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Invesco Senior Secured Loans

European Loan Market Snapshot

Monthly European loan market update: May 2019 (covering April 2019)

The Credit Suisse Western European Leveraged Loan Index ("CS WELLI") returned +0.98% in April, comprised of principal return of +0.59% and interest return of +0.39%.[1] Year-to-date returns are 3.02%.[1]

April was, in general, a strong month for risk assets. ECB and US Federal Reserve policy continued to be supportive, trade developments incrementally inched towards a positive outcome, and continuing subdued volatility helped fuel risk asset returns. In particular, European Banks (as measured by the Euro Stoxx Banks Sector Index) returned +8% for the month,[2] in stark contrast to German Bunds, which had a total return of -0.6% during April. 1Q Euro Area ("EA") GDP numbers were better than expected at +0.4% (versus +0.3% expected) quarter-over-quarter (QoQ), aided by strong developments in Spain and France. The ECB will take some comfort from these numbers, but are likely to remain dovish on positioning.

Similar to recent periods, this month's CS WELLI returns continued to be strongly influenced by the USD-denominated loans portion of the index (which comprise approximately 29% of the CS WELLI), which returned 1.45% in contrast to the 0.82% return of Euro-denominated loans.[1] USD tranches are predominately issued by larger global (US-centric) companies, where USD-denominated loans benefit from a relatively sanguine US macroeconomic environment vis-à-vis Europe and a strong technical market. European primary loan supply was light for the month – affected by the timing of the long Easter break – with just €2.4 billion brought to market, approximately 50% less than the same period last year. Accordingly, the secondary market was active and well bid, with average loan prices increasing by 69 Euro-cents over the month (note that the last-twelve-month average is -7 cents), leading to the strong principal return noted above.

The supply pipeline looks promising, with S&P Leveraged Commentary & Data (LCD) quoting €9.2 billion of institutional loans in its forward calendar (as at 29 April). While year-to-date loan issuance has fallen behind that of prior years, CLO issuance is running ahead of last year despite difficult arbitrage/pricing dynamics. The pace of CLO issuance is likely to ease going forward, although LCD still has €4.9 billion of CLOs in its forward calendar. Whilst loan issuance has been low this month, clearing margins remain in the 375-400 basis points range for B2/B rated loans; these margins are manageable for arbitrage-weary CLOs, although induce a fragile equilibrium.

The CS WELLI's nominal value (size of the market) at the end of the month was €293 billion, a 3.4% increase since year end.[1]

Returns

- Within the CS WELLI, the Energy sector was the outperformer during the month with a total return of 1.78%, followed by Retail, which returned 1.53%, and Consumer Durables, which returned 1.47%. The Aerospace sector with a total return of -4.72% was the clear underperformer; however, positively, all other remaining sectors had positive returns this month.[1]
- CCC rated loans were the clear underperformer this month (similar to last month), with a -1.43% total return. BB and B rated loans returned 0.92% and 1.16%, respectively.[1]
- At month end, the average price of the CS WELLI was €98.38, up €0.69 during the month. The CS WELLI's three-year discount margin is 4.05% (-25 basis points across the month).[1] For comparison, the Credit Suisse Western European High Yield Index returned 1.52% for the month and had a spread-to-worst yield of 4.07%.[3]

Fundamentals

- Data broadly remains weak, but came in better than expected. The first estimate of Euro Area (EA) GDP growth in Q1 was 0.4% QoQ (annualized 1.5%). Spain expanded by 2.9% annualized, France and Austria by 1.2%, Italy by 0.9% (rebounding from recession), and Belgium by 0.7%. Data for Germany, the Netherlands, and most of the smaller countries will be released during the next few weeks. It should be noted these results included several positive one-off factors (car registrations, industrial production, inventories – i.e. stockpiling), which were weak in the last quarter of 2018. Overall, there remains a schism between the Manufacturing and Services sectors, with PMIs pointing to weak external demand. The Manufacturing/Services gap is extreme and becoming unsustainable. Positively, business sentiment indices, notably the German IFO, have bottomed out, which may bode well in the coming months. Recent signs of recovery in China should help EA stabilization in Q2/2H as the externally-driven German economy will benefit, although with a several month lag.
- The GDP numbers will be cautiously received by the ECB. No policy changes are expected, with additional data needed before any shift in sentiment and/or positioning. The next meeting is in June, where details on the Targeted Longer-Term Refinancing Operations bank funding scheme are expected and a probable extension of forward-rates guidance. EURIBOR remains below zero, with modest rate hikes not expected until 2020.
- A trade deal between US and China is expected, although disagreements between the two countries remain and negotiations continue to be challenging. President Trump's decision on European auto tariffs is due by May 18th and could have implications at both geopolitical and economic levels. European parliament elections start May 23rd, the outcome of which will be an important consideration for the Brexit process and could also trigger political changes in Italy. Falling support for non-mainstream parties and insipid economic growth may induce more appetite for fiscal easing.
- There were no defaults during the month. The last twelve month default rate for the S&P European Leveraged Loan Index (based on principal amount) is 0.00%, well below the historical average annual default rate of 3.67%.[4]

Index returns (%)	2013	2014	2015	2016	2017	2018	Feb 2019	Mar 2019	Apr 2019	YTD 2019
Credit Suisse Western European Leveraged Loan Index (EUR-HDG)	8.73	1.96	3.14	6.52	3.30	0.55	0.93	-0.07	0.98	3.02
Credit Suisse Western European HY Index (EUR-HDG)	9.10	4.31	1.36	9.63	6.28	-3.85	1.79	1.01	1.52	6.98

Source: Credit Suisse, as of April 30, 2019. **Past performance is not a guide to future returns.** An investment cannot be made directly in an index.

Investment risks

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested. Most senior loans are made to corporations with below investment-grade credit ratings and are subject to significant credit, valuation and liquidity risk. The value of the collateral securing a loan may not be sufficient to cover the amount owed, may be found invalid or may be used to pay other outstanding obligations of the borrower under applicable low. There is also the risk that the collateral may be difficult to liquidate, or that a majority of the collateral may be illiquid. Compared to the investment grade bonds, junk bonds involve greater risk of default or price changes due to changes in the issuer's credit quality. Diversification does not guarantee profit or eliminate the risk of loss.

1 Credit Suisse Western European Leveraged Loan Index (CS WELLI) in EUR as of April 30, 2019.
2 Euro Stoxx Banks Index (EUR) as of April 30. 2019.
3 Credit Suisse Western European High Yield Index as of April 30, 2019.
4 S&P European Leveraged Loan Index, average default rates covering June 1, 2007 through April 30, 2019.

Important information

All data provided by Invesco, as at April. 30, 2019 in Euro unless otherwise noted. Please note index returns represent total returns in respective base currencies.

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