European Loan Market **Snapshot**

Monthly European loan market update: June 2018 (covering May 2018)

The Credit Suisse Western European Leveraged Loan Index ("CS WELLI") returned 0.03% in May (Interest income of 0.37% and –0.34% of principal), bringing year-to-date ("YTD") total returns to 1.40%.[1]

As we saw in the first quarter, European Loan prices remained stoic despite a broader market sell-off. Trade disputes between the US and China, on-going geopolitical tensions (North Korea) and negative focus on Turkey were prevalent macro themes seen during the month, all of which were eclipsed in the closing days of the month when Italian political events took center stage regarding government formation (or lack of) and its consequences. May 29th was a dramatic day for markets, in general. Most were in free-fall with the concern of Italy leaving the Euro (currency) and a showdown with ECB likely. Italian government debt (BTPs) sold-off by approximately 7% (YTD total-return of –4.3%). By the following day it was clear this was an overreaction and the panic subsided, however the 'damage' had been done. Italian equities (FTSE MIB) suffered their worst month (-8% total return for May) since the Brexit-impacted June 2016 – as did European Banks. The Credit Suisse Western European High Yield Index (–0.88%) had the worst month since the energy crisis of December 2015. European Sovereigns monthly total-returns were –1.30% (YTD –0.2%), although the Bund monthly return of +1.70% (+1.50% YTD) was supported by a flight to safety. Given only approximately 2% of the CS WELLI index is composed of Italian loans, the asset class' reduced interest-rate exposure and senior secured nature contributed to a relatively robust CS WELLI return during the month.

While the European loan market has shrugged off the negative Italian news flow, the market continues to be weighed down by the sustained period of new deal flow (supply of new issuance out pacing demand). This has been exacerbated by the fact that the loan market remained open through this period of volatility whilst the high-yield bond market froze and issuers moved to the loan market. In May, new deal flow amounted to circa €9 billion or 60% higher than the same month last year. The increase is even more dramatic after excluding refinancing and re-pricings, with net new supply amounting to €7 billion, 4.5x more than in May 2017. On a year to date basis, net new supply reached €29 billion, 70% more than in 2017.[2]

The CS WELLI index reached €241 billion representing +12% growth YTD.[1] This has helped to support margins on new deals (new-issue average TLB spreads increasing circa 5bps in the month) and credit metrics (leverage) to remain stable. Eighteen deals (68 YTD) came to market this month. Larger loan deals included ION Trading's €850 million acquisition financing tranche, Zentiva's €705 million LBO financing and Verallia's €550 million refinancing of bonds to loans. Encouragingly, for several deals (ION for example) investors were able to negotiate improved documentation, a trend that is continuing to gain momentum as the year progresses.[2]

Returns

- The CS WELLI sector returns were led by Shipping (+0.82%) and Metals/Minerals (+0.55%) while Retail (−0.68%) and Aerospace (−0.31%) were the largest detractors. CCC rated loans continued to outperform, returning 0.26% for the month (dominated by Energy credits as Brent increased 4.6% during May). However, BB and B rated loans returned 0.01% and −0.07% respectively, a month-on-month pull-back for both ratings (both returned in excess of 0.30% last month).[1]
- The average price of loans in the European market ended the month at €99.08 (a decrease of −€0.26 compared to April), with a three-year discount margin of 3.77%.[1] In comparison, the spread-to-worst for European high yield bonds was 4.31% and thus far YTD have returned -1.07%.

Fundamentals

- The Euro Zone's May inflation prints exceeded expectations, driven partly by energy and services prices. Headline CPI rose to a 13-month high of 1.9% (1.6% was expected) and Core CPI rebounded by 0.4 points from last month to 1.1% (1.0% expected).
- Composite PMIs decreased, for a fourth consecutive month, to 54.1 (from an expected 55.1 in April) and to levels not seen since November 2016. The decrease was seen across Germany and France, with an implied rise in 'non-core' countries. The survey suggests a softening in external demand but little clarity or consistency in terms of economic cycle trends. However GDP growth remains above trend, but less robust than 2017 (2.5%), with consensus forecasts of 2.1% growth this year. Euro Zone Q1 GDP was confirmed at 0.4% quarter-on-quarter in 1Q18. We expect the Euro Zone economy to remain in expansion territory, slightly lower than 2H 2017 with the downside risks mainly related to political risks (Italy and Spain), threats to global trade and oil prices.
- There were no policy announcements at the May ECB meeting and monetary policy was not discussed. Minutes indicate a broad range of views regarding inflation outlooks by Council members. The rise in political risk premiums (Italy and Spain) has dominated the macro environment recently. This, combined with rising inflation and cooling PMIs, will make the ECB's QE tapering plans more difficult as they are unlikely to tighten policy abruptly.
- The last twelve month default rate for the S&P European Leveraged Loan Index (based on principal amount) is 0.42%, well below the historical average annual default rate of 4.01%.[4]
- Lagging three-month senior leverage remained at 4.5x with total leverage remaining stable at 5.2x.[2]

Technicals

- New CLO issuance was €1.7 billion for the month (YTD: €10.4 billion from 25 deals). CLO AAA spreads widened to a low 80 bps context, from a record low of 68 bps observed in February.[5] At the root of the move remains sustained issuance. We believe momentum for new CLO creation is strong with over 30 CLO warehouses accumulating assets (including one from Invesco).

Figure 1

Total return (EUR, in %)	2013	2014	2015	2016	2017	Mar 2018	April 2018	May 2018	YTD 2018
Credit Suisse Western Europe Leveraged Loan Index (EUR-HDG)	8.73	1.96	3.14	6.52	3.30	0.10	0.47	0.03	1.40
Credit Suisse Western Europe HY Index (EUR-HDG)	9.10	4.31	1.36	9.63	6.28	-0.31	0.56	-0.88	-1.07

Source: Credit Suisse, as of 31 May, 2018. 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 of 31 May 2018.
2 Standard and Poor's, Loan Market Commentary and Data (LCD) as of 31 May 2018.
3 Credit Suisse Western European High Yield Index as of 31 May 2018.
4 S&P European Leveraged Loan Index, average default rates covering 1 June 2007 through 31 May 2018.
5 Spreads refers to that over EURIBOR.

Important information

All data provided by Invesco, as at 31 May, 2018 in Euro unless otherwise noted.

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