

NB Global Corporate Income Trust (ASX:NBI)

Market Commentary and Portfolio Update – September 2023

We would like to provide an update on the Global High Yield bond market and NB Global Corporate Income Trust (ASX:NBI).

RECENT MARKET EVENTS

The positive year to date total return outcome in global high yield reversed last year's drawdowns, however the first seven months of 2023 were not without pockets of volatility.

Among the most important market-moving events of the past year was the fact that central banks were battling elevated inflation. The U.S. Federal Reserve moved aggressively in a relatively short time in bringing the fed funds rate from about zero in early 2022 to its current 5 – 5.25% range. Now the question is whether it will continue to apply monetary brakes or see enough evidence of fading inflation to hold steady or even start to ease. Given recent hawkish surprises, we believe it's possible that the central bank will follow through on an additional rate hike. On the other hand, the lagged impacts of its aggressive measures, still evolving banking weakness and generally tighter financial conditions could tip the scales toward extending the existing pause amid a slowing economy. Indeed, we continue to believe that the fed funds rate is at or near its peak and that the Fed may not reach its current estimated terminal rate of 5.50 – 5.75%. At a minimum, it has prepared the market for two-way risk, depending on how pricing and economic growth play out in the months ahead.

The European Central Bank's June decision to raise rates by 25bps and end reinvestment of maturing bonds in its Asset Purchase Programme came at a time when it indicated higher outlooks for core inflation in 2023 and 2024, powered by rising labor costs. That said, the central bank reinforced the importance of data dependency, considering not only inflation, but economic growth and financial conditions. And while Lagarde indicated that another quarter-point hike was likely, she didn't mention the possibility of multiple rates from here, noting that "past rate increases are being transmitted forcefully to financing conditions and are gradually having an impact across the economy." Overall, we anticipate a 3.75% terminal rate in the eurozone, although like the Fed the ECB will likely wait for clear signs that core inflation has not only peaked, but started to fall toward its 2% target.

The tightening of financial conditions as a result of central bank actions so far did result in some bouts of risk-off market sentiment so far in 2023 with a few of the key events being the mini-banking crisis, concerns over rising recession risk and the U.S. debt ceiling debacle, all of which were either resolved or whereby concerns grew less acute over the late spring early summer months. While data remain encouraging and inflation pressures have abated, we cannot remove the risk of a recession nor can we rule out the possibility of a soft landing.

Despite concerns over inflation, the lagged effects of rising interest rates, a mini banking crisis and the U.S. debt ceiling debacle, over the first seven months of 2023, the global high yield bond market saw solid positive returns, driven by more resilient than expected economic data and earnings results from most issuers as well as declining rates of inflation in the U.S. and Europe. Credit markets were solid across the board in the first seven months of 2023 as the ICE BofA Global High Yield Constrained Index returned 1.41% in July and 6.42% year to date. In July, the lowest and middle rated credit tiers outperformed as the BB, B, CCC & lower categories of the ICE BofA Global High Yield Index returned 1.32%, 1.50%, and 1.59%, respectively. Year to date, the CCC & below and B rated credit tiers of the index outperformed with returns of 10.02% and 7.23%, as compared to the BB rated segment of the index which returned 5.28%.

The spread premia required for credit decreased over the period and spread premia tightened even more in lower rated credits, such as CCC & below. Global high yield spreads—as measured by the ICE BofA Global High Yield Constrained Index—narrowed by 86 basis points over the year to date period ended July 31. That said, we believe current valuations are still compensating investors for the average default outlook based on our team's bottom-up default risk assessment, even in the event of a mild recession 2023/2024. Looking forward, our latest bottom-up U.S. high yield default estimates for 2023 and 2024 (3.25% to 3.75%) resemble more of an average default year than the spikes experienced during prior recessions. EM and European default rates also remain relatively contained outside of the more distressed China property and Eastern European region. Broadly, global high yield issuer fundamentals of free cash flow, interest coverage and leverage have remained in favorable ranges with most global high yield issuers well-positioned to navigate the current environment.

We view current yields and spread levels in Global High Yield as attractive, especially given the benign default outlook.

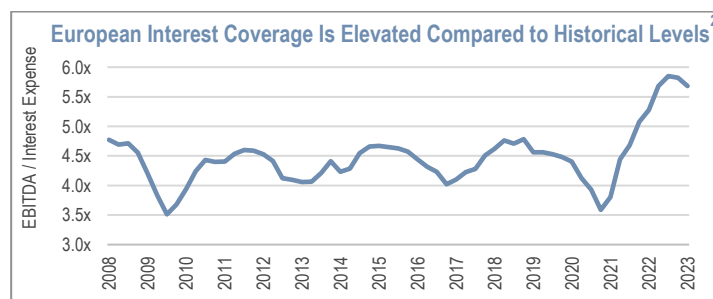
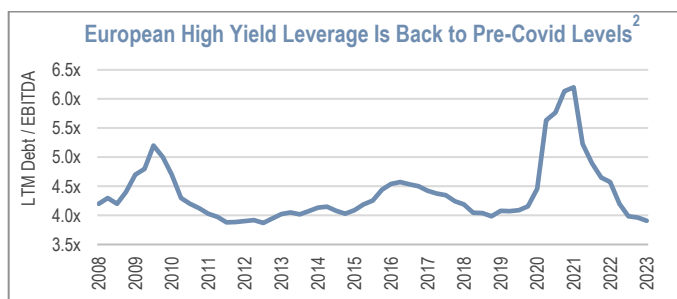
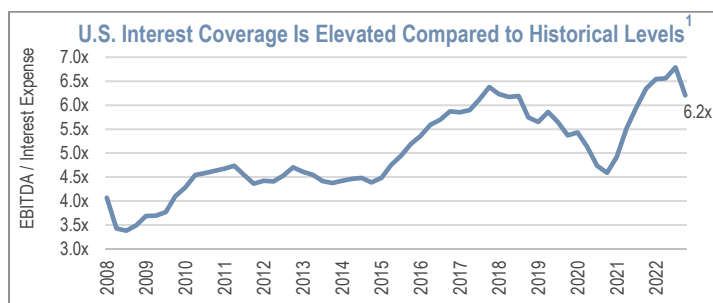
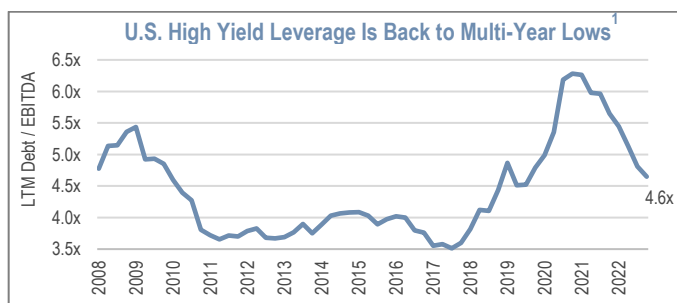
GLOBAL HIGH YIELD MARKET

Whilst there has been much attention given to the potential for recession, high yield issuers have entered this period in a much stronger position than in past periods, such as the GFC. The structure of the high yield market has materially improved over the past 15 years. The percentage of BB rated issuers has doubled since the Global Financial Crisis, while the percentage of CCC rated issuers has declined significantly. New issue trends have also been constructive, with the use of proceeds for the majority of new issuance being directed toward refinancing with a greater skew toward higher quality ratings than in past periods of rising defaults. We believe these trends have structurally lowered the default outlook for the high yield market, particularly relative to the 2001 – 2002 and 2008 – 2009 time period where these metrics were materially weaker.

Time Period	2001/2002	2008/2009	2015/2016	2019/2020	2022/2023
Market Rating (%)					
BB	35.7	38	46.3	48	54.2
B	55.1	43.2	39	40.3	35.3
CCC & Below	9.2	18.8	14.6	11.7	10.5

Inflationary pressures remain as the latest CPI prints are still above central banks' targets of around 2%. However, we believe inflation is likely to continue to trend toward 2% over time and any bouts of sticky inflation in the near term are unlikely to destabilize the favorable credit fundamentals of the Global High Yield Market. Solid consumer fundamentals and strong nominal GDP growth provide a means for most issuers to navigate without material credit degradation. Moreover, credit fundamentals of EBITDA growth, interest coverage and leverage remain in favorable ranges with most issuers continuing to report in line or better than expected operating results.

U.S. and European High Yield Credit Fundamentals



1. Source: JP Morgan data as of March 31, 2023. 2. Source: JP Morgan data as of December 31, 2022

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Overall positive economic growth and strong consumer demand has supported the ability for most issuers to keep prices stable to rising slightly as well as mitigate any existing cost pressures with productivity or other solutions that came out of the tough COVID period where companies had to adjust quickly to maintain operating efficiencies in the face of falling revenues. Sectors/issuers of concern are still primary business models where price is unable to keep pace with rising input costs (typically sectors with weak demand or less demand elasticity; situations where labor costs remain elevated or where there are secular changes in the way consumers are changing behaviors).

DEFAULT OUTLOOK

Default rates in U.S., Europe and other Developed Markets are expected to remain around average after having moved up from the all-time lows of last year. While Emerging Markets ("EM") defaults are on the rise, we are focused on select opportunities away from the higher risk regions and sectors. As of June, the par weighted trailing 12-month U.S. high yield default rate was 1.64%, up 13 basis point from the prior month and up 79 basis points year to date. While the default rate has risen off the lows reached last year, we expect default rates in 2023 and 2024 to remain in a range that is below or around the long-term average. This outlook is based on our bottom-up assessment of issuers, and driven by the higher-quality ratings mix in high yield (57% of issuers with credit ratings of BB), less aggressive new issuance, fewer near-term maturities, as well as an energy sector that is far healthier than in the past few cycles. As for EM high yield corporates, the overall default rate ended last year and started this year in the mid-teens due to non-payment by Russian and Ukrainian issuers, and due to the elevated defaults in the China property sector. Excluding those specific areas, we expect the EM high yield corporate default rate to be relatively benign at around 3.3% in 2023, as EM corporates have entered this period with reasonable liquidity on average.

Our Bottom-Up Default Estimates and Process

The Non-IG Credit team's forward-looking default estimates are derived from a bottom-up process, which is conducted across the entire universe of High Yield issuers. The credit research team utilizes its sector and issuer-specific knowledge and expertise to identify issuers where a default is expected. The analysis of bottom-up factors such as industry, business profile, leverage, cash flow, liquidity and maturity schedule are fundamental to the process. This is in contrast to frequently used methodologies that rely on top-down assumptions and market trading levels to estimate forward looking defaults. Our bottom-up approach to estimating defaults leverages our team's credit research capabilities, and, in our view, provides greater depth and insight into the subject.

Key Drivers of Low Default Rates

Limited near-term debt maturities, structural market quality improvements and credit profiles strengthened by a period of robust economic growth provide most U.S. high yield issuers with the ability to navigate the current operating environment. Elevated nominal GDP growth may also assist in keeping default rates at lower levels, along with a far healthier energy sector (a frequent contributor to defaults in prior years) than in past periods of market volatility.

The highly accommodative capital markets environment of 2021 allowed high yield issuers to term out their capital structures at a low cost of capital. As a result, the favorable maturity profile of the high yield market is providing issuers with plenty of time to adjust to any challenges without the need to refinance maturities. During the COVID pandemic, management teams broadly surprised to the upside in their ability to adapt to a rapidly changing operating environment, which could be an important driver of credit differentiation in the coming quarters.

PORTFOLIO IMPLICATIONS

Market events over recent years have caused significant volatility and subsequent fluctuation in the face value (bond prices) of the underlying bonds and in turn affecting the Net Tangible asset ("NTA") value of the NB Global Corporate Income Trust ("NBI"). We would like to highlight that the change in face value of underlying bonds does not impact the ability of the bonds paying fixed coupons. NBI has continued to pay a consistent monthly income since inception – totaling 51.62 cents since September 2018.

	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Total
FY2019	–	–	–	0.875	0.875	0.875	0.875	0.875	0.875	0.875	0.875	2.469	9.47
FY2020	0.899	0.899	0.899	0.899	0.899	0.899	0.899	0.899	0.899	0.899	0.899	0.971	10.86
FY2021	0.696	0.696	0.696	0.696	0.696	0.696	0.696	0.696	0.696	0.696	0.696	1.985	9.64
FY2022	0.805	0.805	0.805	0.805	0.805	0.805	0.805	0.805	0.805	0.805	0.805	1.012	9.87
FY2023	0.711	0.711	0.711	0.711	0.711	0.711	0.711	0.711	1.218	1.218	1.218	1.218	10.56
FY2024	1.218	1.218											2.44

Past performance is no guarantee of future results. For summary purposes monthly distribution figures have been rounded to 3 decimal places and total financial year distribution figures have been rounded to 2 decimal places. Actual distributions can be found on the ASX website. Certain monthly distributions include a return of capital. Please refer to your monthly distribution statement and AMMA statement for further detail.

Performance based on NTA (net)

The NTA of the Trust has declined primarily as a result of a generalized risk-off environment rather than being driven by material idiosyncratic credit risk.

Despite the challenging market environment over the last few years, the performance of NBI versus the price movement of the broader Global High Yield market (represented by ICE BofA Global High Yield Index (AUD Hedged) benchmark) highlights outperformance over most time periods as per below:

as at 31 August 2023:

	1m	3m	6m	1Y	3Y p.a.	Since inception p.a.
NBI Total Return*	0.25%	3.26%	3.15%	4.96%	0.28%	1.93%
ICE BofA Global High Yield Index (AUD Hedged)	0.02%	2.65%	3.03%	5.33%	-0.27%	1.54%

*Total Return is calculated based on the pre-distribution month end NTA and assumes all distributions are reinvested. Performance is calculated net of management fees and costs. Certain monthly distributions include a return of capital. Past performance is not a reliable indicator of future performance. Periods longer than one year are annualised. The inception date is 26 September 2018.

ASX unit price discount

We have been actively seeking to reduce the discount through various measures. Most recently on 14 March 2023, we announced an increase in NBI's distribution rate which includes a return of capital. We believe the increased distribution rate enhances NBI's competitiveness and should increase demand for units in NBI on the ASX. Other measures we have implemented include the on-market buyback that was in place prior to the increased in the distribution rate and also our ongoing engagement with the advisor community through our regular portfolio update webinars.

The increased distribution rate for NBI is intended to continue until 30 June 2024. While we continue to assess the impact of the increased distribution rate, we are actively considering other measures to reduce the discount. If we do determine to implement another strategy to reduce the discount, we will make a market announcement.

OUTLOOK

Notwithstanding NBI's solid performance, we remain constructive on global high yield at current spread levels. In our view, valuations and yields are compensating investors for the relatively benign default outlook. While real GDP growth has slowed, it remains positive and slowing real demand has helped inflation come down from last year's peak. The lagged effects of monetary tightening and changes in consumer behavior are likely to continue to push the rate of inflation in a downward trend over time. Our analysts remain focused on the specific credit fundamentals of individual issuers in their coverage, assessing the base and downside cases in the event of a soft-landing or recession. Relatively healthy consumer and business balance sheets and growing nominal GDP should continue to be supportive for issuer fundamentals, in our view. While the incoming macroeconomic data and overall credit cycle dynamics can move the high yield market day-to-day, we remain very focused on industry-specific trends and idiosyncratic risks to individual issuers. Despite the potential for short-term volatility resulting from heightened uncertainty on economic growth, we believe our bottom-up, fundamental credit research that focuses on security selection, avoiding credit deterioration, and putting only our "best ideas" into portfolios, will position us well to take advantage of any volatility.

DISCLOSURES

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