ANGELO GORDON

Angelo Gordon's Capital Markets Perspectives

THIRD 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 alternative investment firm, managing approximately $73 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.

** Angelo Gordon's (the "firm") currently stated AUM of approximately $73 billion as of December 31, 2022 reflects fund-level asset-related leverage. Prior to May 15, 2023, the firm calculated its AUM as net assets under management excluding leverage, which resulted in firm AUM of approximately $53 billion as of December 31, 2022. The difference reflects a change in the firm's AUM calculation methodology and not any material change to the firm's investment advisory business. For a description of the factors the firm considers when calculating AUM, please see the disclosure linked here.*

Co-CIO Overview

In the second quarter of 2023, solid performance was observed across the corporate and structured credit markets, with spread compression taking place against a backdrop of fixed income fund inflows and positive investor sentiment across risk assets.

In corporate credit, both the U.S. and European high yield markets posted positive returns in the second quarter, as the effects of spread tightening and coupon payments outweighed the negative impact of higher interest rates. Positive performance was seen across broad sectors. Lower-quality bonds outperformed higher-rated counterparts in the U.S., while Europe saw a flight to quality, with BB-rated bonds outperforming CCCs. The high yield default rate rose to 2.7% in the U.S. – a two-year high – and 1.4% in Europe. Issuance rose slightly in the U.S., coming on the heels of limited supply throughout 2022, but remained constrained in Europe.

In structured credit, national home prices seemed to bottom in February and then rose through the end of the first quarter and beginning of the second quarter. We expect further home price appreciation will be challenged by reduced affordability and rising supply in certain areas, though nationwide supply continues to be constrained, supporting prices. Spread tightening was observed in various areas during the quarter, including in credit risk transfer (CRT), where there was significant spread compression, particularly in the most credit sensitive tranches. However, we believe there is material capacity for further spread tightening, as spreads remain wide of February 2022 levels. RMBS Issuance fell on a quarterly and year-over-year basis, and sell-side analysts are predicting full-year 2023 issuance will be down compared to 2022 and 2021 volumes.

Sponsored middle market lending volume, including direct and syndicated activity, was up 9% quarter-over-quarter but fell 52% year-over-year. Meanwhile, middle market direct lending terms continued to favor lenders, with the average all-in yield for lower middle market deals rising to a record 12.6%.

In merger arbitrage, the termination of the merger between TD Bank and First Horizon Corporation, regulatory challenges to Microsoft's acquisition of Activision Blizzard Inc., and the FTC's lawsuit to block Amgen Inc.'s acquisition of Horizon Therapeutics plc sent merger spreads rising from a tight of approximately 12% in April to 14.9% at the end of June. With this in mind, market participants are currently digesting the potential impact of the new regulatory environment on M&A.

The backdrop for convertible bond issuance remained supportive in the second quarter, with global convertibles and convertible arbitrage strategies posting positive returns on an outright basis. Looking ahead, a "higher for longer" interest rate environment may encourage issuers to come to market to address upcoming bond and convertible maturities.

Turning to real estate, global inflationary pressures have generally subsided from the peak levels seen in recent quarters – primarily due to the effective impact of aggressive interest rate hikes implemented by central banks. However, macroeconomic indicators remain somewhat uneven, suggesting global monetary tightening is likely to persist. Against this backdrop, there has been a sustained, material slowdown in real estate transaction activity due to limited financing availability, rising debt costs, and overall uncertainty regarding valuations. It is becoming increasingly evident that the reduction in credit availability in certain markets has accelerated the stress and distress already present in the real estate market, which we expect will create significant opportunities to identify high-quality assets at reset valuations.

In the U.S., concerns over a widespread banking crisis seemed to abate in the second quarter, as measures were taken to underpin the health of regional and midsize banks. Nonetheless, the constrained availability of credit and expectations of sustained high interest rates caused transaction volumes to fall more than 60% year-over-year. Underlying property fundamentals for all sectors – with the exception of office – have remained stable, suggesting that the prevailing and anticipated stress in the market has largely been the result of asset repricing driven by the rapid rise in interest rates.

In Europe, there has been a persistent economic slowdown, albeit much less severe than initially feared. Interest rates have risen 300 to 400 basis points from their 2020 levels, and monetary tightening is expected to continue. Similar to the U.S., real estate investment activity is significantly behind historic averages as investors choose to closely monitor recessionary indicators.

In Asia, we have witnessed notable economic progress in China and Hong Kong following the easing of COVID-19 policies, which has supported real estate fundamentals. In Japan, interest rates have remained low due to the dissipation of moderate inflation increases. However, South Korea is experiencing some level of stress with rapidly increasing rates, resembling the market dynamics observed in the U.S. and Europe.

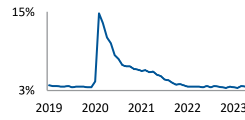
Josh Baumgarten
Co-Chief Executive Officer
Co-Chief Investment Officer
Head of Credit

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

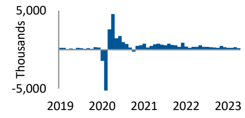
Economic Dashboard & Market Indices

Job Market

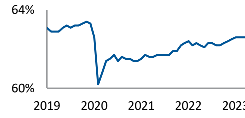
U.S.—Unemployment Rate	As of 6/30/2023
Latest Level	3.6
Change from Prior Period	▼ (0.1)
Frequency	Monthly



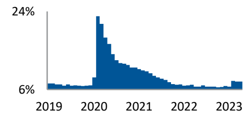
U.S.—Non-Farm Payroll	As of 6/30/2023
Latest Level	209.0
Change from Prior Period	▼ (97.0)
Frequency	Monthly



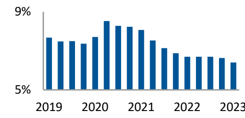
U.S.—Labor Participation Rate	As of 6/30/2023
Latest Level	62.6
Change from Prior Period	0.0
Frequency	Monthly



U.S.—U-6 Unemployed & Margin & Part-Time as Percent of Labor Force & Margin	As of 6/30/2023
Latest Level	6.9
Change from Prior Period	▲ 0.2
Frequency	Monthly

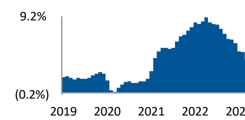


Eurozone Unemployment Rate	As of 6/30/2023
Latest Level	6.4
Change from Prior Period	▼ (0.3)
Frequency	Quarterly

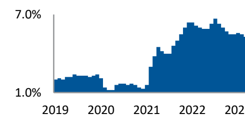


Inflation

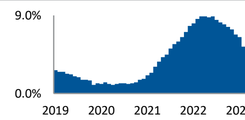
U.S. Consumer Price Index (CPI) Y-o-Y (%)	As of 6/30/2023
Latest Level	3.0
Change from Prior Period	▼ (1.0)
Frequency	Monthly



U.S. CPI Goods Less Food & Energy Y-o-Y (%)	As of 6/30/2023
Latest Level	4.9
Change from Prior Period	▼ (0.4)
Frequency	Monthly

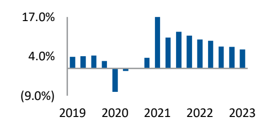


U.S. Producer Price Index (PPI) Y-o-Y (%)	As of 6/30/2023
Latest Level	4.3
Change from Prior Period	▼ (0.6)
Frequency	Monthly

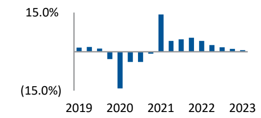


GDP Growth

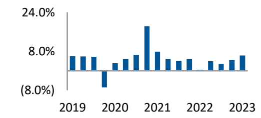
U.S.—GDP Y-o-Y (%)	As of 6/30/2023
Latest Level	6.3
Change from Prior Period	▼ (0.9)
Frequency	Quarterly



Eurozone—GDP Y-o-Y (%)	As of 6/30/2023
Latest Level	0.6
Change from Prior Period	▼ (0.5)
Frequency	Quarterly

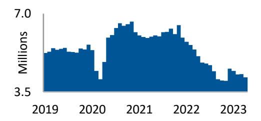


China—GDP Y-o-Y (%)	As of 6/30/2023
Latest Level	6.3
Change from Prior Period	▲ 1.8
Frequency	Quarterly

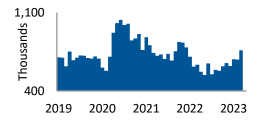


Housing

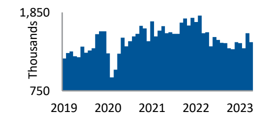
Existing Home Sales	As of 6/30/2023
Latest Level	4.2
Change from Prior Period	▼ (0.1)
Frequency	Monthly



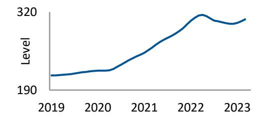
New Home Sales	As of 6/30/2023
Latest Level	697.0
Change from Prior Period	▼ (18.0)
Frequency	Monthly



Housing Starts	As of 6/30/2023
Latest Level	1,434.0
Change from Prior Period	▼ (125.0)
Frequency	Monthly



Case-Shiller Index of Home Value in 20 Cities	As of 5/31/2023
Latest Level	307.9
Change from Prior Period	▲ 3.0
Frequency	Monthly



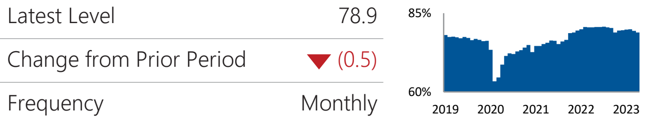
Note: All charts are based on a five-year trend.
Source: Bloomberg (All).

Economic Dashboard & Market Indices *(continued)*

Economic & Market Confidence

Capacity Utilization as a Percent of Capacity — As of 6/30/2023

Latest Level	78.9
Change from Prior Period	▼ (0.5)
Frequency	Monthly



Private Fixed Investment Nonresidential SAAR — As of 6/30/2023

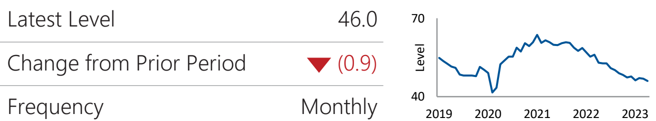
Latest Level	3,609.8
Change from Prior Period	▲ 76.2
Frequency	Quarterly

Residential Fixed Investment as a Percent of GDP — As of 6/30/2023

Latest Level	2.8
Change from Prior Period	0.0
Frequency	Quarterly

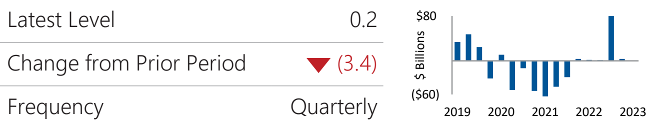
ISM Manufacturing Index — As of 6/30/2023

Latest Level	46.0
Change from Prior Period	▼ (0.9)
Frequency	Monthly



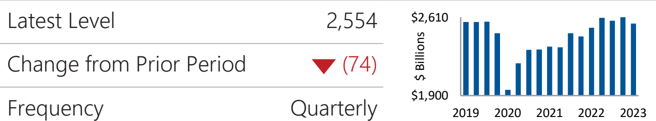
Manufacturing Inventory Change Q-o-Q ($) — As of 6/30/2023

Latest Level	0.2
Change from Prior Period	▼ (3.4)
Frequency	Quarterly



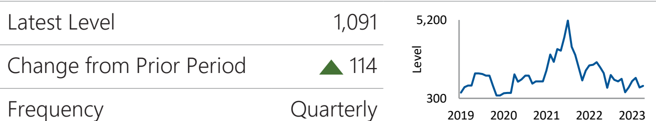
Exports of Goods/Services — As of 6/30/2023

Latest Level	2,554
Change from Prior Period	▼ (74)
Frequency	Quarterly



Shipping Rates — As of 6/30/2023

Latest Level	1,091
Change from Prior Period	▲ 114
Frequency	Quarterly



Personal Income Level — As of 6/30/2023

Latest Level	22,836
Change from Prior Period	▲ 174
Frequency	Monthly

Michigan Consumer Confidence Sentiment — As of 6/30/2023

Latest Level	64.4
Change from Prior Period	▲ 5.2
Frequency	Monthly

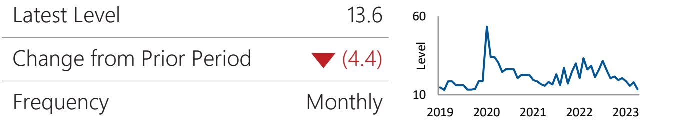
Equity

U.S. Equity Markets—Russell 3000 — As of 6/30/2023

Latest Level	2,554.5
Change from Prior Period	▲ 160.2
Frequency	Monthly

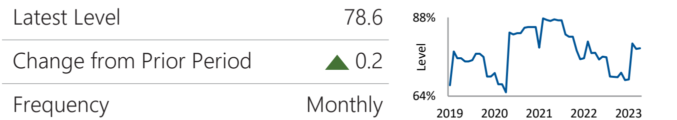
U.S. Equity—VIX — As of 6/30/2023

Latest Level	13.6
Change from Prior Period	▼ (4.4)
Frequency	Monthly

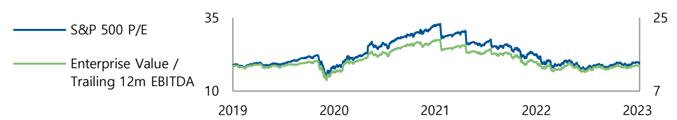


S&P 500 Percentage Exceeding Earning Estimates — As of 6/30/2023

Latest Level	78.6
Change from Prior Period	▲ 0.2
Frequency	Monthly



S&P 500 Historical Valuation Levels — As of 6/30/2023



Trailing P/E on S&P 500 — As of 6/30/2023

Latest Level	21.4
Change from Prior Period	▲ 1.3
Frequency	Monthly

Equity Markets—Euro Stoxx — As of 6/30/2023

Latest Level	461.4
Change from Prior Period	▲ 16.2
Frequency	Monthly

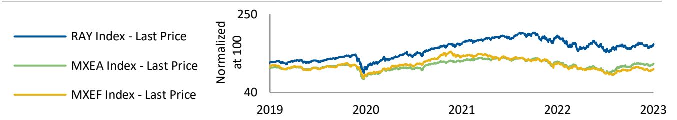
Equity Markets—MSCI EAFE — As of 6/30/2023

Latest Level	2,131.7
Change from Prior Period	▲ 89.9
Frequency	Monthly

Equity Markets—MSCI EM — As of 6/30/2023

Latest Level	989.5
Change from Prior Period	▲ 31.0
Frequency	Monthly

Russell 3000 & MSCI EAFE & MSCI EM — As of 6/30/2023



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

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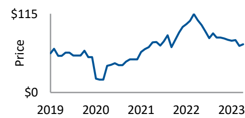
Commodities

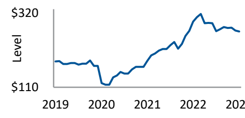
WTI Crude Oil Price
As of 6/30/2023

Latest Level	70.6
Change from Prior Period	▲ 2.6
Frequency	Monthly



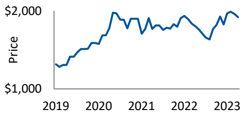
Reuters/Jefferies Commodity Index
As of 6/30/2023

Latest Level	262.0
Change from Prior Period	▲ 8.1
Frequency	Monthly



Gold
As of 6/30/2023

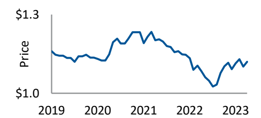
Latest Level	1,919.4
Change from Prior Period	▼ (43.4)
Frequency	Monthly



Foreign Exchange Rates

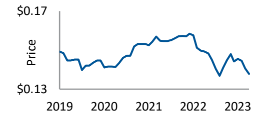
Euro Spot Rate vs. 1 USD
As of 6/30/2023

Latest Level	1.09
Change from Prior Period	▲ 0.02
Frequency	Monthly



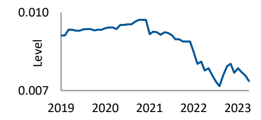
Yuan Spot Rate vs. 1 USD
As of 6/30/2023

Latest Level	0.1379
Change from Prior Period	▼ (0.0028)
Frequency	Monthly



Yen Spot Rate vs. 1 USD
As of 6/30/2023

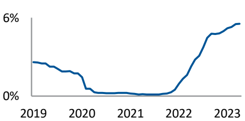
Latest Level	0.0069
Change from Prior Period	▼ (0.0002)
Frequency	Monthly



Rates

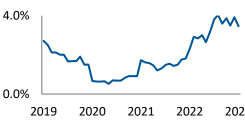
Libor 3M
As of 6/30/2023

Latest Level	5.55
Change from Prior Period	▲ 0.03
Frequency	Monthly



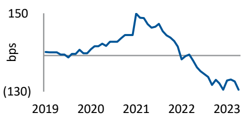
Treasury 10-Yr Yield
As of 6/30/2023

Latest Level	3.84
Change from Prior Period	▲ 0.19
Frequency	Monthly

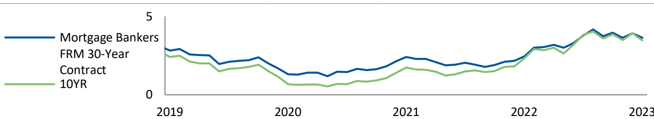


Swaps 2-Yr vs. 10-Yr
As of 6/30/2023

Latest Level	(123.42)
Change from Prior Period	▼ (30.04)
Frequency	Monthly



30-Yr Mortgage & 10-Yr Treasury
As of 6/30/2023



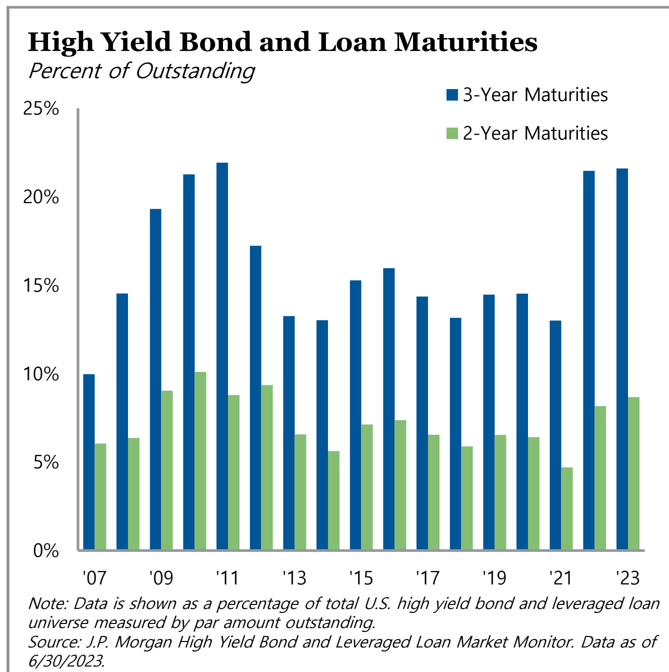
Note: All charts are based on a five-year trend.
Source: Bloomberg (All).

Performing Credit

Leveraged loan performance remained strong in the second quarter of 2023. The J.P. Morgan U.S. Leveraged Loan Index posted a 3.2% return and ended the quarter with a yield of 10.2% and a spread of 572 basis points. The weighted average price of the J.P. Morgan U.S. Leveraged Loan Index at the end of the quarter was $95.00, after trading in a range-bound manner between $93.00 and $95.00 for most of the quarter. The yield on leveraged loans continued to exceed that of high yield bonds, with yields at 10.2% and 8.7%, respectively, at the end of June. In Europe, the J.P. Morgan European Leveraged Loan Index posted a 3.3% quarterly return, ending the second quarter with a weighted average price of €94.40 and yield of 10.0%. In our view, the high average coupon for leveraged loans makes the asset class well-positioned for investor inflows as we continue through 2023.

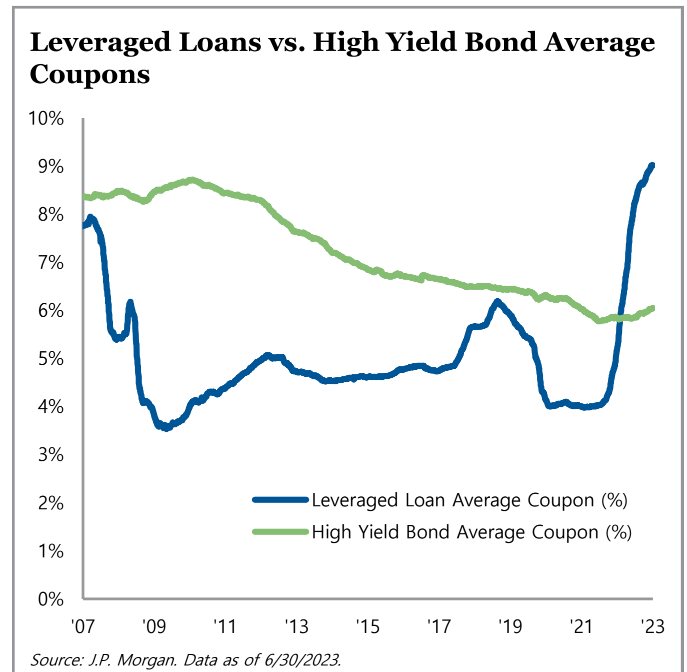
The default rate for leveraged loans rose to 2.8% in the U.S. and 1.4% in Europe as of the end of the second quarter. Looking ahead, J.P. Morgan is forecasting that the U.S. loan default rate will rise to 3.5% in 2023 and 4.0% in 2024, hovering above the long-term average of 3.1%. With 30% of existing loans set to mature in the next two to three years, we anticipate issuers will start coming to the primary market to refinance in late 2023 or early 2024. Fundamentally, average loan issuer leverage continued to decline and was at a four-year low of 4.6x EBITDA as of the end of June, while the average interest coverage ratio stood at 4.6x at quarter-end – similar to pre-pandemic levels.

The major theme we will be monitoring throughout 2023 is the impact rising rates will have on free cash flow. Thanks to the dramatic move in the base rate from 10 basis points in the first quarter of 2022 to above 550 basis points at the end of the second quarter of 2023, we expect cash flows for leveraged credits that did not hedge their floating rate debt will meaningfully decline. In this environment, we believe market participants will be closely monitoring corporate earnings and seeking to ensure issuers have adequate sources of liquidity to manage operations and drive earnings growth.



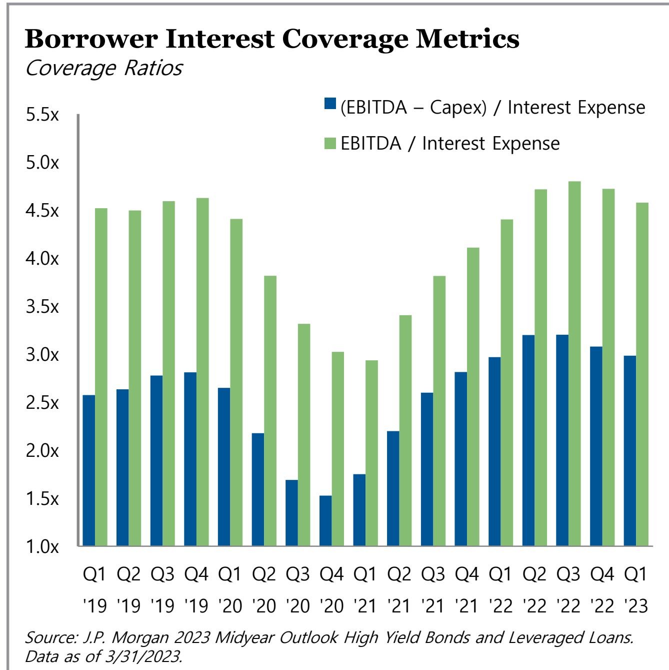
Note: Data is shown as a percentage of total U.S. high yield bond and leveraged loan universe measured by par amount outstanding.
Source: J.P. Morgan High Yield Bond and Leveraged Loan Market Monitor. Data as of 6/30/2023.

We expect issuers will come to the market to address their upcoming maturities starting in Q4 2023 and early 2024.

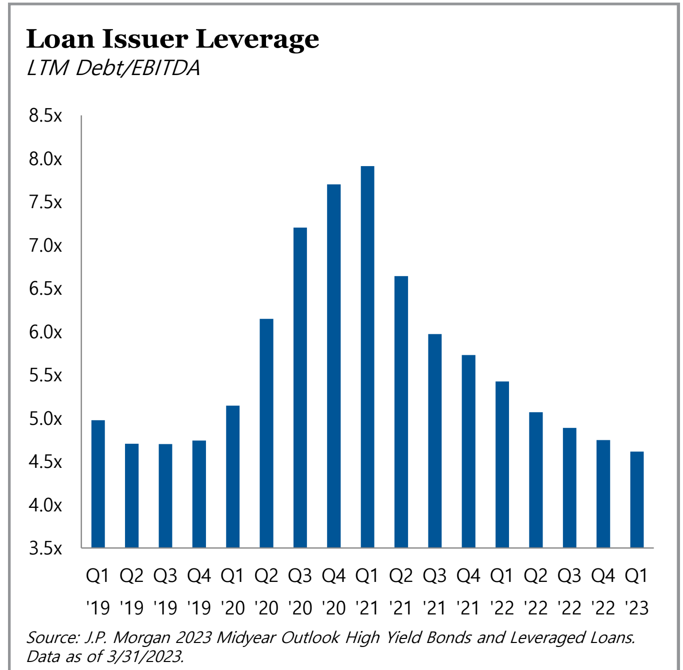


Source: J.P. Morgan. Data as of 6/30/2023.

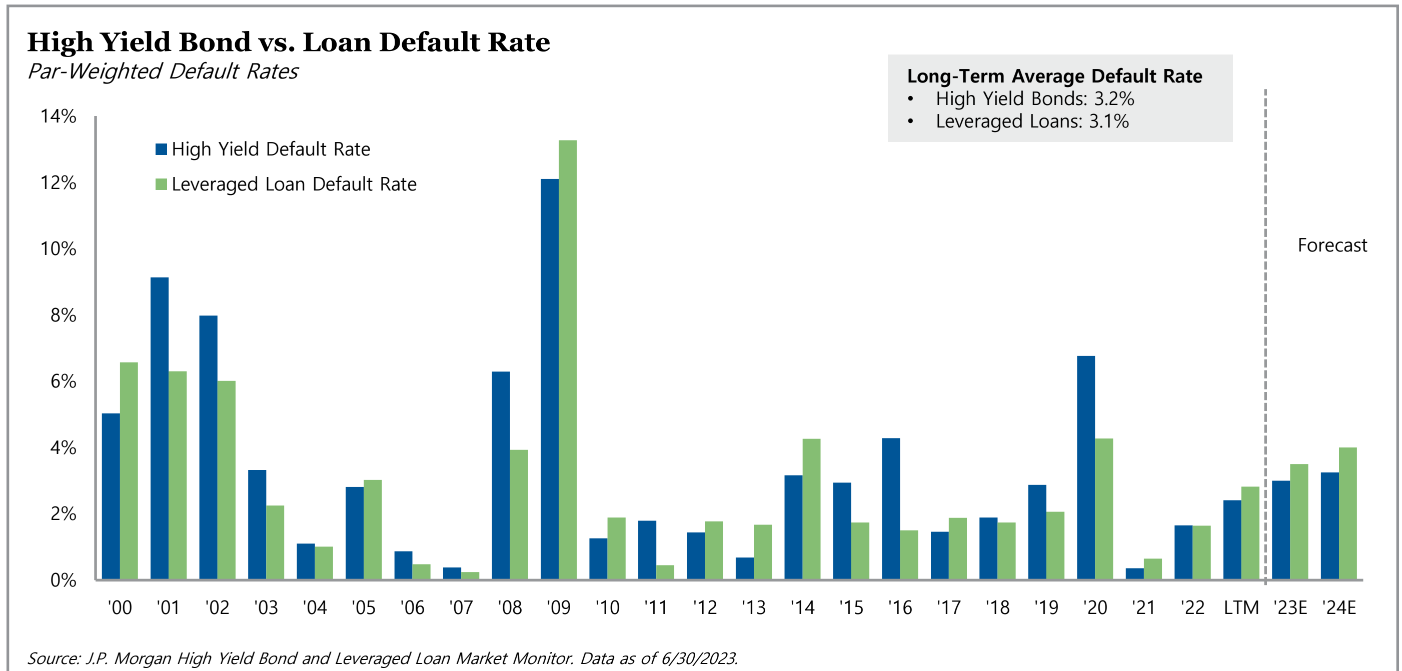
The average coupon for leveraged loans continued to exceed that of high yield bonds due to the higher base rate. A key metric to watch will be the impact of higher base rates on issuers' balance sheets and cash flows.



Coverage metrics for loan borrowers are at a one-year low and set to erode over the coming quarters.



Leverage for loan issuers is at a four-year low, albeit comfortably above the average among high yield issuers.



We continue to expect default rates to rise for both loans and bonds. Most sell-side analysts expect 2023 default rates to hover near their long-term averages.

Maureen D'Alleva
Portfolio Manager

For more information on Performing Credit, click here.

High Yield Credit

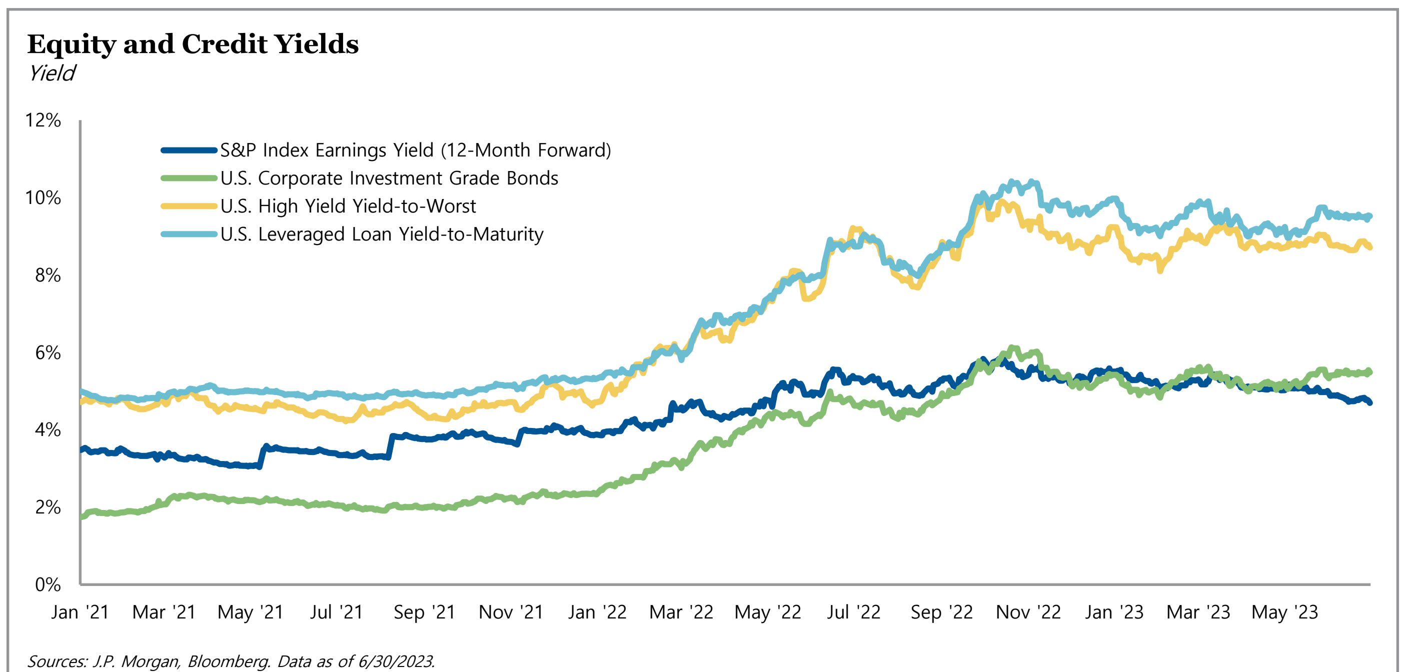
Both the U.S. and European high yield markets produced positive performance in the second quarter, with gains of 1.9% in the United States and 1.8% in Europe for the three-month period ended June 30, 2023. For the first half of the year, U.S. high yield generated a return of 5.8%, while the European high yield return reached 5.1% year-to-date.

In the United States, high yield bond spreads ended June at 434 basis points, tightening 65 basis points during the second quarter and – after beginning the year at 511 basis points – compressing 76 basis points in the first half of 2023. Lower-rated bonds continued to outperform higher-quality bonds; CCCs rose 5.0% while BBs generated an 0.8% return in the second quarter. For the first half of 2023, CCCs significantly outperformed BBs, generating returns of 10.2% and 4.6%, respectively. Twenty of the 21 U.S. sectors tracked by J.P. Morgan ended the quarter with positive performance, with broadcasting producing the only quarterly loss of -0.6%. In Europe, high yield spreads tightened 42 basis points to close the quarter at 494 basis points. Higher-quality BBs bested CCCs both during the second quarter – returning 1.9% versus 0.7% – and over the first six months of the year, generating returns of 4.9% and 2.1%, respectively.

During the second quarter, 28 U.S. companies defaulted or completed a distressed exchange on a combined $31.2 billion of debt – representing the highest level of activity since the second quarter of 2020. Through the first half, 45 companies defaulted or completed a distressed exchange. As of the end of June, the 12-month trailing default rate had increased from 1.91% to a two-year high of 2.71%. Between April and June, the European high yield market experienced four defaults, resulting in the 12-month trailing default rate rising 94 basis points to 1.36%.

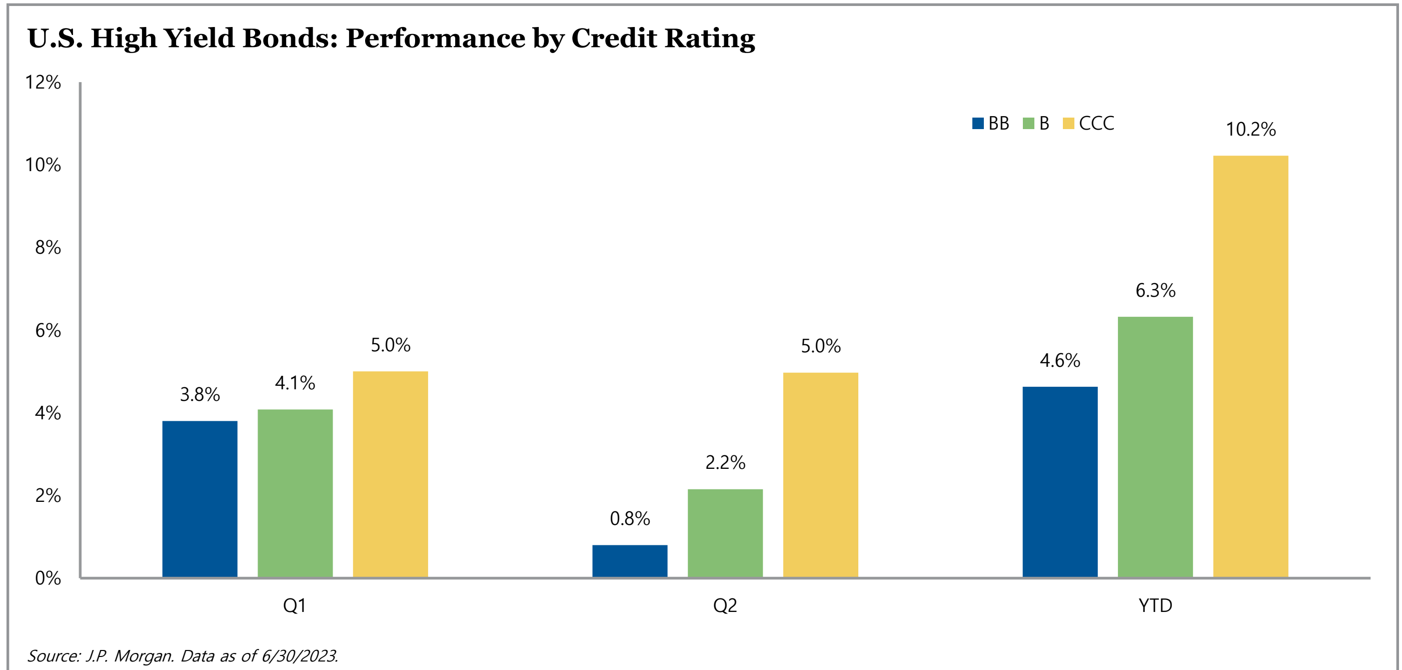
Building on the first quarter's $41 billion of primary market activity, there was approximately $55 billion of new issuance volume in the U.S. in the second quarter, bringing the year-to-date total to nearly $96 billion. This was the highest amount of new issuance recorded since the fourth quarter of 2021, and it comes on the heels of limited supply throughout 2022. In Europe, high yield new issuance totaled €16 billion during the quarter, which was in line with the first quarter's issuance of €16 billion.

In the second quarter, U.S. high yield funds experienced $3.6 billion of net inflows, compared to $14.8 billion of outflows in the first quarter. Year-to-date net redemptions of $11.2 billion were substantially lower than the $45.0 billion of outflows witnessed in the first half of last year. In Europe, high yield funds experienced modest outflows of €248 million during the quarter, though year-to-date inflows still reached €637 million.

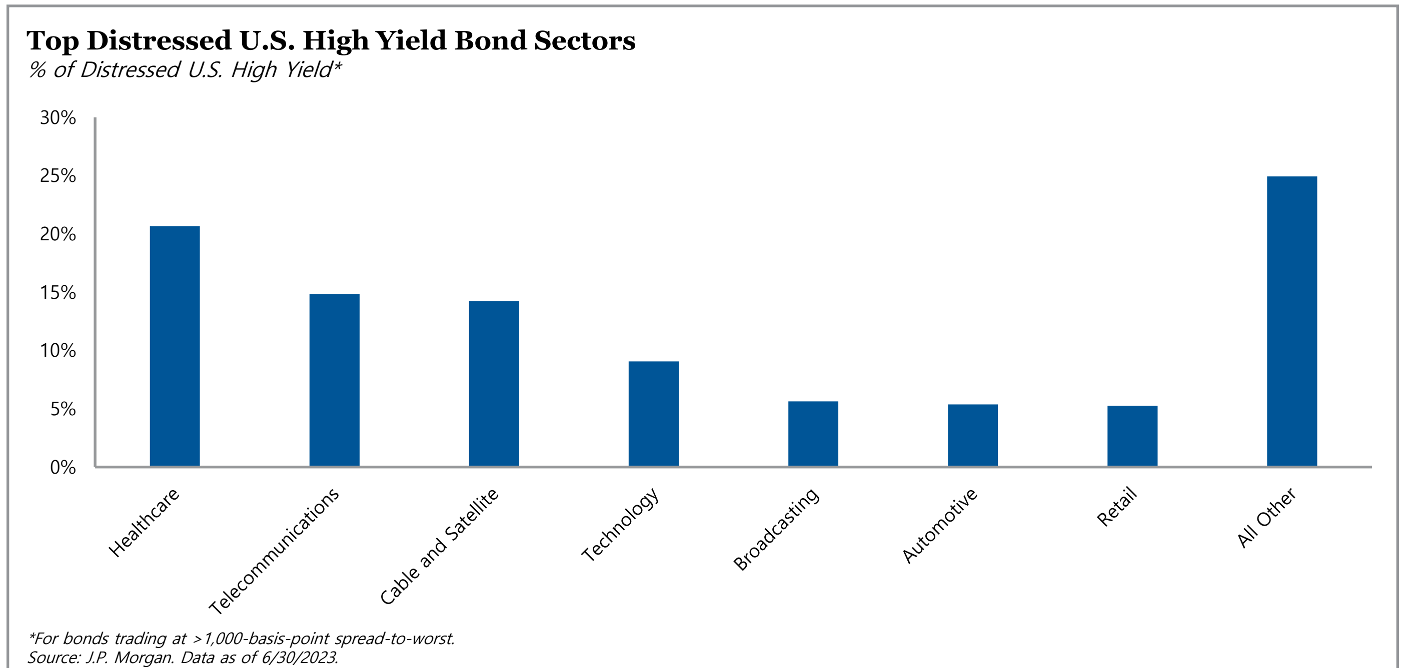


The rise in credit yields has outpaced that of equity yields.

High Yield Credit *(continued)*



In the U.S., CCCs significantly outperformed BBs during the first half of 2023.



Healthcare and telecommunications are the top distressed sectors.

Ryan Mollett
Global Head of Distressed & Corporate Special Situations

For more information on Distressed Debt, click here.

Structured Credit: RMBS

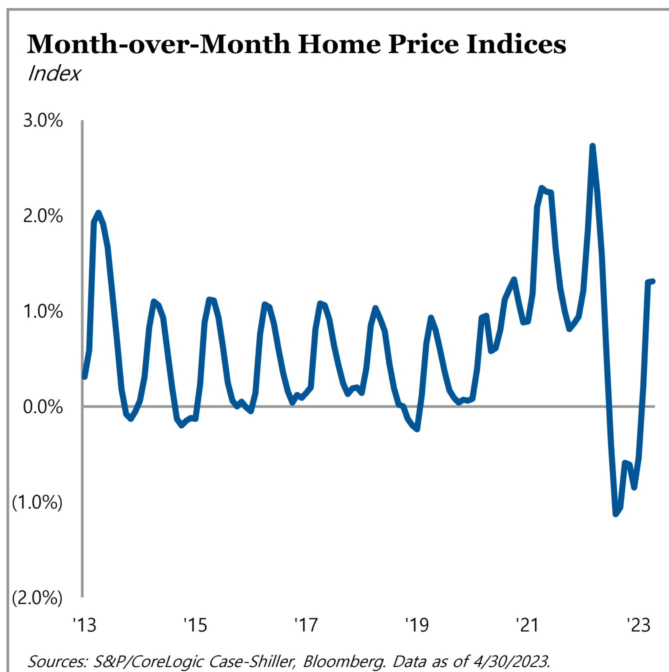
RMBS spreads were tighter during the second quarter, having benefitted from fixed income fund inflows and broader risk-on investing. Credit risk transfer (CRT) tranches tightened significantly, with deep credit tranches as much as 150 to 350 basis points tighter while the belly of the stack contracted approximately 50 to 150 basis points. Senior non-qualified mortgage (NQM) spreads tightened around 15 basis points, and legacy RMBS spreads were 30 to 40 basis points tighter during the quarter. Year-to-date total returns were between 6% and 11% for mezz and subordinate CRT tranches and in the range of 3% to 6% for legacy RMBS. Material capacity for additional tightening exists, as RMBS spreads remain wide of February 2022 levels.

RMBS issuance dropped approximately 19% to $15 billion in the second quarter – compared to $18.6 billion in the first quarter – driven largely by NQM declines. Year-over-year, issuance fell sharply from $45 billion in the second quarter of 2022. Activity in the first half of 2023 totaled $33.5 billion, down approximately 66% year-over-year amid limited origination activity and higher securitization coupons. Sell-side analysts predict full-year 2023 issuance will be $60 to $90 billion, down from $127 billion in 2022 and $213 billion in 2021.

After seven consecutive months of declines, the latest available data suggests national home prices bottomed in February and rose by 1.3% in both March and April. Those increases leave home prices over 2% higher year-to-date and only 2.4% below their June 2022 peak. We expect further home price appreciation to be challenged by reduced affordability and increasing supply in certain areas, though overall supply continues to be constrained, supporting prices.

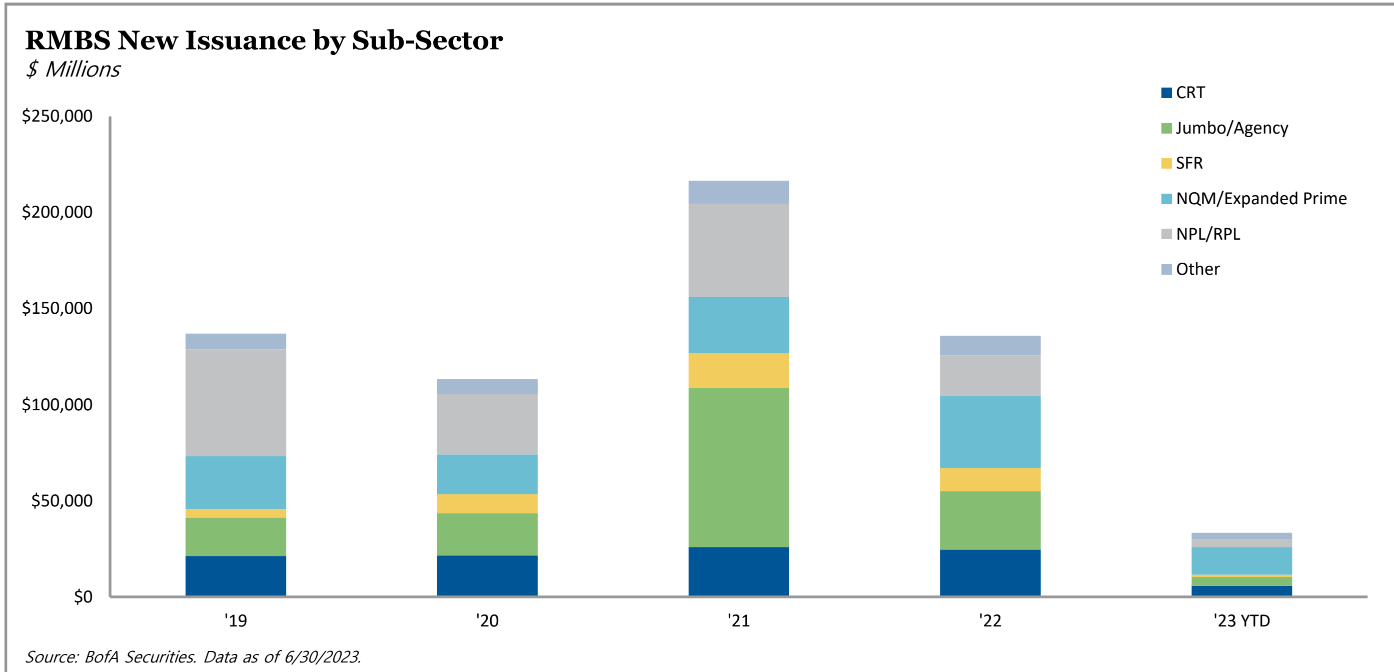
Mortgage rates ended the second quarter around 6.7%, below the October 2022 peak of over 7% and slightly higher than the first quarter's 6.2%. Amid persistently higher prevailing mortgage rates, home prices and activity have exceeded expectations. New home sales have been a driving force, steadily rising from 636,000 in December 2022 to 763,000 in May 2023. Conversely, existing home sales have struggled and were hampered by consistently limited listings. Total listings were roughly 1.08 million in May – down from 1.15 million a year ago and 1.91 million in 2019 – and only 448,000 were new listings of existing homes, well below 620,000 both a year ago and in 2019.

While homeownership affordability sits near all-time lows, against a backdrop of weak supply, demand for housing remains evident as borrowers adapt to a higher-rate environment. The percentage of homes sold off market within two weeks has held steady around 40% to 45%, and the sale-to-list price ratio rebounded to approximately 1x; however, the percentage of active listings with price drops ticked up above 5%. At around 0.8%, the national homeowner vacancy rate remains near its all-time low and below the 1.3% to 1.4% range recorded in 2019.

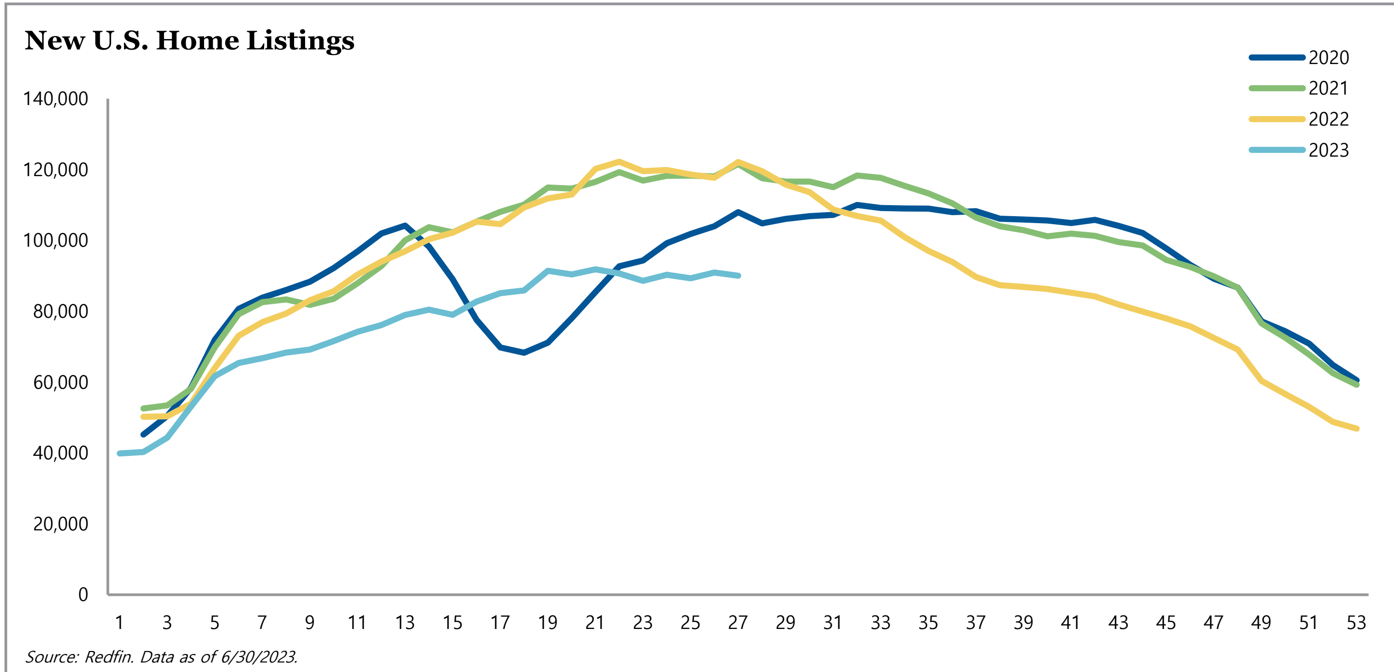


National home prices reversed course into positive territory.

New home sales are rising, while existing home sales have struggled.



Muted housing activity has limited RMBS new issuance.



New listings of existing homes remain very limited, supporting home prices.

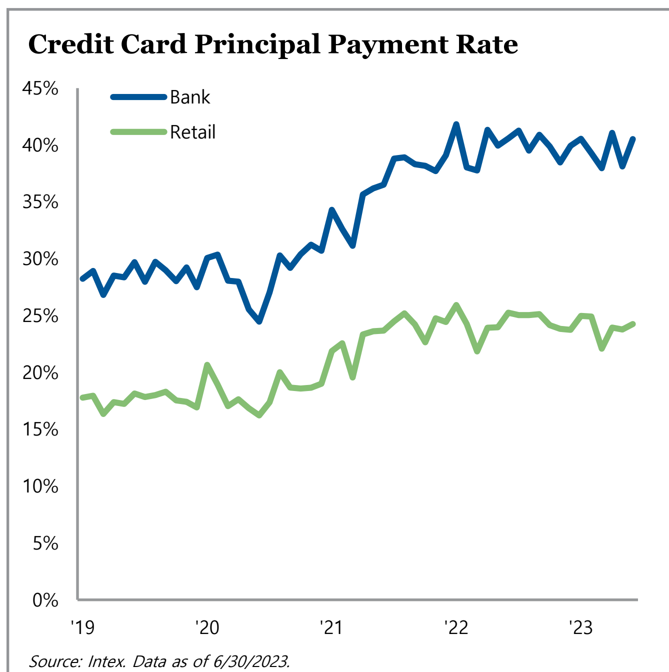
Structured Credit: ABS

ABS spreads were mostly tighter during the second quarter, generally owing to the same support as the mortgage markets. Triple-B subprime auto ABS tightened 20 to 40 basis points, and fixed-rate private credit student loan ABS were 30 to 40 basis points tighter. Subordinate credit card ABS were flat to 10 basis points tighter, while some esoteric sectors were up to 25 basis points wider. Year-to-date, spreads have been mixed. Esoteric sectors like floorplan and rental ABS were 10 to 30 basis points wider over the first half of the year. Triple-B subprime auto spreads tightened 115 basis points, and BB-rated auto and consumer loans tightened 80 to 90 basis points. Notwithstanding the year-to-date rally, ABS spreads ended the first half wide of February 2022 levels, particularly down-in-credit and subordinate tranches. BB-rated auto ABS were approximately 200 basis points wider than February 2022 levels, and double-B consumer loans were over 300 basis points wider.

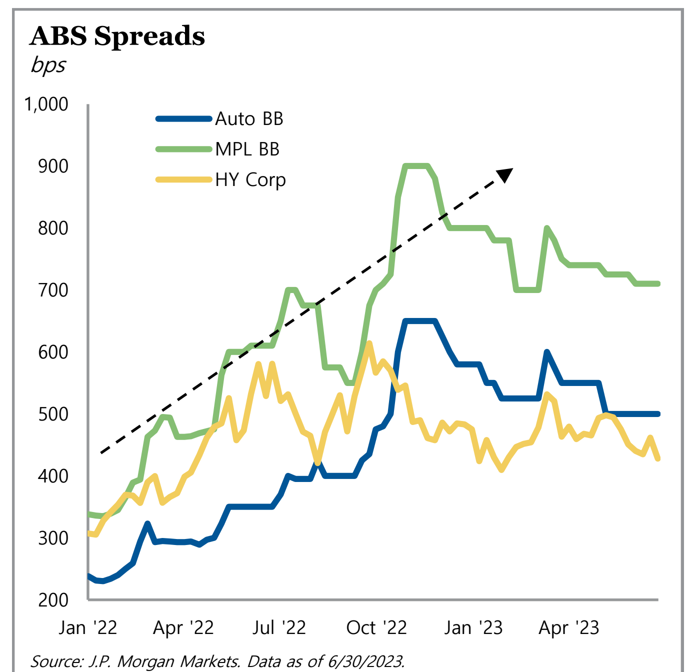
Primary issuance activity totaled $74.5 billion in the quarter, up 17% quarter-over-quarter – led largely by elevated credit card ABS issuance – but still down around 4% year-over-year. Second quarter activity brought year-to-date ABS issuance to $138 billion, down around 6% from year-ago levels. Sell-side analysts generally expect full-year 2023 issuance to hover around $250 billion, down from $253 billion in 2022 and $285 billion in 2021.

Consumer performance data was stable, particularly in the auto and unsecured consumer loan sectors given favorable seasonal effects. While credit cards continue to demonstrate stable performance, a slow grind to pre-pandemic levels may be emerging, with payment rates and early delinquencies underperforming seasonal expectations. However, credit cards continue to far outperform pre-pandemic levels. Student loan performance was favorable, and legacy private credit student loans continued to generate ample recovery proceeds but saw slower prepayments and higher defaults.

Consistent with expectations, the Supreme Court rejected the White House's student loan forgiveness plan. Perhaps more impactful is the resumption of federal student loan payments, which will restart in September and are estimated to average around $247 per month. Reinstating payments will create a drag on household disposable income, and given student loans' low placement in the payment hierarchy, missed payments – following a 12-month "on ramp" period – are likely to negatively impact credit scores. That said, ABS opportunities may emerge, as the payment resumption should increase student loan refinancing and the resultant ABS, which have effectively collapsed since the start of the moratorium. Following the Supreme Court rulings, the White House announced a rulemaking process aimed at creating a new channel for debt relief using the Secretary of Education's authority under the Higher Education Act, which is likely to be challenged. Additionally, the Administration will roll out a previously announced income-driven repayment program.

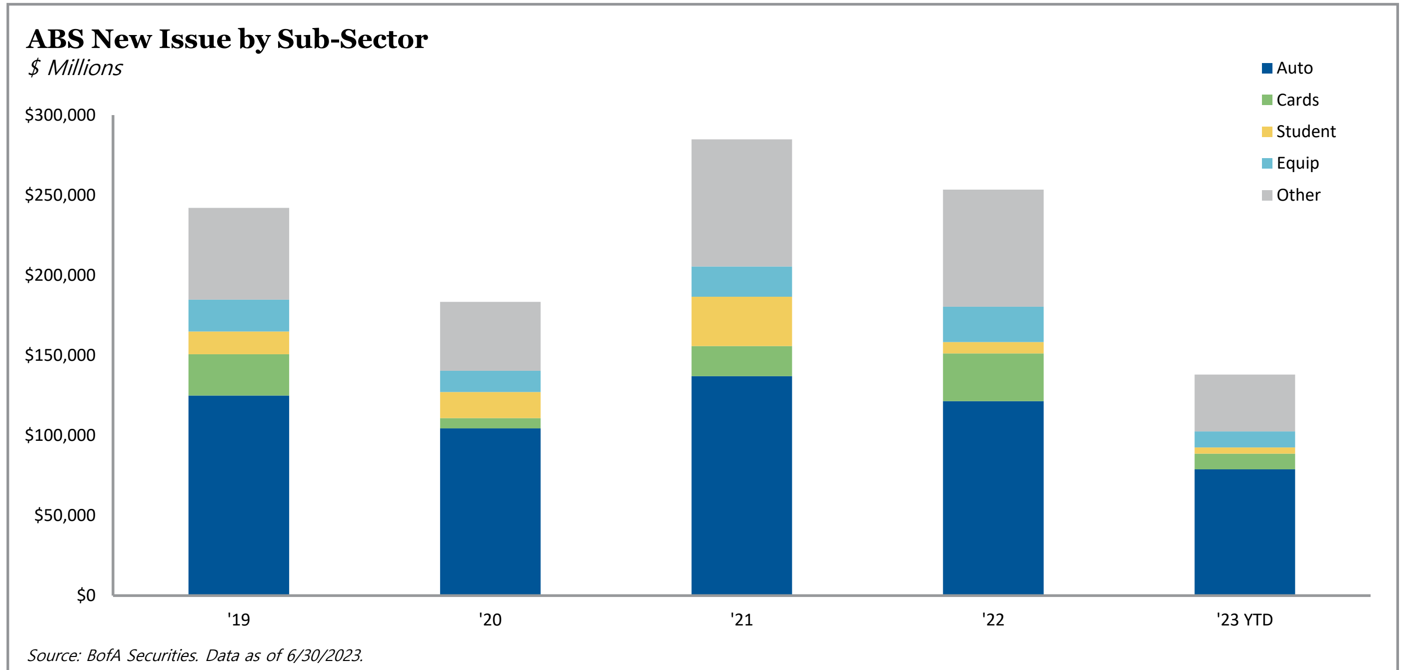


Credit card principal payment rates remained stable.

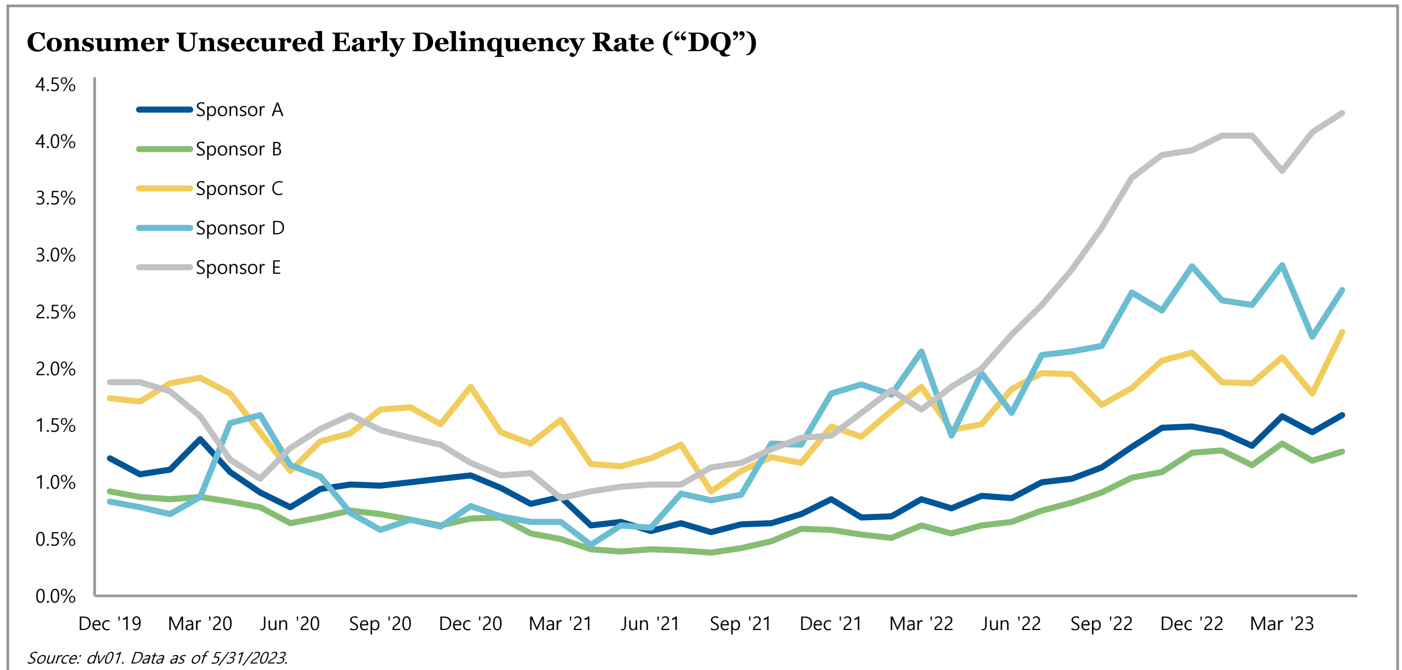


ABS spreads are still wide of February 2022 levels.

Structured Credit: ABS *(continued)*



ABS Issuance in the first half of 2023 was slightly higher than year-ago levels.



Unsecured DQs stabilized slightly due to favorable seasonal effects.

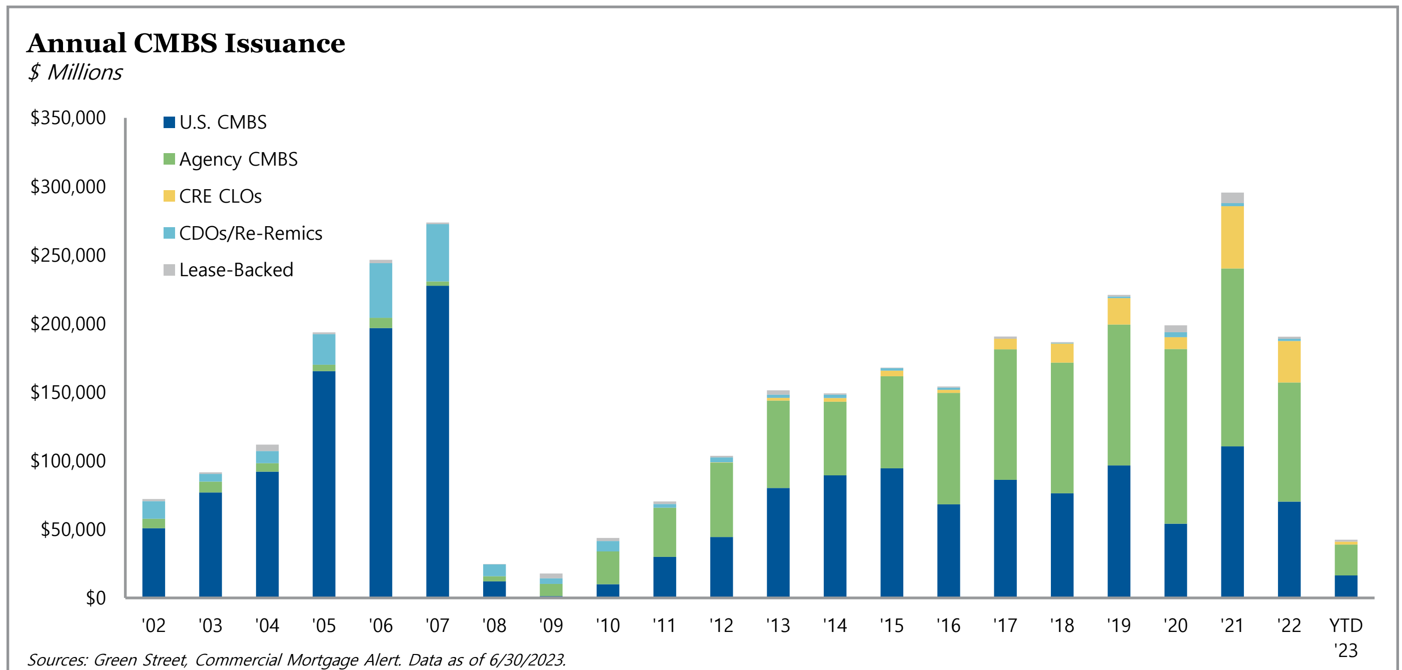
Structured Credit: CMBS

The commercial real estate debt markets were relatively calm during the second quarter of 2023. Senior portions of the capital structure saw moderate spread tightening and a handful of new issue transactions priced. Lower down in credit, the story was more challenging; pricing transparency was limited on anemic trading volumes, and spreads for conduit BBBs were framed as relatively unchanged over the period, but without much conviction.

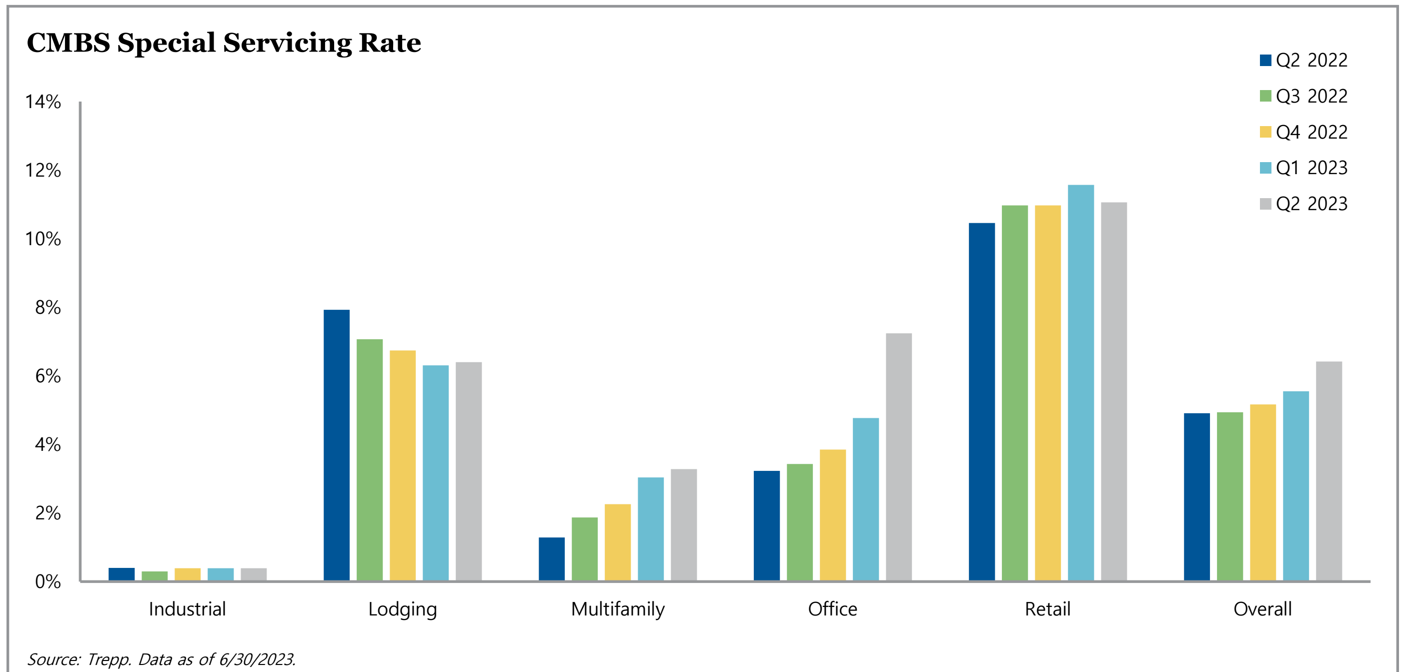
At approximately $20 billion, first-half issuance volume was down 75% year-over-year and equated to about 50% of average issuance volumes going back over the past 12 years. Furthermore, conduit CMBS issuance was down 56% from the prior year, SASB volumes were off 77%, and CRE CLO issuance was down 90%, thus we don't expect a meaningful increase in issuance during the second half of 2023. While constricted lending capacity from competing CRE financing sources – particularly regional banks – may make CMBS look relatively more attractive for borrowers, we don't believe this will be enough to offset significant headwinds. Despite the Fed pausing on a rate hike in June, persistent inflation has the market pricing additional hikes in the second half of 2023 – further pressuring CRE valuations. Additionally, with limited CRE transaction activity, valuations remain unclear. Until trade volumes pick up, there will be limited demand for acquisition financing. From a refinancing perspective, we believe borrowers will be in for sticker shock when they see average conduit CMBS coupons at 6.9% – compared to just 3.9% at the start of this most recent hiking cycle. On the margin, this will likely incentivize borrowers to work with their existing lenders on modifications and extensions rather than taking out new loans.

As we move further into this correction cycle, theoretical negative outcomes are slowly becoming more likely. This can be most easily seen in the percentage of CMBS loans that have been transferred to special servicing. This figure increased significantly during the second quarter, jumping 87 basis points to 6.42%. Unsurprisingly, the performance deterioration was led by office and mixed-use assets, which increased 247 basis points to 7.24% and 196 basis points to 5.96%, respectively.

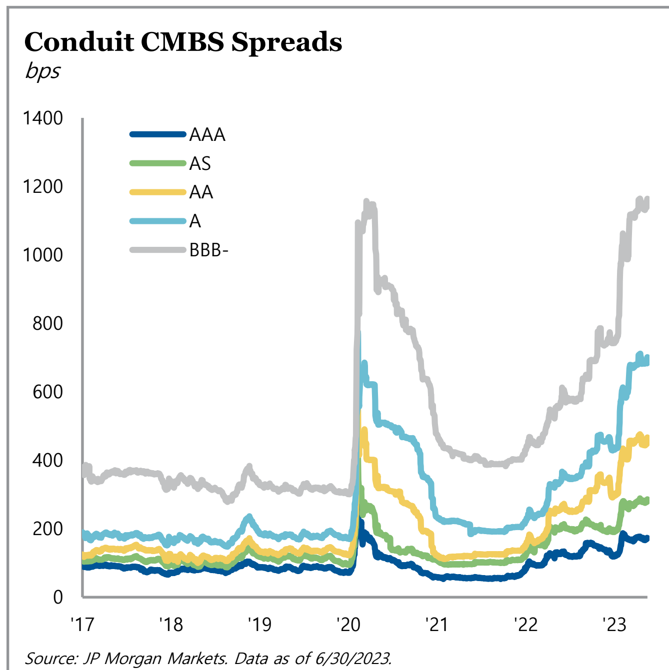
Going forward, we expect to see continued negative headlines and limited near-term prospects for a meaningful price recovery down in credit. However, given current distressed pricing levels, tighter spreads for competing assets, and limited new issue volumes, we would not be surprised to see demand for seasoned credit bonds increase as we move closer to year-end and into early 2024.



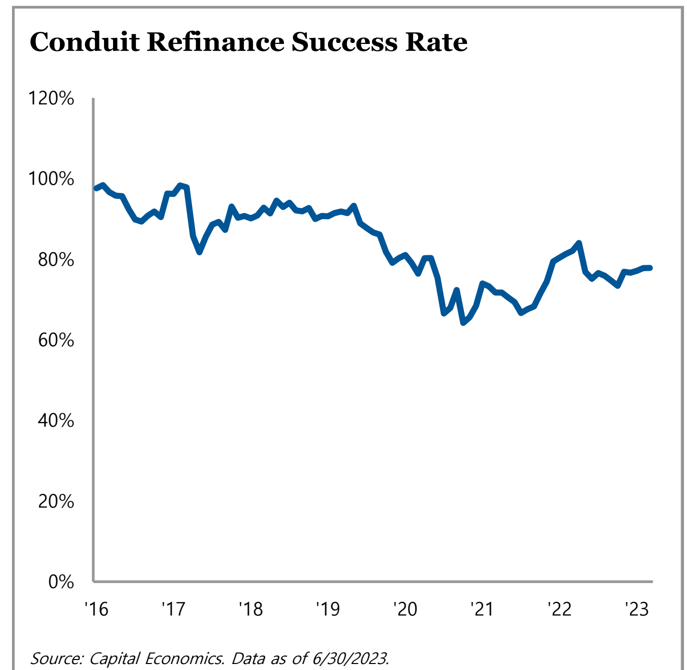
While 2022 issuance volumes were consistent with prior years, high interest rates and low transaction volumes are limiting new issuance to approximately half of historical averages.



The percentage of CMBS loans in special servicing increased by 87 basis points in the second quarter, with loans secured by office properties driving the majority of the increase.



Conduit CMBS spreads below the AAA level continued to drift wider during the second quarter and are now near levels seen at the peak of the COVID-19 panic.



The percentage of CMBS loans repaying by their stated maturity date remains healthy, but we expect it will decline in the second half of this year.

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

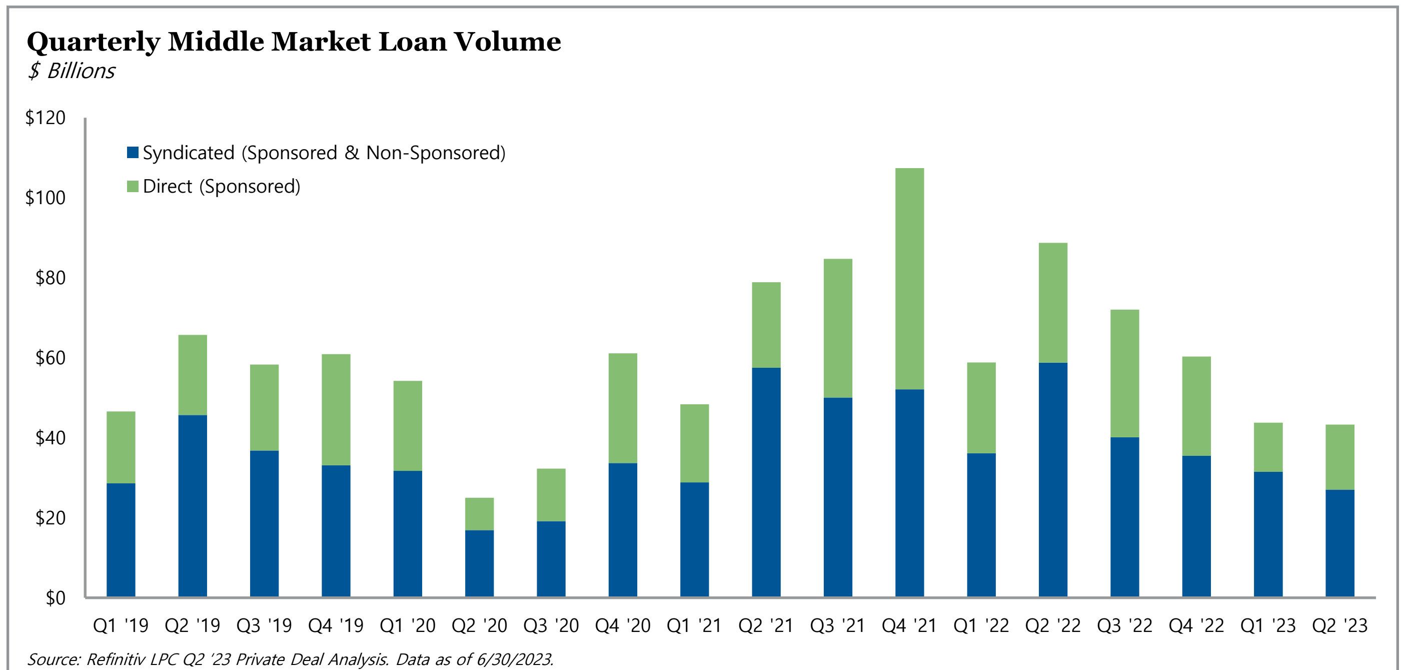
Total sponsored middle market volume, including direct and syndicated activity, was $22 billion in the second quarter of 2023, up 9% quarter-over-quarter but down 52% year-over-year. The decrease was mostly driven by syndicated volume, which fell nearly 65% year-over-year, while direct lending volume was down 45% over the same period and up 32% quarter-over-quarter. Private credit continued to be the preferred source of financing, with the ratio of direct lending to syndicated volume climbing to 2.6x. As leveraged buyout (LBO) volume continued to trend lower, private credit held market share; the volume of LBOs financed in the direct lending market was 11.5 times higher than the volume of syndicated LBOs in the second quarter. In addition, add-on acquisition loan volume was up 25% quarter-over-quarter, implying that incremental commitments continue to support existing portfolio companies.

Middle market direct lending terms continued to favor lenders, with elevated spreads and all-in yields. For direct lender-led deals in the second quarter, the average yield on all first-lien middle market term loans was almost flat at 12.38% and the lower middle market (LMM) set a new record at 12.6%, as lenders continued to extract a spread premium. Although average yields on large corporate deals widened 60 basis points to 10.06%, direct lender-led deals continued to offer a premium. Additionally, LMM spreads hit a new high of SOFR + 654 basis points – up 26 basis points from the beginning of 2023.

Even though total leverage profiles on middle market sponsored transactions ticked up in the second quarter – rising to 4.54x EBITDA after tightening for four consecutive quarters – the reading was the second-lowest since the first quarter of 2017. The increase was driven by the upper middle market, which rose to 5.03x, while the core and lower middle markets edged down to an average of 4.66x and 4.10x, respectively.

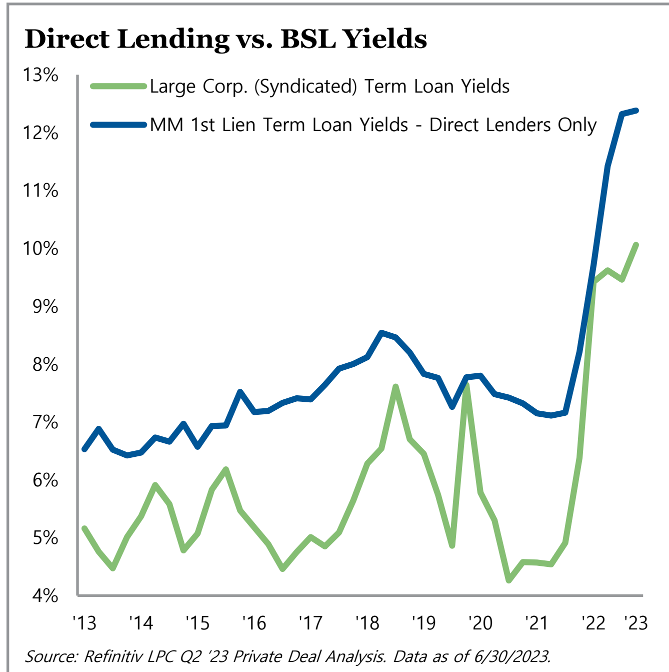
Despite concerns that borrowers are facing challenges due to higher interest costs, the annualized private credit default rate decreased to 1.64% in the second quarter. The default rates in the core and upper middle markets declined while the LMM rate increased incrementally, though we believe the data points are not comparable; the LMM rate is likely driven in part by covenant defaults, which are unlikely to be reflected in the upper and core middle market metrics given the prevalence of EBITDA add-backs and covenant-lite structures in those segments.

Fundraising activity in the U.S. direct lending market remained sluggish in the second quarter but on pace with 2022; nine funds have closed year-to-date, totaling $23 billion raised. While fundraising volumes have declined in 2022 and 2023, the pace of capital raising is in line with or ahead of the three years leading up to 2021 – a record year – implying continued interest in the asset class.

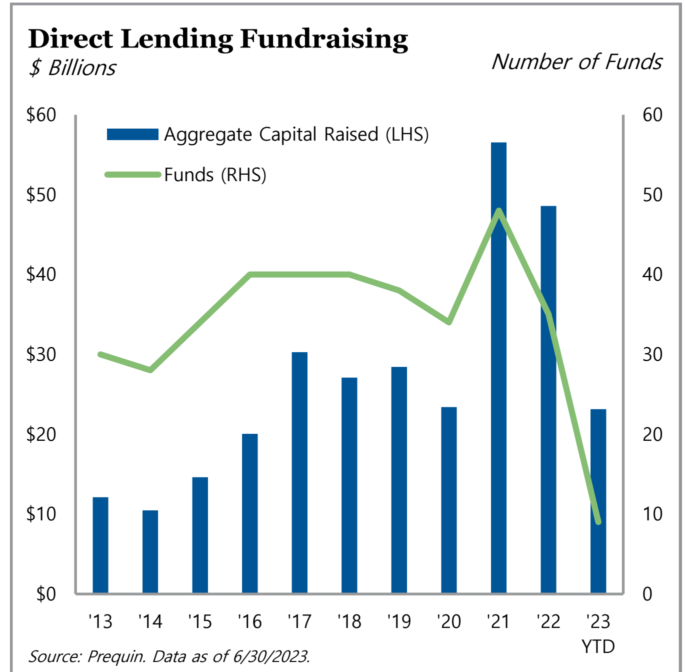


U.S. middle market loan volume totaled $43 billion in Q2 2023, reflecting a quarter-over-quarter increase in direct volume.

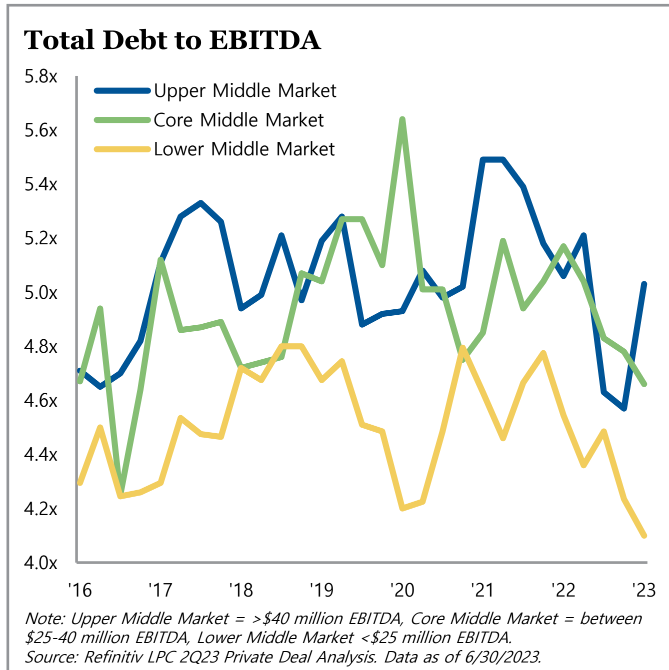
Middle Market Direct Lending *(continued)*



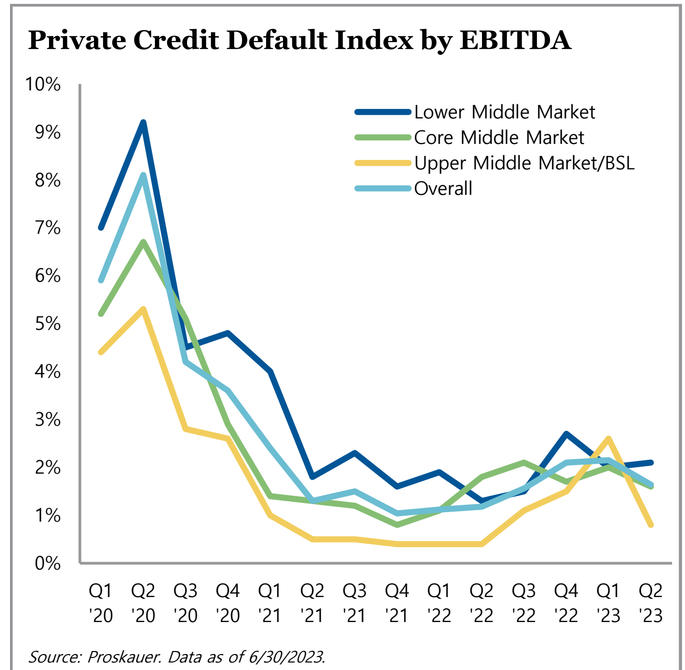
The direct lender yield premium over large corporate deals declined in Q2 2023 but remains above 200 basis points.



Fundraising in the first half of 2023 surpassed $20 billion, keeping pace with 2022.



Trends in total leverage multiples across sponsored middle market direct lending were mixed in the second quarter.



The annualized private credit default rate decreased following two consecutive quarterly increases.

Trevor Clark
Portfolio Manager

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

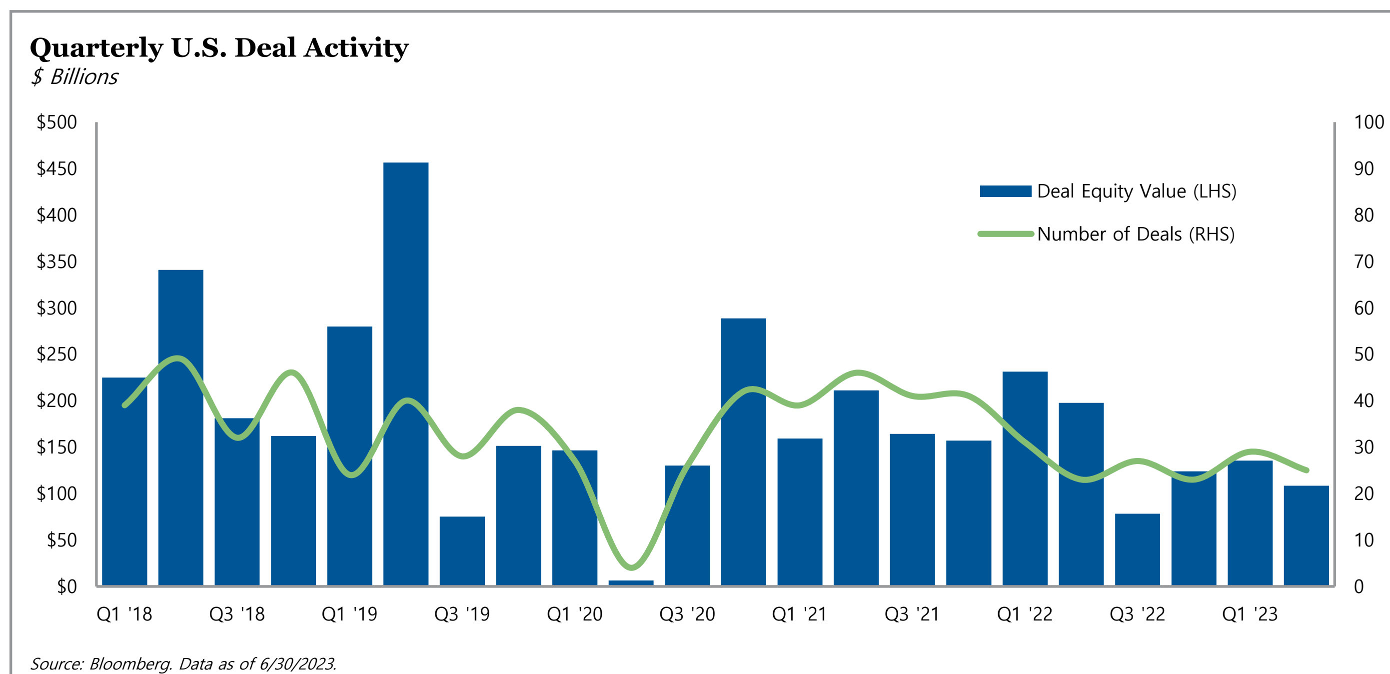
Merger Arbitrage

Although down 45% year-over-year, U.S. M&A activity has remained relatively steady over the past three quarters. In the second quarter, deal count increased slightly from last year and the shift toward midsize deals continued. This dynamic has persisted due to a number of factors, including unpredictable regulator behavior, increased financing costs, and a wide bid-ask spread between buyers and sellers due to continued economic uncertainty.

Healthcare was again the most active sector with 40% of the top ten deals for the quarter, led by Merck's $10.8 billion acquisition of Prometheus Biosciences. Financial sponsor activity accounted for only 16% of deal value, marking a steep decline to levels last seen pre-pandemic. This slowdown may be in part attributable to the industry's apparent interest in the U.S. Department of Justice's final determination on Thoma Bravo's pending acquisition of ForgeRock.

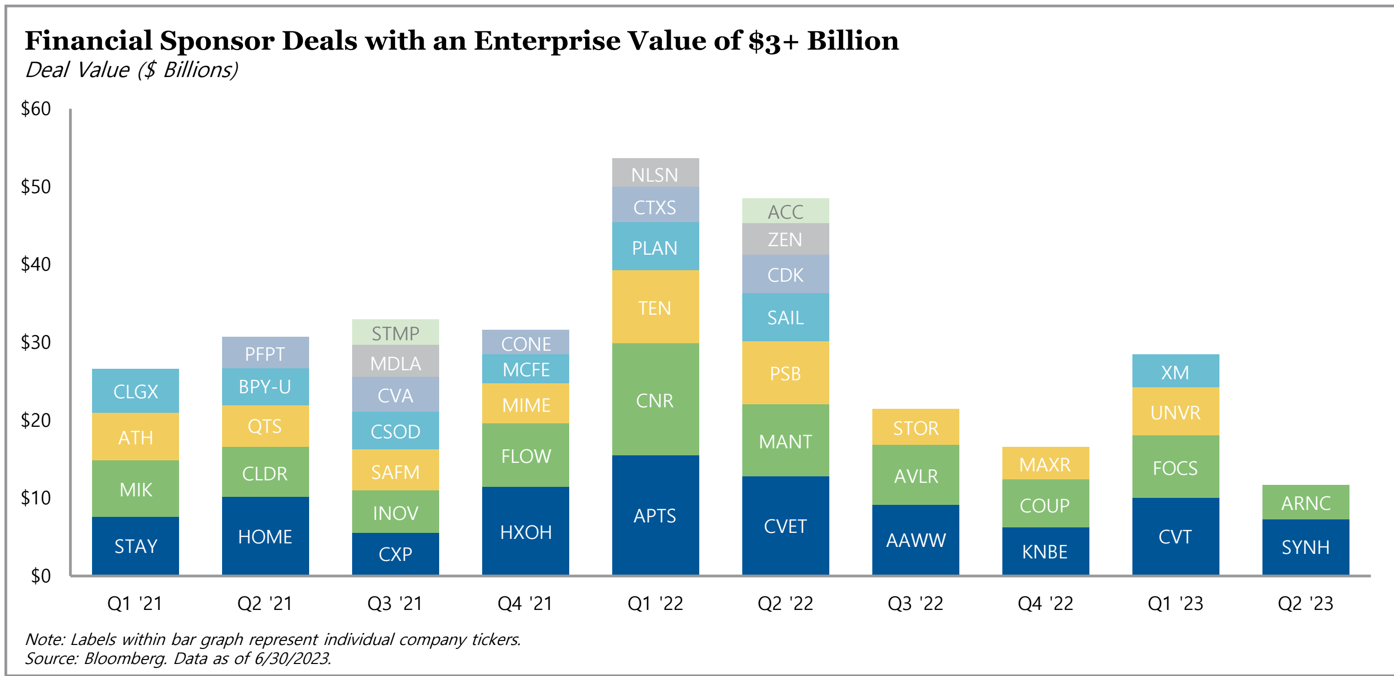
After a rally in late-March, deal spreads continued to tighten through much of April, with market-cap-weighted gross spreads tightening to around 12%. However, a trio of surprise negative events brought that trend to an abrupt end. First, the UK's Competition and Markets Authority (CMA) surprised the market by blocking Microsoft's acquisition of Activision Blizzard Inc. based on concerns over the nascent cloud gaming market. The move – which came shortly after the regulator dropped its concerns about the deal's impact on competition in the console gaming market – sent Activision's stock lower, but Microsoft remains committed to the transaction and continues to battle both the CMA and the U.S. Federal Trade Commission (FTC). Soon after, TD Bank and First Horizon Corporation announced the termination of their merger agreement; the decision was reportedly the result of regulatory challenges faced by TD Bank – unrelated to First Horizon – that are expected to leave the bank unable to secure U.S. regulatory approval for any bank-related M&A for potentially several years. Finally, in May, the FTC delivered a third surprise in the form of a last-minute lawsuit to block Amgen Inc.'s acquisition of Horizon Therapeutics plc, which is due to go to trial in mid-September. This series of events drove spreads to quickly widen approximately 500 basis points in late April through May, though they began to recover as the market digested the news, and spreads ended the quarter at a 14.9% market-cap-weighted gross spread.

We have discussed the uncertainty surrounding the behavior of antitrust agencies around the world, led by the U.S., for the past two years and – looking out at the second half of this year – there appear to be signs of a crescendo forming. While Microsoft and Amgen are only fighting for their respective deals, one could argue that the court rulings on these challenges will impact how boardrooms approach M&A in the near future. This regulatory uncertainty could well become another cost of doing business that boards must account for.



U.S. deal activity has remained subdued but steady over the last four quarters.

Merger Arbitrage *(continued)*



Sponsor activity has slowed as the Federal Reserve has continued to increase interest rates.

Mark Wojtusiak
Head of Merger Arbitrage

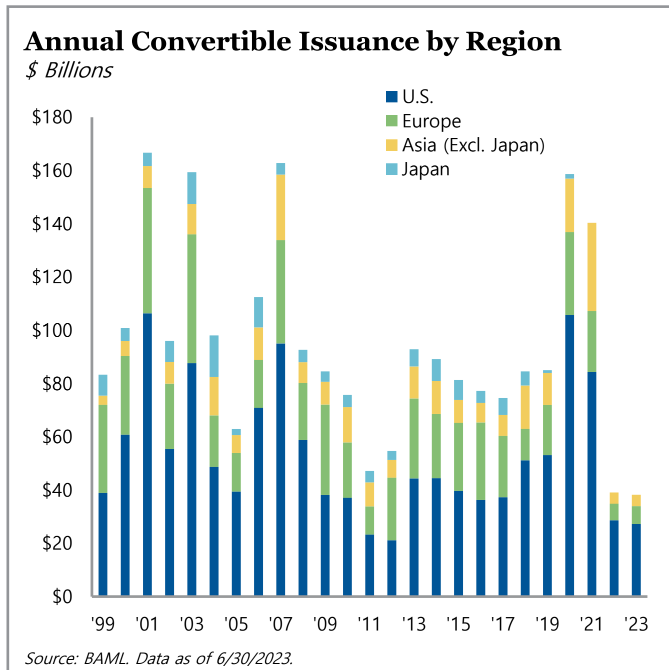
For more information on Merger Arbitrage, click here.

Convertible Arbitrage

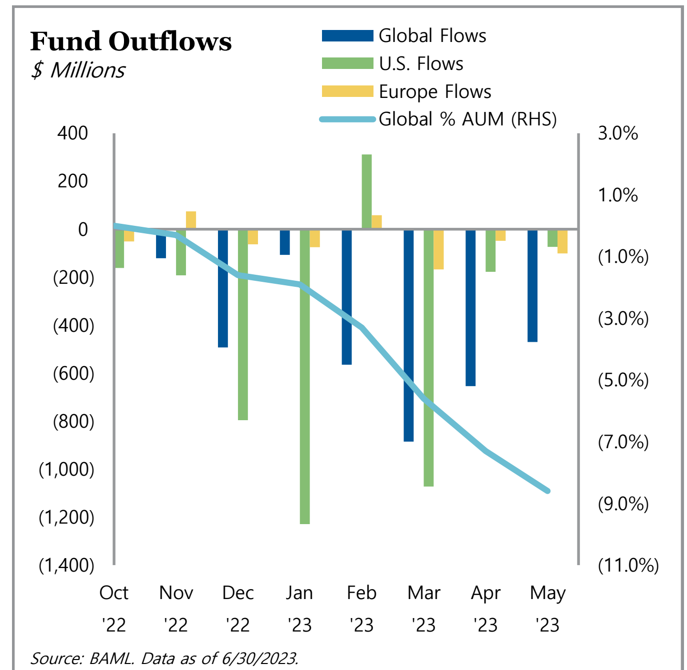
Global equity markets produced solid gains in the second quarter, adding 6.6% and taking the year-to-date return to 14% as investors continued to bet on moderating inflation and a soft-landing in the major economies. U.S. technology stocks performed particularly well, driven by the expected growth of artificial intelligence. Moreover, equity market volatility compressed further despite ongoing geopolitical tensions and central bank policies that may remain restrictive for some time, considering persistently high inflation levels and mixed macro data. Meanwhile, rising interest rates and the prospect of higher peak rates led to weakness in the bond markets in the second quarter. Additionally, commodities – particularly agricultural and energy complex – extended their decline.

Overall, the backdrop remained supportive for convertible bonds. On an outright basis, global convertibles returned 3.55% in the second quarter, and convertible arbitrage strategies gained 2.25%. The primary market saw $19.5 billion of new convertible deals priced in the second quarter. Deal volume in the first half of 2023 totaled $39.3 billion, which is roughly equal to the total volume recorded for full year 2022. With $27.3 billion of deals that came to market, the U.S. was the strongest region for issuance in the first half of this year, followed by Europe at $6.7 billion and Asia at $5.3 billion. From an investor perspective, new issue terms have generally been more attractive, with lower average premiums and higher average coupons – reflecting the cheaper secondary market and new rate environment. In the primary market, the trend away from young, high-growth issuers to more established, higher credit quality issuers continued. We are confident that new issuance will maintain its current pace, or even slightly accelerate, in the second half of this year. As the realization sets in that rates may stay higher for longer, we expect corporates will seek to get ahead of the 2025 and 2026 maturity walls in global high yield and global convertibles.

The prospect of active primary markets and the recent decline in valuations in the secondary market – driven by redemption-led selling and exacerbated by lower levels of realized volatility – leaves us more constructive on the global convertible market than we have been for some time.



Global new issuance in 2023 has already reached last year's total volume.



Outflows from global and European convertible funds have put pressure on the secondary market.

Gary Wolf
Head of Convertible Arbitrage

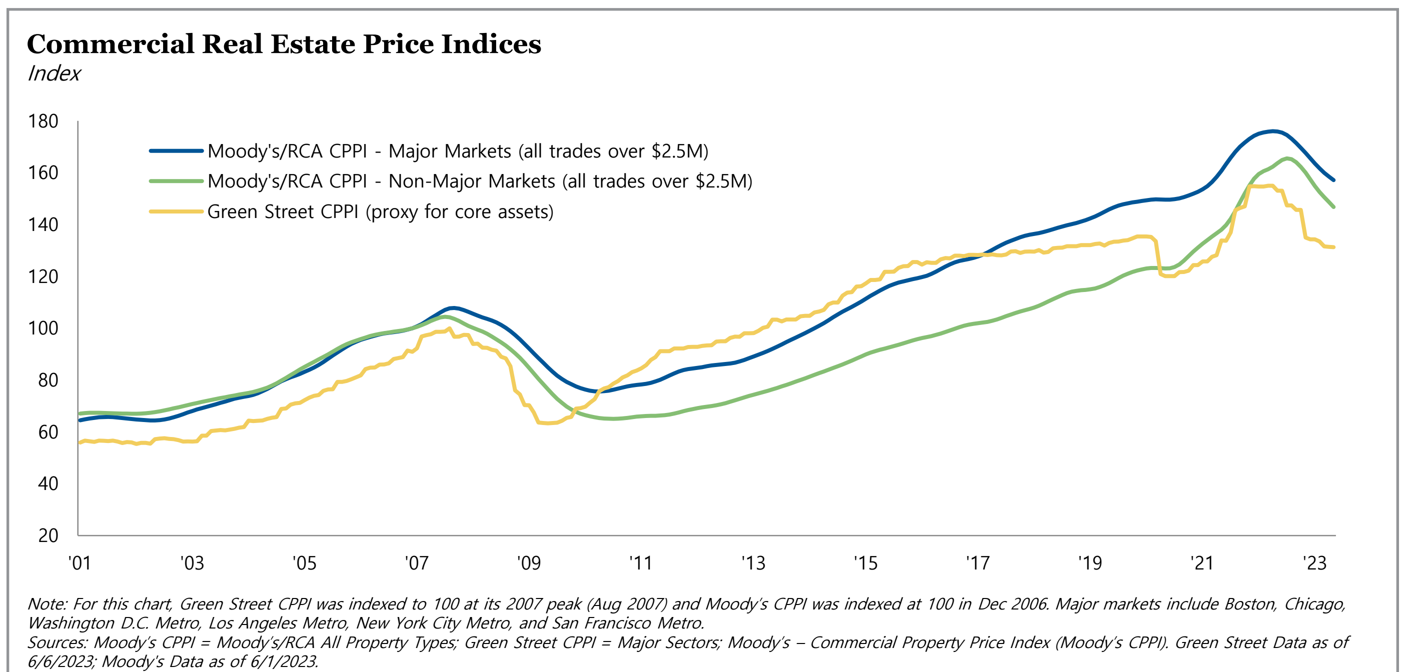
For more information on Convertible Arbitrage, click here.

U.S. Real Estate

The second quarter of 2023 ushered in some relative stability with a systemic banking crisis seemingly contained. However, financing markets continued to remain tight amid concerns about credit issues in existing loan books and uncertain economic prospects. While inflation indicators continue to show signs of moderation, several contributors remain stubbornly high, prompting the Fed to signal further interest rate increases and a "higher for longer" stance. Compounding concerns, the inverted yield curve as measured by the 10-year versus 3-month Treasury spread has widened beyond the levels reached in the lead up to the global financial crisis.

During the second quarter of 2023, commercial property transaction volume fell 63% year-over-year, driven by elevated borrowing rates and a sharp reduction in liquidity and credit availability. All sectors reported decreases in total transaction volume. Lenders are experiencing fewer loan payoffs, shrinking deposits, and increasing economic uncertainty, reducing their appetite to lend. Meanwhile, buyers are having difficulty penciling acquisition opportunities, as cap rates have been slower to adjust than the cost of debt. Risks remain high, as monetary policy works with long, variable lags and the Federal Reserve remains steadfast that it intends to maintain higher interest rates for some time. Moderate economic growth has continued to support stable fundamentals for most property types, excluding office. As such, U.S. commercial real estate has entered the current challenging financial environment on relatively strong footing. Apart from reported multifamily starts, new supply is tapering, and there is no evidence of broad oversupply. Residential mortgage rates are once again climbing, but the for-sale housing market has at least temporarily bottomed – assisted by limited inventory and a modest reset in home prices. Spring selling season demand has largely surprised to the upside, and the FHFA House Price Index increased sequentially in early spring.

Deteriorating fundamentals, higher borrowing costs, and contracting transaction volume are challenging the precision of spot real estate value estimates. The Green Street Commercial Property Price Index ended June down 15.9% from its March 2022 peak. As of the end of the first half of 2023, U.S. REIT shares had recovered year-to-date and were trading at a 16% equal-weighted discount to NAV on average, implying potential further declines for private market property valuations. Green Street Advisors' model, which tracks the historical relative value relationship between private real estate and fixed income (investment grade and high yield), pegged real estate as modestly overvalued.

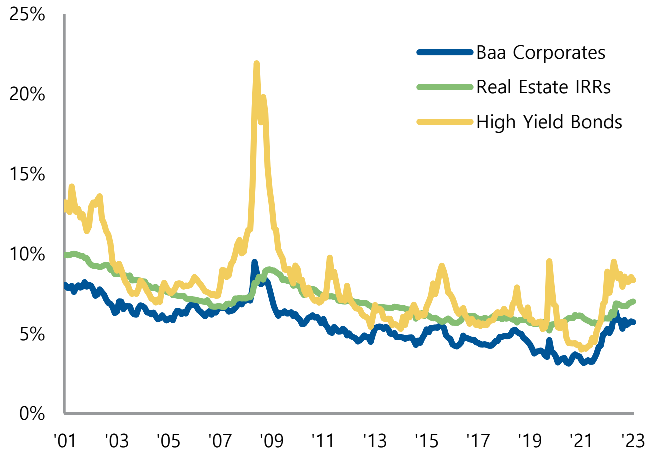


Note: For this chart, Green Street CPPI was indexed to 100 at its 2007 peak (Aug 2007) and Moody's CPPI was indexed at 100 in Dec 2006. Major markets include Boston, Chicago, Washington D.C. Metro, Los Angeles Metro, New York City Metro, and San Francisco Metro.
Sources: Moody's CPPI = Moody's/RCA All Property Types; Green Street CPPI = Major Sectors; Moody's – Commercial Property Price Index (Moody's CPPI). Green Street Data as of 6/6/2023; Moody's Data as of 6/1/2023.

Key indicators imply that private real estate pricing is declining.

U.S. Real Estate *(continued)*

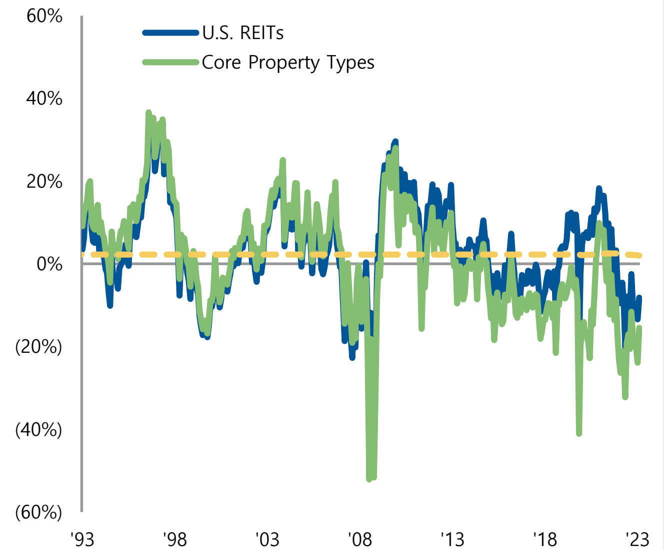
Unlevered Total Return Expectations on Real Estate vs. Corporate Bond Yields



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, Moody's (Baa Corporates), BAML (High Yield Bonds). Data as of 7/1/2023.

Real estate is currently modestly overvalued relative to bond yields.

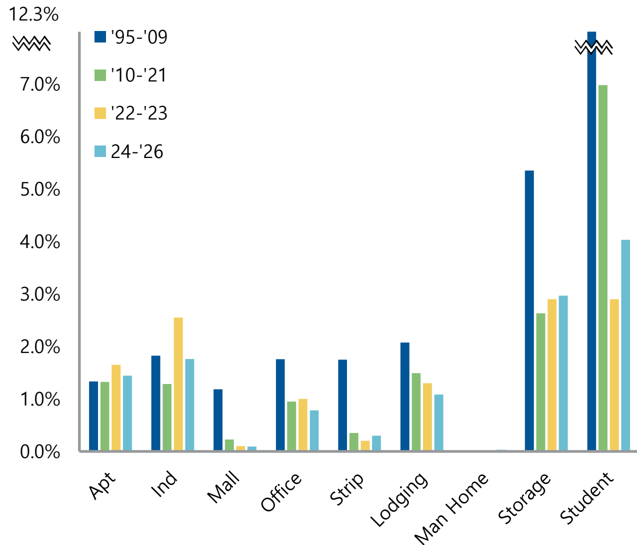
Public-Private Price Comparison



Note: Core Property Types include Office, Retail, Apartment, and Industrial.
Source: Green Street Advisors. Data as of 7/10/2023.

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

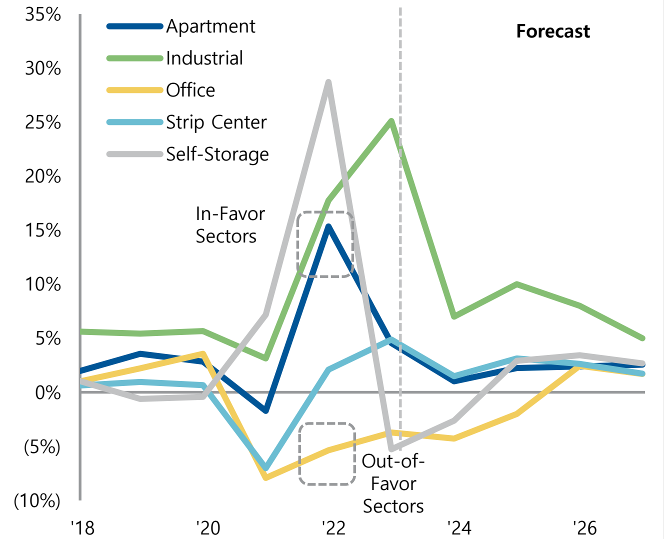
Supply by Sector



Note: Estimates are not shown because impact has not been quantified.
Source: Green Street Advisors. Data as of 5/31/2023.

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. Data as of 6/30/2023.

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

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

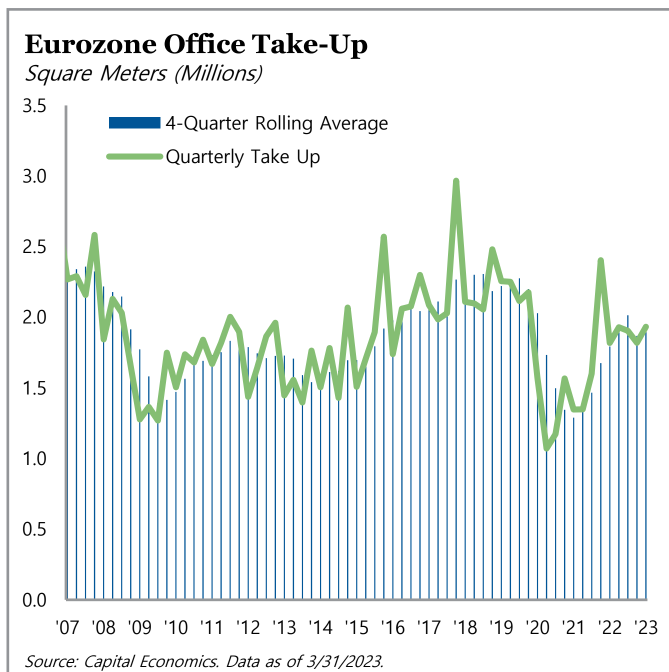
Europe Real Estate

With GDP growth and household spending pulling back, Europe will likely remain in a recession through this year. Generally, the economic downturn has been mild, but the recovery is expected to be slow given market inefficiencies, poor demographics, and the repercussions of a decade-long era of negative yielding debt in Europe. While inflation has dropped from the peak witnessed in 2022, levels are still far above targets, and central banks are continuing their interest rate hike programs. Risk-free rates have already increased between 300 and 400 basis points since 2020. As an interest rate-sensitive industry, commercial real estate has seen a significant decline in values. The price drops triggered by higher borrowing costs have been exacerbated by a number of factors, including the capital required to comply with strict European ESG standards and changes in workforce behavior that have led to altered space configurations or a reduction in leasing demand. Unlike during the GFC – when rates and values declined simultaneously – real estate owners in the current environment are contending with decreasing values alongside rapidly increasing rates, leaving many struggling to defend their assets.

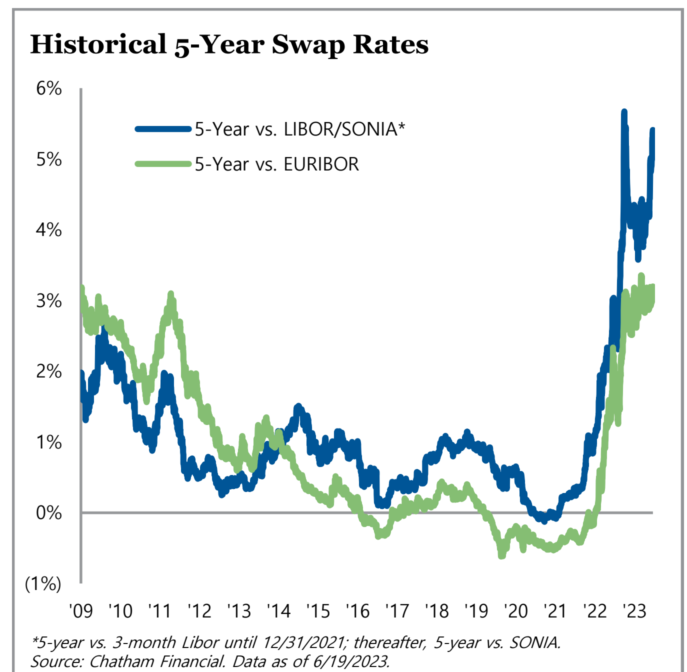
Price discovery has been difficult given large bid-ask spreads, and unsurprisingly, investment volumes in the region have slowed dramatically. Eurozone real estate transactions totaled less than €20 billion in the first quarter, compared to a quarterly average of €31 billion since 2008. The UK has been faring slightly better, with investment volume reaching £8.1 billion during the first quarter – a 3.2% increase quarter-over-quarter but still far below historical averages.

The logistics, self-storage, and life science markets continued to see the most liquidity, while the office and retail markets remained slow. However, there has been positive net absorption in the European office sector – totaling approximately two million square feet in the first quarter – and there are buyers for prime assets. Fully remote work is less common in Europe than in the U.S., with about 90% of employees doing at least half of their work from a physical office, according to CBRE research. Additionally, partially remote work was rather common before the pandemic, and total European office usage is approximately 85% of pre-pandemic levels.

Office take-up in the eurozone has reached pre-pandemic levels. In early 2023, Europe office vacancy was 7.6% compared to over 20% in the U.S. However, office vacancy has varied significantly depending on location and product quality. For example, in central London, overall office vacancy as of the end of May was 8.5%, while new-build or prime vacancy was only 1.4%. A major reason for these low vacancy rates is the lack of supply in the region; office supply growth has been approximately 1% or less per year since 2011. Given current market conditions, we expect some possible purchasing opportunities from distressed owners and continued buyer appetite for high-quality real estate.

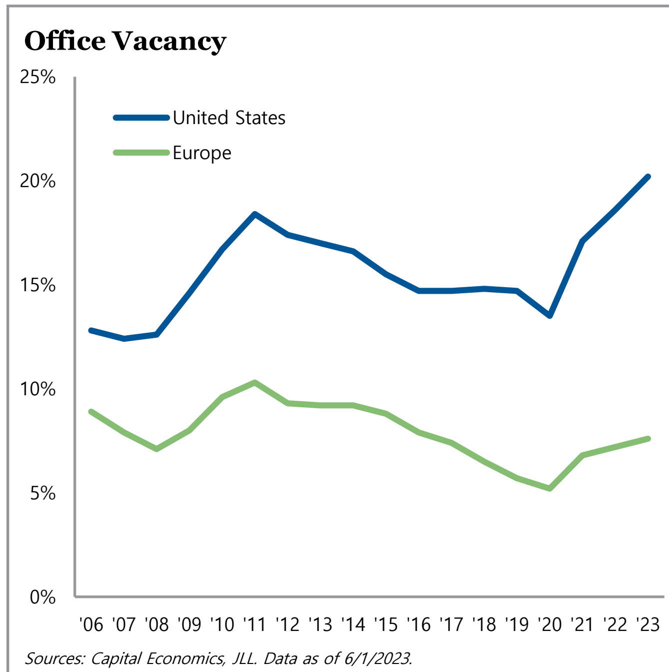


Office take-up reached 90% of its pre-pandemic level in early 2023.

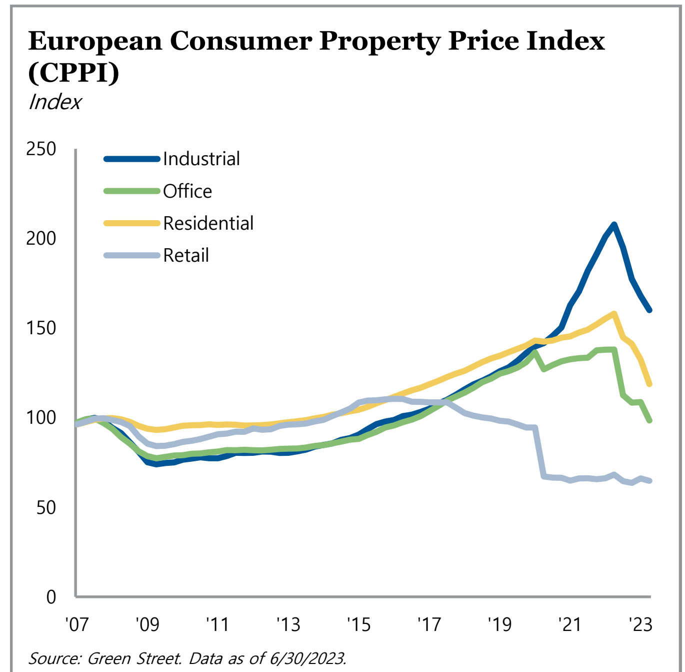


For levered buyers, the cost of interest rate hedging has more than doubled in the last year.

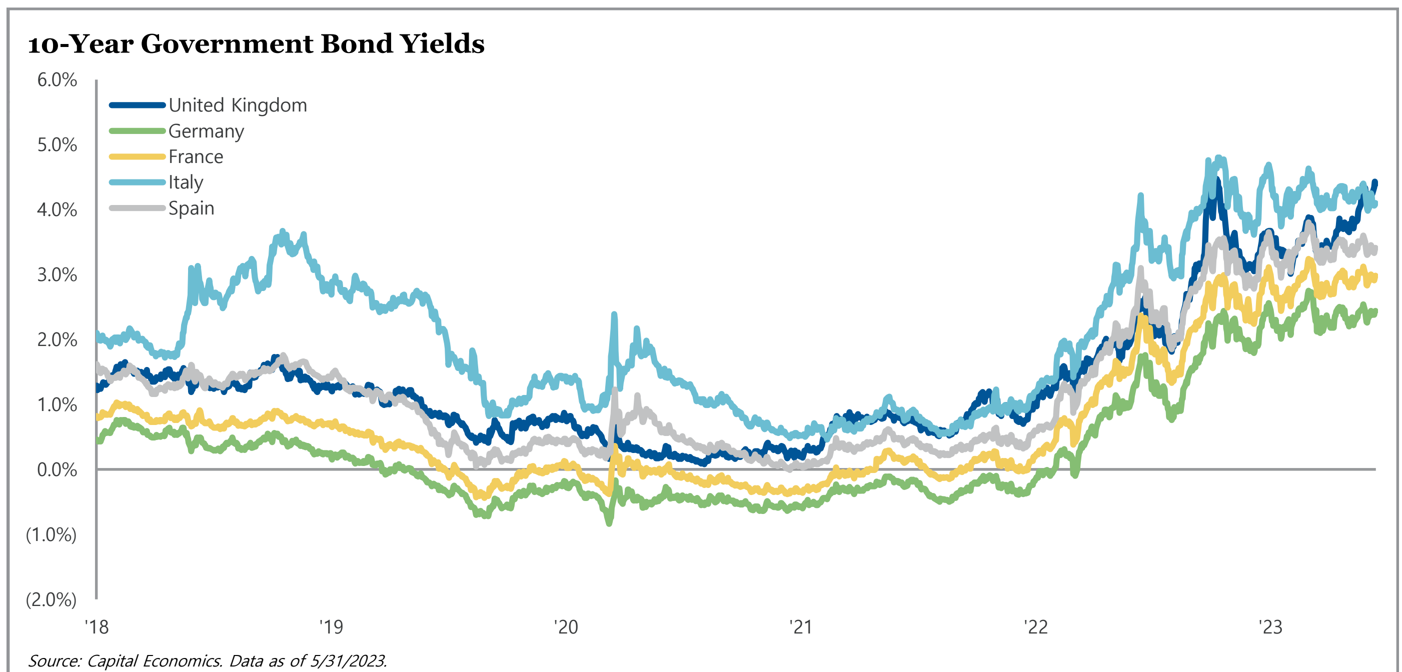
Europe Real Estate *(continued)*



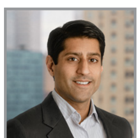
Europe office vacancy remains low relative to the U.S., caused in part by a lack of supply.



Inflation and interest rate increases have led to declines in values across sectors.



More rate hikes are expected as central banks continue to manage inflation.



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For more information on Europe Real Estate, click here.

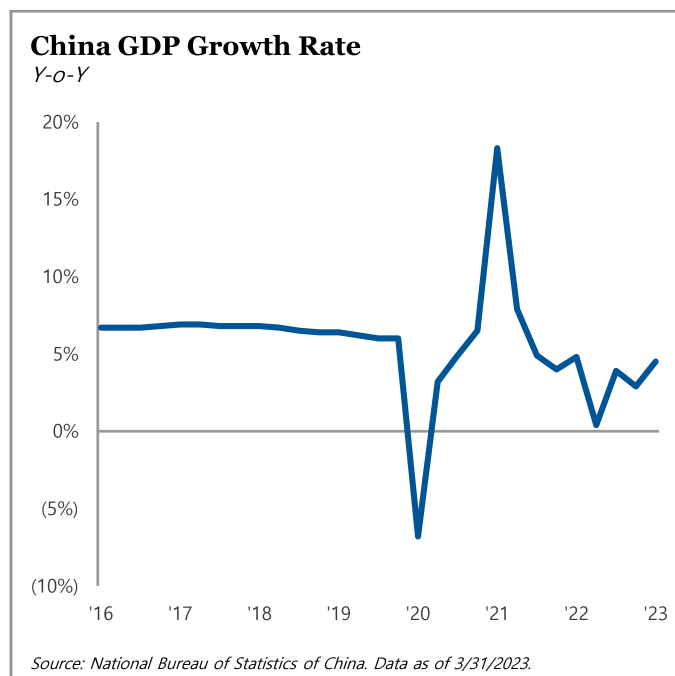
Asia Real Estate: China

China's economy gained some momentum and grew 4.5% year-over-year in the first quarter of 2023 – following expansion of 2.9% in the previous quarter – despite the impact of geopolitical tensions and overseas interest rate hikes. In December 2022, China shifted its focus to economic growth and announced the reopening of borders and relaxation of its zero-COVID policy, and accommodative macroeconomic policies continued to be announced throughout the first quarter of 2023. The People's Bank of China cut the reserve requirement ratio by 25 basis points in March, and policies supporting the real estate industry, platform enterprises, and the private economy were introduced during the quarter. In the first quarter of 2023, exports increased 4.8% year-over-year and value-added industrial output rose by 3.0%. Domestic retail sales increased 5.8% in the first quarter, and online retail sales increased 8.6%. China remains highly focused on developing its advanced manufacturing sector, particularly in industries such as life sciences, integrated circuitry, and new energy. While total fixed-asset investment activity only grew 5.1% year-over-year in the first quarter, fixed-asset investment in high-tech industries grew 16.0% year-over-year.

In Beijing, we observed an uptick in office leasing demand in the first quarter of 2023, which came on the heels of a quiet market in the second half of 2022. A new office building was delivered in the first quarter, adding 65,010 square meters of office space to the leasing market. Net absorption amounted to roughly 18,600 square meters, with the CBD area recovering first and generating more than one-third of the total leasing transactions during the quarter. Domestic companies accounted for nearly half of the leasing demand. Overall, Grade A office rents decreased by 0.9% in the first quarter, and the office market's overall vacancy rate rose modestly from 10.0% to 10.4%. In the Zhongguancun submarket of Beijing, known as China's Silicon Valley, rents were down 1.9% quarter-over-quarter and vacancy increased to 8.6%.

Industrial and logistics leasing continued to recover in the first quarter. In Shanghai, industrial rents rose 2.6% year-over-year; meanwhile, vacancy declined 0.2 percentage points to 9.4%.

In terms of overall market activity, total commercial real estate transaction volume amounted to RMB 54.7 billion in the first quarter of 2023 – up 6% year-over-year due to the easing of China's zero-COVID policy and gradual economic recovery. 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 improved modestly in the first quarter.

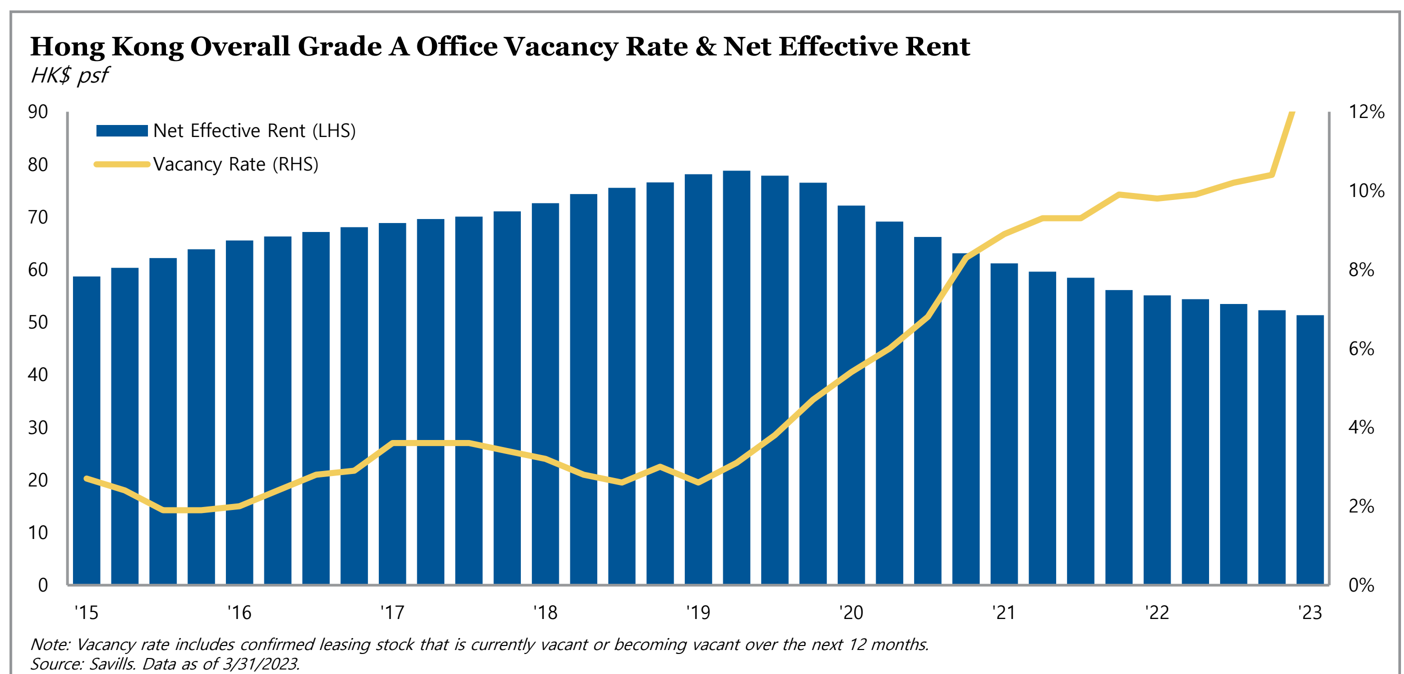
CNY values became stronger in the second quarter of 2023.

Asia Real Estate: Hong Kong

With Hong Kong's border opening and relaxation of COVID-19 restrictions during the fourth quarter of 2022, we began to see an improvement in overall market sentiment in the first quarter of 2023 and expect this trend to continue through the rest of the year. That said, Hong Kong has followed the U.S. interest rate-hike cycle, which has caused distress among some property owners. This unique dynamic could create an attractive investment entry point for opportunistic real estate investors, who may seek to take advantage of the near-term capital market disruption while market fundamentals improve over the balance of the year.

After contracting 4.1% in the fourth quarter of 2022, Hong Kong's economy grew 2.7% in the first quarter of 2023, driven by the strong recovery of inbound tourism and domestic demand. Total exports of goods declined significantly in the first quarter, falling 18.7% year-over-year amid the challenging global market environment. Private consumption surged – increasing 13.0% year-over-year the first quarter – as consumer sentiment meaningfully improved following the easing of anti-COVID-19 measures in both Hong Kong and mainland China. Additionally, unemployment declined from 3.5% in the fourth quarter of 2022 to 3.1% in the first quarter of 2023. We expect the reopening of Hong Kong's borders with mainland China earlier this year will help support continued economic recovery through the balance of 2023.

In the first quarter of 2023, residential prices retreated 5.1% year-over-year – remaining below the high recorded in September 2021 – but increased 7.4% quarter-over-quarter. Commercial real estate investment transaction volume fell 54.9% quarter-over-quarter to HK$7.6 billion, as activity primarily consisted of small-ticket deals. Investment sentiment for retail properties improved, with the retail market showing signs of recovery as inbound tourists returned; HK$4.3 billion worth of retail assets changed hands in the first quarter of 2023, accounting for 56% of the quarter's total commercial real estate investment transaction volume – the highest proportion since the third quarter of 2020. Investment demand in the first quarter was largely supported by local investors, which accounted for 56% of the quarterly transaction volume. The office sector continued to remain weak, both in terms of tenant demand and investor interest. As of March 2023, Hong Kong's office vacancy increased slightly to 13.4%, while rents fell by 1.8% in the first quarter.



Hong Kong's office market vacancy remained stubbornly high, as China's economic recovery has been muted.

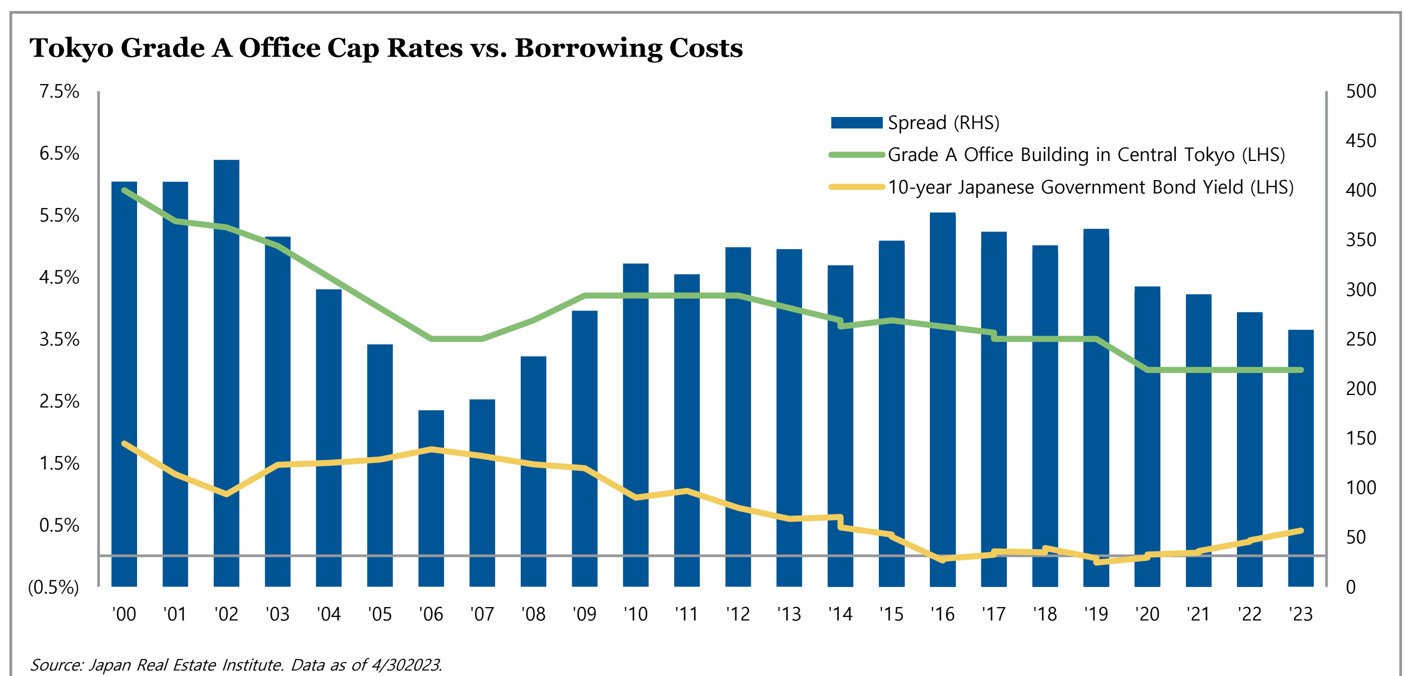
Asia Real Estate: Japan

In the first quarter of 2023, Japan's real GDP grew 2.7% quarter-over-quarter, driven by strong private consumption and corporate capex. Japan's labor market remained healthy, with unemployment at 2.6% as of May 2023. The inflation rate was 3.2% in May – down from the 41-year high of 4.2% that was recorded in January – and real wages continued their 14-month decline, falling 1.2%. Since taking office in April, Bank of Japan (BoJ) Governor Kazuo Ueda has maintained the BoJ's monetary easing policy, stressing that inflation must be accompanied by real wage growth. As a result, the Japanese interest rate market remained stable, with Japan's base rate (TIBOR) remaining below 10 basis points.

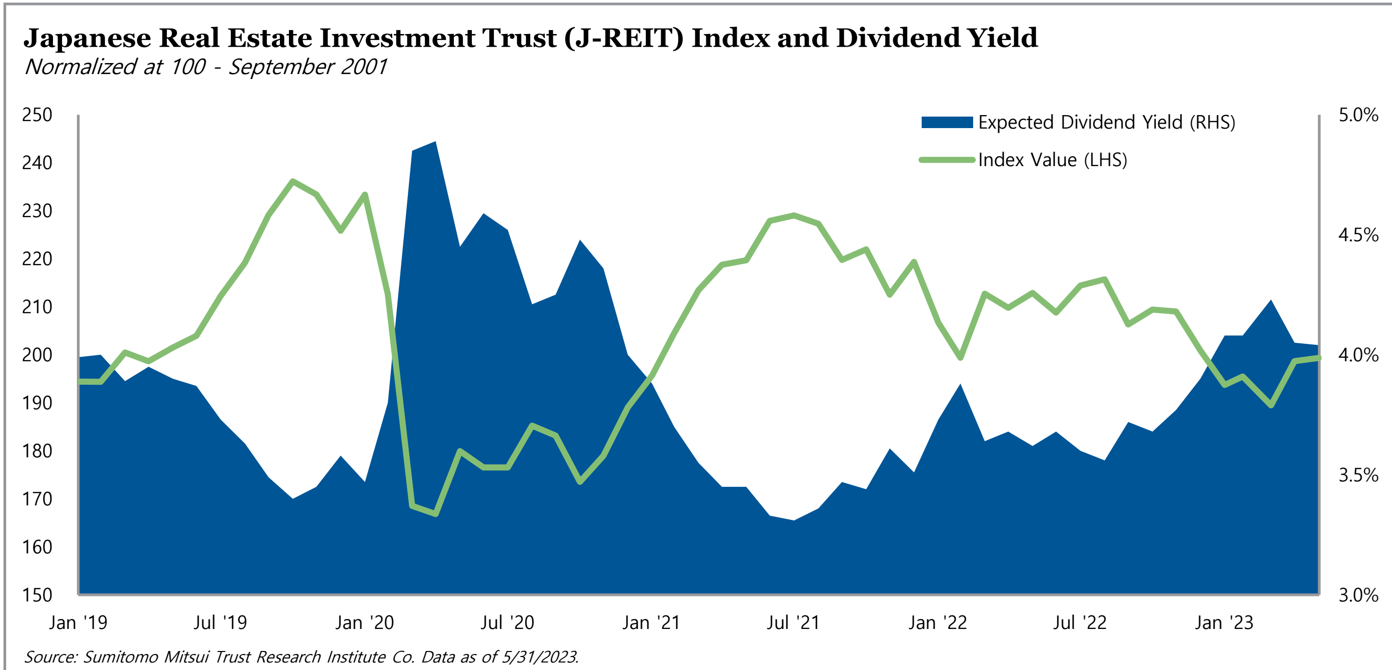
Office real estate fundamentals remained robust in the first quarter. All-grade vacancy rates remained relatively flat, inching down from 4.7% to 4.6% in Tokyo and up from 3.5% to 3.6% in Osaka. In both Tokyo and Osaka, stable vacancy rates were supported by corporate demand for office space, with several companies upgrading from older, self-owned buildings. We also continued to observe the trend described in last quarter's CMP report, with many companies seeking to improve their office space to attract and retain talented employees. We expect office demand will remain stable given the limited impact of remote working in Japan.

Logistics fundamentals softened in the first quarter, with vacancy rates for multi-tenant facilities in the greater Tokyo area rising from 5.6% to 8.2% on the back of significant new supply. The vacancy rate for facilities that were built more than one year ago also increased, rising from 1.1% to 2.5%. Nevertheless, demand remained strong, with net absorption in the first quarter up 26% from last year's quarterly average. Demand from logistics companies also remained robust, supported by the continued growth in the e-commerce industry.

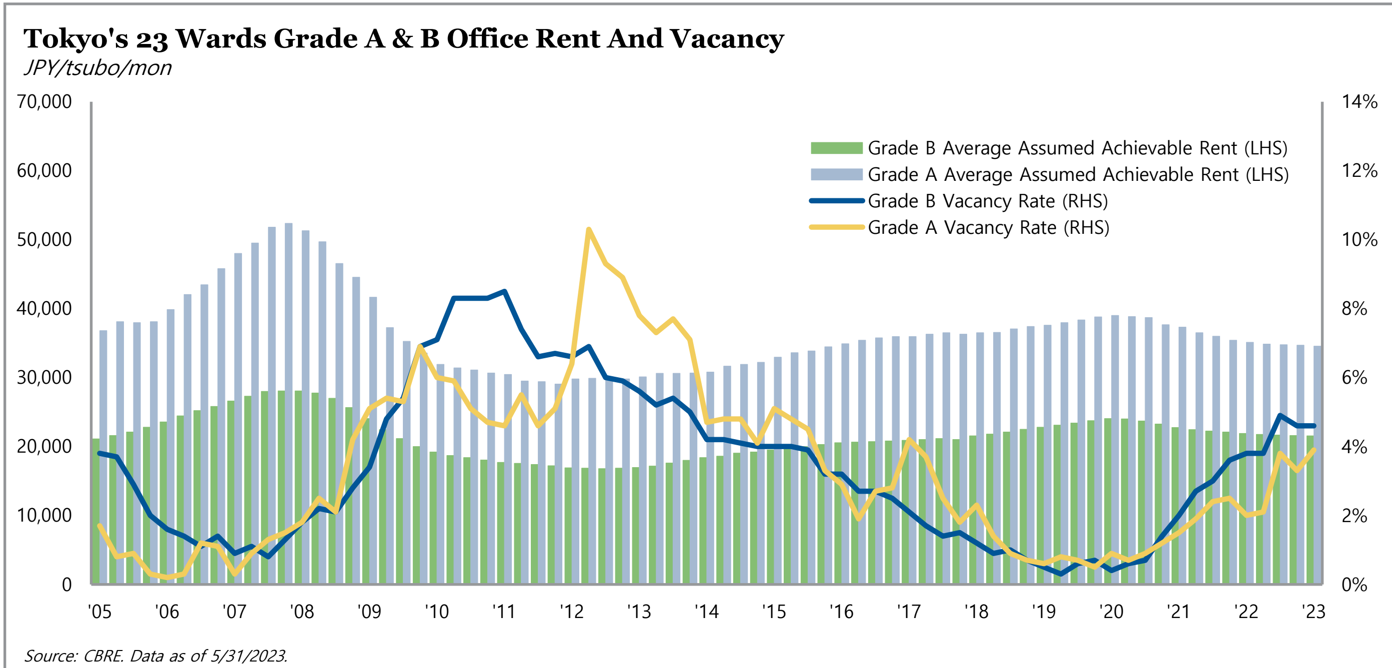
Transaction volume in the first quarter of 2023 was up 102% year-over-year – representing the third-highest first-quarter level on record, only exceeded by the volumes witnessed in the first quarter of 2008 and 2017. Both domestic and foreign buyers were active in the first quarter, with domestic buyer transaction volume, excluding Japanese REITs (J-REITs), up 142% year-over-year. Investment volumes increased year-over-year across all sectors, led by office – with the largest quarterly volume at ¥605 billion, up 135% year-over-year – and hotel – which recorded the most significant growth, up 962% year-over-year to ¥145 billion. Given the robust lending market and stable financial environment, we believe the buyer pool will remain strong, resulting in high liquidity for stabilized assets.



Japan maintained its low-rate policy, resulting in wide office cap rate spreads.



The performance of J-REITs declined, resulting in higher yields and limiting their ability to execute accretive acquisitions.



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

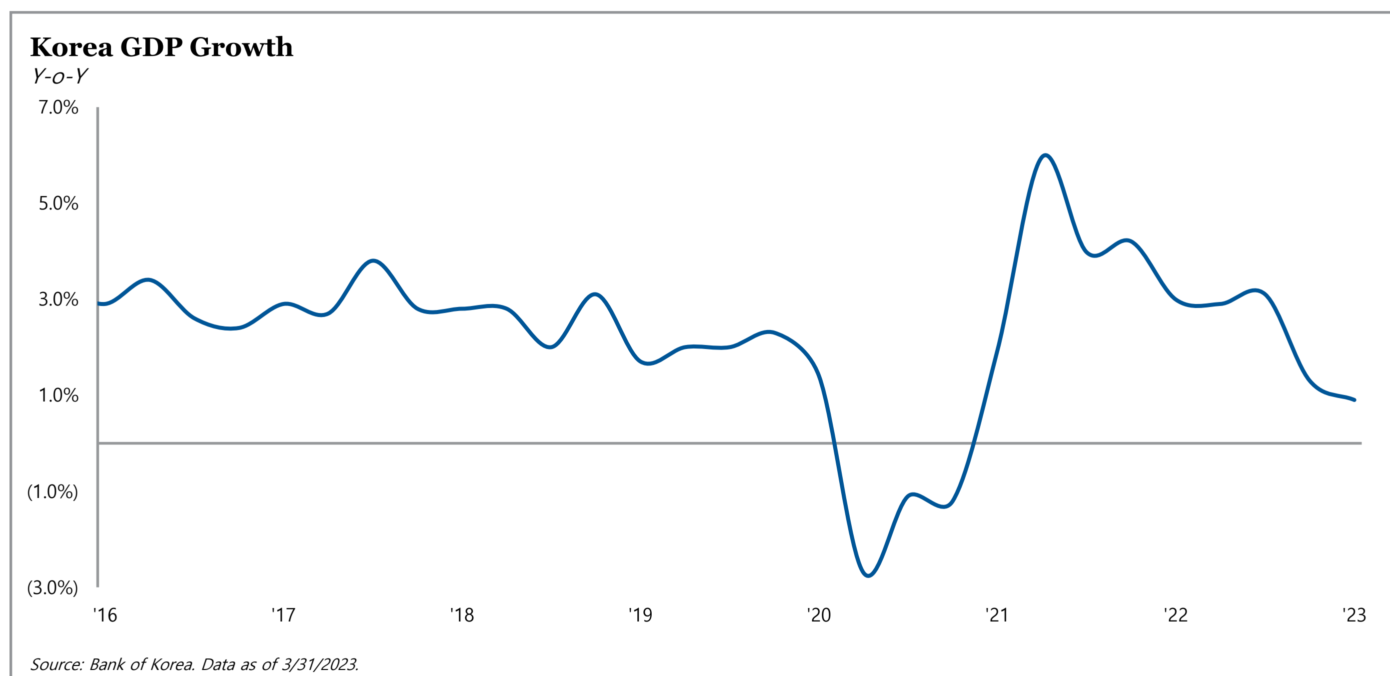
Asia Real Estate: South Korea

After raising the base rate for the seventh consecutive time in January 2023, the Bank of Korea (BoK) held the rate steady at 3.50% at the close of the first quarter – pausing the rate-hike trend. South Korea's GDP reflected a return to growth in the first quarter, albeit at a modest pace of 0.3% quarter-over-quarter. The positive turnaround was primarily driven by a rebound in private consumption. However, amid growing economic woes globally and deepening sluggishness in the domestic housing market, the BoK lowered its forecast for 2023 growth to 1.6% – down from the previous forecast of 1.7% announced in November 2022.

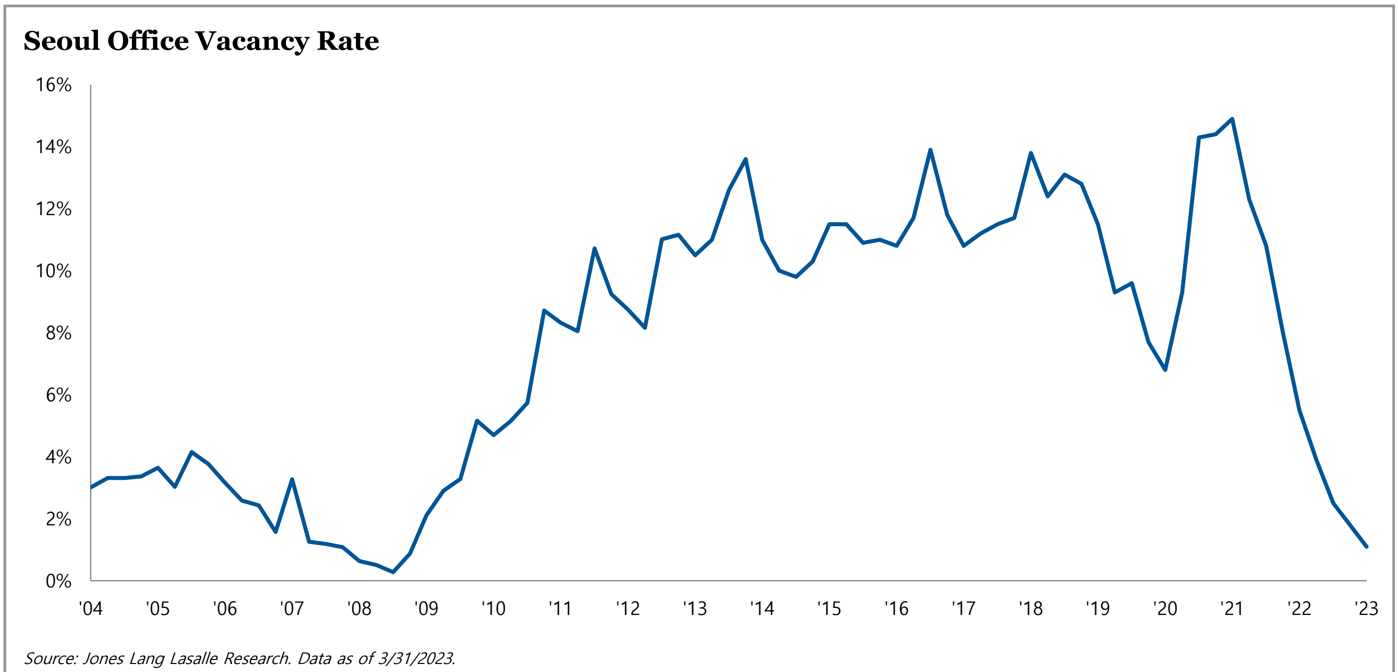
On the real estate front, office cap rates stood at 4.4% in the first quarter of 2023 – in line with the previous quarter. Spreads between prime office cap rates and Korean government bond yields (i.e., 5-year treasury bonds) widened and stood at approximately 100 basis points as of the end of the first quarter. This spread widening can be attributed to lower treasury yields, which stood at 3.4% at the end of the first quarter – down 48 basis points quarter-over-quarter. This yield movement was caused by a shift in market expectations, as speculation that the BoK was nearing the end of its rate-hike cycle increased.

Office fundamentals remained strong, backed by robust demand. Prime office vacancy in Seoul rose incrementally to 2.7% at the end of the first quarter; however, it is important to note that this 0.5-percentage-point uptick from the previous quarter was due to a temporary increase in supply from a single prime office asset in the Gangnam Business District, which was fully leased up by a major conglomerate shortly after delivery. Office rents in Seoul increased 8.1% quarter-over-quarter, marking the strongest quarter-over-quarter growth since the fourth quarter of 2008. Investment activity totalled ₩1.0 trillion in the first quarter of this year, approximately 26% of the ₩3.8 trillion recorded in the first quarter of 2022. Capital markets activity continued to contract in the first quarter in light of the high interest rate environment.

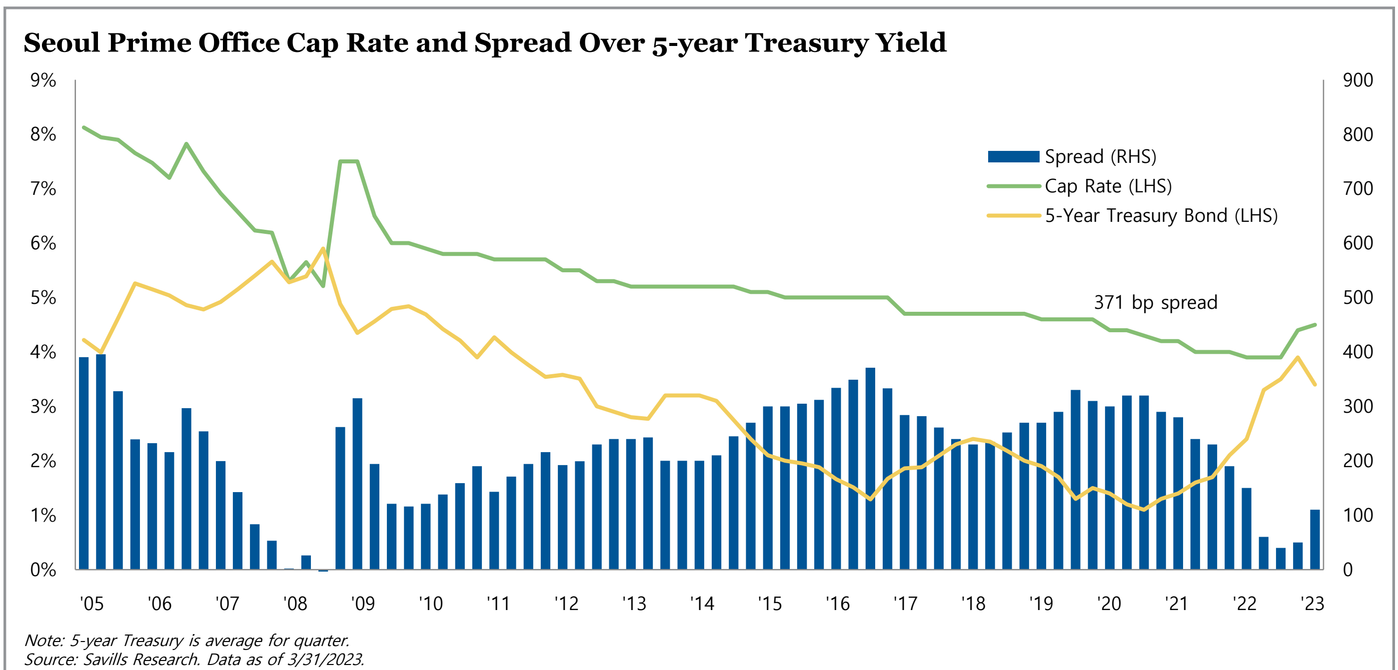
Logistics vacancy in Greater Seoul increased to 12.6% in the first quarter – up 440 basis points quarter-over-quarter. The spike in vacancy was the result of new supply spilling over from last year due to construction delays. However, with most of the new supply being concentrated in the South and Southeast – regions that continue to demonstrate strong demand – net absorption in the Seoul metropolitan area totalled an all-time high of approximately 10 million square feet. Logistics investment activity showed signs of mild recovery, with transaction volume totalling ₩0.8 trillion in the first quarter – up approximately 9.2% quarter-over-quarter. Amid a tight lending market, investors continue to search for opportunities to acquire attractive assets from distressed sellers at significant discounts.



Korea's GDP growth declined as higher interest rates weighed on the economy.

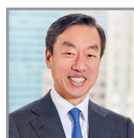


Vacancy is nearing historic lows as local Korean companies increase their space per office worker to attract and retain talent.



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

Wilson Leung
Co-Portfolio Manager
Head of Asia Real Estate


Steven Cha
Co-Portfolio Manager
Asia Real Estate

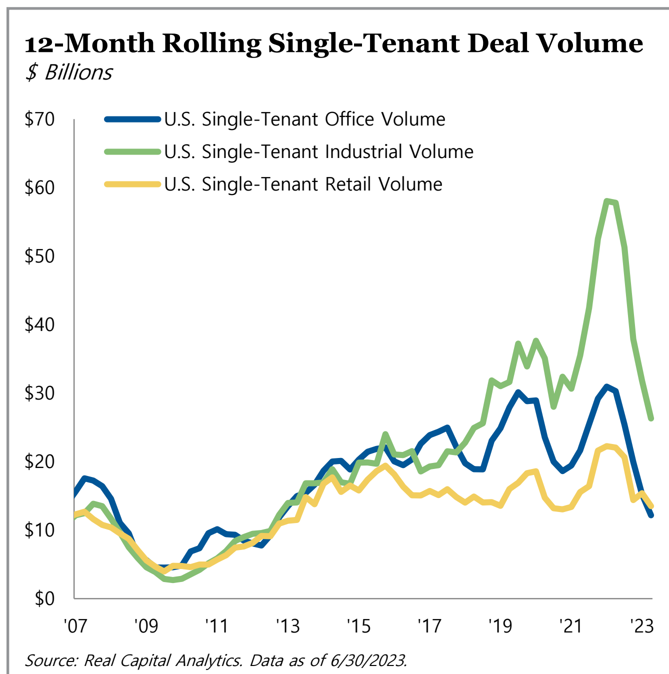
For more information on Asia Real Estate, click here.

Net Lease Real Estate

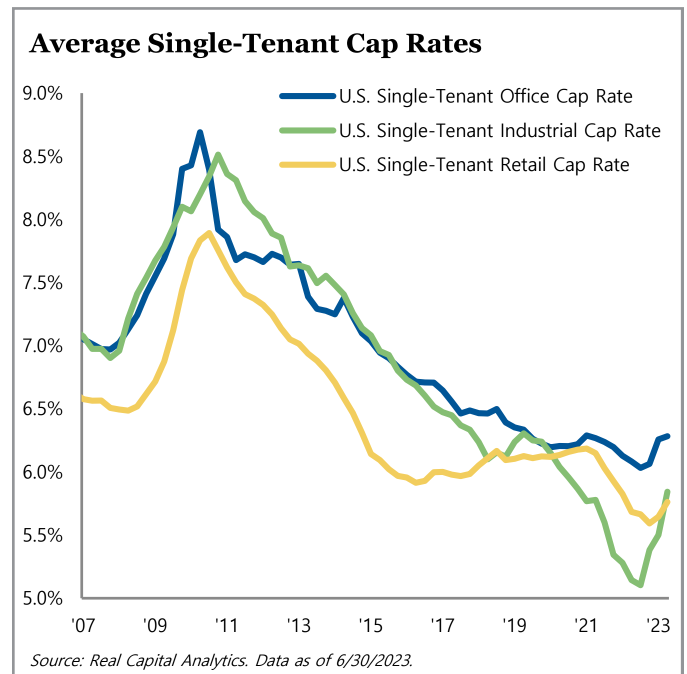
As of the second quarter of 2023, trailing 12-month U.S. single-tenant transaction volume totaled $52 billion, according to Real Capital Analytics (RCA). Since the peak recorded in the second quarter of 2022, trailing 12-month transaction volume has declined by 55%. Single-tenant transaction volume is at its lowest level in nearly a decade, primarily driven by declines in office volume. This overall decline in transaction volume may be attributed to a number of factors, including higher interest rates and the pull-forward effect that contributed to deal volume in 2021 and 2022 being unusually high. When taking activity over the last three years into account, the resulting average transaction volume is comparable to the levels witnessed in 2019, as opposed to those recorded in 2021 or 2022.

Cap rates – which reached all-time lows in 2021 and 2022 – have started to climb back toward historic norms. As of the second quarter of 2023, trailing 12-month U.S. single-tenant transaction cap rates averaged 5.96% – an increase of 18 basis points quarter-over-quarter and up 37 basis points from the low recorded in the third quarter of 2022. At this pace, the average single-tenant cap rate is projected to finish this year at 6.20%, which is comparable to the average rate recorded at the end of 2019.

As leveraged companies approach maturities and private equity firms look to acquire businesses, sale-leasebacks continue to be an attractive source of capital relative to high-yield debt, and we expect this will drive an uptick in the volume of sale-leaseback transactions over the coming quarters.



Transaction volume is at multi-year lows.



Cap rates are increasing across asset types.

Gordon Whiting
Portfolio Manager

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