ANGELO GORDON

Angelo Gordon's Capital Markets Perspectives

FIRST QUARTER 2023

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Angelo Gordon's Capital Markets Perspectives (CMP) is a quarterly publication that provides information and our portfolio managers' views on the credit and real estate markets. We hope you find this to be a valuable resource and enjoy our latest look at the markets.

Angelo Gordon is a leading, privately-held alternative investment firm, managing approximately $52 billion across a broad range of credit and real estate strategies. Founded in 1988, the firm has been investing on behalf of pension funds, corporations, endowments, foundations, sovereign wealth funds, and individuals for over 30 years.

Over our entire history, Angelo Gordon's investment approach has consistently relied on disciplined portfolio construction backed by rigorous research and a strong focus on capital preservation.

We have grown by pursuing strategies that complement and build on our core capabilities, and we now have over 650 employees in offices across the U.S., Europe, and Asia. Combining deep industry sector and market expertise with a collaborative, knowledge-sharing culture, we creatively seek out investment opportunities that allow us to exploit inefficiencies in global credit and real estate markets.

Co-CIO Overview

Although a range of macroeconomic concerns continued to dominate headlines, spreads tightened across many asset classes in the fourth quarter. However, the vast majority of those asset classes recorded double-digit losses for full year 2022, raising questions about the future viability of the traditional 60/40 portfolio model.

In corporate credit, U.S. and European high yield markets saw negative performance on a quarterly and annual basis. Higher-quality bonds outperformed lower-rated counterparts in both markets, indicating a preference for lower credit risk. In the U.S. and Europe, meaningfully higher yields also led to significantly lower new issuance activity in 2022. Supported by demand for floating rate assets, robust CLO formation, and strong issuer fundamentals, leveraged loans outperformed high yield last year, with the average coupon for leveraged loans exceeding that of high yield bonds for the first time.

In residential and consumer debt, spreads for credit risk transfer and senior non-qualified mortgage tranches tightened during the fourth quarter despite the negative trend in home prices. Spreads across these securitized residential debt sectors ended 2022 wider year-over-year, though price discovery in some areas was hampered due to limited supply. Spreads for securitized ABS sectors were mixed in the fourth quarter and consumer debt performance data remained varied, with delinquencies exceeding pre-pandemic levels in select pools of unsecured consumer and subprime auto loans. ABS and RMBS supply declined year-over-year, though the drop was less significant than that witnessed in corporate credit.

In middle market direct lending, higher base rates and spreads as well as wider original issue discounts drove yields to nearly 12%, leverage is generally lower, and strong lender protections are prevalent. Additionally, full-year origination volume increased, as borrowers turned to direct lenders when the syndicated loan and high yield markets effectively shut down.

In the face of higher rates and lower valuations, convertible bonds underperformed in both the fourth quarter and full year 2022. Global primary market activity for convertible bonds declined in the fourth quarter and the SPAC market remained quiet, though in the U.S., some sponsors rushed to liquidate structures ahead of year-end.

The merger arbitrage market saw a quarter-over-quarter uptick in U.S. deal activity in the fourth quarter, though full-year M&A volume was down slightly. Looking ahead, although many of the anticipated headwinds remain the same, the sector is expected to benefit from valuations being repriced and record levels of dry powder in the private equity and U.S. corporate markets.

Turning to real estate, the commercial real estate market has been in a period of significant transition. In the fourth quarter, increased debt costs and less available leverage continued to present challenges. In the face of an uncertain economic outlook, fourth quarter 2022 investment volumes fell dramatically year-over-year. Although limited transaction data has made it difficult to ascertain private market valuations, buyers and sellers have started to acknowledge that recent valuations are no longer valid, and write-downs are expected across all property types. As the era of readily available, inexpensive debt ends, property owners have and will continue to be faced with difficult refinancing decisions – driving pockets of stress and distress and the need for rescue capital. We believe these trends will continue in the near-term, as rates are expected to remain elevated through 2023.

In the U.S., transaction volume in the fourth quarter fell 62% year-over-year, reflecting a material shift in dynamics. Maturing debt and liquidity needs continue to create a wide bid-ask spread; as a result, most of the recently witnessed transaction activity has occurred only in situations where a sale was necessary. With regard to valuations, the Green Street Commercial Property Price Index ended 2022 down 13%, after increasing 24% in 2021, and U.S. REIT shares declined 24% during the year. Although financing pressures are driving a correction in pricing, most property sectors have exhibited strong fundamentals, and importantly, supply remains moderate.

In Europe, macroeconomic concerns have put pressure on the market; however, the economy proved resilient, with projected 2022 GDP growth currently at 0.6% instead of the previously anticipated contraction. A mild winter thus far has alleviated concerns about a rapid increase in energy prices; however, inflation levels remain elevated, with both services and core goods inflation levels increasing year-over-year. Given increased borrowing costs, investment volume in the eurozone decreased 15% year-over-year in the third quarter, and property values fell 17% from June to November 2022.

Market dynamics were somewhat mixed across Asia. The economy has contracted in Japan and Hong Kong, while both China and South Korea have exhibited economic growth. However, with the exception of South Korea, interest rates remain steady across the region, and real estate fundamentals have generally been resilient – particularly in the office and logistics sectors. China's relaxation of its zero-COVID policy is expected to strengthen the economic backdrop in Asia as we enter 2023, which will likely improve general market sentiment across commercial real estate.

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Head of Real Estate

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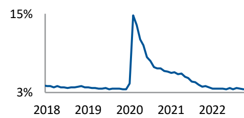
Economic Dashboard & Market Indices

Job Market

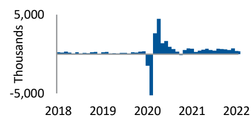
U.S.—Unemployment Rate
As of 12/31/2022

Latest Level	3.5
Change from Prior Period	(0.1)
Frequency	Monthly



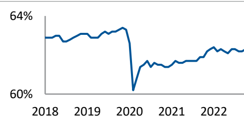
U.S.—Non-Farm Payroll
As of 12/31/2022

Latest Level	223.0
Change from Prior Period	(33.0)
Frequency	Monthly



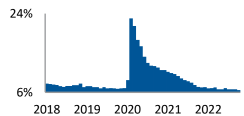
U.S.—Labor Participation Rate
As of 12/31/2022

Latest Level	62.3
Change from Prior Period	(0.1)
Frequency	Monthly



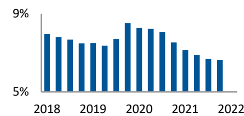
U.S.—U-6 Unemployed & Margin & Part-Time as Percent of Labor Force & Margin
As of 12/31/2022

Latest Level	6.5
Change from Prior Period	(0.2)
Frequency	Monthly



Eurozone Unemployment Rate
As of 9/30/2022

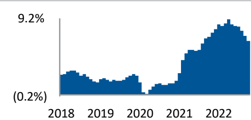
Latest Level	6.6
Change from Prior Period	(0.1)
Frequency	Quarterly



Inflation

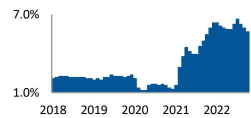
U.S. Consumer Price Index (CPI) Y-o-Y (%)
As of 12/31/2022

Latest Level	6.5
Change from Prior Period	(0.6)
Frequency	Monthly



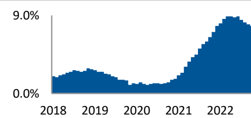
U.S. CPI Goods Less Food & Energy Y-o-Y (%)
As of 12/31/2022

Latest Level	5.7
Change from Prior Period	(0.3)
Frequency	Monthly



U.S. Producer Price Index (PPI) Y-o-Y (%)
As of 12/31/2022

Latest Level	7.8
Change from Prior Period	(0.2)
Frequency	Monthly



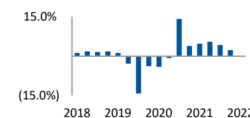
GDP Growth

U.S.—GDP Y-o-Y (%)
As of 12/31/2022

Latest Level	7.3
Change from Prior Period	(1.9)
Frequency	Quarterly

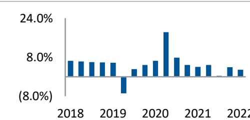
Eurozone—GDP Y-o-Y (%)
As of 9/30/2022

Latest Level	2.3
Change from Prior Period	0.0
Frequency	Quarterly



China—GDP Y-o-Y (%)
As of 12/31/2022

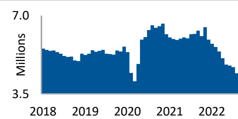
Latest Level	2.9
Change from Prior Period	(1.0)
Frequency	Quarterly



Housing

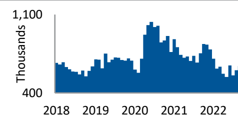
Existing Home Sales
As of 12/31/2022

Latest Level	4.0
Change from Prior Period	(0.1)
Frequency	Monthly



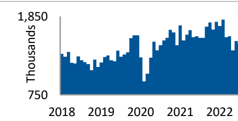
New Home Sales
As of 11/30/2022

Latest Level	640.0
Change from Prior Period	0.0
Frequency	Monthly



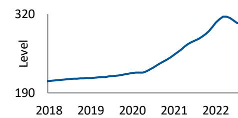
Housing Starts
As of 12/31/2022

Latest Level	1,382.0
Change from Prior Period	(19.0)
Frequency	Monthly



Case-Shiller Index of Home Value in 20 Cities
As of 10/31/2022

Latest Level	304.3
Change from Prior Period	0.0
Frequency	Monthly



Note: All charts are based on a five-year trend.
Source: Bloomberg (All).

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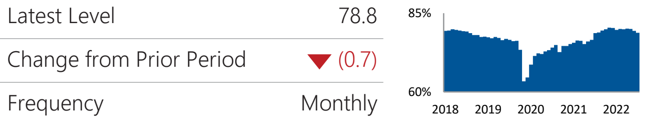
Economic & Market Confidence

Capacity Utilization as a Percent of Capacity — As of 12/31/2022

Latest Level	78.8
Change from Prior Period	▼ (0.7)
Frequency	Monthly

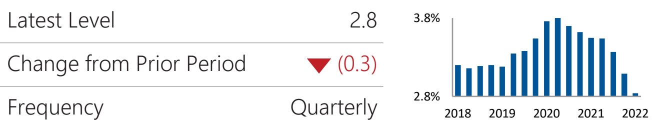


Private Fixed Investment Nonresidential SAAR — As of 12/31/2022

Latest Level	3,438.6
Change from Prior Period	▲ 35.2
Frequency	Quarterly

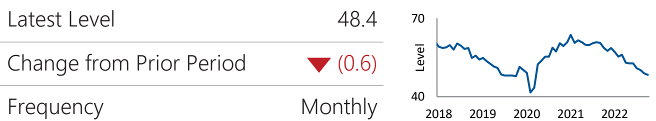
Residential Fixed Investment as a Percent of GDP — As of 12/31/2022

Latest Level	2.8
Change from Prior Period	▼ (0.3)
Frequency	Quarterly



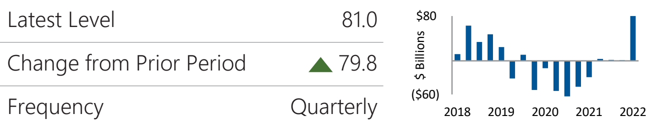
ISM Manufacturing Index — As of 12/31/2022

Latest Level	48.4
Change from Prior Period	▼ (0.6)
Frequency	Monthly



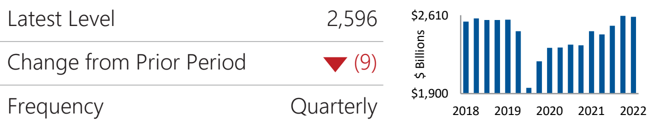
Manufacturing Inventory Change Q-o-Q ($) — As of 12/31/2022

Latest Level	81.0
Change from Prior Period	▲ 79.8
Frequency	Quarterly



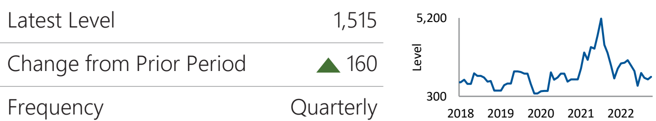
Exports of Goods/Services — As of 12/31/2022

Latest Level	2,596
Change from Prior Period	▼ (9)
Frequency	Quarterly



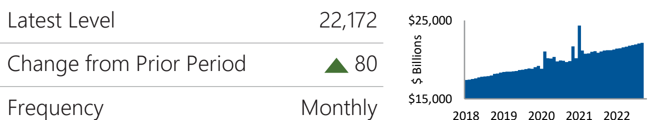
Shipping Rates — As of 12/30/2022

Latest Level	1,515
Change from Prior Period	▲ 160
Frequency	Quarterly



Personal Income Level — As of 11/30/2022

Latest Level	22,172
Change from Prior Period	▲ 80
Frequency	Monthly



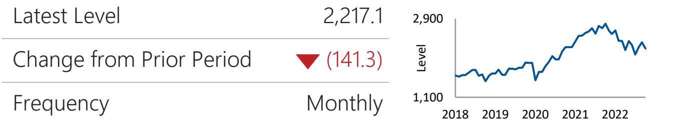
Michigan Consumer Confidence Sentiment — As of 12/31/2022

Latest Level	59.7
Change from Prior Period	▲ 2.9
Frequency	Monthly

Equity

U.S. Equity Markets—Russell 3000 — As of 12/31/2022

Latest Level	2,217.1
Change from Prior Period	▼ (141.3)
Frequency	Monthly

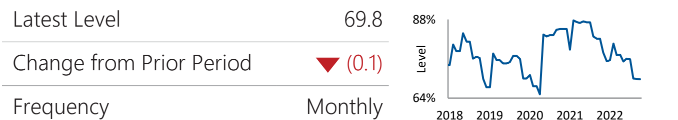


U.S. Equity—VIX — As of 12/31/2022

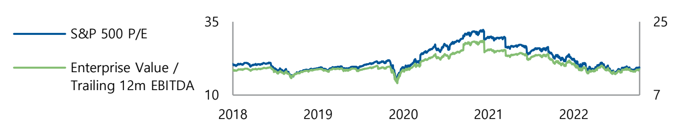
Latest Level	21.7
Change from Prior Period	▲ 1.1
Frequency	Monthly

S&P 500 Percentage Exceeding Earning Estimates — As of 12/31/2022

Latest Level	69.8
Change from Prior Period	▼ (0.1)
Frequency	Monthly

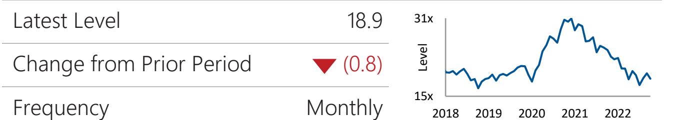


S&P 500 Historical Valuation Levels — As of 12/31/2022



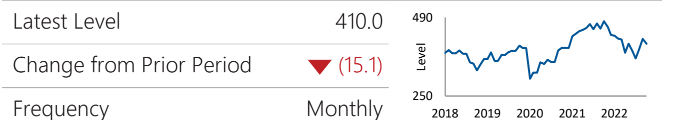
Trailing P/E on S&P 500 — As of 12/31/2022

Latest Level	18.9
Change from Prior Period	▼ (0.8)
Frequency	Monthly



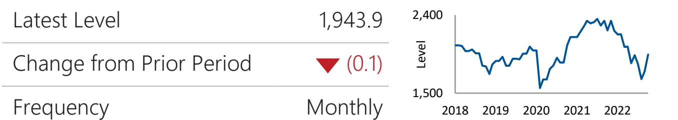
Equity Markets—Euro Stoxx — As of 12/31/2022

Latest Level	410.0
Change from Prior Period	▼ (15.1)
Frequency	Monthly



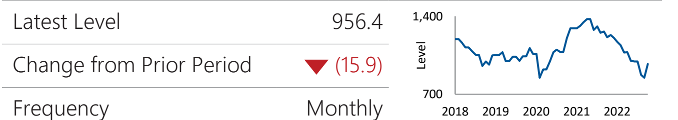
Equity Markets—MSCI EAFE — As of 12/31/2022

Latest Level	1,943.9
Change from Prior Period	▼ (0.1)
Frequency	Monthly

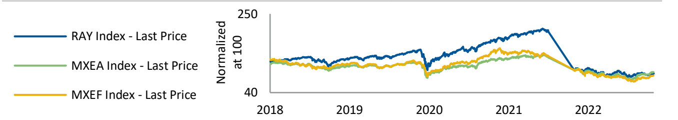


Equity Markets—MSCI EM — As of 12/31/2022

Latest Level	956.4
Change from Prior Period	▼ (15.9)
Frequency	Monthly



Russell 3000 & MSCI EAFE & MSCI EM — As of 12/31/2022



Note: All charts are based on a five-year trend.
Source: Bloomberg (All).

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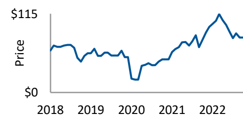
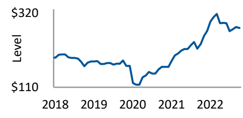
Economic Dashboard & Market Indices *(continued)*

Commodities

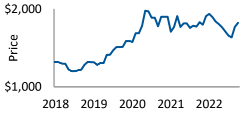
WTI Crude Oil Price	As of 12/30/2022
Latest Level	80.3
Change from Prior Period	▼ (0.3)
Frequency	Monthly



Reuters/Jefferies Commodity Index	As of 12/30/2022
Latest Level	277.7
Change from Prior Period	▼ (2.0)
Frequency	Monthly

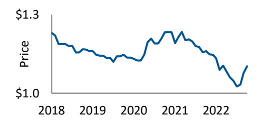


Gold	As of 12/30/2022
Latest Level	1,824.0
Change from Prior Period	▲ 55.5
Frequency	Monthly

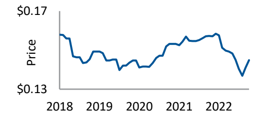


Foreign Exchange Rates

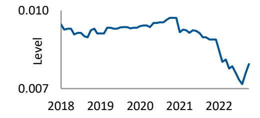
Euro Spot Rate vs. 1 USD	As of 12/30/2022
Latest Level	1.07
Change from Prior Period	▲ 0.03
Frequency	Monthly



Yuan Spot Rate vs. 1 USD	As of 12/30/2022
Latest Level	0.1450
Change from Prior Period	▲ 0.0039
Frequency	Monthly

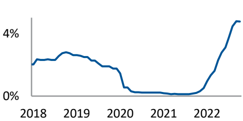


Yen Spot Rate vs. 1 USD	As of 12/30/2022
Latest Level	0.0076
Change from Prior Period	▲ 0.0004
Frequency	Monthly

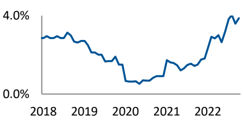


Rates

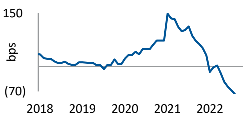
Libor 3M	As of 12/30/2022
Latest Level	4.77
Change from Prior Period	▼ (0.01)
Frequency	Monthly



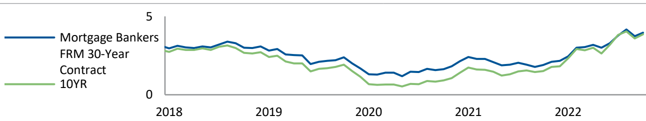
Treasury 10-Yr Yield	As of 12/30/2022
Latest Level	3.87
Change from Prior Period	▲ 0.27
Frequency	Monthly



Swaps 2-Yr vs. 10-Yr	As of 12/30/2022
Latest Level	(87.48)
Change from Prior Period	▲ 18.80
Frequency	Monthly



30-Yr Mortgage & 10-Yr Treasury As of 12/30/2022



Note: All charts are based on a five-year trend.
Source: Bloomberg (All).

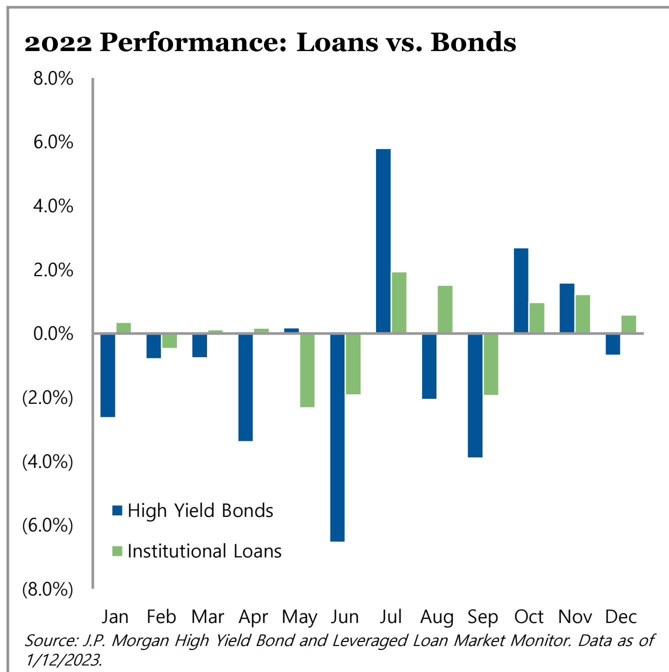
Performing Credit

Leveraged loan performance was strong in the fourth quarter, with positive returns posted for all three months of the period. The J.P. Morgan U.S. Leveraged Loan Index posted a quarterly return of 2.8%, bringing the full-year 2022 return to -1.1%. Loans clearly outperformed in comparison to other assets in 2022, with the S&P 500 down 18.1%, U.S. high yield down 11.2%, and U.S. investment grade down 15.3%. The J.P. Morgan U.S. Leveraged Loan Index ended 2022 with a weighted average price of $92.80 and spread of 656 basis points. The weighted average yield of the index was 10.8%, a near-record high in the post-global financial crisis (GFC) era, only exceeded by the 12.7% yield achieved during the depths of the COVID-19 crisis in March 2020. The average leveraged loan coupon also surpassed the average high yield coupon for the first time on record, with the average coupon for leveraged loans at 7.7%, versus 5.8% for high yield. In our view, the high average coupon for leveraged loans makes the asset class well-positioned for investor inflows as we start 2023.

Issuance in the U.S. remained muted in the fourth quarter, with the net supply of loans in full year 2022 totaling $163 billion. This trend of low issuance is echoed across other parts of the corporate bond market, including investment grade, high yield, and CLOs; for example, CLO net issuance volume totaled $124 billion in 2022. Additionally, net supply lagged the prior four-year average across the four sub-markets in corporate credit. It was estimated that the U.S. leveraged loan and high yield markets would shrink by 6% and 10%, respectively, in 2022, which is expected to provide technical support to the credit market against continued demand for yield.

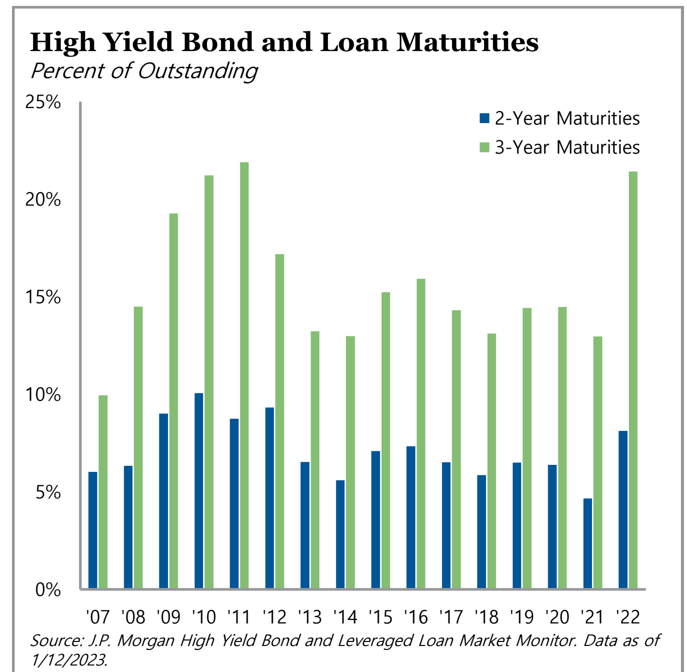
The J.P. Morgan European Leveraged Loan Index posted a 3.4% return in the fourth quarter – bringing the full-year return to -3.1% – and ended 2022 at a weighted average price of $91.20 and yield of 10.7%. We expect the pipeline of new loan issuance will grow in 2023, due to higher retail demand, a stabilization of interest rates, a pick-up in M&A, and declining corporate cash balances.

Turning to defaults, the default rate on U.S. leveraged loans – including distressed exchanges – was unchanged from the prior quarter and ended 2022 at 1.6%, below the J.P. Morgan forecast of 1.75%. Looking ahead, J.P. Morgan is forecasting a U.S. loan default rate of 3.5% in 2023 and 4.0% in 2024, hovering just above the long-term average of 3.1%. The European trailing 12-month default rate stood at 0.4% at year-end and is forecasted to be 3.0% in 2023 and 2.5% in 2024.



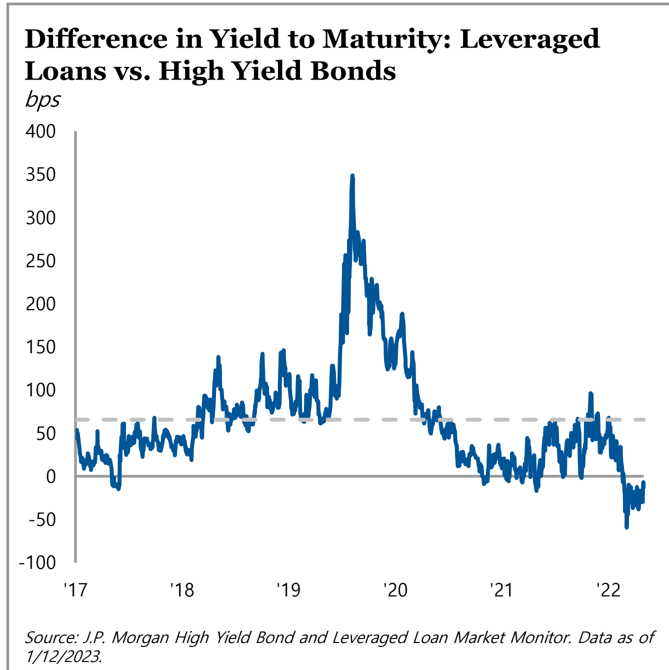
Source: J.P. Morgan High Yield Bond and Leveraged Loan Market Monitor. Data as of 1/12/2023.

Leveraged loans outperformed high yield bonds in 2022; the asset class benefited from its floating rate nature, strong CLO formation, and robust issuer fundamentals.

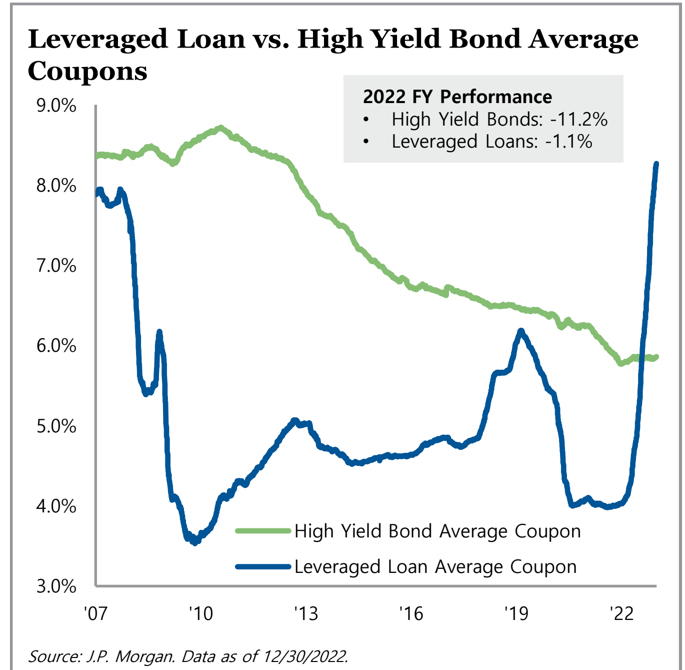


Source: J.P. Morgan High Yield Bond and Leveraged Loan Market Monitor. Data as of 1/12/2023.

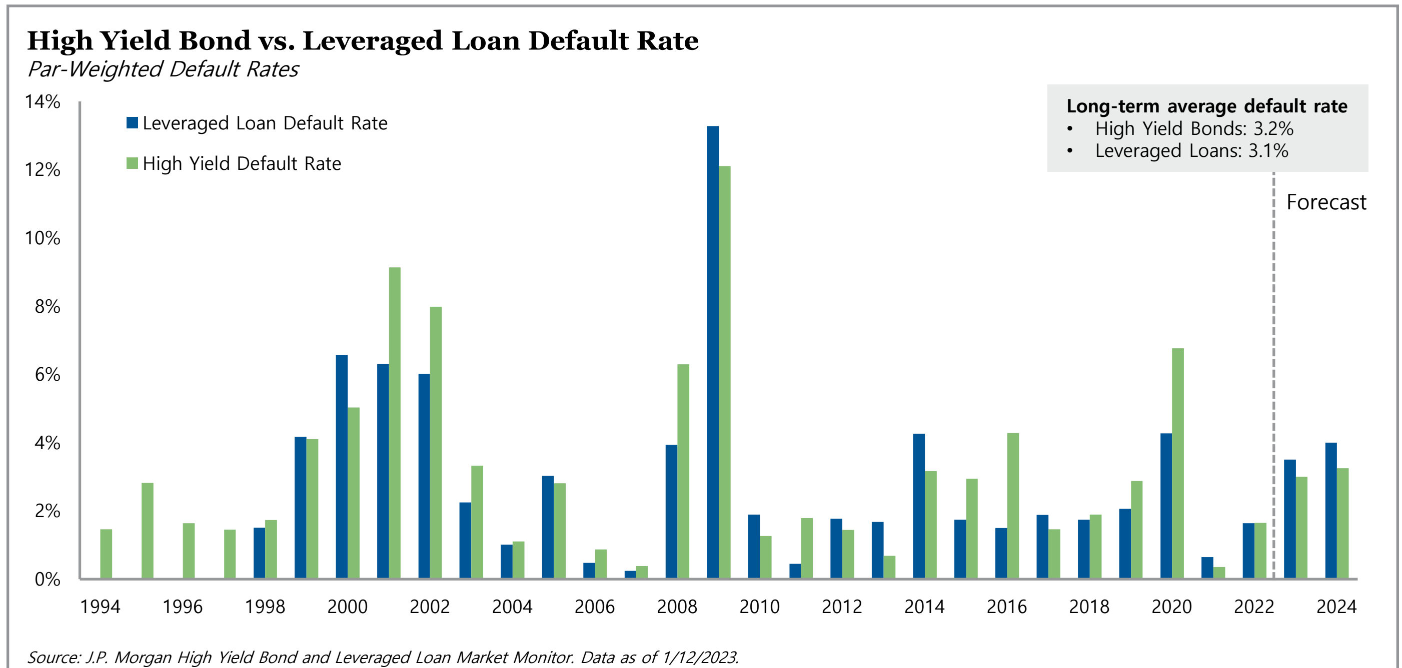
Near-term maturities are muted. We expect issuers will need to address their maturing liabilities starting in early 2024.



The average leveraged loan yield to maturity exceeded that of high yield bonds by 13 basis points, well above the historical average of -66 basis points.



The average coupon for leveraged loans exceeded that of high yield bonds for the first time on record.



We expect default rates to rise for both loans and bonds, as most sell-side analysts expect 2023 default rates to hover around their long-term averages.

Maureen D'Alleva
Portfolio Manager

For more information on Performing Credit, click here.

High Yield Credit

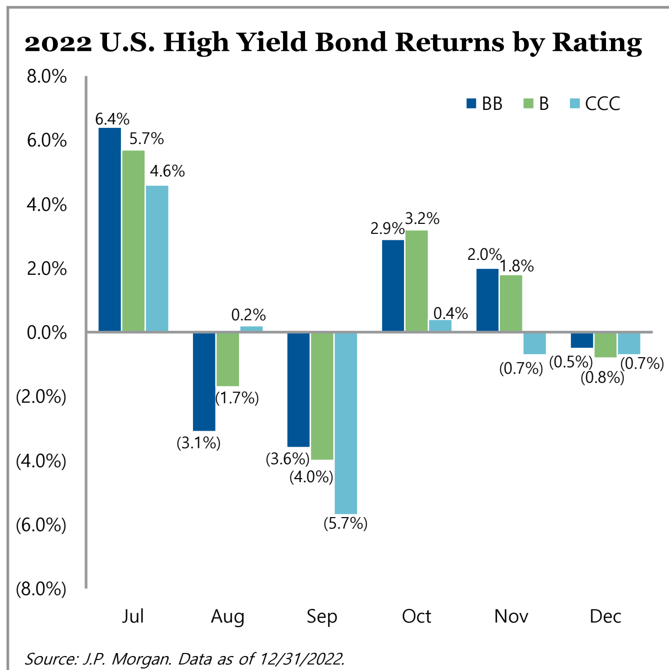
After three consecutive quarters of negative returns, U.S. high yield gained 3.6% in the fourth quarter of 2022. However, the full-year 2022 return of -10.6% was the second-worst calendar-year performance on record, trailing only the global financial crisis in 2008. Euro-currency high yield – comprised of euro- and sterling-denominated corporate bonds – rose 5.2% in the fourth quarter of 2022, which resulted in a full-year return of -9.8% for the asset class. Rising interest rates, inflation concerns, recession fears, and the Ukraine-Russia conflict, among other factors, challenged the market performance of nearly every asset class globally in 2022.

U.S. high yield bond spreads tightened 64 basis points in the fourth quarter, ending 2022 at 511 basis points, which was 135 basis points wider than the beginning of the year. In Europe, high yield spreads began 2022 at 384 basis points, rose sharply to 724 basis points by September, and then compressed 142 basis points during the fourth quarter to close the year at 582 basis points. Higher-quality bonds outperformed lower-rated bonds during the last quarter, as well as for the full year. In the U.S., BBs returned 4.5% in the fourth quarter and -9.5% for the trailing 12 months, while CCCs lost 0.9% last quarter and 19.5% in full year 2022. Similarly, in Europe, a -9.0% annual return for BBs bested the -15.2% one-year performance of CCCs. All U.S. sectors produced a negative return in 2022, ranging from -3.9% for energy to -19.7% for broadcasting.

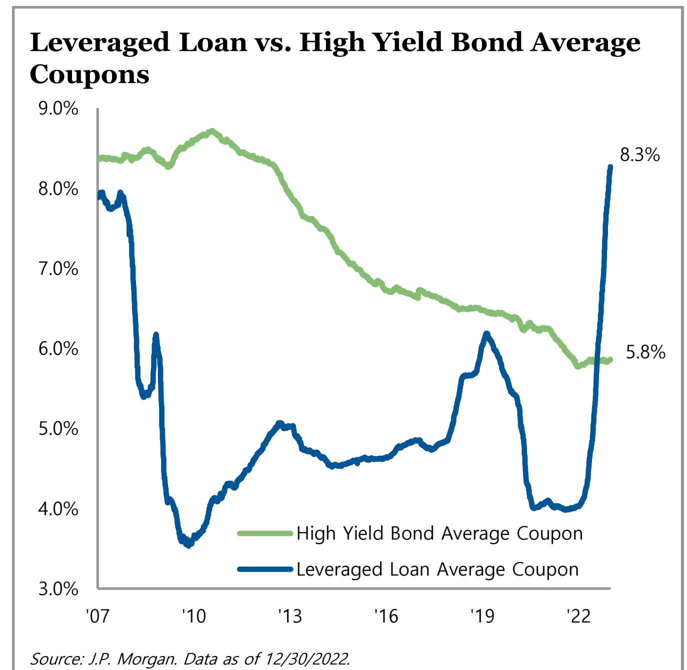
There were no defaults in the fourth quarter, though there were nine distressed exchanges, bringing the full-year total to 35 companies with either a default or distressed transaction. After ending 2021 at a record-low 0.3%, the U.S. high yield default rate rose to 1.65% by year-end 2022 – still well below the long-term historical average of 3.2%. In the fourth quarter, the European high yield market experienced its first two defaults since March, which brought the full-year total to six companies defaulting on a combined €2.0 billion of debt – equating to a default rate of only 0.4% for 2022.

A near doubling of yields over the course of the year – from 4.7% in December 2021 to 9.2% in December 2022 – subdued new issuance in the U.S. high yield bond market. Primary activity totaled just $106.5 billion in 2022, the lightest annual amount since 2008 and a decline of 78% from 2021's record volume. With yields rising over 500 basis points during 2022, high yield new issuance in Europe totaled just €8.8 billion in the fourth quarter and €31.8 billion for the full year, which was the lowest total since 2009.

Despite an estimated $7.3 billion of net capital inflows in the fourth quarter, U.S. high yield funds experienced a record $47 billion of net outflows in full year 2022. In Europe, although fourth quarter net inflows to high yield funds reached nearly €660 million, full-year net withdrawals were estimated at €12.3 billion.



CCC-rated bonds generally underperformed in both up and down markets in the second half of 2022.



Average yields on loans have benefitted from rising rates and exceeded those of bonds for the first time in more than 15 years.

Ryan Mollett
Global Head of Distressed & Corporate Special Situations

For more information on Distressed Debt, click here.

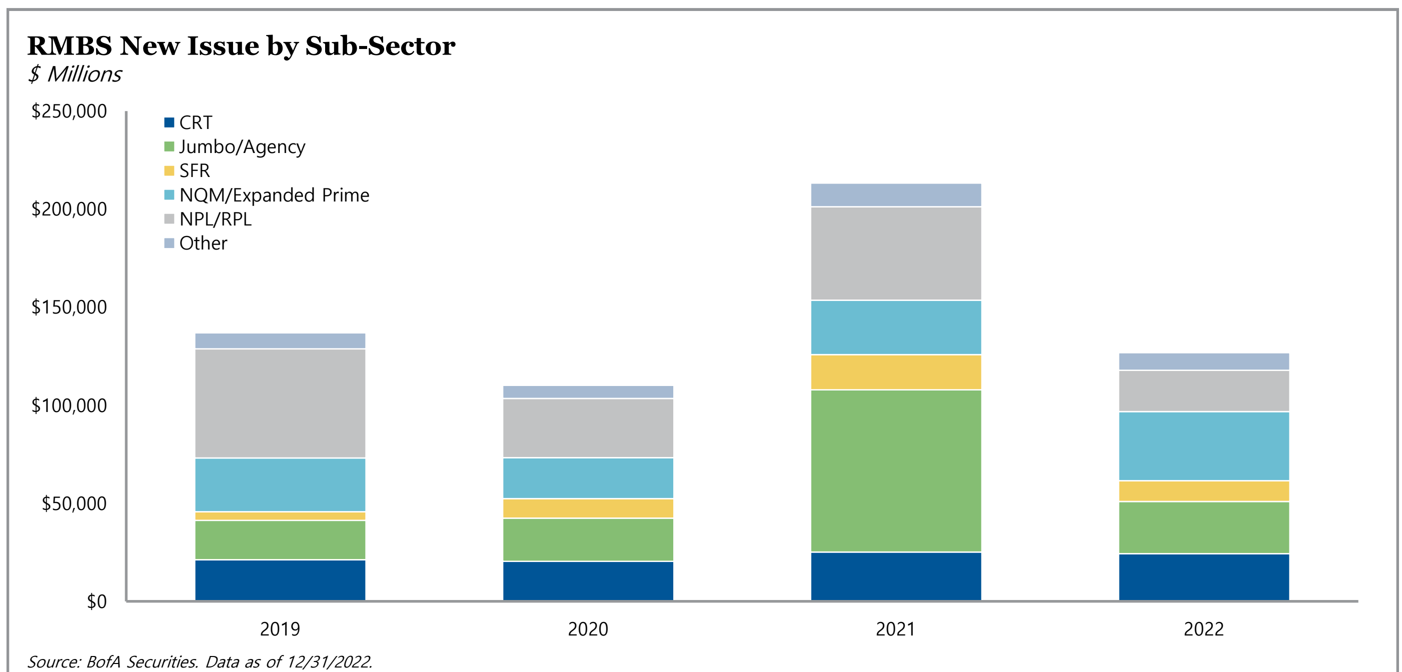
Structured Credit: RMBS

Spreads for securitized residential debt sectors were tighter into year-end. During the fourth quarter, credit risk transfer (CRT) tranches tightened by up to 30-60 basis points and senior non-qualified mortgage (NQM) spreads rallied 50-60 basis points, while BB-rated NQM were relatively unchanged. Despite the tightening, CRT and NQM spreads ended 2022 materially wider than year-end 2021. Deep credit CRT tranches were up to 500-600 basis points wider at year-end 2022, while the middle of the stack was approximately 300-350 basis points wider. Senior NQM tranches were more than 100 basis points wider, and BB-rated NQM were around 370 basis points wider year-over-year, though with hampered price discovery due to limited new and secondary supply.

Quarterly new issuance fell sharply to $5.4 billion, down from $26 billion in the third quarter and $64 billion a year ago. That activity brought full-year 2022 issuance – comprised of NQM, jumbo/agency-eligible, and CRT – to $127 billion, down 40% year-over-year. Base effects are partly at play, as 2021 metrics included postponed issuances from 2020, and mortgage origination volume in 2021 benefitted from a large refinancing wave. The decline in originations in 2022 contributed to less securitization activity, which was most apparent in jumbo/agency-eligible – down 66% year-over-year.

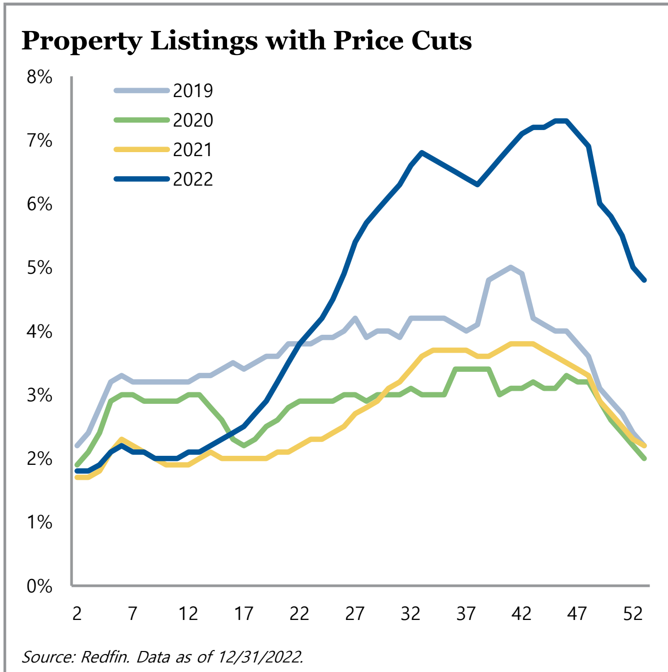
Negative monthly home price readings have persisted according to the most recent data; the October reading of the S&P/CoreLogic Case-Shiller Index was down 0.53% on a non-seasonally adjusted basis, bringing year-to-date national home price appreciation to approximately 7%. That October reading marked the fourth consecutive month of falling prices, totaling around -3%, reversing some of the strong gains made in the first half of 2022. We expect home prices will continue falling on reduced affordability and increasing supply in certain areas, though overall supply still remains constrained. Our underwriting currently assumes national home prices will record a peak-to-trough decline of 20% and gradually recover to a long-term rate of +3% thereafter.

Housing activity declined in 2022, with fewer new listings and pending sales, and buyers were slower to transact as the year continued. By year-end, only 28% of pending sales were off the market within two weeks, down from over 50% in the first quarter and 32-35% at the end of 2020 and 2021. Home ownership affordability, which set a new low in June 2022, was relatively unchanged as of the latest data from September. Meanwhile, listing price trends were mixed. After sustaining levels near 7%, the percentage of active listings with price cuts fell inside of 5%, though this coincided with an increase in days on market (DOM), which rose to 40 days as of year-end 2022. This DOM figure exceeded the year-end 2020 and 2021 levels of approximately 30-35 days but remained below 2019's 53 days. Additionally, the average sale-to-list ratio continued to decline and ended 2022 at 0.98x, or a 2% discount to list.

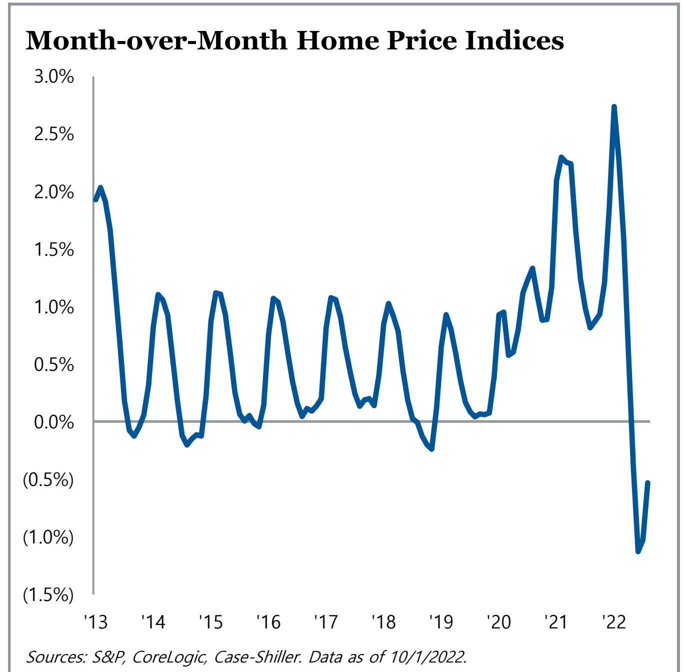


RMBS new issuance fell 41% in 2022 amid higher mortgage rates and wider spreads.

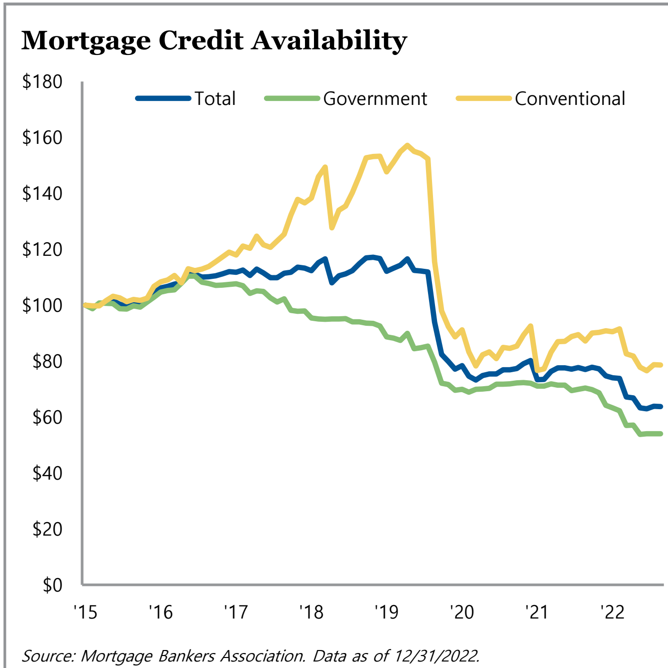
Structured Credit: RMBS *(continued)*



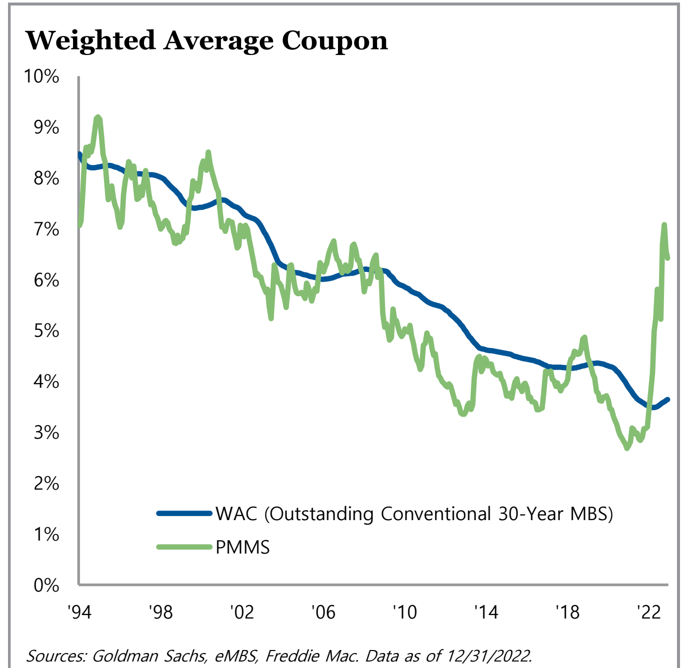
The percentage of active listings with price drops remained elevated.



Monthly changes in home prices continued to decline.



Mortgage underwriting remained significantly tighter than pre-pandemic.



Prevailing rates are much higher than the note rate on existing mortgages.

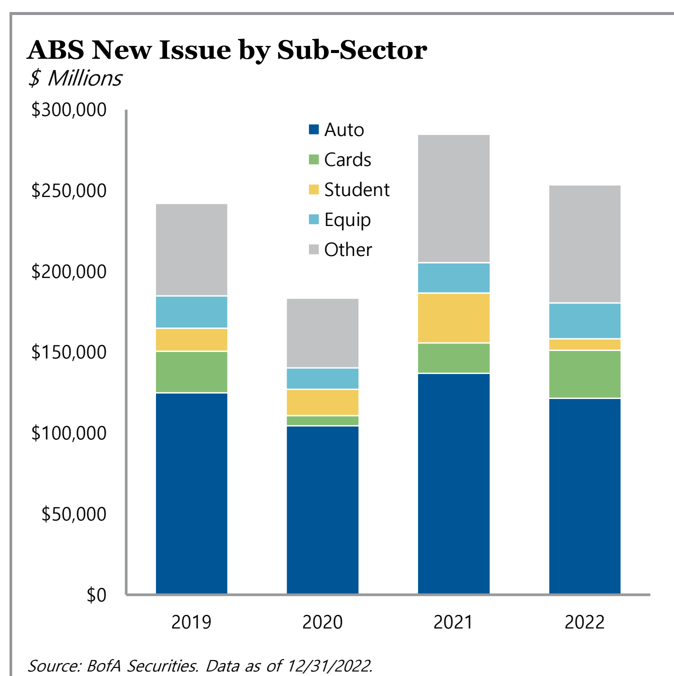
Structured Credit: ABS

Spreads for securitized ABS sectors were mixed during the fourth quarter. BBB-rated credit card ABS spreads were generally 15-30 basis points wider at quarter-end, while BBB-rated private credit student loan ABS tightened by 10-20 basis points. On an annual basis, ABS generally finished 2022 at materially wider levels, reflecting varied collateral performance across asset classes and, at times, challenging liquidity environments. Subordinate credit card and student loan ABS tranches were approximately 75-100 basis points wider in 2022. BB-rated subprime auto ABS finished the year more than 300 basis points wider, closing in on a spread of 600+ basis points at year-end; meanwhile, BB-rated consumer loans were over 450 basis points wider, reaching a spread of 800+ basis points in December.

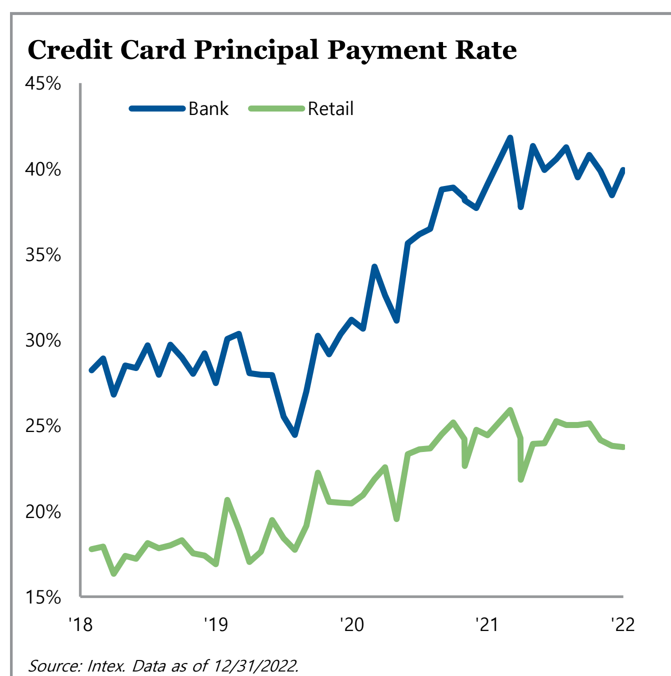
Primary ABS activity totaled $50 billion in the fourth quarter, a decline of 12% quarter-over-quarter and down 26% year-over-year. The decline was partly due to lower auto ABS volume, as higher lending rates and wider securitization spreads weighed on issuance activity. Auto ABS deals that were postponed in 2022 may resurface in the securitization pipeline for 2023. Full-year 2022 ABS activity totaled $253 billion – an 11% decline from 2021, primarily due to lower student loan ABS activity.

Consumer debt performance data remains varied. Weakness in unsecured loans is perhaps most visible in delinquencies, which were above pre-pandemic levels for two prominent platforms, while prepayments continued to fall. This performance is mirrored by subprime auto loans, though some improvement may emerge with the upcoming tax refund season. Credit cards remain stable on payment rates, low front-end delinquencies, and high gross yields. Student loan prepayments continued to slow, but there has been no meaningful degradation as defaults, front-end delinquencies, and forbearance remain range bound. Legacy private credit student loans continued to generate ample recovery proceeds, which have more than offset new defaults, and have seen limited front-end delinquencies.

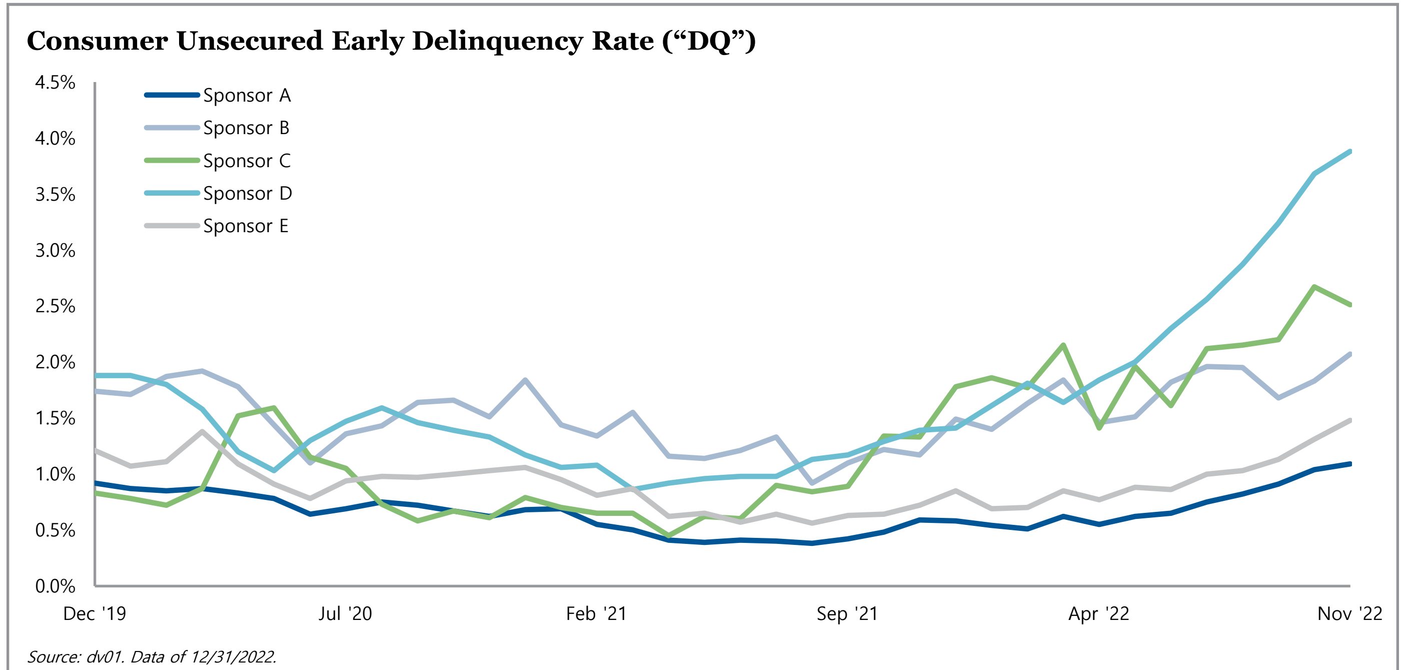
In November, the White House extended the student loan payment moratorium until June 30, 2023, as it contends with state challenges to its student loan forgiveness program. The moratorium has provided a tailwind for consumer assets, as borrowers have been able to forgo an average payment of $460 per month. A group of six states challenged the forgiveness program, arguing it causes them economic harm due to the loss of tax revenue and profits from relationships with student loan servicers. Another group contended that the administration does not have the power to create the program. In both cases, the administration has argued it had authority to create the program under the HEROES Act of 2003, which allows the U.S. Secretary of Education to grant relief during national emergencies, such as the COVID-19 pandemic. The Supreme Court will hear oral arguments in February, with a decision expected around June.



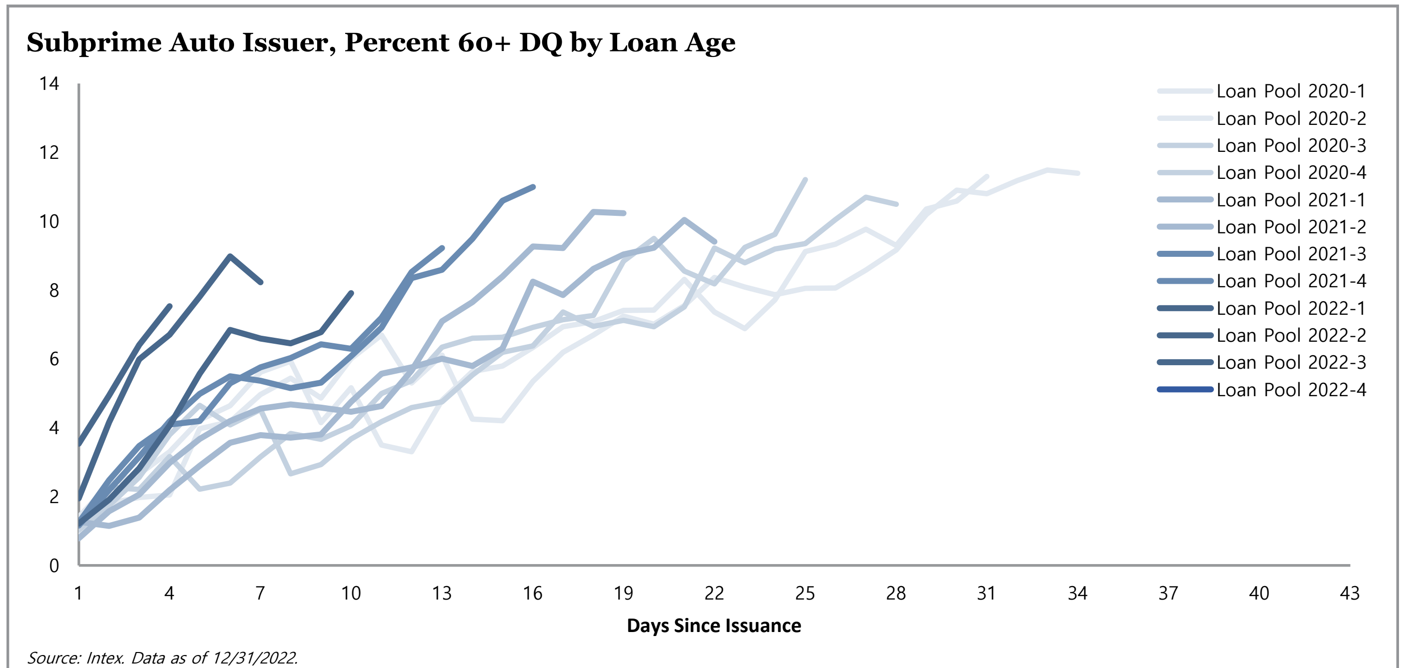
Full-year 2022 ABS new issuance was 11% lower year-over-year.



Credit card principal payment rates remained stable.



Unsecured consumer loan performance continued to weaken.



Subprime auto ABS have sequentially deteriorated.

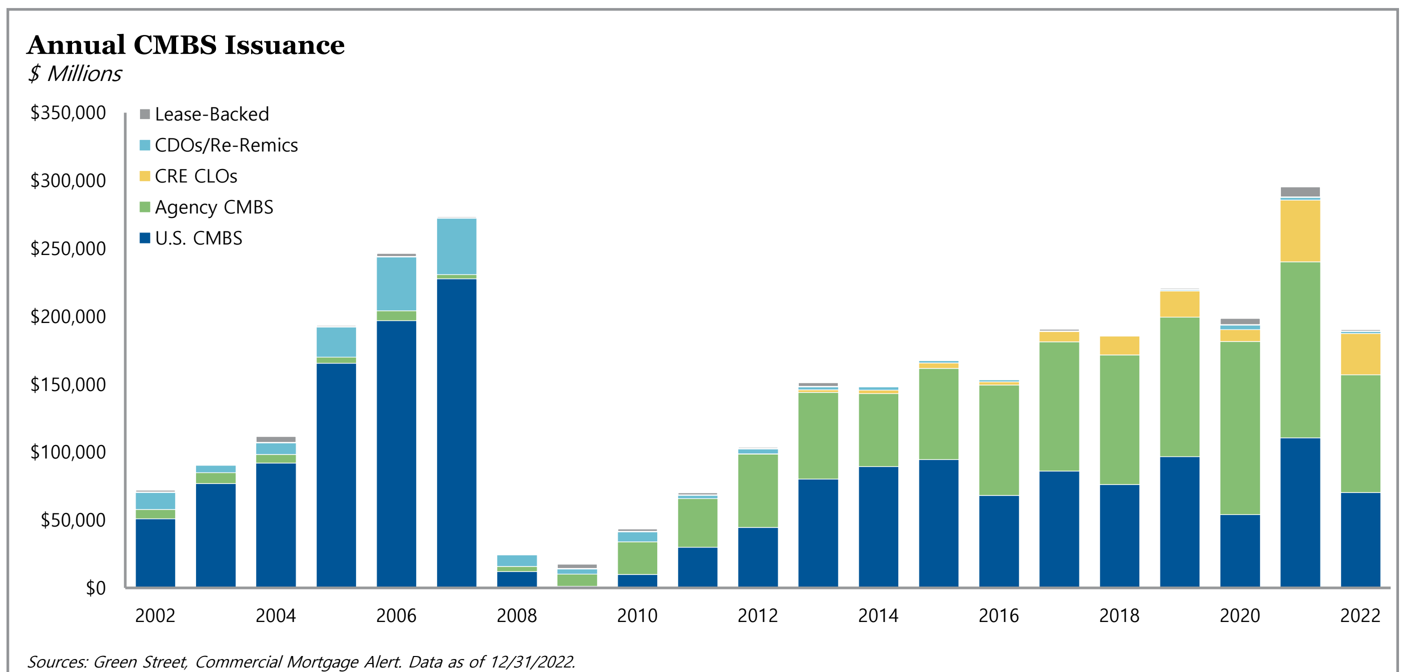
Structured Credit: CMBS

The themes that weighed on CMBS pricing all year accelerated in the fourth quarter, with the Fed's continued rate increases having both technical and fundamental impacts. From a technical standpoint, fund flows away from the asset class resulted in significant selling pressure, primarily from the money manager community. These sales took place during a period in which dealers and hedge funds – typically reliable sources of liquidity – were reluctant to add exposure. The impact of these dynamics was most pronounced in the mezzanine portion of the capital stack. Conduit single-A, BBB, and BBB- bond spreads all widened by approximately 125 basis points during the period. On a positive note, the higher rate environment has stifled new loan origination and new issue supply. Although single-borrower and commercial real estate (CRE) CLO deals now make up a larger portion of securitized CRE debt issuance, conduit volumes in 2022 were at the lowest level since 2012.

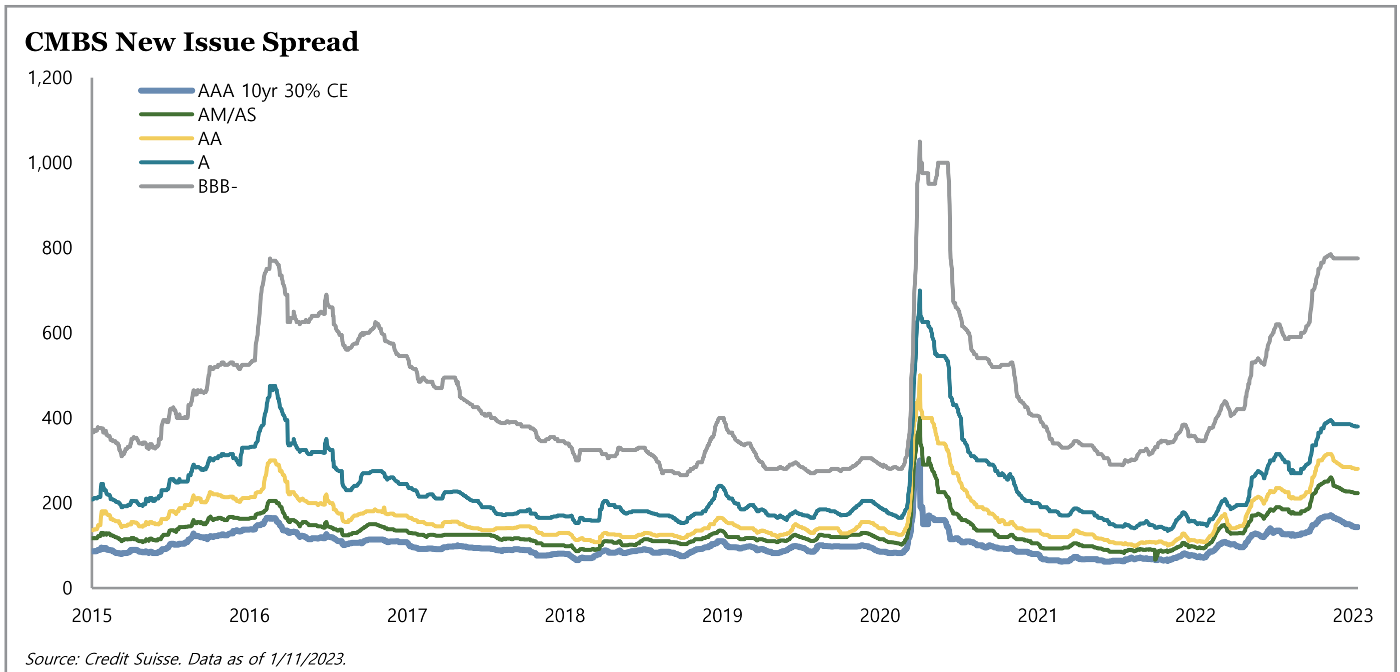
Higher rates are increasing financing costs on floating rate deals and making extensions more expensive for borrowers. With limited real estate transactions for comparison, it's difficult to pinpoint current capitalization rates; however, the significant increase in the risk-free rate is pushing cap rates higher, and without meaningful property-level cash flow growth, real estate prices must move lower. This is reflected in public REIT prices, with the MSCI U.S. REIT Index – a broadly diversified REIT index – down 24.5% in 2022.

Multifamily and industrial assets are well-positioned to continue pushing cash flows higher, though these property types have some of the lowest starting cap rates and therefore the smallest margins for error. At the other end of the spectrum, office properties continue to struggle with tepid demand, as companies try to optimize their space needs against developing remote work trends and the potential for a broader economic slowdown. Well-located Class A office properties with full suites of desirable amenities are weathering current conditions better than others. In retail, holiday sales outpaced 2021, and new supply remains limited. Retailers are making progress in determining the right physical presence to maximize omni-channel sales and most have corrected the right sides of their balance sheets. Finally, in the hotel sector, 2022 was another year of recovery. In December, overall U.S. occupancy levels were consistent with 2019, and average daily rates were up approximately 15%. Revenue per available room (RevPAR) levels for economy and mid-scale hotels were 20% higher than in 2019, while levels for luxury, upper upscale, and upscale hotels were up only 0-9%.

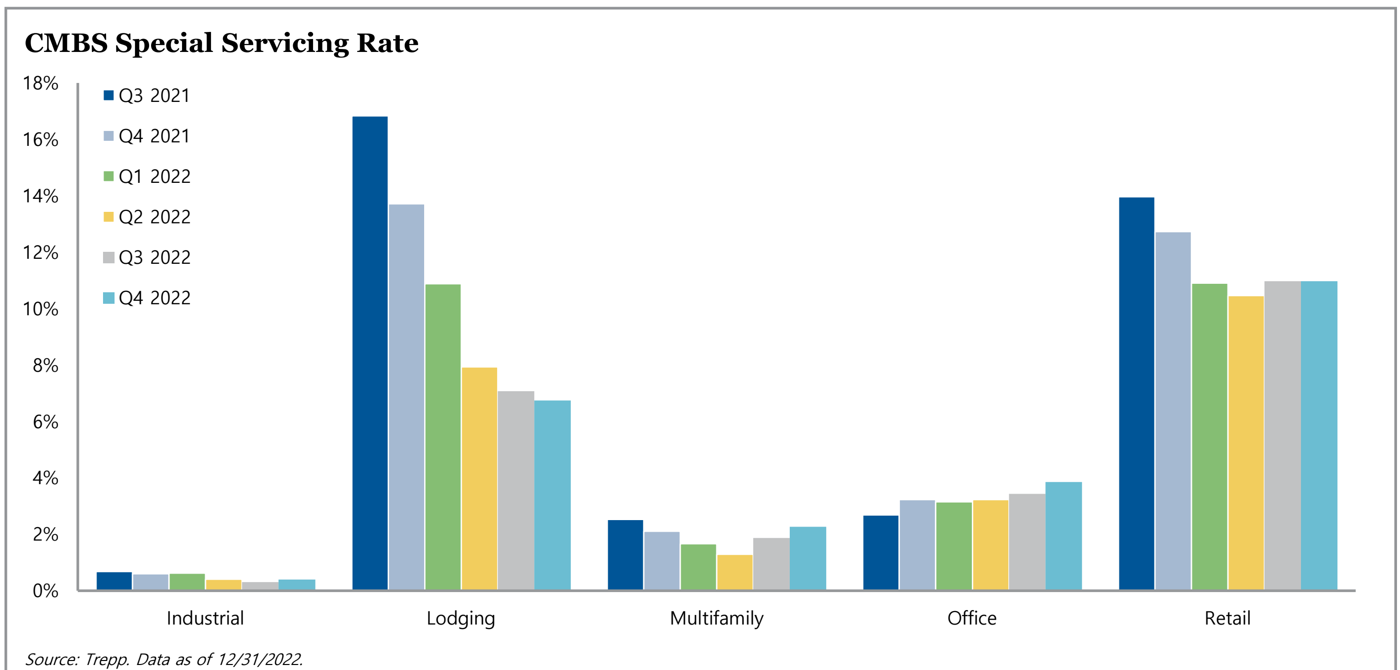
The overall CMBS delinquency rate increased from 2.92% to 3.04% during the fourth quarter. While this was a small degradation in performance, it reversed the positive trend that had been in place since the second half of 2020. Continued improvements in the lodging sector were more than offset by increased delinquencies in the apartment sector.



A strong first half and continued agency demand kept annual issuance volumes respectable in 2022, but market volatility and higher interest rates are expected to keep deal flow slow in 2023.



CMBS spreads continued to widen in the fourth quarter, particularly in the credit sensitive portions of the capital structure.



The percentage of CMBS loans in special servicing increased by 24 basis points in the fourth quarter, reversing a trend of declining rates that has been in place since the second half of 2020.

TJ Durkin
Head of Structured Credit

Yong Joe
Co-Portfolio Manager, Structured Credit

Andrew Solomon
Portfolio Manager, Commercial Real Estate Debt

For more information on Structured Credit, click here.

Middle Market Direct Lending

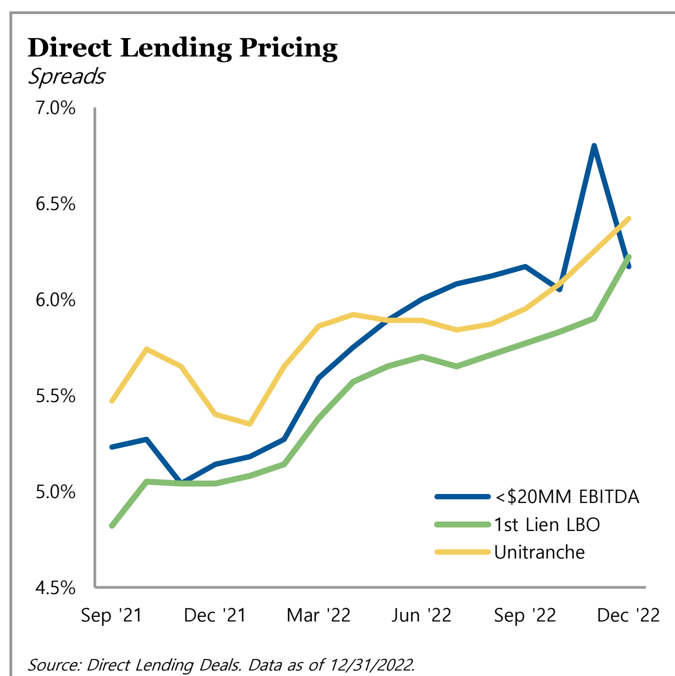
U.S. middle market direct lending origination volume decreased during the fourth quarter, totaling $28 billion. While this represented a decline of approximately 30% quarter-over-quarter, full-year 2022 volume increased nearly 32% year-over-year. The full-year increase was driven by two main factors: (1) jumbo loans accounting for a larger share of volumes and (2) private markets remaining active while volatility essentially shut down the syndicated loan and high yield markets. In the fourth quarter, LBO activity continued to represent the majority of capital deployed at 65% of total volume, while LBOs comprised 35-54% of overall activity in the preceding three quarters.

The direct lending environment today is offering arguably the most favorable risk-adjusted terms in nearly a decade; elevated base rates and spreads as well as wider original issue discounts (OIDs) have driven yields to nearly 12%, leverage is generally lower, and strong lender protections are prevalent. Average yields in the lower middle market (LMM) reached 11.6% in December, a 520-basis point increase from year-end 2021. In the broadly syndicated loan (BSL) market, single-B loan yields averaged 9.8% in December, down 40 basis points month-over-month and up 500 basis points year-over-year. On average, spreads widened across the board in 2022 and are expected to continue their trajectory into 2023. In December, spreads for LMM loans averaged 617 basis points, up 103 basis points year-over-year, and unitranche loan spreads reached a two-year high at 642 basis points – up 102 basis points year-over-year.

Leverage profiles continued to decrease broadly across market segments in the fourth quarter; at 34%, the share of mid-market sponsored deals with total leverage below 4x EBITDA increased to the highest level since the third quarter of 2020. LMM total debt multiples declined to 3.8x EBITDA as of year-end 2022, down from 5.7x at the beginning of the year, while larger market segments dropped from 4.7x to 4.3x over the course of last year.

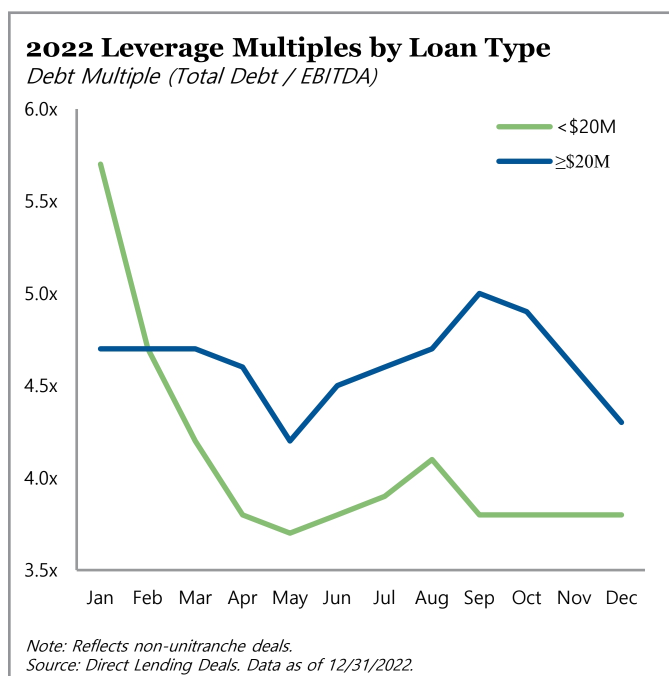
The annualized private credit default rate increased for the first time in 18 months in the third quarter of 2022, rising 38 basis points to 1.56%. However, quarterly default rate data has been trending downward since the 8.1% peak witnessed in the second quarter of 2020. Companies with greater than $50 million in EBITDA accounted for most of the third quarter default activity, implying that lender protections – which are more prevalent in the LMM – are supportive.

Fundraising activity in the U.S. direct lending market slowed in 2022, with $37 billion raised by North American managers focused on senior debt and unitranche loans. However, 2021 was a banner year, with $73 billion raised for those same strategies. Although short of 2021 levels, 2022 fundraising beat the five-year average of $27 billion, which suggests last year was a period of normalization. In addition, the number of funds in the market dropped approximately 30% in 2022, with the average fund size decreasing 28%.



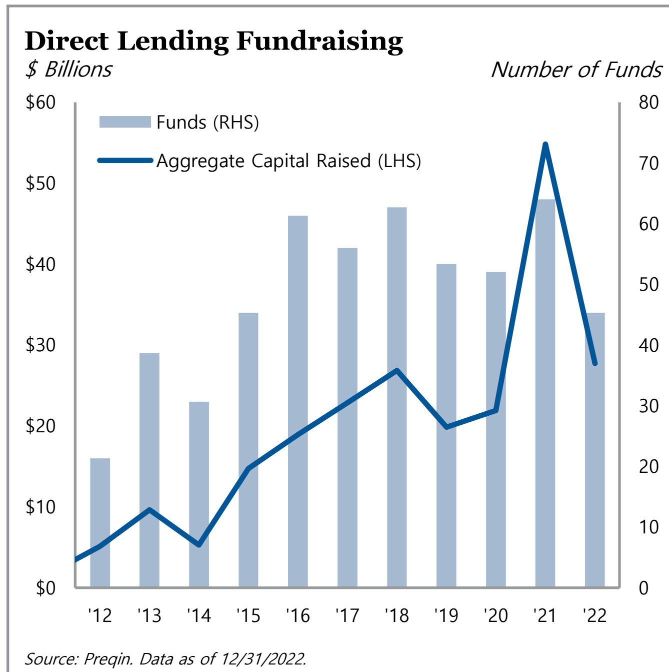
Source: Direct Lending Deals. Data as of 12/31/2022.

Spread increases were observed across the board in 2022, driving all-in yields to nearly 12%.

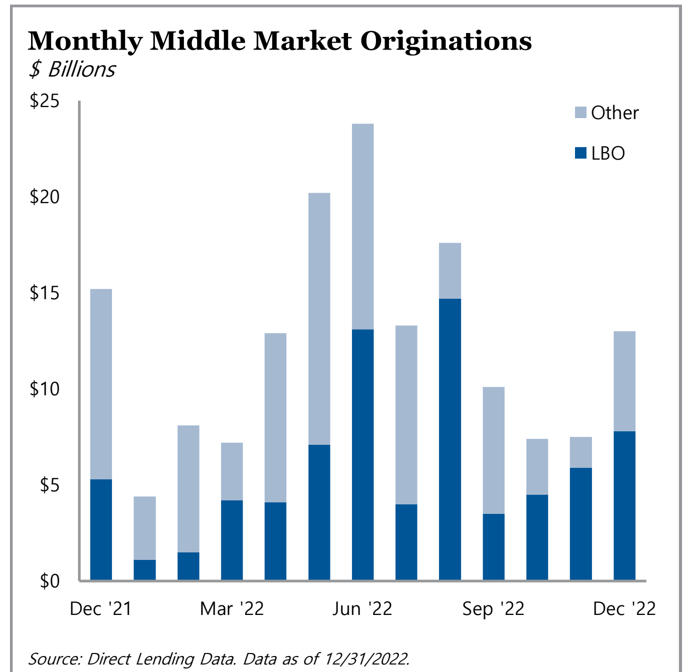


Note: Reflects non-unitranche deals.
Source: Direct Lending Deals. Data as of 12/31/2022.

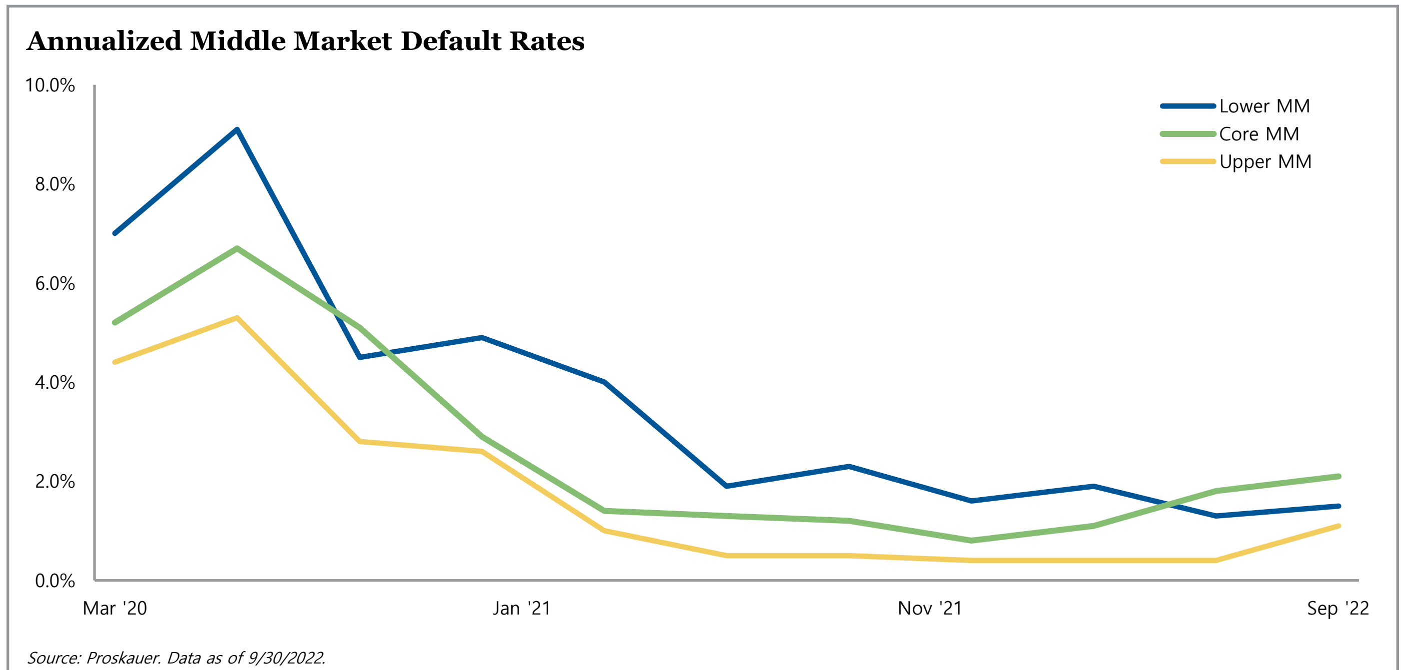
Leverage levels moved lower across all structures in 2022, with the lower middle market continuing to have the lowest leverage at 3.8x EBITDA.



While 2022 fundraising fell short of 2021 levels, it remained steady and above the five-year average.



While origination volume declined in Q4 2022, full-year volume increased year-over-year, showing the resilience of the private markets.



The annualized private credit default rate increased for the first time in 18 months; however, default rates have been trending downward since Q1 2020 and remain muted.

Trevor Clark
Portfolio Manager

For more information on Middle Market Direct Lending, click here.

Merger Arbitrage

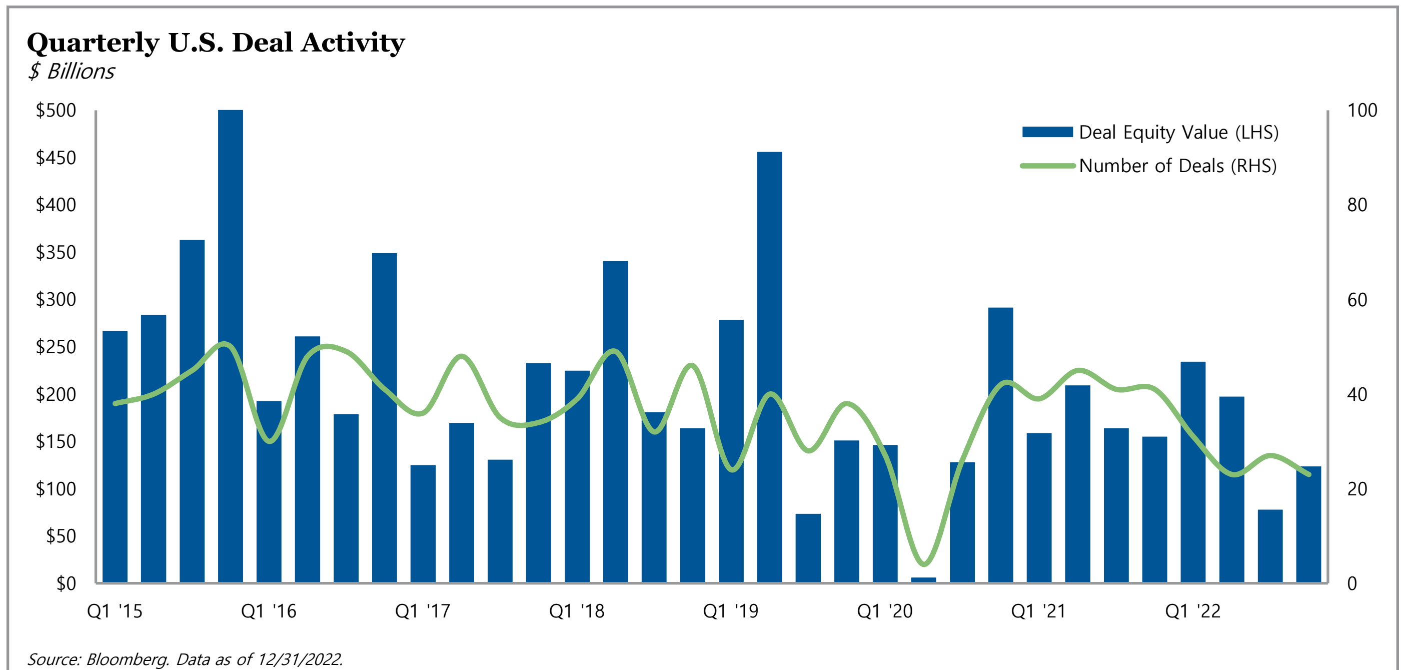
For full year 2022, U.S. M&A volume was down slightly but finished in line with the 10-year average. The year was a tale of two halves, with the first six months of 2022 ranking as the fifth-best first half since 2000, while the last six months of the year ranked as the ninth-weakest second half. The slowdown in the second half was due to an increasingly challenging macroeconomic environment, rapidly rising inflation, increasing fears of a recession, and the sharpest rise in interest rates since the early 1980s. At year-end, the investable deal universe had an average adjusted annualized spread of 11.3%, aggregate deal value declined to $330 billion, and the total arbitrage profit pool stood at $47.9 billion.

In the fourth quarter, deal volume increased 12% quarter-over-quarter as U.S. inflation data continued to cool off, drawing buyers back to the M&A table. Three strategic deals led the quarter, all of which were larger than $17 billion in equity value. While spreads finished the period flat, there were plenty of trading opportunities along the way.

The private equity space remained extremely active in 2022, with full-year deal volume reaching the highest level since 2007. Despite a challenging financing market, PE sponsors accounted for nearly 35% of U.S. M&A deals and over 27% of total volume last year. Sponsors announced eight deals at equity values greater than $10 billion – leaning heavily on direct lenders for acquisition financing – and proved to be steady buyers despite the market turmoil.

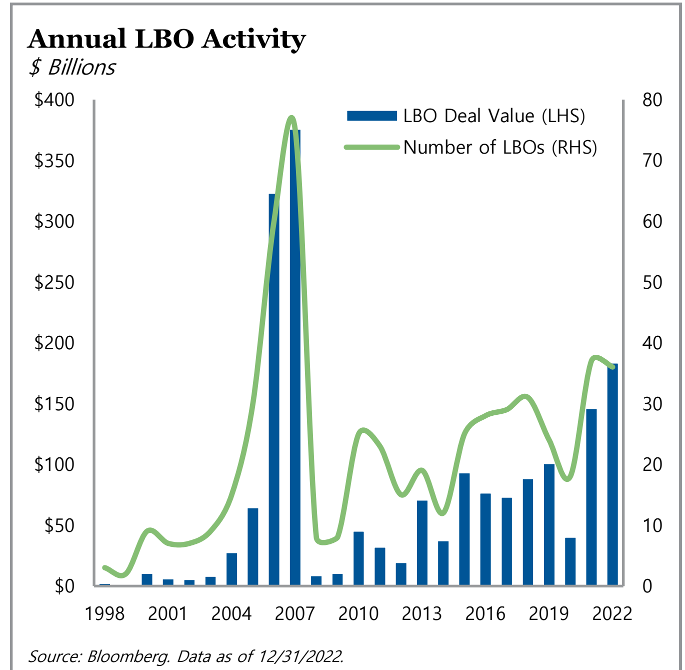
Antitrust continued to be a theme of focus, as regulatory agencies started scrutinizing and challenging deals based on a variety of novel theories of harm in 2022; this led to longer transaction review processes, impacted trading and investing opportunities, and resulted in a string of court losses in the U.S. and Canada. Thus far, courts have relied on current laws governing M&A, well-established precedents, and commercial realities when rejecting these antitrust challenges. However, it appears these recent outcomes have not discouraged antitrust agencies' ongoing efforts to expand the boundaries of their enforcement powers.

Turning to the M&A outlook for 2023, although many of the anticipated headwinds will sound familiar from last year, the current market environment is very different from that of early 2022. Slower projected economic growth, increased financing costs, and heightened regulatory scrutiny will continue to be headwinds for M&A in 2023. However, with valuations being repriced, S&P 500 companies sitting on $1.7 trillion of cash, and global private equity funds holding $2.5 trillion of dry powder, we believe opportunistic deals will begin to present themselves. Additionally, as they face an increased cost of capital and growing threat of activism, company management teams may turn to M&A to create shareholder value.

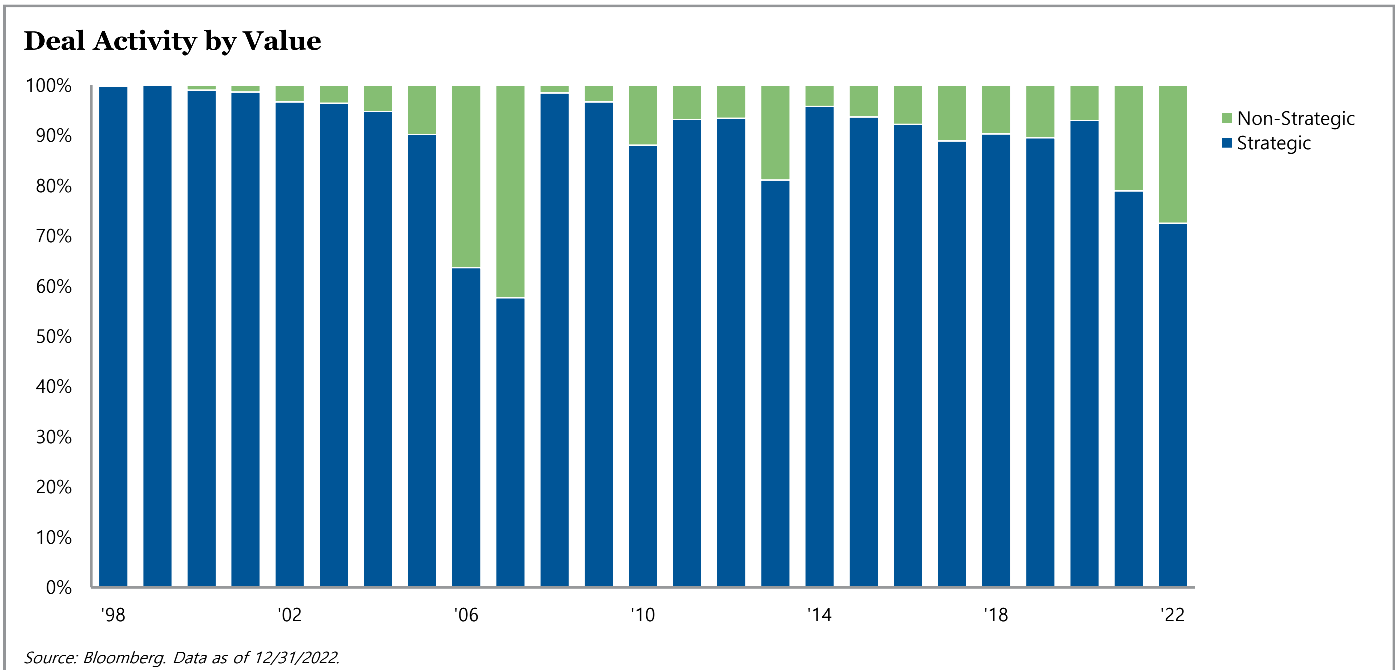


M&A slowed in the second half of 2022, due to credit markets being dislocated.

2022 was another strong year for U.S. M&A volumes despite equity and credit market volatility.



Record dry power drove financial sponsor activity to its highest post-GFC level.



In 2022, financial sponsors accounted for the largest percentage of total deal volume since 2007 – a post-GFC high.

Mark Wojtusiak
Head of Merger Arbitrage

For more information on Merger Arbitrage, click here.

Convertible Arbitrage

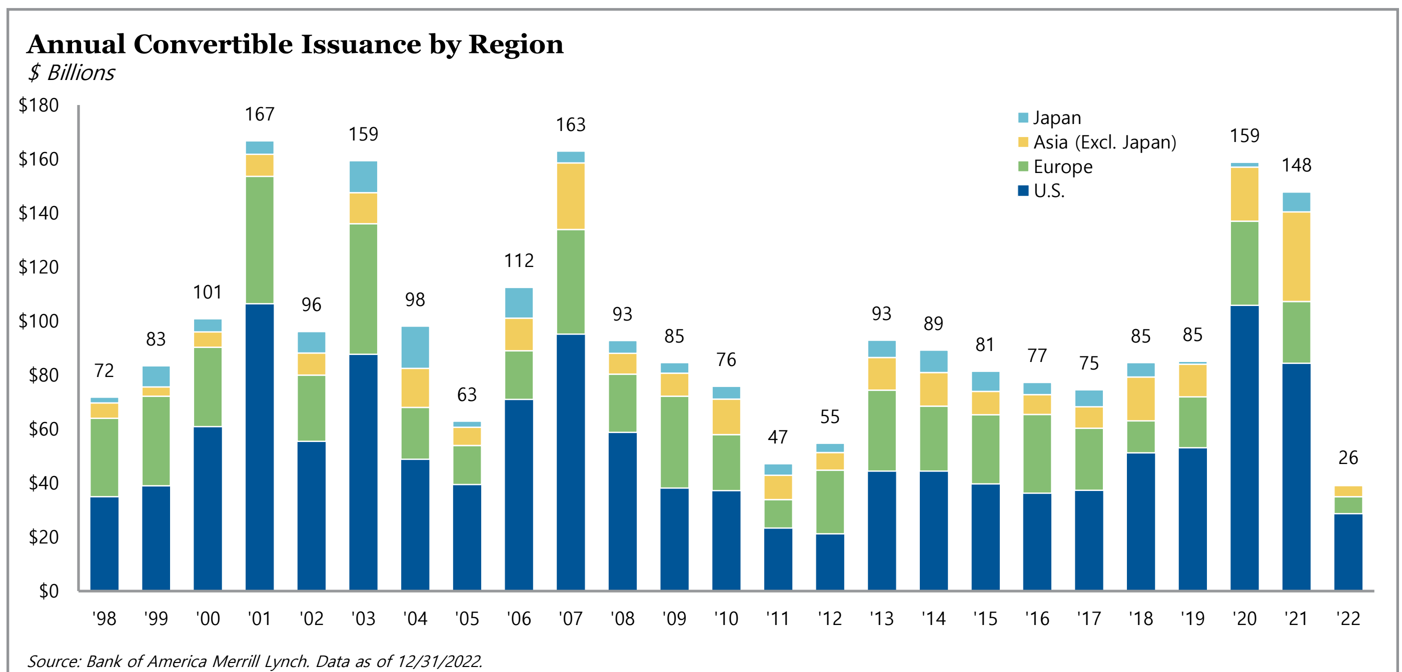
Global equity markets recovered some lost ground in the fourth quarter, gaining 7.11%. This was mostly driven by signs of softening inflation in the U.S. and Europe and corresponding expectations that central banks may slow their pace of monetary tightening. Nonetheless, 2022 went down as the worst year for equities since 2008, with global markets losing 17.4%. Similar to equities, corporate credit and sovereign bonds had broadly positive fourth quarters but suffered significant annual losses.

On an outright basis, convertible bonds again underperformed in the fourth quarter. The ICE BofA Global 300 Convertible Index gained 2.5%, reducing the full-year loss to -14.94%. Convertible arbitrage strategies returned 2.43% in the fourth quarter, resulting in a similarly disappointing -12.5% annual return. As hedging strategies failed and valuations crunched, cutting exposure to the asset class proved to be the only effective risk-reduction approach, which positioned asset managers that had the ability to move into cash and cash equivalents to outperform.

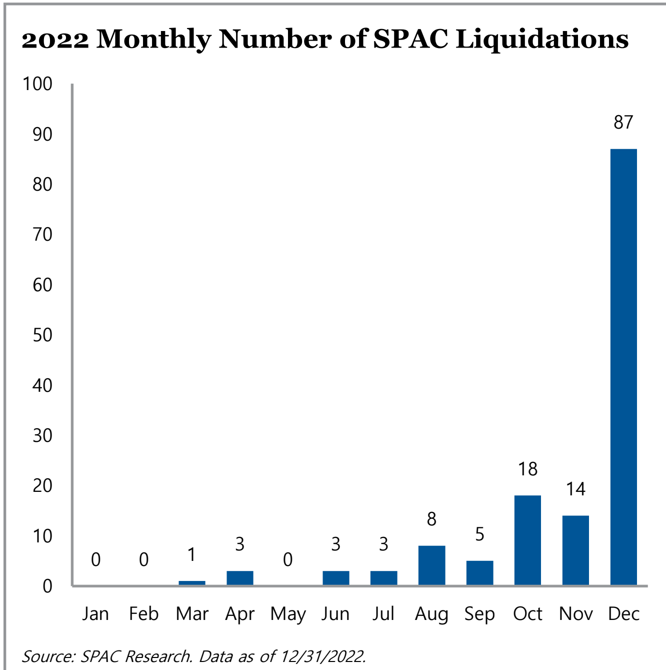
The global primary market for convertible bonds saw total deal volume of $13.4 billion in the final quarter of the year, bringing the 2022 total to just below $40 billion – a significant decline from the strong issuance recorded in 2021 and 2020. However, we expect there will be a noteworthy recovery in primary market activity in 2023. An environment of higher rates, wider credit spreads, elevated volatility, and depressed share prices will make convertible bonds an attractive alternative for corporates seeking to address their financing needs.

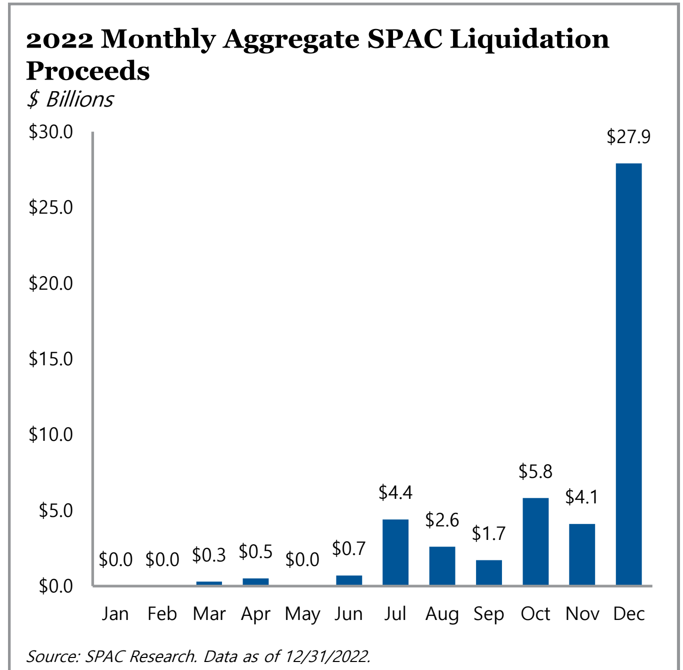
Overall, the global SPAC market remained quiet in the fourth quarter. Primary market and de-SPAC activity continued to be very subdued as the product returns to its rightful niche status. In the U.S., we saw sponsors rush to liquidate structures early and ahead of year-end in an effort to protect themselves from potentially adverse changes in the tax code. In Europe, the vast majority of SPACs face their business combination deadlines within the next six months.

We believe hawkish central banks fighting elevated inflation amid low economic growth will remain the main theme of focus for markets in 2023. While less experienced convertible market participants may find it difficult to operate in an unfamiliar environment that now has a multitude of moving parts, we believe established participants in the space that have worked through past economic cycles will be well positioned to both capitalize on any dislocations that may arise and identify attractive risk/reward opportunities while the SPAC market is releasing capital.

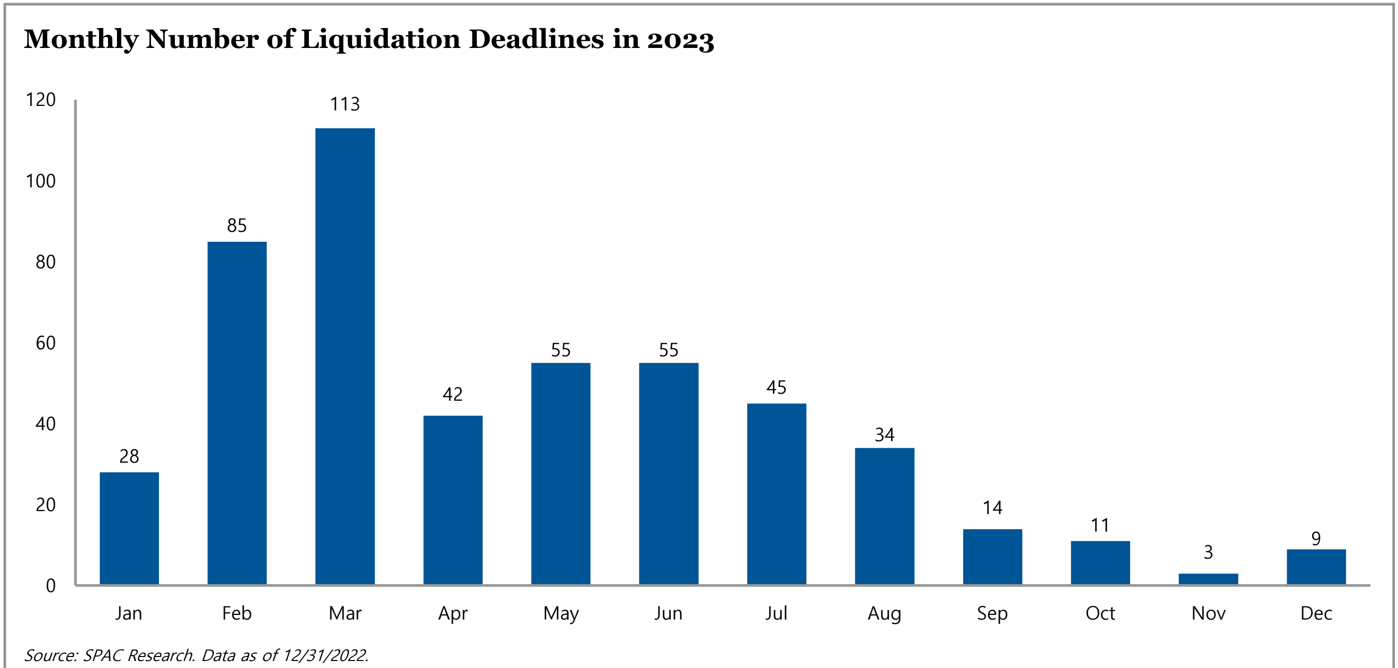


Convertible primary activity in 2022 fell well short of the record issuance levels seen in recent years.

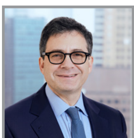




A significant number of SPACs returned cash to shareholders early, as sponsors feared potentially adverse changes in the tax code.



A substantial portion of the existing SPAC universe will disappear in the first half of 2023.



Gary Wolf
Head of Convertible Arbitrage

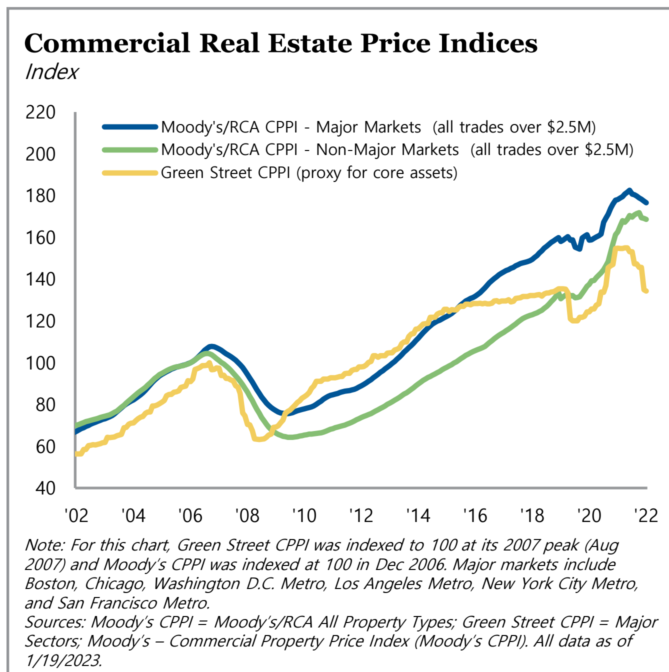
For more information on Convertible Arbitrage, click here.

U.S. Real Estate

Real estate market dynamics shifted dramatically throughout 2022. In the fourth quarter, commercial property transaction volume fell 62% year-over-year, driven by elevated interest rates and borrowing spreads, reduced lender appetite, inflationary pressures, and weak consumer sentiment. While the decline in sales is emblematic of a weaker real estate market, it is important to note that December 2021 was a record month and therefore a particularly tough point of comparison. With respect to property types, all sectors reported decreases in total transaction volume on a year-over-year basis in the fourth quarter. Notably, for full year 2022, retail was the only property type that saw a year-over-year increase in sales, which were up 4%. Lenders are experiencing fewer loan payoffs, shrinking deposits, and reduced visibility, collectively reducing their appetite to lend. Currently, there is evidence of a wide bid-ask spread across private real estate markets, as sellers are anchoring themselves to yesterday's cap rates and buyers are having difficulty arranging accretive financing. Private market dynamics are gradually catching up to the valuation trends that have persisted in public REIT markets. In the near term, we expect elevated interest rates, slower growth, and the potential for a recession will put continued pressure on private real estate valuations and likely trigger pockets of stress and distress and the need for rescue capital. On a positive note, there has been some stabilization in the 10-year Treasury yield and inflation is coming off a boil, indicating we're now likely closer to the end of rate hikes than the beginning.

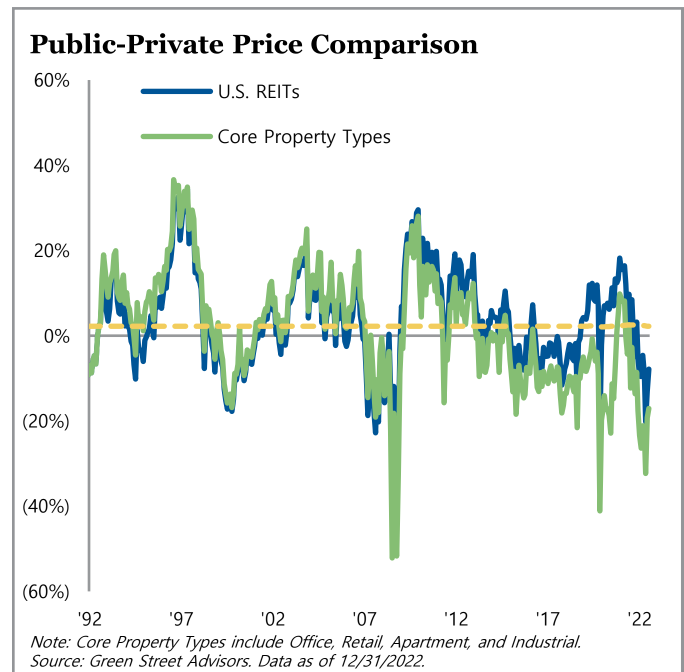
Economic growth is slowing as consumer balance sheets weaken and softening business confidence leads to hiring freezes and layoffs. Although inflation is also showing signs of deceleration, the Federal Reserve remains intent on maintaining higher interest rates for some time. As a result, a recession is highly anticipated, as evidenced by the inverted Treasury yield curve. We view the labor market as one of the most important drivers for real estate demand and have started to see signs of softening; however, it is important to keep in mind that the labor market is starting from a position of strength, as evidenced by a historically low unemployment rate and record level of job openings. Despite a challenging macroeconomic and financial backdrop, U.S. real estate fundamentals for most property types are entering this environment on relatively strong footing. While there are certain areas of elevated supply, there is no evidence of broad oversupply.

Deteriorating fundamentals, higher borrowing costs, and contracting transactional evidence are challenging the precision of spot real estate value estimates. The Green Street Commercial Property Price Index ended 2022 down 13%, after increasing 24% in 2021. U.S. REIT shares have plunged, ending full year 2022 down 24.4%. Public company valuations vary by property type; traditional property types – including apartments, industrial, office, and shopping centers – have been trading at a 20.7% equal-weighted discount to NAV on average, implying further declines for private market property valuations. Green Street Advisors' model, which tracks the relative value relationship between private real estate and fixed income (investment grade and high yield), pegged real estate as 13% overvalued.



Note: For this chart, Green Street CPPI was indexed to 100 at its 2007 peak (Aug 2007) and Moody's CPPI was indexed at 100 in Dec 2006. Major markets include Boston, Chicago, Washington D.C. Metro, Los Angeles Metro, New York City Metro, and San Francisco Metro.
Sources: Moody's CPPI = Moody's/RCA All Property Types; Green Street CPPI = Major Sectors; Moody's – Commercial Property Price Index (Moody's CPPI). All data as of 1/19/2023.

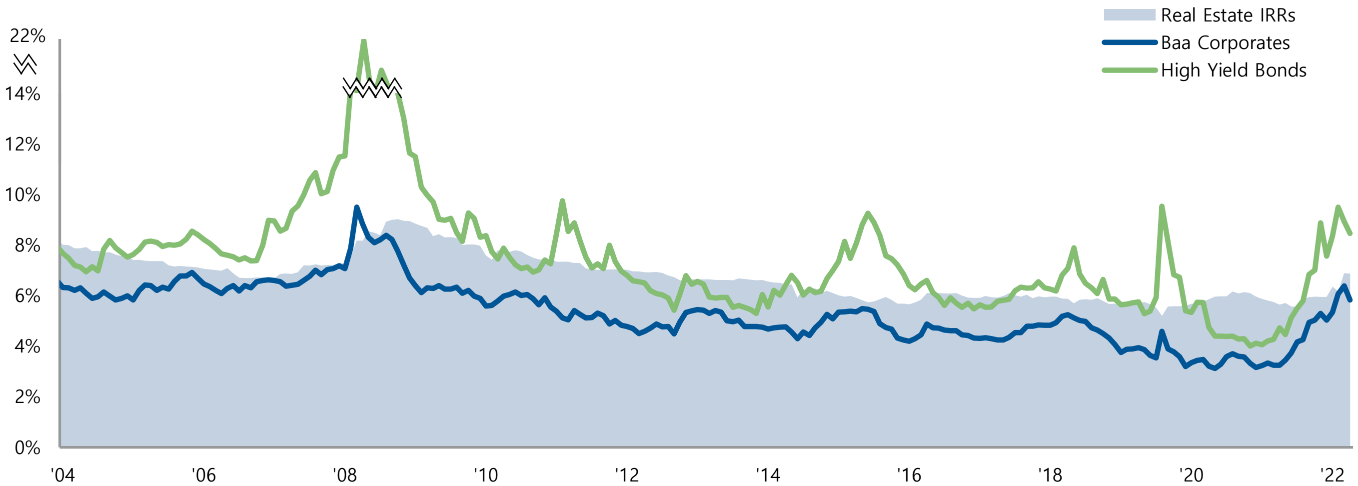
Key indicators imply that private real estate pricing is declining.



Note: Core Property Types include Office, Retail, Apartment, and Industrial.
Source: Green Street Advisors. Data as of 12/31/2022.

Public company valuations vary by property type but, on average, imply private market property valuations are overvalued and expected to experience further declines.

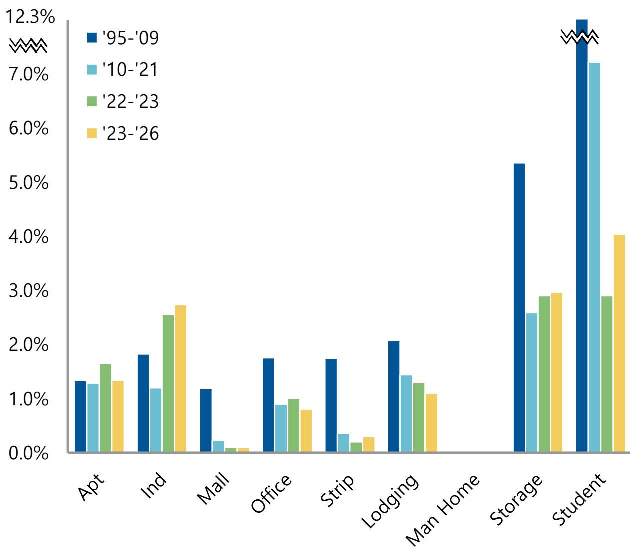
Unlevered Total Return Expectations on Real Estate vs. Corporate Bond Yields



Note: 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).
Sources: Green Street Advisors (October '22), Moody's (Baa Corporates), BAML (High Yield Bonds). Data as of 1/19/2023.

Unlevered real estate has historically offered a return between investment grade and high yield bonds. Real estate is currently modestly overvalued relative to bond yields.

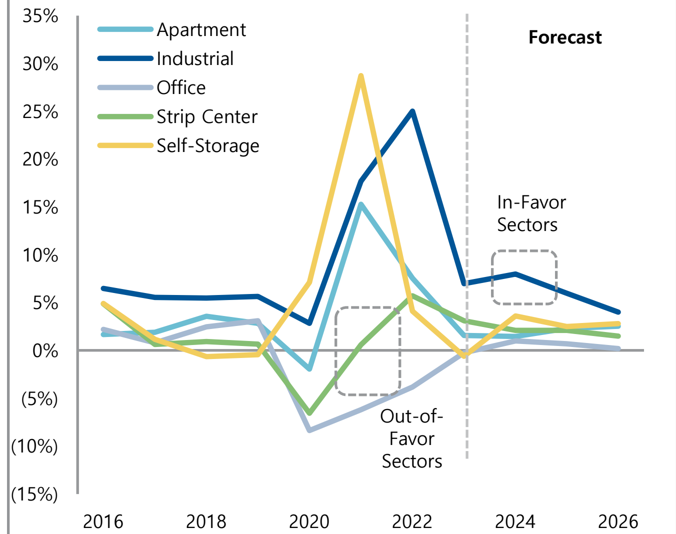
Supply by Sector



Note: Estimates are not shown because impact has not been quantified.
Source: Green Street Advisors. Data as of 12/31/2022.

New deliveries are declining for property types facing challenges, while apartments, industrial, and alternative sectors are experiencing elevated and rising supply.

Market RevPAF Growth: Occupancy & Rent Growth



Source: Green Street Advisors. Data as of 1/19/2023.

Multifamily, industrial, and alternative sectors have exhibited moderating revenue growth, while office and retail remain on a slow growth trajectory with risks to the downside.

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

Matt Jackson
Co-Portfolio Manager
U.S. Real Estate

For more information on U.S. Real Estate, click here.

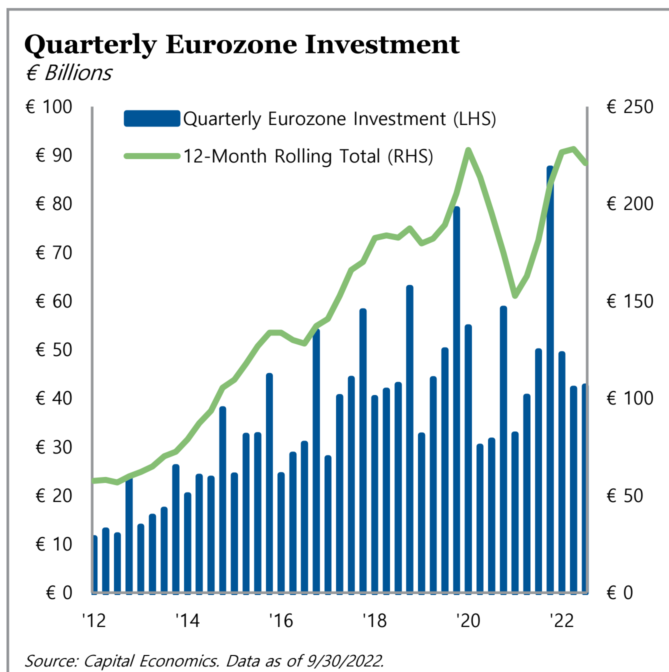
Europe Real Estate

Although fears of a recession have been looming over Europe, economic data from late 2022 suggests that expectations may be more pessimistic than reality. Goldman Sachs has estimated full-year 2022 GDP growth of 0.6%, instead of the anticipated contraction, after the economy showed resilience in the fourth quarter. Headline inflation decreased to 9.2% in December, though core inflation reached a record high at the end of the year, with both services and core goods inflation levels increasing year-over-year. As a result, the ECB will likely continue its tightening strategy, but the region's unemployment rate remains at a record low of 6.5%. The Sentix Investor Confidence Index increased in January, signaling a more positive outlook than expected. Overall, the eurozone will likely experience a slowdown during 2023; however, we believe there will be pockets of growth, particularly in major cities. Notably, January marked the end of negative-yielding debt, which totaled more than $18 trillion globally just two years ago. This phenomenon persisted from 2014 to 2022 and was extremely prevalent in Europe. Many irrational investment decisions were made because of this uncommon yield environment, and we expect volatility and opportunity to arise as interest rates normalize.

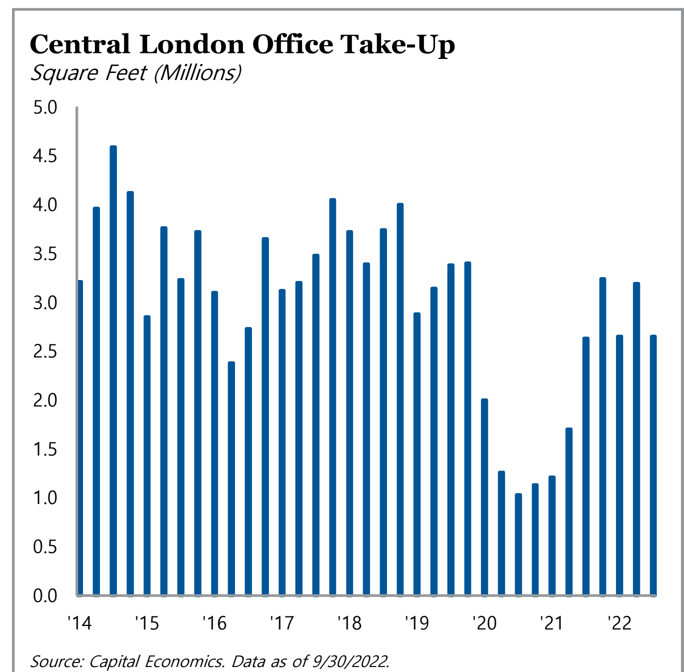
European real estate investment markets slowed late in 2022, as interest rates rose rapidly and investors and tenants anticipated an economic decline. Investment volume was down 15% year-over-year in the third quarter, with office properties seeing the least activity. However, prime office rents grew 1.5% quarter-over-quarter during the third quarter, suggesting resilient demand for high-quality, well-located properties.

Economic data from the UK suggests a recession is already underway. Total business investment in the third quarter was more than 8% below its 2019 peak. GDP contracted month-over-month in November, suggesting a fourth quarter contraction after also shrinking 0.3% in the third quarter. The Bank of England base rate was 3.5% in December and is expected to rise further, given CPI inflation was still nearly 11% in November. Rising rates have also taken a toll on the residential housing market; in November, mortgage approvals dropped to their lowest level since June 2020. Housing prices have dropped 4.3% from their August 2022 peak, but rental rates continue to grow because of high inflation and lack of housing supply.

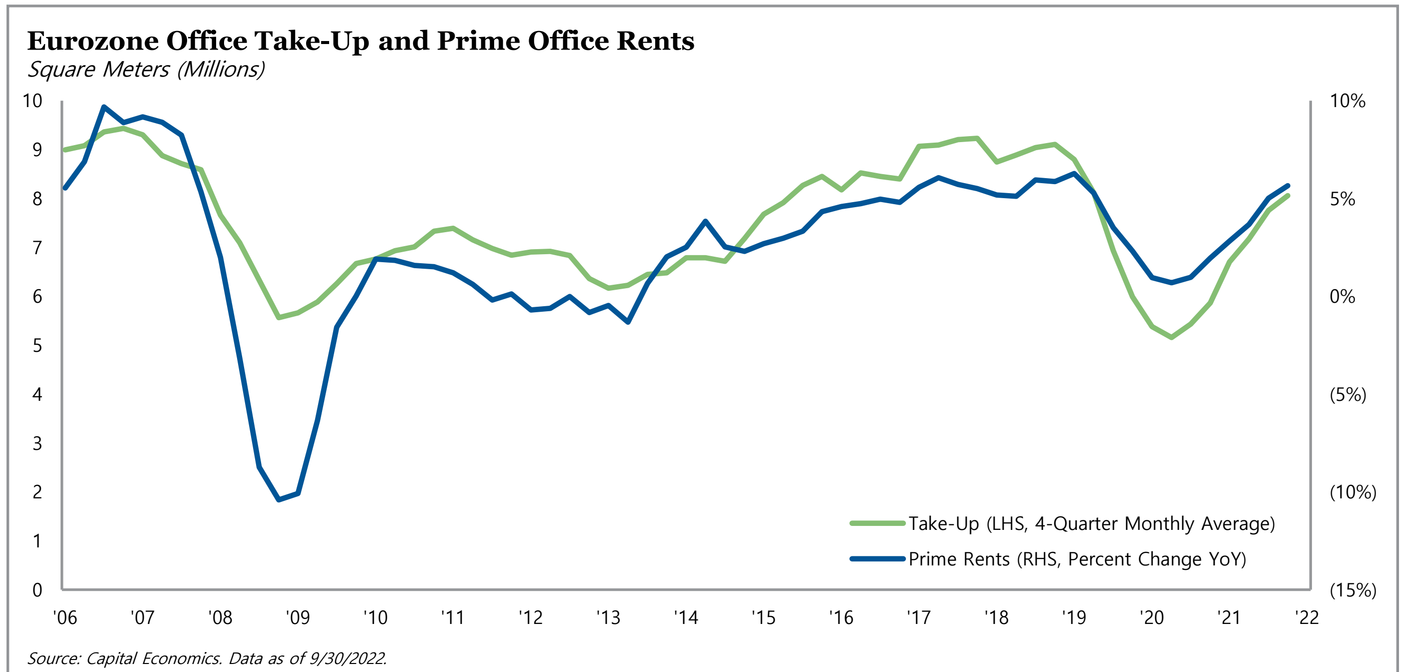
On the commercial property side, real estate values have already been affected by worsening economic conditions. According to MSCI, European all-property values fell 17% from June to November 2022. Investment activity nearly stalled at year-end, with preliminary data from Colliers suggesting that only £800 million was transacted during November – the second-lowest amount since 2000. Despite this backdrop, tenants continue to lease central London office buildings. During the third quarter, take-up dipped slightly to 2.7 million square feet, consistent with 2021 levels. Like the continent, demand for prime office space remains strong despite economic conditions and work-from-home culture; 75% of recent London office leases, totaling approximately 3.5 million square feet, were in new or completely refurbished buildings.



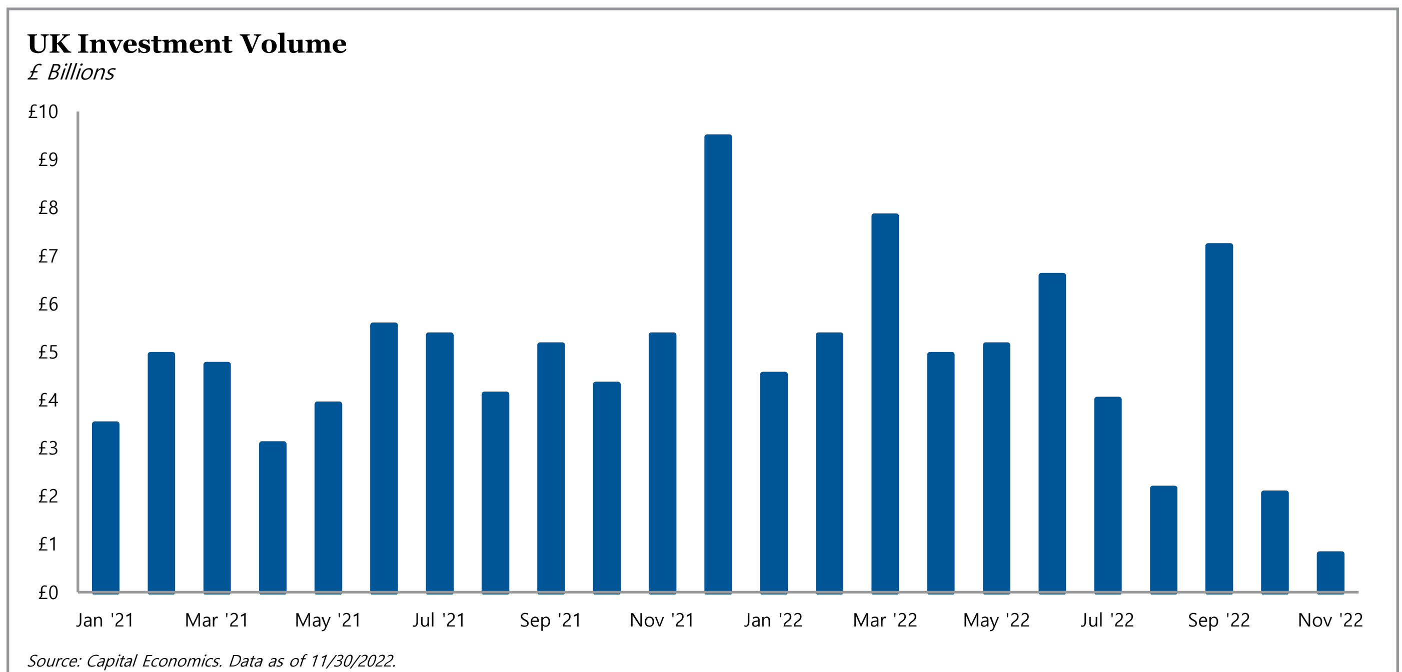
As interest rates increased, investment volume decreased in late 2022.



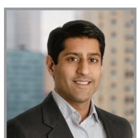
Despite economic uncertainty, occupiers continued to lease prime office space in central London.



Tenant demand for office space in high-quality markets remained strong.



UK real estate investment activity slowed significantly in late 2022.



Anuj Mittal
Co-Portfolio Manager
Head of Europe Real Estate

Tom Rowley
Co-Portfolio Manager
Europe Real Estate

For more information on Europe Real Estate, click here.

Asia Real Estate: China

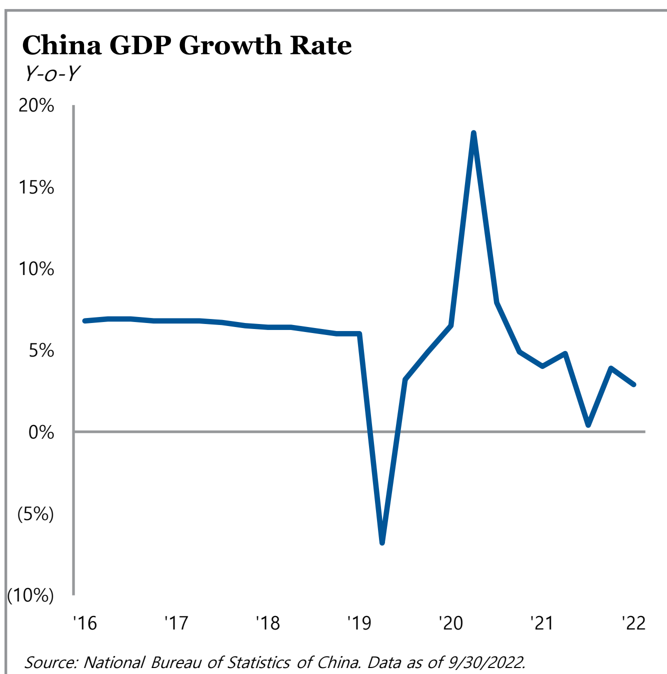
China's economy grew 3.9% year-over-year in the third quarter of 2022, rebounding at a faster-than-anticipated rate despite a resurgence in COVID-19 infections. This marked a significant improvement on the 0.4% growth recorded in the second quarter of 2022 and was attributable to the 19 new policies introduced to stabilize economic growth, which provided for additional fiscal stimulus, business aid, and city-specific property policies and led to the reduction of the five-year loan prime rate from 4.45% to 4.30% in August 2022.

In the first three quarters of 2022, exports increased 9.9% year-over-year, and value-added industrial output rose by 3.9%. Domestic retail sales increased 0.7% over the same period, while online retail sales increased 4.0%. China remains highly focused on further developing its advanced manufacturing sector, particularly in life sciences, integrated circuitry, and new energy; fixed-asset investment in high-tech industries grew 20.2% year-over-year in the first three quarters of 2022, while total fixed-asset investment activity grew only 5.9%. In December 2022, China shifted its focus to economic growth and announced the reopening of borders and the relaxation of its zero-COVID policy. We expect reopening to be the dominant theme in 2023, and a strong rebound in growth is expected after the bumpy transition.

In Beijing, we observed stagnant office leasing demand – mainly driven by intermittent COVID-19 lockdowns covering key office submarkets – and no new supply was delivered in the third quarter. Stringent COVID-19 policies similarly erased expansionary and relocation demand, with net absorption amounting to roughly 14,000 square meters – a decline of approximately 70% from the quarterly net absorption recorded in the second quarter. Domestic companies accounted for nearly 75% of leasing demand. Overall, Grade A office rents decreased slightly in the third quarter, down 0.4%. With no new completions, the office market's overall vacancy rate declined for the seventh consecutive quarter, sliding from 9.8% to 9.7% – the lowest vacancy level recorded in the last twelve quarters. In the Zhongguancun submarket of Beijing, known as China's Silicon Valley, rents remained largely flat and vacancy stood at 2.1%, the lowest level in the city.

Industrial and logistics leasing recovered in the third quarter. In Shanghai, industrial rents rose 3.1% year-over-year; meanwhile, vacancy declined 0.1 percentage points to 9.8%.

In terms of overall market activity, total commercial real estate transaction volume amounted to RMB 150 billion in the first three quarters of 2022, a 28% decrease year-over-year. Business parks and logistics warehouses remained the most popular asset classes and are well-positioned to benefit from China's structural shift toward innovation-driven growth as well as the continued expansion of e-commerce and third-party logistics companies.



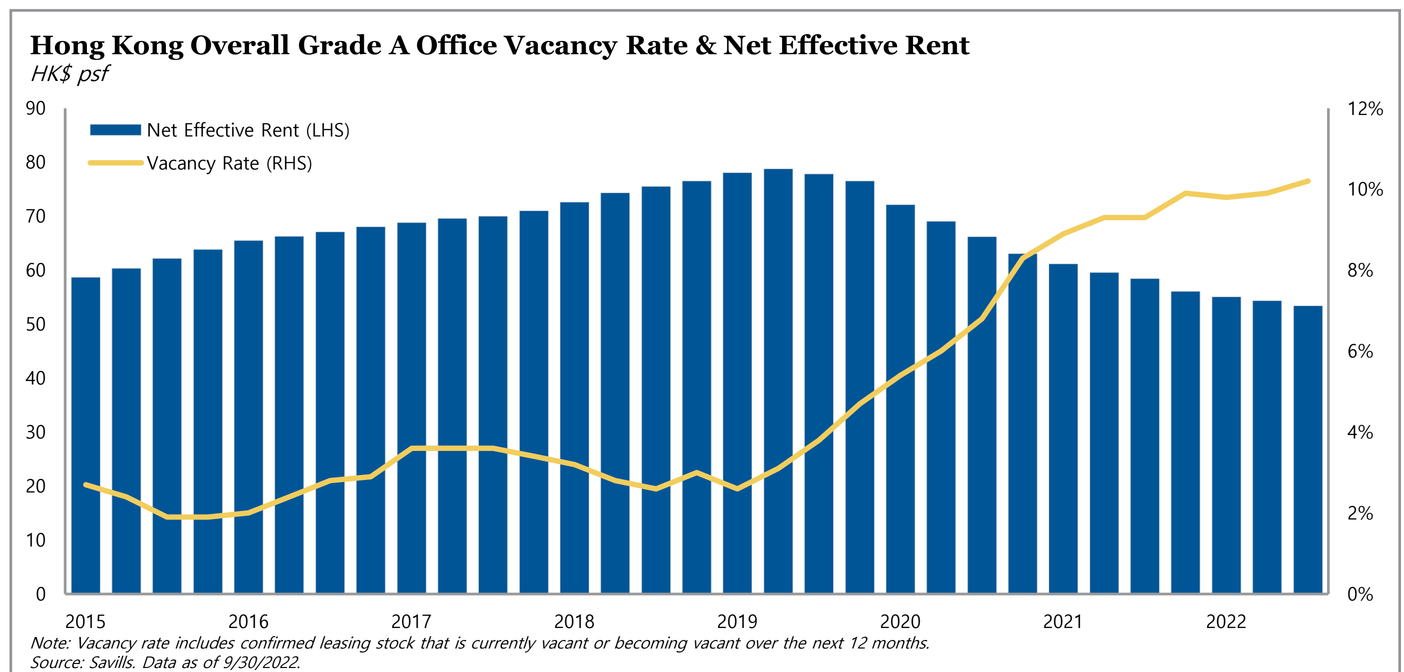
China's GDP growth continued to moderate due to COVID-19 lockdowns; however, the recent relaxation of the quarantine requirements should improve growth in 2023.

CNY strengthened significantly during the fourth quarter.

Asia Real Estate: Hong Kong

Hong Kong's economy contracted further in the third quarter of 2022, declining 4.5% year-over-year, compared to the 1.3% year-over-year contraction recorded in the second quarter. The impacts of sharp interest rate hikes by the major central banks weighed heavily on domestic demand, though improved labor market conditions and the disbursement of consumption vouchers in August 2022 supported private consumption. The worsening external environment and continued disruptions to cross-boundary transportation dragged heavily on export performance, with the total export of goods declining significantly in the third quarter – falling 15.6% year-over-year. Private consumption expenditure was virtually unchanged from a year ago in the third quarter. Unemployment fell from 4.7% in the second quarter to 3.9% in the third quarter. Despite these results, Hong Kong's economy is expected to rebound in 2023, driven in part by the reopening of its borders with mainland China, without the need for quarantine, starting January 8, 2023.

After reaching a high in September 2021, residential prices retreated 10.7% year-over-year and decreased 6.6% quarter-over-quarter in the third quarter of 2022. Demand for industrial buildings remained high, with HK$17.6 billion worth of industrial assets changing hands in the first three quarters of the year. Commercial real estate investment transaction volume rose 7.9% quarter-over-quarter to HK$49.0 billion, which can be attributed to several large deals completed during the year. Investment demand in the third quarter was largely supported by property funds, which accounted for 49% of the quarter's total transaction volume – the second-highest percentage recorded since the onset of the pandemic. As of September 2022, Hong Kong's office vacancy increased slightly to 10.2%, while rents fell by 1.7% in the third quarter – a slower pace of decline than in previous quarters.



Note: Vacancy rate includes confirmed leasing stock that is currently vacant or becoming vacant over the next 12 months.
Source: Savills. Data as of 9/30/2022.

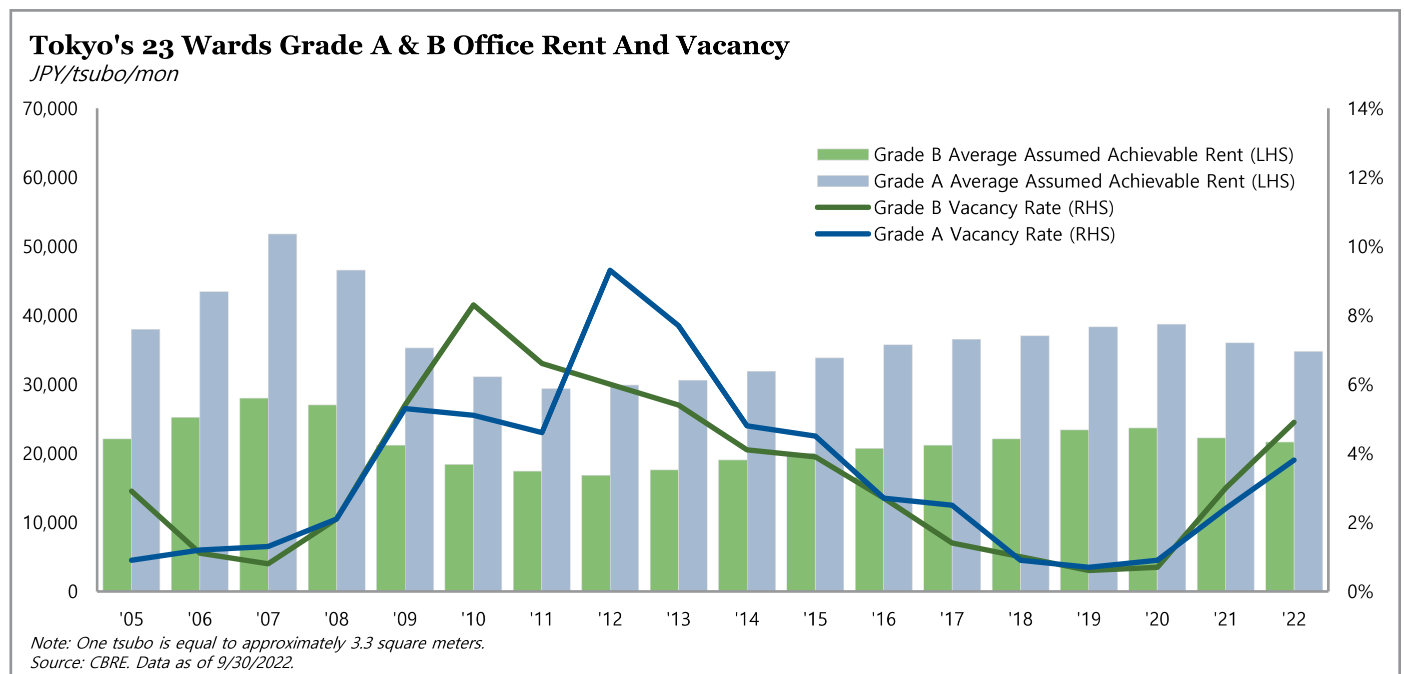
Hong Kong's office vacancy remained high, while rental levels remained weak.

Asia Real Estate: Japan

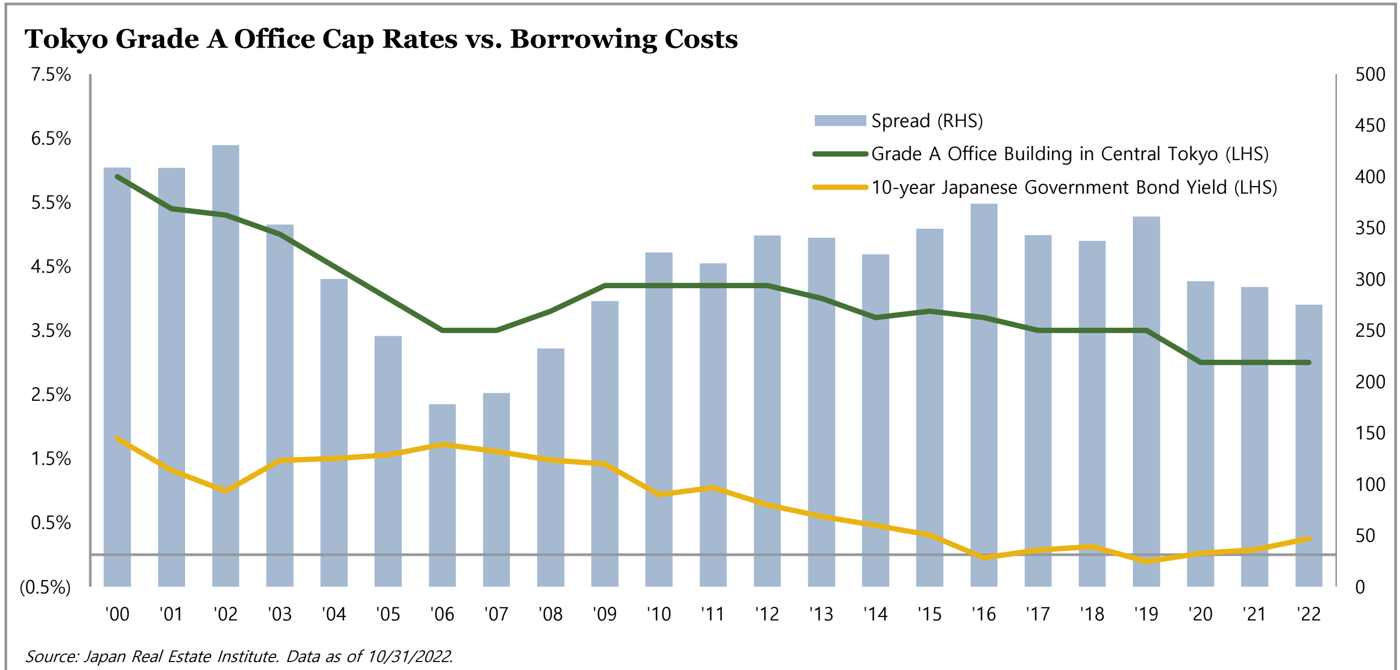
Japan's real GDP contracted slightly in the third quarter of 2022, down 0.3% quarter-over-quarter, with robust consumer spending and capital expenditure offset by a temporary increase in imports resulting from the significant depreciation of the yen. Japan's labor market remained healthy, with unemployment at 2.5% as of December 2022. While inflation moved higher – reaching 4.0% by the end of 2022 – many economists believe these increases are temporary, as wage increases have yet to be achieved. The Bank of Japan (BoJ) forecasts that Japan's CPI will increase by 1.6% in 2023 and 1.8% in 2024. In December, the BoJ tweaked its yield curve control policy, allowing 10-year government bond yields to rise from a cap of 0.25% to 0.50%. Despite this change, policy rates remain unmoved and the BoJ has signaled that it intends to continue its current monetary easing policy.

The Japanese office market softened slightly in the third quarter. Grade A vacancy rates rose from 2.1% to 3.8% in Tokyo and from 4.3% to 4.7% in Osaka, mainly due to vacancies in new buildings. Japan's logistics fundamentals remained stable in the third quarter, with vacancy rates for multi-tenant facilities in the greater Tokyo area rising slightly to 5.2%, up from 4.7%. On the other hand, the vacancy rate for properties that are more than one year old remains at a low level of 1.7%. E-commerce growth continues to be strong, and with online sales accounting for only 8.8% of Japan's total retail sales, further expansion of the logistics market is expected.

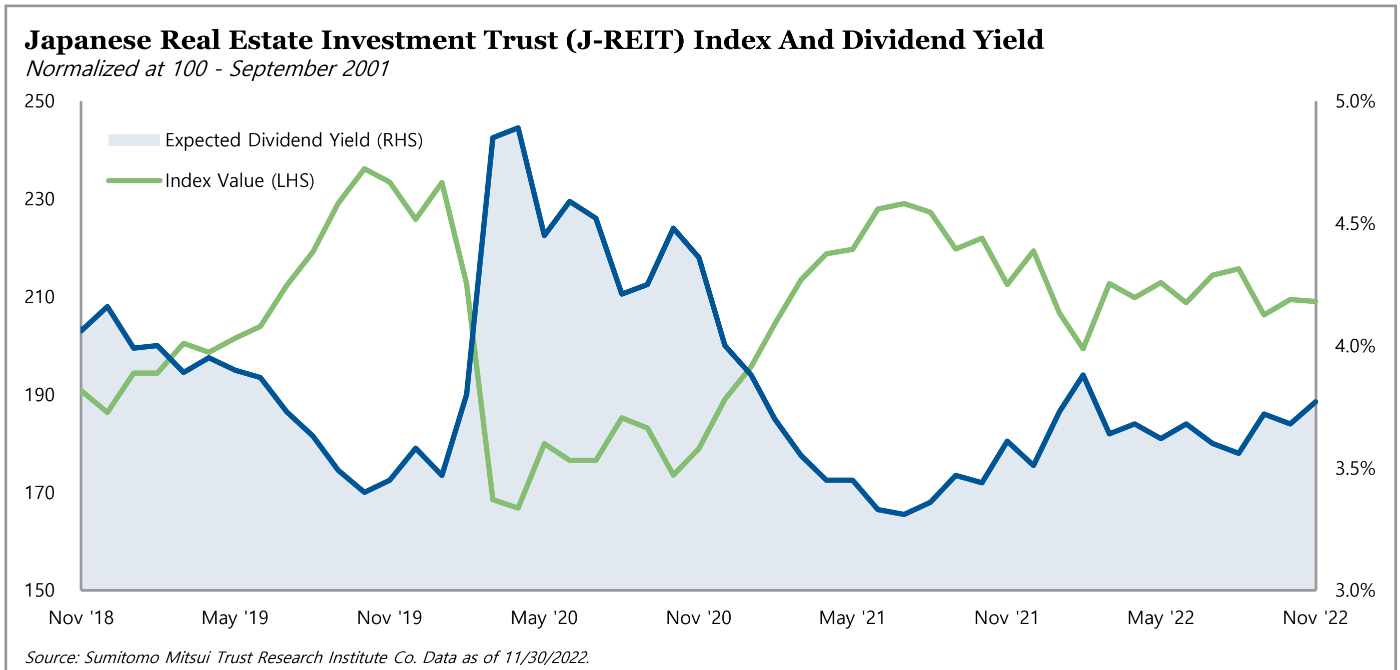
The Japanese real estate investment market remained robust, with active buyers purchasing stabilized properties at low cap rates. Liquidity for these assets continued to be supported by aggressive lenders in the marketplace.



Tokyo's office vacancy edged up slightly, while overall market fundamentals remained stable.



Despite global interest rate rises, interest rates in Japan remained low and, as a result, office cap rate spreads continued to remain wide.



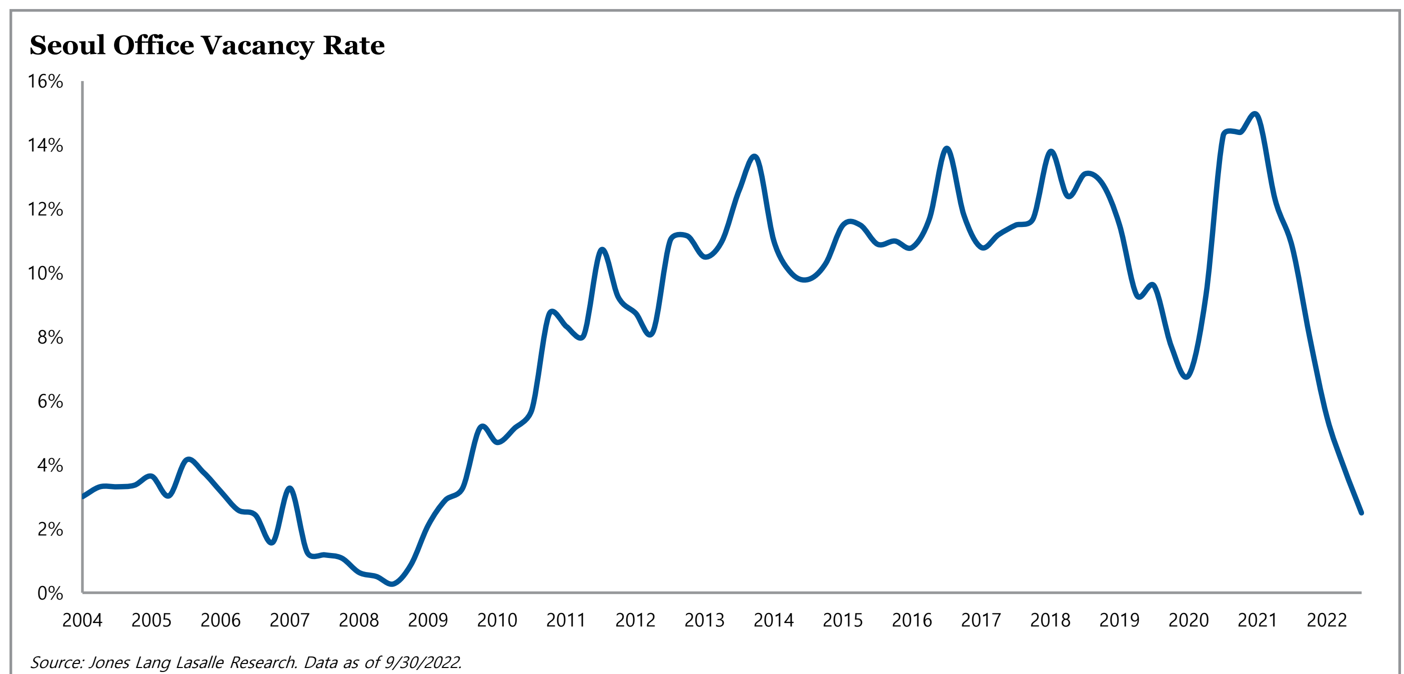
J-REIT yields edged up slightly during the fourth quarter.

Asia Real Estate: South Korea

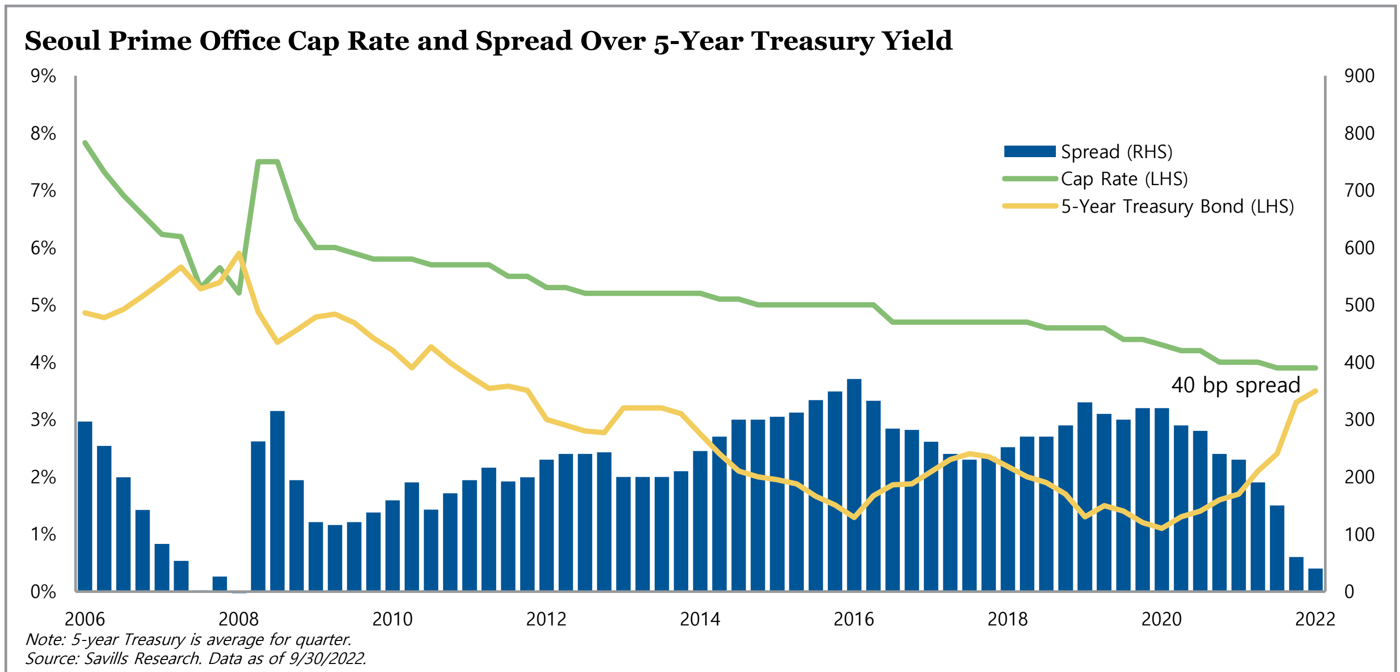
In the third quarter, South Korea's GDP increased 3.1% year-over-year, driven largely by increased domestic consumption and equipment investment. However, uncertainty caused by external risks – such as the Russia-Ukraine war, high energy prices, and increased interest rates – is expected to prompt the Bank of Korea (BoK) to lower its forecast for 2023 growth from 2.1% to 1.7%. Korea's inflation rate as of September 2022 was 5.6%, falling from its peak of 6.3% in July. In light of the continued hawkish stance of the BoK, financing yields are moving up sharply, leading to early signs of distress across asset classes as financing conditions deteriorate.

On the real estate front, office cap rates stood at 3.9% in the third quarter – unchanged since first quarter of 2022 despite the BoK's base rate increases. The average spread between prime office cap rates and Korean government bond yields (i.e., 5-year treasury bonds) narrowed to 40 basis points. In the current environment, most investors are taking a wait-and-see attitude. That said, investor interest in the office sector remains intact given the strong market fundamentals. Prime office vacancy in Seoul decreased to 3.3% at the end of the third quarter, down 160 basis points from 4.9% as of the end of the second quarter. Office rents increased an average of 4.3% year-over-year across all major business districts in Seoul, with the Gangnam Business District recording the highest increase of 8.7%. Investment activity totalled ₩10 trillion as of the end of the third quarter of 2022 – 67% of annual transaction activity in 2021, which was a record year with activity totalling ₩14.9 trillion.

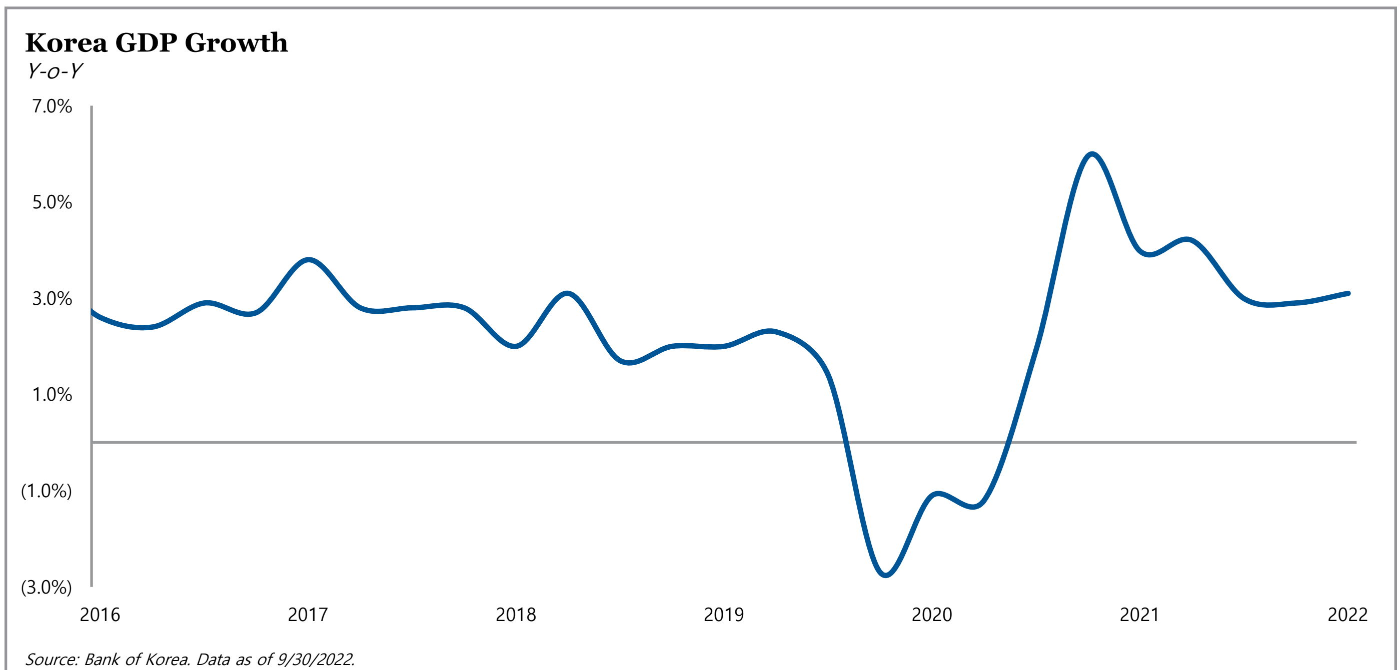
Market fundamentals in the logistics sector remained strong, with logistics vacancy in Greater Seoul at only 4.0% – up 40 basis points quarter-over-quarter, largely due to new supply in the western and southeastern districts of Greater Seoul. Macro headwinds driving increased replacement costs – on both the construction and financing front – have either delayed or halted many new projects, and new supply is expected to decrease. Logistics continued to be attractive to investors given the sound fundamentals of the sector. However, with financing yields on the rise, we expect there will be more distressed investment opportunities in 2023.



Strong tenant demand driven by IT companies continued to drive down office vacancy rates across the city.

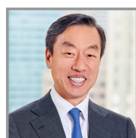


Cap rate spreads tightened significantly as Korean Treasury yields have moved in response to U.S. rate hikes.



The Korean economy showed signs of recovery in 2022, though a slowdown is expected as interest rates rise in conjunction with U.S. rate hikes.

Wilson Leung
Co-Portfolio Manager
Head of Asia Real Estate



Steven Cha
Co-Portfolio Manager
Asia Real Estate

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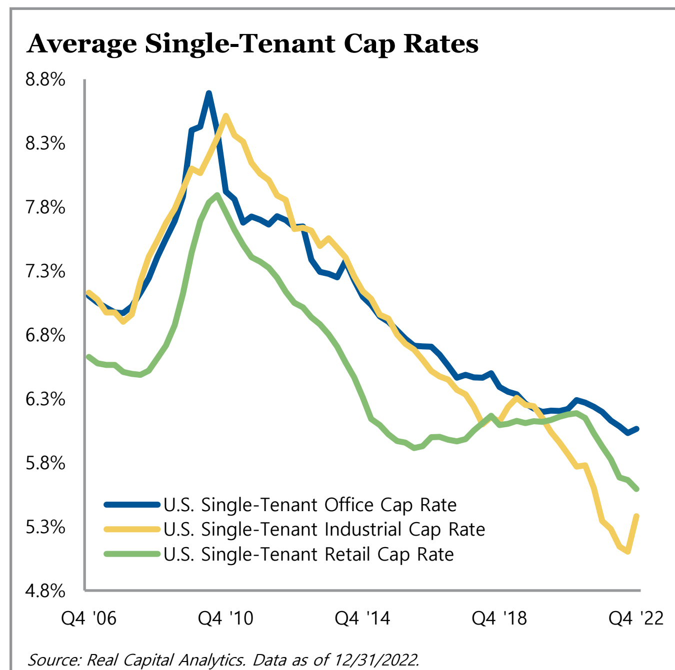
Net Lease Real Estate

As of the fourth quarter of 2022, trailing 12-month U.S. single-tenant transaction volume totaled $72 billion, according to Real Capital Analytics (RCA). Volume declined 32% in the fourth quarter of 2022, the largest single quarter-over-quarter decline in more than 15 years. For reference, from the peak in the third quarter of 2007 to the trough in the third quarter of 2009, single-tenant transaction volume declined 73%. The single-tenant volume of $72 billion recorded in the fourth quarter of 2022 represents a 36% decline from last year's peak of $112 billion, which was witnessed in the second quarter of 2022. Additionally, this decline in volume was evenly split across the industrial, retail, and office segments.

The quarterly movement in single-tenant cap rates was not as notable as volume; cap rates ended the fourth quarter at an average of 5.7%, versus 5.6% in the third quarter, resulting in a quarter-over-quarter increase of only 10 basis points. This increase in the quarterly average was driven by upward movement in industrial cap rates, a trend that has not been witnessed for several years. According to Green Street data, while industrial cap rates have started to increase, the sector is still in a much better position than it was leading up to the global financial crisis (GFC) – when industrial proved its economic sensitivity. The primary factors contributing to the industrial sector being better positioned today than it was heading into the GFC include historically low vacancy rates and continued demand, driven by ongoing efforts to improve supply chain resilience.

Turning to the net lease space broadly, although inflation and high interest rates could negatively impact the sector, we believe the sector remains well positioned given predictions of a recession in 2023. In a volatile rate and economic environment, we believe net lease assets with long-term leases offer a refuge in the event of a flight-to-quality trend and have the ability to ride out a lull in the transaction market, though we would also stress the importance of having the appropriate debt strategy for such conditions in place.



There was a moderate increase in cap rates in the fourth quarter, mostly driven by industrial.

Single-tenant volume declined significantly in the fourth quarter of 2022.

Gordon Whiting
Portfolio Manager

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