Credit Opportunities Fund

Market Overview

For traditional fixed income markets, the second quarter of 2022 was not unlike the first. Financial conditions continued to tighten during the period as aggressive anti-inflation rhetoric from the Federal Reserve turned into policy action, driving Treasury yields higher across the curve and pressuring bonds in general and duration-sensitive assets especially. The Bloomberg US Aggregate Bond Index fell again, losing 4.7%, and is on track to post consecutive annual declines for the first time since its inception in 1976.[1]

While floating-rate debt remained relatively resilient, recent months saw the broad weakness across markets begin to seep into this space as well. The Credit Suisse Leveraged Loan Index delivered a total return of -4.6% for the second quarter, comparing favorably to the -9.8% performance of the Bloomberg US Corporate High Yield Index but a marked deterioration from its flattish first quarter.

Though inflation and tighter financial conditions are starting to weigh on borrowers, credit fundamentals have remained mostly supportive, for now. Loan issuance, in contrast, has been battered by higher rates and volatility, as well as increased competition from more traditional debt investments. In such an environment, we are putting money to work selectively with an eye toward the long term.

Credit Fundamentals Generally Remain Supportive...

With inflation showing few signs of abating from current multi-decade highs, Federal Reserve rhetoric and action appears focused on achieving price stability before elevated inflation levels become anchored in the national psyche. March's 25 basis point hike moved the federal funds rate off the zero lower bound for the first time in nearly two years, and the Fed grew more forceful in the second quarter. It raised rates 50 basis points in May and another 75 basis points in June, and futures markets are pricing in a minimum 75 basis points of additional tightening in July, with 100 basis points a possibility.[2] As a complement to these rate hikes, the Fed in June began the process of quantitative tightening by letting maturing securities run off its balance sheet.

This effort comes with no small risk, as past attempts to engineer a "soft landing" of the economy have shown. Indeed, toward the end of the second quarter and into the beginning of the third, tighter financial conditions appeared to inspire fear not just of an inflation-dampening economic deceleration but of a full-fledged recession. We have begun to see signs that fiscal tightening and higher interest rates are causing demand to soften; in the US, for example, consumer sentiment has deteriorated, manufacturing activity is slowing and mortgage applications are down.[3] The impact of recessionary concerns was most evident in the bond markets. After climbing near 3.5% by mid-June—from close to 1.5% to start 2022—the 10-year US Treasury finished the first half of the year near 3.0%, a rally that suggests to us that markets expect central bank policy restraint to come to a premature end in the face of withering economic growth.[4] Meanwhile, the yield curve inverted briefly twice during the second quarter and has entered into a lengthier negative position in early July; such inversions have long been regarded as a potential harbinger of recession.[5]

Despite all the noise, loan fundamentals have remained generally solid. Borrower revenues and earnings have held up thus far, and interest coverage has been strong even as leverage inched back up to 2020 levels after easing somewhat in 2021. The loan market's default rate, a lagging indicator, remains near all-time lows, though the distress ratio, a forward indicator, climbed as the bid price on more performing loans fell below 80 cents on the dollar. Though loan downgrades in June exceeded upgrades for the first time in 16 months, the market's overall credit quality continues to be strong. . At 3.5%, the S&P/LSTA Leveraged Loan Index's share of paper rated C or lower is well shy of the post-global financial crisis average of 6.4%. Only one notch higher, however, the B- cohort stands at a record 28% of the index, suggesting the market's rating composition could shift quickly.[6]

While it's not hard to imagine some fundamental deterioration going forward in light of broad macroeconomic trends, the market appears to be pricing much of this in. At about 91 cents on the dollar, the loan market's current average bid implies a mild recession and some deterioration in credit fundamentals, but not a hard landing. For context, the market traded as low as 65 cents during the global financial crisis and 80 cents during the worst of Covid.

1. Source: FactSet; data as of June 30, 2022.
2. Source: CME Group; data as of July 14, 2022.
3. Source: Bureau of Labor Statistics, Institute for Supply Management, Mortgage Bankers Association; data as of June 30, 2022.
4. Source: Bloomberg; data as of June 30, 2022.
5. Source: Bloomberg; data as of July 15, 2022.
6. Source: Leveraged Commentary & Data; data as of June 30, 2022.

...Even as Support from Market Technicals Weakens

Though leveraged loan issuance followed up its record-setting 2021 with a strong January 2022, it's been all downhill from there. During the second quarter, acute recession fears were added to a roster of headwinds that already featured inflation, supply-chain disruptions, war between Ukraine and Russia, rising interest rates and escalating funding costs. Total US institutional loan volume in the US fell to about $55 billion during the period, its lowest level since the onset of Covid-19 brought the market to a near standstill two years ago.[7] The deals that have been getting done have typically been larger packages essential to the completion of a merger or acquisition (M&A)—though these have been priced at steep discounts to par, absorbed by the underwriting banks.

Collateralized loan obligation (CLO) formation followed a similar downtrend. Demand for loans historically has been driven by a combination of CLO formation and retail funds, with the former typically the much larger contributor. Institutional investors—often insurance companies, mutual funds, and banks and other financial institutions—are the primary investors in CLOs. With yields across traditional fixed income asset classes continuing to back up while CLO spread premia tightened, institutional buyers of these vehicles have with multiple high-quality alternatives to CLO investment, many of which entail considerably less complexity. In addition, CLO demand from foreign institutions has been further hampered by steadily rising dollar-hedging costs.

While not a lot of CLO new issuance is happening, these vehicles tend to be treated as buy-and-hold investments by institutions. This has mitigated some of the selling pressures we've seen in the mutual fund space, where flows turned negative in the second quarter after providing more than a year of positive support for loan market technicals.

The direct lending market appears somewhat complacent currently. In our experience, activity in this space tends to react to broader market trends with a lag of 30 days or so, but we've yet to see that in 2022. Unlike the loan market, private credit issuance has improved after a first quarter slowdown, and we're even seeing signs of more borrower-friendly structures. And though activity is off 2021's record pace, demand for direct lending opportunities continues to far outstrip supply given nearly $400 billion of undeployed capital in private credit vehicles. With $1.3 trillion in private equity dry powder waiting to be put to work, current complacent attitudes have the potential to persist.[8]

Conclusion

We entered 2022 expecting loan markets to reflect 2021's buoyant attitudes for some period of time before entering into a more problematic state later in the year. However, while conditions certainly have grown more complicated for lenders and investors, all is not doom and gloom. Though the exact number is opaque, a number of borrowers in the loan universe use credit derivatives or rate caps to hedge the interest rate risk of their balance sheets; depending on the characteristics of the hedge, this may provide a buffer against rising market rates for some period of time (typically 60–90 days but potentially as much as 270 days). Further, the risk of a loan "maturity wall" seems low given the access to liquidity that characterized the past couple of years, which should help mitigate defaults over the next few years.

For those with a multiyear investment horizon and a patient, selective approach, we believe now may a good time to put money to work in the alternative credit space. As noted earlier, the broadly syndicated loan market as a whole is trading at a discount that suggests a mild recession; deeper bargains are likely to emerge should the economic picture worsen. That said, attempts at market timing are unlikely to produce favorable results. Instead, we look to deep credit analysis to identify borrowers and sectors we believe may prove resilient in what could be a prolonged period of uncertainty. While our underwriting is unlikely to immunize us from the issues currently bedeviling markets broadly, we expect it could mitigate the impacts over the long term.

7. Source: Leveraged Commentary & Data; data as of June 30, 2022.
8. Source: Preqin; data as of June 30, 2022.

Average Annual Returns as of Jun 30, 2022

	3 Month	YTD	1 Year	Inception	Expense Ratio[1] Gross[2]	Net	Adjusted[3]	Inception Date
First Eagle Credit Opportunities Fund – Class A FECAX (without load)	-4.42%	-4.05%	-0.39%	4.88%	4.31%	3.07%	2.25%	Dec 2, 2020
First Eagle Credit Opportunities Fund – Class A FECAX (with load)	-7.77%	-7.40%	-3.86%	2.54%	4.31%	3.07%	2.25%	Dec 2, 2020
First Eagle Credit Opportunities Fund – Class I FECRX (without sales charge)	-4.40%	-3.93%	0.06%	5.63%	4.00%	2.82%	2.00%	Sep 15, 2020

Disclosures

The performance data quoted herein represent past performance and do not guarantee future results. Market volatility can dramatically impact the Fund's short-term performance. Current performance may be lower or higher than figures shown. The investment return and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Past performance data through the most recent month-end are available at www.firsteagle.com or by calling 800-334-2143. The average annual returns are historical and reflect changes in share price, reinvested dividends and are net of expenses.

"With load" performance for Class A shares gives effect to the deduction of the maximum sales charge of 3.50%.

1 The annual expense ratio is based on expenses incurred by The Fund, as stated in the most recent prospectus.FEIM has contractually undertaken to waive and/or reimburse certain fees and expenses of the Fund so that the total annual operating expenses (excluding interest, taxes, brokerage commissions, acquired fund fees and expenses, dividend and interest expenses relating to short sales, and extraordinary expenses, if any) ("annual operating expenses") of the Class A and Class I shareholders are limited to 2.25% and 2.00%, respectively, of average net assets. This undertaking lasts until April 30, 2024 and may not be terminated during its term without the consent of the Board of Trustees. The Fund has agreed that each of Class A and Class I will repay FEIM for fees and expenses waived or reimbursed for the class provided that repayment does not cause annual operating expenses (after the repayment is taken into account) to exceed either: (1) 2.25% and 2.00% of the class' average net assets, respectively; or (2) if applicable, the then-current expense limitations. Any such repayment must be made within three years after the date in which the Fund incurred the fee and/or expense. Additionally, FEIM has agreed to pay the Fund's organizational and offering costs until effectiveness of the Fund's registration statement and such costs will not be recoupable by FEIM. Effective May 1, 2022 through April 2024, these expense limitations were raised to 2.25% and 2.00%, respectively, of average net assets of Class A and Class I.

2. The Gross Expense Ratio includes an estimate of interest payments the Fund expects to incur in connection with its use of leverage of 0.81% and Acquired Fund Fees and Expenses (''AFFE''), which are fees and expenses incurred by the Fund in connection with its investments in other investment companies, which are excluded from the expense waiver.

3. The Adjusted Expense Ratio of 2.00% for Class I and 2.25% for Class A excludes certain investment expenses, such as interest expense from borrowings and repurchase agreements and dividend expense from investments on short sales, incurred directly by the Fund or indirectly through the Fund's investments in underlying First Eagle Funds (if applicable), none of which are paid to First Eagle. The information is not intended to provide and should not be relied on for accounting or tax advice. Any tax information presented is not intended to constitute an analysis of all tax considerations.

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Class A Shares. The minimum initial investment for Class A Shares is $2,500 per account. The minimum subsequent investment amount for Class A Shares is $100.

Diversification does not guarantee investment returns and does not eliminate the risk of loss.

Class I Shares. The minimum initial investment for Class I Shares is $1 million per account. There is no minimum subsequent investment amount for Class I Shares.

The Credit Opportunities Fund is an Interval Fund, a type of fund that, in order to provide liquidity to shareholders, has adopted a fundamental investment policy to make quarterly offers to repurchase between 5% and 25% of its outstanding Common Shares at net asset value ("NAV"). Subject to applicable law an approval of the Board of Trustees for each quarterly repurchase offer, the Fund currently expects to offer to repurchase 5% of the Fund's outstanding Common Shares at NAV.

The Credit Opportunities Fund's Common Shares are not listed for trading on any national securities exchange, have no trading market and no market is expected to develop.

A collateralized loan obligation (CLO) is a single security backed by a pool of debt.

Risk Disclosures

All investments involve the risk of loss of principal.

An investment in the First Eagle Credit Opportunities Fund (the "Fund") involves a number of significant risks. Below is a summary of some of the principal risks of investing in the Fund. Before you invest, you should be aware of various risks, including those described below. For a more complete discussion of the risks of investing in the Fund, see the Fund's prospectus under the heading, "Principal Risks of the Fund."

Strategies whose investments are concentrated in a specific industry or sector may be subject to a higher degree of risk than funds whose investments are diversified and may not be suitable for all investors.

There are risks associated with investing in securities of foreign countries, such as erratic market conditions, economic and political instability and fluctuations in currency exchange rates.

Investments in loans potentially expose the Fund to the credit risk of the underlying borrower, and in certain cases, of the financial institution. The Fund's ability to receive payments in connection with the loan depends primarily on the financial condition of the borrower. Even investments in secured loans present risk, as there is no assurance that the collateral securing the loan will be sufficient to satisfy the loan obligation. The market for certain loans is expected to be illiquid and the Fund may have difficulty selling them. In addition, loans often have contractual restrictions on resale, which can delay the sale and adversely impact the sale price

Investments in debt securities and other obligations of companies that are experiencing significant financial or business distress involve a substantial degree of risk, including a material risk that the issuer will default on the obligations or enter bankruptcy. The level of analytical sophistication, both financial and legal, necessary for successful investment in distressed assets is unusually high. There is no assurance that First Eagle Alternative Credit will correctly evaluate the value of the assets collateralizing the Fund's investments or the prospects for a successful reorganization or similar action in respect of any company.

Investors may not have access to all share classes at certain financial intermediaries. Please consult your financial professional for more information.

Investors should consider Common Shares of the Fund to be an illiquid investment. There is no guarantee that investors will be able to sell the Common Shares at any given time or in the quantity the investor desires.

An investment in the Credit Opportunities Fund is not suitable for investors who need certainty about their ability to access all of the money they invest in the short term.

One cannot invest directly in an index. Indices do not incur management fees or other operating expenses.

Credit Suisse Leveraged Loan Index is designed to mirror the investable universe of the USD-denominated leveraged loan market. The index inception is January 1992. The index frequency is daily, weekly and monthly. The **Bloomberg US Aggregate Bond Index** is a broad-based, market capitalization-weighted bond market index representing intermediate term investment grade bonds traded in the United States. Investors frequently use the index as a stand-in for measuring the performance of the US bond market. The **Bloomberg US Corporate High Yield Bond Index** is composed of fixed-rate, publicly issued, non-investment grade debt, is unmanaged, with dividends reinvested, and is not available for purchase. The index includes both corporate and non-corporate sectors.The **S&P/LSTA Leveraged Loan Index** measures the performance of 100 large loan facilities meeting specific inclusion criteria. The index is modified market value-weighted and is fully rebalanced semi-annually. In addition, the index is reviewed weekly to reflect pay-downs and ensure that it continually maintains 100 loan facilities.

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The First Eagle Funds are offered by **FEF Distributors, LLC**, a subsidiary of First Eagle Investment Management, LLC, which provides advisory services.

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