (Yrs)	-	-	5.01	0.25	2.04	8.48	8.92	4.13	6.81	4.65	7.41	Measure of interest rate risk. Weighted avg maturity of cash flows (coupons & principal).
Mod Duration (Yrs)	-	-	4.88	0.25	1.99	8.38	8.79	4.10	6.76	4.62	7.38	Modified Macaulay Dur. +/- 1% rate change effect on price (eg 5 = -5% loss from +1% rate)
Eff Duration (Yrs)	-	-	3.67	0.25	1.51	8.43	6.22	2.10	6.39	3.98	7.53	Duration calc for bonds with options. Equals mod duration if options are non-impactful.
Convexity	-	-	-0.20	0.00	-0.08	1.35	0.03	-2.34	0.42	-0.21	1.23	Measures change in duration as rates change. Positive if duration rises as rates fall.
Credit Rating	B	BBB	B	B	BB	A	AA	AAA	AA	AAA	AAA	Aggregate composite rating using ICE BofA methodology (S&P, Moody's, Fitch).
# Issues	1,998	1,002	1,975	1,427	255	8,617	58,847	619	16,922	432	263	Number of stocks/bonds within index.
Par Value (\$bn)	-	-	1,397	1,190	179	7,153	1,493	6,323	27,349	342	11,160	\$ value of bonds within index by par.
Market Val (\$bn)	2,150	32,510	1,413	1,092	181	8,349	1,703	6,798	30,931	381	12,773	\$ value of bonds/stocks within index by market price.
% of Total Market	6.20	93.80	4.20	3.25	0.54	24.84	5.06	20.22	92.01	1.13	37.99	Approximation of stock/bond market value relative to its broader respective market.
Return/Vol Ratio	0.61	0.72	0.69	0.79	0.89	0.34	0.46	0.68	0.37	0.26	0.11	Return (YTML) per unit of volatility (5-year standard deviation)
Return/Dur Ratio	-	-	1.55	-	3.37	0.23	0.28	0.69	0.18	0.15	0.06	Return (YTML) per unit of duration (effective duration)
Return/Down Ratio	0.29	0.32	0.26	0.27	0.31	0.13	0.15	0.47	0.18	0.18	0.07	Return (YTML) per unit of downside (maximum drawdown)

As of 8/3/2020. *Bloomberg long-term (3-5 year) projection based on consolidation of sell-side analyst estimates. Source: Bloomberg. Indices: Russell 2000, Russell 1000, ICE BofA High Yield, S&P/LSTA Loan, ICE BofA BB-B 1-3Y, ICE BofA Corp, ICE BofA Muni, ICE BofA MBS, ICE BofA Broad Market, ICE BofA Agency, ICE BofA Treas.

Investment Discipline from Credit Data

Credit is the lifeblood of the modern economic system. The analysis of macroeconomic credit fundamentals (liquidity, solvency, interest rates, leverage) can provide equity and credit investors with a disciplined framework for understanding and reacting to market conditions. This is especially true in today's market of record-breaking volatility.

Stock prices are roughly 20 times more volatile than their fundamentals, as noted by Robert Shiller, when pointing out the excess volatility could not be explained by the efficient market theory. Excess volatility appears to be derived from behavioral psychology. Credit fundamentals, especially their positive/negative directional momentum, have historically cut through behavioral price noise, offering indication of where we are in the cycle and where we're going.

Credit risk, interest rate risk, and yield curve risk are 3 key components of macroeconomic credit. Penn Capital's weekly credit insights focus on these core factors, seeking to help investors make disciplined and informed decisions. Weekly updates can be accessed on our [website](#).

High yield credit, the bonds and loans of companies rated below BBB, provide especially useful indication (such as high yield credit spread movements). High yield credit has historically exhibited earlier and greater sensitivity, and therefore indication, to changes in macroeconomic credit conditions that we believe truly drive the market. For that reason, we emphasize high yield credit in our analysis.



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Senior Managing Partner



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Senior Partner

Disclosure

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The ICE BofA US HY Cash Pay BB-B Rated 1-3 Year Index is a subset of The Bank of America US Cash Pay High Yield Index, which tracks the performance of non-investment-grade corporate bonds with a remaining term to final maturity less than three years and rated BB-B. The ICE BofA US High Yield Index tracks the performance of US dollar denominated below investment grade rated corporate debt publicly issued in the US domestic market. The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed rate taxable bond market. The ICE BofA High Yield OAS (Option-Adjusted Spreads) Index is the calculated spread between a computed OAS index of all bonds in a given rating category and a spot Treasury curve. An OAS index is constructed using each constituent bond weighted by market capitalization. The S&P/LSTA Leveraged Loan Index is a market value-weighted index designed to measure the performance of the US leveraged loan market based upon market weightings, spreads and interest payments. The ICE BofA US Corporate Index tracks the performance of US dollar denominated investment grade corporate debt publicly issued in the US domestic market. The ICE BofA US Treasury Index tracks the performance of the US dollar denominated sovereign debt publicly issued by the US government in its domestic market. The ICE BofA US Municipal Securities Index tracks the performance of U.S. dollar-denominated investment grade tax-exempt debt publicly issued by U.S. states and territories, and their political subdivisions, in the U.S. domestic market. The ICE BofA US Mortgage Backed Securities Index tracks the performance US Mortgage Backed Securities Index. The ICE BofA US Asset Backed Securities & Commercial Mortgage-Backed Securities Index tracks the performance US asset backed securities and commercial mortgage-backed securities. The ICE BofA Agency & Quasi-Government Index tracks the performance of US dollar denominated US agency debt issued in the US domestic market. Qualifying securities must have an investment grade rating (based on an average of Moody's, S&P and Fitch). A copy of Penn Capital's current written disclosure statement discussing our advisory services and fees is available upon request. Investors cannot invest directly in an index. PC – WR031720