Credit Opportunities Fund

Market Overview

A very strong year for floating-rate credit ended on a positive note. Loans were bolstered in the fourth quarter—as they has been for much of 2023—by improving demand against limited new supply, rising secondary-market prices and high base rates.

The Morningstar LSTA US Leveraged Loan Index delivered a total return of 2.9% for the period to finish 2023 up 13.3%, its best performance since the global financial crisis and second-best ever.[1] A 7.2% surge in the Bloomberg US Corporate High Yield Index over the last three months of 2023 pushed its annual return to 13.4%, beating loans by a nose. A very strong 6.8% gain by the Bloomberg US Aggregate Bond Index during the fourth quarter allowed it to avoid the ignobility of three consecutive annual declines.[2]

Despite the continued strong performance of the loan markets, we remain concerned about steadily deteriorating credit fundamentals. Borrowers entered the current rate-hike cycle in good shape, but the accumulated impact of high interest costs has reduced their buffer against adverse conditions. As a result, defaults seem likely to increase in 2024 even if the widely anticipated rate cuts come to pass.

Pivot or No, Fundamental Deterioration Likely to Persist

Most risk assets posted strong returns for 2023, but the headline numbers obscure what was a volatile year for many asset classes in the face of oscillating expectations for Federal Reserve policy. While the prospect of "higher for longer" policy rates spurred a sharp selloff in Treasuries from April through October, dovish sentiment reemerged toward year-end to fuel a furious rally across a wide range of assets. Market dynamics heading into the new year suggested investors were confident that a soft landing was just over the horizon and the Fed would soon cut policy rates.

In conjunction with markedly improved inflation metrics, Fed rhetoric helped support the notion of a near-term pivot. Even the typically measured Fed Chair Powell has taken a softer stance of late; while falling short of declaring victory over inflation, he reiterated at the December Federal Open Market Committee press conference that 2% inflation wasn't a prerequisite for rate cuts and noted his caution not to "overshoot" the target with restrictive monetary policy that would unnecessarily weigh on economic activity. The latest dot plot of economic projections pointed to a federal funds rate of 4.6% by end-2024—implying 75 basis points worth of cuts from the current 5.25–5.50% range. Futures markets continued to be even more optimistic about easing, however, assigning a greater than 50% probability that rates would end 2024 no higher than 4%.[3]

In our view, however, the continued strength of the domestic labor market remains a significant impediment to target-level inflation, as well as a drag on corporate margins and profits. Wage growth has been far less responsive to Fed tightening than broader inflation metrics; though off its cyclical peak, the Atlanta Fed Wage Growth Tracker (at 5.2% in its latest reading) continues to reflect a pace of wage increases not seen since 2001.[4] Previous episodes of wage growth at or near the current rate were reined in only when exceeded by two-year Treasury yields for a period of time; "higher for longer"—and the economic slowing and job losses likely to accompany it—may be a necessity if the labor markets don't begin to demonstrate some slack.

The par-weighted loan default rate including distressed exchanges—a backward-looking indicator—rose about 250 basis points over 2023 to finish the year at 3.2%; the loan default rate excluding distresses exchanges was 2.1%.[5] Notably, default rates continued to be higher for non-sponsored borrowers than for their sponsored brethren, and the difference widened to more than 100 basis points by year-end.[6] The distress ratio—a forward-looking indicator that reflects the percentage of institutional loans trading below $80—eased slightly into year-end as loan prices rallied but remained quite elevated at 7.1%.[7] Rating agencies maintained their pessimistic outlook for credit performance going forward, with downgrades exceeding upgrades at a ratio of 2.42x.[8]

1. Source: PitchBook | LCD; data as of December 31, 2023.
2. Source: FactSet; data as of December 31, 2023.
3. Source: Federal Open Market Committee, "Summary of Economic Projections," Federal Reserve System (December 13, 2023)
4. Source: Bloomberg, Haver Analytics, Federal Reserve Bank of Atlanta; data as of November 30, 2023.
5. Source: JPMorgan; data as of January 2, 2024.
6. Source: PitchBook | LCD; data as of December 31, 2023.
7. Source: JPMorgan; data as of January 2, 2024.
8. Source: PitchBook | LCD; data as of December 31, 2023.

For borrowers in the broadly syndicated loan and direct lending spaces, the uncertain macro background and high cost of capital have translated into slower revenue and EBITDA growth and higher interest expenses, weighing on free cash flow. We believe the deterioration in borrower fundamentals over the past two years or so has eaten into their cushion against adverse conditions, and default rates are likely to continue to increase even if a Fed pivot provides some relief. Of course, there is also risk in the Fed doing nothing. Maintaining current policy settings for an extended period increases the possibility that the accumulated impact of higher interest rates will bring about a hard landing—likely solving the inflation problem but at the expense of recession and an increase in loan defaults. If, on the other hand, the Fed pivots to rate cuts before inflation fully recedes to its target level, pricing pressures could quickly reignite and require even higher policy rates to extinguish.

Lower Rates Could Spur a Rebound in the Demand for Capital

In contrast with credit fundamentals, technical factors have been quite supportive of the both the broadly syndicated and direct lending markets, as demand for new issues continued to far outstrip their low supply.

Though well off the lows seen in the back half of 2022, loan primary issuance in the fourth quarter continued to be sluggish and dominated by refinancings, which accounted for more than half of the quarter's total activity. Notably, refinancings for 2023 as a whole exceeded non-refinancing deals for the first time since 2011 and for only the second time in 20 years. With yields high and capital availability tight for certain borrowers, amend-and-extend deals—in which lenders agree to push out a loan's maturity through an amendment rather than a new credit facility—also were quite popular during the quarter and established a new annual record in 2023. In contrast, mergers and acquisition (M&A) activity, a key driver of lender volumes, remained moribund amid the sharply higher cost of capital and macro and geopolitical uncertainty.

Though demand for loans—historically driven by a combination of collateralized loan obligation (CLO) formation and retail fund flows, with the former typically the much larger contributor—was down year-over-year in 2023, it outpaced supply handily to help support secondary market prices. An uptick in CLO activity in the second half of the year bolstered demand, and lower interest rates may support continued improvements in 2024. Loan retail funds, meanwhile, saw small outflows for the fourth quarter after a slightly positive third; regardless, the near-breakeven pace of the second half was a massive improvement over the significant outflows seen in the first two quarters of the year.[9]

Direct lending has been impacted by a similar imbalance in supply and demand, as private equity dealmaking, by both count and value, has declined in six of the past seven quarters and is down sharply from its 2021 peak. "Platform" buyouts—in which a private equity firm acquires a relatively large business that it intends to expand over time through the purchase of multiple smaller businesses (aka, a "buy and build" strategy)—were particularly weak in the more conservative dealmaking environment. In contrast, "add-ons"—the smaller acquisitions that are assimilated into a sponsor's platform company—continued to provide private equity sponsors a way to deploy capital, albeit in smaller chunks, as they wait for markets to be more amenable to larger deals. Meanwhile, add-on volume seems likely to persist as lenders and sponsors continue to manage their existing portfolios, and refinancing activity is likely to accelerate if rates ease.

Though dealmaking has been challenged for much of the past 18 months, there are signs the leveraged-buyout space may be thawing. The potential release of pent-up M&A energy bodes well for new-money volumes ahead, for both loans and direct lending. Putting more than $2.5 trillion of private equity dry powder to work on acquisitions at a conservative loan-to-value ratio of 50% would require $1.25 trillion of private credit capital.[10]

Getting up for the Letdown

While a policy pivot—widely expected by markets and Fed governors alike—may come to pass in 2024, the reason for it remains uncertain. Will the central bank cut rates because its mission of vanquishing inflation has been accomplished? Or because the economy's soft landing has encountered increasing turbulence due to any one of a number of possible triggers? We think the latter scenario is the more likely impetus for easing, suggesting potential headwinds for leveraged borrowers whose fundamentals are far less healthy today than they were at the start of the tightening cycle.

As such, we've positioned the portfolio for the possibility that the market's optimism goes unrealized. The portfolio remains biased toward de-risking while maintaining optionality to take advantage of potential opportunities as they emerge. We're also biased toward liquidity, favoring broadly syndicated loans over direct lending and focusing on higher-quality paper across all investment types. We also continue to be thoughtful about loan structuring, which we believe provides an added measure of downside mitigation. Ultimately, our disciplined investment process and rigorous underwriting will dictate the path forward.

9. Source: PitchBook | LCD; data as of December 31, 2023.
10. Source: Preqin; data as of October 30, 2023.

Average Annual Returns as of Dec 31, 2023

	YTD	1 Year	3 Year	Inception	Expense Ratio[1] Gross[2]	Net	Adjusted[3]	Inception Date
First Eagle Credit Opportunities Fund – Class A FECAX (without load)	12.12%	12.12%	6.23%	6.62%	4.72%	4.03%	2.25%	Dec 2, 2020
First Eagle Credit Opportunities Fund – Class A FECAX (with load)	9.32%	9.32%	4.99%	5.40%	4.72%	4.03%	2.25%	Dec 2, 2020
First Eagle Credit Opportunities Fund – Class A-2 FCAAX (without load)	11.61%	11.61%	-	6.18%	5.35%	4.53%	2.75%	May 31, 2022
First Eagle Credit Opportunities Fund – Class A-2 FCAAX (with load)	8.82%	8.82%	-	4.50%	5.35%	4.53%	2.75%	May 31, 2022
First Eagle Credit Opportunities Fund – Class I FECRX	12.46%	12.46%	6.68%	7.06%	4.44%	3.78%	2.00%	Sep 15, 2020

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.

Investments are not FDIC insured or bank guaranteed and may lose value.

"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, Class A-2 and Class I shareholders are limited to 2.25%, 2.75% and 2.00%, respectively, of average net assets. This undertaking lasts until 30-Apr-2024 and may not be terminated during its term without the consent of the Board of Trustees. The Fund has agreed to repay the Adviser 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 2.25%, 2.75% and 2.00% of the class' average net assets, or such other lower amount as may be in place at the time of repayment. Any such repayment must be made within three years after the date in which the Fund incurred the fee and/or expense.

[2] The Gross Expense Ratio includes an estimate of interest payments the Fund expects to incur in connection with its use of leverage of 1.78% 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 net expense ratio is the gross expense ratio after waivers and/or reimbursements.

[4] The Adjusted Expense Ratio of 2.00% for Class I, 2.25% for Class A and 2.75% for Class A-2 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.

The minimum initial investment for Class A Shares and Class A-2 Shares is $2,500 per account. The minimum subsequent investment amount for Class A Shares and Class A-2 Shares is $100. 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 initial investment minimums may be modified for certain financial firms that submit orders on behalf of their customers. The Fund or the Distributor may lower or waive the minimum initial investment for certain classes of shares or categories of investors at their discretion. The minimum initial investment may also be modified for current officers, trustees, directors, and employees of the Fund, First Eagle, the Adviser, the Subadviser, the Distributor, certain other subsidiaries of First Eagle, The Blackstone Group Inc., Corsair Capital LLC, employees of certain firms providing services to the Fund (such as the custodian and the shareholder servicing agent), and to the immediate family members of any such persons or to any trust, pension, profit-sharing or other benefit plan for only such persons. Please see the Statement of Additional Information for details.

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 and 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 on a quarterly basis.

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.

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

The **federal funds rate** is the interest rate at which depository institutions (banks and credit unions) lend reserve balances to other depository institutions overnight on an uncollateralized basis. **Atlanta Fed's Wage Growth Tracker** is a three-month moving average of median wage growth based on hourly data. **Distress ratio** measures the proportion of speculative-grade issues with option-adjusted composite spreads of more than 1,000 basis points relative to US Treasuries. **Collateralized Loan Obligations (CLO)** are a form of securitization where payments from multiple middle sized and large business loans are pooled together and passed on to different classes of owners in various tranches. A CLO is a type of collateralized debt obligation. **Dry powder** is a term referring to marketable securities that are highly liquid and considered cash-like. Dry powder can also refer to cash reserves kept on hand by a company, venture capital firm or individual to cover future obligations, purchase assets or make acquisitions. **Boadly-Syndicated Loans (BSL)** Are the most common form of leveraged bank loans, i.e., loans supported by cash flows to finance mergers, acquisitions, and recapitalizations.

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."

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. These risks may be more pronounced with respect to investments in emerging markets.

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.

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.

Below investment grade securities or comparable unrated instruments may be subject to greater risks than securities or instruments that have higher credit ratings, including a higher risk of default, and the Fund might have difficulty selling them promptly at an acceptable 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.

Morningstar LSTA US Leveraged Loan Index is a market-value weighted index that measures the performance of the US leveraged loan market. **Bloomberg US Corporate High Yield Bond Index** (Gross/Total) measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below and 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 corporate sectors are Industrial, Utility and Finance, which include both US and non-US corporations. A total return index tracks price changes and reinvestment of distribution income. **Bloomberg US Aggregate Bond Index** (Gross/Total) is an unmanaged broad-based benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market, including Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM passthroughs), ABS, and CMBS and is not available for purchase. A total return index tracks price changes and reinvestment of distribution income.

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

This commentary represents the opinion of the First Eagle Credit Opportunities Fund portfolio managers as of the date noted and is subject to change based on market and other conditions. The opinions expressed are not necessarily those of the entire firm. These materials are provided for informational purposes only. These opinions are not intended to be a forecast of future events, a guarantee of future results, or investment advice. Any statistics contained herein have been obtained from sources believed to be reliable, but the accuracy of this information cannot be guaranteed.

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Investors should consider investment objectives, risks, charges and expenses carefully before investing. The prospectus and summary prospectus contain this and other information about the Funds and may be viewed at www.firsteagle.com. You may also request printed copies by calling us at 800-747-2008. Please read our prospectus carefully before investing.

The First Eagle Credit Opportunities Fund is offered by **FEF Distributors, LLC**, a subsidiary of First Eagle Investment Management, LLC, which provides advisory services.

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