European Loan Market Snapshot

Monthly European loan market update: December 2017 (covering November 2017)

Returns

- The Credit Suisse Western European Leveraged Loan Index ("CS WELLI") returned 0.07% during November, of which interest income of 0.33% partially offset by principal decline of –0.26%.[1] This brings the year-to-date return to 3.29%.
- The new issuance market roared back to life following a slow October. Total issuance for the month of November reached €14.8 billion, the largest print since March which brings the year-to-date supply to €96.3 billion, more than 1.8x in the same period last year. Excluding recapitalizations and re-pricings, net new supply – driven by M&A activity – was €8.6 billion, surpassing the previous intra year high in September and the highest level since May 2007. Of the €39.7 billion of net new supply this year, 20% was issued in September and November and 70% since June. The abundance of supply weighed on the market with investors focusing their intentions on the new deal opportunities rather than the secondary market. While this has dampened short term performance, it is actually a healthy turn of events given the medium risk/return profile, as well as the breadth and depth (liquidity), of the asset class. The total face value of the CS WELLI ended the month at €215 billion, 34% higher than at the end of December 2016.
- While most of the CS WELLI had positive returns for the month, the most notable decliners where in the Energy (–6.01%) and Telecommunication (–1.24%) sectors. The Telecommunications sector traded lower mainly off the back of slightly weaker than expected results and concerns of debt levels at the borrower, Altice, who provides pay television, fixed-line telephony, and mobile services. Given the vast majority of CCC rated loans reside in the Energy sector, it was no surprise that the CCC ratings category was a laggard returning –2.33% with BB and B rated loans returning 0.06% and 0.21% during November.[1]
- The average price of loans in the European market ended November at €99.06, with a spread-to-three year of 3.90%.[1]

Average loan price includes all loans January 1997 through November 2017.

Fundamentals

- The Eurozone area growth story continues. November's flash composite PMIs rose to a 6.5 year high (57.5 versus 56 expected) a level that implies an approximate 3.5% year-over-year GDP growth rate. Manufacturing PMI, were particularly strong rising 1.5 points to 60 (versus 58.2 expected) – the highest in 17 years. Services PMI also slightly beat (56.2 versus 55.2 expected). Subdued core inflation has kept the pressure off the ECB to move more quickly towards tighter policy. With growth continuing to improve and the level of slack narrowing, the ECB may come under pressure to maintain expectations of a very gradual removal of easy policy, although the market continues to price no rate-hikes in 2018.
- The last twelve month default rate for the CS WELLI (issuer weighted) decreased from 2.43% from November 2016 to 1.16% November 2017, well below historical averages.

Technicals

- New institutional loan volume for the month was €14.8 billion, a material increase on the €8.1 billion monthly average seen in the first 10 months of the year, and 1.7x more than the €8.6 billion in the same month last year. Year-to-date institutional loan issuance has reached €96.0 billion.
- CLO formation amounted to €4.74 billion in November representing a notable increase on both September (€1.60 billion) and October (€1.83 billion) and higher than the monthly average achieved this year of €1.76 billion. November typically sees CLO activity spike as arrangers look to print new deals before the holiday lull. Spread compression abated in the face of heightened issuance levels. Strong supply also brought about manager differentiation with CLO AAA liability spreads ranging from E+73 to E+82 in the period. Year-to-date CLO formation reached €19.39 billion, this compares favorably with the €16.8 billion of new creation in the whole of 2016.[2]

Valuations

- Primary:
  - The average lagging three month all-in-yield on primary deals was 3.98%. Lagging three-month senior leverage decreased from 4.4x at the end of December 2016 to 4.6x at the end of November 2017.[2] Total leverage also slightly increased from 4.9x to 5.1x from December 2016 to November 2017.
- Secondary:
  - At November month end, European loans were providing a spread-to-three year takeout of 3.90%(the same level as October but versus 5.27% at the same time last year). In comparison, the spread-to-worst for European high yield bonds was 3.55% (compared to 3.04% at the prior month's end and 4.97% at the same time last year).[1]

Figure 1

Total return (EUR, in %)	2015	Sep-16	2016	1Q17	2Q17	3Q17	Sep-17	Oct-17	Nov-17	2017 YTD
Credit Suisse Western Europe Leveraged Loan Index (EUR-HDG)	3.14	0.74	6.52	1.18	0.88	0.80	0.34	0.33	0.07	3.29
Credit Suisse Western Europe HY Index (EUR-HDG)	1.36	-0.42	9.63	1.97	2.08	1.76	0.53	0.90	-0.59	6.25

Source: Credit Suisse, as at 30 November 2017. Past performance is not a guide to future returns. An investment cannot be made directly in an index.

1 Credit Suisse Western European Leveraged Loan Index (CS WELLI) as at November 30, 2017
2 Standard & Poor's, Loan Market Commentary and Data (LCD) as at 30 November 30, 2017

Important information

All data provided by Invesco, as at Sept 31, 2017 unless otherwise noted.

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 law. 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 investment grade bonds, junk bonds involve a greater risk of default or price changes due to changes in the issuer's credit quality. Diversification does not guarantee a profit or eliminate the risk of loss.

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