Quarterly Market Outlook – Q2 2024

As of March 2024 – *Unless otherwise stated*

The new macro equilibrium state, which features low unemployment, disinflation and moderate GDP growth, has created, in our view, a near perfect environment for credit investing. The recent course of rapidly rising base rates has been digested by the market, companies, and consumers. It seems as though the soft landing has materialized, or at least something very close to it.

Government stimulus may have softened the blow of higher rates as consumers and corporations found themselves flush with cash, which helped them to cope with the rising cost of capital. Risk asset pricing has reacted accordingly – higher equity prices and tighter credit spreads. **However, the medium and longer term impacts of waning government stimulus and Fed tightening from early 2022 through mid-2023 are still not fully understood.** We believe **markets are pricing in too much Fed accommodation over the course of the next year. Our view is that the Fed will ease no more than twice by the end of Q1 2025**.

Most macro indicators are currently in a favorable range, but several areas of the US economy are experiencing a moderation in growth – slowing but not declining. **Our "Base" case scenario calls for continued growth, tamed inflationary pressure, and a healthy employment environment – yet with moderation in the positive trends we have experienced over the last few quarters**. This moderation in constructive factors is beginning to have an effect on businesses and consumers. For the **first time in several years, we are seeing "cracks" in a handful of places *all at the same time (e.g.* manufacturing, retail sales, small business hiring, consumer loan growth, and employment data)*.*** It is not our "Base" case to expect a decline in growth, but if our "Bear" case downside scenario were to play out, it would likely be follow through from these initial indications.

For this reason, **we see the current state of the cycle as uncertain – which leads us to invest with extra caution in a few sectors until we have a better read on the situation** (which should only require another 3-6 months of data). **These areas are the consumer, commercial real estate, and corporate direct lending**. Although we see some opportunities in these sectors, additional care in underwriting and patience will be required for success.

Macroeconomic Environment

- Restrictive policy has tamed inflationary pressure and achieved disinflation – though inflation remains above the Fed's target of 2%. We expect the Fed to ease no more than twice over the next 12 months
- **Larger dispersion of outcomes is expected** as **potential cracks manifest *simultaneously* in a handful of areas**
- Higher rates and above target inflation will likely be a persistent reality

Corporate Credit Landscape

- Private and public credit markets are both showing strength (spread tightening and issuance activity)
- **Income and total return in credit strategies rivals that of what could be expected in the equity markets**
- **Caution may be warranted as higher-for-longer rates might impact corporate borrower's ability to meet their floating rate interest obligations**
- Fresh capital and banks shedding of risk are fueling the refinancing wave in private credit

Real Estate Debt

- Commercial real estate is a focus - **liquidity events will reveal a bottom – patience and diligence will be critical to success**
- Residential real estate continues to be strong with a high level of equity. Low activity levels are a result of higher rates and high valuations
- Margin degradation in both commercial and residential from tempered rent increases but rising holding costs from a combination of increases in insurance, property taxes, operating expenses and debt costs

The State of the Consumer

- Consumer behavior continues to cool, with **negative performance in lower credit borrowers**
- Credit is being extended to a more limited set of borrowers as income is flat, savings fall, and debt costs rise
- **Consumer related debt must be underwritten to a more draconian "worst case" downside scenario**
- As the state of the consumer is in flux, the household "waterfall" of payment priorities may change and be different from past cycles

Quarterly Market Outlook – Q2 2024

NOMURA CAPITAL MANAGEMENT

As of March 2024 – *Unless otherwise stated*

Views on the Credit Markets

Asset Class	Underweight	Cautious	Neutral	Cautious Optimism	Overweight
Residential Real Estate					✓
Commercial Real Estate				✓	
Asset Based Lending				✓	
Direct Lending			✓		
Special Situations / Opportunistic Capital Solutions				✓	
Specialty Finance				✓	
Public Market Credit		✓	→ ✓		

The views expressed in this chart are those of the Investment Team of Nomura Capital Management, LLC and are based on the Investment Team's forward-looking assessment of credit markets as of the date referenced above. The views expressed herein are subject to change at any time following the publication of this report. The arrows in the chart reflect the change in the Investment Team's outlook of each credit market since its prior quarterly market commentary. This chart is provided for informational purposes only and is not intended to represent a recommendation from Nomura Capital Management, LLC to invest in, or divest from, the credit market asset classes referenced herein.

Quarterly Market Outlook – Q2 2024

NOMURA CAPITAL MANAGEMENT

As of March 2024 – *Unless otherwise stated*

Economic Outlook (12 – 18 Months)

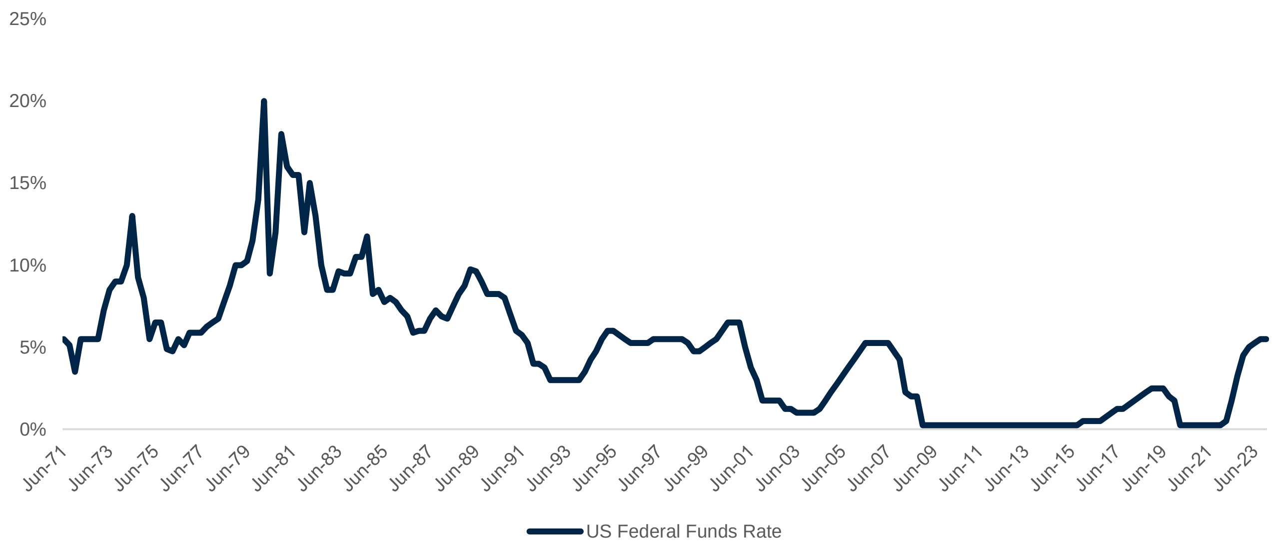
	Bear	Base	Bull
Probability	**25%**	**60%**	**15%**
Growth (Real GDP, QoQ)	-1.50%	1.50%	4.00%
Inflation (Core PCE, YoY)	2.00%	2.50%	3.00%
Unemployment	6.00%	4.25%	4.00%
Risk Assets	Price Depreciation	Slightly Higher	Higher
Base Rates	Lower	Modestly Lower	Modestly Higher
Volatility	Higher	Modestly Higher	Flat
	▪ Shallow recession, although possibly could persist for longer than recent slowdowns ▪ Unemployment increases amid weaker hiring and cost cutting in response to pressure on corporate profit margins ▪ The Fed lowers rates against the weaker macro backdrop and risk assets are revalued lower ▪ Volatility increases due to uncertainty ▪ Credit environment is in a state of malaise, but significant credit issues in both the commercial real estate and corporate sectors ▪ Default rates rise	▪ Moderate economic growth with inflation above the Fed target of 2% ▪ Fed maintains rates in restrictive territory, but lowers rates from recent highs ▪ Risk asset prices rise slightly though dispersion drives returns ▪ Volatility increases as outcomes are more uncertain ▪ Default rates remain slightly elevated, though continue to improve from the recent peak ▪ Near perfect environment for credit	▪ Soft Landing is achieved and the full recognition of this encourages a new wave of growth and extension of the business cycle ▪ Inflation rises slightly with increased demand pressure, although is moderated by incremental Fed hikes and diminished supply side pressure ▪ Unemployment remains low, though increased demand pressure is offset by an improved participation rate ▪ Volatility remains flat with no increase in uncertainty in the market

The views expressed in this chart are those of the Investment Team of Nomura Capital Management, LLC and are based on the Investment Team's forward-looking assessment of the general macro-economic environment as of the date of this report. The Bull/Base/Bear Market ("Market Scenarios") outcome probabilities noted in this report reflect the Investment Team's forward-looking estimate of the probability of each Market Scenario occurring within the next 12-18 months from the date of this report. The market metrics noted within this report (Growth, Inflation, Unemployment, Risk Assets, Base Rates and Volatility) represent the Investment Team's forward-looking estimate of each market metric resulting from the corresponding Market Scenario. All views and estimates contained within this report are as of the date of this report and are subject to change at any time following the publication of this report.

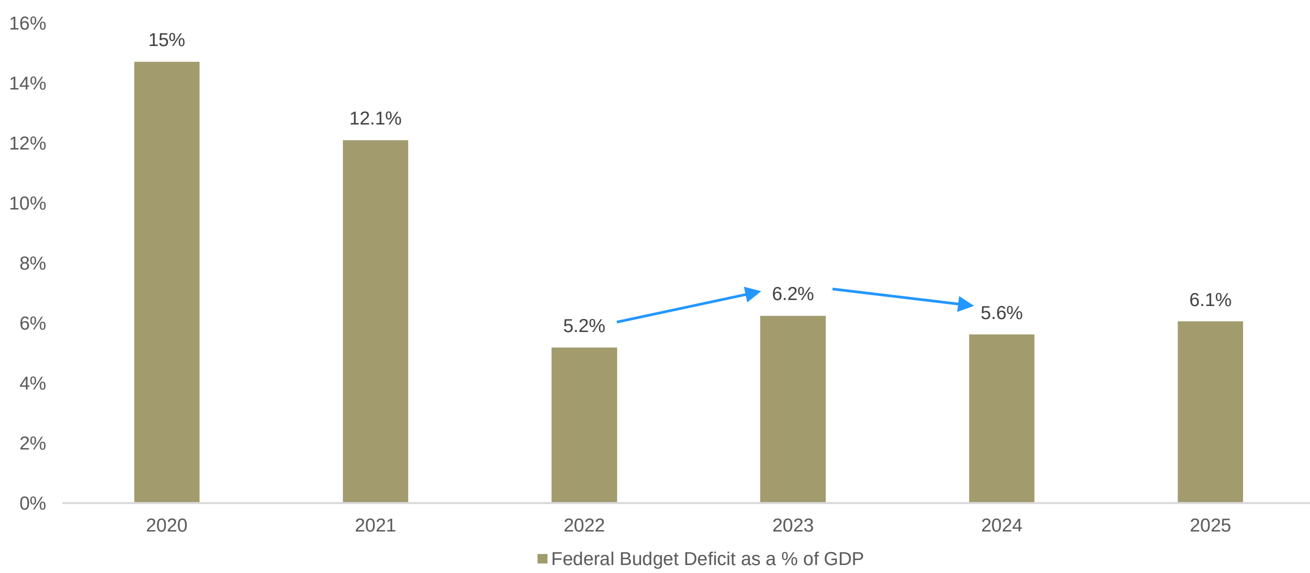
As of March 2024 – *Unless otherwise stated*

Macroeconomic Environment – Fiscal Spending Supported the Economy in 2023

As the Fed began raising rates in 2022 at the fastest pace since the 1970s, many were predicting a recession in 2023



After the initial hikes starting in March 2022, fiscal spending in 2023 may have helped soften the blow of rising rates as the federal budget deficit as a percentage of GDP grew from 5.2% to 6.2%

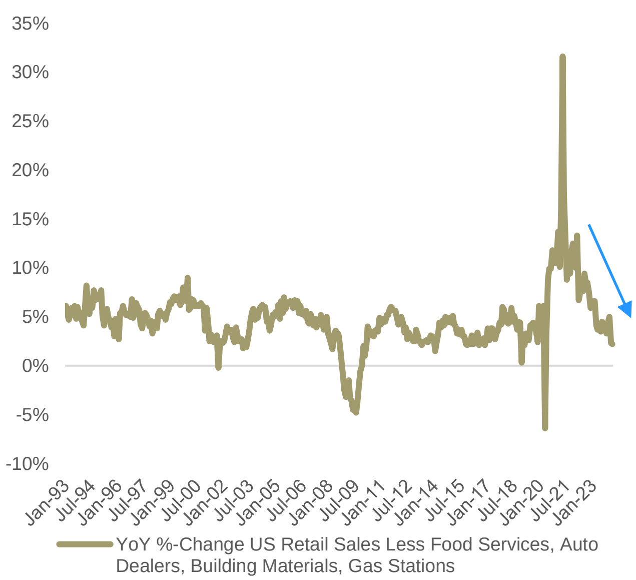


[1] Interest rates data sourced from Bloomberg
[2] Federal budget data sourced from the Congressional Budget Office

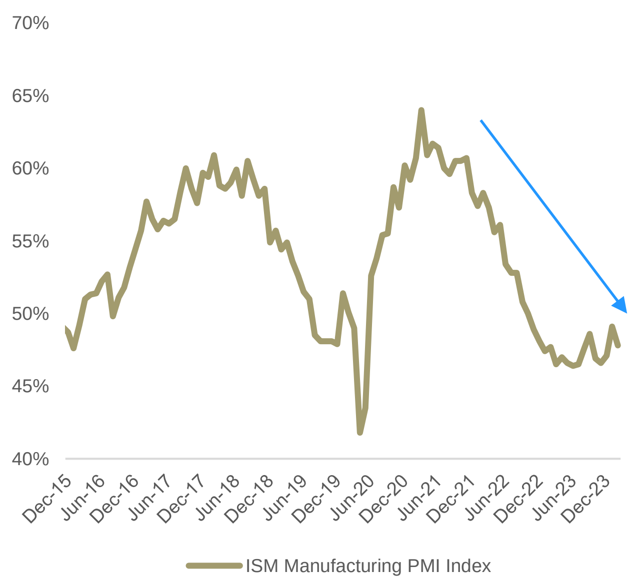
As of March 2024 – *Unless otherwise stated*

Macroeconomic Environment – Economic Activity Appears to be Moderating

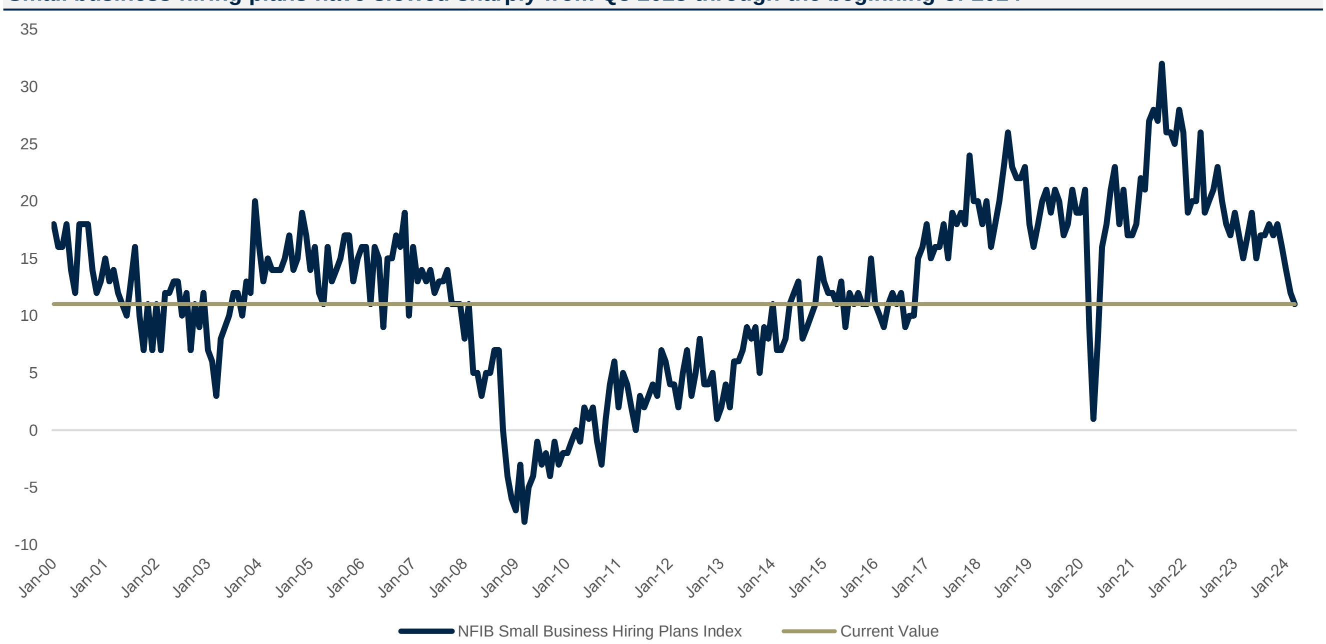
US Core Retail Sales growth has been trending downwards from post-COVID highs



At the same time, manufacturing activity has hovered around a near-term low



Small business hiring plans have slowed sharply from Q3 2023 through the beginning of 2024

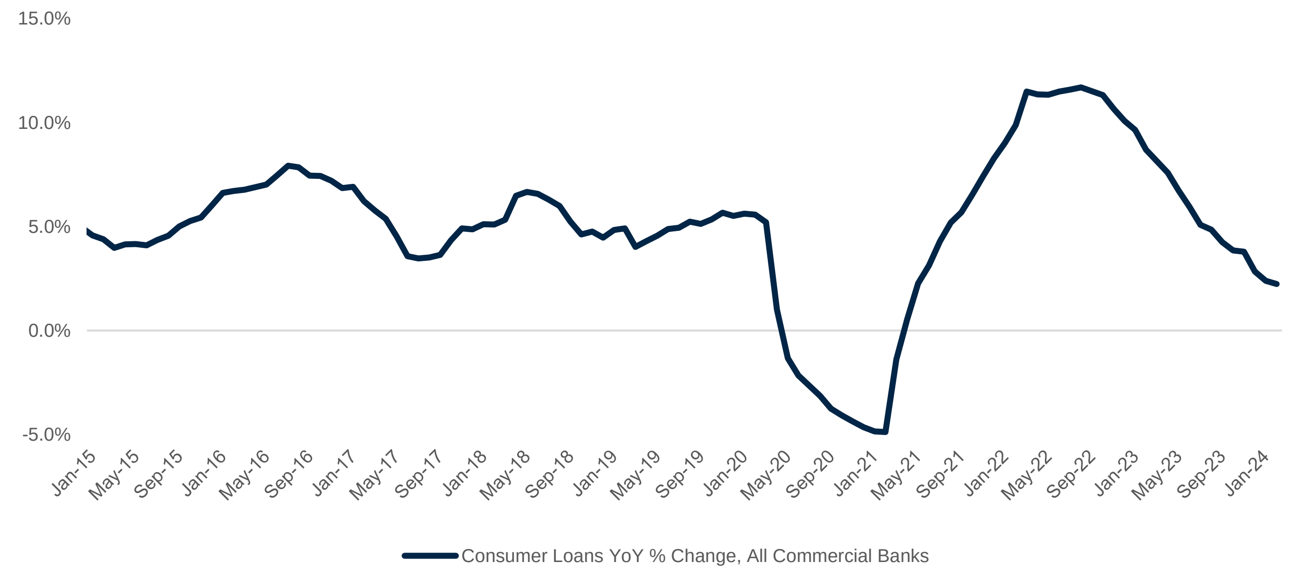


[1] *All data and charts on this page is sourced from Bloomberg*

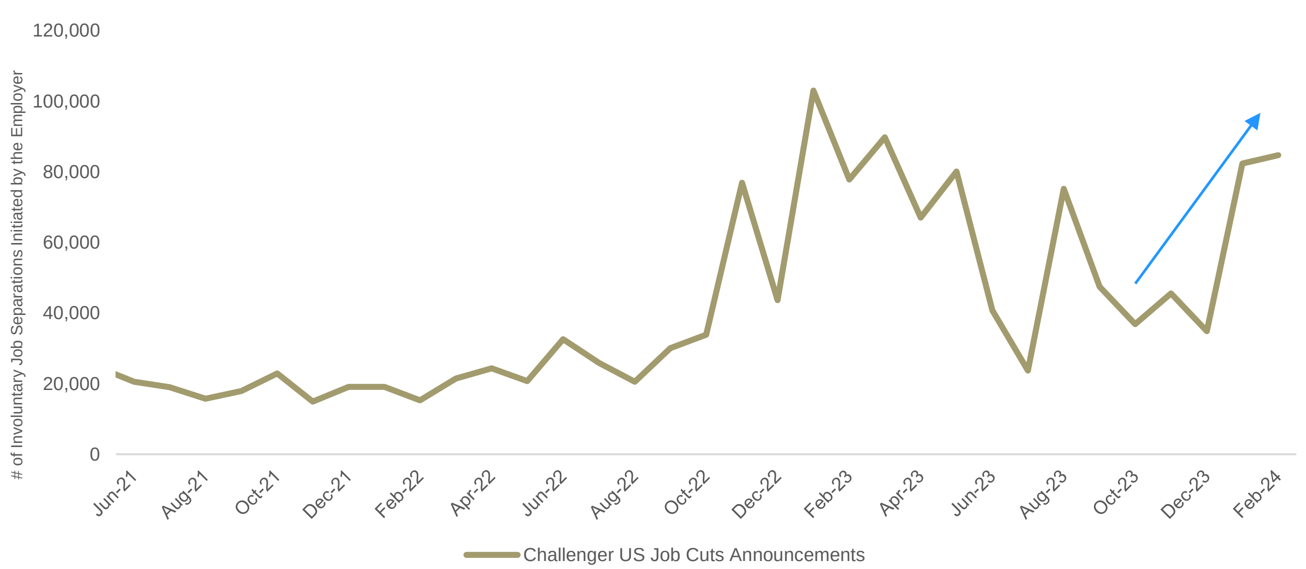
As of March 2024 – *Unless otherwise stated*

Macroeconomic Environment – Economic Activity Appears to be Moderating

Amid rising rates, consumer loan growth has moderated following the sudden increase from 2020-2022



Slowing economic activity may have begun to impact the labor market, shown through layoff announcements



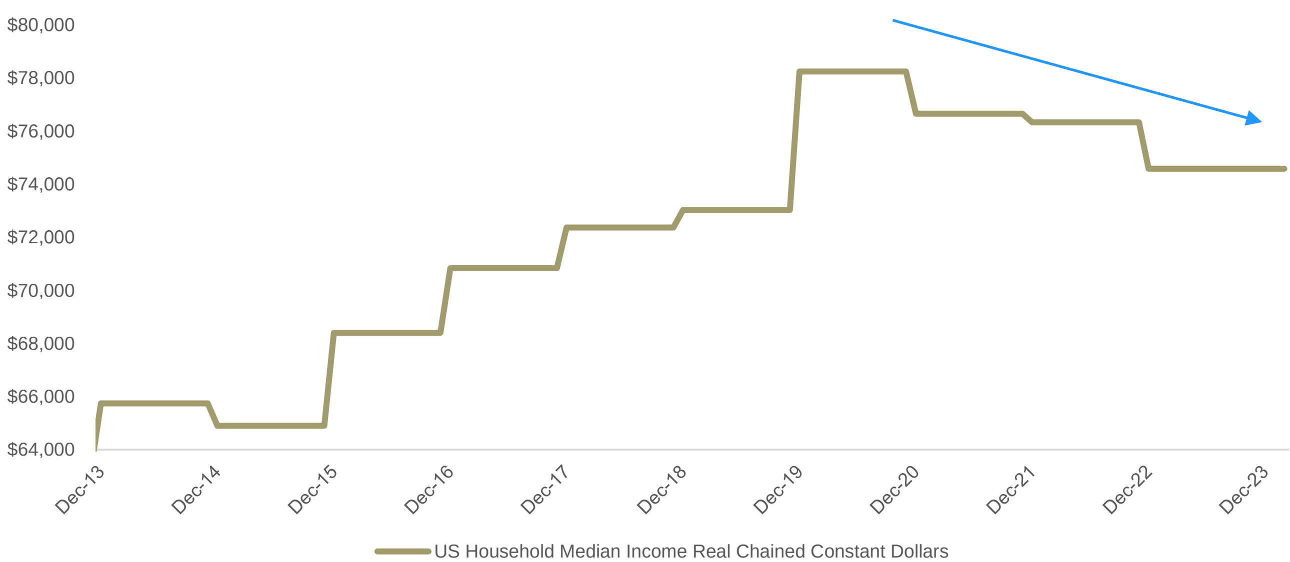
[1] *Consumer loan growth data sourced from the Federal Reserve Bank of St Louis*

[2] *Challenger layoff data is sourced from Bloomberg*

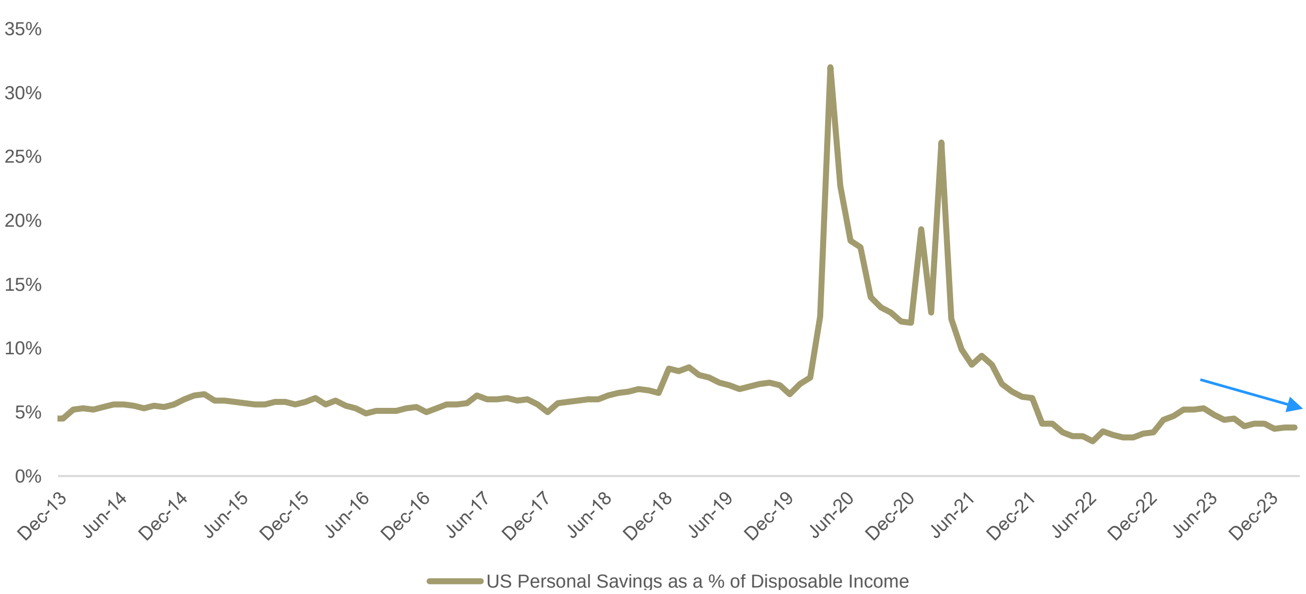
As of March 2024 – *Unless otherwise stated*

State of the Consumer – Impact of Stimulus May be Fading

Amid elevated inflation, the median household income in the US decreased



In keeping with the theme, personal savings has gradually decreased as time moves further and further away from COVID stimulus

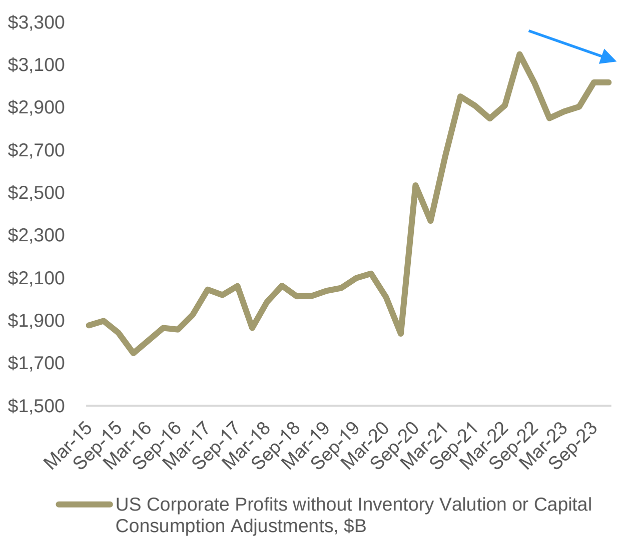


[1] *All data and charts on this page is sourced from Bloomberg*

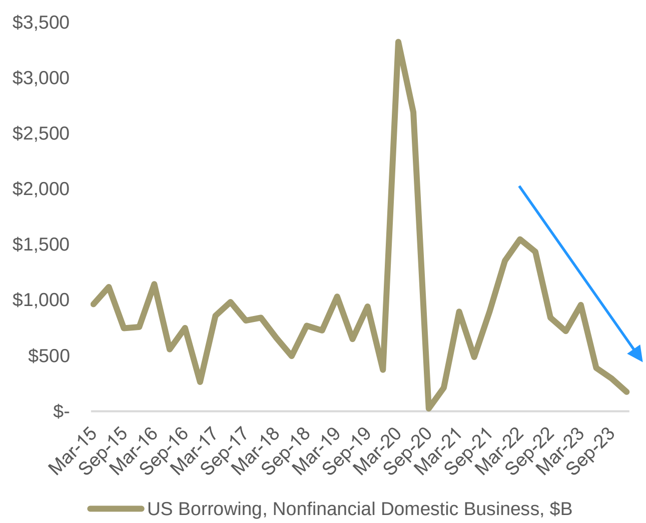
As of March 2024 – *Unless otherwise stated*

US Corporates – The Skew Towards Exceeding Earnings Expectations Could Be Normalizing

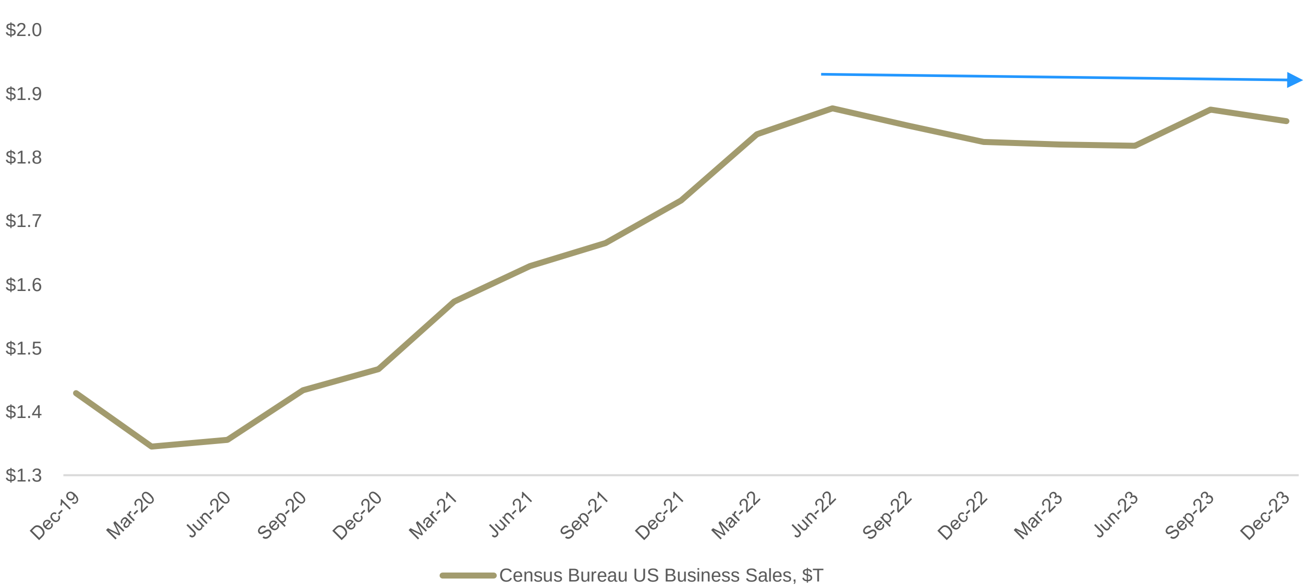
US Corporate profits have remained relatively flat since Q1 2021



Corporate borrowing has decreased as borrowing costs have increased



Sales have stagnated which may further deter corporates from borrowing additional funds

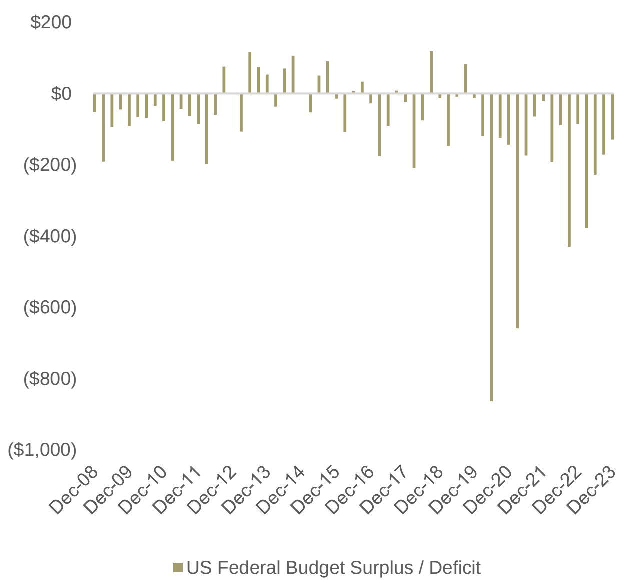


[1] *All data and charts on this page is sourced from Bloomberg*

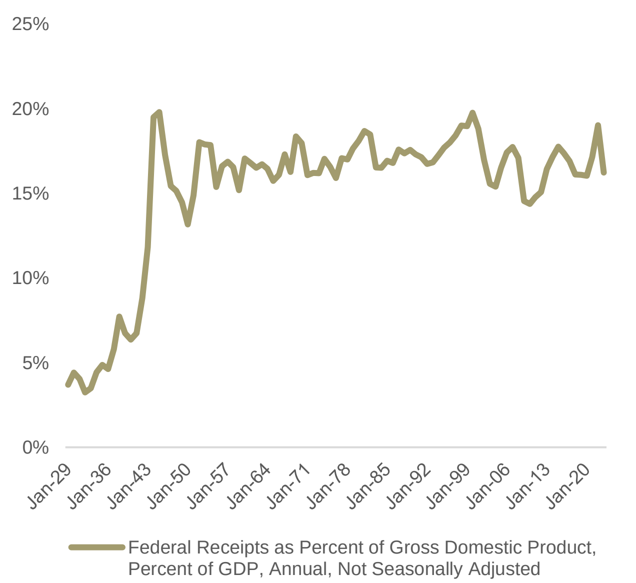
As of March 2024 – *Unless otherwise stated*

US Government – Scale of Recent Government Stimulus shown in Budget Deficit and Borrowing

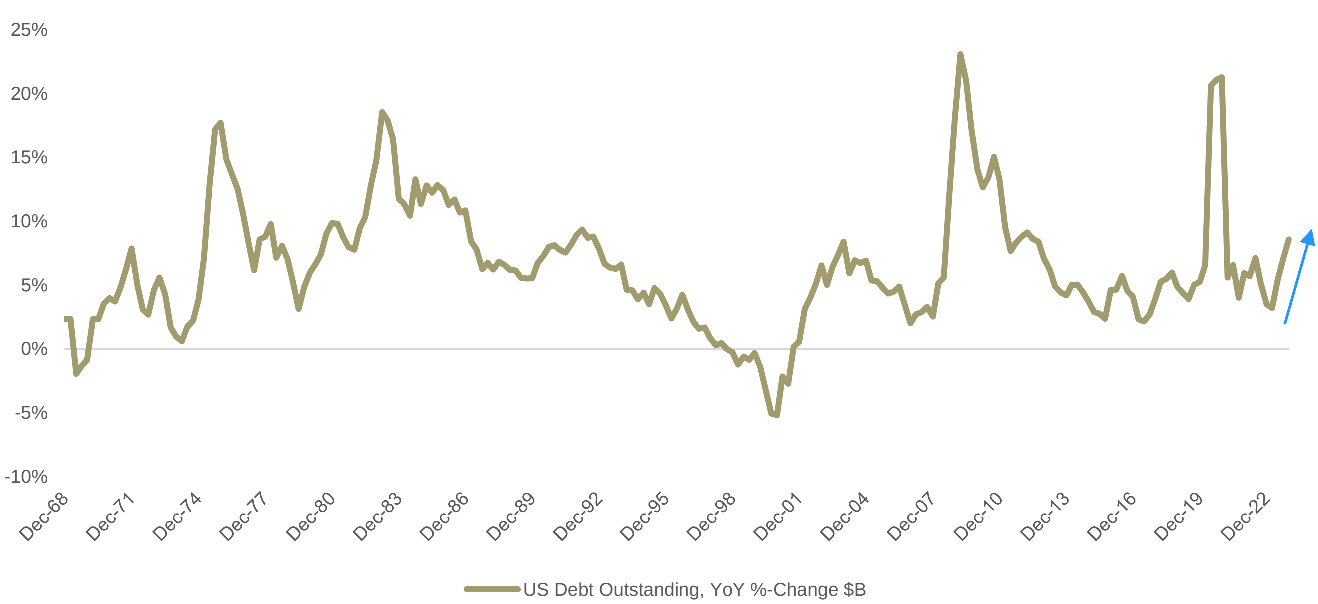
Since 2020, the Federal government has reported a budget deficit in every quarter



At the same time, tax receipts have remained relatively stable



Outstanding government debt has been increasing since Q1 2023



[1] *All data and charts on this page is sourced from Bloomberg except for graph 2 in which data was sourced from The Federal Reserve Bank of St Louis*

Examples of Opportunities in the Credit Markets

The following information represents illustrative examples and common themes among the types of transactions that may be available in the asset based and corporate lending asset classes.

*Common themes are highlighted in **gold**.*

	Asset Based Lending EXAMPLE	**Real Estate** EXAMPLE
Situation Overview	▪ Transaction represents an opportunity to provide ***"Gap Capital"*** backed by a ***diversified book*** of SME loan receivables	▪ Transaction represents an opportunity to provide ***"Gap Capital"*** backed by a ***diversified book*** of properties
Investment Profile	▪ ***Purchase of whole loan receivables***	▪ ***Corporate debt*** solution
Why Is It Interesting	▪ ***Highly structured transaction,*** involving multiple concentration limits and eligibility criteria ▪ Short duration underlying asset profile enabling real-time adjustments based on market conditions ▪ ***Intersection of Corporate and Asset Based Exposure***	▪ ***Highly structured transaction,*** with asset pools being uncrossed and non-recourse ▪ Properties are strategically located in prominent areas ▪ ***Intersection of Corporate and Asset Based Exposure***
Return Profile	▪ Investment in this example has a potential ***15.0%*** net return profile	▪ Investment in this example has a potential ***16.0%*** net return profile

Disclaimer

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