Webinar Summary

PGIM

THE STATE OF THE CREDIT MARKETS

Downgrades, Defaults and Opportunities

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Credit markets have rebounded impressively from the darkest days of the coronavirus-induced massacre, but nevertheless remain fragile. There are many risks remaining that could present significant headwinds to a robust and lasting recovery, among them growing unemployment, credit downgrades, crippling debt levels and the potential for more bankruptcies. PGIM recently brought together a panel of thought leaders to discuss these topics and a host of others, including where to best find opportunities in the current environment and in the future. Following are a few highlights of the webinar, which can be listened to here.

- **Where the Fed has been, and where it's going:** While the crisis has already been met with never-before-seen intervention, the Fed will remain accommodative until employment recovers, which could be a two- to three-year process. The flood of liquidity is making its way into the risk markets, which is partly behind the better-than- expected performance of equity and spread markets at this stage of the crisis. The "low-for-longer" backdrop is here to stay, and it's our expectation that the Fed is only 50% of the way through its accommodation, which will continue to be a powerful driver for risk markets.

- **This time it really is different in real estate:** There is less overall leverage in the system compared with the global financial crisis, and the impact of distress this time around will be more dispersed both regionally and by sector and property type. At some point distress will emerge and opportunities will arise to acquire assets at better costs than seen in recent years. Longer-term, diversified opportunities exist in housing that is affordable to wide swaths of the population, along with cold- and self-storage and medical buildings.

- **Opportunities in private debt:** Mid-market firms have shown great resiliency in shifting business models and preserving cash, without major help from the Fed. Default rates are higher, but so are recovery rates, and there remain many good companies with bad balance sheets, creating an excellent investment environment in direct lending. Business services firms with variable cost structures should continue to benefit in the current environment.

- **Fallen angels are worth looking at:** While headwinds remain for both the economy and corporate revenue, the behavior of lower-rated companies is now aligned with bondholders, which could create opportunities in the crossover space in the BBB and BB space. Energy, money-center banks and auto-related names may offer good value.

- **The 'haves' and 'have nots' in healthcare:** Among smaller names, firms related to the support of fighting COVID-19, such as linens businesses, are doing well, while those tied to elective procedures continue to struggle. While larger healthcare systems are also being impacted by the curtailment of elective procedures, many are benefiting from participation in the government's CARES Act program. Going forward, it's likely there will be more spent on healthcare and there will be greater government support for the industry, a favorable development for the majority of operators.

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