Onex Credit Market Update & Sector Commentary

Q2 2025

Key Macro and Economic Themes

- ***Government policy and geopolitical uncertainty are now at the forefront of investor concerns***
  - "Uncertain" is our best word to describe this environment. Seemingly every day a new policy change or headline whipsaws the market. With a sharp rally well off the April 9 lows, it appears markets are taking the view that we have already witnessed "peak" trade uncertainty. While it is increasingly challenging to have conviction in the macro, what is evident is the range of potential outcomes has widened. No credit portfolio can be fully immune from exposure to macroeconomic or policy changes, but we can attempt to mitigate risk by allocating towards more defensive industries and running diversified portfolios in an effort to minimize idiosyncratic policy driven risk.
  - We see meaningful risks to the global economy if the announced broad-based tariffs remain in place and believe prolonged uncertainty around them (even if rolled back) could cause lasting damage to consumer and business sentiment. The policy vacillation hampers long-term planning and is likely to have a chilling effect on investment. In an economic backdrop that was already slowing, the downside risks have been further accentuated.
  - One potential counterbalancing force is the 2026 election cycle, which should increase pressure on the administration to course-correct if we start seeing more pronounced economic weakness. Even a tax cut by itself may not be enough to stimulate the economy from the overhang of policy induced paralysis. The administration has shown willingness to pivot with respect to certain policies in response to volatility in financial markets —while this provides some comfort, it does not preclude the risk of unintended or unforeseen outcomes.[1] Markets are inherently complex and sensitive to shifts in policy direction.
  - While tariff policy has dominated the narrative since the April 2 announcements, there are several other government policy vectors currently impacting investors — the Department of Government Efficiency ("DOGE"), Medicaid, Federal Reserve (the "Fed") independence, FDA/drug development, immigration, tax cuts to name a few — on top of new and continuing geopolitical tensions.
- ***Hard economic data remains resilient, while soft data shows signs of deterioration***
  - The majority of hard economic data prints indicate the economy was slowing but still healthy through April. U.S. nonfarm payrolls rose by 177k in April (compared to 185k in March), the unemployment rate was unchanged at 4.2%, and average hourly earnings grew 0.2% month-over-month (3.8% year-over-year).[2] The labor picture remains solid, and we've yet to see any meaningful tick up in unemployment. Retail spending and durable goods orders have shown surprising strength; however, there is a risk data has been inflated by pull-forward demand from tariff front running and the data will get weaker over the coming months.
  - We've seen notable weakness in soft indicators such as consumer confidence and PMI surveys, though we are hesitant to attach too much weight to sentiment-based indicators. Negative headlines and uncertainty are likely weighing on sentiment, but these headwinds can be repaired far faster than true damage to the labor market (which remains healthy for now). We continue to watch for signs of this malaise in sentiment bleeding into the hard economic data and potentially driving unemployment higher.
  - April 2025 Fed Beige Book noted "Economic activity was little changed since the previous report, but uncertainty around international trade policy was pervasive across report. The outlook in several Districts worsened considerably as economic uncertainty, particularly surrounding tariffs, rose".[3]
- ***Corporate sentiment continues to remain cautious against an uncertain backdrop***
  - Themes around caution were prevalent throughout Q4'24 earnings releases, and concerns have only increased post the "Liberation Day" tariff announcements. Cyclical industrial sectors such as chemicals and building products softened further off an already weak baseline.

[1] Sources: Wall Street Journal 'Trump Authorizes 90-Day Pause on Reciprocal Tariffs'. April 9, 2025. 'White House Considers Slashing China Tariffs to De-Escalate Trade War'. April 23, 2025.
[2] Source: US Bureau of Labor Statistics. May 2, 2025.
[3] FederalReserve.gov. 'Overall Economic Activity' Report. April 2025.

- Companies are facing challenges in forecasting earnings amid the rapidly evolving macro and policy environment, particularly in tariff impacted or cyclical industries. For example, Lockheed Martin[4] and RTX[5] excluded the impact of tariffs when providing 2025 guidance, though RTX did attempt to provide a range of estimates on their earnings call. United Airlines laid out two 2025 estimates, one for a "stable environment" and one for a "recessionary environment".[6] American Airlines, Delta, Southwest, and Alaska Air pulled or cut their 2025 guidance.[7]
- The narrative on the consumer has been more mixed and at times conflicting. Q1'25 reports from financials indicate overall stability – Synchrony Financial stated, "we have not seen the consumer pull back for us. Sales have been consistent both on a weekly basis all the way throughout second week into April". Capital One called the US consumer "a source of strength in the economy".[8] Conversely, we are starting to see consumer softness broaden out into previously resilient sub-sectors such as travel and airlines. Delta cited "softness in both consumer and corporate travel" and noted "consumers remain cautious". Southwest went a step further stating "leisure demand drop is the worst seen since [the pandemic]". We have seen continued discretionary spending declines in experiential concepts like Dave & Busters and TopGolf.[9] For now, we view these data points as "softness" as opposed to something more concerning, and the consumer remains supported *for now* by low unemployment and moderating inflation. The theme of consumers seeking "value" continues to be prominent.
- Europe has emerged as a relative outperformer in a sharp reversal of recent trends. Optimism around fiscal stimulus (Germany is particularly noteworthy) and the potential for increased defense spending have been a tailwind for the Euro and European equities.

- ***The Fed's dual mandate for employment and price stability may conflict, forcing the Fed to prioritize one***
  - We are concerned with the risks of an inflationary supply shock and a negative demand shock hitting the economy at the same time, potentially setting up the risk of stagflation. There is no clear precedent for the impact of a broad-based supply side economic restructuring and it also remains unclear if the administration truly intends to follow through with what will likely be a painful realignment.
  - Chairman Powell openly acknowledged this potential for a "challenging scenario in which our dual-mandate goals are in tension". Given the risks, he indicated a preference to "wait for greater clarity before considering any adjustments", likely implying the Fed will be reactive as opposed to proactive.[10]
  - The implication to our investing approach is clear: we neither assume a "bailout" for risk assets if growth slows, nor underwrite capital structures whose feasibility is predicted on lower rates. The potential for stagflation raises a scenario where high rates may coincide with economic slowdown.
  - Looming in the backdrop is the risk of a challenge to Fed independence. President Trump has openly criticized Powell's unwillingness to cut rates, though has since refuted the intention to remove him.[11] The initial ripple effects of such tensions have surfaced fears in interest rate and FX markets and remain watchful for signs of escalating financial stability risks (particularly foreign governments selling US Treasuries).

Market Observations and Commentary

- ***Credit markets have proven more resilient than equities and spreads have widened off historic lows but it remains unclear if markets are pricing in potential risks***
  - Despite the S&P 500 declining ~5% year-to-date through end of April, credit markets have been resilient with the JPM indices in positive territory through April for both US leveraged loans and high yield bonds. Dispersion amongst loan ratings cohorts is notable, with Double-Bs materially outperforming split Single-B/Triple-Cs by ~200 bps year-to-date. Tariff sensitive issuers (retail and autos) and economically cyclical credits (chemicals, consumer discretionary, building materials) have meaningfully underperformed, while more defensive sectors (consumer staples, healthcare, telecom) have outperformed.[12]

[4] Sourced from the relevant company's earnings reports and filings.
[5] See note 4.
[6] See note 4.
[7] Bloomberg. April 24, 2025.
[8] See note 4.
[9] See note 4.
[10] FederalReserve.gov. 'Economic Outlook' Release. April 16, 2025.
[11] Wall Street Journal 'Trump Renews Call for Rate Cut, Slams Fed Chair'. April 21, 2025. Reuters 'Trump says he has no plans to fire Fed's Powell; market jumps'. April 22, 2025.
[12] JPM High Yield Bond and Leveraged Loan Indices. April 30, 2025.

- U.S. corporate credit spreads have modestly widened after beginning the year at historically tight levels.[13] Leveraged loan and high yield spreads remain far lower than the peaks during previous periods of volatility in 2020 and 2022.[14] There is dispersion below the surface, indicating the market isn't wholly complacent around risk. Double-B and Single-B rated loan spreads have remained tight supported by strong technicals, while Triple-C loan spreads have experienced significant decompression.
- Absent a few volatile trading days in early April, we would characterize the secondary loan market as very orderly and resilient. Large loan outflows were quickly absorbed by new CLOs and warehouses ramping. Primary loan markets have reopened after a several week pause and we saw the QXO/Beacon deal tighten and still trade up on the break.
- The recent volatility has pressured CLO liabilities in the secondary market which had touched their tightest levels since the Russia / Ukraine conflict began.[15] This cooled CLO new issuance which has been the main driver of loan demand. After some stability, activity has picked up first in the US and now in Europe with strong demand from overseas and domestic banks, insurance companies and money managers, albeit at wider levels. With loans recovering most of the weakness, CLO liabilities have some room to tighten before the CLO arbitrage becomes more compelling from the perspective of the equity investors. We expect this will slow issuance for a period (which we view as healthy) and keep some discipline around the new issue loan market as well. With little M&A / LBO activity on the calendar, existing CLOs will continue to grab for the highest quality loans in the secondary market.

- ***Credit markets continue to experience a tight supply / demand balance, particularly in direct lending***
  - While the much-anticipated rebound in buyout activity has underwhelmed to date and is likely to remain sluggish as tariff and macro uncertainty slows deal volume, in Q1'25 loan capital markets produced the heaviest net issuance since Q1 2022.[16] The broadly syndicated loan ("BSL") market supply / demand imbalance has somewhat moderated and the market feels less overheated compared to the start the year. B3/B- and CCC downgrades are effectively shrinking the investible universe for CLOs resulting in a deep bid for "higher quality" loans, particularly those rated B2/B and higher.[17]
  - Direct lending markets slowed during the quarter, with Q1'25 direct lending deal count ~16% lower quarter-over-quarter and sponsor-backed deal count ~24% lower quarter-over-quarter.[18] Capital continues to be allocated into the industry and direct lending funds / BDCs did not appear to experience the same level of outflows as BSL funds during April's heightened volatility. Deployment needs, particularly in upper middle market BDCs, remain acute and are resulting in deals clearing at tight levels despite broader market volatility. The core middle market has widened modestly, but less than we would have otherwise expected. Larger direct lenders seem willing to move down market to meet deployment needs, creating a very competitive backdrop for deals across all segments of the direct lending market.
  - While direct vs BSL competition remains intense, each market seems to have found its niche. Larger, cleaner, and better rated companies have a clear cost of capital advantage in the BSL market, while companies that are smaller, more complex, or have weaker credit metrics are better served with a more bespoke direct solution. Direct lending had stepped in and taken share when BSL markets were more dislocated, while more recently, the direct lending market has been losing higher quality deals to the BSL market. We saw a large deal move to the BSL market in Q1'25 and expect several higher quality deals to continue this trend, making the transition.
- ***Liability management remains prevalent, but we have noticed a subtle shift in company and sponsor priorities***
  - Hopes of a slowdown in liability management exercises ("LMEs") in Q1'25 after the Serta ruling have proven futile as advisors display ever more creativity in structuring new deals. Cooperative agreements are helping evolve the game theory of processes and have evolved from purely "defensive" maneuvers into tools creditors can use to play "offense" to improve their position relative to other creditors.
  - The economics in LME transactions have approached more of an equilibrium as more deals have been completed. Compared to some of the initial transactions like Serta and Incora, we have seen a clear trend towards more "consensual" LMEs where the "majority group" economics are balanced against the desire to avoid litigation.

[13] Bloomberg. April 30, 2025.
[14] Spread levels are reflected by the OAS of the BofA ICE US High Yield Bond Index (H0A0) and the 3-year DM of the Credit Suisse Leverage Loan Index (CSLLI). As of April 30, 2025.
[15] S&P U.S. Leveraged Finance And BSL CLO Quarterly (Q2 2025). May 1, 2025.
[16] JPM High Yield / Leveraged Loan Market Monitor. April 1, 2025.
[17] See note 16.
[18] Pitchbook | LCD – US Private Credit & Middle Market Quarterly Wrap. April 9, 2025.

Many of the deals closed in the past 6-12 months have reached 99+% lender consent, removing the tail risk of an adverse litigation outcome.

- The profile of LMEs and sponsor priorities in the transactions also seem to have somewhat shifted over time. In our experience, many of the initial deals were driven by a large liquidity need, with discount capture and to a lesser extent maturity extension being the other key sponsor objectives. More recently, we have seen sponsors target capital structures with '27 and '28 maturities, where the key focus is maturity extension and new money, with discount capture being *relatively* deprioritized. As the LME equilibrium has evolved, it has become harder to capture economics from the majority lender group, while sponsors are realizing that maturity extension and runway are more likely to allow for a path to equity return rather than a modest amount of discount capture. This is particularly true for businesses undergoing cyclical or tariff headwinds where there may still be a path to equity value over time. Many of the initial LMEs were particularly weak or challenged companies, and potential for discount capture is lower in less stressed situations. As maturity is a sacred right under most loan documents, we believe the focus on lengthening runway will continue the trend towards more "consensual" LMEs.

Sector and Earnings Commentary

Technology: ***Software is largely fulfilling its role as a defensive sub-sector and is relatively insulated from tariff or macro risks; however, tariff uncertainty looms largely over hardware while slower macro may hurt IT services***

- Infrastructure software (ERP, CRM, HCM, LMS) has continued to perform well. Providers have been largely insulated from IT spending rationalization due to their mission critical functions and sticky, embedded nature. Management teams have flagged emerging signs of a slowdown, which typically means lengthening sales cycles and lower new logo growth as opposed to a material decline in retention rates.
- Point solution software has seen a more pronounced slowdown in growth. Retention rates have largely held up so far resulting in decent overall performance despite limited growth.
- Enterprise cybersecurity remains a growing, but highly competitive end market. Companies need to adequately differentiate their product, provide an integrated platform solution, and effectively manage MSP relationships when selling to SMB customers. Dispersion in performance has been high, and weaker operators have turned into market share donors.
- Hardware performance improved during the past several quarters as companies worked through excess inventory and demand trends stabilized. Expectations were for performance to continue to improve throughout the year, but tariffs and supply chain disruptions may have negatively impacted the recovery. Sustained tariffs may drive cost inflation and lead to demand destruction if prices are fully passed on.
- IT services started to see recent green shoots of demand for a return to IT project spending. Expectations for a rebound in 2025 are now in flux with potential macro headwinds.

Healthcare: ***Policy driven uncertainty is a key focus for the sector broadly with potential cuts to Medicare impacting facilities and services, tariffs on pharmaceuticals and devices, and potential regulatory changes to drug development impacting pharmaceutical services***

- Earnings for healthcare facilities and services companies were generally a continuation of recent trends: solid volumes and pricing growth and stabilizing costs. However, the go-forward outlook is dominated by potential cuts to Medicaid and has led to compressed valuations across the sector. There is ongoing debate on Medicaid benefit cuts, in addition to work requirements, provider tax reform, and removal of Biden-era policy. It remains to be seen what the final deal looks like, but we do not expect draconian cuts to be politically palatable and believe it will be a manageable headwind for the sub-sector.
- While recent operating performance has been solid, pharmaceutical manufacturers also face policy uncertainty as the Trump Administration is investigating potential tariffs on active ingredients and finished pharmaceuticals. There have also been discussions of targeting the tax "inversions" and Ireland based manufacturing of large pharmaceutical companies. With high reliance on India and China to supply active ingredients, pharmaceutical companies will be challenged to shift their supply chains quickly to the US.
- Pharmaceutical services linked to drug supply chain development remain challenged due to weak R&D spending and the uncertain policy environment. The contract research organizations ("CROs") have been highly competitive for new contract wins; however, we have seen signs that this headwind is somewhat abating. Recent departures at the HHS and FDA have the potential to slow the drug approval timeline. Policy changes can have a sharp impact on the industry

as evidenced by Charles River Laboratories stock dropping ~30% after the FDA announced they would pull back from animal testing.[19]

- Healthcare IT remains a defensive sub-sector with strong financial results amid the continued adoption of solutions, driving a mix of higher volumes as well as pricing power on cross sell/upsell. There has been increased regulatory scrutiny around some of the healthcare IT business models, but we see limited risks to our names based on the current regulatory environment.

Financial Services: ***Operating performance continues to be strong, positive secular trends remain intact, and the sector has been relatively insulated from tariff or supply chain risks***

- Insurance brokerage platforms are largely insulated from catastrophe carrier losses and continue to benefit from rate increases. We expect price growth to moderate in 2025 as inflation cools, and increased underwriting capacity comes into the market. Specialty lines have demonstrated particularly robust organic growth, benefitting from policy growth away from the admitted market to the excess & surplus market. We have seen "consolidation of consolidators" with large scale M&A such as the merger of Gallagher and Assured in addition to the potential sale of Risk Strategies.[20]
- RIA platforms continue to attract positive flows despite weaker equity markets given secular asset growth in the fiduciary, independent channel. Revenues are billed as a percentage of AUM and thus have some sensitivity to market declines, but this is somewhat mitigated by the usage of 60/40 portfolio models.
- Independent broker dealers continue to invest in M&A to attract assets to their lower cost, scaled platforms. They benefit from their multi-year earnings visibility on their hedged portion of client cash balances. Market concerns from Q3'24 over regulatory and competitive pressure on IBD rate cards have largely faded. We continue to believe IBDs will be relatively insulated from these pressures relative to warehouses and banks as they don't face the same perceived conflicts of interest.
- The fund administration sub-sector performance has been stable due to their essential, non-discretionary services and the growing demand for outsourcing amid complex regulations.
- Despite headwinds from reduced consumer discretionary demand, companies in our FinTech portfolio continue to perform well, driven by the steady rise of digital payments fueled by technological advancements and evolving consumer preferences.

Telecom: ***Continuation of recent trends with cable continuing to cede subscribers to fixed wireless and fiber***

- Competition for subscribers remains intense and cable broadband subscribers remains under pressure from multiple angles. Fixed wireless access offerings from wireless carriers offer a cheaper alternative to cable and fiber and have continued to take share at the lower end of the consumer spectrum in the period. At the higher end, fiber builds from telecoms are also taking share in select markets.
- 2025 was anticipated to be the start of funding flows from the federal Broadband Equity, Access, and Deployment ("BEAD") program. However, with Elon Musk as an advisor in the White House and a new chair of the NTIA, alternatives to fiber-based technology (LEO satellite, fixed wireless) are now being assessed which could delay and potentially change funding.
- We don't expect tariffs to have a meaningful impact on results in the sector given the domestic, service-based offerings. Direct impact is likely limited to capital expenditure inflation, with the second order impact coming from consumer pressure, potentially influencing ARPU/churn.

Gaming/Lodging/Leisure: ***Recent performance has been solid, but potential pressure on the consumer is a risk***

- Hotels and cruise lines continued to show strong demand in 2024 and Q1'25. While softness among lower-end consumers remained a recurring theme during the quarter, the overall tone was cautiously optimistic.
- Cruise commentary was overall constructive throughout Q1'25 earnings, though a modest divergence between Royal Caribbean Group and Norwegian Cruise Line Holdings was noteworthy. Royal Caribbean Group indicated 2026 bookings were in line with the prior year but with higher prices; further, they haven't seen any material pullback in onboard spend or close in bookings, which tend to be reliable real time indicators. Norwegian Cruise Line Holdings had more conservatism in their commentary, lowering yield and occupancy guidance while indicating that they saw

[19] Bloomberg. As of May 1, 2025.
[20] Insurance Insiders 'Risk Strategies Draws Marsh McLennan Interest as Howden Talks Falter'. April 1, 2025.

some softening in the 12-month forward position due to macro volatility, particularly from US passengers on European sailings.[21]

- Gaming was more mixed with weather, continued labor cost inflation and incremental competition all weighing on Q1'25 results. Go-forward trends remain generally stable, with Boyd noting that they "have not seen any meaningful shift in consumer behavior or spending patterns thus far in the second quarter" while Caesars' CEO provided similar optimism on their Q1'25 earnings calls.[22]
- U.S. revenue per available room ("RevPAR") grew +0.8% year-over-year in March, marking another month of deceleration for lodging following +1.9% in February and +4.5% in January, despite expectations for a favorable shift given the upcoming Easter holiday.[23] Further, headwinds noted by the airlines, such as less government travel and weaker inbound international tourism, are likely to negatively impact the lodging sector, though increased domestic tourism may be a potential partial offset.
- While the sector faces limited direct tariff risk, it may still be affected by second-order impacts from a decline in consumer confidence.

Aerospace and Defense: ***Long-term demand trends remain intact but expectations for tariffs to further pressure supply chains***

- Boeing and Airbus' production rates have begun to show signs of improvement in Q1'25, albeit supply chains remain in flux and delivery delays remain an albatross on the industry.[24] Original equipment manufacturing ("OEM") exposed companies experienced improving throughput while absolute levels remain depressed.
- Aftermarket continues to benefit from tight supply and an overall aged fleet. Engine-focused maintenance firms are operating at full capacity, and suppliers have been able to push price for uncontracted volumes.
- Aircraft lessors have continued to benefit from OEM delays, resetting COVID-era lease deals, and extended aircraft/engine lifespans, driving aftermarket demand. Airlines are increasingly signaling capacity rationalization which may somewhat cool lessor pricing power.
- Tariffs will have a negative impact on a historically fragile supply chain as the complex global nature of sourcing and developing raw materials into final products will disrupt the recovering marketplace. Outside of the plane engines, most supply chains are sourced in the country of production. The majority of parts sourced in Canada and Mexico are USMCA compliant, which are, as of now, exempt from the most recent tariffs. Delta has indicated they will not take delivery of Airbus aircraft if they have to pay tariffs, while Chinese airlines didn't take delivery of Boeing planes.[25] Aerospace is one of the few industries where the US is a net exporter, which may provide opportunities in the short run to address trade imbalances.
- The defense sector's visibility is at a low point, with a combination of contractor reviews being competed by DoD Secretary Hegseth and lower priority contracts being targeted by DOGE. Recent performance remains solid; however, policy uncertainty is a key overhang.

Airlines: ***Notable softness in demand, but depth of slowdown is unclear and dependent on the consumer***

- The airline industry continued to face operating headwinds from increased costs coupled with softening demand. Expectations for 2025 are much more muted now, given an increasingly wary consumer. Delta, American, Alaska, and Southwest either cut or withdrew guidance for 2025.[26] There is little visibility into booking and revenue trends beyond the summer, but the major carriers highlighted a willingness to reduce capacity in the second half of 2025 if demand is weaker-than-expected.
- Inbound travel has been a notable headwind. According to the National Travel and Tourism Office, international travel into the US declined 4.4% in 1Q and was down 10% in March in particular.[27]
- Overall, the industry is significantly better positioned than in previous cycles from a liquidity and leverage perspective. We believe low-cost carriers will likely face the most acute ongoing challenges given their domestic focus and limited premium/corporate travel exposure, including overcapacity and margin pressures, despite efforts to diversify and introduce premium products.

[21] See note 4.
[22] See note 4.
[23] Barclay's Equity Research Q1'25 Preview: Accumulating Headwinds. April 22, 2025.
[24] See note 4.
[25] Wall Street Journal 'U.S. Customs Confirms That USMCA-Compliant Auto Parts Are Exempt From Tariffs'. May 1, 2025.
[26] See note 4.
[27] National Travel and Tourism Office's (NTTO) April 2025 Air Passenger Travel Survey.

Business Services: ***Generally well insulated from tariff impacts; however, companies servicing more cyclical end markets may be impacted by macroeconomic headwinds***

- Professional services have generally continued to perform well. Businesses with more stable, recurring revenue profiles have been particularly defensive. We continue to see deal activity, for example, there were several private equity buyouts of accounting firms.[28] Firms more exposed to capital markets activity have had relatively weaker performance, though many have other counter-cyclical work such as restructuring advisory to help provide an offset. Lack of M&A activity is likely a continued headwind in 2025 given the uncertain macro backdrop.
- Environmental and waste services should be well insulated from tariff and macro uncertainty. The industry is generally recession resistant with the ability to pass through cost increases from fuel, labor and equipment to the end customer. Given the limited capacity of existing assets, consolidation and M&A activity is likely to continue for the foreseeable future. GFL's sale of its Environmental Services segment (mid-teens enterprise value) will likely serve as an anchor for market comps in the services space.[29]
- Businesses that are tied to subscription/contractual revenues continue to see annual price increases, with flat to slightly higher volumes. Services companies with end markets tied to consumers have shown some volume declines, while commercial end markets have displayed steady volumes. Credits within the security space (such as home or business security) or information management have outperformed expectations, while credits within auto services (car washes, tire retailers, collision repair) have seen mixed performance.

Media and Education: ***Legacy media continues to lose share to digital while education should remain a more defensive sector well insulated from tariff impacts***

- Legacy media such as TV broadcasting and radio continue to face weak operating trends. We struggled to underwrite the long-term economics of the sector and have largely exited exposure to the sector. Potential macroeconomic headwinds, tariff impacts to auto manufacturers, and policy changes around pharmaceutical advertising represent further downside risks to the sector. Conversely, we have concentrated our new investments in the digital media channels including search, and mobile, which comprise ~70% and growing of total U.S. advertising spend today.[30]
- Our view on the education sector has become more constructive in recent quarters, as positive growth in U.S. higher education enrollment has led to improved performance, including textbook publishers. Further, healthcare education service providers have performed well this year amid secular demand for healthcare professionals and a moderating teacher shortage. Potential impacts on federal funding related to the elimination of the Department of Education remain a discussed risk, but we believe it is manageable as federal funding contributes to a relatively small amount of funding for K-12 school and higher education (10-15%).[31] We don't expect the federal changes to impact the far larger state and local level funding.

Industrials: ***Tariff and macroeconomic uncertainty loom over industrials. The rebound in cyclical sectors such as chemicals and housing has failed to materialize, and performance has sequentially deteriorated***

- The industrial sector remains mixed, with a decline in unit volumes somewhat offset by price increases. Less cyclical sectors such as waste and filtration have shown favorable performance, while general industrial, agriculture and construction remain weak. Strength in Commercial HVAC seen in the last few years will likely moderate. Distributors with pass through mechanisms are better positioned than manufacturers. The industrials sector will bear the brunt of a dual challenge starting in the second half of 2025: a weakening macroeconomic environment and likely implementation of new tariffs.
- Despite the strong finish to 2024, autos are in the cross hairs of tariffs wars and the outlook is uncertain unless further clarity emerges. The administration imposed a 25% tariff on imported vehicles and auto parts beginning May 3. Vehicles and parts from Canada and Mexico are temporarily exempt if USMCA-compliant, but carveouts are narrow and could expire. General Motor faces greater risk, with significant exposure to Mexico and Canada, while Ford is somewhat better positioned given its U.S. production base.[32]
- The manufacturing recession continued during the quarter as industrial cyclicals have continued to produce weak performance. Companies serving professional-grade end markets should fare better than those serving consumer markets. Demand pull forward could benefit trucking in the first half of 2025; however, it may lead to weaker

[28] Thomas Reuters 'The rise of private equity in accounting: Not just for large firms anymore'. August 20, 2024.
[29] GFL 'GFL Environmental Inc. Announces Agreement to Sell Environmental Services Business Valued at $8.0 Billion'. January 7, 2025.
[30] Statista Ad Spending by Media. October 2024.
[31] EducationWeek 'Trump's Push to Slash Federal K-12 School Funds, Explained'. April 24, 2025.
[32] See note 4.

performance for the remainder of the year. We have positioned our portfolio into "cyclical survivors" – credits with liquidity, sponsorship and operating in consolidated markets with some pricing power.

- Chemical companies continue to post disappointing results. Demand trends remained weak in several key end markets such as construction, automotive, and broad industrial applications while supply gluts and related price declines emerged in many chemical product lines driven by Chinese overcapacity.
- US housing credits have been under pressure since late-2024. Mortgage rates remain stubbornly high despite three fed cuts while housing affordability is poor for a large portion of home buyers, thus limiting demand. Latest earnings generally underperformed and outlooks remain weak. Most of our building products' credits are insulated from direct tariff impacts given the majority of companies produce domestically. We maintain our focus on credits that we believe have strong mid-cycle earnings potential and requisite liquidity to navigate the downcycle.

Food and Packaging: ***Continued pressure on volumes amidst de-stocking and a softer consumer***

- Packaged food earnings were generally mixed to weak, with continued pressure on volumes largely driven by the impact of inflationary pressures and diminished discretionary income. Increased GLP-1 adoption, trade down to private label and the consumer push back against higher prices (food generally up 30% vs pre-pandemic)[33] is having an impact on the overall sector. General Mills, an early packaged food reporter in 2025, posted soft numbers and cut guidance – called out inventory destocking, softer snacking and softer away from home demand (foodservice) as primary drivers.[34]
- Commodity prices have remained favorable while beef, cocoa, coffee, and sugar remain headwinds. Tariffs on Mexico - accounting for ~80% of U.S. fresh vegetable import volumes – are likely to lead to higher prices.[35] Canada is also a significant source of US wheat. We are seeing a few M&A transactions as larger food companies seek to bulk up and optimize their food portfolio - Pepsi acquiring Poppi and Siete Foods and Advent acquiring Sauer brands.[36]
- Packaging company performance was mixed depending on end market. Some producers are still experiencing lingering destocking, particularly in the medical and label segments, while industrial end markets declined on a year-over-year basis. Consumer-related packaging performed more favorably, although the significant rebound anticipated from weak year-ago trends did not materialize. Tariffs are likely to have a minimal impact on the sector as the majority of companies produce and sell locally.

Consumer and Retail: ***The consumer has been resilient yet increasingly discerning***

- Previously highlighted themes have continued – a discerning consumer focused on value, trade down to private label, shift to club and mass retailers, and a slowdown in spending on big ticket items (outside of a temporary tariff induced pull forward). Yet, overall spending is still resilient and consumers are supported by low unemployment, and low gas prices which should preclude a significant spending slowdown.
- Consumer credits reported mixed earnings, with consumer staples largely performing in line, while discretionary spend remains under pressure (e.g., high single digit same store sales ("SSS") declines at discretionary experiential concepts like Dave & Buster's and TopGolf).[37] Recent data skews negative - consumer confidence has dropped significantly, and retail sales are weak. We've observed that bad weather in January and February has negatively impacted Q1'25 results. Post the April 2 tariff announcement, we have heard that retailers are de-stocking and being very mindful of their inventory, which is likely to lead to softer results and outlooks for consumer products companies. The consumer products universe has moderate to high exposure to tariffs with appliances, apparel and footwear most exposed.
- Q1'25 retail earnings were generally positive with e-commerce particularly strong. The FY25 outlook is cautious due to weakening consumer confidence, impact from tariffs, supply chain disruptions and inflation. We have significantly reduced our exposure to retail and currently invested primarily in companies with low tariff exposure, defensive balance sheet, and leaders in their respective categories with scale and strong operating performance.
- QSRs had a weak earnings season as well with almost across the board traffic and SSS declines. In restaurants, QSRs have struggled (low to mid-single digit declines) after years of price hikes, making their value proposition weaker. McDonald's reported -3.6% SSS decline in the US for Q1'25, their worst SSS performance since COVID impacted Q2'20 quarter.[38] SSS decline was driven by high single digit traffic declines, not only in the lower income consumer cohort

[33] CPI Food Category - US Bureau of Labor Statistics. As of May 1, 2025.
[34] See note 4.
[35] Office of US Trade Representative.
[36] Pepsico 'PepsiCo to Acquire poppi'. March 17, 2025. Advent 'Sauer Brands completes acquisition by Advent'. February 19, 2025.
[37] See note 4.
[38] See note 4.

(which has been under pressure for a while but also broadened this quarter to the middle-income consumer cohort).[39] Instead, consumers are shifting to places like Chili's, which reported 25%+ SSS growth,[40] offering more perceived value over the likes of McDonald's. Broadline foodservice distributors have remained resilient due to their diversification in restaurant and non-restaurant chains catering to both affluent and budget consumers.

Commodities, Power, and Utilities: ***Commodity backdrop remains uncertain and volatile***

- Oil prices have remained under pressure in 2025 – OPECs decision to increase supply, negative revisions to consumption growth from weak macro, and lower geopolitical risk premiums. US E&Ps are lowering production and focusing on cash flow generation.[41] We are more constructive on the outlook for natural gas – lower associated gas supply from weaker oil production, lower storage levels, and substantial demand growth from new LNG plants. Overall, energy issuers in both the leveraged loan and HY markets enter this weaker oil environment with credit profiles that are materially stronger than prior cycles. We have focused our exposure to operators in basins with lower break-evens and midstream issuers with a significant mix of take-or-pay contracts with creditworthy counterparties.
- Power valuations remain supported on the thesis of substantial demand growth driven by AI/data centers, electrification, and re-shoring. We are constructive in the near-to-medium, but the long-term outlook is less clear on the back of all the anticipated capacity expected to come online. Several nuclear reactor extensions and reactivations, large new supply projects including newbuild gas generation, and retirement date extensions for coal and other less economic thermal generation have been announced. Demand growth related to AI remains an area to monitor as we have seen several reports of delayed CAPEX spending and shifting project timelines from the hyper-scalers. Merchant power is ultimately a commoditized and cyclical industry, and AI demand underwhelming or excess supply growth could quickly depress industry-wide economics. To mitigate this longer-term uncertainty, we have focused our investments on credits that are expected to delever in the next few years from peak cycle cash flows.
- We have seen volatile price movements across metals and mining associated with recent tariff increases and uncertain end market demands. US based steel producers are benefiting from tariffs on imported steel, but slowing end market demand could weigh on utilization and volumes. China remains a key demand driver across most commodity sectors. Balance sheets across the sector have generally improved and are better positioned to withstand a cyclical downturn. We remain focused on companies with limited price sensitivity in their business models with greater importance on long-term contracts tied to volumes in their respective markets.

[39] See note 4.
[40] See note 4.
[41] See note 4.

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