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Crescent Capital High Yield Bonds

The high yield asset class began 2015 facing two major headwinds: declining crude oil prices and potential rising interest rates. During the first quarter, both turned into tailwinds providing our market with some much needed support and ending the negative trend we had seen since the second half of 2014. While continuing to be volatile, the price of WTI crude oil finally seemed to settle in a trading range ending months of persistent declines. Although prices were well-below last year's level, investors took comfort that oil had at least found a bottom (for now). Combined with the European Central Bank's expansion of their monetary stimulus in late January, a modest upward move in January was followed by a strong rally in February. The market took a step back in early March, but dovish commentary following the Fed's FOMC meeting late in the month helped minimize the retracement. As a result, the Bank of America U.S. High Yield Master II Index ("Index" or "Benchmark") ended the quarter up 2.54%, ending the two quarter streak of losses. The Benchmark yield to worst was 6.08% at quarter end and the spread over U.S. Treasuries was 486 basis points, roughly 25 basis points tighter than where we began the year but more than 110 basis points above the low seen in mid-2014.

Despite solid performance in Q1, the fundamental news during the quarter generally surprised to the downside. Aside from a strong February payroll number, most other macro-economic data came in weaker than expected. The election of a new government in Greece renewed concerns about the future of the Euro. Uncertainty over Iran nuclear negotiations, Saudi airstrikes in Yemen and a rising U.S. dollar all contributed to the negative backdrop. Specific to the high yield market, earnings data from high yield issuers told a weakening story as well. According to Bank of America, of the 386 high yield companies their analysts follow the average y/o/y change in EBITDA was -6.1%. Energy companies obviously weighed heavily on the overall market reporting a 26% EBITDA drop on the back of lower crude oil prices, but even excluding energy, EBITDA would have contracted (-0.4%). That marked the first negative growth quarter we've seen since the last recession. Most market strategists maintain their default forecasts for 2015 in the 1.5% to 2.0% range (well-below the historical average of 3.8%), but some have increased their 2016 estimates during the quarter to reflect increased risk in the energy space next year.

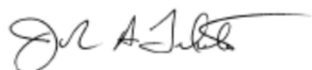
In contrast to fundamentals, the technical picture for our market was solidly positive. Demand for the asset class was strong with JPMorgan reporting high yield mutual funds inflows of $3.8 billion and $8.4 billion in January and February, respectively. An outflow in March of $2.1 billion wasn't enough to dampen the overall trend and the quarter ended with $10.0 billion of fund inflows, recouping all of the outflows experienced in December 2014. The supply front was just as strong with $95.6 billion of new issues, the seventh largest quarterly total in history and comfortably ahead of the $88.3 billion priced in the prior year period. It's worth noting that over 33% of the new issue volume this year was acquisition-related financings, up from 26% in 2014, reflecting an evolution of the market from the refinancing-heavy issuance we had seen for the past several years. Reflecting investor appetites, most of the issuance was higher quality with double-B and single-B rated credits accounting for 34% and 57% of new supply, respectively, and triple-Cs just 9%.

As we think about what lies ahead, most of our focus remains on the two issues we faced at the start of the year. While prices for WTI crude oil have crossed into the $50s recently and have held that level so far in April, near-term challenges remain. A potential diplomacy deal with Iran, historically high storage levels in Cushing, OK, and seasonal low demand all loom over prices. While we've seen a healthy response from the industry in terms of aggressive capex reductions and disciplined cost and liquidity management, we continue to believe in a "U-shaped" recovery which implies a longer time horizon for many high yield energy credits to fully recover. We still believe that current energy security prices are oversold and remain generally overweight the sector across our portfolios, but have tempered expectations that this will be a quick turnaround for the industry and expect more ups and downs in the quarters to come.

The other major challenge is interest rates. While the Fed removed the "patient" language from their forward view on rates, they revised the "dots" which we believe pushes out the potential for an increase in interest rates until September. Moreover, we believe the pace of interest rate increases is going to be slower than we had feared earlier this year. One of the primary reasons for this shift is the sharp increase in the U.S. dollar which rose 12.7% vs. the Euro during the quarter. The rapid appreciation has created a significant earnings headwind for U.S. multinational companies. With continued stimulus efforts by the ECB putting pressure on the Euro, a strong US dollar appears likely to remain prevalent. While we saw some impact of this on Q4 corporate earnings, the issue is likely to become more evident in Q1 results. An analysis by Bank of America noted that only 25% of revenues for U.S. high yield companies are generated outside the U.S. so our market is less impacted than other asset classes, but it will still be a challenge for some issuers. We believe the Fed may be hard-pressed to stick to its original June target given the appreciation of the U.S. dollar, low inflationary pressures, and weakening macro-economic data. This "low for longer" rate strategy should bode well for the high yield asset class if it comes to fruition.

As we look ahead, we are cautious about where we stand in the credit cycle. We have been shifting away from riskier credits, particularly CCC-rated bonds. We have become increasingly more selective about new issues and have looked to avoid taking on any more commodity risk, particularly in metals and mining which we believe have serious cyclical and secular issues. Our underwriting process is as thorough as ever, but we have become vigilant about exiting positions where fundamentals show early signs of deterioration. We are redeploying capital in sectors where we still expect positive underlying growth and have been comfortable extending duration in improving credits given the near-term outlook for interest rates. As we look around the world and see negative yields on European sovereign debt, we continue to feel that U.S. high yield is an attractive asset class as it is remains one of the only places in fixed income for investors to earn high current income. As always, we appreciate your support and welcome any questions you may have.

Sincerely,



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