MAY CREDIT OUTLOOK

Costlier Financing & Tighter Credit Conditions

PMI Index & Unemployment

U.S. manufacturing rate was 47.1% on the ISM Index for April, which was an increase of 0.8% from prior month. Any reading under 50.0% is contractionary, marking the fifth straight month of declines. Additionally, new orders fell for eight consecutive months and backlogs followed with seven straight months. However, the ISM employment index was at 50.2%, which grew by 3.3% over the previous month and pushed it into expansionary territory. Furthermore, the U.S. added 253,000 jobs, which was above estimates by 70,000. The unemployment rate was unchanged in April at 3.4%, which marks a 50-year low. Additionally, wages grew by 4.4% year to date; adding to the narrative of a resilient labor market.

Inflation

Inflation for the month of April came in at 4.9% and an increase of 0.4% due to shelter, used vehicles, and gas prices. However, inflation is under 5.0%, the first time since June 2021 and at its slowest rise in 2 years. This is after 10 consecutive rate hikes totaling 5 percentage points and bringing rates to the highest levels in 16 years. The Fed may be content with the reduction but it's still far off from its goal of 2.0%. We anticipate rate hikes will slow because of banking sector troubles, constricting lending, and overall weakening macroeconomic activity.

Insolvency

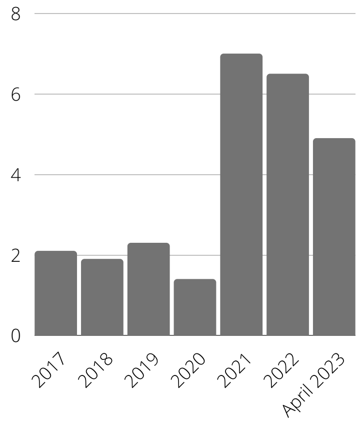
Total filings continued to increase in April, which grew by 9.0% when compared to April 2022. Specifically, Chapter 11 filings increased by 32.0% and small business filings jumped to 81% when compared to the prior year. Also, new cases continue to increase when compared to closing cases month over month, which is the first time since early 2019. The last time this trend occurred over consecutive months was in early 2012. All in all, we believe bankruptcies will be elevated through the remainder of the year.

CURRENT & EVOLVING CREDIT RISKS

Amend, Extend, or Draw Down

It's predicted most distressed exchanges will transition to defaults, which could account for over 60% of total defaults. To avoid this scenario companies will either amend, extend, or exchange debt. Some may draw down on revolvers, but this could trigger covenants causing a liquidity crisis. We've also seen companies offering preferred stock, but high rates make it expensive, and it's associated with poor credit metrics. We note none of these provide a long-term sustainable credit solution and financially troubled companies will face difficult management decisions.

U.S. Annual Inflation Rate



Risk Growing

Loans rated CCC+ or below have grown to 7.4% for April, an increase of 0.4% from the prior month. Additionally, the weakest links considered B- or below, have increased for two consecutive quarters. These two metrics are good indicators for depicting continuous elevated credit stress. Overall, we anticipate further credit rating declines.

Banks Faltering

First Republic Bank is now the third bank to fail over the last two months. Concerns grow as large banks continue to increase their size and influence through consolidations. Banks are facing outflows as worries and fear take hold, which could spread to other financial institutions. The latest rate hike of 25 basis points has many wondering whether this crisis will worsen and future impact on tightening credit markets.