

Delta Investment Management is a registered investment advisory firm. Delta welcomes discussions with individuals seeking investment advice and advisors seeking a new turnkey asset management solution.

Delta manages portfolios at TD Ameritrade and Schwab.

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November 5, 2021

The New Credit Cycle

What is a credit cycle? The encyclopedic definition of a credit cycle is the expansion and contraction of access to credit over time. When times are good, credit flows freely to corporations and default rates are low. Eventually, a point of excess (home loans in 2008) or stress (Covid shutdown in 2020) is reached, default rates spike, credit availability shrinks and the boom cycle busts.

Credit cycles play out over a period of years. As equity investors, we care about the credit cycle as it greatly influences whether we are experiencing a bull or bear stock market. What happens in the credit market ends up in the equity market -- ranging from positives including stock-buybacks, dividends, lower debt expense to negatives including defaults and business failure.

A new credit cycle has begun.

- Weak issuers defaulted during Covid (see spike in credit spreads in 2020 in chart below).
- Balance sheets were rebuilt with a push-out of maturities and refinancing at lower rates.
- Companies implemented huge cost reductions because of the uncertainty of not knowing when the economy would reopen during Covid. These costs have not been added back in many cases.
- Free cash flow (FCF) relative to the debt burden is much improved.
- The high-yield debt default rate in the US in 2021 is projected to be 0.31%. The long-term average high-yield default rate is 4%.

If history repeats, the bullish aspect of the credit cycle should last for years.

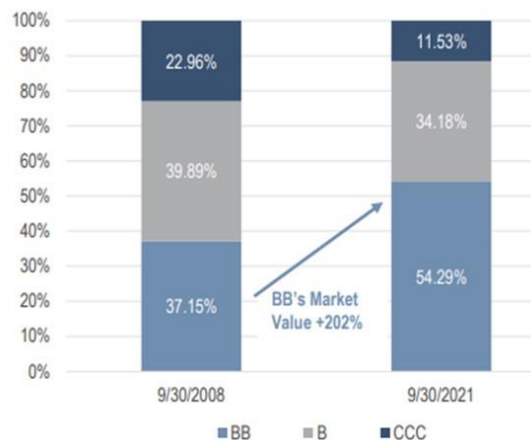
High Yield Spreads and Stock Market Cycles



The S&P 500 delivers double digit average annual returns when credit spreads are tight. When the high-yield spread rises above 5%, the stock market generally depreciates. Today, high-yield spreads are near all-time lows (well below 5%) and should remain there for several years.

One factor that may extend the current credit cycle longer than expected is the quality of high-yield credit has improved. In 2008, roughly 37% of the high-yield market had a rating of BB. The rest was worse (single B or CCC). Today, about 54% of the high-yield market has a rating of BB. The high-yield market today is substantially higher credit quality than it was in 2008. This should keep default rates lower for longer.

High-Yield Credit Quality Improvement



Speaking of cycles, the earnings reporting cycle is more than half way completed. 82% of reporting S&P 500 companies exceeded earnings estimates. The blended earnings growth rate in the third quarter for the S&P 500 is 36.6%. A month ago, analyst expectations were for earnings growth of 27.4%.

Let Us Help You Position Your Portfolio – Give Us a Call Today

We have unique and sophisticated investment methods that seek to capture the stock market's gains while minimizing drawdowns in bear markets. If you would like to learn more about how we manage money, we invite you to give us a call at **(415) 249-6337**, visit www.deltaim.com or email us at info@deltaim.com.



"Now we just have to sit back and wait for the Fed to bail us out."

Delta Stock Market Dashboard

MARKET SENTIMENT IS

BULLISH

THIS WEEK'S NUMBER IS

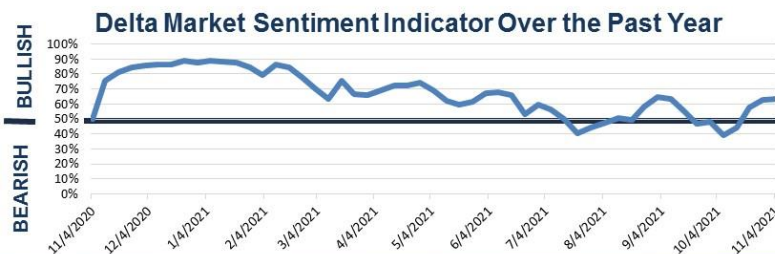
63.6

Our technical indicator increased from 62.4 to 63.6 this week

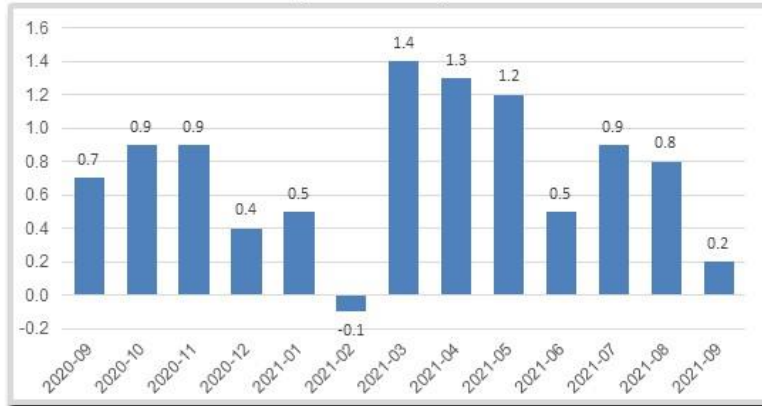
INDICATOR STATISTICS

Consecutive Bullish Weeks:	3
Cycle Inception Date:	10/21/2021
Range:	57.5 – 63.6
Mean:	61.3
Bullish Weeks YTD:	39
Bearish Weeks YTD:	5
*S&P 500	3.1%
*DJIA	1.4%
*NASDAQ	5.2%

* Percentage change during current cycle



Leading Economic Index % Change Monthly Sep 2020 – Sep 2021



Source: The Conference Board – last update 10/21/2021

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