Implications of Coronavirus

March 2020

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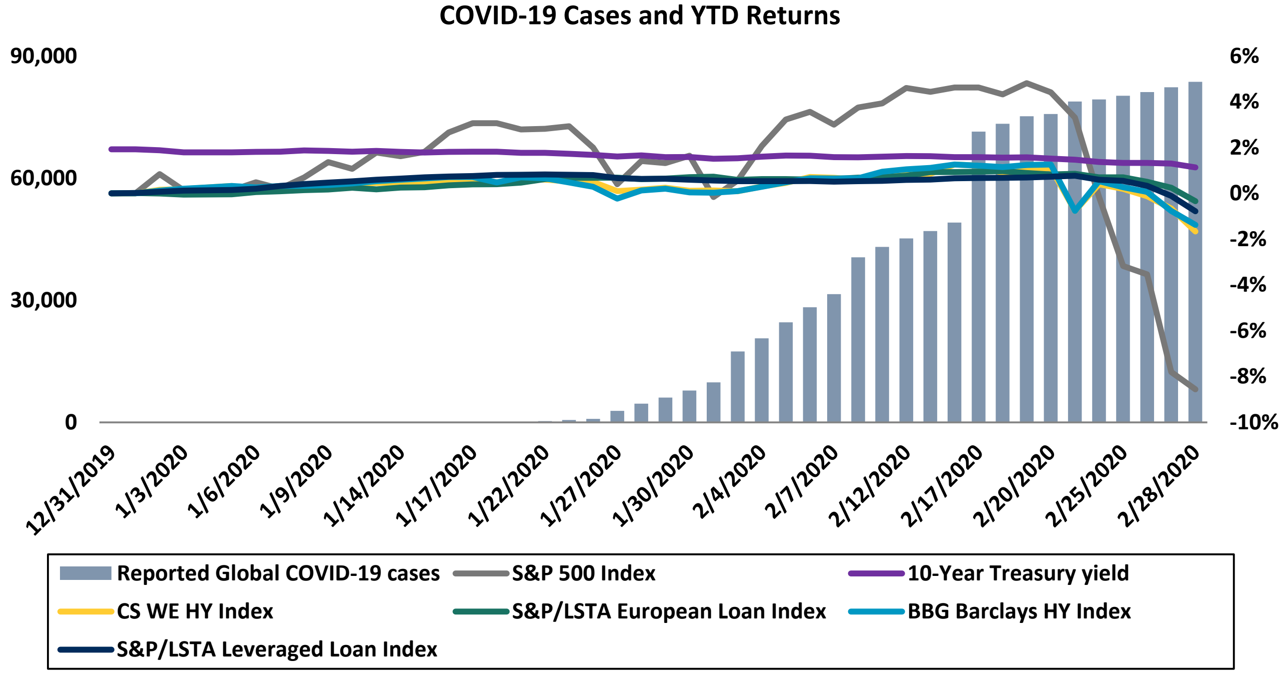
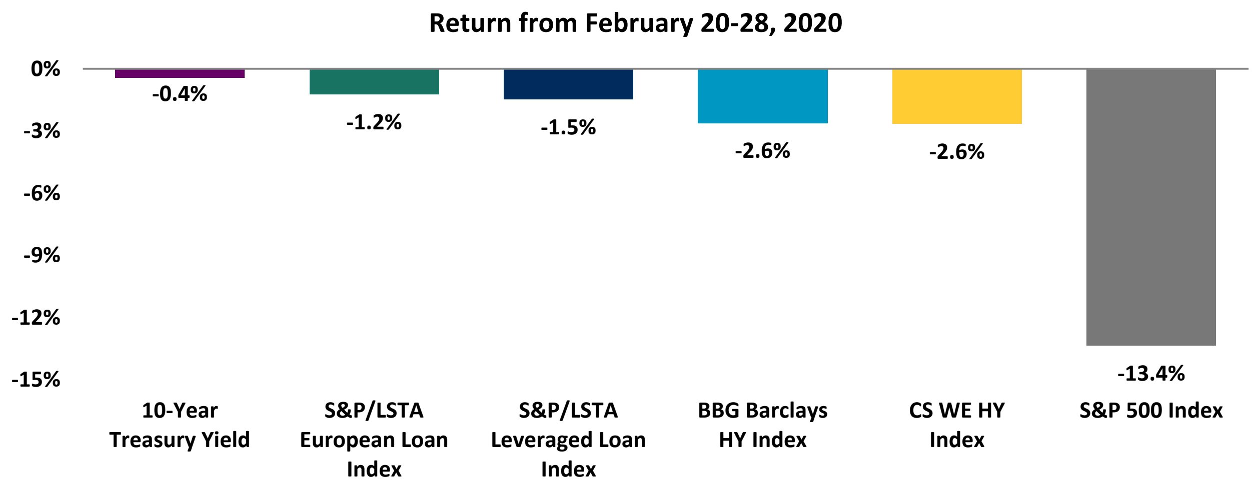
Like most market participants, the GSO liquid credit strategies team has been closely monitoring the coronavirus as it continues to spread worldwide. The reaction of the loan and high yield markets remained orderly at the onset compared to sharp declines in the equity markets.



Source: World Health Organization, Bloomberg LP, Credit Suisse, S&P/LSTA, Bloomberg Barclays. As of February 28, 2020.

As reported coronavirus cases continued to spread to Europe and North America, volatility began to spill over from the equity markets and credit spreads started to widen. The global credit markets have not reacted as dramatically as equities, however, and continue to remain orderly. Underperformance has been concentrated in lower quality loans and high yield bonds and industries most impacted by the spread of the virus such as metals and mining, energy, retail, broadcasting, transportation, leisure, and chemicals.



Source: World Health Organization, Bloomberg LP, Credit Suisse, S&P/LSTA, Bloomberg Barclays. As of February 28, 2020.

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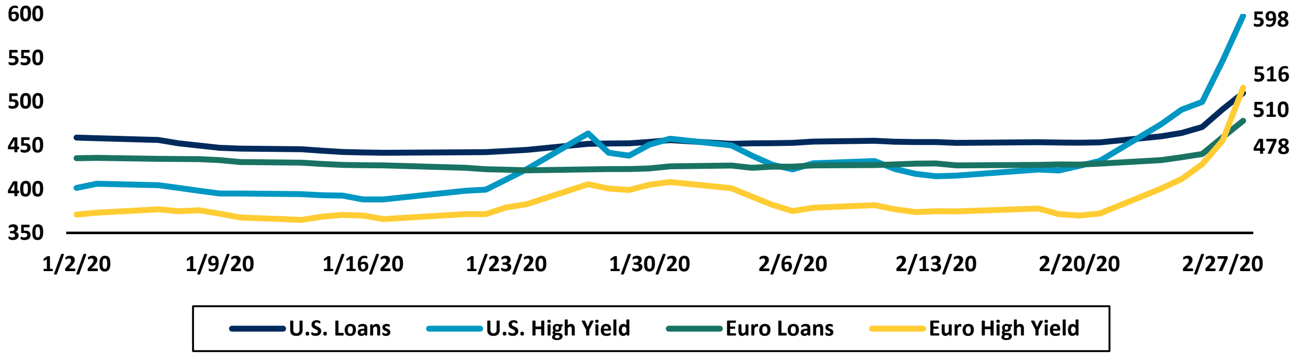
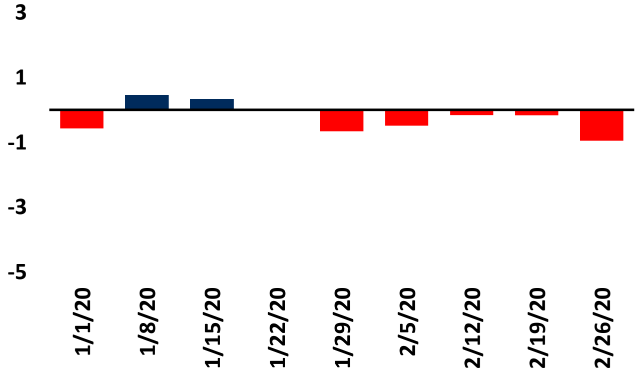
Loan and High Yield Bonds Spreads (bp)



Source: Credit Suisse U.S. Loan and High Yield Indices, JP Morgan European Leveraged Loan Index, and Credit Suisse Western European High Yield Index, as of February 28, 2020. Loan spreads represented by discount margin (3-year life); high yield spreads represented by spread to worst.

Retail loan and high yield outflows have persisted in 2020, and we expect this trend to continue given the 50bp rate cut announced by the Federal Reserve on March 3, 2020, the largest emergency cut since the Financial Crisis. CLOs and institutional investors, however, have remained buyers of high quality loans and bonds, supporting both secondary prices and liquidity. The recent volatility has also suppressed repricing activity that was prevalent in January which may help offset the recent decline in LIBOR.

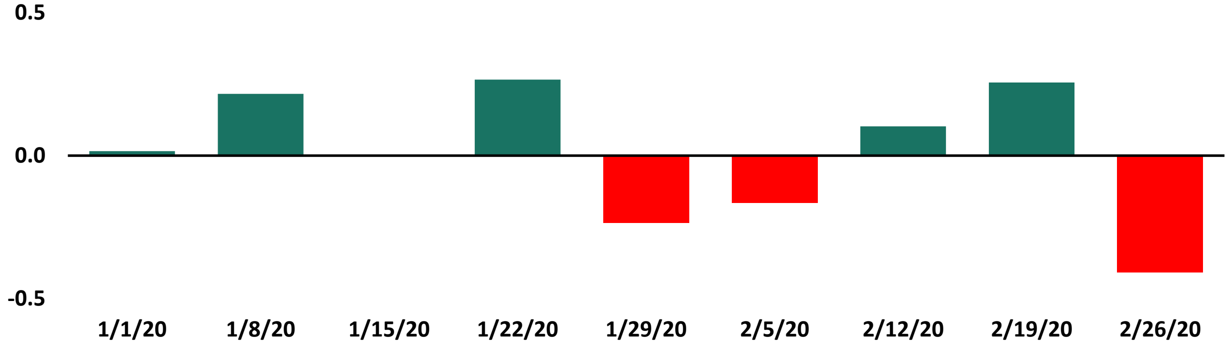
U.S. Weekly Loan Fund Flows ($ in billions)



U.S. Weekly High Yield Fund Flows ($ in billions)

Source: JPM, Lipper, as of February 26, 2020; includes weekly reporting funds only.

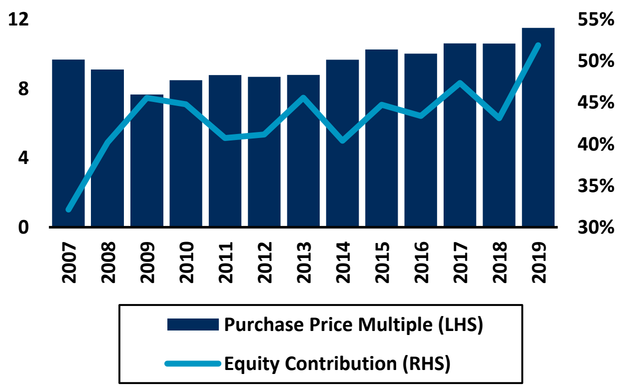
European Weekly High Yield Fund Flows (€ in billions)



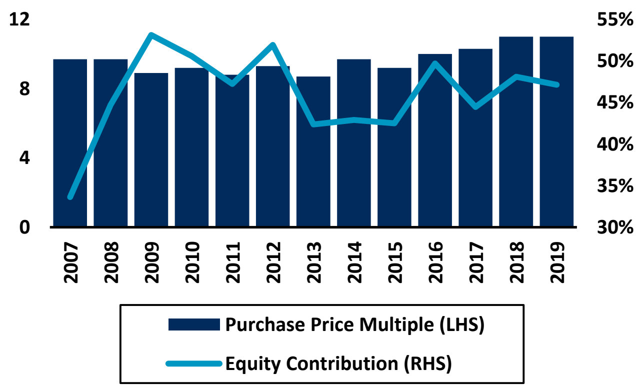
Source: JPM, as of February 26, 2020; includes weekly reporting funds only.

Currently we expect that recent trends in average corporate capital structures should help companies weather a short-term slowdown in growth. U.S. and European companies have increasingly been capitalized with larger equity contributions relative to total debt suggesting more conservative capital structures with lower loan to enterprise value ratios. Equity contributions averaged 52% to U.S. LBOs and 47% to European LBOs in 2019 versus 32% and 34% in 2007, respectively. Further, the amount of secured leverage relative to unsecured leverage has increased as well. In the U.S., secured leverage accounted for over 80% of total leverage in 2019 versus 72% in 2007. In Europe, secured leverage contributed over 90% to total leverage in 2019 versus 77% in 2007.

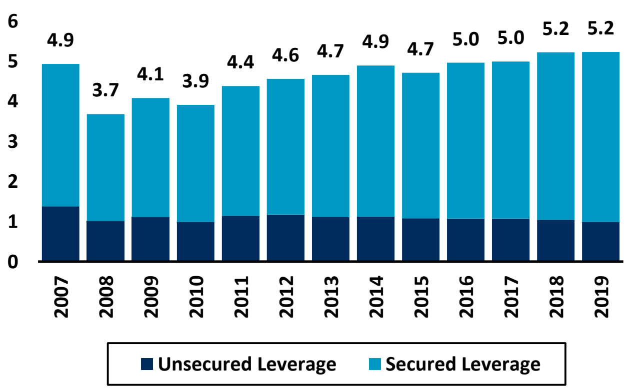
U.S. LBO Multiples and Equity Contribution



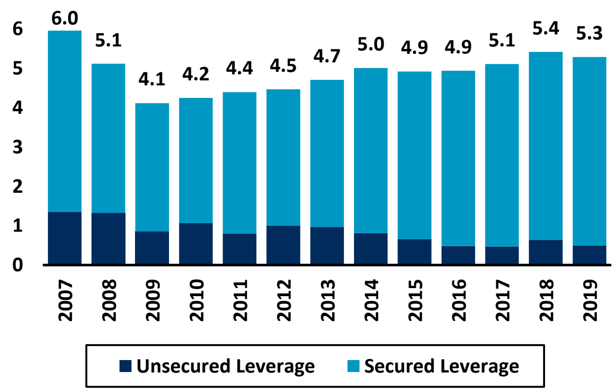
European LBO Multiples and Equity Contribution



U.S. Total Leverage of Loan Issuers



European Total Leverage of Loan Issuers



Source: LCD, as of December 31, 2019; leverage represented by new issue deals only. Secured leverage is leverage through the first lien debt, which is secured by the issuer's collateral; unsecured leverage is inclusive of second lien and subordinated debt, which is not secured by the issuer's collateral.

Similarly, we expect that limited near term loan and high yield bond maturities over the next 1-2 years should help prevent any spike in default rates, although we continue to monitor any companies which might not generate sufficient near term cash flows.

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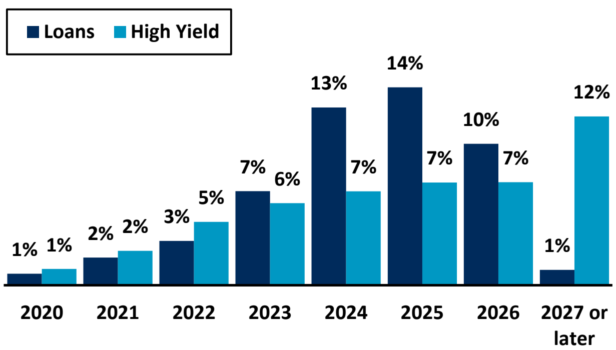
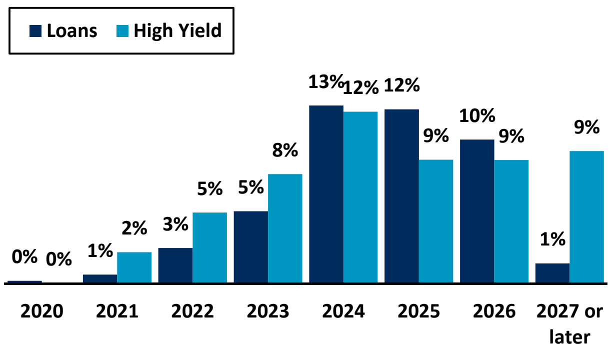
U.S. Maturities
(% Outstanding)



European Maturities
(% Outstanding)



Source: JPM for U.S maturities, as of January 10, 2020; $2.7 trillion U.S. loans and high yield bonds outstanding. S&P/LSTA European Leveraged Loan Index and Credit Suisse WE High Yield Index, as of January 31, 2020; €467 billion European loans and high yield bonds outstanding.

GSO Specific Analysis

Currently we expect the coronavirus to have only a modest impact on the performance of companies within our U.S. and European liquid credit portfolios, and we expect this impact to be largely contained to Q1/Q2. This may change should the disease continue to spread and the impact on our European liquid credit portfolios may be larger given the recent increase in confirmed cases in Europe, specifically Italy. Additionally, we believe the companies in our portfolios to have solid business profiles, sound liquidity buffers, and healthy diversification by geography to mitigate any negative impact of the coronavirus. Our 32 member global credit research team is highly focused on monitoring for coronavirus related risks and continues to monitor developments and provide updates across our portfolios.

Particular industries of concern ranked by level of exposure are hotels, gaming and leisure, transportation, retail, automotive, and energy. We continue to stay in close contact with management teams and sponsors of the companies in our portfolios and are continually evaluating the impact of this virus on our investments. Where we believe this impact is limited, we may look to add to positions selectively in high quality and resilient businesses in order to take advantage of depressed prices. In the primary market, we continue to push for favorable concessions on new transactions, which has been accretive to our portfolios.

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