CAPITAL MARKETS PERSPECTIVES

THIRD QUARTER 2019

TABLE OF CONTENTS

I.	Co-CIO OVERVIEW	1
II.	PORTFOLIO MANAGERS' OVERVIEW	2
III.	ECONOMIC DASHBOARD AND MARKET INDICES	12
IV.	CHART OF THE QUARTER	15
V.	INVESTMENT STRATEGIES	
	Performing Credit	16
	Distressed Debt	18
	Middle Market Direct Lending	19
	Energy	20
	Residential and Consumer Debt (RMBS/ABS)	22
	Commercial Real Estate Debt (CMBS)	24
	Merger & Convertible Arbitrage	26
	Liquid Credit	27
	Real Estate – United States	28
	Real Estate – Europe	30
	Real Estate – Asia	31
	Net Lease Real Estate	33
	Private Equity	34

ANGELO GORDON is a privately-held registered investment advisor dedicated to alternative investing. The firm was founded in 1988 and currently manages approximately $34 billion. We seek to generate absolute returns with low volatility by exploiting inefficiencies in selected markets and capitalizing on situations that are not in the mainstream of investment opportunities. We creatively seek out new opportunities that allow us to remain a leader in alternative investments.

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

Through the midpoint of 2019, equity markets continued their strong performance, with the S&P 500 Index's 18.5% return representing its strongest first half of the year in over two decades, and most European stock composites also posting double-digit gains year-to-date through June. Expectations of easier monetary policies from the U.S. Federal Reserve and European Central Bank, coupled with a modestly more constructive tone around trade negotiations, buoyed global equity returns higher. First half performance was similarly strong across the U.S. and European credit markets, as most high-grade and high yield indices returned mid- to upper-single digit returns over the first six months of 2019. Defaults remained low, and spreads tightened in both the leveraged loan and bond sectors. Measured at the broadest levels by market returns, conditions appeared positive globally.

Beneath the strong returns, however, several indicators suggested a significantly contrasting sentiment around the environment and its prospects. For example, while the equity markets welcomed the potential for central banks in both the United States and Europe to pursue accommodating monetary actions – it is now widely anticipated that the U.S. Federal Reserve is likely to cut interest rates throughout the remainder of the year, and the ECB may revive a second round of asset purchases through the corporate sector purchase program (CSPP) – bond markets inferred a more cautious read, focusing on slowing growth in the U.S. and continued deterioration of economic data in Europe as the rationale for the policy shifts. At a more technical level, positioning within the debt market also implied a more measured view and outlook, with investors expressing a preference toward higher quality ratings, larger issue sizes, and more liquid segments of the market. These shifts exacerbated pressures in less-favored subsectors, such as energy, and second-tier issuers, where bid/ask spreads are a false-front and there is scarce or minimal liquidity in many names.

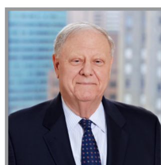
The conflicting signals of the markets create challenges for positioning credit portfolios today, including the relationship between risk and expected return. Is it better to be defensive by buying higher-quality issuances (in theory, as they are priced richly in both absolute and relative terms), or extend for higher yield in lower-quality, more cyclically-sensitive names? Is it preferable to be positioned higher in the capital structure to optimize liquidity optionality, or to focus lower, with an expectation that capital market conditions remain buoyant? Posed differently, what should return expectations be when nearly 50% of high yield bonds in the U.S. currently yield less than 5%, while only 10% yield over 10%?

We remain very aware of the broader market backdrop, as well as the range of influential underlying trends. At points in time like today, we continue to rely on our years of investment experience, extreme focus on downside protection, and deep fundamental credit analysis to be the primary guides of security selection and portfolio construction for each of our credit strategies.[1]

Real estate continues to perform well in the first half of the year, following the lead of an economy now in its longest economic expansion in U.S. history. REITs led the way with an 18% overall price increase and ended the half with a negligible 1% discount to NAV, as compared to previously experiencing some of their widest discounts at year-end 2018. This has helped bolster private market values, as public markets have historically led private values. Overall, investment activity softened versus the same period of 2018, but prices continued to move higher, albeit slowly. With capital raising continuing at strong levels (the first half of 2019 was the peak capital raise since the GFC), fundamentals that remain fairly supportive, and costs to borrow driving lower, we believe U.S. real estate will continue to look attractive to investors on an absolute and relative basis. However, we are keeping a close eye on the political winds and have real concerns over changes afoot, including the newly introduced rent stabilization laws in NYC – as well as similar attempts elsewhere – and real estate tax increases across certain struggling municipalities.

In Europe, political uncertainty and decreasing corporate investment continue to be contributing factors to a slowing economy in both the U.K. and major continental economies. However, negative interest rates and an expectation for continued stimulus by central banks have allowed real estate yields to remain exceptionally low – and prices to increase – for stabilized assets. Solid real estate fundamentals are equally supportive of real estate values, with limited supply being added and attractive levels of lease take-up resulting in vacancy rates remaining well below previous peaks and rental rates remaining stable to increasing. Like the U.S., Europe is equally active in efforts for future rent stabilization reform – including cities such as Berlin, London, and Paris.

Similar to Europe, the Asia markets are nuanced and require a market-by-market analysis. Japan continues to experience very low overall vacancy rates (sub 1%) in the major office markets. Global rate declines continue to be supportive of values, helping J-REITs to see a 9% increase in the first half. Similarly, in China – despite challenges from disputes on trade and weakening economic data – the Shanghai stock market saw a 19% increase, and real estate fundamentals remain positive with overall rental rate increases. Hong Kong saw significant increases in residential values, while the office markets cooled, challenged by social unrest and trade concerns. Meanwhile, in Korea, residential prices continue to move up and the office market has seen improvement in an otherwise over supplied – but decreasingly so – market.



Michael Gordon
CEO, Co-Chief Investment Officer

Josh Baumgarten
Co-Chief Investment Officer, Head of Credit

Adam Schwartz
Co-Chief Investment Officer, Head of Real Estate

[1] There is no guarantee that the funds' investment objectives will be successful or that losses can be avoided.

Maureen D'Alleva
Portfolio Manager

PERFORMING CREDIT

Following one of their largest gains in over a decade during the first quarter of 2019, leveraged loans experienced another positive quarter, with the J.P. Morgan index returning 1.63% in the second quarter of 2019. With the exception of the energy and metals & mining industries, performance was positive across all industries and ratings during the quarter. Loan prices declined modestly into quarter-end, as demand for floating rate product waned as the market priced in Fed cuts. As of quarter-end, less than 8% of loans were trading above par, with nearly 45% trading between $99 and $100. The continued positive performance of the asset class is notable given the continued steady outflows from loan funds, a decline in CLO issuance, and the expectation of further rate cuts. Outflows from loan funds were just under $9 billion for the quarter and now exceed $20 billion for the year, versus almost $8 billion and $12.6 billion of inflows in the second quarter and first half of 2018, respectively. Offsetting the technical pressure of outflows was an approximately 65% year-over-year decline in loan issuance, and refi/reset activity was off substantially – declining from over $108 billion in the second quarter of 2018, to just under $55 billion in the second quarter of 2019. Second lien issuance has remained relatively modest at under $8 billion in each of the last three quarters. Given the limited ability of CLOs to hold second liens, these securities have generally been placed into a small group of sophisticated buyers. Finally, fundamental performance of the entire asset class remains positive. At quarter-end, the par-weighted default rate for loans stood at 1.30%, which is down 42 basis points year-to-date and down 69 basis points year-over-year.

Despite loan fund outflows in the first half of the year, it is important to note that other aspects of the market are still experiencing growth. In the second quarter, CLO issuance continued the trend seen at the end of the first quarter, bringing outstanding CLO AUM to $642 billion, which is an increase of almost $50 billion since the end of 2018. Other sources of demand – such as SMAs – have also continued to grow, with outstanding AUM reaching $491 billion, an increase of $15 billion since the end of 2018. All of this has resulted in a larger outstanding loan market, with loan funds making up by far the smallest portion. With respect to loan funds, although outflows have continued, the size of those outflows have decreased, and loan funds now represent just under 10% of the overall loan market.

Ryan Mollett
Global Head of Distressed & Special Situations

Dan Pound
Co-Portfolio Manager

DISTRESSED DEBT

The U.S. and European high yield markets continued their strong performance in the second quarter of 2019. U.S. high yield gained 2.4% for the quarter, bringing its year-to-date return to 9.9% through June. Euro-currency high yield also kept pace, delivering a 2.1% gain in the second quarter and 7.8% over the first six months of 2019. The high yield markets in both regions benefitted from declining base rates – enabled by dovish central bank comments – as well as ongoing spread compression. In the U.S., for example, high yield spread-to-worst declined more than 100 basis points from January to June, settling at 461 basis points at the end of the second quarter 2019, approximately 150 basis points below the 20-year average. As an indication of the current market, 48% of high yield bonds in the U.S. currently yield less than 5%, while only 10% yield over 10%, according to a J.P. Morgan analysis.

Globally, higher-quality issuers maintained their performance leadership over lower-quality counterparts. In the U.S., BB rated bonds returned 3.0% in the second quarter 2019, as compared to 1.9% for CCC rated bonds, while year-to-date through June, BBs delivered 10.5% versus an 8.8% gain for CCCs. Interestingly, even within the CCC universe, there were clear themes, with higher-quality, larger size, more liquid, and lower-yielding each outperforming. In Europe, BB rated bonds returned 2.0% in the second quarter, exceeding the 0.6% quarterly return of CCCs.

Default rates have ticked up modestly, but remain low and well below long-term averages, with the U.S. and European high yield default rates standing at 1.6% and 1.8%, respectively, at June 2019. In the U.S., 24 companies defaulted or completed distressed exchanges, totaling approximately $22 billion year-to-date, with the energy sector accounting for one-third of the number of defaults and just over one-quarter of the debt volume.

U.S. high yield new issuance was active in the second quarter of 2019, totaling $75 billion across 220 issuers – the highest level since the third quarter of 2017 and up from $54 billion in the comparable second quarter of 2018. In Europe, while high yield issuance strengthened in the second quarter and drove the mid-year totals to €35 billion from 70 issuers, first half 2019 volume was down approximately 20% relative to 2018 and 30% to 2017. In both geographies, refinancing accounted for the majority of activity. In the U.S., refinancing represented approximately 75% of total activity and surpassed general corporate purposes and acquisition financings for the 29th consecutive month.

U.S. high yield mutual funds took in $12 billion of capital through the second quarter of 2019, the largest year-to-date inflows since 2012. Flows were positive in five of the first six months of 2019. This intake was a substantial pivot from the $45 billion of outflows in 2018 and $20 billion of outflows in 2017. In contrast, U.S. leveraged loan funds experienced $20 billion of outflows through the second quarter of 2019, compared to inflows of $13 billion over the first six months of last year. June was the ninth consecutive month of loan fund outflows, which declined by $41 billion over this period.

Trevor Clark
Portfolio Manager

MIDDLE MARKET DIRECT LENDING

After a weak first quarter, syndicated middle market loan volume came roaring back to $40 billion in the second quarter – an increase of over 45% from the first quarter. Refinancing volume picked up from first quarter lows, but still remains below last year's levels. Much of the increase in issuance was driven by the non-sponsored market, although – in aggregate – this continues to be the smaller portion of the market. Syndicated issuance in the first six months of the year is down over 40% from last year. However, syndicated volume does not tell the whole story, as lenders with strong direct origination platforms may often have a capital base that allows them to speak for an entire transaction, thereby avoiding the need to syndicate out a portion of the deal. In a recent market survey, lenders indicated that the most critical components to winning a deal today are reputation, key relationships, and hold size. This represents a shift from last year, when lenders felt that flexibility on leverage and documentation were the biggest factors in winning a deal. Hold sizes have undergone an interesting transformation over the last several years. In 2016, approximately 15% of survey respondents who were non-bank lenders had a hold size of over $100 million. This year, over 40% of non-bank lenders indicated that their hold size was in excess of $100 million. The story for banks is slightly different, as few banks have a hold size greater than $75 million – rather the shift has been from a typical hold size of $25-50 million, to one between $50 and $75 million.

Over the last year, lenders in aggregate have become modestly more concerned about the economy, although the majority continue to have a mixed view, reflecting the belief that growth may be uneven and will likely be sector specific. Concerns about the performance of the middle market through the next inevitable cycle remain centered around the impact EBITDA definitions and covenant-lite or wide transactions will have on ultimate recoveries. While covenant-lite loans are more rampant in the broadly syndicated loan market, they are still present in the middle market, and even more so in large middle market sponsored deals as opposed to traditional middle market sponsored deals. Furthermore, we believe there are significant differences across lenders within the middle market, and that these differences will ultimately manifest themselves in performance through the next cycle.

Todd Dittmann
Portfolio Manager

ENERGY

After trading above $60 from April through mid-May, WTI has again retreated. The $45 to $65 price band has been reliable for some time, with OPEC increasingly committed to providing the floor and U.S. shale reliably supplying the ceiling. Continued production growth from U.S. shale, refinery outages, and global geopolitical concerns have dominated headlines. OPEC's compliance with its production cuts exceeded 104% through June, while supply outages in Iran, Libya, and Venezuela persist. As a result of OPEC's latest semi-annual meeting, cartel members have approved a nine-month extension of the existing cuts through March 2020, while the Saudis and Russia more permanently formalized their mutual commitment to the shale-OPEC market share fight that was launched in November 2014 – a 'charter of cooperation' one news source has called "a marriage to eternity." Ironically, OPEC market share has fallen materially since that contest was launched.

Amidst persistent commodity price volatility, we remain in an environment in which both public and private capital is rationed. The traditional sources of funding for the sector – public and private equity, high yield, banks, and asset sales – are largely inaccessible, and investors demonstrate no desire to return.

Despite a 19% year-to-date return for the S&P 500, the XOP and OSX indices have generated negative returns for the year, and valuations continue to cheapen. As a result, most management teams cannot access the equity markets. Less than $300 million has been issued by oil and gas producers in 2019, and only one follow-on transaction has successfully priced in the last 11 months.

While the leverage of most energy issuers has decreased, the cost of debt capital has increased. The Credit Suisse Energy High Yield Index now offers a yield of 8.3%. Exploration and production (E&P) credits yield 9.2%, while oilfield services credits yield 10.4%. These secondary levels are increasingly irrelevant as indicators of the cost to access new money. For example, during the quarter, we saw a new E&P issue come 300 basis points wide to levels suggested by already outstanding comps.

Additionally, virtually all new issue within both the high yield and leveraged finance markets has stemmed from BB rated borrowers – primarily midstream. Per Jefferies, upstream issuance is tracking to the lowest levels in the past five years, with most issues trading at a significant discount to par. As with the energy equity markets, debt investors have withdrawn. Banks are currently hosting U.S. Office of the Comptroller of the Currency representatives for annual shared national credit reviews, and with the potential for incremental criticized loan classifications, wallets remain shut.

The volatility-induced dislocation in the energy financing markets has significantly bolstered the new issue opportunity set for our business, while the materializing dislocation in the high yield market – caused by investor malaise and a decline in value of proved undeveloped locations – is increasingly generating interesting distressed opportunities.

TJ Durkin
Co-Portfolio Manager

Yong Joe
Co-Portfolio Manager

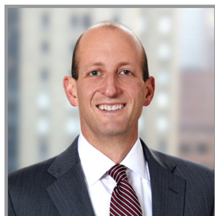
RESIDENTIAL AND CONSUMER DEBT (RMBS/ABS)

Mortgage- and asset-backed sectors performed well during the second quarter. The credit-risk transfer (CRT) market, which serves as a barometer of overall mortgage credit, extended its first quarter spread tightening, outperforming high yield corporates and other broader markets throughout the quarter. Fannie Mae and Freddie Mac made structural modifications to their CRT deals as their programs evolved to balance their needs, and the changes were well-received by the market, with new issue deals often being multiple times oversubscribed. However, tighter spreads for some CRT tranches led to significantly higher price premiums to par, creating some prepayment concerns should refinancing activity pick-up as a result of lower prevailing mortgage rates. Legacy RMBS spreads were unchanged to modestly tighter on relatively light trading volumes. Despite the lackluster activity, the sector remains well-supported. Spread performance was strong across new issue and secondary ABS, although market participants seemed to tilt their attention towards new issue, where deals continued to be well oversubscribed.

Quarterly new issuance of U.S. RMBS fell sharply to $22.3 billion – a 34% year-over-year decline – and year-to-date issuance of $48.7 billion equates to an 11% decline from the first half of 2018. Despite this overall decline, the non-QM sector continued to record strong growth as issuance rose 82% year-over-year to $5.6 billion in the second quarter. The CRT market also continues to grow, with issuance up 15% to $5.3 billion for the same period. Year-to-date, new issuance of non-QM and CRT grew dramatically – increasing 180% to $11.2 billion and 5% to $10.2 billion, respectively, from the first half of 2018. As we mentioned last quarter, the non-QM market remains positioned to grow as credit availability modestly expands to underserved, creditworthy borrowers whose profiles may not conform to agency and government mortgage underwriting criteria. U.S. ABS new issuance was $69.3 billion in the second quarter, a modest rise of 6% year-over-year. Issuance of auto and other ABS rose 18% and 20%, respectively, during the quarter and was offset by declines in credit card and student loan ABS issuance. Year-to-date issuance of U.S. ABS was relatively flat versus year-ago levels.

Annual home price appreciation continued to moderate in the second quarter. The latest CoreLogic Case-Shiller report showed an increase in national home prices of 3.6% year-over-year, down from 4.2% in the previous quarter and from 6.5% a year ago. Housing activity has remained somewhat mixed, as buyers continue to face affordability headwinds from rising prices and a limited stock of housing in lower- and middle-price tiers. While the latter inventory headwind has created challenges for buyers, it continues to be a source of support for home prices, as housing demand far exceeds the tight inventory available across much of the country.

Agency MBS spreads widened versus benchmark rates during the second quarter, as the sharp rally in interest rates has resulted in elevated gross supply, prepayment uncertainty, and increased implied volatility. The further shift in the Fed's policy stance – from a neutral to an easing bias – helped the outlook for the sector and brought some stability to spreads into quarter-end. Agency MBS spreads look compelling versus corporate credit spreads, drawing support from money managers as they experience inflows, and underinvested banks have been pulled off the sidelines given the decreased likelihood of higher yields. Going forward, investors will continue to face the same headwinds present in the second quarter, however, further spread tightening will be limited at current rate levels.



Andrew Solomon
Portfolio Manager

COMMERCIAL REAL ESTATE DEBT (CMBS)

Although CMBS spreads experienced some intra-quarter movements, they largely ended the month in-line with levels seen at the beginning of April. Given the strength of the market during the first quarter, spreads generally tightened during the first half of the year. Despite ongoing broader market uncertainty, the CMBS market has largely remained insulated from any meaningful volatility.

After a slow start to the year, CMBS issuance picked up in the second quarter. At the end of the first quarter, volumes were running 15% behind 2018 levels. Thanks to a pick-up in the second quarter, as of June 30, 2019, the year-to-date gap narrowed to approximately 5%, and with a robust pipeline of new deals expected to price before the end of August, the gap should narrow even further.

From our perspective, the CMBS market's recent stability can largely be attributed to fundamentals. The asset class is still performing well, with post-crisis conduit deals reporting average delinquency rates of approximately 1%. There is not an over-supply of commercial space, which historically has often been a pre-condition for a turn in the real estate cycle. Additionally, financing for borrowers is available from a number of different types of lenders and rates are very low by historical standards. In such an environment, it is difficult for investors to believe a broad-based sell-off is imminent.

At the halfway point in the year, we thought it might be insightful to provide some detail on the composition of this year's 19 new issue conduit CMBS deals and to also compare their metrics to historical averages.

Average deal size was $855 million, which is approximately 7% smaller than the average deal size over the past four years and remains significantly smaller than deals issued pre-crisis. BBB- subordination levels of 7.1% – a measure of the amount of credit support or protection BBB- bond holders have – are essentially unchanged from the beginning 2017, which is when risk retention rules were implemented. Average loan size of $19 million and top 10 loan concentration of 52% are also remarkably consistent over the past few years. Underwritten loan-to-value percentages were 58% – within one percentage point of where they have been for the past three years.

A few changes worth noting are that loans secured by office properties increased by five percentage points to 34% in 2019, while retail exposure declined by six points to 24%. The percentage of full-term interest only loans increased by three points to 55%. As these overall metrics demonstrate, even at this point in the cycle, underwriting has remained stable and we have not discerned any worrisome trends.

David Kamin
Co-Portfolio Manager

MERGER ARBITRAGE

Following a strong first quarter, the second quarter saw both year-over-year and sequential increases in announced M&A deal value, despite the year-over-year decline in deal count.

Propelled by the announcement of large deals such as the merger of Raytheon and United Technologies, AbbVie purchasing Allergan Plc, and Anadarko Petroleum being acquired by Occidental Petroleum, U.S. M&A deal value increased 35% year-over-year and approximately 15% sequentially. In fact, the top 10 deals announced during the quarter accounted for over 80% of the total announced deal value for the quarter. These mega-deals, as we've called them, helped the second quarter finish among the stronger quarters historically and capped off the second strongest first half in 20 years.

Merger arbitrage spreads reached some of their tightest levels ever in April, as there was a lull in new deal announcements to start the quarter, credit spreads tightened, and equity markets continued to trade higher as volatility fell. Spreads widened in May and into the end of the quarter, as tensions with China increased when the U.S. Commerce Department placed China's Huawei and 70 affiliates on its Entity List, effectively banning the company from purchasing parts and components from U.S. companies without U.S. government approval. Additionally, while we highlighted a number of mega-deals that were announced during the quarter, particularly during May and June, there were no notable deal closures that allowed merger arbitrage investors to cycle those profits into newly announced deals. In contrast, a few deals saw regulatory timing delays, which were driven by U.S. and international antitrust agencies requesting more information. While this led to spreads widening during the quarter, it also provided attractive entry opportunities.

While cross-border M&A with U.S. targets continues to slow due to rising U.S.-China tension and global regulatory protectionism, the backdrop for M&A remains constructive. Besides the upcoming U.S. Presidential election being a potential catalyst – a point we mentioned last quarter – the recent pivot by the Fed, which signals one or two upcoming interest rate cuts, continues to provide companies with cheap and easy access to credit. With global growth slowing during the quarter and many companies facing technology disruption, M&A can provide CEOs and boards with sustained earnings and/or dividend growth.

Gary Wolf
Portfolio Manager

CONVERTIBLE ARBITRAGE

Risk assets enjoyed another solid quarter, as a pull-back in May was followed by a strong rally in June, driven by dovish central bank commentary and growing market expectations of impending easing measures. The MSCI World Index returned 3% in local currency terms in the second quarter. Credit markets also posted positive returns across the board, with investment grade outperforming high yield and U.S. dollar leading euro. Convertible bonds rose 1.6% in the second quarter, bringing the first half 2019 return to 9.3%. Hedged convertible strategies benefited modestly, as the Credit Suisse Convertible Arbitrage Index gained 0.35% in the second quarter.

The pace of global convertible new issuance slowed down somewhat in the second quarter, as the expected direction of borrowing costs reversed. The total primary volume reached $18.1 billion and the U.S. market continued to set the pace ($11.8 billion issued) – followed by Europe ($3.1 billion) and then Asia ($2.9 billion, including U.S.-listed Chinese issuers) – while Japan remained anemic ($0.3 billion).

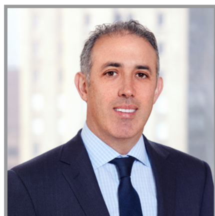
Corporate confidence remains subdued, and risks to the capex cycle still appear to be skewed to the downside. Geopolitical tensions on several fronts add to uncertainty. While trade talks resumed at the G20 summit and further near-term escalation was avoided, a U.S.-China deal remains elusive, leaving markets to price a wide range of potential outcomes. Overall, U.S. trade policy continues to be very unpredictable and presents an overhang on the global growth outlook. Global central banks, however, are providing support as they gradually restart their easing engines. Globally, the amount of negative yielding assets has shot past the 2016 peak, again forcing investors to take more risks. Central banks' previous attempts to dial back their stimulus measures have shown that markets don't easily unwind the imbalances that have been created. Against this backdrop, we continue to seek exposure to cheap volatility embedded in convertible bonds.

R Christian Wyatt
Head of Multi-Strategy Research

LIQUID CREDIT

High yield markets were volatile in the second quarter. Weak global data coupled with escalating trade tensions lead to a 2% pull back in the month of May. Then, an accommodative central bank response from both the Fed and the ECB, as well as the easing of trade tensions, led to an over 3% rebound in June. As the market began to anticipate a 50-basis point interest rate cut from the Fed in July and another 25-basis point cut later this year, 10-year Treasuries compressed over 50 basis points to yield 2%. The overall search for yield in 2019 has led to a 9.83% year-to-date total return for high yield through June 30th, driven by significant high yield inflows of $20.4 billion year-to-date. However, there is significant dispersion in performance among ratings buckets. BBB/BB spreads are at multi-year tights (78 basis points), while BB/CCC spreads are at multi-year wides (586 basis points), as buyers continue to flock towards perceived quality and liquidity. Given this dynamic, over 75% of BBs now trade above their call price, offering challenging risk-reward.

In specific sectors, high yield energy credits exposed to the commodity (oil/gas) underperformed credits less exposed to the commodity as investors rotated capital. In contrast, high yield metals & mining single name credit volatility was much lower than commodity volatility, as clean balance sheets and low convexity limited moves in either direction. Industrials moved in-line with broader high yield, as still-supportive U.S. and global conditions underpinned earnings and credit spread tightening. Meanwhile, high yield media & telecom modestly outperformed, primarily driven by strength in Dish Networks and Sprint. Both companies are set to benefit from regulatory approval of the T-Mobile-Sprint merger, as Sprint's highly levered balance sheet will benefit from the earnings power of the combined company, and Dish's potential acquisition of divested assets from the merger will provide longer-term clarity on its future business plan. Lastly, high yield healthcare underperformed in the second quarter, driven by the physician services and pharmaceutical sectors, as potential regulatory changes and fears of additional litigation risk impacted several issuers.



Adam Schwartz
Portfolio Manager
Head of Real Estate

Reid Liffmann
Co-Portfolio Manager
U.S. Real Estate

REAL ESTATE - UNITED STATES

Commercial property transactions in the second quarter of 2019 rose slightly year-over-year, a reversal from last quarter's pullback. The plunge in absolute costs to borrow – including a narrowing of bond spreads and drop in treasury rates – alongside some optimism around trade outcomes helped lift deal flow. Whereas the first quarter had no entity level deal closings, those transactions resurfaced modestly in the second quarter. Still, entity level transactions were just $3.9 billion, only 3% of activity. Since 2005, these deals accounted for 8% of volume on average. 2018 was the third biggest year ever for M&A and the peak year thus far post-financial crisis, so the year-over-year drop-off continues to be unsurprising. Transaction volume fell a modest 1% in the top six major metros, while sales increased 5% in non-major metros, as defined by RCA.

The major property sectors saw mixed results. The office sector was the leader for growth in activity, up 30% year-over-year, as major deals closed in technology centric markets. Apartments remained the category leader in dollar volume, while activity grew 19% year-over-year. Despite robust fundamentals and strong investor appetite, industrial transaction volumes were down 13% year-over-year. Portfolio sales fell 42%, while the sale of individual assets was flat. However, several entity level transactions were announced and should drive future sales growth for the sector, but those deals likely won't close until the third or fourth quarter of 2019. Prologis recently announced the acquisition of Industrial Property Trust for nearly $4 billion, and Blackstone agreed to acquire GLP's U.S. logistics portfolio for $18.7 billion in the second quarter. To put this figure into perspective, the industrial market has seen an average transaction volume of $22 billion per quarter over the last two years. Retail volumes again declined – down 32% year-over-year – but were destined to shrink given that the mega-deal combining Unibail-Rodamco and Westfield closed in the second quarter of 2018. Excluding this transaction, volume would have grown year-over-year in the second quarter of 2019. Zooming out to all property types, the seniors housing & healthcare sector has been exceptional in 2019, leading growth in both the first and second quarters. Transaction volumes rose 51% year-over-year in the second quarter, as investors embraced the looming demographic surge.

This choppy transaction volume is occurring against the backdrop of the longest economic expansion in U.S. history. Once again, low absolute yields and an accommodative Federal Reserve Board are making headlines and have been relatively supportive for commercial real estate, particularly given benign economic news and the plentiful debt and equity capital that is on the sidelines and targeted for real estate. Fundamentals remain stable across most property types and supply growth – as measured by starts relative to existing inventory – has begun to decline, though there continues to be pockets of overbuilding. Rent growth continues to moderate, and occupancy levels have likely peaked.

The fundamental backdrop helps explain the solid returns for REITs in 2019. Year-to-date capital flows into U.S. registered real estate mutual funds and ETFs improved relative to 2018, when public markets suffered their worst-ever year of outflows at $20.8 billion. However, in a continuing transition of capital from active to passive management, there have been approximately $1.3 billion of outflows from U.S. mutual funds, as approximately $2.8 billion flowed into U.S. REIT ETFs.

On the valuation front, the Green Street Commercial Property Price Index was up 1% over the last three months and 2% over the trailing 12 months. Manufactured housing and industrial continue to lead the sector higher, both rising 5% in the second quarter. After holding steady last quarter, retail values resumed their decline, led by regional enclosed malls. 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, in aggregate, as appropriately priced versus yields in the bond market. Fair value, however, varies significantly across sectors. After narrowing the valuation gap in the first quarter, listed real estate equities maintained a negligible discount to NAV – just -1% – after ending 2018 near some of the widest discounts this cycle.

Anuj Mittal
Co-Portfolio Manager
Europe Real Estate

REAL ESTATE - EUROPE

Brexit uncertainty continued in the second quarter, which may have contributed to the economic slowdown the U.K. is beginning to experience. With an estimated 0.1% quarter-over-quarter contraction, as reported by Capital Economics, the third quarter is expected to see minimal growth, if not further decline. Business investment has already fallen over the past three quarters, and retail growth – the major force behind 2019 spending – is expected to drop to only 0.1% three months-over-three months in June. It will likely take several quarters to recover, even after a Brexit decision is made.

Continental Europe has seen slow GDP growth as well, and indicators for June suggest that trend will continue into the third quarter. All four major economies have seen negative trends in manufacturing PMIs. According to TIS Group, German manufacturing orders and Spain's job creation dropped to 2009 levels, while the continent's overall unemployment rate reached 7.5% in the second quarter – the lowest since 2008. Germany's unemployment rate rose for the first time since 2013, suggesting the manufacturing downturn is finally affecting the labor market. In addition, the number of firms across that continent that previously reported labor shortages has started to decline. Even more concerning are the negative yields on German, Belgian, Austrian, and French bonds. Even under new leadership, it is unclear how the ECB will be able to stimulate the continent's deteriorating economy.

Although the U.K. faces sluggish growth and an uncertain political future, real estate fundamentals of supply and demand remain positive. London continues to capture most of the limited growth, with 2018 seeing 4% year-over-year growth in office-based employment, as compared to only 1.4% year-over-year growth nationally. London office take-up was strong in the second quarter, with approximately 256,000 square meters transacted, representing a 13% increase on the 15-year average, as reported by JLL. London's vacancy rates remain well below their previous peaks, suggesting that a major drop in rental values is unlikely. Rental value growth for Central London will likely be modest but positive through 2019.

A similar story exists in some major continental cities. France appears to be faring relatively well compared to its peers, with the economy outperforming the eurozone average in both the first and second quarters. Paris office vacancy stayed low and steady at 5.3% in the first quarter, with some central submarkets posting vacancy as low as 2%, the lowest level since the dotcom crash in early 2001. Overall, office vacancy across the continent decreased to 5.8% in the second quarter, the lowest rate since 2002. Major drivers of the vacancy drop include robust demand, ongoing conversions of structural vacant space, and active pre-letting. Office take-up in the region reached approximately 3.2 million square meters in the second quarter, down only 5% from record levels at the same time last year. The European Office Rental Index increased 1.5% quarter-over-quarter, pushing the continent's annual rental growth to 5.9% – the strongest since the second quarter of 2008. Barcelona, Madrid, and Milan outperformed the region's growth, with quarter-over-quarter increases of 2.9%, 2.1%, and 1.6%, respectively. The solid real estate fundamentals are expected to remain stable through the second half of the year.

Wilson Leung
Portfolio Manager
Head of Asia Real Estate

Steven Cha
Co-Portfolio Manager,
Asia Real Estate

REAL ESTATE - ASIA

Japan

In the first quarter of 2019, Japan's real GDP increased by an annualized rate of 2.2%, achieving positive growth for the second consecutive quarter. However, the growth was mainly attributable to the increase in public investment, as other GDP components were slightly negative. Japan's labor market continued to be tight, with the unemployment rate remaining at a historic low of 2.4%. Retaining workers continues to be a key consideration for companies – placing upward pressure on wage growth. Looking ahead, Prime Minister Abe's government looks likely to raise the consumption tax from 8% to 10% in October 2019. Given that the government has employed various income support measures – including the provision of free education and nursery care – the impact of the consumption tax hike is expected to be milder than in 2014, when there was a significant decline in private consumption. In the July 21 Upper House election, the ruling party – the Liberal Democratic Party (LDP) – maintained its majority but did not win a supermajority of more than two-thirds.

On the real estate front, the Japanese REIT ("J-REIT") Index increased 9% from the end of 2018 to end of June 2019, reaching a 12-year high. This surge is a response to the downward shift in global interest rates, particularly in the U.S. The Japanese 10-year treasury bond turned slightly negative to -0.14%. In addition, real estate fundamentals in the office sector across Japan's main cities remain robust. Strong tenant demand has pushed Grade A office vacancy down to 0.6% in Tokyo, and Osaka's vacancy remained at a historical low of 0.5% in the first quarter of 2019. Vacancy levels for Grade B properties have also declined to 0.5% in Tokyo and 0.9% in Osaka. While real estate transaction volume fell by 30% year-over-year, the decline is primarily due to a lack of product rather than limited investor demand. Investor interest, both onshore and offshore, remains strong – with a particular focus on core, yield-generating properties. Domestic Japanese banks continue to demonstrate a strong lending appetite for the real estate sector, with no sign of capital markets softening in the short-term.

China

Overall, China's economic growth in the first quarter of 2019 topped expectations at 6.4%, exceeding market predictions of 6.2% and in-line with the 6.0-6.5% full year target. However, several factors – including the escalation of U.S.-China trade tensions, low inflation risk, and weakening U.S. and China economic data – continue to weigh on investor sentiment. Some of these concerns have been eased by the Chinese government's continued accommodative monetary policy and fiscal stimulus. Examples of this policy include the People's Bank of China's (PBOC) lowering of the required reserve ratio for banks in January and May, a RMB 2 trillion tax cut announced in March, and a major infrastructure investment plan. The Shanghai Stock Exchange Composite Index was up 19% as of June 2019, after a disappointing performance in 2018. The Chinese RMB depreciated slightly to 6.87 RMB per USD at mid-year, down 0.2% from the start of the year, after a rally in first quarter and a subsequent decline due to heightened trade tensions.

On the real estate front, office fundamentals in large Chinese cities continue to be positive, underpinned by rapid growth in the services and technology sectors. In the first quarter, tier one cities – such as Beijing and Shanghai – saw temporarily subdued demand for office space due to trade uncertainties, but vacancy rates and rents continued to stay at healthy levels. In Beijing, the office sector continued to be a landlord's market, with tight vacancy of 4.6% and rental growth of 4.0% year-over-year. In Shanghai, core Central Business District (CBD) Grade A office rents were down a moderate 1.4% quarter-over-quarter, and vacancy edged up 80 basis points to 12.9%, due to a supply boom in a few emerging areas.

Investment demand for prime commercial properties in tier one cities – such as Beijing and Shanghai – was robust. Overall commercial real estate transaction volume in China rose to RMB 53 billion in the first quarter of 2019 – up 32.1% year-over-year – more than half of which was attributable to foreign investors. Foreign investors continued to be lured by China's strong economic growth, opportunities for diversification, and comparatively less competition from local buyers. Yields in tier one cities remained steady in the first quarter of 2019; however, debt-laden companies – including several large developers and conglomerates – have accelerated sales of their real estate portfolios to repay maturing loan obligations. We believe that these event-driven special situations may continue to present attractive buying opportunities for investors in 2019.

Hong Kong

Hong Kong's economy softened with only 0.6% year-over-year growth in the first quarter of 2019, while the unemployment rate remained at a 20-year low of 2.8%. Despite ongoing U.S.-China trade tensions and a bout of social unrest caused by the extradition law protests, Hong Kong's residential property investment market gained momentum in the first half of 2019, driven by pent-up self-use and investment demand. Residential transaction volume – as measured by transacted units – in the first half of 2019 rose by 48%, as compared to the second half of 2019. Overall residential prices bottomed out in February 2019 and finished the mid-year at a record high – up 9.2% from the start of the year, according to Centaline, Hong Kong's leading residential brokerage.

Hong Kong *(continued)*

Scarcity of available land in Hong Kong and a long-term supply shortage continues to underpin real estate fundamentals. As of April 2019, Grade A office vacancy remained tight at 2.0% in Central, Hong Kong (CBD) and 2.7% in Hong Kong overall. Despite the subdued leasing demand in the first quarter of 2019, which was due to People's Republic of Chica (PRC) and multinational tenants' wait-and-see approach amid trade uncertainties, Hong Kong's office market remained a landlord's market. In the first quarter of 2019, office rents rose by approximately 2.9% year-over-year in Central and by 1.6% year-over-year across Hong Kong. Given the wide disparity of rents between the CBD and non-core office submarkets, this decentralization trend should continue as cost-conscious tenants are forced to move to less expensive areas.

South Korea

In the first quarter of 2019, the South Korean economy contracted 0.4% quarter-over-quarter, as a result of the sluggish exports and investments in the quarter. While exports and investments are forecasted to recover in the latter half of the year, the Bank of Korea ("BoK") lowered its 2019 GDP forecast from 2.5% to 2.2% due to economic headwinds. Additionally, the BoK lowered its benchmark policy rate from 1.75% to 1.50% in July 2019, which is the first rate cut in three years. This rate cut comes amidst sluggish global economic growth, trade tensions, moderated domestic growth prospects, and household debt burden.

On the real estate front, the spread between prime office cap rates and Korean government bond yields (i.e. 5-year treasury bond) remained largely unchanged from the previous quarter at 270 basis points, which is above the 10-year average of approximately 220 basis points. Investment activity in the commercial office sector remains robust. Transaction volume in the first quarter of 2019 was in-line with that of the same period last year, when commercial office transactions reached a record high of $10 billion. We continue to expect strong demand for stabilized core properties, as Korean institutions ramp up their investment portfolios with yield-generating real assets. The prime office vacancy rate in the major business districts in Seoul declined to 11.5% in the first quarter of 2019 – down 130 basis points from the previous quarter – on the back of expansionary and upgrade demand. The residential market in Seoul continues to be robust, with Seoul apartment prices rising 7.5% year-over-year as of June 2019. In Gangnam, the prime residential district in Seoul, apartment prices have increased 3.3% year-over-year as of June 2019. However, the current government is implementing a new residential policy that includes tax reforms to curb speculative investment in the residential sector, which may impact future price growth.

Gordon J. Whiting
Portfolio Manager

NET LEASE REAL ESTATE

As of the second quarter of 2019, the trailing 12-month U.S. single-tenant transaction volume totaled $68 billion, according to Real Capital Analytics (RCA). Transaction volume has hovered at decade highs of $68-69 billion for the last three quarters. Since the trough of $11 billion in 2009, the largest growth can be seen in industrial volume, which is up nearly 10x, with office up 6x and retail up 3x. Throughout the run-up in volume, cap rates have generally compressed in tandem; however, retail cap rates appear to have found a bottom in the second quarter of 2016 and industrial cap rates in the second quarter of 2018, with industrial cap rates increasing 25 basis points over the last year. While single-tenant industrial cap rates have widened slightly, there is still tremendous demand for industrial assets as volume continues to grow. For all industrial (single-tenant and multi-tenant), the difference between cap rates for primary markets and secondary markets is approximately 70 basis points, and the difference in price per square foot is $121, according to Newmark Knight Frank. The cap rate spread has remained fairly steady over the last three to four years, while the price per square foot differential appears to have widened, with secondary market prices remaining more stagnant.

Arthur Peponis
Portfolio Manager

PRIVATE EQUITY

The private equity industry had a weaker second quarter of 2019, with the notable exception of multiples paid. For the first six months of 2019, deal volume – on both a global and North American basis – decreased from 2018, reversing the trend of the first quarter of 2019. In North America, there were $108 billion of transactions in the first two quarters of 2019, as compared to $136 billion from the prior year, or a decrease of 21%. Global deal volume in the first six months of 2019 decreased 16% year-over-year to $179 billion. Although dry powder set another all-time high, reaching $738 billion at June 30, 2019, the increase was only $2 billion from March 31, 2019, which is very low by historical standards. However, average multiples paid in the first two quarters of 2019 were 11.1x EBITDA, higher than the 10.3x level during the first quarter of 2019 and the 10.6x achieved in calendar 2018. Average leverage for buyouts in the first half of 2019 was 5.8x multiple of EBITDA, which is consistent with 2018. Equity contribution as a percentage of total capitalization was at 43%, which is similar to prior years. As previously stated, trends in multiples paid develop over several quarters, so one cannot infer much – if anything – from the increase seen in the second quarter. With a robust level of dry powder and lower deal volume, it is not surprising that we saw this increase in multiples paid. For the first two quarters of 2019, exits declined approximately 5% year-over-year and dollar volume decreased approximately 12%, reflecting smaller monetizations. Broadly speaking, although there may be some concern about deal activity in the private equity space, the amount of dry powder should provide a floor to multiples paid, with levels consistent with prior years.

ECONOMIC DASHBOARD

Market Indices: Third Quarter 2019

ANGELO GORDON
CELEBRATING 30 YEARS

JOB MARKET

Macro Economics		Five-Year Trend
U.S. – Unemployment Rate		As of 6/30/2019
Latest Level	3.7	
Change from Prior Month	0.1	
Latest Direction	Deteriorating	
Frequency	Monthly	
U.S. – Non-Farm Payroll		As of 6/30/2019
Latest Level	224.0	
Change from Prior Month	152.0	
Latest Direction	Improving	
Frequency	Monthly	
U.S. – Labor Participation Rate		As of 6/30/2019
Latest Level	62.9	
Change from Prior Month	0.1	
Latest Direction	Improving	
Frequency	Monthly	
U.S. – U-6 Unemployed & Margin & Part-Time as % of Labor Force & Margin		As of 6/30/2019
Latest Level	7.2	
Change from Prior Month	0.1	
Latest Direction	Deteriorating	
Frequency	Monthly	
Eurozone Unemployment Rate		As of 3/31/2019
Latest Level	7.7	
Change from Prior Month	(0.2)	
Latest Direction	Improving	
Frequency	Quarterly	

INFLATION

Macro Economics		Five-Year Trend
U.S. Consumer Price Index (CPI) Y-o-Y %		As of 6/30/2019
Latest Level	1.6	
Change from Prior Month	(0.2)	
Latest Direction	Decreasing	
Frequency	Monthly	
U.S. CPI Goods Less Food and Energy Y-o-Y %		As of 6/30/2019
Latest Level	2.1	
Change from Prior Month	0.1	
Latest Direction	Increasing	
Frequency	Monthly	
U.S. Producer Price Index (PPI) Y-o-Y %		As of 6/30/2019
Latest Level	2.3	
Change from Prior Month	(0.2)	
Latest Direction	Decreasing	
Frequency	Monthly	

GDP GROWTH

Macro Economics		Five-Year Trend
U.S. – GDP Y-o-Y %		As of 6/30/2019
Latest Level	4.0	
Change from Prior Quarter	(0.6)	
Latest Direction	Deteriorating	
Frequency	Quarterly	
Eurozone – GDP Y-o-Y %		As of 3/31/2019
Latest Level	1.2	
Change from Prior Quarter	0.0	
Latest Direction	No Change	
Frequency	Quarterly	
China – GDP Y-o-Y %		As of 6/30/2019
Latest Level	6.2	
Change from Prior Quarter	(0.2)	
Latest Direction	Deteriorating	
Frequency	Quarterly	

HOUSING

Macro Economics		Five-Year Trend
Existing Home Sales		As of 6/30/2019
Latest Level	5.3	
Change from Prior Month	(0.1)	
Latest Direction	Deteriorating	
Frequency	Monthly	
New Home Sales		As of 6/30/2019
Latest Level	646.0	
Change from Prior Month	42.0	
Latest Direction	Improving	
Frequency	Monthly	
Housing Starts		As of 6/30/2019
Latest Level	1,253.0	
Change from Prior Month	(12.0)	
Latest Direction	Deteriorating	
Frequency	Monthly	
Case-Shiller Index of Home Value in 20 Cities		As of 5/31/2019
Latest Level	216.0	
Change from Prior Month	1.0	
Latest Direction	Improving	
Frequency	Monthly	

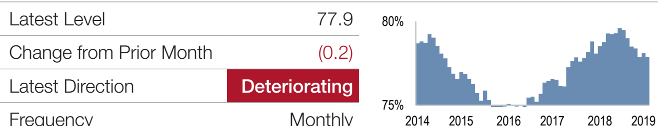
Source: Bloomberg (All).

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

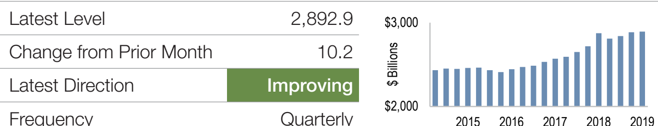
ECONOMIC DASHBOARD *(continued)*

ECONOMIC & MARKET CONFIDENCE

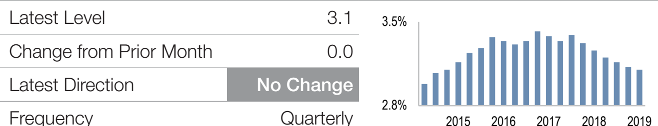
Macro Economics		Five-Year Trend
Capacity Utilization as a % of Capacity		As of 6/30/2019
Latest Level	77.9	
Change from Prior Month	(0.2)	
Latest Direction	Deteriorating	
Frequency	Monthly	



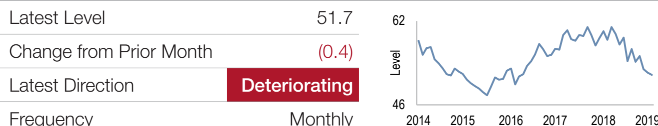
Private Fixed Investment Nonresidential SAAR		As of 6/30/2019
Latest Level	2,892.9	
Change from Prior Month	10.2	
Latest Direction	Improving	
Frequency	Quarterly	



Residential Fixed Investment as a % of GDP		As of 6/30/2019
Latest Level	3.1	
Change from Prior Month	0.0	
Latest Direction	No Change	
Frequency	Quarterly	

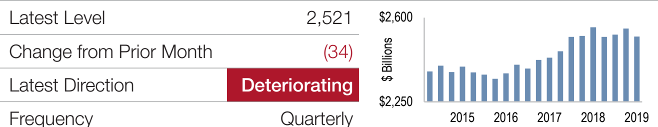


ISM Manufacturing Index		As of 6/30/2019
Latest Level	51.7	
Change from Prior Month	(0.4)	
Latest Direction	Deteriorating	
Frequency	Monthly	

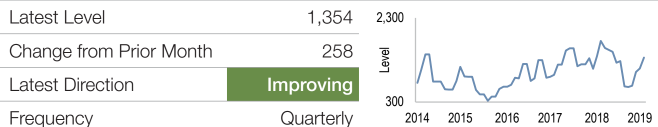


Manufacturing Inventory Change Q-o-Q $		As of 6/30/2019
Latest Level	20.4	
Change from Prior Month	(10.7)	
Latest Direction	Decreasing	
Frequency	Quarterly	

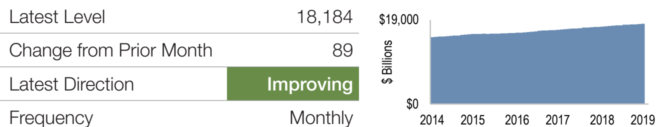
Exports of Goods/Services		As of 6/30/2019
Latest Level	2,521	
Change from Prior Month	(34)	
Latest Direction	Deteriorating	
Frequency	Quarterly	



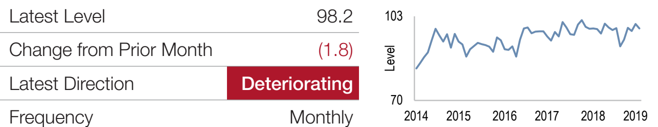
Shipping Rates		As of 6/30/2019
Latest Level	1,354	
Change from Prior Month	258	
Latest Direction	Improving	
Frequency	Quarterly	



Personal Income Level		As of 5/31/2019
Latest Level	18,184	
Change from Prior Month	89	
Latest Direction	Improving	
Frequency	Monthly	

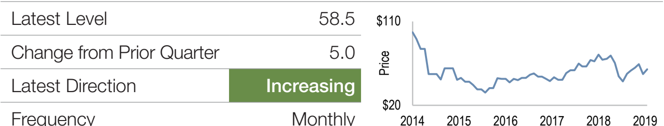


Michigan Consumer Confidence Sentiment		As of 6/30/2019
Latest Level	98.2	
Change from Prior Month	(1.8)	
Latest Direction	Deteriorating	
Frequency	Monthly	

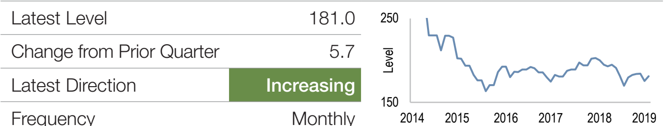


COMMODITIES

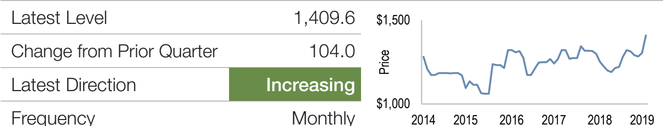
Macro Economics		Five-Year Trend
WTI Crude Oil Price		As of 6/30/2019
Latest Level	58.5	
Change from Prior Quarter	5.0	
Latest Direction	Increasing	
Frequency	Monthly	



Reuters/Jefferies Commodity Index		As of 6/30/2019
Latest Level	181.0	
Change from Prior Quarter	5.7	
Latest Direction	Increasing	
Frequency	Monthly	

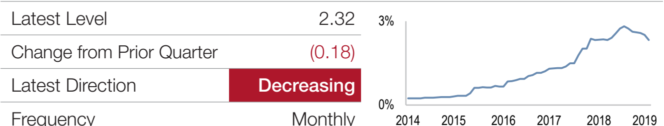


Gold		As of 6/30/2019
Latest Level	1,409.6	
Change from Prior Quarter	104.0	
Latest Direction	Increasing	
Frequency	Monthly	

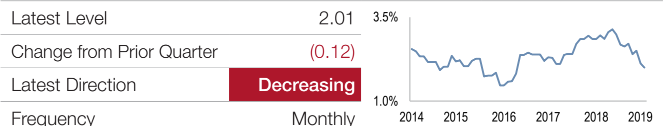


RATES

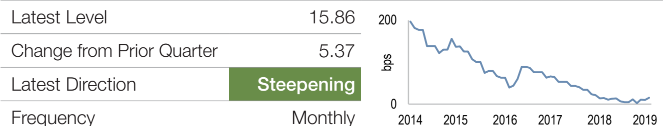
Macro Economics		Five-Year Trend
LIBOR 3M		As of 6/30/2019
Latest Level	2.32	
Change from Prior Quarter	(0.18)	
Latest Direction	Decreasing	
Frequency	Monthly	



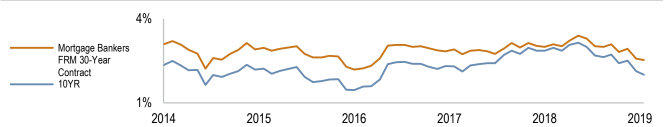
Treasury 10-Yr Yield		As of 6/30/2019
Latest Level	2.01	
Change from Prior Quarter	(0.12)	
Latest Direction	Decreasing	
Frequency	Monthly	



Swaps 2Y vs. 10Y		As of 6/30/2019
Latest Level	15.86	
Change from Prior Quarter	5.37	
Latest Direction	Steepening	
Frequency	Monthly	



30-Yr Mortgage and 10-Yr Treasury — As of 6/30/2019



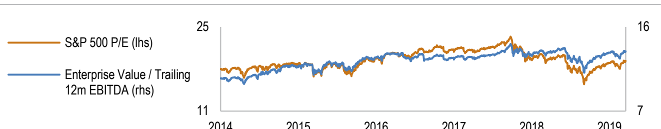
Source: Bloomberg (All).

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

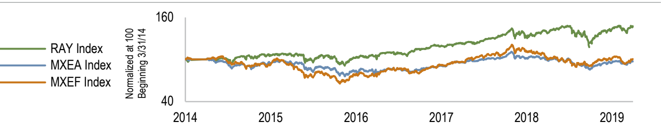
ECONOMIC DASHBOARD *(continued)*

EQUITY

Macro Economics		Five-Year Trend
U.S. Equity Markets – Russell 3000		As of 6/30/2019
Latest Level	1,730.9	
Change from Prior Month	111.2	
Latest Direction	Rally	
Frequency	Monthly	
U.S. Equity – VIX		As of 6/30/2019
Latest Level	15.1	
Change from Prior Month	(3.6)	
Latest Direction	Decreasing	
Frequency	Monthly	
S&P 500 Percentage Exceeding Earning Estimates		As of 6/30/2019
Latest Level	75.8	
Change from Prior Month	0.2	
Latest Direction	Increasing	
Frequency	Monthly	
S&P 500 Historical Valuation Levels		As of 6/30/2019



Macro Economics		Five-Year Trend
Trailing P/E on S&P 500		As of 6/30/2019
Latest Level	19.2	
Change from Prior Month	1.1	
Latest Direction	Increasing	
Frequency	Monthly	
Equity Markets – Euro Stoxx		As of 6/30/2019
Latest Level	375.8	
Change from Prior Month	18.0	
Latest Direction	Increasing	
Frequency	Monthly	
Equity Markets – MSCI EAFE		As of 6/30/2019
Latest Level	1922.3	
Change from Prior Month	104.9	
Latest Direction	Increasing	
Frequency	Monthly	
Equity Markets – MSCI EM		As of 6/30/2019
Latest Level	1,054.9	
Change from Prior Month	56.9	
Latest Direction	Increasing	
Frequency	Monthly	
Russell 3000 – MSCI EAFE – MSCI EM		As of 6/30/2019

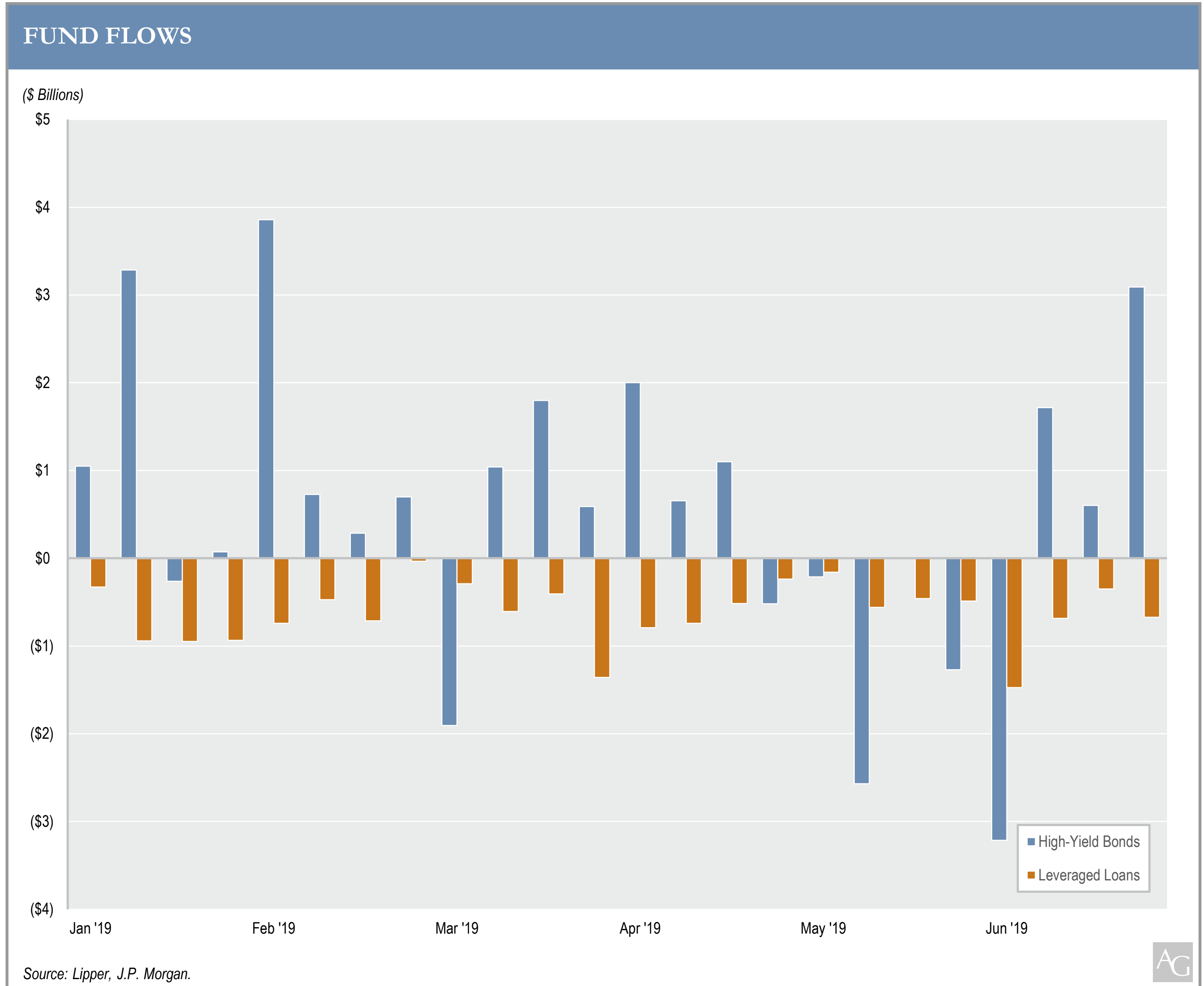


FOREIGN EXCHANGE RATE

Macro Economics		Five-Year Trend
Euro Spot Rate vs. 1 USD		As of 6/30/2019
Latest Level	1.14	
Change from Prior Quarter	0.02	
Latest Direction	Improving	
Frequency	Monthly	
Yuan Spot Rate vs. 1 USD		As of 6/30/2019
Latest Level	0.1456	
Change from Prior Quarter	0.0008	
Latest Direction	Improving	
Frequency	Monthly	
Yen Spot Rate vs. 1 USD		As of 6/30/2019
Latest Level	0.0093	
Change from Prior Quarter	0.0000	
Latest Direction	No Change	
Frequency	Monthly	

Source: Bloomberg (All).

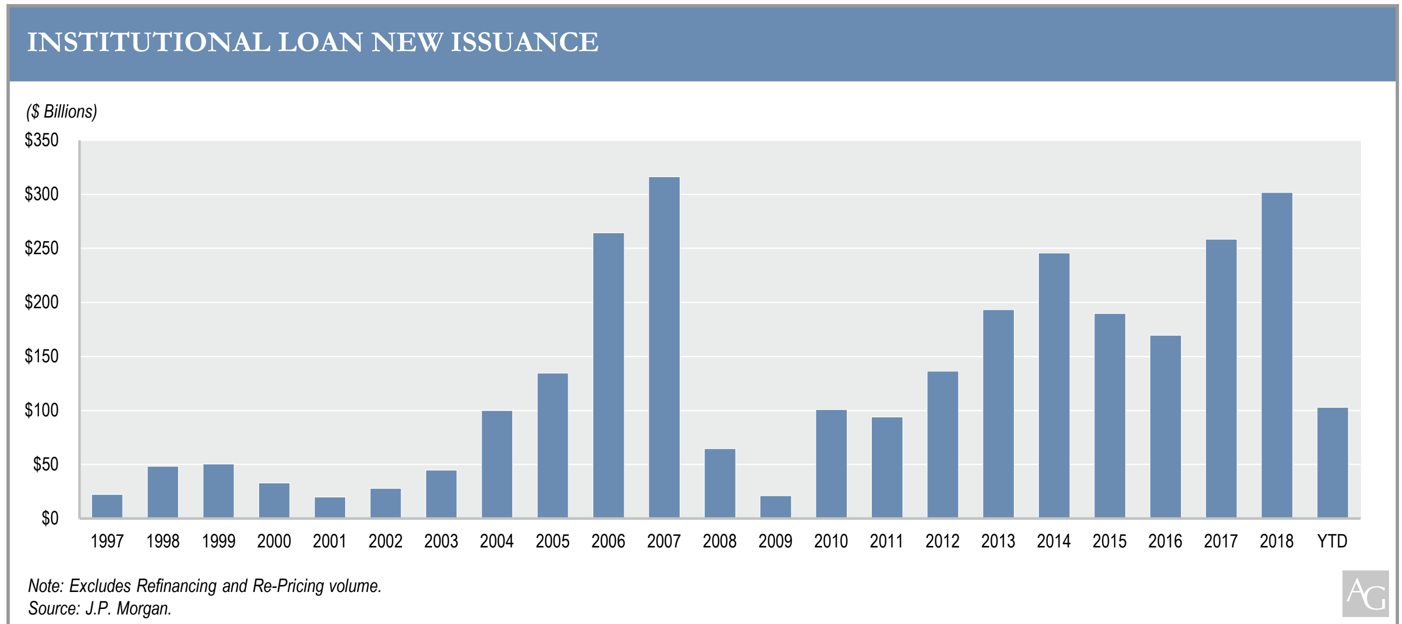
"Latest Direction" is from the last "Frequency" measurement.



As of June 30, 2019, high yield bond funds have experienced $12.0 billion of inflows, while leveraged loans have experienced $19.9 billion of outflows.

PERFORMING CREDIT

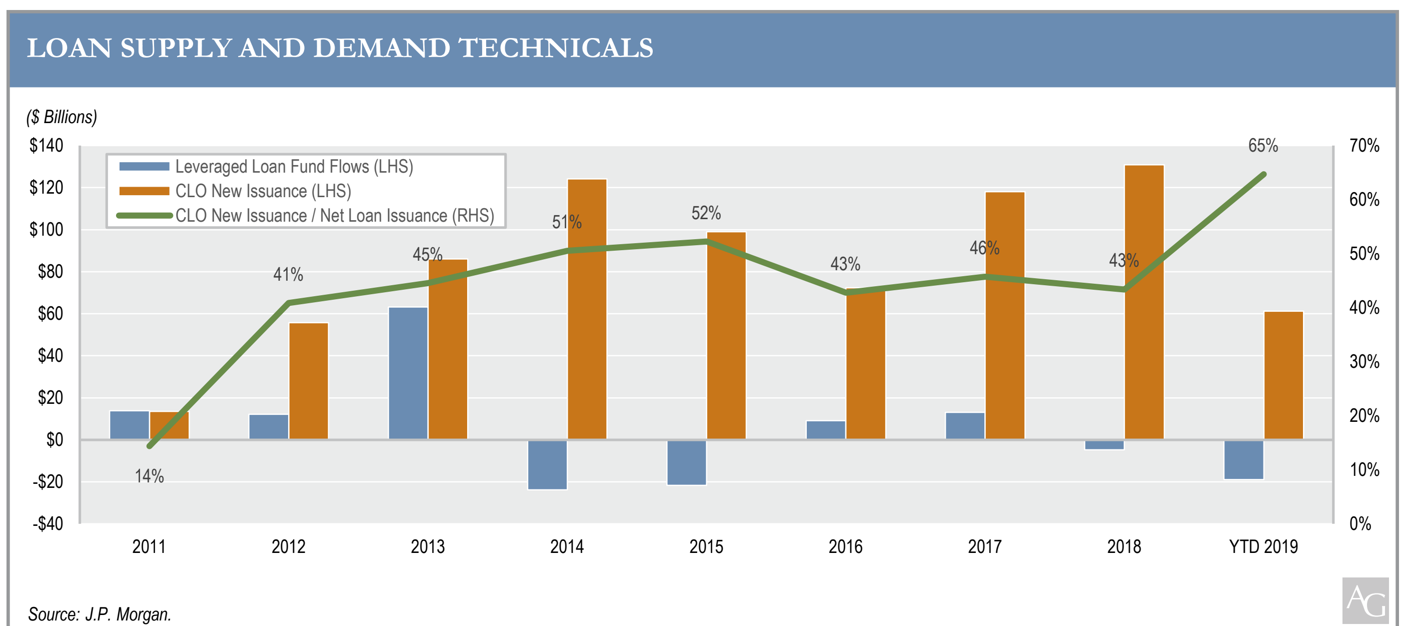
INSTITUTIONAL LOAN NEW ISSUANCE



Note: Excludes Refinancing and Re-Pricing volume.
Source: J.P. Morgan.

Year-to-date loan issuance is down versus 2018, providing technical support to the leveraged loan market amidst continued outflows from loan funds.

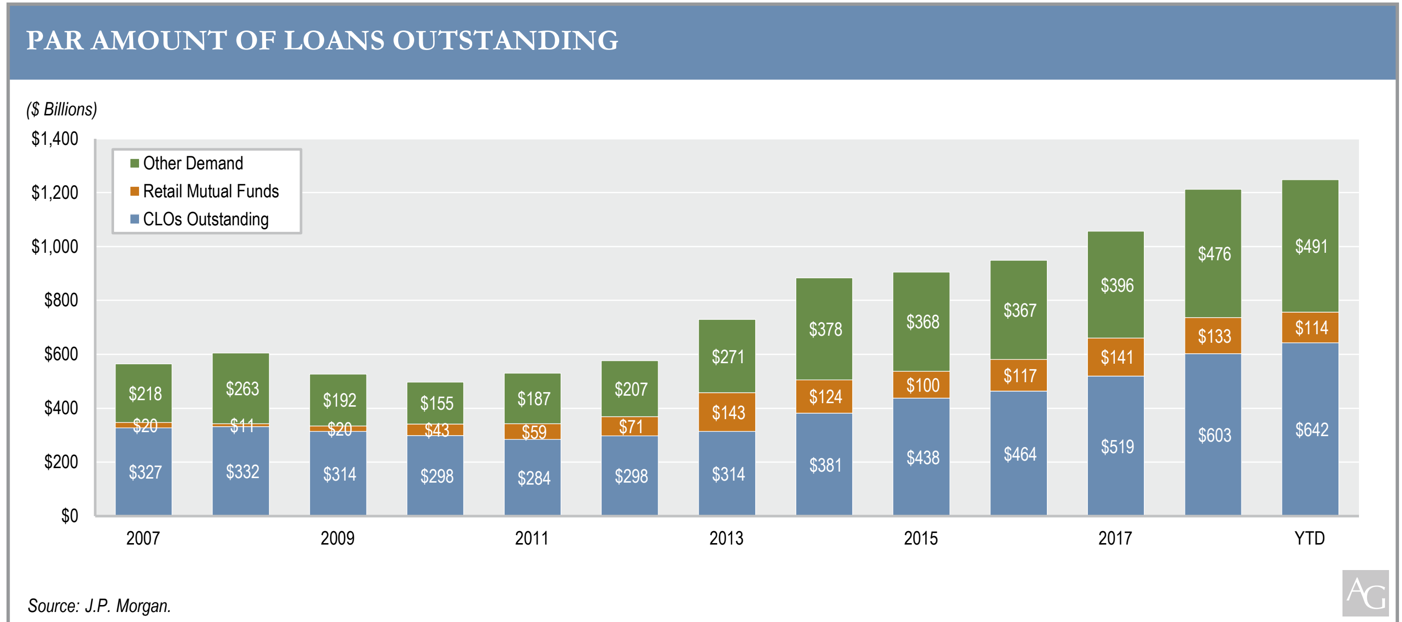
LOAN SUPPLY AND DEMAND TECHNICALS



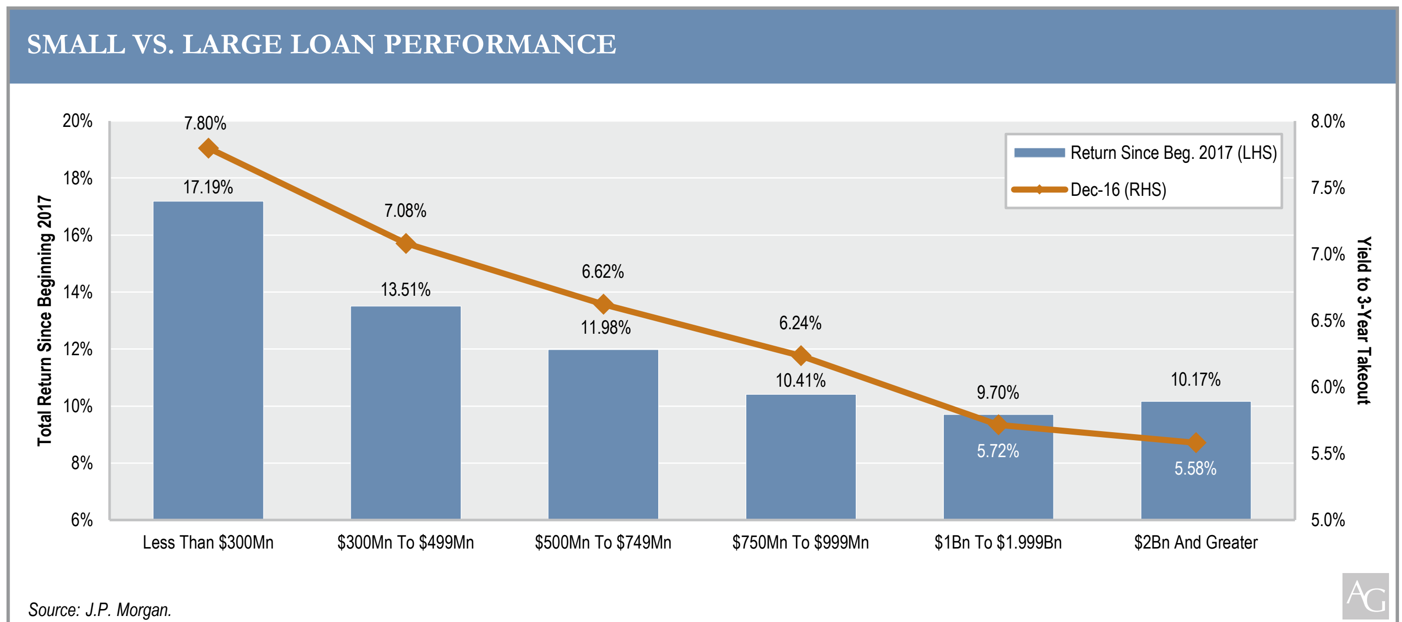
Source: J.P. Morgan.

CLO new issuance remains strong, more than offsetting loan fund outflows.

PERFORMING CREDIT *(continued)*

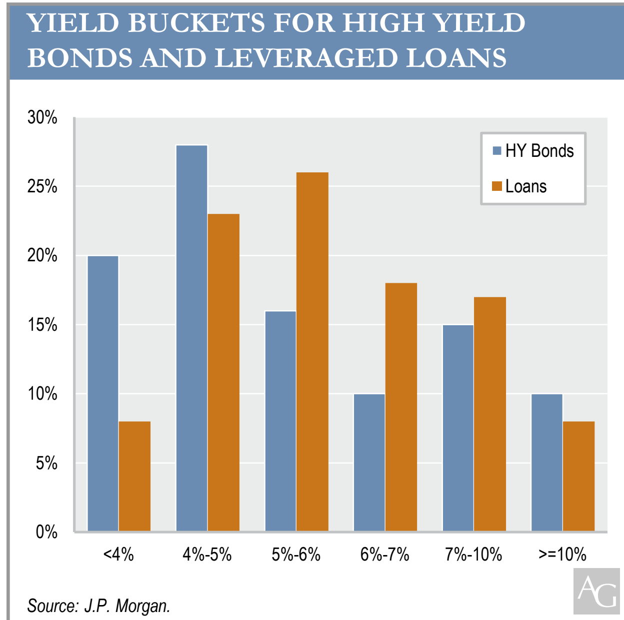


The par amount of loans outstanding is at an all-time high. CLOs and SMAs continue to be strong sources of demand for the leveraged loan market, as the amount outstanding represented by loan funds continues to shrink.

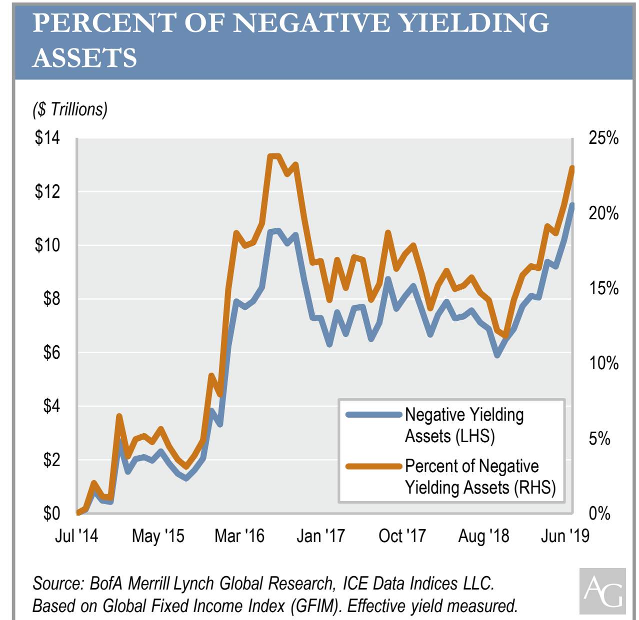


Smaller tranches of loans have outperformed larger tranches since the beginning of 2017.

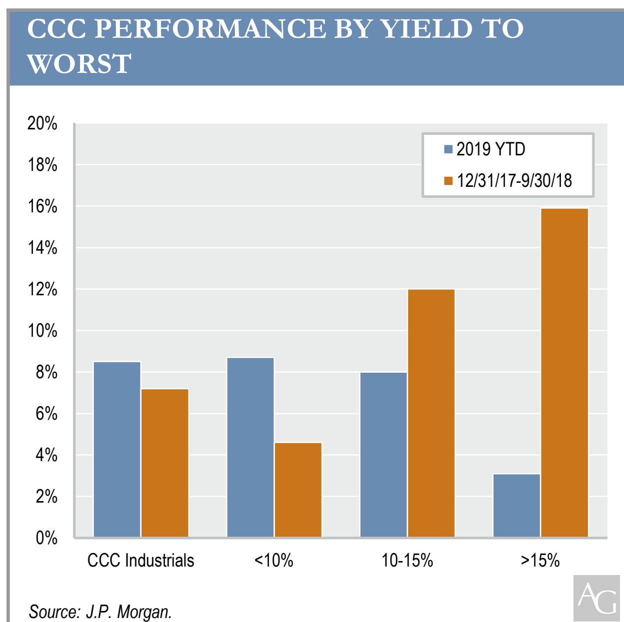
DISTRESSED DEBT

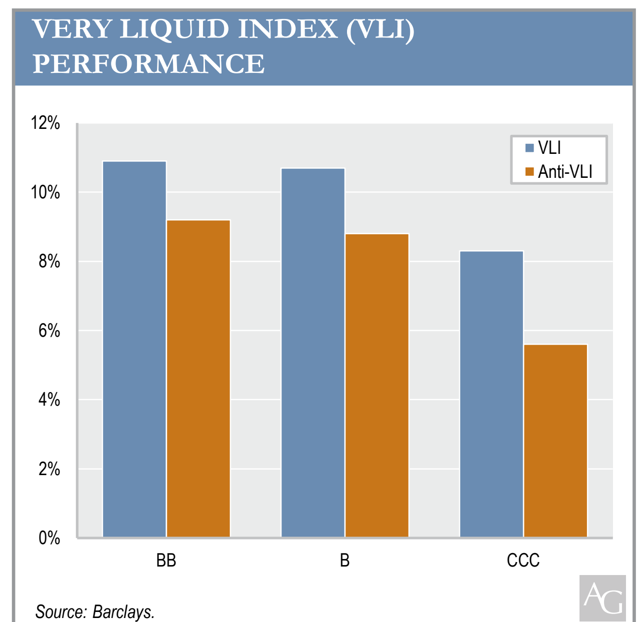


Nearly 50% of high yield bonds yield less than 5%, and only 10% yield greater than 10%.



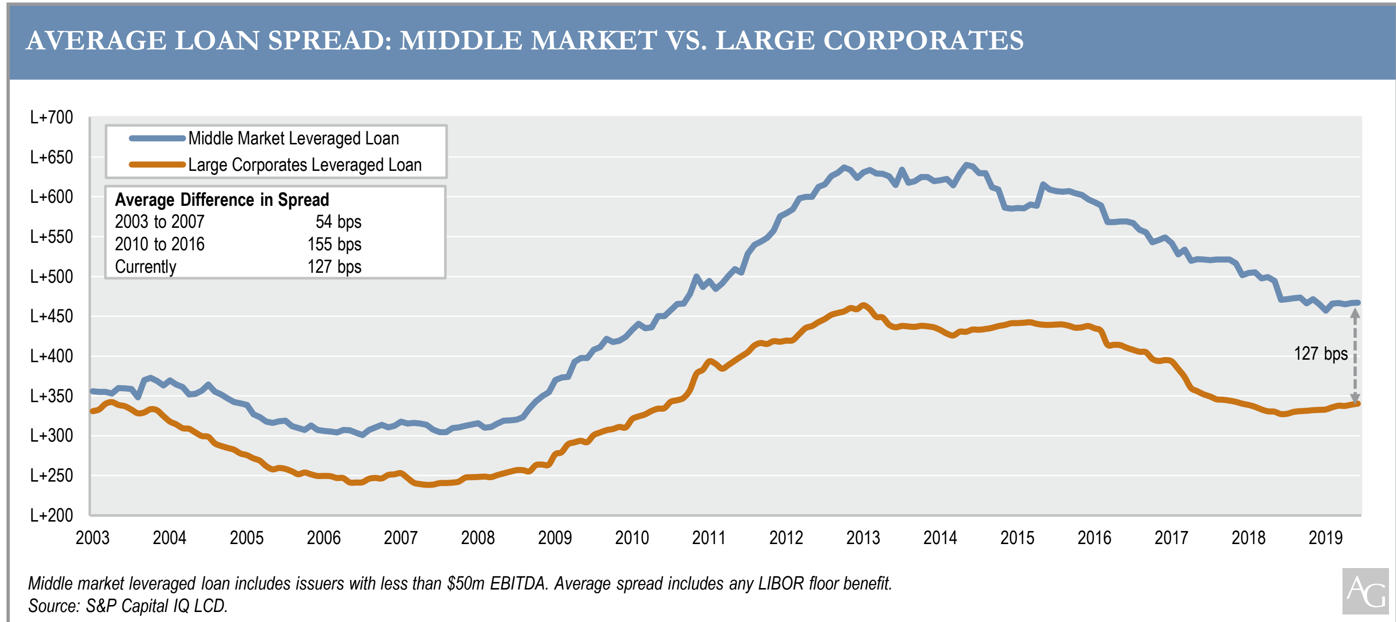
$11 trillion—over 20% of all sovereign and corporate bonds globally—trade at negative interest rates.



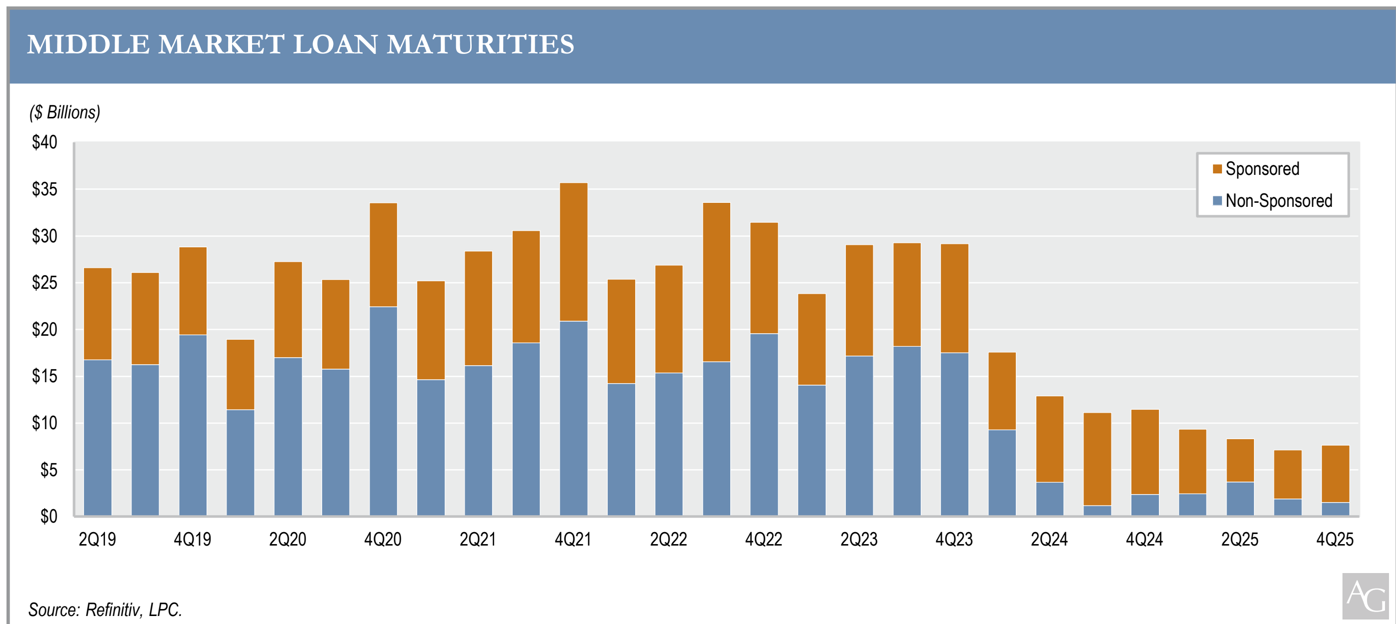


Year-to-date, high yield investors have preferred lower risk and more liquid issuances. CCCs with lower yield to worst have outperformed the highest yield CCCs this year, and the VLI has outpaced the rest of the market—particularly for CCCs.

MIDDLE MARKET DIRECT LENDING



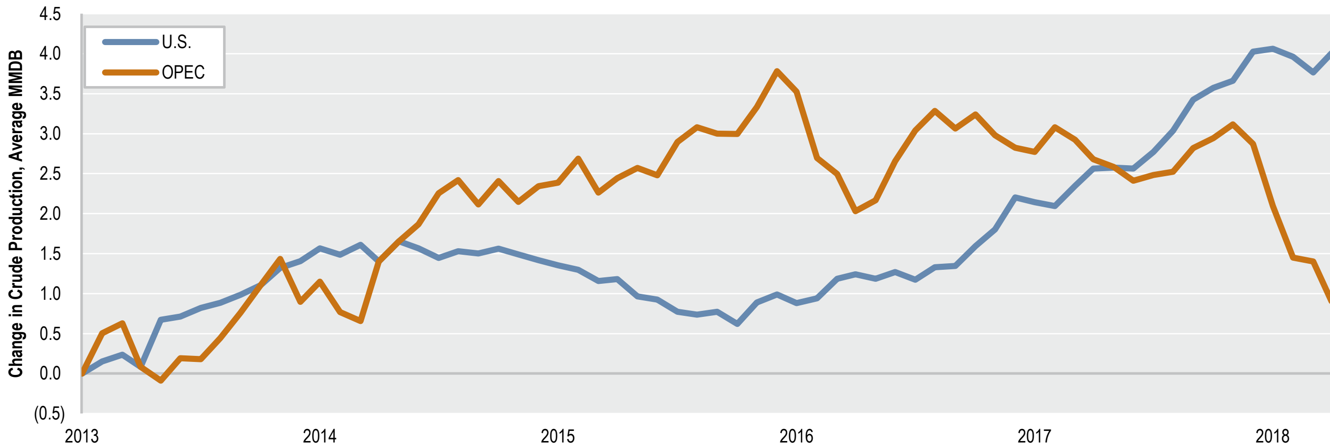
Middle market loans continue to offer an attractive premium versus large corporate loans.



Upcoming middle market loan maturities should create demand for new issuance and refinancing.

ENERGY

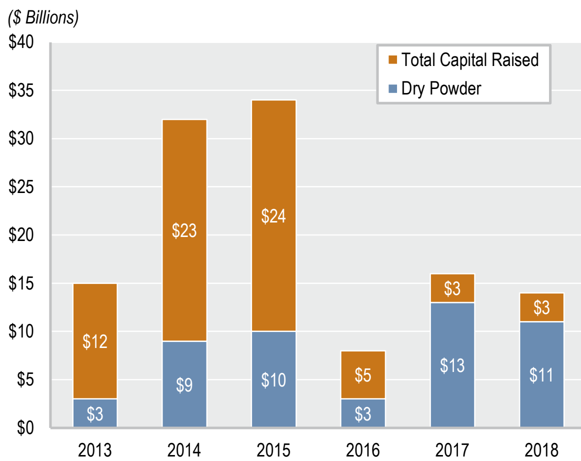
OPEC MARKET SHARE VS. U.S. SHALE



Source: U.S. Energy Information Administration.

As U.S. shale production has accelerated in the last two years, OPEC has lost market share. With its production cuts persisting through 2020, OPEC's share of global production is expected to decline below 30% for the first time since 1991.

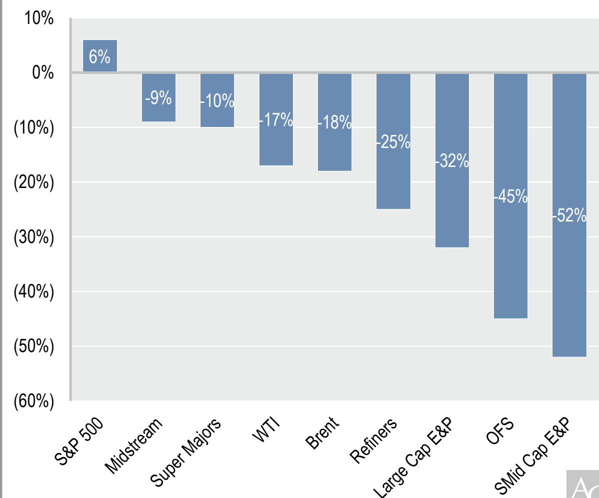
ENERGY PRIVATE EQUITY RAISED VS. DRY POWDER REMAINING



Source: Wells Fargo.

Energy private equity capital is trapped as exit opportunities remain elusive.

EQUITY PERFORMANCE BY SUB-SECTOR SINCE 10/15/18 OIL PRICE PEAK

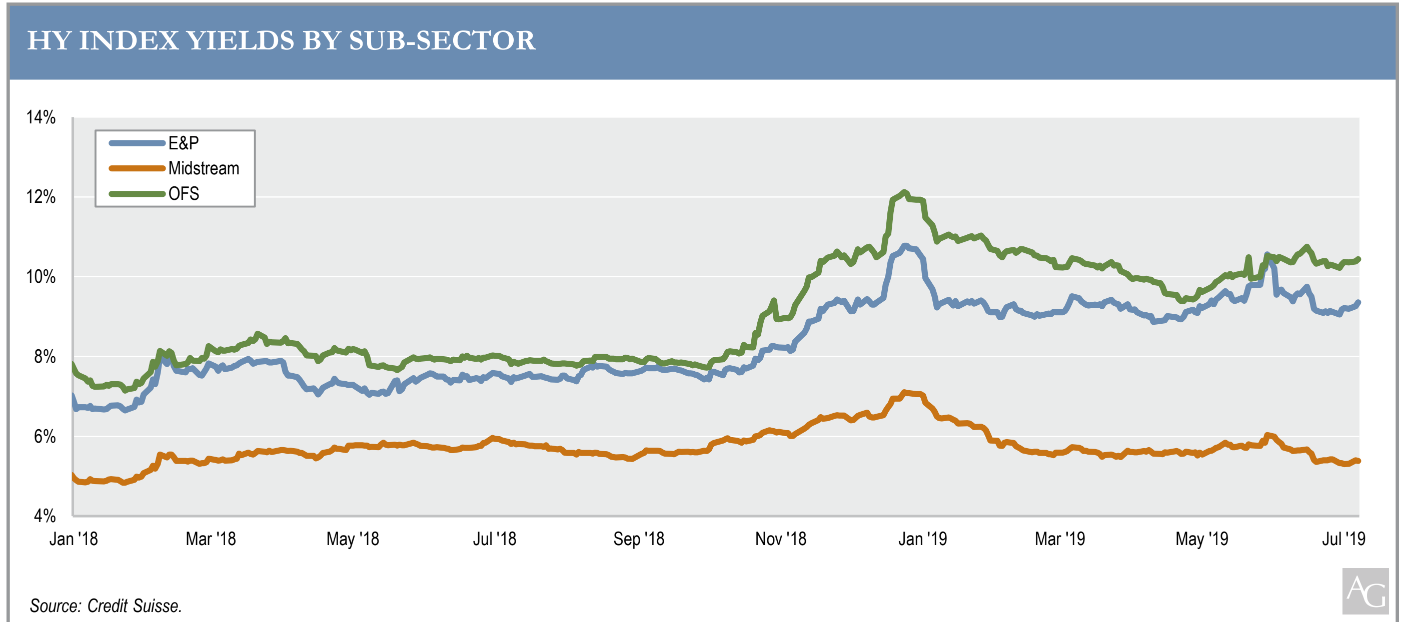


Source: Bloomberg, Barclays Research.

Since WTI peaked at $76 in October 2018, all sub-sectors have significantly underperformed the S&P 500.

ENERGY *(continued)*

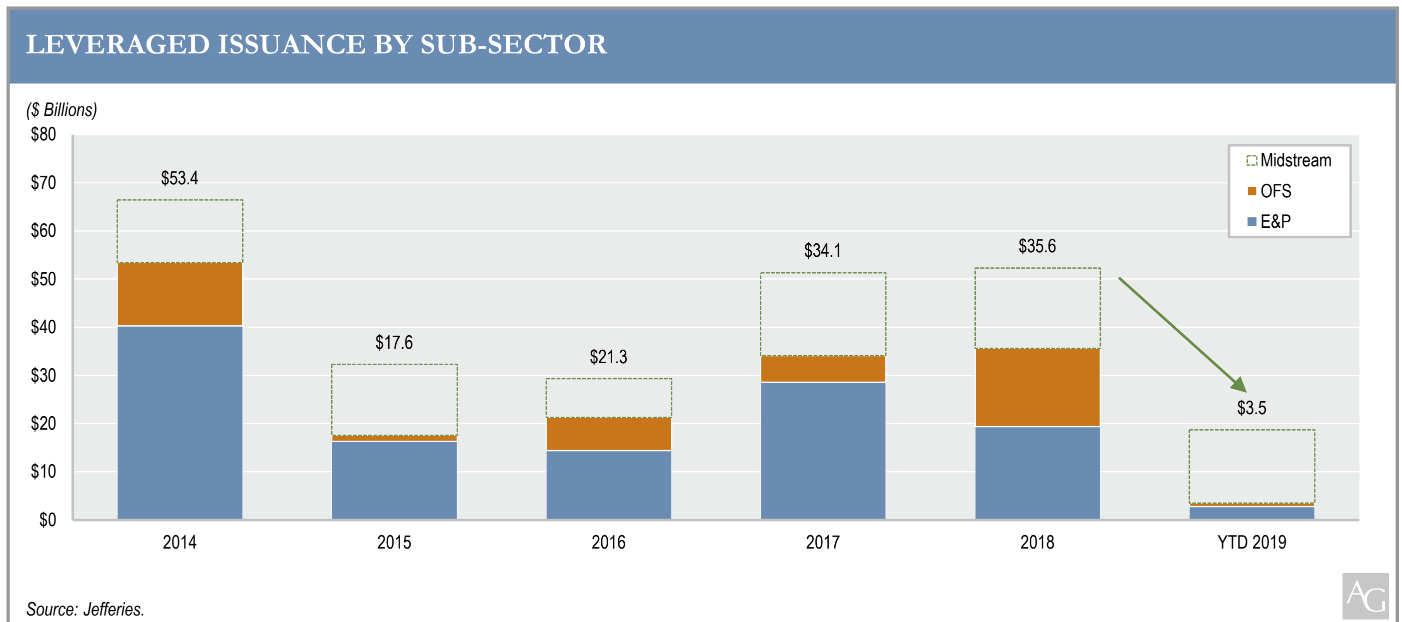
HY INDEX YIELDS BY SUB-SECTOR



Source: Credit Suisse.

Yields for E&P and oilfield services borrowers remain elevated, while yields for midstream borrowers have tightened.

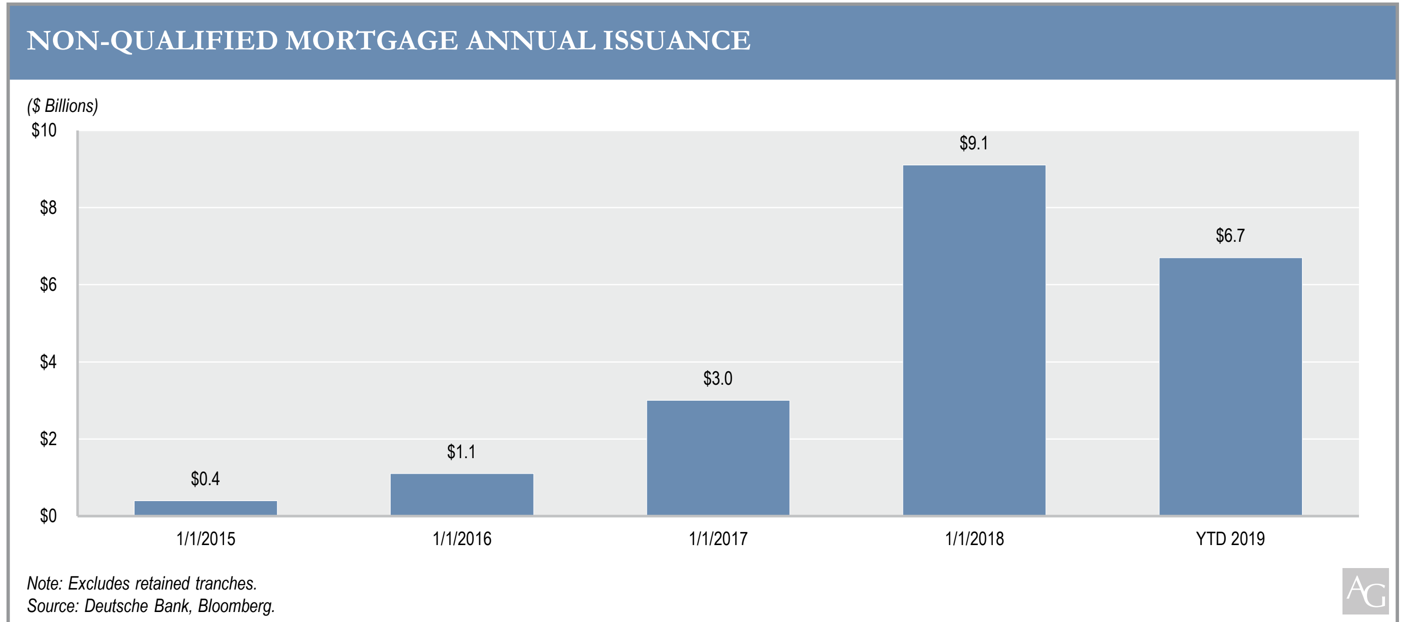
LEVERAGED ISSUANCE BY SUB-SECTOR



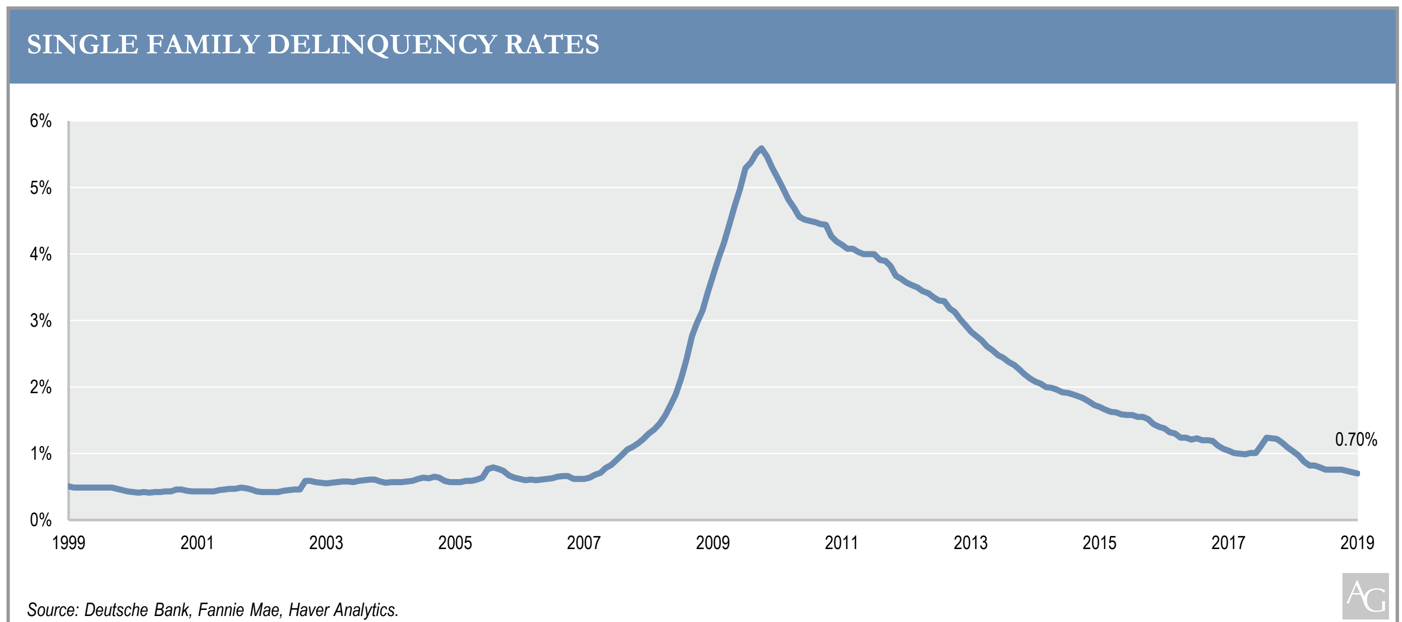
Source: Jefferies.

Leveraged issuance by non-midstream borrowers has fallen off a cliff this year.

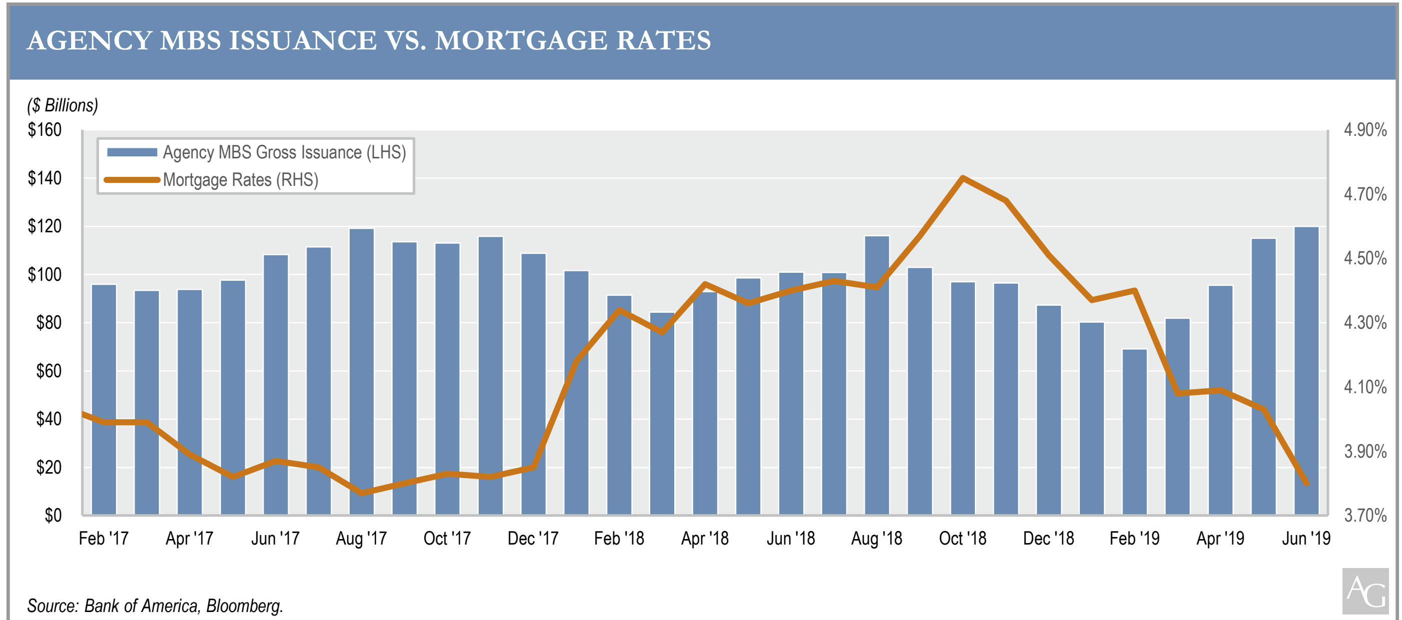
RESIDENTIAL AND CONSUMER DEBT (RMBS/ABS)



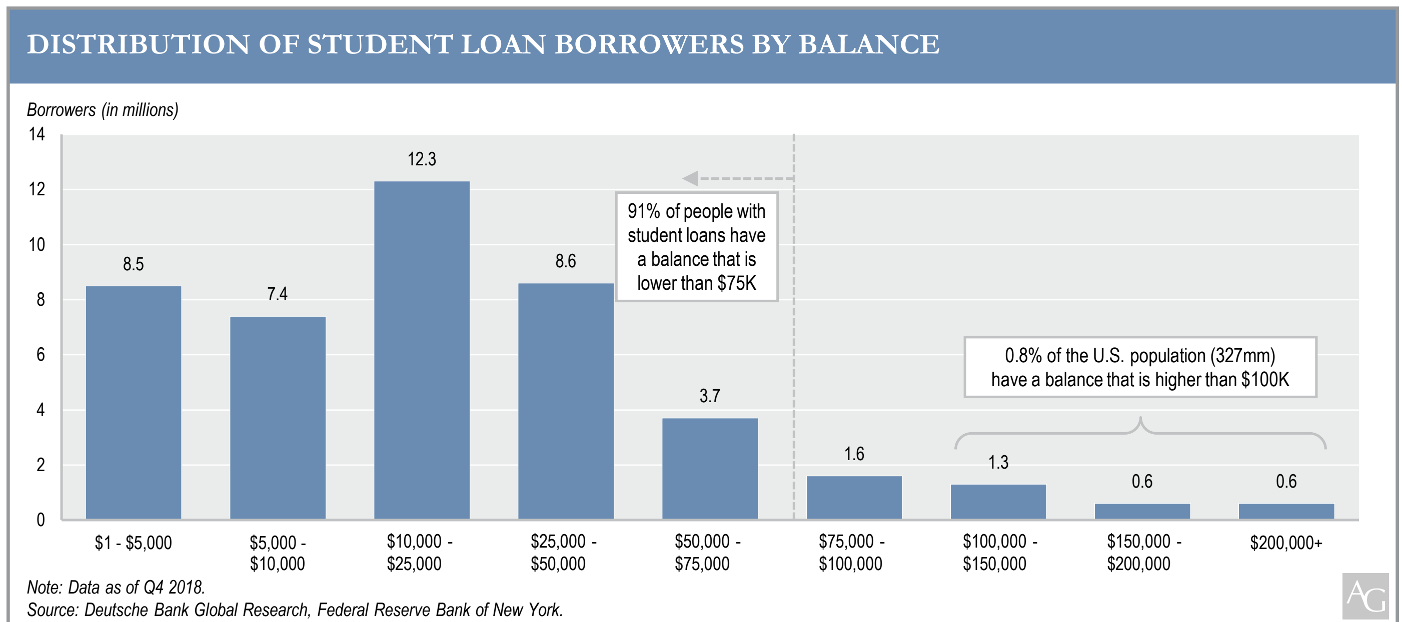
Non-QM issuance has grown exponentially from 2015-2018. Year-to-date issuance sets 2019 to be the most active year yet.



Single-family delinquency rates are near record level lows.



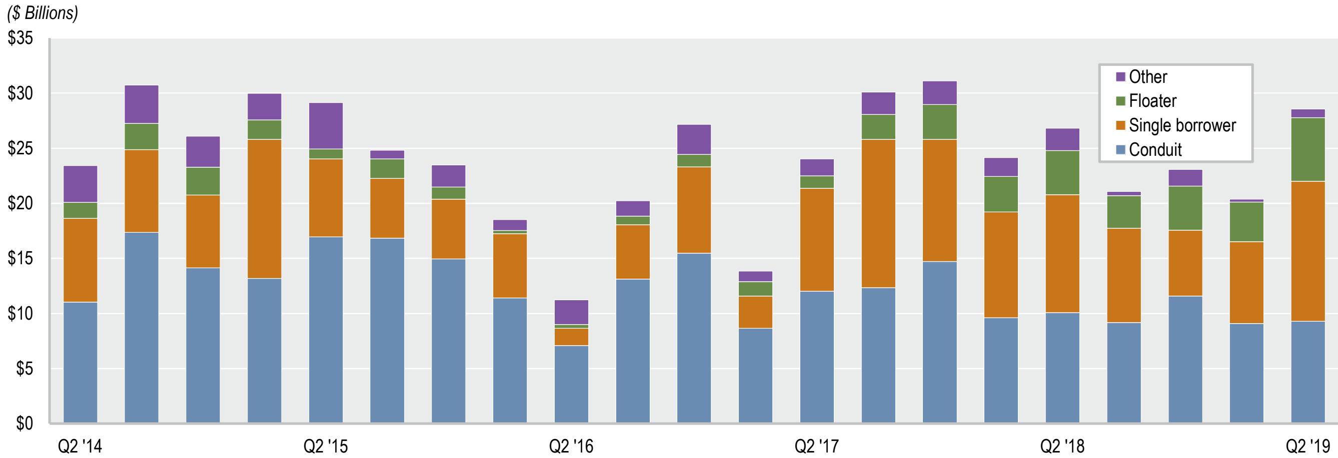
Agency RMBS issuance has increased steadily throughout 2019 as mortgage rates have declined to levels not seen since late 2017.



Although student loan debt outstanding has grown, most student loan balances are between $10K and $25K.

COMMERCIAL REAL ESTATE DEBT (CMBS)

QUARTERLY PRIVATE LABEL ISSUANCE



Source: Credit Suisse, Commercial Mortgage Alert.

Quarterly new issuance increased versus Q1 2019, with single-asset/single-borrower accounting for the largest share.

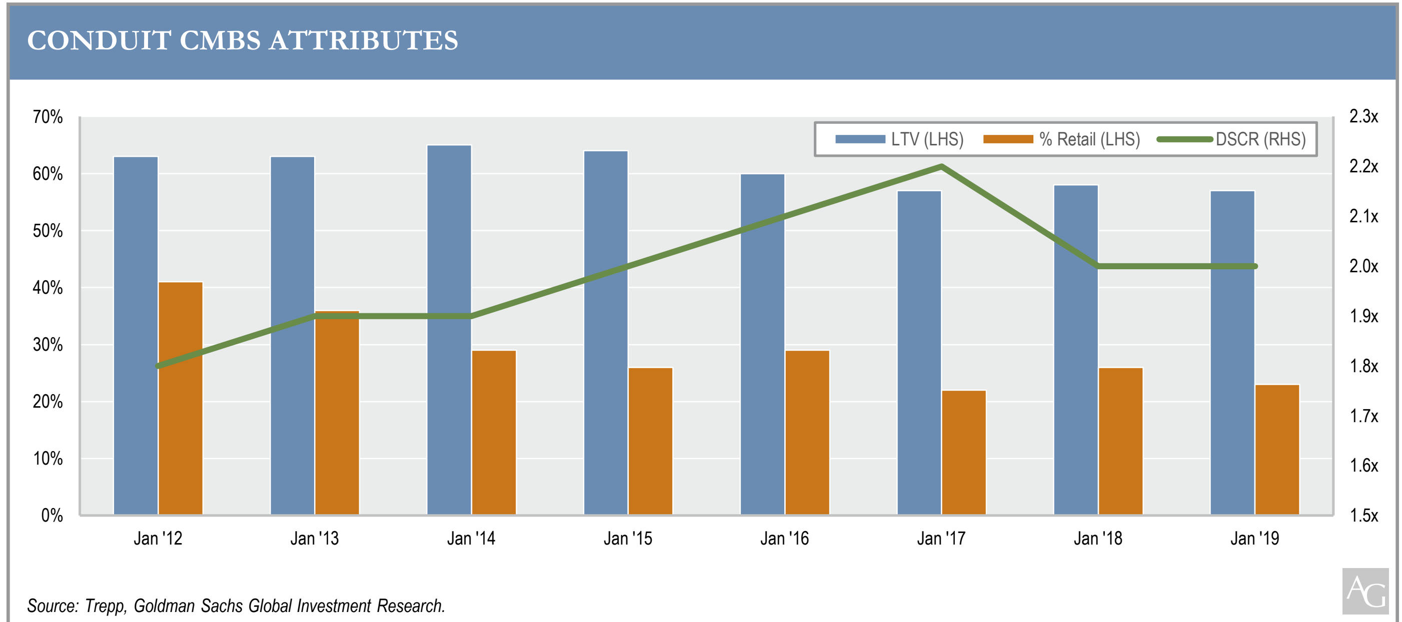
NEW CONDUIT CMBS DELINQUENCIES

Note: Rate of new 60+ day delinquencies, US conduit CMBS collateral with loan age >= 12 months.
Source: Trepp, Goldman Sachs Global Investment Research.

Low delinquency rates for CMBS are indicative of conservative underwriting and an extended period of commercial real estate price appreciation.

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

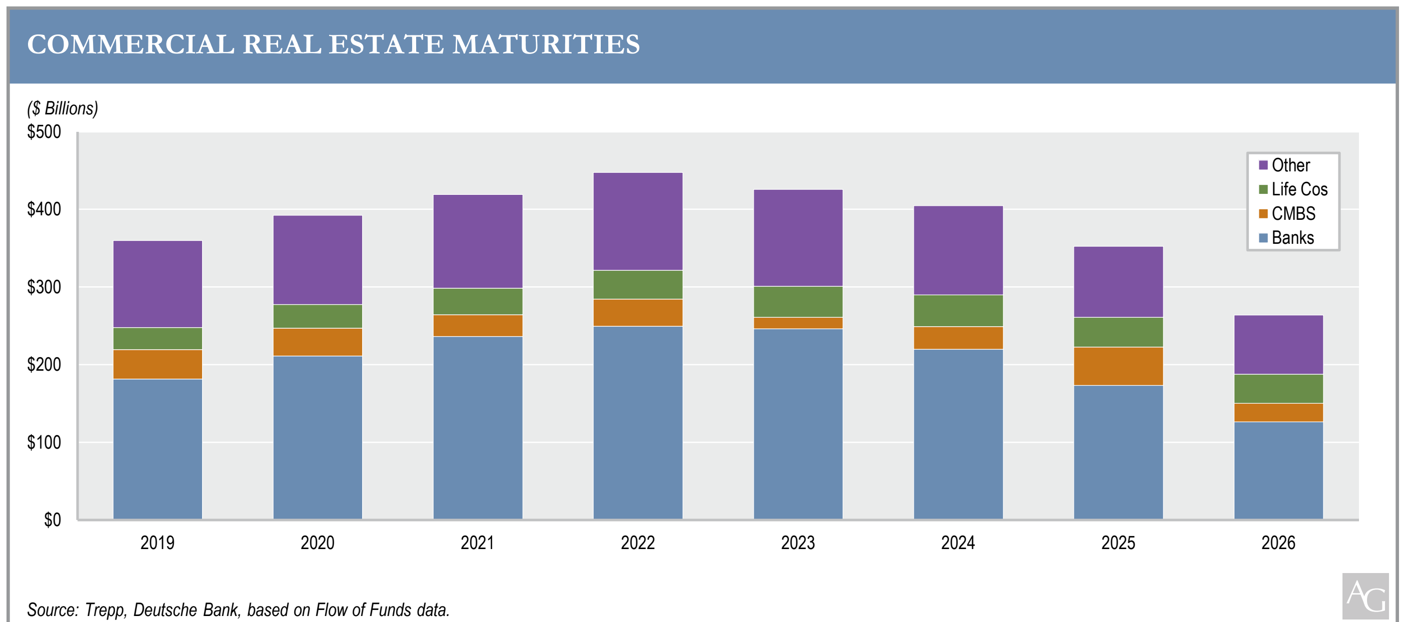
CONDUIT CMBS ATTRIBUTES



Source: Trepp, Goldman Sachs Global Investment Research.

CMBS deals have shifted away from higher retail exposure in more recent vintages.

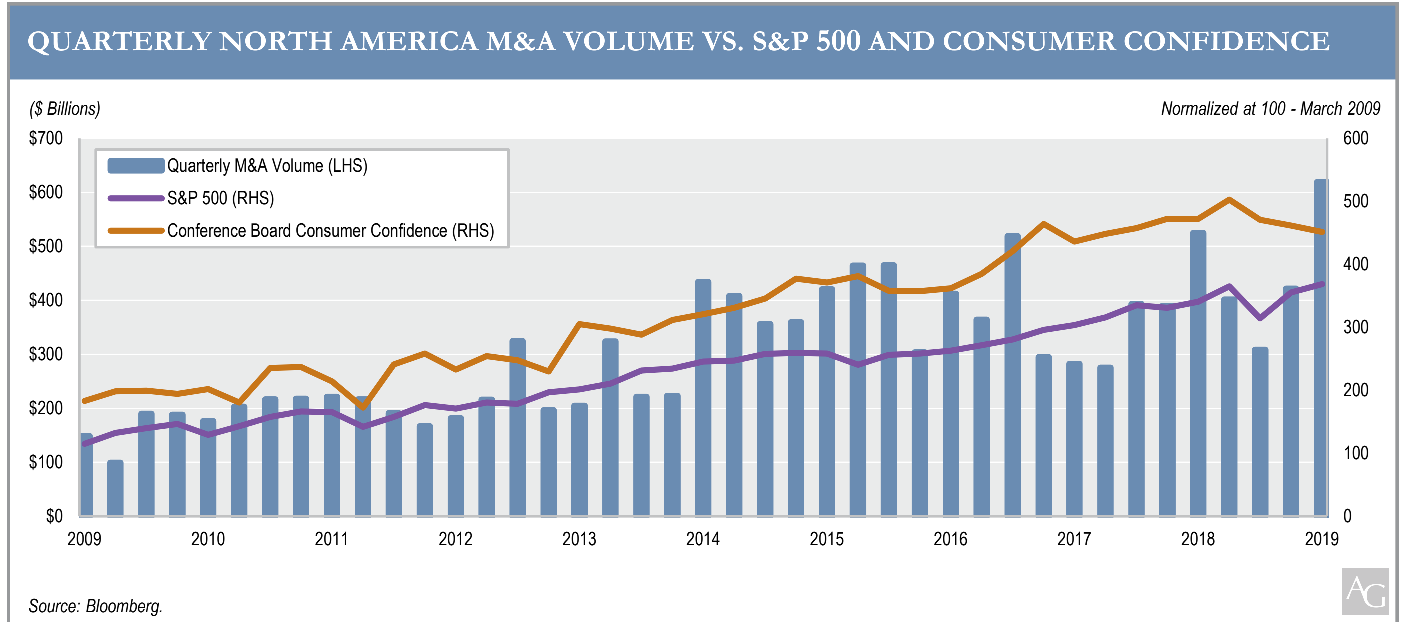
COMMERCIAL REAL ESTATE MATURITIES



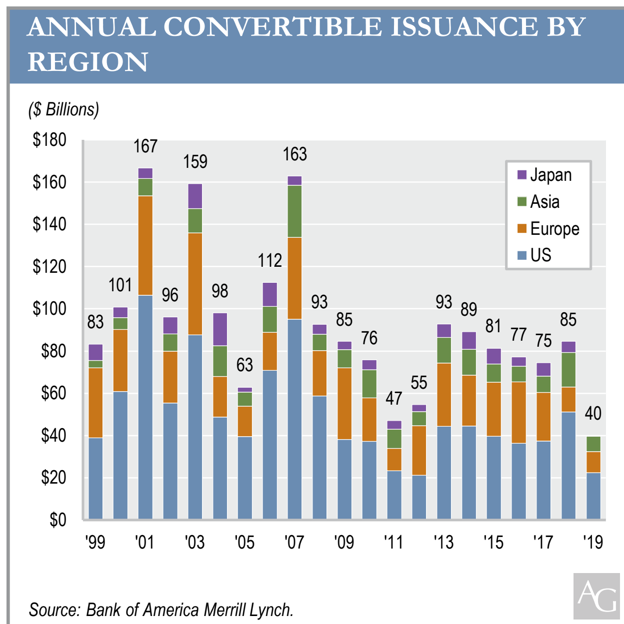
Source: Trepp, Deutsche Bank, based on Flow of Funds data.

In each of the next seven years, there are over $350 billion of commercial real estate loans maturing, creating a robust pipeline of deal flow.

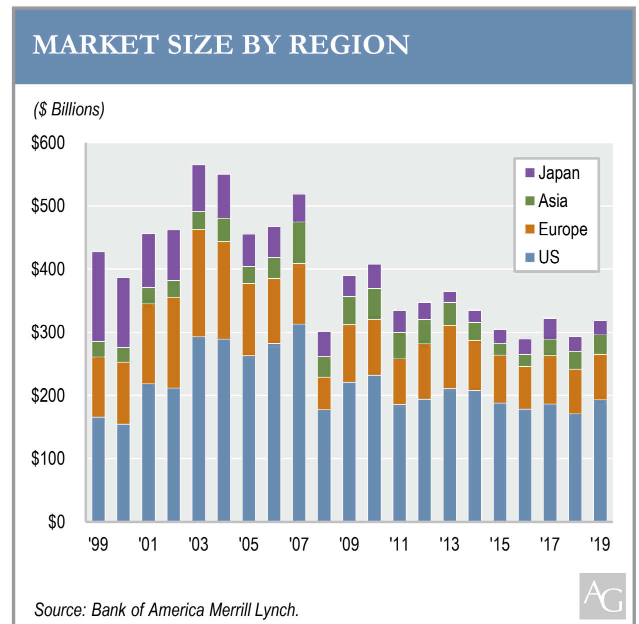
MERGER & CONVERTIBLE ARBITRAGE



The return of large-cap deals helped M&A volumes grow since last quarter, despite a decline in deals announced.



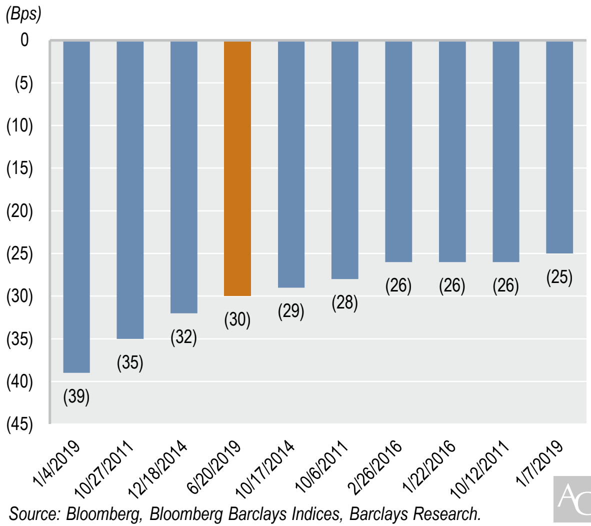
2019 global new issuance is on track to reach last year's strong level.



Global convertible market cap remains above $300 billion.

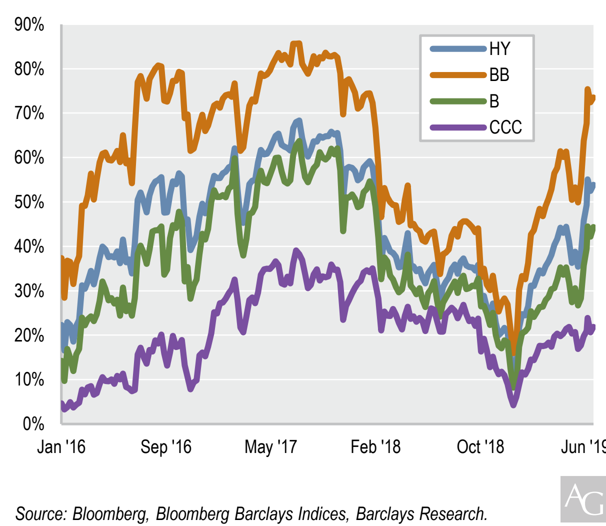
LIQUID CREDIT

LARGEST SINGLE-DAY TIGHTENING OF HIGH YIELD



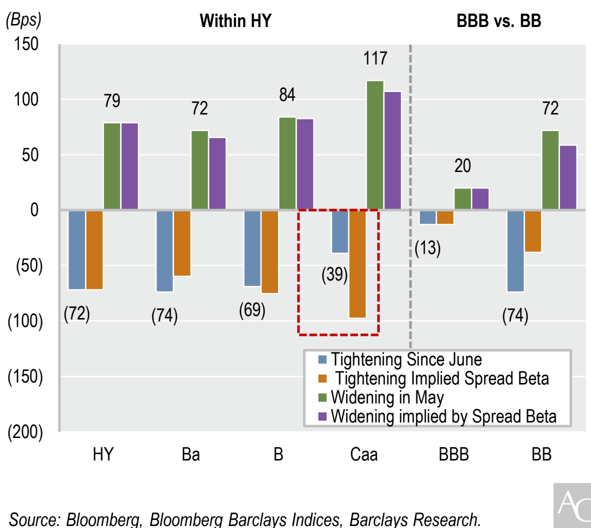
June witnessed one of the most significant one-day tightening moves in high yield over the last nine years.

NOW ~3/4 OF BBs ARE TRADING ABOVE CALL



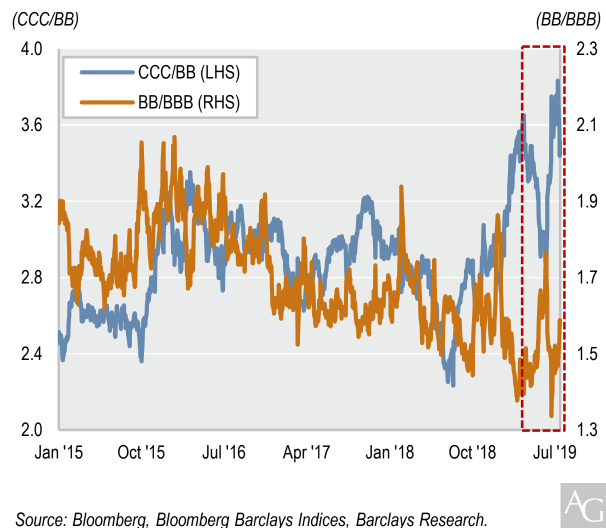
75% of BB high yield credits trade above their call price.

CHANGES IN SPREAD VS. BETA-IMPLIED



CCC credits significantly underperformed beta-implied tightening in June.

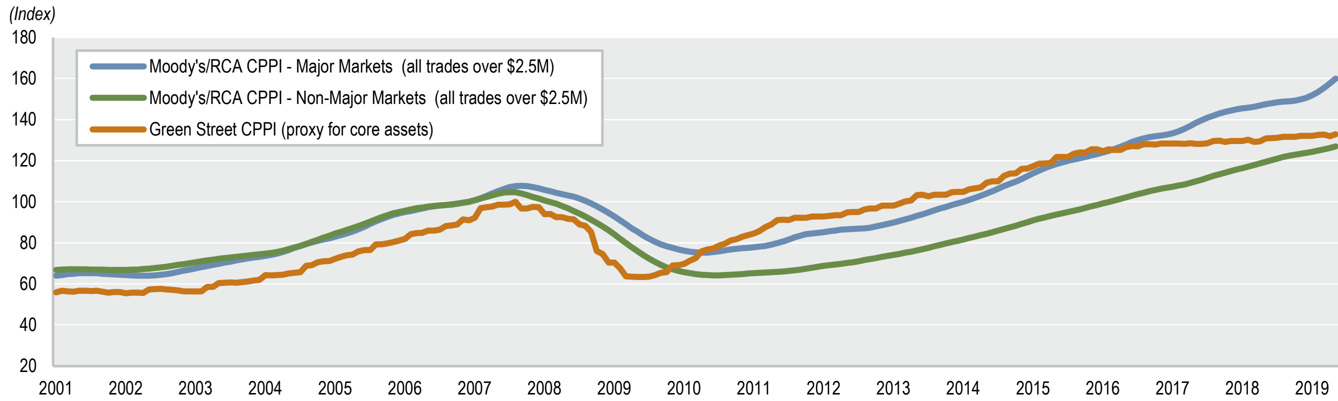
BB/BBB AND CCC/BB AT EXTREME LEVELS



Spreads between BB/BBB and CCC/BB are at multi-year tights and wides, respectively.

REAL ESTATE – UNITED STATES

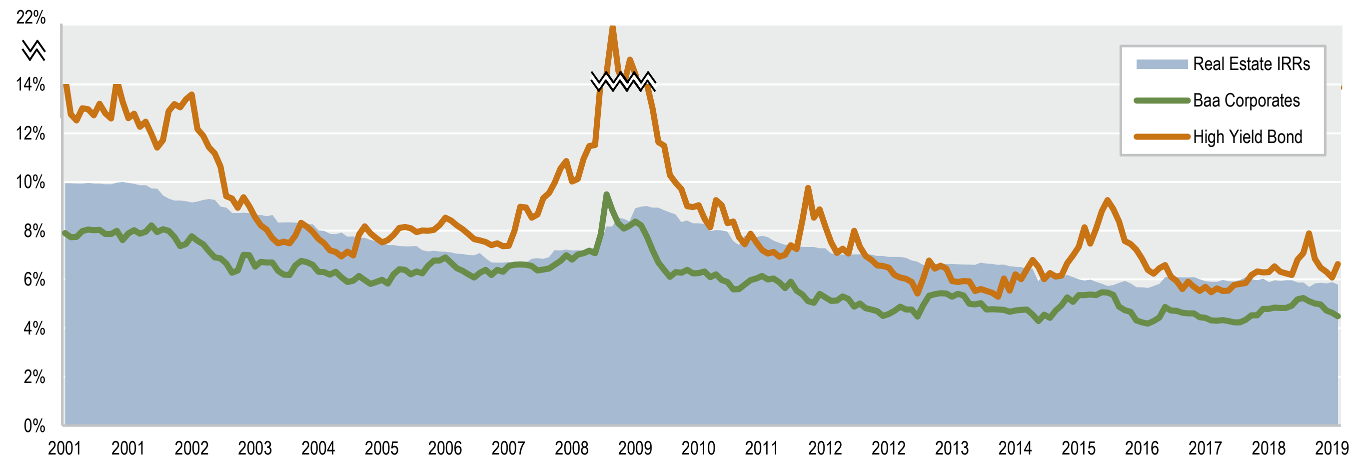
COMMERCIAL REAL ESTATE PRICE INDICES



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 May '19), Green Street Advisors – Commercial Property Price Index (Green St CPPI) (data through May '19). 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 to move modestly upward. Across the major sectors, apartments and industrial have led the way in price growth, while retail continues to lag.

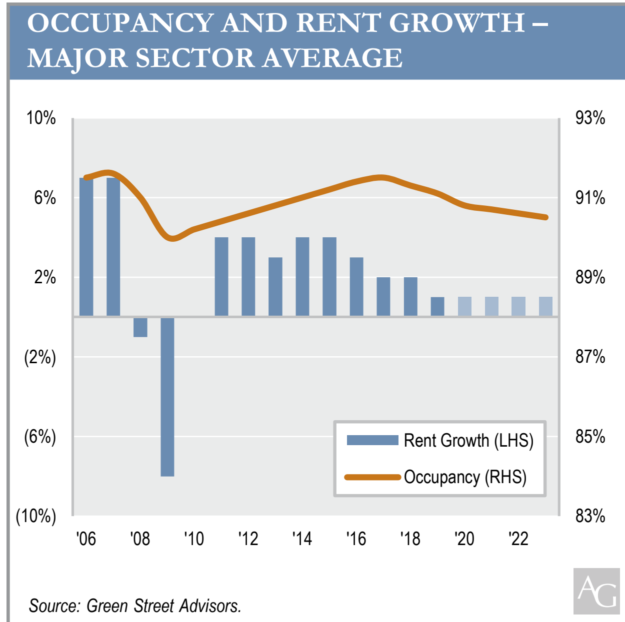
UNLEVERED TOTAL RETURN EXPECTATIONS ON REAL ESTATE VS. CORPORATE BOND YIELDS



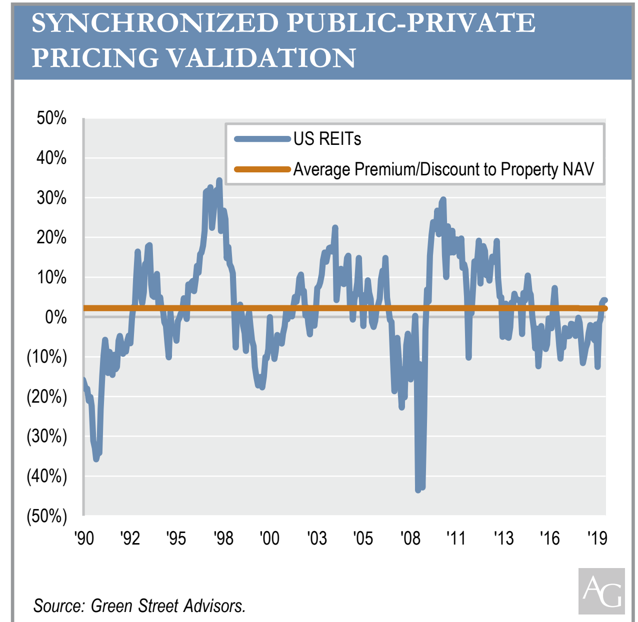
Real Estate IRRs is an equal-weighted average of the asset-weighted averages for the five major property sectors (apartment, industrial, mall, office, and strip center).
Source: Green Street Advisors (June '19), Moody's (Baa Corporates), BAML (High-Yield Bonds).

Unlevered real estate has historically offered a return between investment grade and high yield bonds. Real estate currently appears fairly priced on a relative basis.

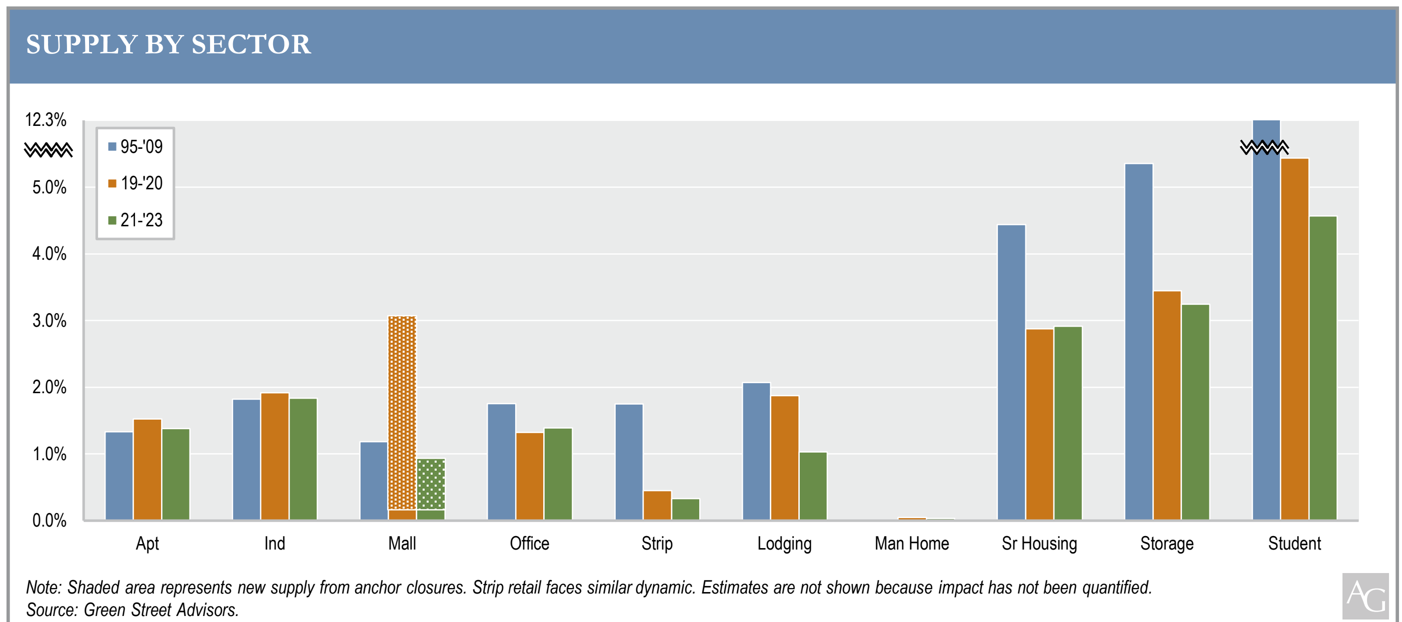
REAL ESTATE – UNITED STATES *(continued)*



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



After a period of sustained discount to NAV, current pricing parity reflects a return to cycle trend growth and a more patient monetary policy.



New deliveries are at cycle peak but leveling off, and senior, student, and storage have seen the heaviest new supply as a percentage of existing stock.

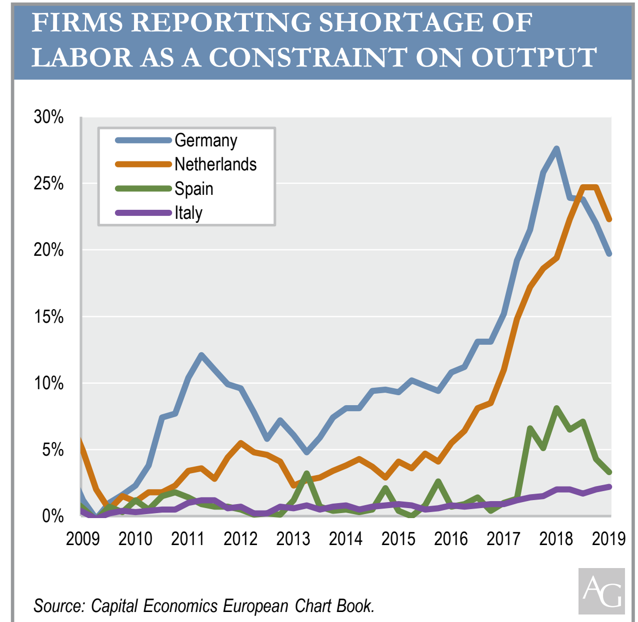
REAL ESTATE – EUROPE

CITY OF LONDON AVAILABILITY RATES

Source: Capital Economics UK Commercial Property Outlook.

London vacancy levels have been flat since Brexit was announced.

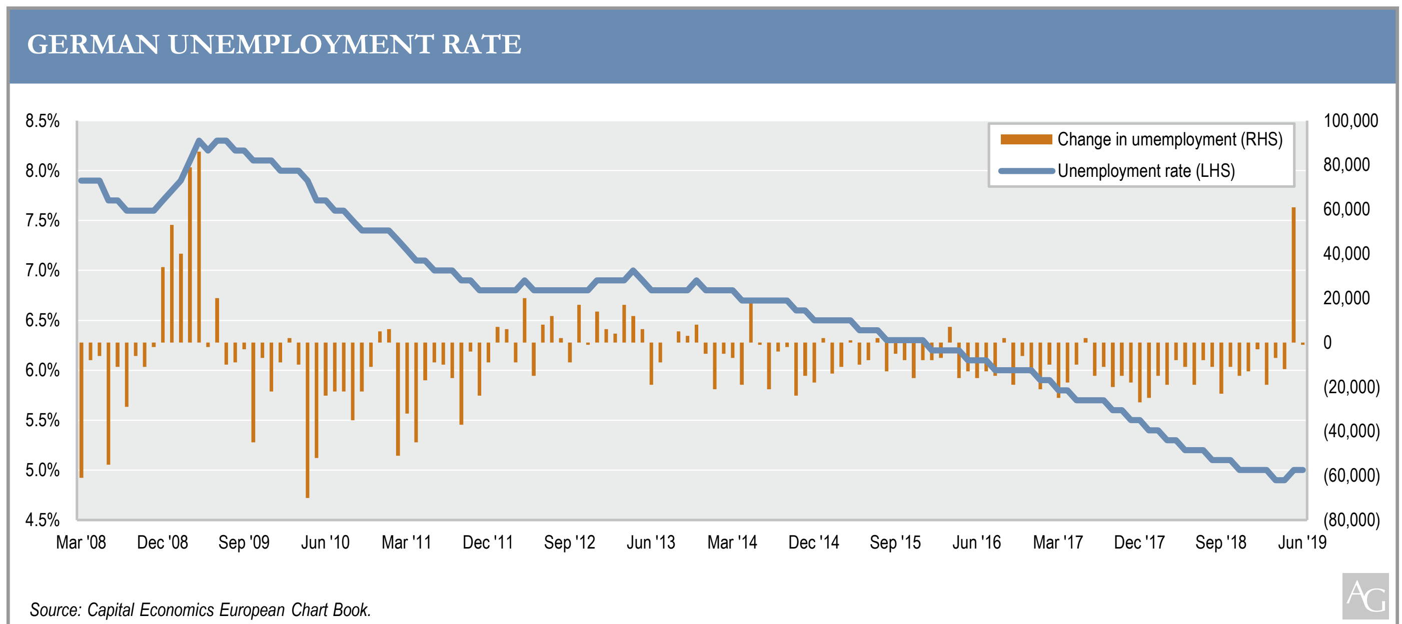
FIRMS REPORTING SHORTAGE OF LABOR AS A CONSTRAINT ON OUTPUT



Source: Capital Economics European Chart Book.

Labor shortages are a less common complaint across Europe.

GERMAN UNEMPLOYMENT RATE

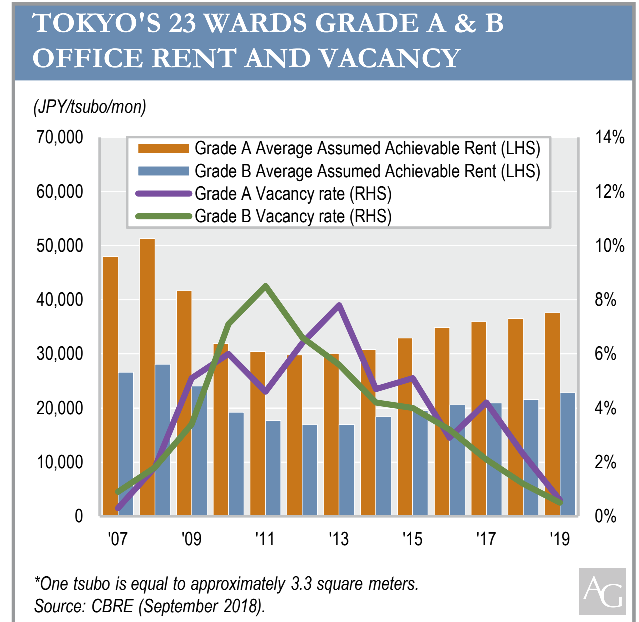


Source: Capital Economics European Chart Book.

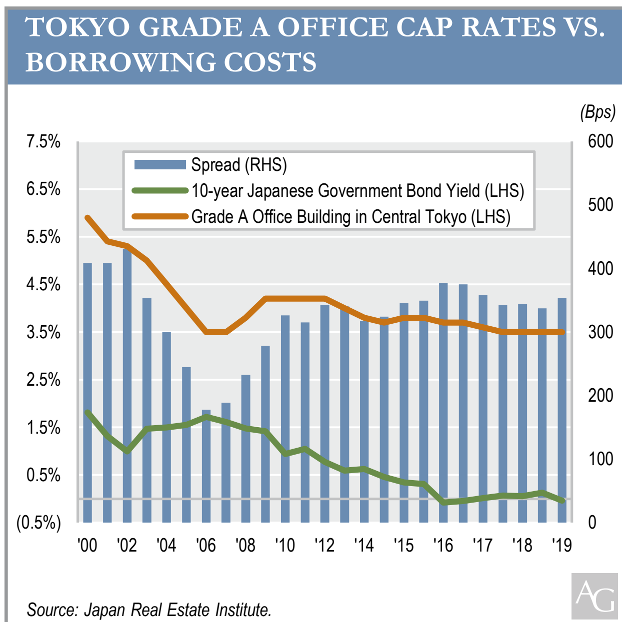
Recent German unemployment data may be beginning to reverse trend.

REAL ESTATE – ASIA

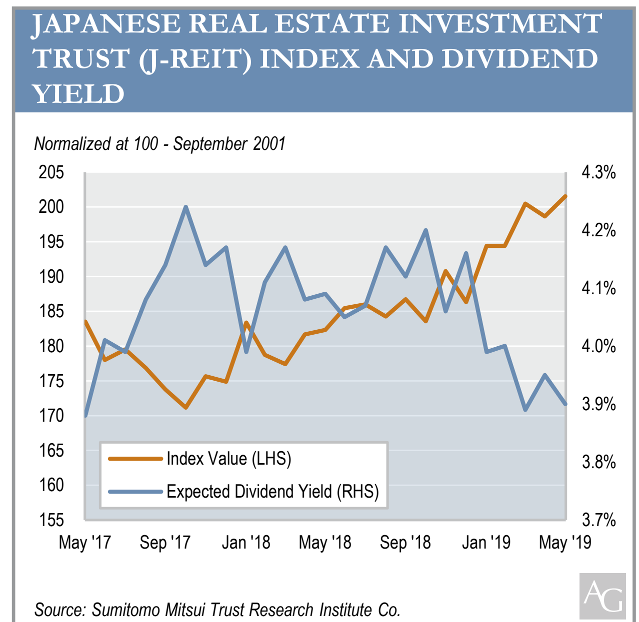
China's GDP growth has fallen to 6.2% due to trade tensions, but remains in the expected range of 6.0 – 6.5.



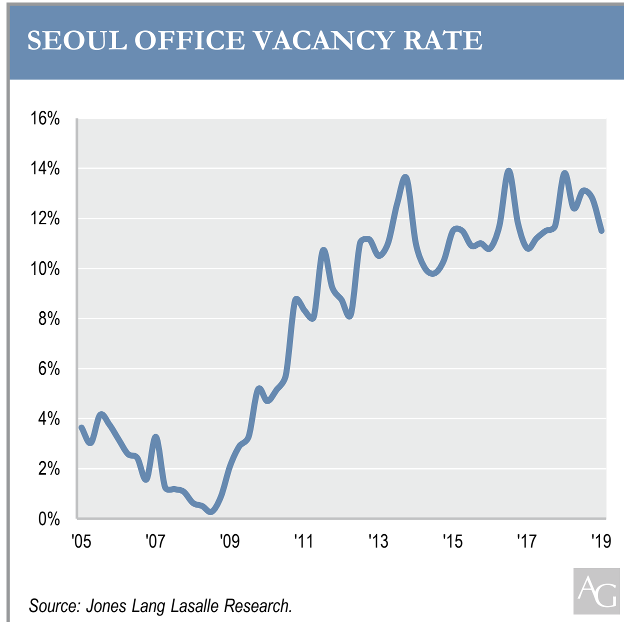
Tokyo office fundamentals continue to be strong with vacancy falling to nearly 0% and rents rising.



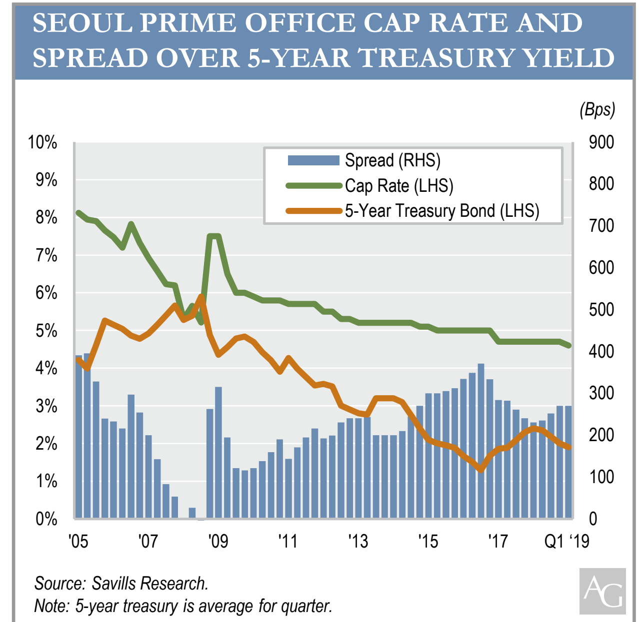
Cap rate spreads continue to be wide at nearly 350 bps.



The JREIT index increased 9% year-over-year as of June 2019, reaching a 12-year high.



Seoul office vacancy remains high as new supply weighs on the market, although we are seeing some tapering.

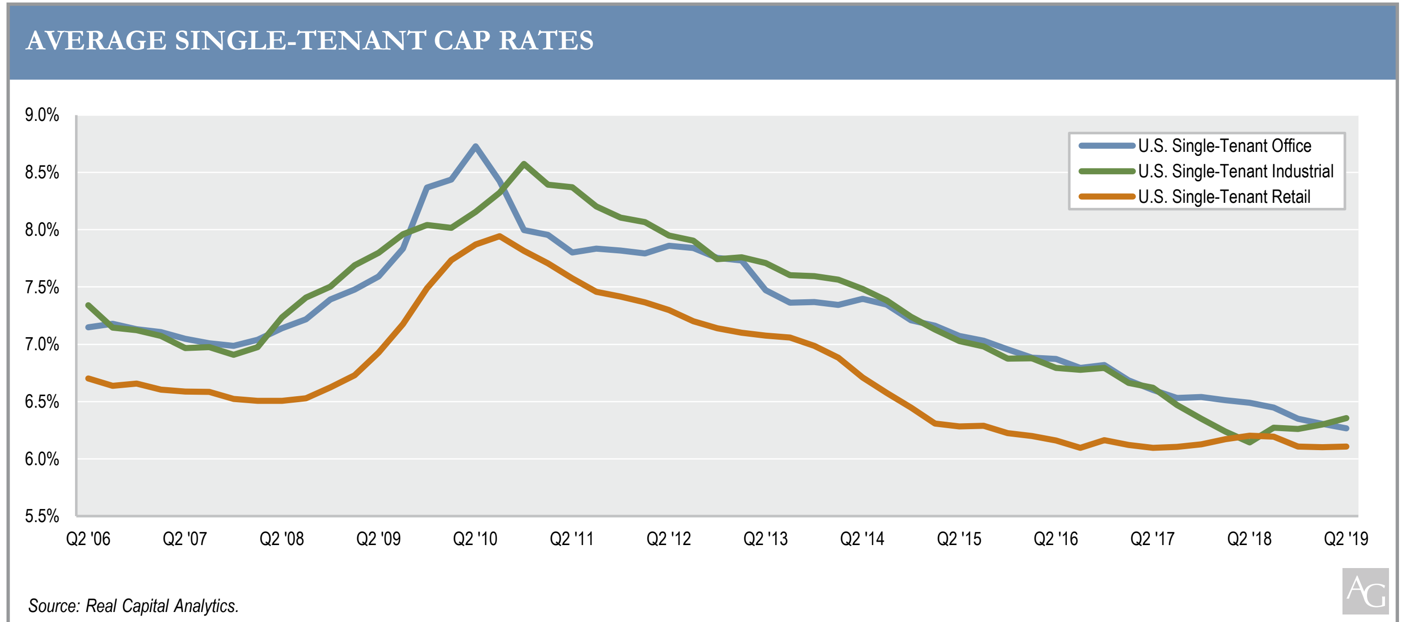


Cap rate spreads widen as Korean treasury yields decline.

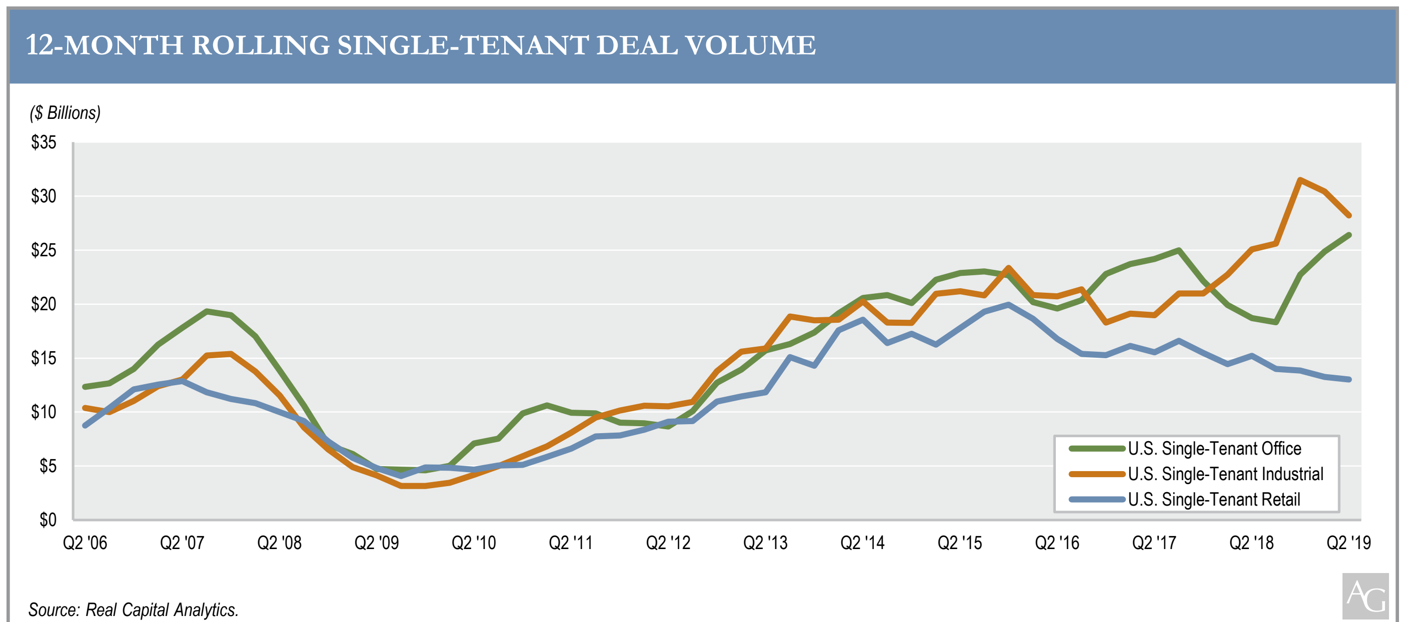
GDP growth declines as trade tensions rise and global demand for exports fall.

CNY weakens against USD.

NET LEASE REAL ESTATE



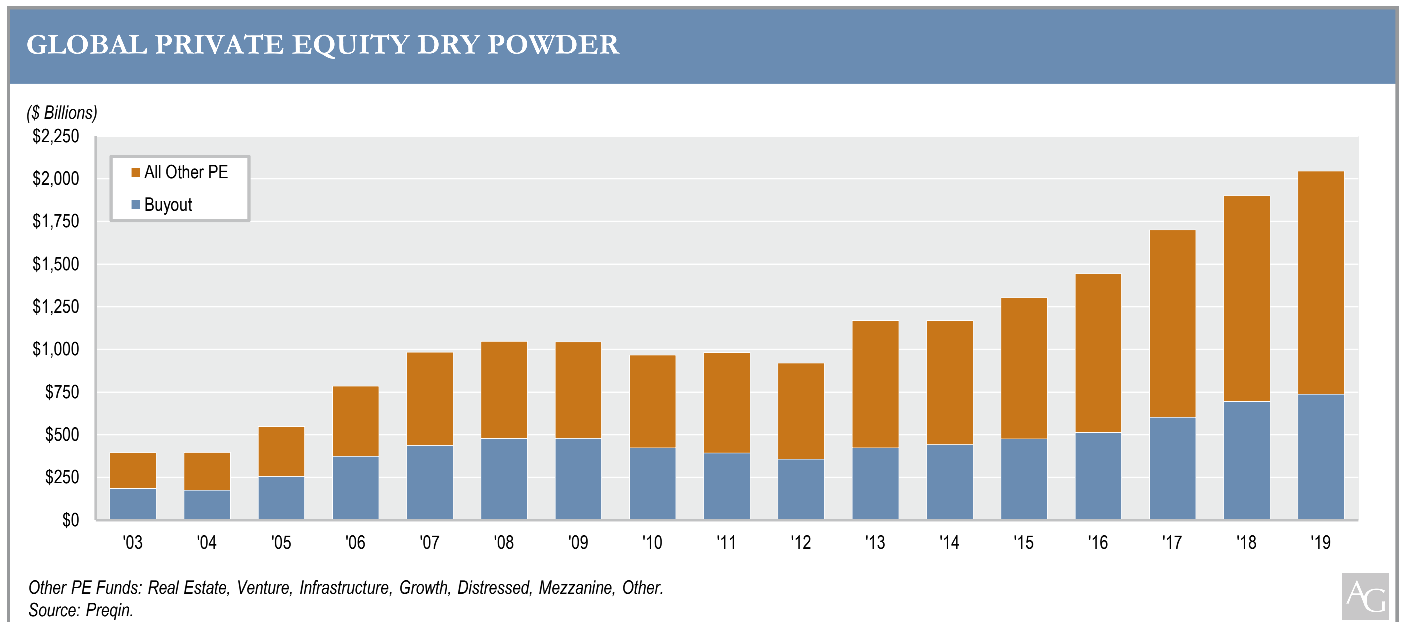
While retail and industrial cap rates appear to have found a floor, office continues to compress.



Growth in office volume largely offset the declines in industrial and retail.

PRIVATE EQUITY

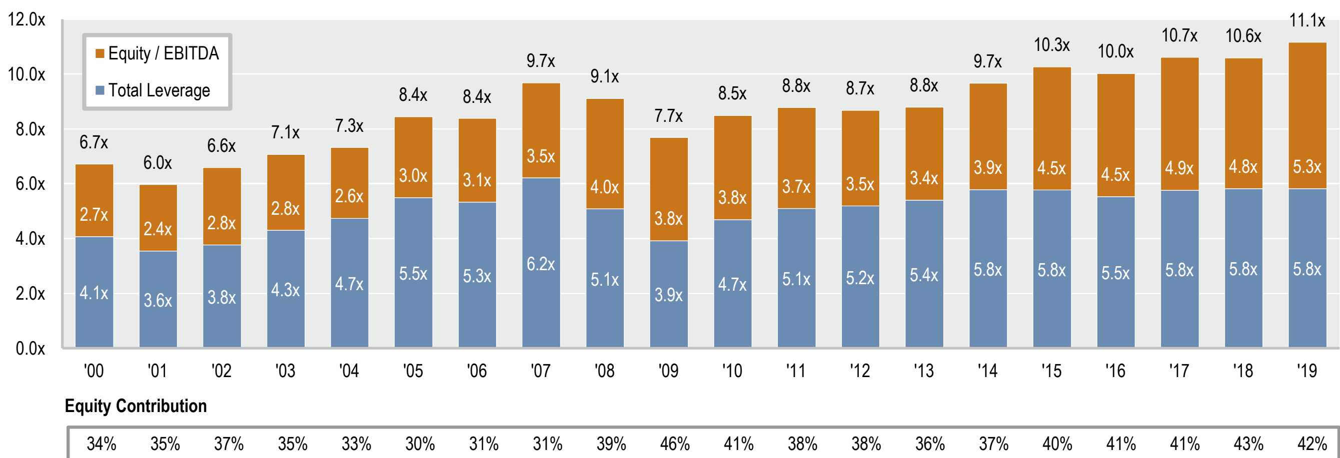
For the first six months of 2019, year-over-year deal volume decreased 21% in North America and 16% globally.



Buyout dry powder at June 30, 2019 stood at an all-time record of $738 billion, albeit a very modest increase of $2 billion from March 31, 2019.

PRIVATE EQUITY *(continued)*

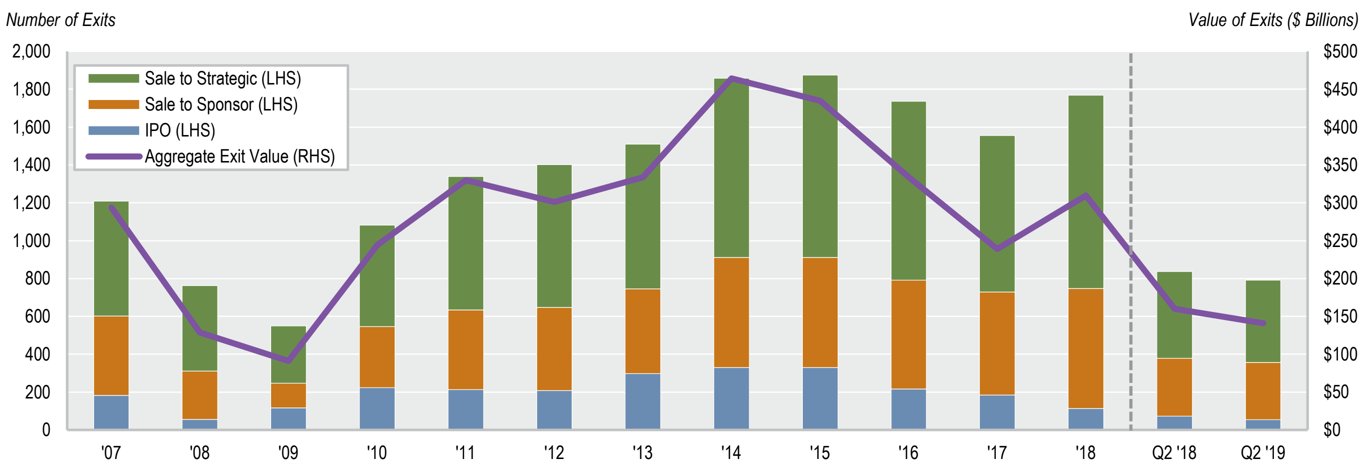
LBO PURCHASE PRICE BREAKDOWN



Source: S&P Capital IQ LCD.

LBO multiples in the first two quarters of 2019 (11.1x) were high and are on pace to set a year-end record.

PRIVATE EQUITY EXITS



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

The first six months of 2019 were weaker year-over-year, with the number of exits decreasing 5% and dollar volume down 12%, reflecting smaller monetizations.

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