CAPITAL MARKETS PERSPECTIVES

FIRST QUARTER 2019

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We have expertise in a broad range of absolute return strategies for both institutional and high net worth investors. Our dedicated team of employees seeks to deliver consistent, positive returns in all market environments. We have built our name on our breadth of talent, intensive research and risk averse approach to investing. Our long-term experience gives us the insight and patience to turn our vision into profitable, stable businesses.

CO-CIO OVERVIEW

ANGELO GORDON
CELEBRATING 30 YEARS

The fourth quarter of 2018 seemingly represented the beginning of a new market paradigm for corporate credit, in which pockets of heightened price and spread volatility were encouraged by dormant structural changes that had disturbed markets for years. Whereas the first three quarters of 2018 generally saw a continuation of the prior several years theme of muted market volatility and a lack of credit dispersion, the fourth quarter was a distinct step change in market tone, investor sentiment and price movements. Prior to October, global corporate credit markets enjoyed robust liquidity, elevated capital markets activity, retail inflows, and broad-based spread compression as investors continued to pull markets tighter in search of yield. However, fourth quarter corporate activity, particularly in areas with greater exposure to retail fund outflows, suffered from widening spreads, general illiquidity, and soft, shallow volumes. Energy markets had a particularly rough quarter, suffering from a $34/bbl drop in the price of WTI from October to December, leading to multiple hung bank bridge financings and a repricing of the bank price decks. While we do not think this paradigm shift definitively marked the end of one credit cycle stage and the beginning of another, it does introduce what we believe will be a transition period in which markets are steadily more concerned over general illiquidity, episodic and highly selective access to capital markets and an increasingly inefficient transmission mechanism between buyers and sellers. Interestingly, and opposed to previous market cycles in which deteriorating sub-investment grade credit led to a dislocation, it is actually the significant growth in the investment grade market, particularly the $2.5 trillion BBB market, that appears most concerning from a market perspective.

The asset backed credit market proved significantly more resilient and stable during the fourth quarter. The residential debt market saw modest spread widening but little forced selling and mostly orderly risk reduction into year-end. Limited supply in the housing market provided a strong technical foundation, even if the fourth quarter saw some signs of slowing growth. Further, solid employment statistics coupled with wage acceleration has the U.S. consumer in a very solid spot, leading to the lowest household debt service ratio in 40 years. Last, while commercial real estate debt market sentiment has shifted in the face of increased retail related bankruptcies, we have yet to see a significant response in terms of CMBS market trading prices. We believe this will be an interesting area to watch in 2019.

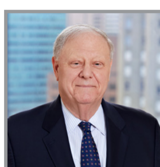
Finally, the corporate lending markets remained stable and largely immune to the headwinds buffeting the more liquid corporate credit markets in the fourth quarter. Despite certain surveys indicating concerns on forward-looking economic growth, the middle market private loan space was quite active from an issuance perspective with new issue spreads and leverage levels remaining consistent sequentially. In fact, fourth quarter 2018 issuance capped off a record year for sponsored issuance. Energy lending on the other hand was not as active from a primary markets perspective given the volatility in the underlying commodities sector. While fourth quarter activity was more muted, the forward calendar appears quite promising with a growing subset of companies that need to access the capital markets and a limited number of capital providers with flexibility to provide it.

Looking ahead, despite minimal near-term loan or bond maturities, sound corporate fundamentals, and a healthy U.S. consumer, a structurally changed market and altered buyer behavior are causing idiosyncratic opportunities from micro-cycles and single-name stress. The lack of capital from banks and markets that have essentially doubled in size post the GFC will also lead to opportunities to be a liquidity provider to markets that are increasingly susceptible to volatility.

Real estate has not yet seen the same sudden shift in dynamics noted above. With less quantitative data and a slower transaction cycle, perhaps it is yet to come. Fundamentals remain positive despite historical low cap rates, and robust corporate occupier fundamentals across most markets should lead to continued positive performance. For example, NYC saw 42 million square feet of leasing in 2018, the highest level since 2001. With real estate lease commitments typically being a leading indicator, it would seem that such robust leasing activity is not reflective of an impending recession. Similarly, sales volumes were up for the US as a whole but aided by some very active public market M&A activity (up greater than 150% over 2017) rather than individual property sales in the private market. With REITs down 4.6% for 2018, we expect the public market activity to continue to see bargain hunters step back in as witnessed since the first days of 2019. Fundraising for 2018 remained active but less so than 2017, while cross border capital flowing into U.S. real estate increased over its 2017 pace.

In London, leasing activity was similar to NYC, at the highest levels in four years. Despite Brexit getting closer and closer, investment activity continues to attract foreign buyers with London investment activity up 15% over 2017. Prospects for continued growth in broader Europe are on the decline though and as a result the ECB is unlikely to raise rates, resulting in continued attractive levered yields for real estate investors. On the debt side across both the U.S. and Europe new financings remain disciplined. U.S. CMBS issuance saw 2018 overall loan to value ratios below 60% for the second year in a row, a very healthy level. Liquidity and sentiment seem to be driving flows more so than credit risk and fundamentals.

In Asia, despite varying levels of economic growth and continued concerns over potential U.S. – China trade war, fundamentals continue to improve. In Japan wages were up, vacancies remained at historic lows, and offshore core investors continued to look for investment product. Korea saw continued consumption and export growth and Seoul office transactions hit record levels of activity. Similarly, the residential markets saw double digit price gains. China saw continued rental rate increases and a concerted effort by the Chinese government to ease monetary policy and add fiscal stimulus. Investment activity remains strong in major Chinese cities, but we also began to see signs of some forced sales as a result of excess leverage in some parts of the market.



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PERFORMING CREDIT

After benefitting from steady inflows throughout the year, 2018 ended in dramatic fashion with loan prices falling as funds experienced record outflows in December. Although, if you blinked you would have missed it, as prices rebounded in January. The fourth quarter started with the same strong tone that had characterized the market for well over a year with strong demand due to inflows into loan funds and CLO formation. However, in mid-October, sentiment shifted due to numerous factors, including reduced expectations for future rate hikes by the Federal Reserve and heightened media coverage of credit quality of the asset class. As a result, inflows into loan funds reversed course and in December the two largest weekly outflows on record were reported at $3.3 and $3.5 billion each. By quarter end, outflows had topped $15 billion and negated the healthy inflows enjoyed for most of the year. These outflows weighed on prices; by mid-December less than 1% of the JP Morgan index was trading above $100, compared to over 60% at the beginning of October. The average price of the JP Morgan index declined $2.70 month-over-month resulting in December performance of -2.3%.

Despite this year-end slide, loans were one of the few asset classes that delivered positive returns for the full year, with the JP Morgan index posting a 1.08% gain and outperforming High Yield by 323 basis points and Investment Grade corporate credit by 348 basis points. It is important to note that this poor performance occurred without any sign of significant fundamental deterioration. Also notable was the outperformance of second liens versus first liens. Given its size, the second lien loan market is less widely followed and, much like smaller sized first lien issuances, is often overlooked by large money managers who place a premium on liquidity due to the structure of their daily liquidity funds. The structure of these funds can lead to a focus on issuance size over underlying credit quality. Furthermore, daily liquidity vehicles can intensify pressure on the market, in both rising and falling markets, as we saw into the end of the year. Raising capital to meet redemptions in late December is not ideal, as liquidity dries up quickly. January has seen a quick turn around and as outflows slowed to start the year, the average price of the JP Morgan index rebounded by $1.78 to $96.8 in the first nine days of the month, offsetting much of the decline experienced in December.

Over the course of 2018, the leveraged loan market crossed the $1 trillion mark, largely due to growth of approximately 20% in CLO AUM. Net CLO issuance of $128 billion set an all-time record and was driven by the repeal of U.S. risk retention, the strong underlying loan market and strong demand for CLO debt. Over the last five years the CLO market has doubled in size to approximately $600 billion and although issuance may decline next year, CLOs are still expected to be a good source of demand for loans.

Trevor Clark
Portfolio Manager

MIDDLE MARKET DIRECT LENDING

Middle market syndicated loan issuance ticked up slightly in the fourth quarter to nearly $43 billion, resulting in full-year issuance of $183 billion, the highest level since 2014. Total 2018 sponsored issuance reached $80 billion, a new all-time high after last year's prior record-setting total. Sponsored deal count was virtually on par with last year, at 539 versus 540. New money accounted for $50 billion of the $80 billion in total issuance and was driven by add-on acquisitions and LBO activity. Non-regulated lenders continue to gain market share over banks; in 2018 they had a close to 45% market share as lead arrangers or bookrunners on syndicated sponsored transactions, up from less than 15% five years ago. Cov-lite volume picked up slightly from the third quarter but remained below the more elevated levels of the first half of the year. The average deal size for a middle market covenant-lite loan increased for the third consecutive quarter, to $265 million, highlighting an important theme, that the middle market is neither uniformly defined nor characterized by standardized deals. Cov-lite loans, for example, have not been a factor for smaller EBITDA deals.

In a recent survey, lenders cited weakening of economic and issuer performance as their major concern for 2019. Other responses included increasingly weak covenants and the vanishing illiquidity premium driven by strong inflows into the asset class. Last year in the same survey lenders cited tax reform, a return of volatility and rising rates as their biggest concerns. Interestingly, despite the aforementioned lender concerns about future performance, 50% of non-bank lenders indicated a willingness to lend north of 6x total debt to EBITDA. This reinforces one of the themes investors are increasingly focused on, namely understanding a lender's investment approach and target market. The return of volatility to the broader markets, along with the recent bouts of fear regarding the economic cycle have reminded investors of the importance of manager differentiation, as performance dispersion will undoubtedly increase as we enter the next cycle.

Todd Dittmann
Portfolio Manager

ENERGY

After a rapid decline from $76 to $42 per barrel, WTI rebounded to $50 in mid-January, boosted by improving trade talks, a dovish Fed, a USD sell off and material OPEC+ cuts. With oil's precipitous and rapid drop and natural gas's concurrent rally, serious commodity price volatility resurfaced after an eight-month period of more benign, $65 to $75 oil. With the return of volatility after only a brief hiatus, traditional providers of energy capital further retreated, and the costs of energy capital increased.

Energy's weighting as a percentage of the S&P 500 has declined to historically low levels, below 6%, as frustrated generalists spurn oil and gas, oilfield service and midstream companies. Over the last three years, valuations have compressed by three to five turns for public oil and gas companies and by about two turns for midstream companies. Even though the midstream sector now offers dividend yields substantially in excess of those paid by utility, tobacco and real estate issuers, investors thus far remain unmoved by the suggestion that the midstream is a defensive sector. During the second half of 2018, energy equity issuance declined significantly, with the IPO market firmly shut from July onward.

Energy high yield sold off, now yielding 8.5% on average, and issuance declined for four consecutive quarters. The high yield market remains inaccessible for all but the largest and best energy credits. And although early October borrowing bases were redetermined at higher prices, syndicate-leading banks have since reduced bank price decks twice and are poised to do so again. This fact, and December's $1.6 billion in hung bank bridge financings, likely make April's upcoming borrowing base redeterminations significant credit contraction events for which a growing list of borrowers should now be arranging term debt. Finally, asset sales have waned as a source of capital. The acquisition and divestiture market has stalled, with the number of announced transactions during the fourth quarter reaching the lowest level since 2008/09.

With a shrinking supply of, and steady-to-growing demand for, capital across the traditional energy sub-sectors, we have seen increases in dividend and debt yields despite decreases in valuation multiples and leverage. This is an attractive situation. The lack of access to and higher costs of capital should drive consolidation in the industry. With many capital sources sidelined and sector capital expenditures projected to grow through 2020, non-traditional providers are well-positioned to fund growth, non-core monetizations and consolidation.

Ryan Mollett
Head of Global Distressed Debt

Dan Pound
Co-Portfolio Manager

DISTRESSED DEBT

During the fourth quarter of 2018 the price behavior of risk assets emphatically announced the arrival of a transformed market paradigm in which sustained equity and debt volatility led to a global selloff in most asset classes. The challenging quarter resulted in a poor performance year for most asset classes with 90% of global assets suffering from a negative performance year, in dollar terms. Whereas the post-GFC period of broad-based, and largely synchronized global economic expansion was dominated by excess liquidity courtesy of central bank activity which dampened volatility and elevated asset correlations, late-2018 market activity demonstrated a decidedly different tone. With pain felt in portfolios globally, both retail and institutional investors withdrew cash from corporate credit sub-asset classes, and in turn, left primary markets effectively shut. In fact, fourth quarter primary loan supply was at its lowest level in almost two years and down by nearly 50% from the prior year. In high yield, both U.S. and European primary markets saw no new issuance at all in December. U.S. fourth quarter high yield issuance was down 75% from the prior year, and at its lowest level in 10 years. This contributed to the absolute amount of outstanding U.S. high yield at year-end 2018 shrinking for the third consecutive year. In Europe, fourth quarter new issue volume was at its lowest since the end of 2014, and what did print in the primary markets conceded considerably wider spreads. Spreads for U.S. primary issue B loans during the fourth quarter for instance jumped to L+508 on average, their highest point in six and a half years.

With primary markets debilitated, softness crept into secondary markets and accelerated into year-end with bids becoming increasingly scarce. Spiking equity volatility (the VIX hit 36 before settling at 25 in December) and significant retail withdrawals stripped demand from an otherwise healthy year and were enough to reverse cumulative inflows from the prior three quarters. U.S. retail investors withdrew $12 billion from domestic loan funds and $8 billion from high yield funds in December alone. Secondary market downward pressure also caused loan prices to sink below par, with the percentage of performing loans trading above par shrinking to under one percent by year-end (a 10-year low). U.S. high yield spreads jumped 205 basis points during the quarter, peaking at around 575 (itself roughly the post-GFC average). However, U.S. CCC bond spreads jumped nearly 350 basis points during the quarter, to more than 1100 at one point, before settling at 1070.

In the near term, we believe distressed opportunities will continue to be predominantly driven by micro-cycles and idiosyncratic stress, impacting the prices of single name credits feeling the pain of a fractured market landscape, forced selling and a constrained buyer universe. The transformed market structure is puzzlingly juxtaposed with healthy corporate fundamentals: high yield EBITDA margins were almost 18% by year-end (the highest in 10 years) and trailing debt multiples for the high yield universe were at multi-year lows (just under 3.9x). Macro fundamentals also appear to be sound amidst modest GDP growth, low unemployment, and a healthy U.S. consumer. Against this backdrop, however, a structurally altered credit market landscape will continue to cause significant swings in price and spreads. In such an environment, extremely cautious credit selection and highly active position management will be paramount for success.

David Kamin
Co-Portfolio Manager

MERGER ARBITRAGE

Global M&A volume in 2018 was the third largest on record, trailing only 2007 and 2015. The year began on a high note as M&A volumes surged following the U.S. tax reform bill. By mid-year however, M&A volumes began to slow as geopolitical tensions approached boiling point when China refused to approve Qualcomm's acquisition of NXP Semiconductors. As U.S. and China rhetoric tempered, there was a sense of renewed confidence that the current M&A cycle was not over when Comcast challenged Disney for both Twenty-First Century Fox and Sky plc, and later in the year when IBM Corp. announced its acquisition of Red Hat Inc., its largest ever. With respect to particular trends, China outbound M&A has fallen 50% in the last two years while acquirers from Europe and Japan have become increasingly active. Additionally, 2018 saw a broad set of industries participate instead of being led by one or two, as has been the norm.

The fourth quarter of 2018 was the strongest of the year for merger arbitrage investors despite the market correction. The quarter saw a thawing of regulatory approvals which led to multiple deal closings: the DOJ and various states approved both Aetna's sale to CVS and Cigna's purchase of Express Scripts; Takeda shareholders approved its acquisition of Shire plc; and China approved United Technologies acquisition of Rockwell Collins. The closing of these deals helped propel additional gains for arbitrage investors in what was already a healthy year. Further, M&A volumes enjoyed a quarter-over-quarter increase with both strategic and private equity buyers taking advantage of lower equity prices to strike deals, providing new investment opportunities for the arbitrage community.

On balance, the current M&A cycle appears poised to continue into 2019. While slowing global growth and increasingly protective regulatory regimes provide headwinds, CEOs and their boards in all industries continue to face disruptive technologies. This has forced companies to look beyond their current market for acquisition targets as industry lines blur. Additionally, CEO and board confidence remains near highs and acquisition financing remains at attractive levels.

Gary Wolf
Portfolio Manager

CONVERTIBLE ARBITRAGE

Broad market turbulence intensified throughout the fourth quarter of 2018, sending global equities sharply lower. The MSCI World Index lost 13.5% in local currency terms, erasing year-to-date gains and leading to a -9.1% return for the full year. Credit markets were also softer, especially in high yield. The combined effects dragged global convertible bonds down significantly. The main global convertibles index lost 6.3% in the fourth quarter, wiping out prior gains, for a -0.3% annual return. Convertible valuations also suffered in the general risk-off environment. Several of the largest long-only managers fell short of their benchmark indices in both the fourth quarter and in full year 2018, leading to increased redemption expectations and causing further weakness in convertible implied volatilities. The CS Convertible Arbitrage Index fell 5.4% in 2018, with most of the drawdown occurring in the fourth quarter.

Unsurprisingly, the primary market for convertibles experienced a slowdown in the fourth quarter, with global new issuance amounting to $10 billion. Nonetheless, the $84 billion total deal volume for the full year was the highest issuance level since 2014. The U.S. was by far the most active market, with $51 billion of new convertibles offered. Europe, however, only contributed $12 billion, its lowest level since 2011. The balance was made up by Asia and Japan. The rising interest rate backdrop was an important driver behind the U.S. deal flow. The serious risks that led to a rocky finish in 2018, including central bank monetary tightening, trade tensions, a China slowdown, and weaker growth in Europe, remain very much relevant for 2019. Higher levels of uncertainty and volatility should create new opportunities for convertible arbitrage strategies in the coming year.

Michael Liebman
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LIQUID CREDIT

After a year in which bouts of decompression were characteristic of markets recovering from retreating central banks, volatile market conditions returned in the fourth quarter of 2018 in spades. With such conditions came a generally more expensive environment for corporate borrowers to access credit markets. A commonly referenced IG index widened by the end of 2018 to its widest level in two and a half years, up almost 30% from one year prior. With re-priced credit markets frozen into year-end, the December calendar was the slowest month for investment-grade issuance since 1995. In the U.S., high yield spread widening and virtually closed capital markets, along with elevated correlations, picked up significantly as participants sold whatever had bids, regardless of fundamentals. It has already become clear that transitioning from any period of "easing" to "tightening" of this magnitude is categorically unprecedented. However, how markets behave as they re-price towards the 'other side' is very challenging to predict. It is clear that a new paradigm has encroached and as the market adjusts, there are sure to be prolonged periods of volatility. It is our view that relative outperformance in a period of such volatility will be found in single name credit selection and a focus on fundamentals.

TJ Durkin
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RESIDENTIAL AND CONSUMER DEBT (RMBS/ABS)

Spreads for mortgage- and asset-backed sectors were mixed during the fourth quarter of 2018. While legacy RMBS spreads widened modestly, they outperformed other securitized asset classes due to strong technical demand and favorable underlying fundamentals. The credit-risk transfer (CRT) market, which is the most liquid product in mortgage credit with the most overall beta, widened in sympathy with broader markets. The widening was most pronounced in the lower part of the capital structure, steepening out the credit curve. Despite this widening, there was little forced selling from investors, and dealers reduced their CRT exposure in an orderly fashion into year-end. On the other hand, asset-backed spreads at the bottom of the capital structure were mostly firm, supported by market depth and limited supply. Senior ABS spreads were a little wider due to investor selling that was mostly absorbed by dealers.

Quarterly new issuance of RMBS rose 3.2% year-over-year to $24.3 billion, while ABS new issuance fell by 11.7% year-over-year to $54.3 billion on lower credit card ABS volume. Fourth quarter activity brought full-year 2018 new issuance to $117.7 billion of RMBS and $244.0 billion of ABS, a year-over-year rise of 29.6% and 2.0%, respectively, compared to full-year 2017. The sharp increase in RMBS was driven primarily by securitizations of newly originated jumbo and non-qualified mortgages. New issuance of RMBS and ABS in 2018 marked the most active year in the post-crisis era, and, for ABS in particular, new issuance continued to approach 2005-2007 height activity of approximately $260 billion annually.

Home prices continued to appreciate, although signs of slower growth and more muted activity persisted during the quarter. The latest CoreLogic Case-Shiller report showed an increase in national home prices of 5.5% year-over-year. Rising mortgage rates, reduced affordability and a shortage of inventory in many markets kept housing activity depressed during both the fourth quarter and 2018. Further, the National Association of Homebuilders Market Index retreated from 74 in December 2017 to 56 in December 2018. Despite these challenges, home prices continued to benefit from persistently tight supply of housing in many markets across the nation.

Agency MBS had a difficult fourth quarter, widening as benchmark rates fell sharply in response to a reversal in sentiment around the path of the economy in 2019. While the Fed's continued runoff of agency MBS holdings remains a headwind for spreads, reduced concern over materially higher rates should be a positive for bank demand. Asset allocators concerned over the potential for poor corporate credit performance in a slowing economy should also offer support for agency MBS valuations.

Andrew Solomon
Portfolio Manager

COMMERCIAL REAL ESTATE DEBT (CMBS)

Numerous factors contributed to the sharp decline in the equity and credit markets during the quarter, including fears that the Fed would overshoot, raising interest rates too much against a slowing economic backdrop, increasing signs of an economic slowdown in China and the huge drop in oil prices. These macroeconomic factors and the resulting asset price changes were certainly reminiscent of late 2015 and early 2016. However, the CMBS market behaved in a much more orderly fashion than it did three years earlier. At the time, risk retention was looming, thus creating uncertainty as to how the market would comply with the new regulations at the same time as a large wave of CMBS loans were set to mature. This time around we observed very little forced selling into generally illiquid markets. From a technical standpoint one of the key issues facing the market should actually be beneficial for pricing, namely, that new supply in 2019 is likely to be fairly limited, especially for traditional multi-borrower conduit deals.

The one glaring exception to the relative performance of CMBS versus three years ago was new issue 10-year conduit deals, especially transactions that came to market in December. At the top of the capital structure AAA spreads ended the year approximately 35 basis points wider, but with 10-year swap yields roughly 40 basis points tighter the overall impact on yield is minimal. At the BBB level new issue spreads ended the quarter approximately 200 basis points wider; for an asset with a duration of seven years, this equates to a price correction of approximately 14. Price moves of this magnitude made BBBs more compelling than they have been for at least the last two years.

Gordon J. Whiting
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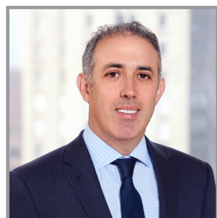
NET LEASE REAL ESTATE

As of the fourth quarter of 2018, the trailing 12-month U.S. single-tenant transaction volume totaled $63 billion, according to Real Capital Analytics (RCA). In 2018, overall volume increased by 7%, driven by a 36% increase in industrial volume, partially offset by a 16% decline in retail and a 4% decline in office. While volumes have fluctuated across property type, cap rates were flat in 2018, according to RCA. Over the last 10 years, retail cap rates hit a low in the third quarter of 2016 and industrial cap rates in the second quarter of 2018. Office cap rates remain 10 to 30 basis points wide of industrial and retail, however office cap rates have continued to compress in 2018 and are at the lowest point in the past 10 years. The retail market softened slightly in early/mid 2018 as the market continues to digest high-profile bankruptcies, such as Sears Holdings, however overall retail cap rates have remained fairly steady. Morgan Stanley compiled total return data from the National Association of Real Estate Investment Trusts (NAREIT) indicating that the triple net lease asset class is one of the best performing real estate asset classes (compared to lodging, malls, self-storage, health care, multi family, and others) over the last 25 years.



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REAL ESTATE

United States

Preliminary numbers for headline commercial property transactions in 2018 were up 11% year-over-year. Entity-level deal volume more than doubled and reached its highest levels of the recovery. Volume of single asset sales at higher absolute dollar values (> $50 million), has also grown at a faster pace than that of smaller deals (<$50 million). Listed REIT transaction activity was down over 21% as NAV discounts and a focus on leverage curtailed activity. Institutional/ fund activity increased 13% as they worked to deploy near record levels of dry powder.

US real estate M&A activity surged in 2018. Deals aggregated $90.55 billion in deal value, up 154.7% compared to the $35.55 billion recorded in 2017. The pickup in activity was driven by a widening gap between publicly traded and privately-owned real estate.

Throughout the first half of 2018, cross-border buyers accounted for approximately 14% of transaction volume, up 29% year-over-year. However, that largely reversed in the third quarter with year-to-date volume through September 30 up less than 1% and accounting for 12.8% of the mix. European and Canadian capital grew notably, making up for declines in activity from Asia and the Middle East. The surge in Chinese investment in US real estate ended abruptly in 2018 as investors who had previously purchased $57.7 billion since 2000 while selling only $7.1 billion, became net sellers in 2018.

Re-financing markets continued to be active as investors tap the market as an alternative to selling assets. Refinancing transactions comprised 62% of year-to-date volume through September 30, up from 54% in 2016 and 59% in 2017. Debt funds have been gaining market share and, on the margins, moving up the risk spectrum by increasing their relative share of value-add and construction loans. As the yield curve has flattened, lenders have been willing to accept narrower spreads year-on-year.

Fundamentals remain decent across most property types, but new supply in office, industrial, and multi-family is roughly at long-term levels, and there are pockets of overbuilding. Rent growth is moderating and occupancy levels have likely nearly peaked.

On the valuation front, The Green Street Commercial Property Price Index was unchanged in December and increased 2% during 2018, roughly the same as in 2016 and 2017. The usual suspects continue to perform well with Manufactured Housing up 16% and Industrial up 11% on a trailing twelve-month basis. Malls and strip centers are down 7% and 2%, respectively. Green Street Advisor's model, which tracks the relative value relationship between real estate and fixed income (investment grade and high yield), pegs real estate at about 12.5% overvalued. Given the sharp move in credit in December, some of which has reversed in the new year, the gap is to be expected. Listed real estate equities are near some of the widest discounts this cycle as public markets investors remain skittish about fundamentals being disconnected from historically low cap rates. Further, public markets suffered their worst-ever year of outflows from US REIT mutual funds and ETFs, losing $14 billion. This follows several years of decay including -$9 billion in 2017, -$5 billion in 2016, and -$6 billion in 2015. Looking forward, the public private tension seems likely to manifest itself in increased privatization activity.

Europe

Non-performing loan sales in Europe reached record highs in 2018; the deleveraging resulted in real estate loan and real estate owned asset sales with a face value of €114 billion, surpassing 2017 volume by more than 11%. Sellers appeared to scramble to meet annual non-performing exposure reduction targets by year-end, evidenced by almost 75% of fourth quarter 2018 activity occurring in December. Approximately 43% of the total amount of transactions corresponded to commercial real estate loan sales, and the remainder to residential mortgage and real estate owned portfolios. Southern Europe accounted for 77% of the total closed volume, led by Spain, with 35% of the total, down 21% from 2017. Italy was a close second, with 31% of the total 2018 volume, and Ireland in third place, with 14% of the total volume closed, as analyzed by Evercore.

Commercial office markets in the euro-zone continue to benefit from strong demand, despite easing economic growth. On a four-quarter moving basis, the take-up of office space was up around 10% on a year-over-year basis ending in the third quarter; however, following a strong first half of the year, investment activity across the euro-zone dipped, falling by around 4.5%. Economic growth across the euro-zone has slowed faster than expected over the course of 2018. Concerns about the outlook for global growth and several country-specific issues have weighed heavily – financial conditions in Italy tightened and are expected to get worse, reform prospects in France have deteriorated due to ongoing protests, and weaker exports reported in the fourth quarter were the primary driver behind Germany's first quarterly economic contraction since 2015. The manufacturing and services managers indices have fallen back to the lowest readings since 2016. Household consumption growth, at just 0.1% quarter-over-quarter in Q3 2018, was its slowest since the end of 2014. While these factors are likely to moderate rental growth, they also keep new supply in check. Specifically, net cumulative supply growth of office is estimated to be less than 1.0% per annum on average across the twenty-two markets followed by Green Street.

Europe *(continued)*

Office take-up in London reached nearly 15 million square feet last year, 14% higher than the long-term average and the highest level since 2014, according to Knight Frank. The increase in total take-up comes as the last 12 months saw 48 deals of more than 50,000 square feet, compared with 39 deals the year before. Throughout 2018 there was a general move towards investment in London, with commercial property transactions 15% higher than the 2017 total, in contrast to a 19% decline year-over-year for commercial transactions outside of London. The share of overseas investors remained above 50% which is in line with the previous four years and suggests this is unlikely to change in the lead up to Brexit. While commercial property returns are expected to moderate considerably in 2019, GDP is largely expected to rebound if a Brexit deal is secured, from a likely 1.3% in 2018, to 2.2% in 2019 – the fastest pace since before the referendum. Even with a "no deal" Brexit, consensus is that monetary and fiscal stimulus would provide support to occupier demand in the U.K., preventing a hard landing.

Japan

In the third quarter of 2018, Japan's real GDP decreased by an annualized rate of 2.5%. A series of natural disasters, including a powerful typhoon in September and an earthquake in Hokkaido, weighed on private capital investment and exports. Despite the economic contraction, the unemployment rate remained at a historical low of 2.4%, and this year's spring labor management talks revealed that the rate of wage increase for Japanese major companies was 2.53%, the highest increase in the last 20 years. In December, the TOPIX plunged to its lowest price since November 2016, and Japanese 10-year government bond yield fell to a 2-year low of 0.01%, following Wall Street declines due to U.S. uncertainty. With this risk-off situation, the Japanese REIT ("J-REIT") Index outperformed the TOPIX and the J-REIT Index increased 6% from the beginning of 2018.

While real estate investment volume in the third quarter fell by 25% year-on-year, investment volumes for regional cities, including Osaka and Nagoya, increased by 28% during the quarter. Offshore, core-focused investors continue to actively pursue investment opportunities in Japan as asset values remain below prior peak levels and financing terms continue to be very attractive. Tokyo Grade A office vacancy fell to 0.9% and Grade B office vacancy also remained low at 1.0%, following strong tenant demand. Although Grade A supply is scheduled to come on line in Tokyo in 2019, strong pre-leasing activities thus far suggest that real estate fundamentals will remain strong in 2019. Osaka's tight office supply condition kept market vacancy at a historical low of 0.9% for Grade A and 1.4% for Grade B. Last November, Osaka was selected to hold the World Expo in 2025. The Osaka government expects that the event will attract 28 million visitors and boost the local economy by $18 billion, which will help underpin economic growth after the 2020 Tokyo Olympics.

China

Although the last quarter of 2018 continued to be dominated by headlines of a US-China trade war, a slightly more positive tone has been struck after months of heightened tensions. On December 1, 2018, President Trump and President Xi agreed to a 90-day truce at the G20 Summit in Buenos Aires. Both sides agreed to not impose additional tariffs after January 1, 2019 when Washington was set to raise tariffs on US$200 billion of Chinese imports. All eyes remain on whether both parties can reach an agreement by the truce deadline. In either case, it appears that the impact on China's economy will be manageable, as the Chinese government has enacted policy easing measures such as fiscal stimuli, tax cuts and rebates, and further reductions in the domestic banks' required reserve ratio.

Overall, China's economic growth in the first three quarters of 2018 topped expectations at 6.7%, exceeding the 6.5% target set at the beginning of the year. However, several factors including trade tensions, US rate hikes and the recent downturn of the US equity markets continued to weigh on investor sentiment. The Shanghai Stock Exchange Composite Index finished the year down 25%, the lowest level in four years, while Hong Kong's Hang Seng Index finished the year down 14%. The Chinese RMB depreciated another 6% to 6.88 RMB per USD by year-end.

On the real estate front, office fundamentals in large Chinese cities continue to be positive underpinned by rapid growth in the services sector. Demand for office space in tier one cities remained strong while vacancy rates stayed at healthy levels. In Shanghai, Grade-A office rents were up 2% in the first three quarters of 2018 while vacancy stayed at 10% despite a supply wave that delivered significant amounts of new office product in 2017 and 2018. In Beijing, office occupancy continued to be tight with only 3.2% vacancy as of September 2018, and full year rental growth is projected to be 5%.

Investment demand for prime commercial properties in tier one cities such as Shanghai and Beijing remained strong. On the other hand, debt-laden companies, including several of the large developers and conglomerates, accelerated sales of their real estate portfolios to repay maturing loan obligations. We believe that these event-driven special situations may present attractive buying opportunities for investors in the new year.

Hong Kong

The Hong Kong economy delivered solid growth of 2.9% year-over-year in the third quarter of 2018. Unemployment remained at a 20-year low of 2.8%. The U.S.-China trade war, U.S. interest rate hikes as well as the introduction of a vacancy tax on newly built residential properties has led to a negative sentiment in the property investment market as buyers increasingly take a wait-and-see attitude. Residential transaction volume dropped by over 50% in the final few months of 2018, and average prices declined by approximately 7% in the second half of the year. Nonetheless, overall residential prices still finished the year up 5.4% according to Centaline, Hong Kong's leading residential brokerage.

Scarcity of available land in Hong Kong and long-term supply shortage continues to underpin real estate fundamentals. As of September 2018, office vacancy remained tight at 1.6% in the Central (CBD) and 4.2% overall in Hong Kong. Strong office fundamentals have lifted office rents in Central by nearly 7% and by 5% across Hong Kong in the first three quarters. As a result, the rental gap between Central and decentralized office areas continue to increase. This office decentralization trend should continue as cost-conscious tenants are pushed out of Central and are forced to move to less expensive decentralized areas. We continue to believe that decentralized office may present an attractive investment opportunity; however, price expectations remain high and investors should take caution as it appears that we are quite late in the investment cycle.

South Korea

The South Korean economy grew 0.6% quarter-on-quarter in the third quarter of 2018 on the back of solid consumption and exports. However, analysts expect that headwinds in the global economy may impact the Korean economy in 2019 and, as a result, we may see lower growth. The Bank of Korea ("BoK") raised its benchmark policy rate by 25 basis points from 1.50% to 1.75% in November 2018, the first hike since November 2017, as part of its effort to moderate the widening interest rate gap between the U.S. and Korea. Most economists expect the BoK to maintain rates at 1.75% throughout 2019 due to low inflationary pressures and moderated growth prospects. The spread between prime office cap rates and Korean government bond yields (i.e. 5-year treasury bond) widened 17 basis points from the previous quarter to 252 basis points, which is above the 10-year average of approximately 220 basis points. In light of the wide spread, the recent rise in policy rates may not have a dramatic impact on real estate capital values. Investment activity in the commercial office sector remains robust as evidenced by the record commercial office transaction volume in Seoul. As of the third quarter of 2018, commercial office transactions amounted to $8 billion, nearing the volume achieved for the full year of 2017. We expect continued strong demand for stabilized core properties as Korean institutions ramp up their investment portfolios with yield-generating real assets. Prime office vacancy rate in the major business districts in Seoul rose slightly by 0.7% points from the previous quarter to 13.1% with addition of new office supply. We do not expect vacancy rates to stabilize in 2019 due to moderated corporate and economic growth prospects. The residential market in Seoul continues to be robust with Seoul apartment prices rising 13.6% year-on-year as of December 2018. In Gangnam, the prime residential district in Seoul, apartment prices have increased by 15.1% year-on-year.

Arthur Peponis
Portfolio Manager

PRIVATE EQUITY

The private equity industry had a robust 2018 with strength across the board. Deal volume on both a global and North American basis increased significantly from 2017, reaching the highest levels since the financial crisis. For North America, there were $238 billion of transactions in 2018 as compared to $175 billion from the prior year or an increase of 36%. Global deal volume in 2018 increased 23% year on year to $429 billion. Interestingly, there was a decline in dry powder during the second quarter of 2018 which was highly unusual given the consistent quarterly increases we have seen for the past four years. This drop proved to be an anomaly as dry powder increased materially in the last half of 2018. As a result, dry powder set another all-time high, reaching $695 billion at year end, an 11% year-over-year increase. Average multiples paid in 2018 were 10.6x EBITDA, effectively at the same level as 2017's 10.7x which was an all-time record. Average leverage for buyouts in 2018 was 5.8x multiple of EBITDA which is consistent not only with 2017, but also prior years. Equity contribution as a percentage of total capitalization was at 43% which is the highest percentage since 2009 but only slightly higher than the 41% seen in 2017. The number of exits increased in 2018 by approximately 14% on 2017 exits with dollar volume increasing nearly 30%, reflecting larger dollar monetizations given the strong M&A market. As we enter 2019, there are concerns relating to the economy as well as considerable geopolitical risks. These factors, among others, have contributed to the volatility we have seen in the markets over the past several months. While the private equity industry certainly is not insulated from market conditions nor immune to downturns in the economy, the record level of dry powder should provide a floor for deal volume and transactions multiples.

ECONOMIC DASHBOARD

Market Indices: First Quarter 2019

ANGELO GORDON
CELEBRATING 30 YEARS

JOB MARKET

Macro Economics		Five-Year Trend
US – Unemployment Rate		As of 12/31/2018
Latest Level	3.9	
Change from Prior Month	0.2	
Latest Direction	Deteriorating	
Frequency	Monthly	
US – Non-Farm Payroll		As of 12/31/2018
Latest Level	312.0	
Change from Prior Month	136.0	
Latest Direction	Improving	
Frequency	Monthly	
US – Labor Participation Rate		As of 12/31/2018
Latest Level	63.1	
Change from Prior Month	0.2	
Latest Direction	Improving	
Frequency	Monthly	
US – U-6 Unemployed & Margin & Part-Time as % of Labor Force & Margin		As of 12/31/2018
Latest Level	7.6	
Change from Prior Month	0.0	
Latest Direction	No Change	
Frequency	Monthly	
Eurozone Unemployment Rate		As of 9/30/2018
Latest Level	8.0	
Change from Prior Month	(0.2)	
Latest Direction	Improving	
Frequency	Quarterly	

INFLATION

Macro Economics		Five-Year Trend
US Consumer Price Index (CPI) Y-o-Y %		As of 12/31/2018
Latest Level	1.9	
Change from Prior Month	(0.3)	
Latest Direction	Decreasing	
Frequency	Monthly	
US CPI Goods Less Food and Energy Y-o-Y %		As of 12/31/2018
Latest Level	2.2	
Change from Prior Month	0.0	
Latest Direction	No Change	
Frequency	Monthly	
US Producer Price Index (PPI) Y-o-Y %		As of 12/31/2018
Latest Level	2.4	
Change from Prior Month	0.0	
Latest Direction	No Change	
Frequency	Monthly	

GDP GROWTH

Macro Economics		Five-Year Trend
US – GDP Y-o-Y %		As of 9/30/2018
Latest Level	5.5	
Change from Prior Quarter	0.1	
Latest Direction	Improving	
Frequency	Quarterly	
Eurozone – GDP Y-o-Y %		As of 9/30/2018
Latest Level	1.6	
Change from Prior Quarter	(0.6)	
Latest Direction	Deteriorating	
Frequency	Quarterly	
China – GDP Y-o-Y %		As of 12/31/2018
Latest Level	6.4	
Change from Prior Quarter	(0.1)	
Latest Direction	Deteriorating	
Frequency	Quarterly	

HOUSING

Macro Economics		Five-Year Trend
Existing Home Sales		As of 12/31/2018
Latest Level	5.0	
Change from Prior Month	(0.3)	
Latest Direction	Deteriorating	
Frequency	Monthly	
New Home Sales		As of 10/31/2018
Latest Level	544.0	
Change from Prior Month	(53.0)	
Latest Direction	Deteriorating	
Frequency	Monthly	
Housing Starts		As of 11/30/2018
Latest Level	1,256.0	
Change from Prior Month	39.0	
Latest Direction	Improving	
Frequency	Monthly	
Case-Shiller Index of Home Value in 20 Cities		As of 11/30/2018
Latest Level	214.2	
Change from Prior Month	0.6	
Latest Direction	Improving	
Frequency	Monthly	

Source: Bloomberg (All).
"Latest Direction" is from the last "Frequency" measurement.

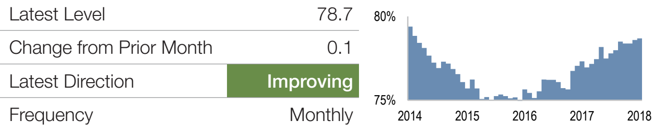
ECONOMIC DASHBOARD *(continued)*

ECONOMIC & MARKET CONFIDENCE

Macro Economics	Five-Year Trend

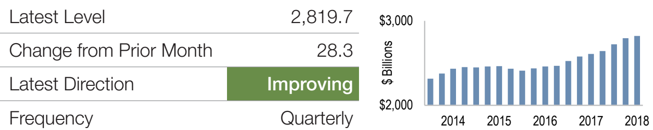
Capacity Utilization as a % of Capacity — As of 12/31/2018

Latest Level	78.7
Change from Prior Month	0.1
Latest Direction	Improving
Frequency	Monthly



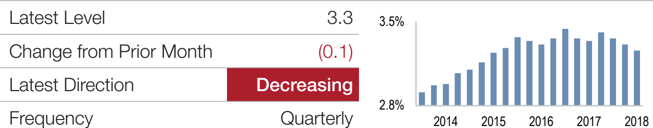
Private Fixed Investment Nonresidential SAAR — As of 9/30/2018

Latest Level	2,819.7
Change from Prior Month	28.3
Latest Direction	Improving
Frequency	Quarterly



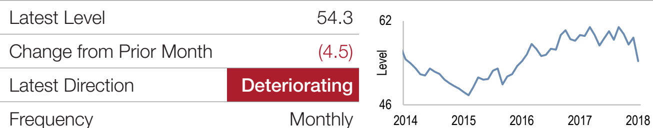
Residential Fixed Investment as a % of GDP — As of 9/30/2018

Latest Level	3.3
Change from Prior Month	(0.1)
Latest Direction	Decreasing
Frequency	Quarterly



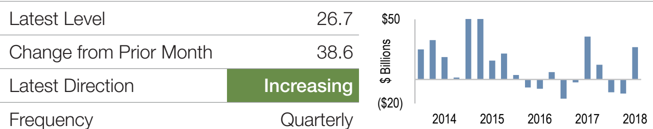
ISM Manufacturing Index — As of 12/31/2018

Latest Level	54.3
Change from Prior Month	(4.5)
Latest Direction	Deteriorating
Frequency	Monthly



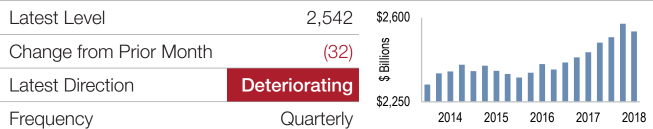
Manufacturing Inventory Change Q-o-Q $ — As of 9/30/2018

Latest Level	26.7
Change from Prior Month	38.6
Latest Direction	Increasing
Frequency	Quarterly



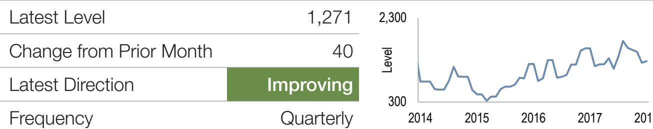
Exports of Goods/Services — As of 9/30/2018

Latest Level	2,542
Change from Prior Month	(32)
Latest Direction	Deteriorating
Frequency	Quarterly



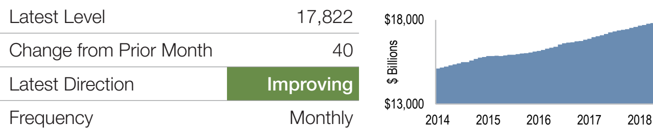
Shipping Rates — As of 12/31/2018

Latest Level	1,271
Change from Prior Month	40
Latest Direction	Improving
Frequency	Quarterly



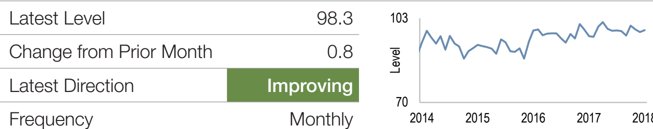
Personal Income Level — As of 11/31/2018

Latest Level	17,822
Change from Prior Month	40
Latest Direction	Improving
Frequency	Monthly



Michigan Consumer Confidence Sentiment — As of 12/31/2018

Latest Level	98.3
Change from Prior Month	0.8
Latest Direction	Improving
Frequency	Monthly

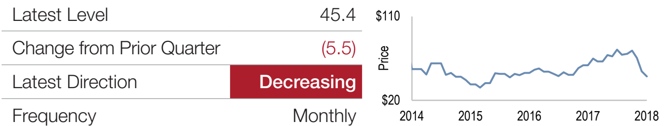


COMMODITIES

Macro Economics	Five-Year Trend

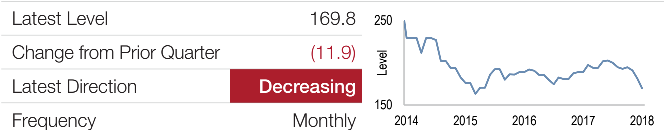
WTI Crude Oil Price — As of 12/31/2018

Latest Level	45.4
Change from Prior Quarter	(5.5)
Latest Direction	Decreasing
Frequency	Monthly



Reuters/Jefferies Commodity Index — As of 12/31/2018

Latest Level	169.8
Change from Prior Quarter	(11.9)
Latest Direction	Decreasing
Frequency	Monthly



Gold — As of 12/31/2018

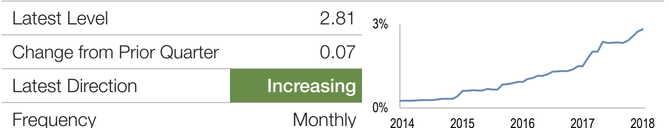
Latest Level	1,282.5
Change from Prior Quarter	62.0
Latest Direction	Increasing
Frequency	Monthly

RATES

Macro Economics	Five-Year Trend

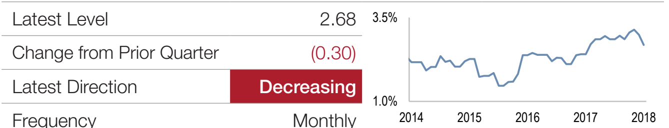
LIBOR 3M — As of 12/31/2018

Latest Level	2.81
Change from Prior Quarter	0.07
Latest Direction	Increasing
Frequency	Monthly



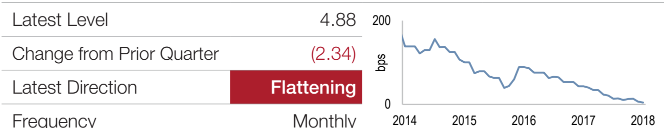
Treasury 10 Yr Yield — As of 12/31/2018

Latest Level	2.68
Change from Prior Quarter	(0.30)
Latest Direction	Decreasing
Frequency	Monthly

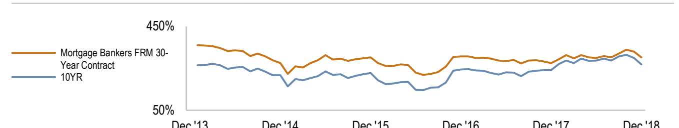


Swaps 2Y vs. 10Y — As of 12/31/2018

Latest Level	4.88
Change from Prior Quarter	(2.34)
Latest Direction	Flattening
Frequency	Monthly



30 Yr Mortgage and 10 Yr Treasury — As of 12/31/2018



Source: Bloomberg (All).

"Latest Direction" is from the last "Frequency" measurement.

ECONOMIC DASHBOARD *(continued)*

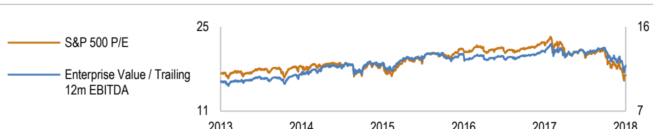
EQUITY

Macro Economics		Five-Year Trend
US Equity Markets – Russell 3000		As of 12/31/2018
Latest Level	1,472.1	
Change from Prior Month	(153.9)	
Latest Direction	Sell-off	
Frequency	Monthly	

US Equity – VIX		As of 12/31/2018
Latest Level	25.4	
Change from Prior Month	7.4	
Latest Direction	Increasing	
Frequency	Monthly	

S&P 500 Percentage Exceeding Earning Estimates		As of 12/31/2018
Latest Level	76.3	
Change from Prior Month	(0.4)	
Latest Direction	Decreasing	
Frequency	Monthly	

S&P 500 Historical Valuation Levels As of 12/31/2018



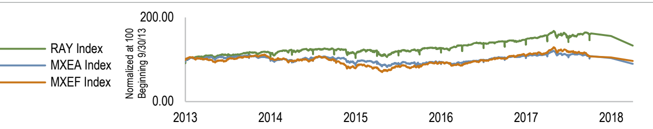
Trailing P/E on S&P 500		As of 12/31/2018
Latest Level	16.9	
Change from Prior Month	(1.9)	
Latest Direction	Decreasing	
Frequency	Monthly	

Equity Markets – Euro Stoxx		As of 12/31/2018
Latest Level	328.5	
Change from Prior Month	(20.5)	
Latest Direction	Decreasing	
Frequency	Monthly	

Equity Markets – MSCI EAFE		As of 12/31/2018
Latest Level	1,719.9	
Change from Prior Month	(89.7)	
Latest Direction	Decreasing	
Frequency	Monthly	

Equity Markets – MSCI EM		As of 12/31/2018
Latest Level	965.8	
Change from Prior Month	(28.9)	
Latest Direction	Decreasing	
Frequency	Monthly	

Russell 3000 – MSCI EAFE – MSCI EM As of 12/31/2018



FOREIGN EXCHANGE RATE

Macro Economics		Five-Year Trend
Euro Spot Rate vs. 1 USD		As of 12/31/2018
Latest Level	1.15	
Change from Prior Quarter	0.02	
Latest Direction	Improving	
Frequency	Monthly	

Yuan Spot Rate vs. 1 USD		As of 12/31/2018
Latest Level	0.1454	
Change from Prior Quarter	0.0017	
Latest Direction	Improving	
Frequency	Monthly	

Yen Spot Rate vs. 1 USD		As of 12/31/2018
Latest Level	0.0091	
Change from Prior Quarter	0.0003	
Latest Direction	Improving	
Frequency	Monthly	

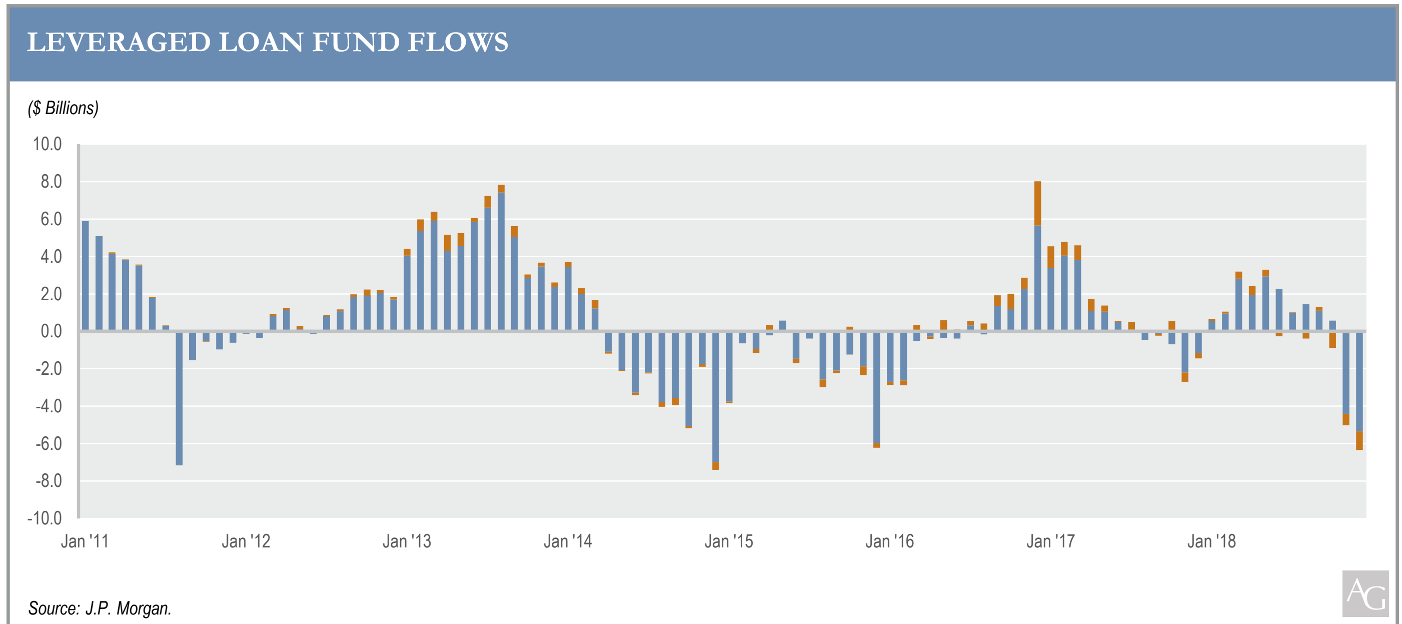
Source: Bloomberg (All).

"Latest Direction" is from the last "Frequency" measurement.

The risk-off sentiment and sharp rally in rates led US 10-year notes to end the year at 2.68%, a decline of nearly 60bps during the quarter.

PERFORMING CREDIT

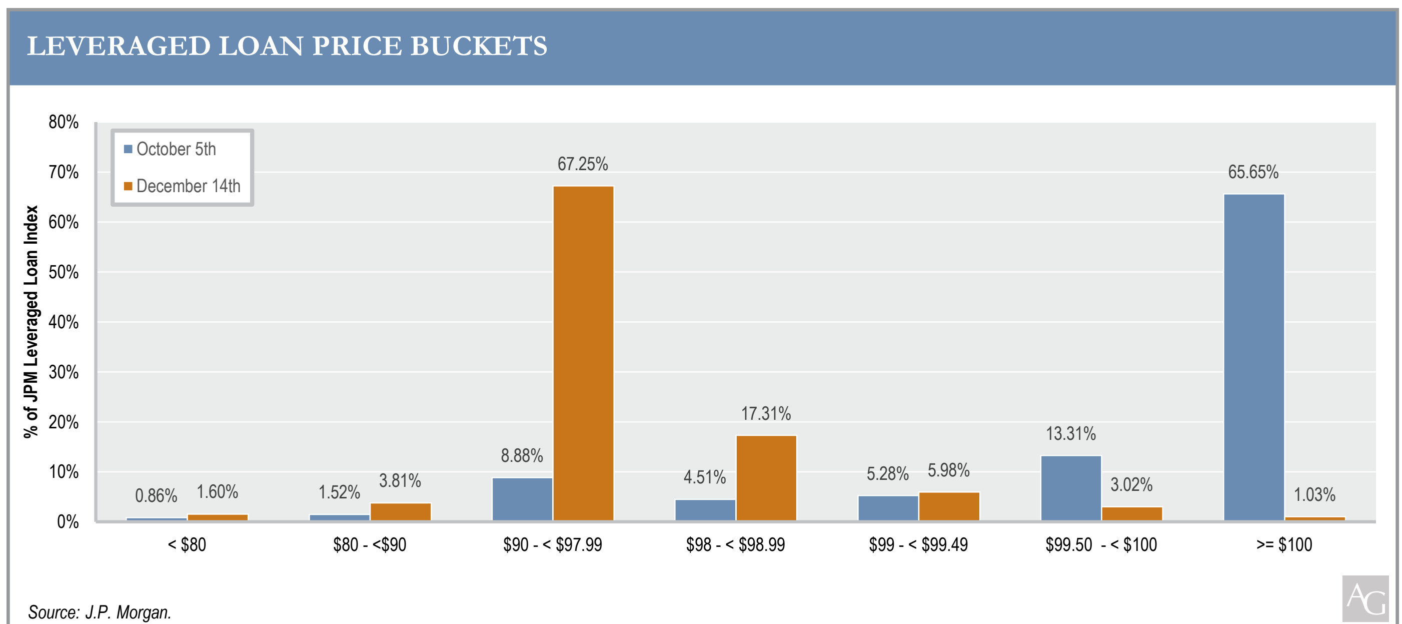
LEVERAGED LOAN FUND FLOWS



Source: J.P. Morgan.

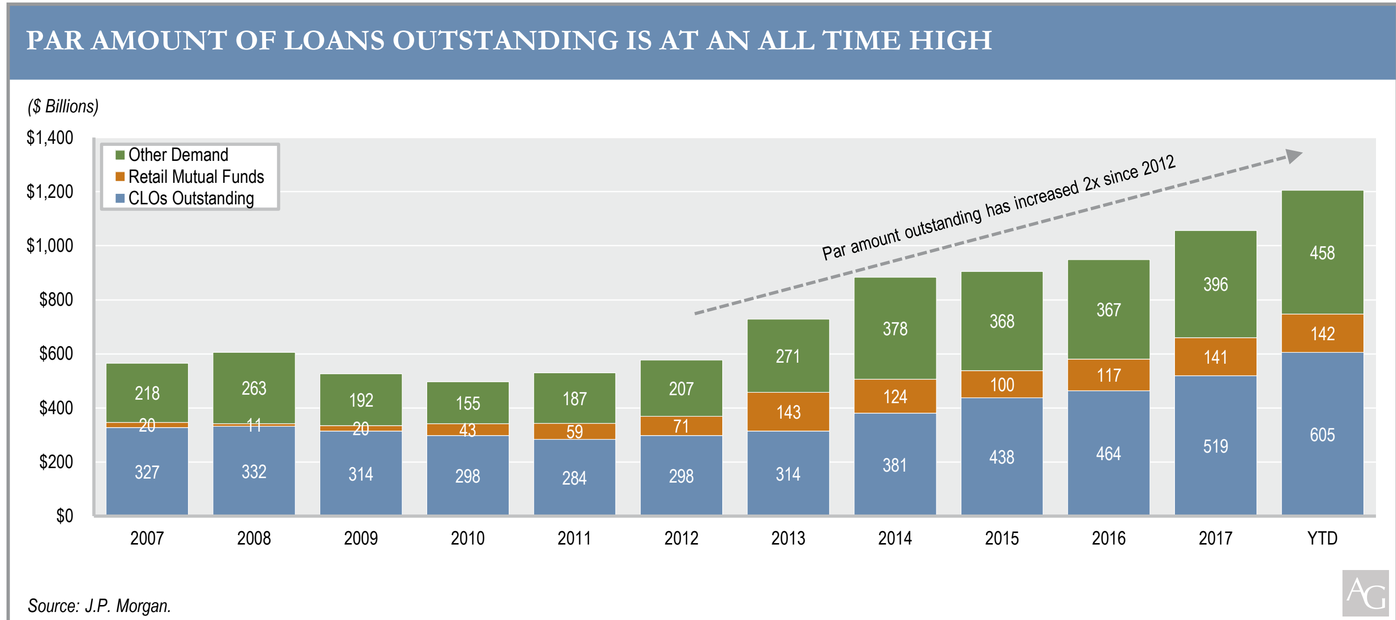
Q4 saw the largest outflows from leveraged loan funds since 2016.

LEVERAGED LOAN PRICE BUCKETS



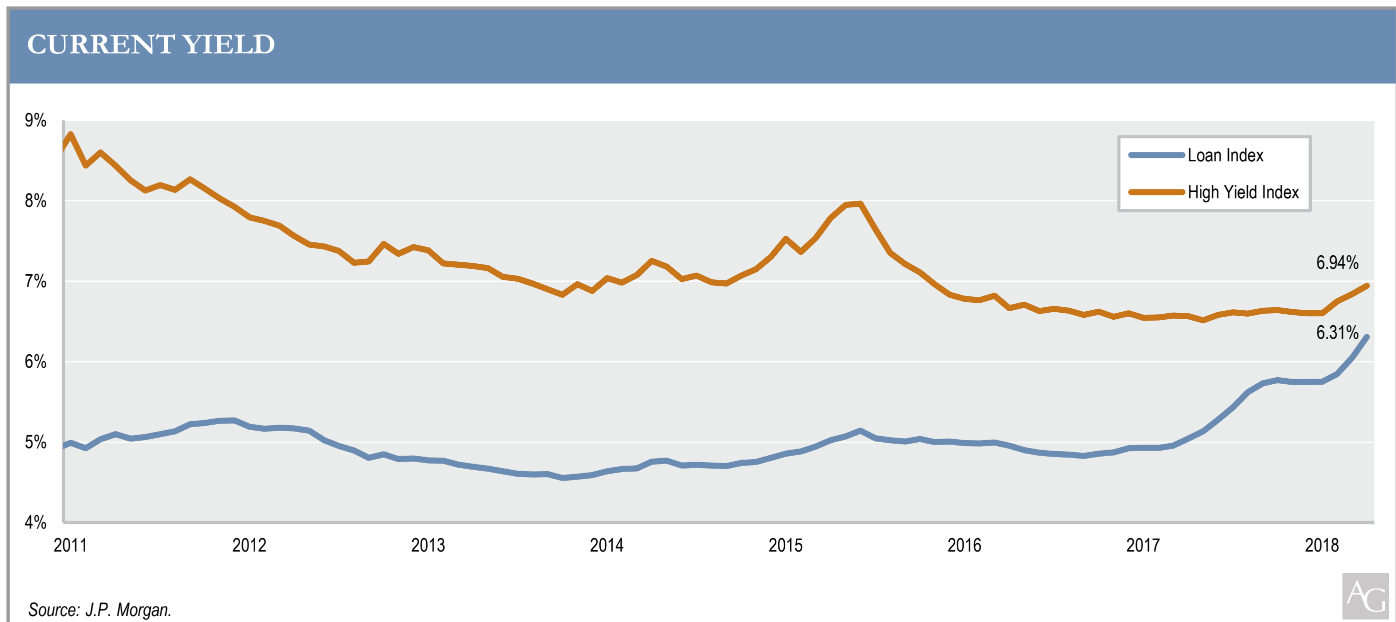
Source: J.P. Morgan.

These large outflows were a significant technical factor which led the majority of loans into below par price buckets.



Source: J.P. Morgan.

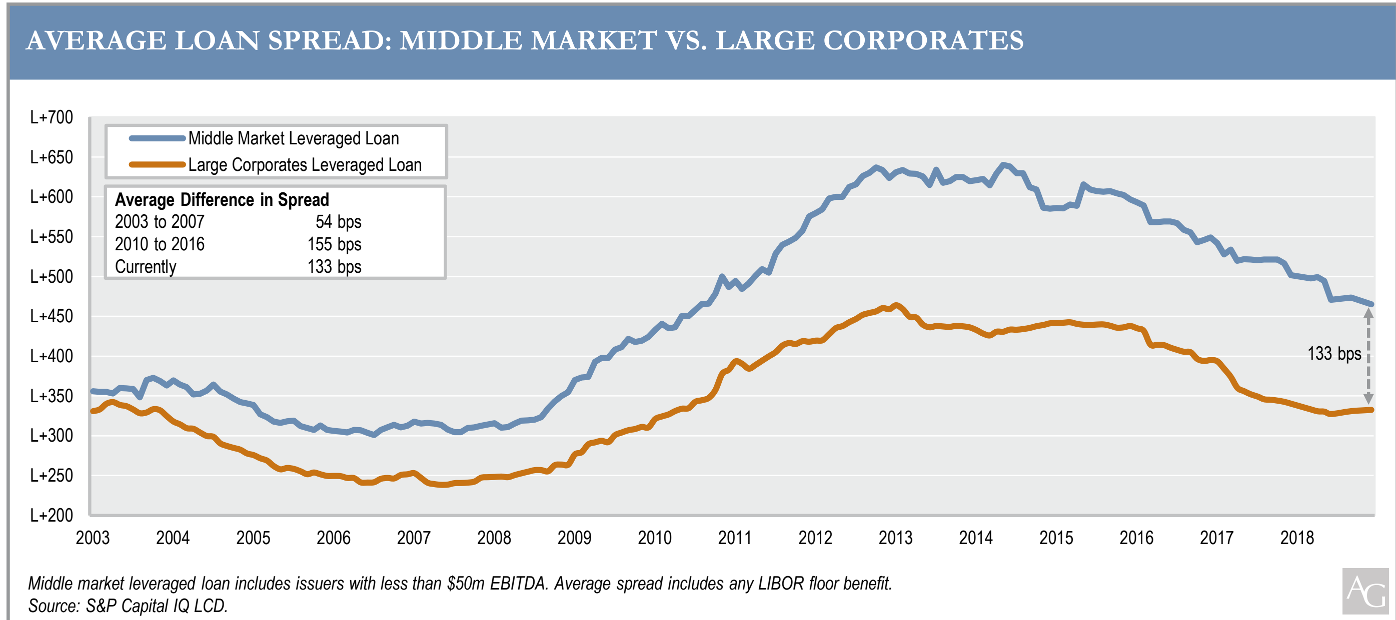
Despite a weaker tone in Q4, overall strong demand, especially from CLOs, has continued to support the growth of the leverage loan market.



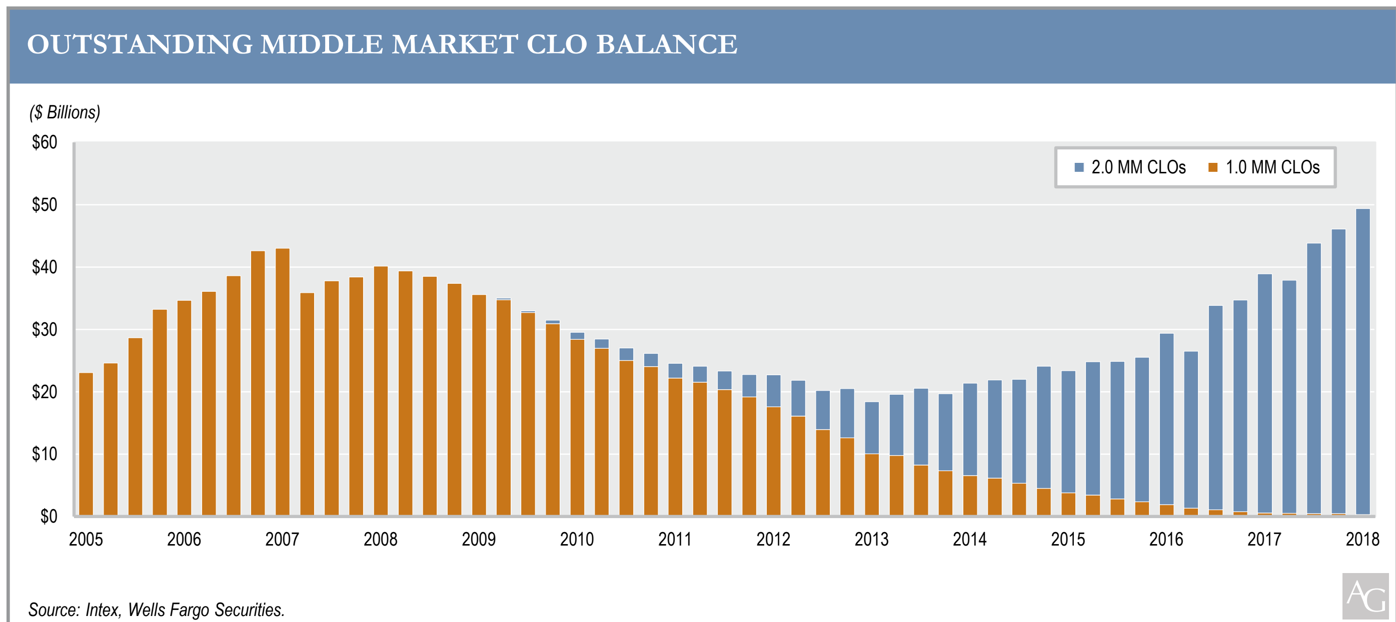
Source: J.P. Morgan.

Loans offer attractive risk adjusted returns compared to high yield.

MIDDLE MARKET DIRECT LENDING



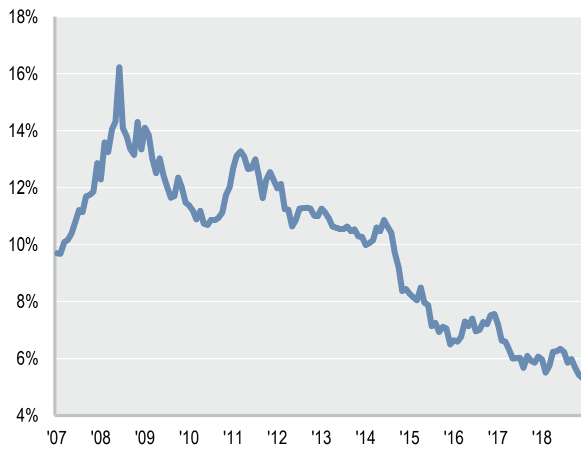
Middle market loans continue to offer an attractive premium relative to the historical average.



Middle market CLO issuance remains robust, resulting in a markets size of nearly $50 billion.

ENERGY

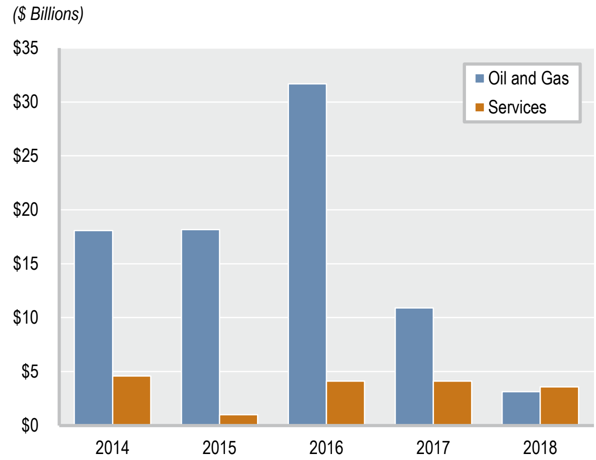
ENERGY EQUITIES WEIGHTING AS A PERCENT OF THE S&P 500



Source: Bloomberg.

With a weighting below 6% of the S&P 500, energy equities are nearing a historic level of unimportance.

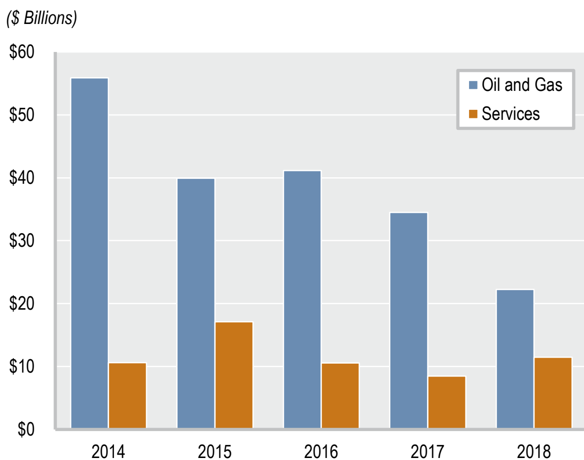
SUPPLY OF ENERGY CAPITAL: EQUITY ISSUANCE DECLINING



Source: PLS Capitalize.

Appetite for oil and gas and oilfield services equity has declined significantly. The IPO market has been closed since July 2018.

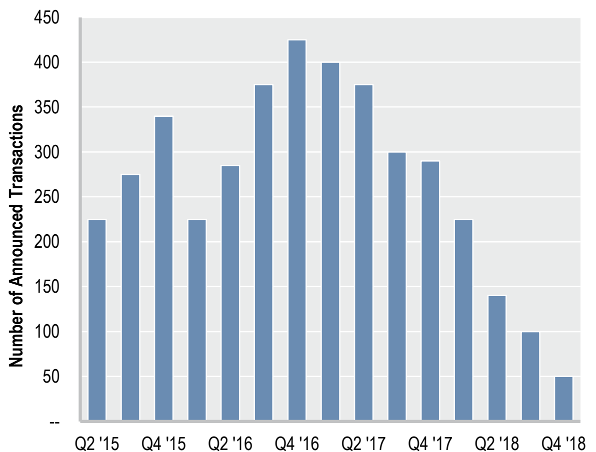
SUPPLY OF ENERGY CAPITAL: HIGH YIELD ISSUANCE DECLINING



Source: PLS Capitalize.

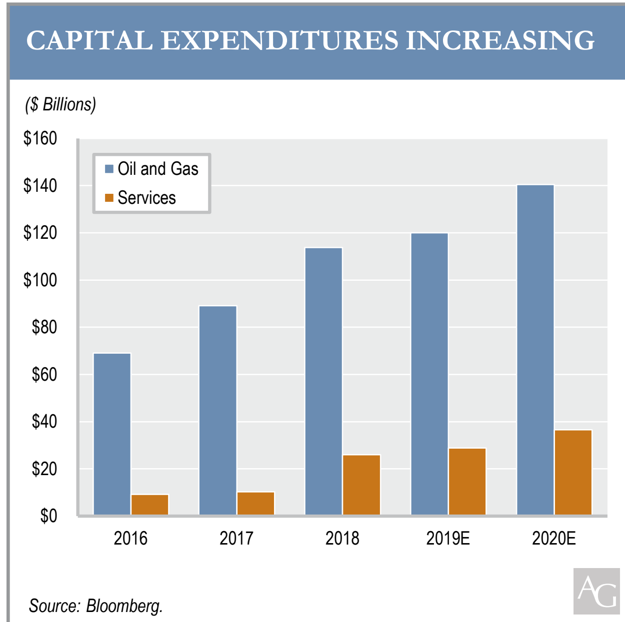
Oil and gas and oilfield services high yield issuance continues to wane.

PACE OF A&D SLOWING CONSIDERABLY

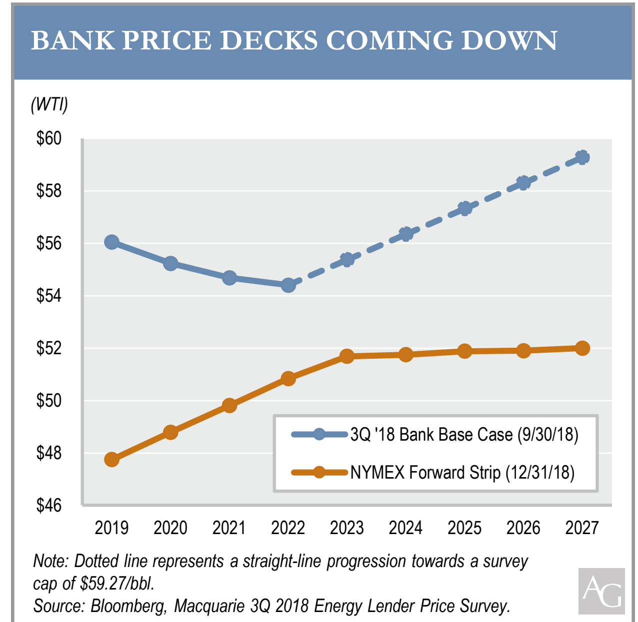


Source: BMO Capital Markets.

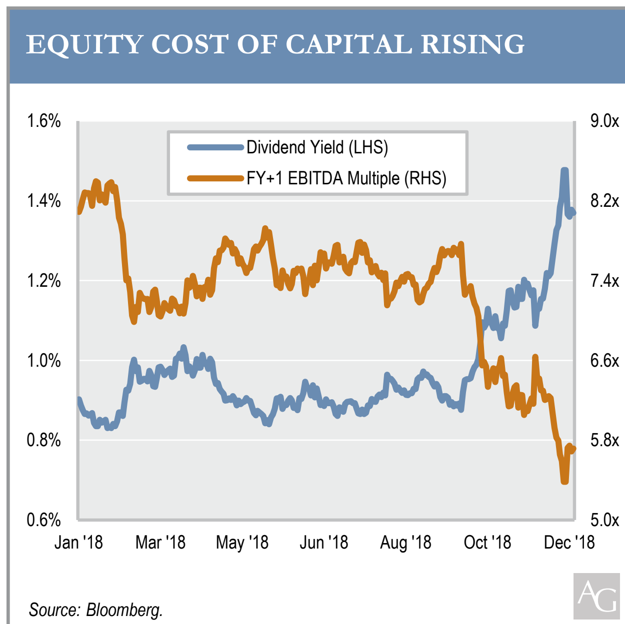
Capital discipline has suppressed public company acquisition appetites, foreclosing on an often previously accessed capital source.



Despite the recent moderation in WTI, capital expenditures are projected to increase in 2019-2020.

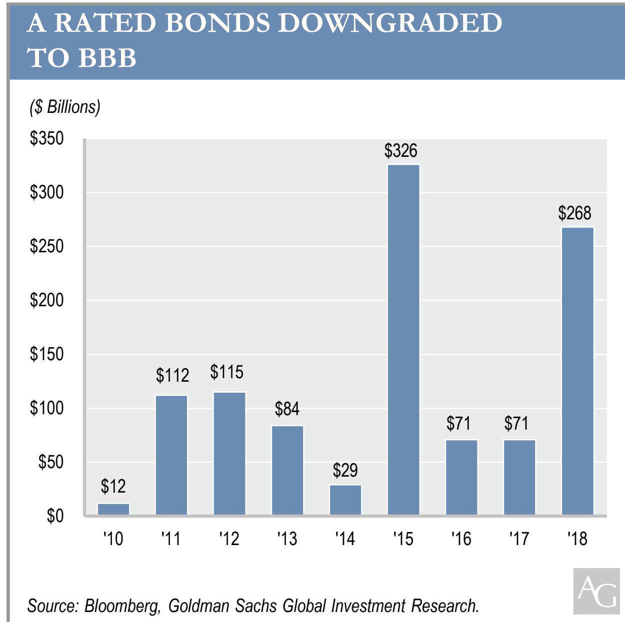


Bank price decks have declined materially since borrowing base redeterminations in October 2018.

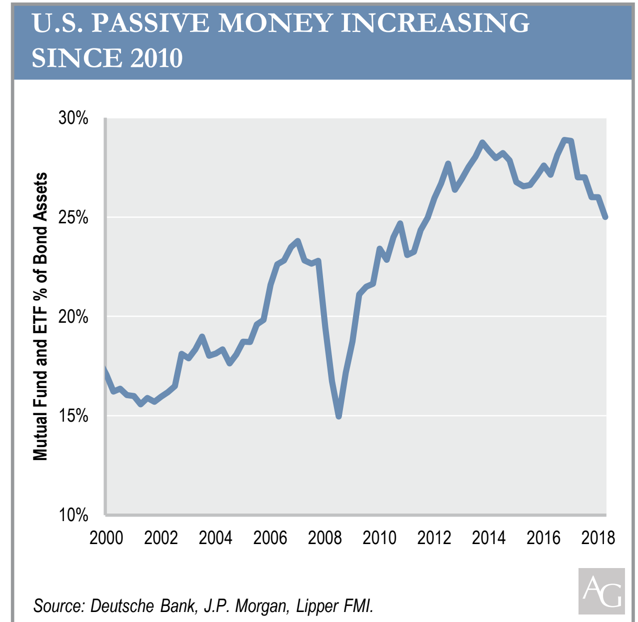


The equity and debt cost of capital is rising.

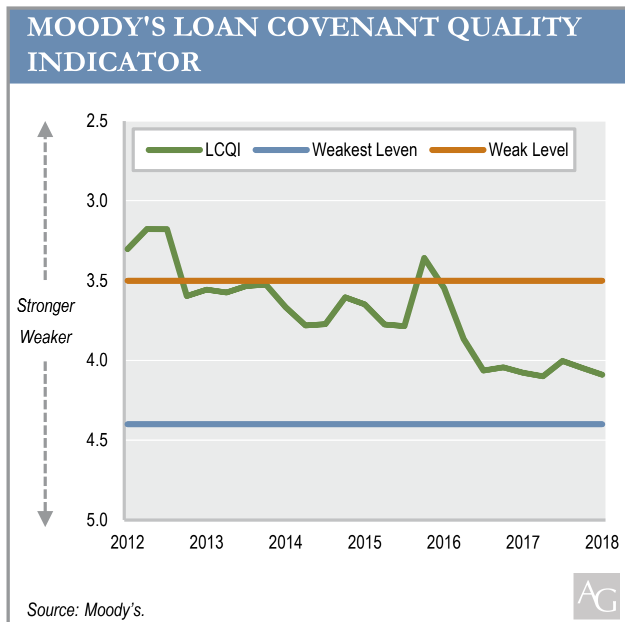
DISTRESSED DEBT



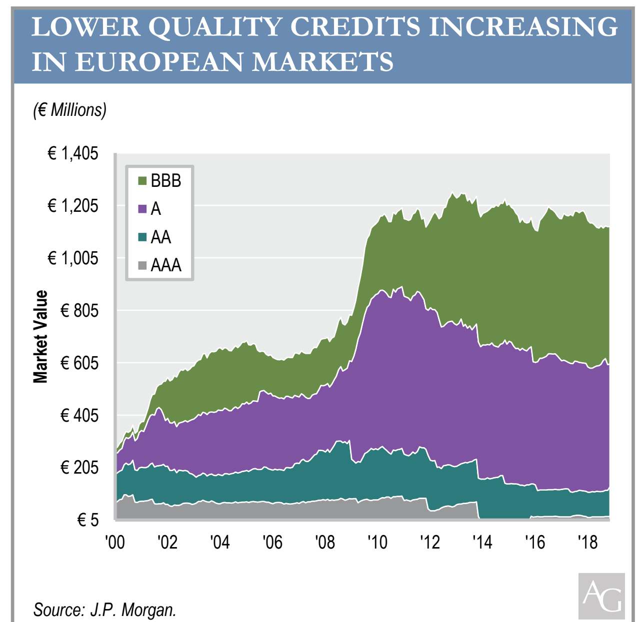
The BBB category is enormous and growing.



Passive, rules-based investing continues to grab market share.



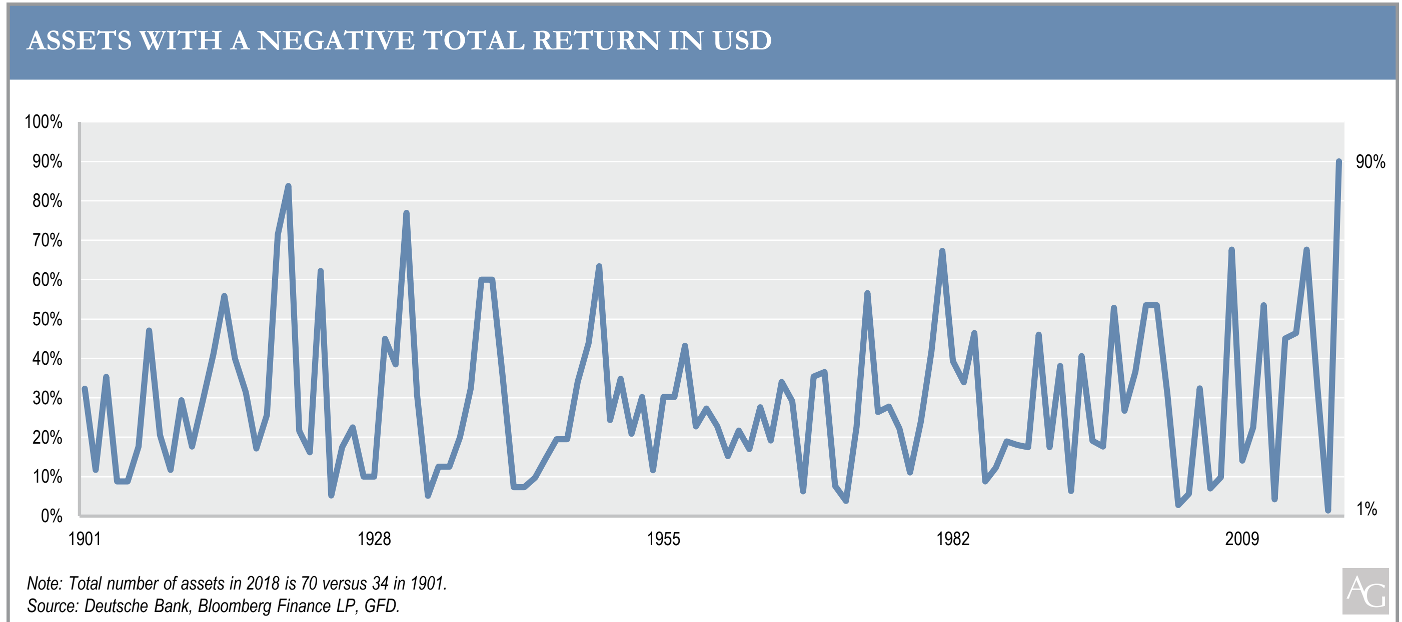
Creditor rights, in the form of covenant quality, is at multi-year lows.



Lower quality credits have also been grabbing share in Europe.

DISTRESSED DEBT *(continued)*

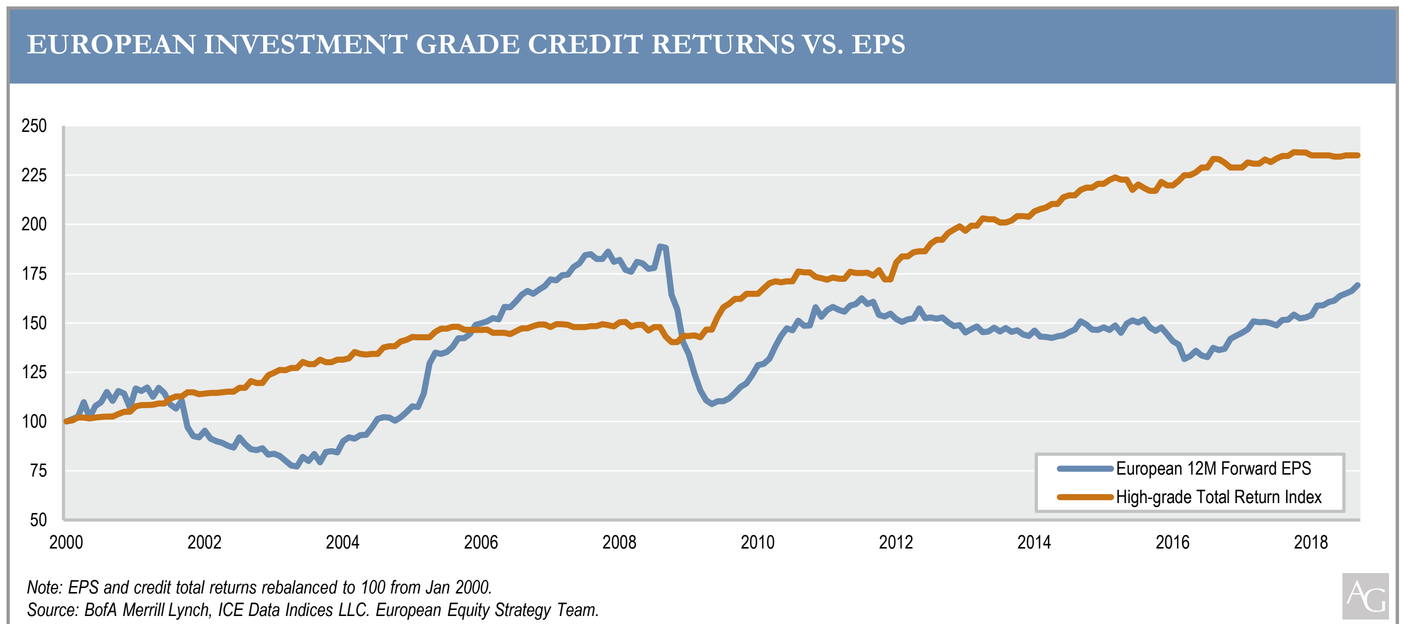
ASSETS WITH A NEGATIVE TOTAL RETURN IN USD



Note: Total number of assets in 2018 is 70 versus 34 in 1901.
Source: Deutsche Bank, Bloomberg Finance LP, GFD.

The last quarter of 2018 drove a significant portion of global assets into negative performance territory.

EUROPEAN INVESTMENT GRADE CREDIT RETURNS VS. EPS

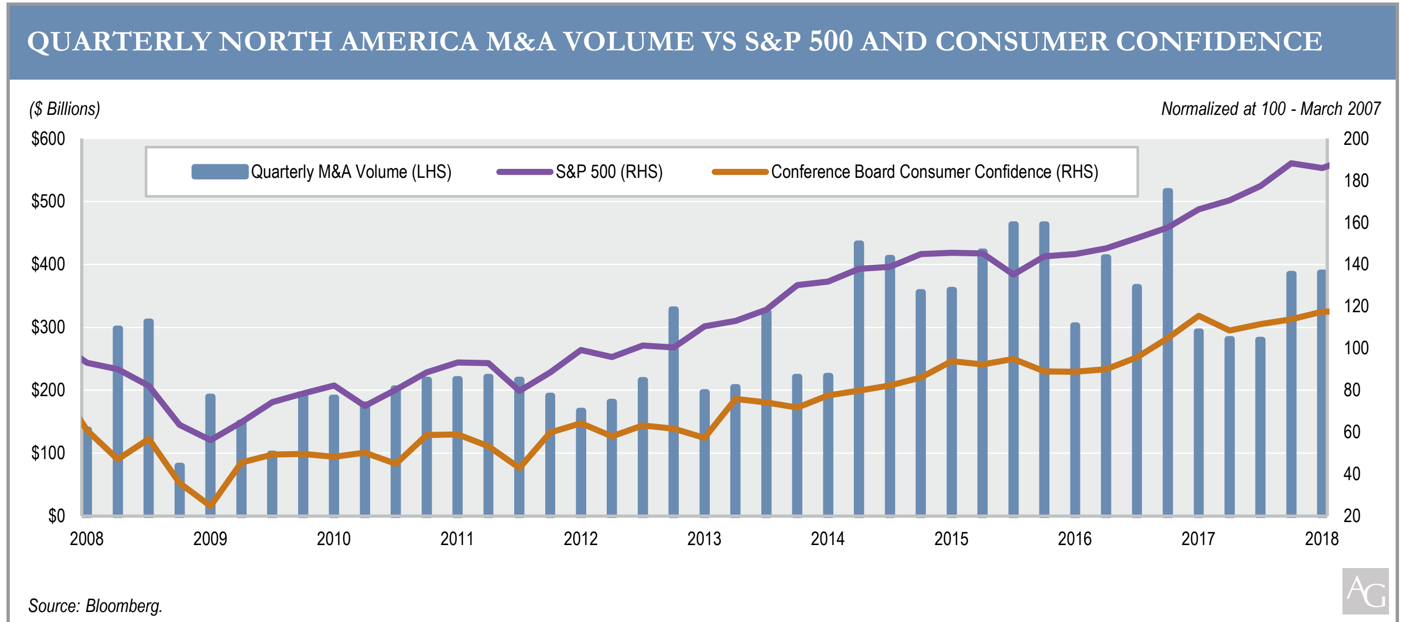


Note: EPS and credit total returns rebalanced to 100 from Jan 2000.
Source: BofA Merrill Lynch, ICE Data Indices LLC. European Equity Strategy Team.

Central bank easing has driven IG credit returns well above what equity markets may suggest.

MERGER & CONVERTIBLE ARBITRAGE

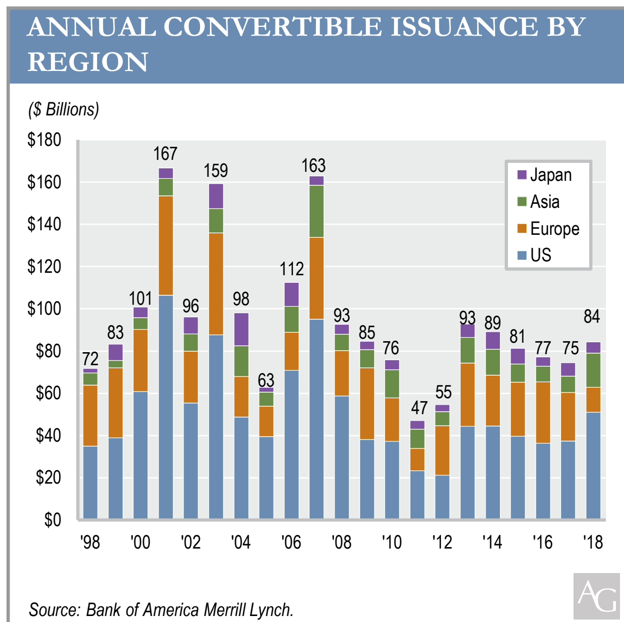
QUARTERLY NORTH AMERICA M&A VOLUME VS S&P 500 AND CONSUMER CONFIDENCE



Source: Bloomberg.

U.S. M&A volumes slowed in the second half but performed well for the full year.

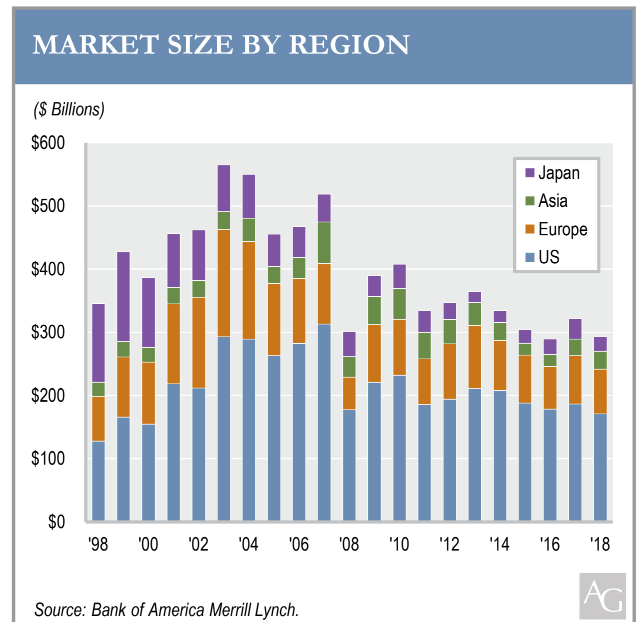
ANNUAL CONVERTIBLE ISSUANCE BY REGION



Source: Bank of America Merrill Lynch.

2018 global issuance hit the highest level since 2014, driven by the U.S.

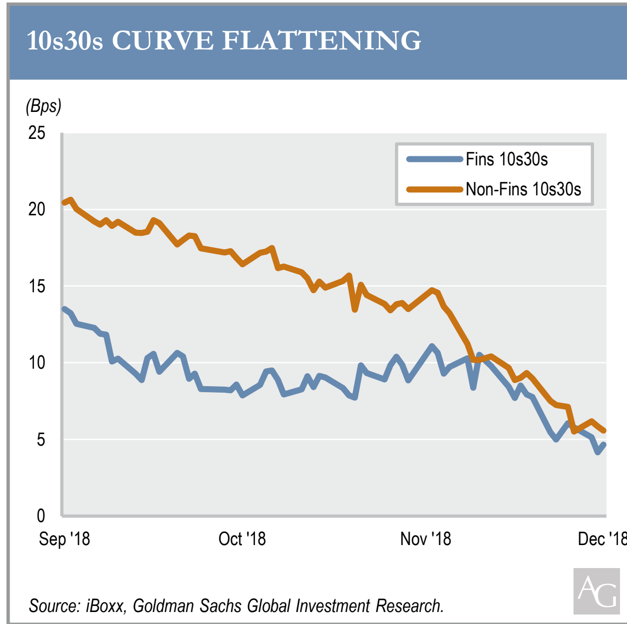
MARKET SIZE BY REGION



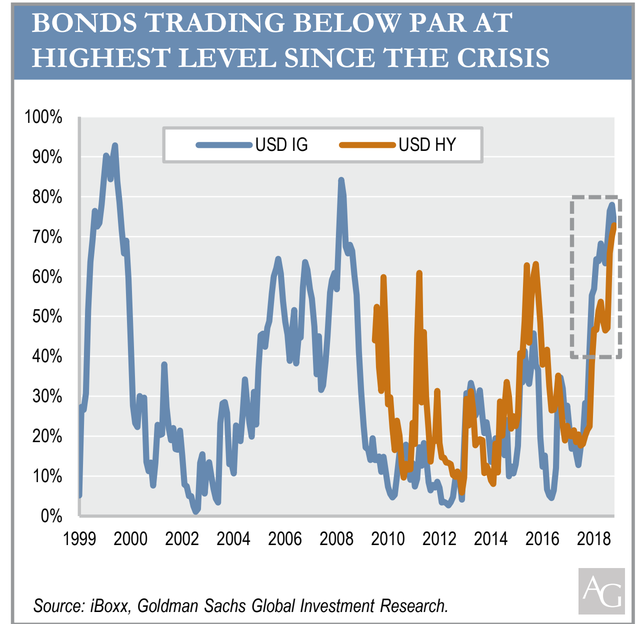
Source: Bank of America Merrill Lynch.

Global convertible market cap sits just below $300 billion.

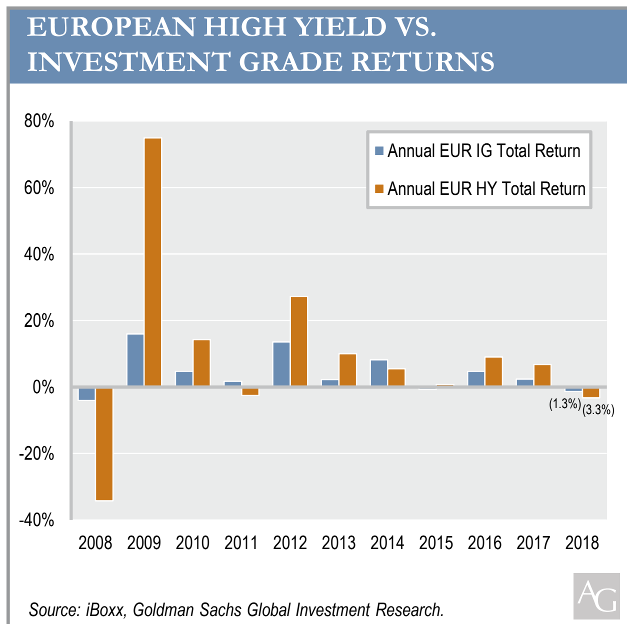
LIQUID CREDIT



Back end flattening accelerated into year-end 2018.



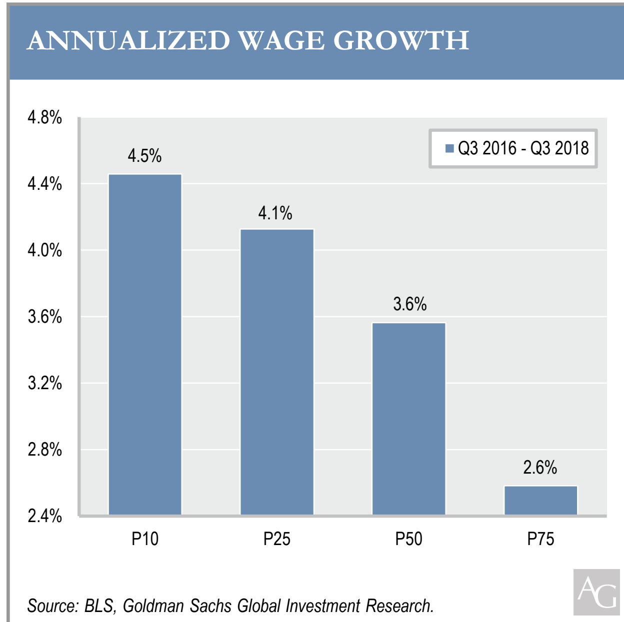
Wide spreads and higher rates edged the number of U.S. bonds below par at multi-year highs.

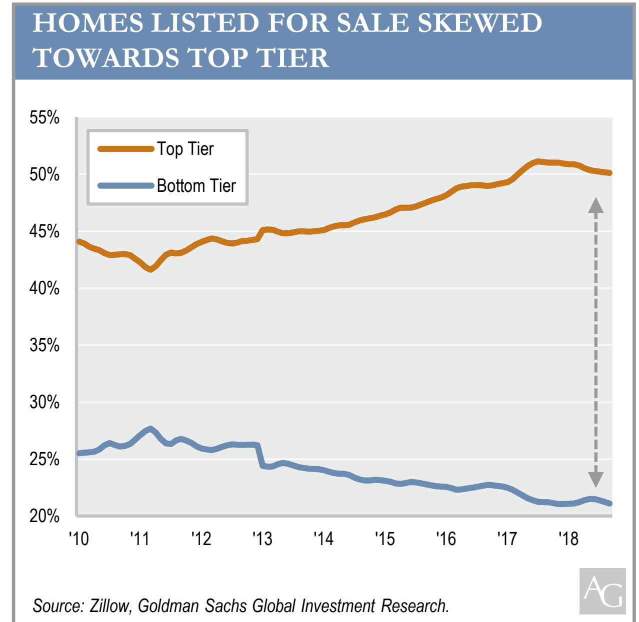


European bonds irrespective of ratings quality traded off in 2018.

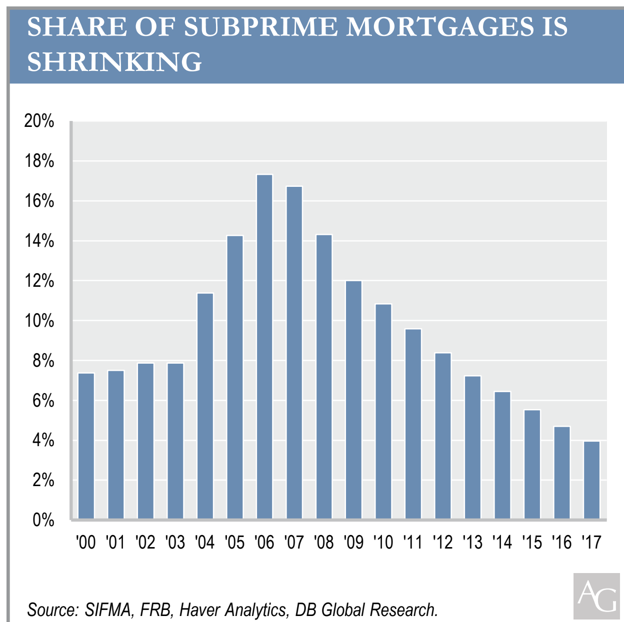
Minimal 2018 Euro-denominated multi-national IG issuance has supported spread performance and led to elevated differentials.

RESIDENTIAL AND CONSUMER DEBT (RMBS/ABS)

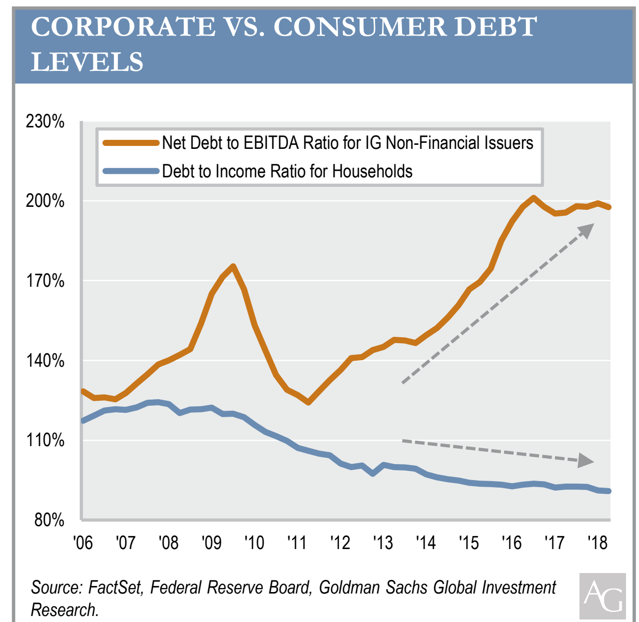




Relatively strong wage growth by lower income households and a low supply of bottom tier homes support continued home price appreciation in this market segment.

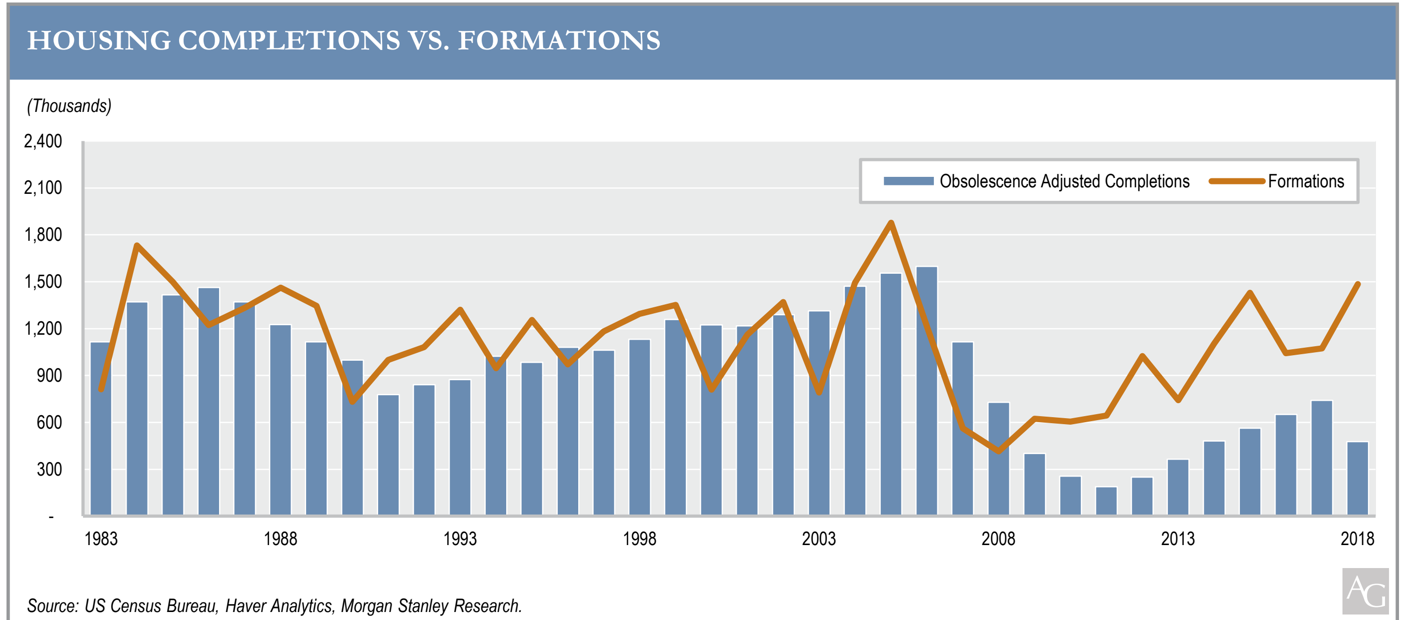


Subprime mortgages as a percentage of all outstanding mortgages are well below pre-crisis levels, a reflection of the health of the underlying consumer.



Leverage has diverged quite significantly between households and non-financial corporate issuers.

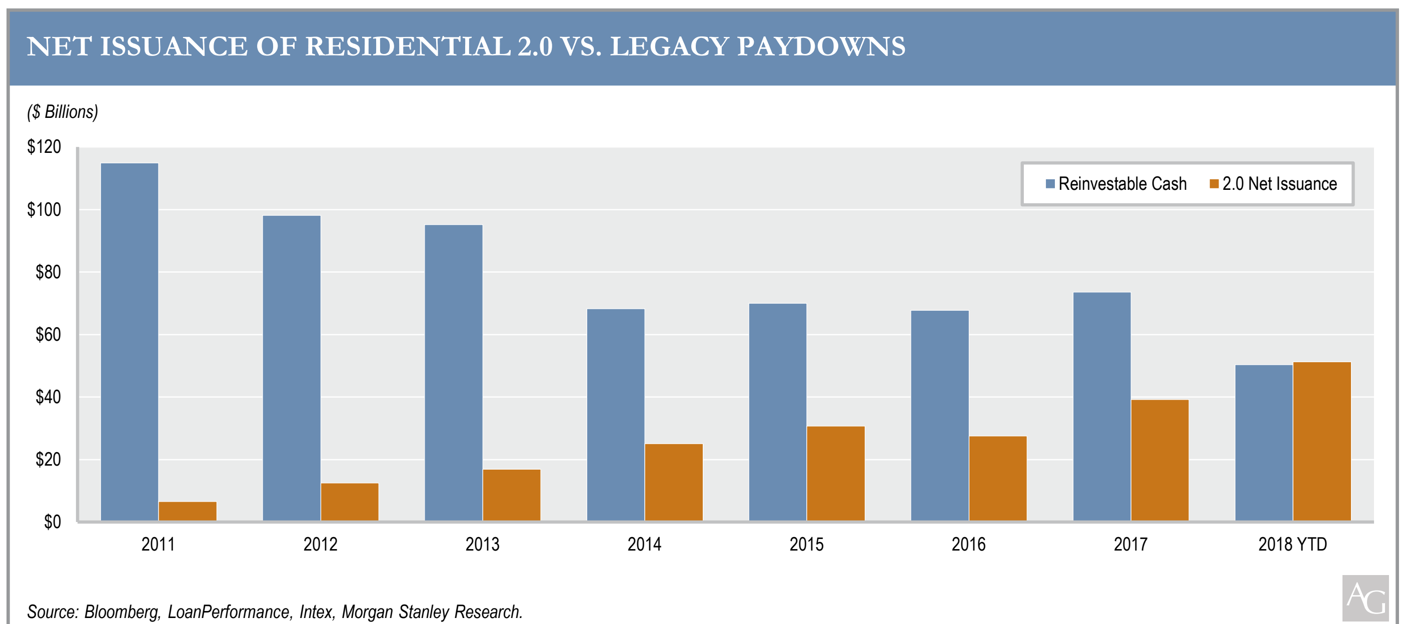
HOUSING COMPLETIONS VS. FORMATIONS



Source: US Census Bureau, Haver Analytics, Morgan Stanley Research.

Housing market supply remains tight, as completions remain well below household formations.

NET ISSUANCE OF RESIDENTIAL 2.0 VS. LEGACY PAYDOWNS

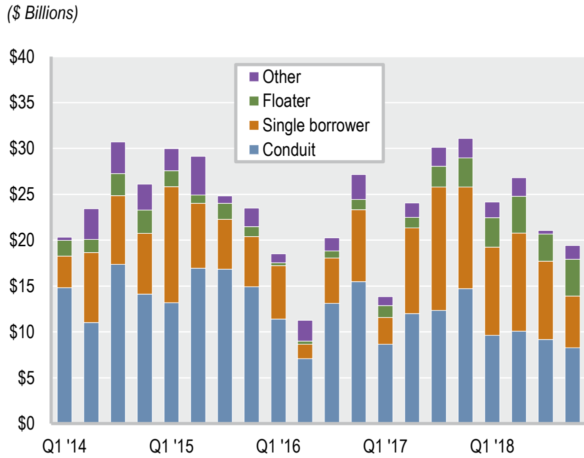


Source: Bloomberg, LoanPerformance, Intex, Morgan Stanley Research.

For the first time since the crisis, net issuance of residential 2.0 products now exceeds cash paid out by legacy products.

COMMERCIAL REAL ESTATE DEBT (CMBS)

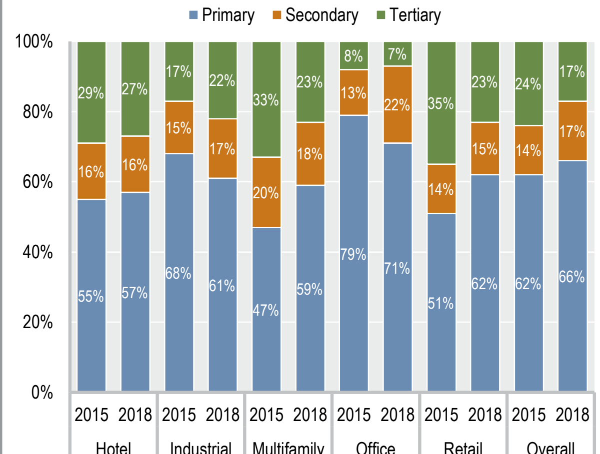
QUARTERLY PRIVATE LABEL ISSUANCE



Source: Credit Suisse, Commercial Mortgage Alert.

Single-Asset/Single-Borrower issuance was about equal to conduit issuance which has historically made up the majority of non-agency CMBS issuance.

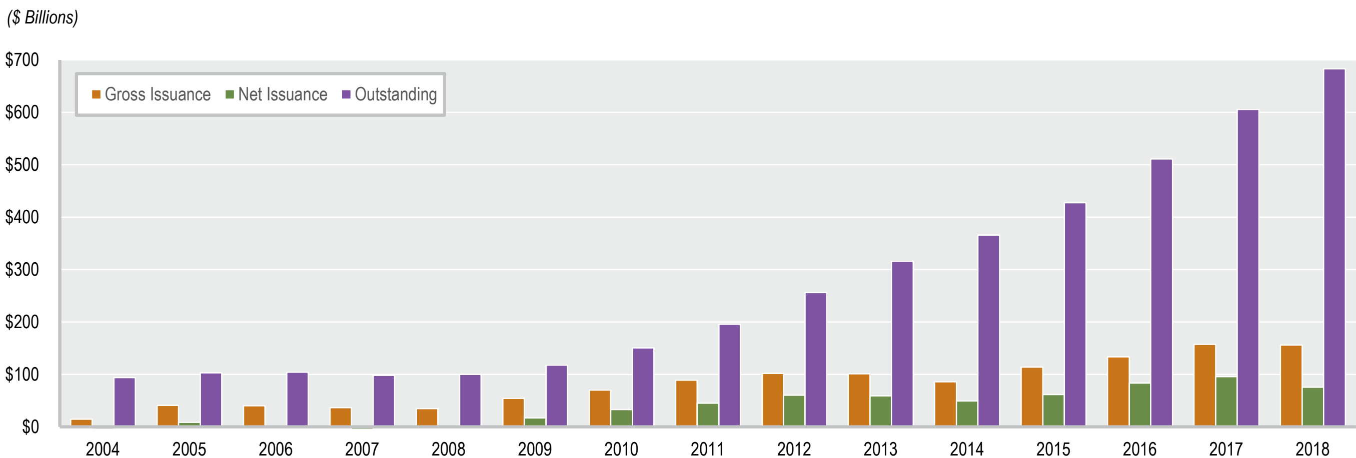
CONDUIT CMBS ISSUANCE



Note: Excludes portfolio loans, as of 11/5/2018.
Source: Bloomberg LP, and Wells Fargo Securities.

CMBS conduit deals consistently have greater exposure to primary markets than to either secondary or tertiary markets.

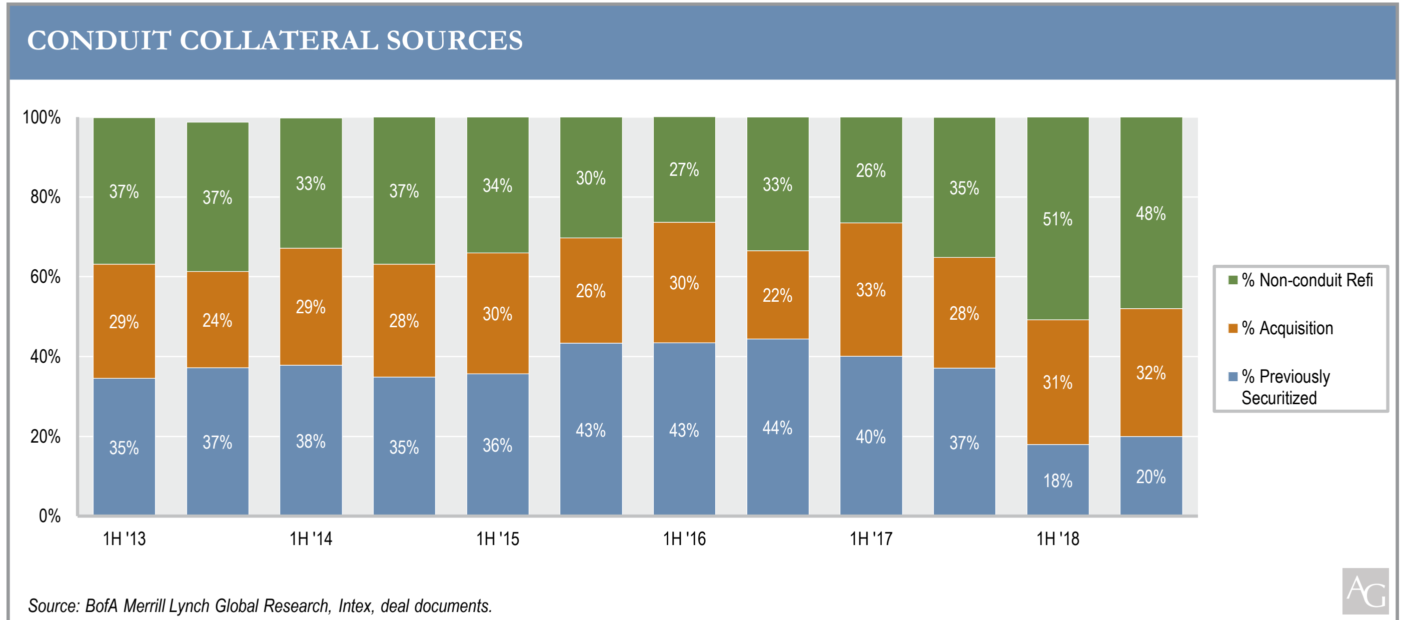
AGENCY CMBS OUTSTANDING



Source: BofA Merrill Lynch Global Research, Intex, Bloomberg, BNY Mellon.

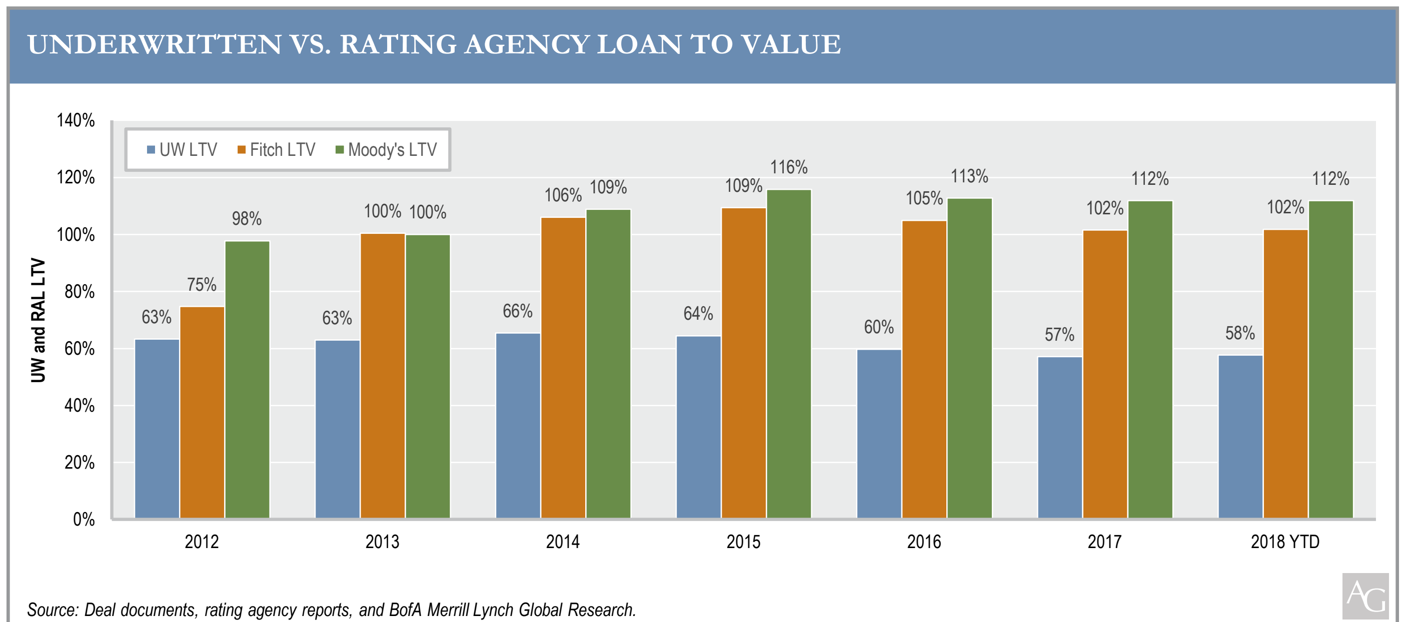
The agency CMBS market has continued to grow each year since the crisis and is a nearly $700 billion market today.

COMMERCIAL REAL ESTATE DEBT (CMBS) *(continued)*



Source: BofA Merrill Lynch Global Research, Intex, deal documents.

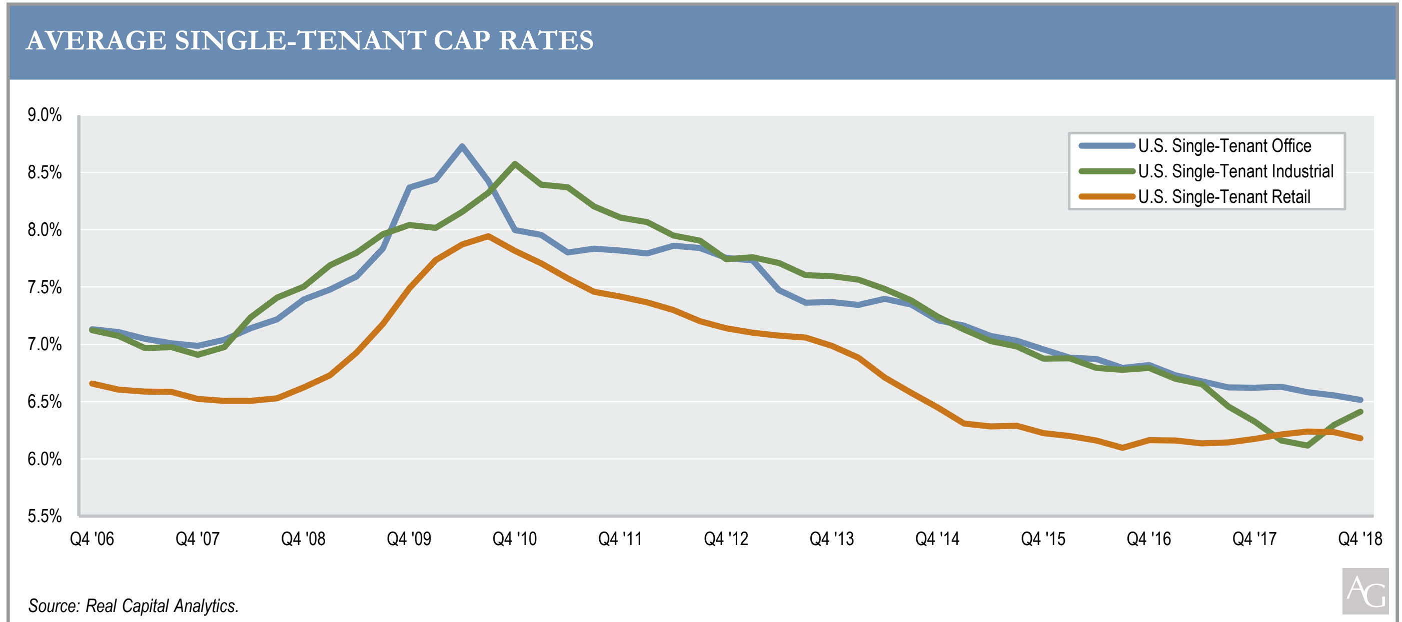
CMBS conduit deals often provide financing for both acquisition loans and loans that have not previously been securitized.



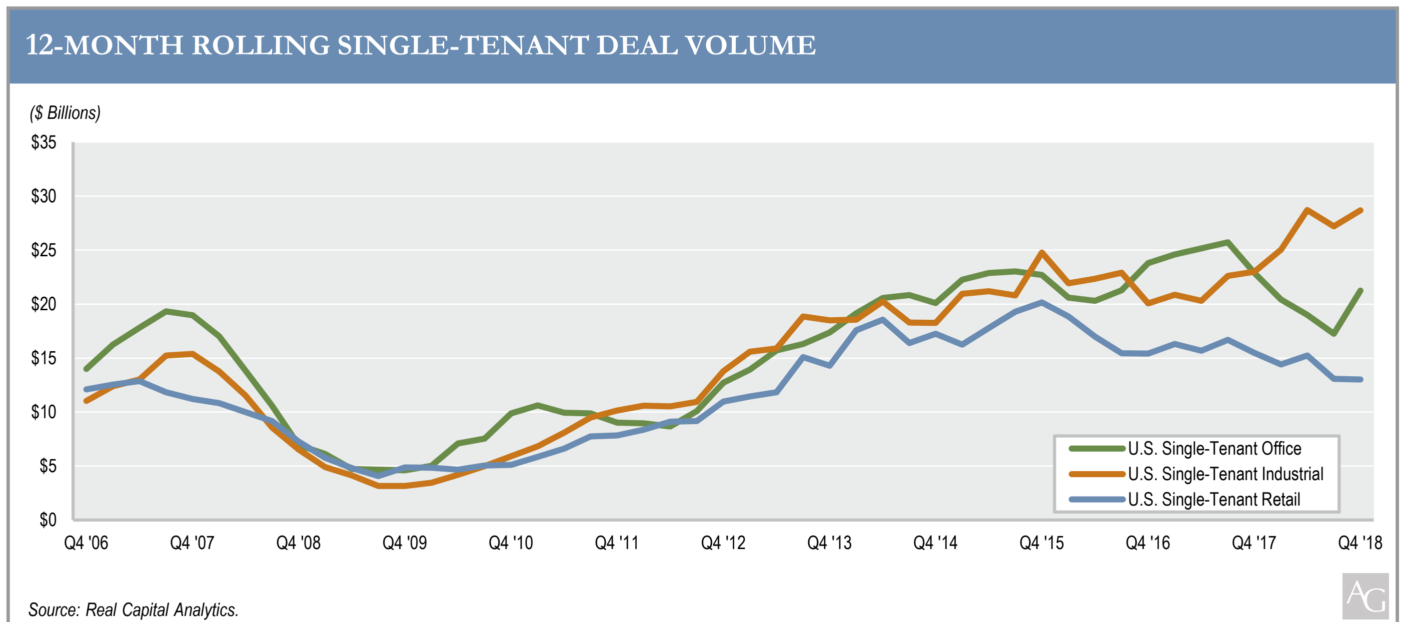
Source: Deal documents, rating agency reports, and BofA Merrill Lynch Global Research.

Underwritten LTVs have largely been stable over the last several years, as have rating agency LTVs.

NET LEASE REAL ESTATE



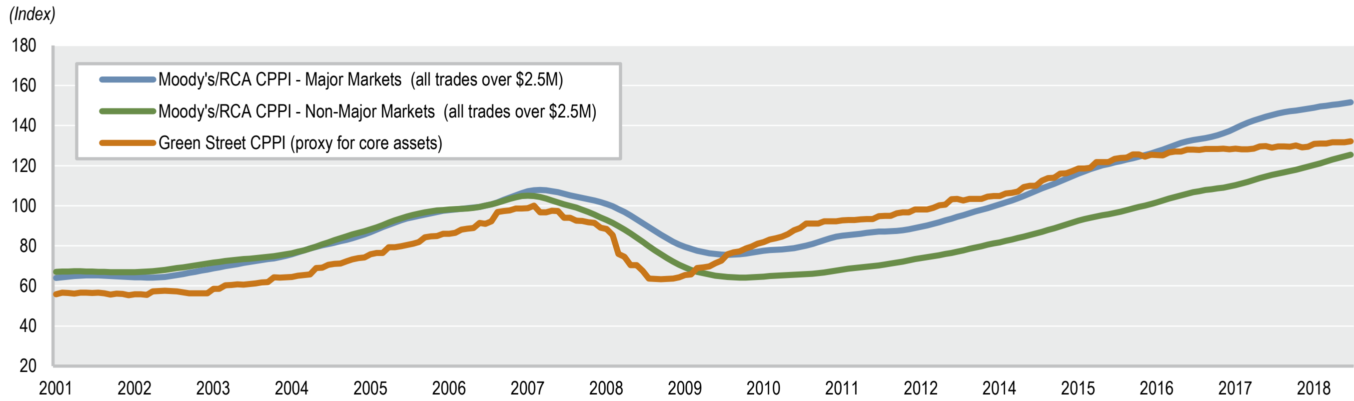
Office cap rates continue to compress, while industrial and retail cap rates have increased since recent lows.



Strong volume in industrial more than offset declines in office and retail.

REAL ESTATE – UNITED STATES

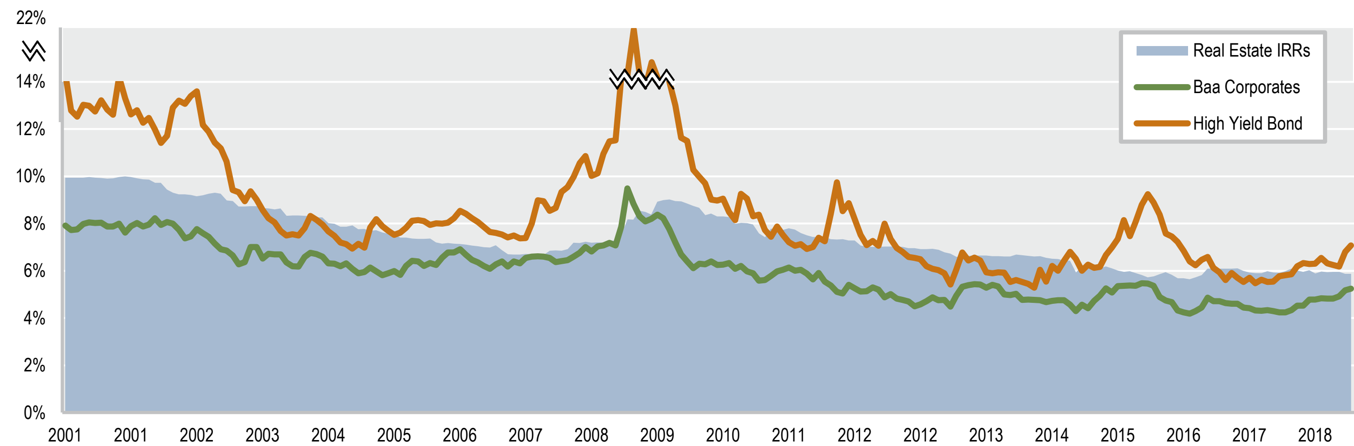
COMMERCIAL REAL ESTATE PRICE INDICES



Source: Moody's CPPI = Moody's/RCA All Property Types.
Green Street CPPI = Major Sectors.
Sources: Moody's – Commercial Property Price Index (Moody's CPPI) (data through Nov '18), Green Street Advisors – Commercial Property Price Index (Green St CPPI) (data through Nov '18). Note: For this chart, Green St CPPI was indexed to 100 at it's 2007 peak (Aug 2007) and Moody's CPPI was indexed at 100 in Dec 2006.
Note: Major markets include Boston, Chicago, Washington D.C. Metro, Los Angeles Metro, New York City Metro and San Francisco Metro.

Price gains continue to level off in core markets, while broader market pricing continues its slow upward trend. Across the major sectors, apartments and industrial have led the way in price growth, while retail and hotel assets have lagged.

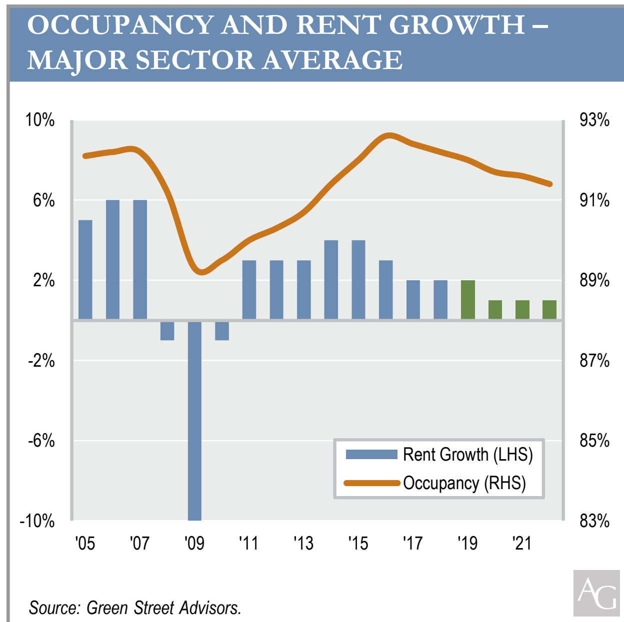
UNLEVERED TOTAL RETURN EXPECTATIONS ON REAL ESTATE VS. CORPORATE BOND YIELDS



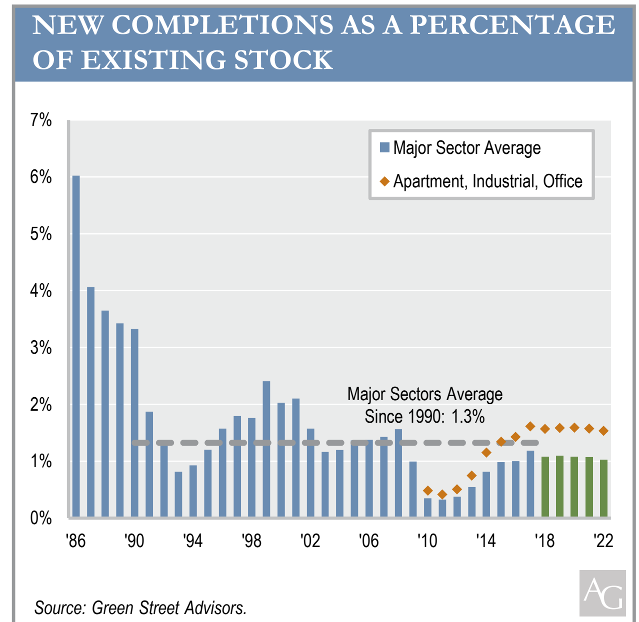
Real Estate IRRs is an equal-weighted average of the asset-weighted averages for the five major property sectors (apartment, industrial, mall, office, and strip center).
Source: Green Street Advisors (Dec' 18), Moody's (Baa Corporates), BAML (High-Yield Bonds).

Unlevered real estate has historically offered a return between investment grade and high yield bonds. Given the rise in bond yields real estate today is a little pricey versus Baa bonds and about fairly valued versus high yield. Taken together, a reversion to the historical spread would mean a modest decline in property values.

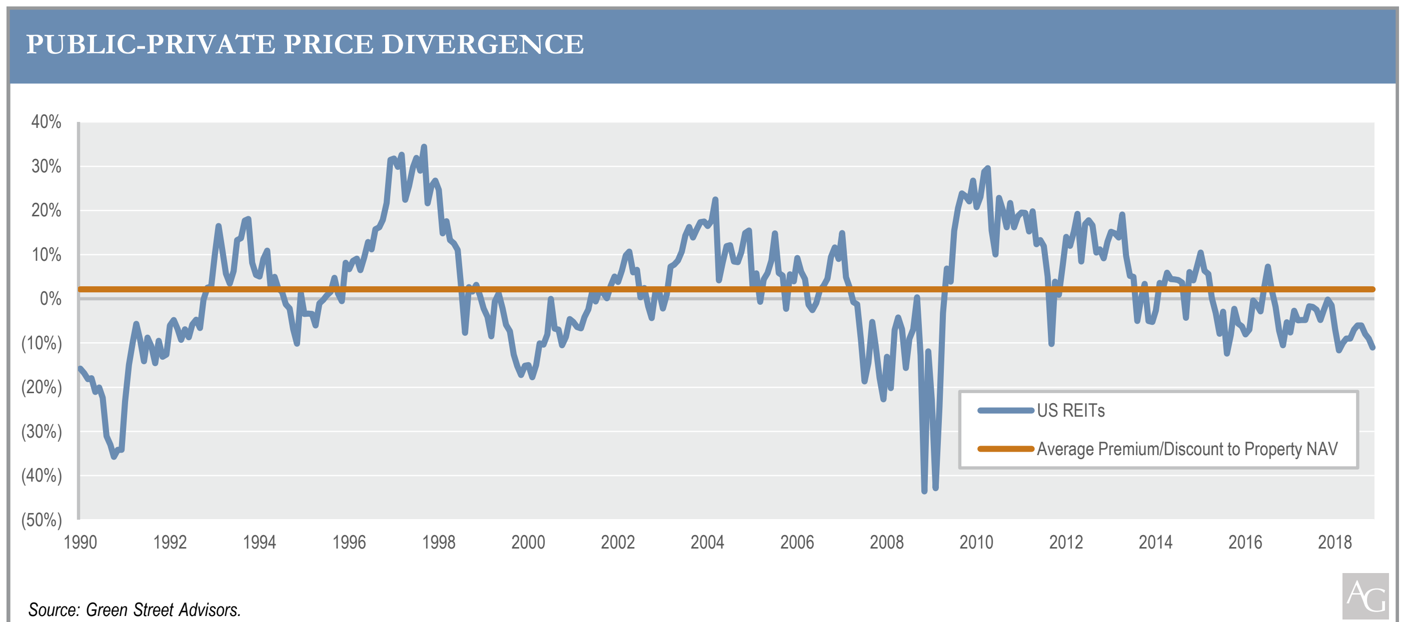
REAL ESTATE – UNITED STATES *(continued)*



As supply growth has ramped up, the pace of rent growth has slowed and occupancy has modestly declined.

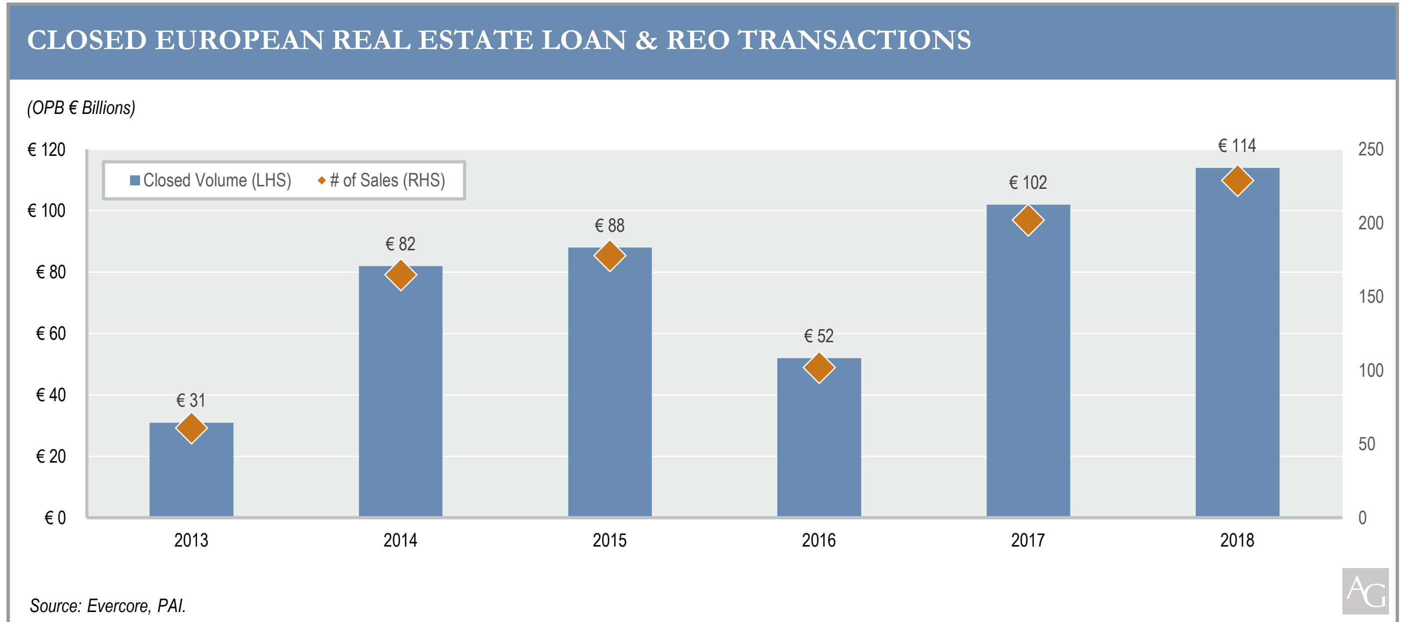


Industrial and multi-family deliveries are running at or above the long-term supply average, resulting in overall major sector supply growth that approaches the long-term average despite low new retail supply.

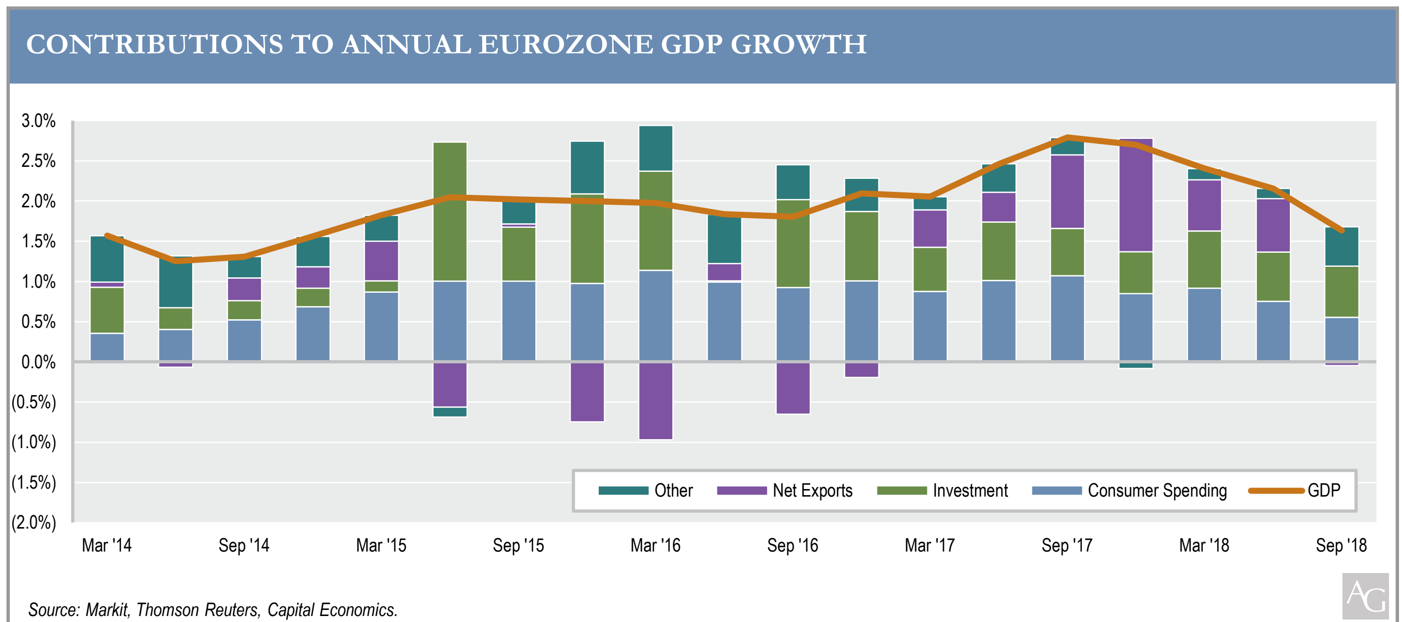


Discounts and premiums to net asset values – underlying property values – typically are leading indicators to changes in real asset values in the private markets. Prevailing discounts to NAV, magnified by structural stock market attributes and trends, currently portend a modest correction in private property values.

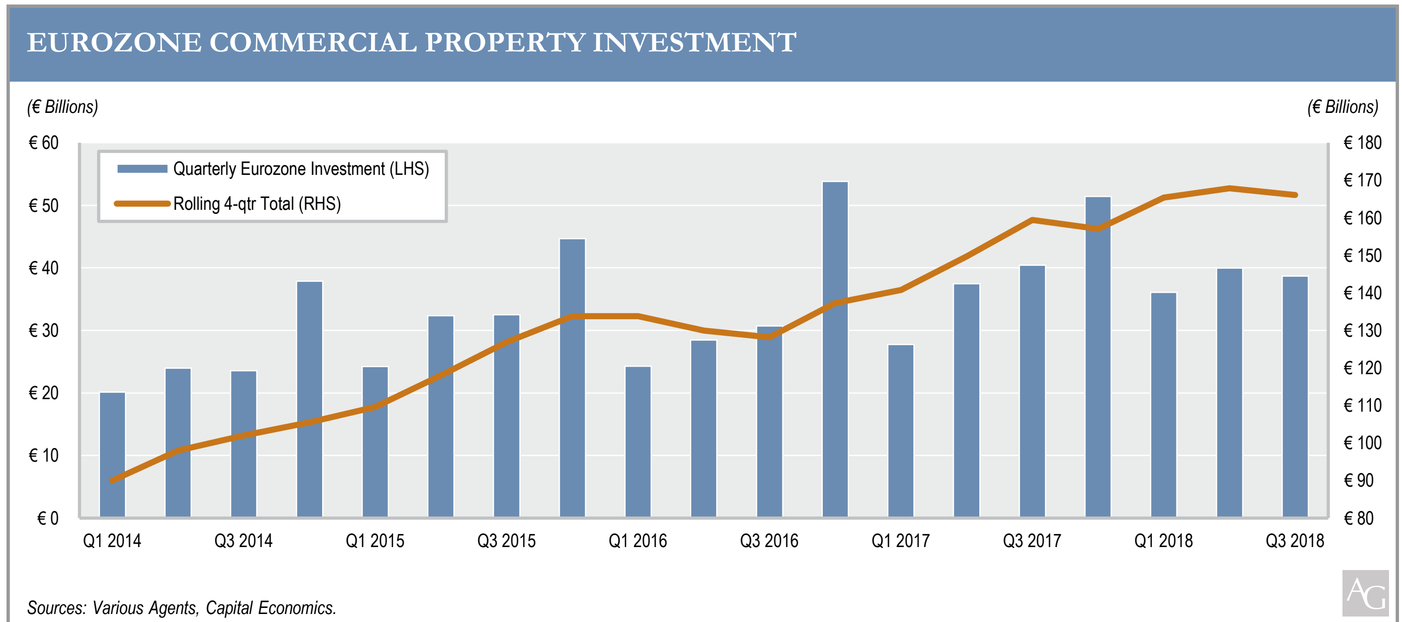
REAL ESTATE – EUROPE



Closed real estate NPL and REO transactions reach a new high in 2018, with Spain, Italy and Ireland leading in contributed volume.



After strong increases in 2017, Eurozone GDP growth stalled in 2018, with a significant decline in net exports in the last quarter of 2018.

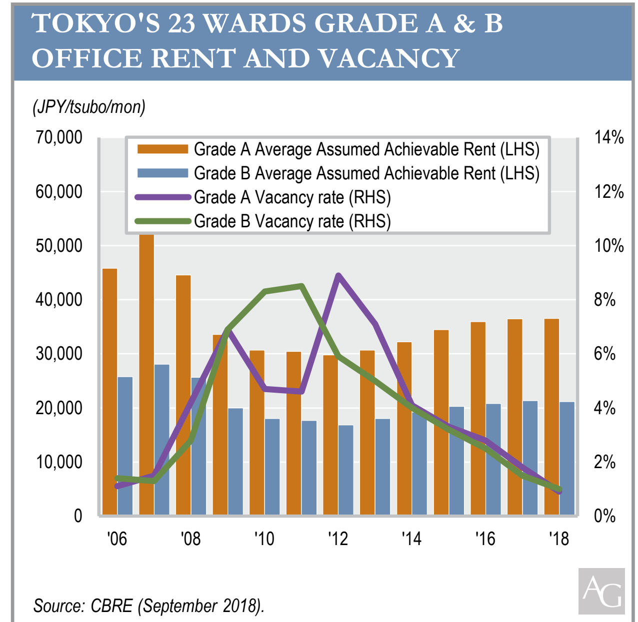


While commercial property investment in the Eurozone leveled off in 2018, the rolling four quarter average surpassed €160 billion.

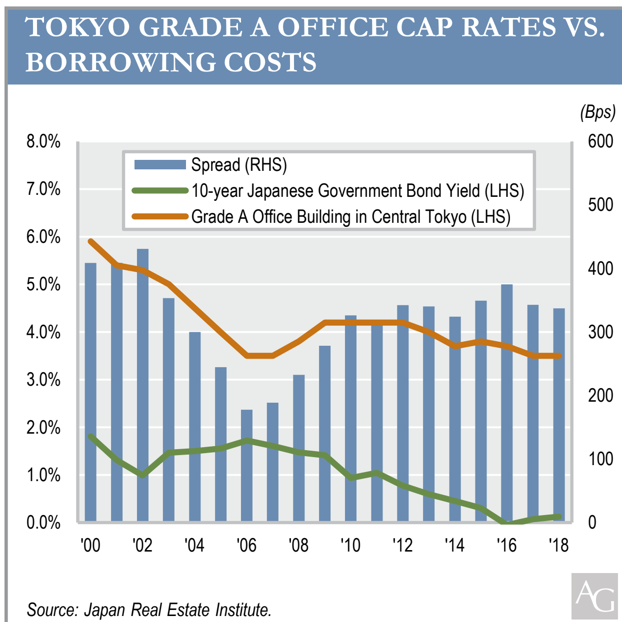
The value of UK commercial property deals declined slightly from the 2017 level; however, volume was considerably higher than prior to the financial crisis.

REAL ESTATE – ASIA

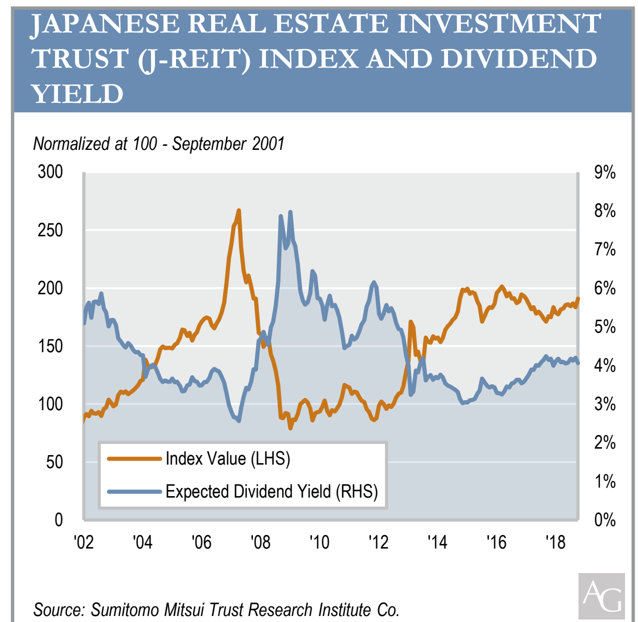
GDP growth continued to move downwards toward 6.0%-6.5%.



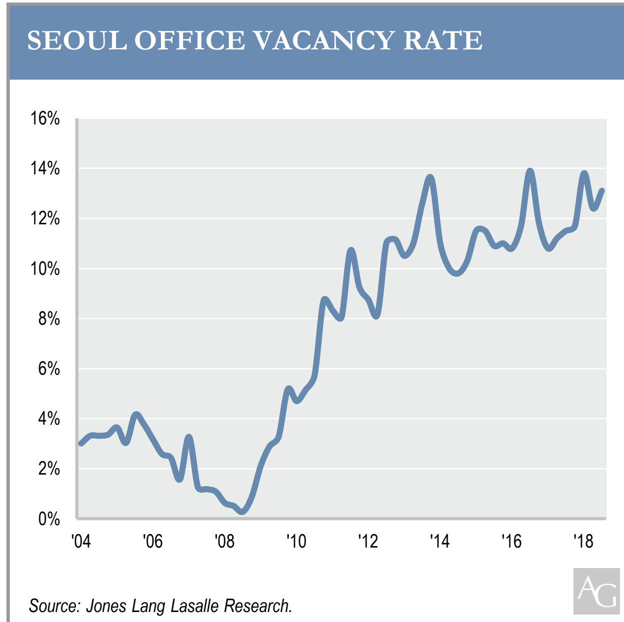
Office fundamentals in Tokyo continue to be strong with limited vacancy and rising rents.



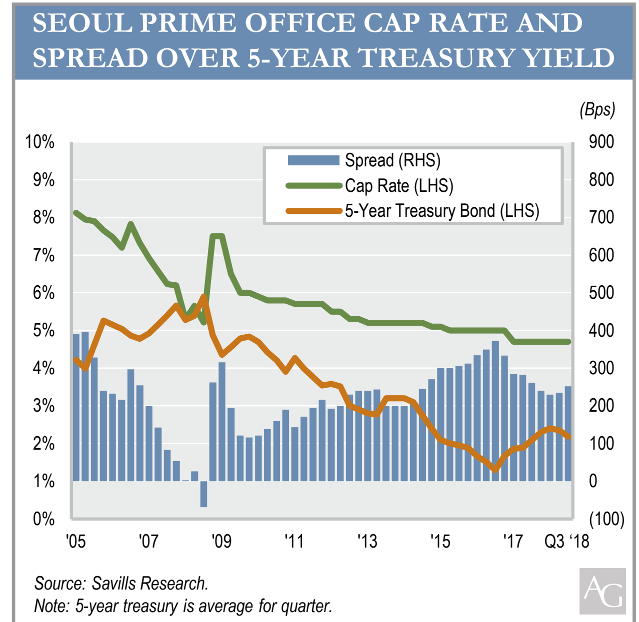
Cap rate spreads continue to be wide as government bond yields remain low.



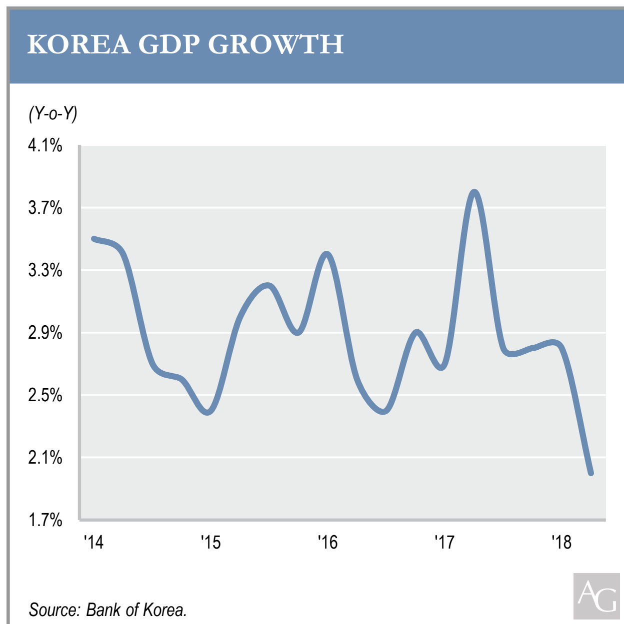
J-REIT Index performance showed modest improvement in 2018.



Office vacancy in Seoul remains high as new supply continues to weigh on the market.



Cap rate spreads remain wide at over 250 bps.

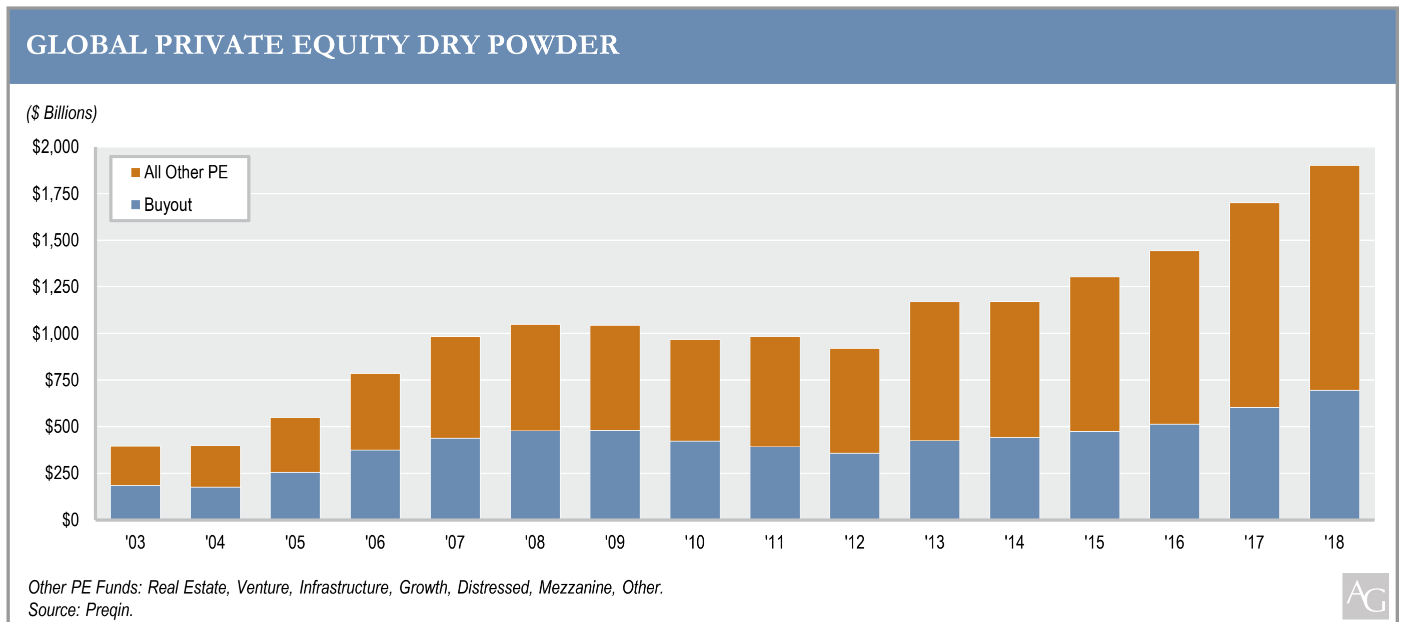


GDP growth declined in the third quarter reflecting lower global demand.

CNY remained weak against USD throughout 2018.

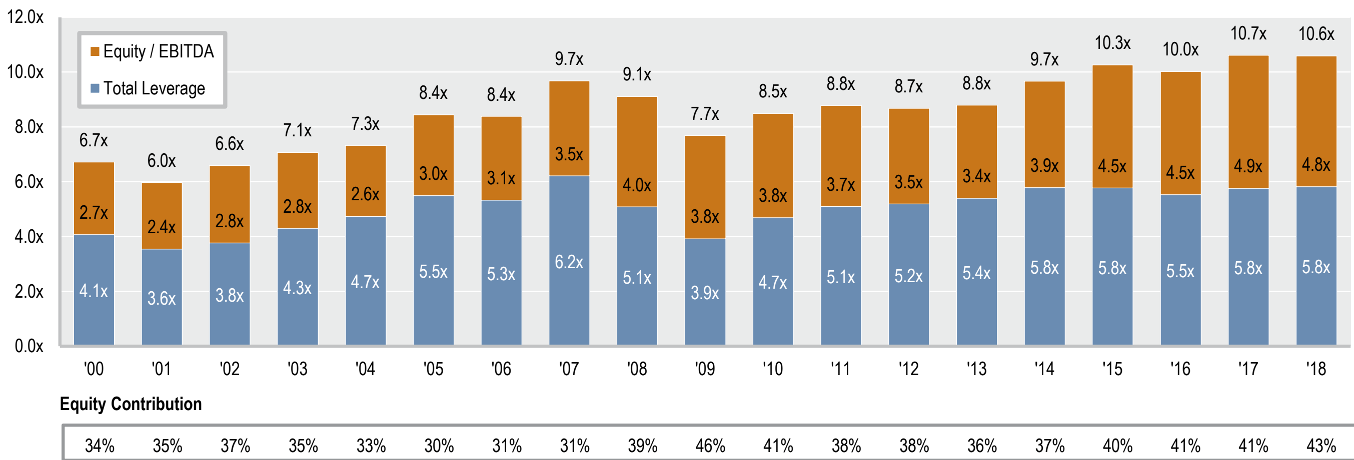
PRIVATE EQUITY

Deal volume had its best year since the financial crisis. Global deal volume in 2018 had a year on year increase of 23%, while deal volume in North America increased 36%.



Buyout dry powder at December 31, 2018 which stood at an all-time record of $695 billion increased 11% from the end of 2017.

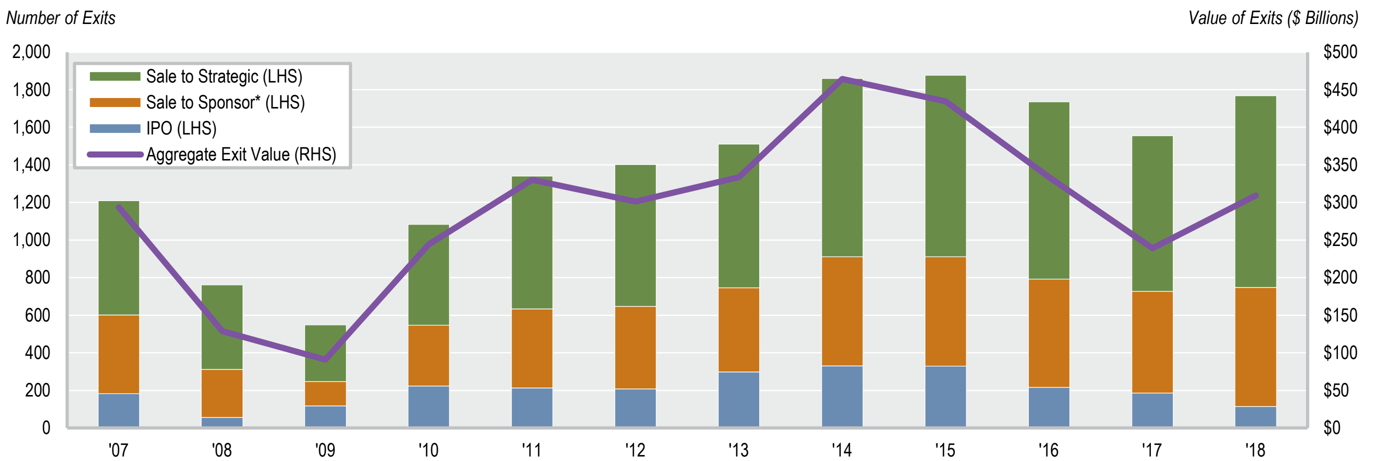
LBO PURCHASE PRICE BREAKDOWN



Source: S&P Capital IQ LCD.

LBO multiples in 2018 (10.6x) remained high and were slightly below the record level of 10.7x level set in 2017.

PRIVATE EQUITY EXITS



* Sale to Sponsor includes management-led buyouts.
Source: Preqin.

2018 was a strong year for exits with the number of transactions and dollar volume increasing 14% and 30% respectively from 2017.

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