US Loan Market Snapshot

Monthly US Loan Market Update: November 2016

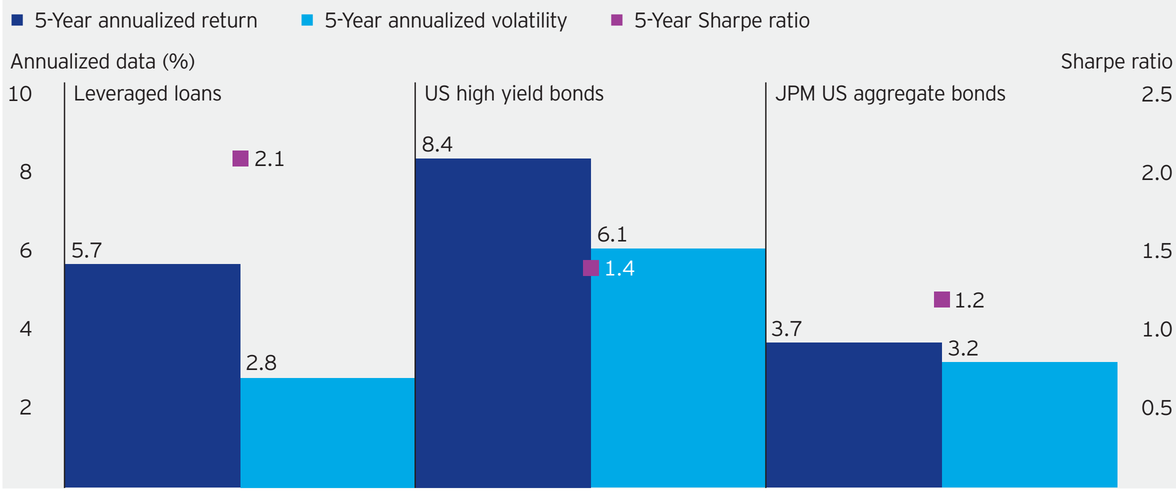
The loan market returned 0.83% in October – the fourth consecutive month with returns in excess of the coupon. Year-to-date returns of 8.61% have been fueled by a combination of strong current income as well as price appreciation, as prices have rallied post mid-February with muted volatility.[1] While the average price of the index continues to trade at a discount, the median price is closer to par with many loans trading above par. Loans performed well on both an absolute and risk-adjusted basis as capital markets continued to adjust expectations ahead of possible US Federal Reserve (Fed) actions in coming months as well as the US Presidential election in early November.

An uptick in Treasury yields weighed on longer duration fixed income with the 10 year Treasury ending the month at 1.83% – up over 20 basis points (bps) from the end of last month and its highest level in six months. Loans significantly outpaced longer duration fixed income with the 10 year Treasury returning (–1.90%) and the High Grade Bond Index returning (–0.83%). Loan returns also exceeded the High Yield Bond Index (0.31%) and the S&P 500 (–1.82%)[2] as high yield bond prices declined modestly in the face of higher risk free rates, weaker technicals, and anxiety around political uncertainty. Loans continued to benefit from a tailwind in commodity related sectors in the month as well as the outperformance in the lower quality ratings categories. Higher quality "BB" (0.30%) and "B" (0.85%) ratings categories underperformed the "CCC's" (3.43%) and "D's" (4.90%).[1]

Economic indicators continued to be supportive of fundamentals with third quarter GDP climbing 2.9% – the fastest growth in two years and technicals remained robust with strong demand exhibited across the loan market's constituents with limited net new issue supply. Loans remain well positioned for both higher rates as well as political uncertainty due to their floating rate and defensive characteristics. The average price in the loan market was $97.54 at the end of October – with 55% of the market trading at or above par and a small percentage of stressed and distressed outliers weighing on the broader average.[1] At the current average price, senior secured loans are providing a 5.74% yield.[1]

Average loan price includes all loans January 1997 through October 2016.

Loans have exhibited attractive risk-adjusted total returns over the last 5 years



Source: J.P. Morgan Leveraged Loan Index, J.P. Morgan US HY Bond Index and J.P. Morgan US Aggregate Bond Index as of September 30, 2016. Past performance is not a guarantee of future results. An investment cannot be made in an index.

Fundamentals

- US GDP growth for the third quarter was 2.9%, up from 1.4% last quarter.
- As of the end of October, over half the companies in the S&P 500 reported earnings with both revenue and earnings trending positively for the first time in six quarters – a positive indicator for supportive corporate fundamentals for the loan asset class.
- There was one new default in October, Tervita Corp, but the small size of the deal kept the trailing 12 month default rate at 1.95%.[1]

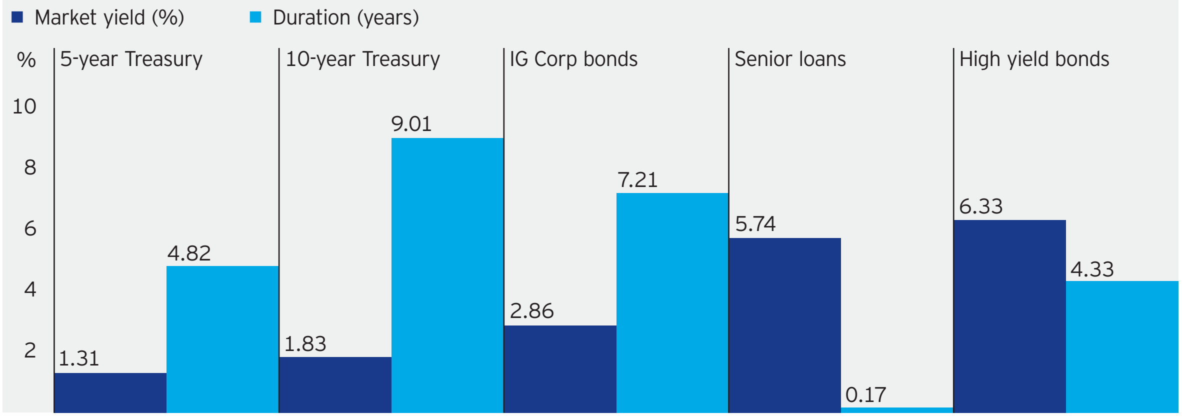
Technicals

- Technicals were strong in October – contributing to the muted volatility for the asset class.
- CLO issuance of $16.7 billion was the strongest monthly total this year and the second highest monthly total on record.[3]
- Retail mutual funds and ETF's had an inflow of $1.5 billion in October – extending the streak of consecutive weeks with positive inflows to 13, with over $3.7 billion in inflows over that period. Year-to-date flows remain negative at -$2.2 billion, well below the -$13.1 billion in outflows through the first 10 months of 2015.[3]
- New issuance volume of $76.7 billion in October was the highest total this year. The asset class continued to experience spread compression as 80% of new issue volume was dedicated to refinancing and re-pricing transactions. Total new issue volume for the year is $368 billion and $133.3 billion net of refinancings and re-pricings versus $286.3 billion gross and $155.8 billion net for the same period last year.[3] Despite the wave of re-pricings, the loan market continued to reject deals deemed to be too aggressive or opportunistic.

Relative value/market opportunity

Loans continue to be well positioned for the uncertainty surrounding the upcoming election and possible rate hikes by the US Fed. The floating rate feature provides insulation from increasing rates while the senior, secured status contributes to the relatively muted volatility. At LIBOR's current level of 88 bps, it has surpassed the LIBOR floor set on 33% of loans[4] converting those loans back into truly floating rate instruments. At the 100 bps threshold, 95.4% of loans[4] will meet or exceed the LIBOR floor. While the spread differential between high yield bonds and senior secured loans widened this month largely due to loan spreads tightening and bonds widening, it remains tighter than the historical average.

Loans continued to offer investors a high level of current income with short duration



Source: Bloomberg L.P., BAML, S&P LCD as of October 31, 2016. Investment grade corporate bonds represented by a subset of the BBG BARC U.S. Aggregate Index; the senior secured loan asset class is represented by S&P/LSTA Leveraged Loan Index; and high yield bonds represented by BAML High Yield Master Index. Past performance cannot guarantee comparable future results. An investment cannot be made directly in an index. Diversification does not guarantee a profit or eliminate the risk of loss.

	$ Price	**Yield (%)**	**Spread to worst**	**At forward Libor**	**Duration (years)**
5-Year Treasury	99-23	1.31%			4.82
10-Year Treasury	97-02	1.83%			9.01
Bloomberg Barclays US Agg Index	105.62	2.12%	T + 0.69		5.59
Bloomberg Barclays IG Index	107.13	2.86%	T + 1.28		7.21
ML US HY Index	99.10	6.33%	T + 5.02		4.33
S&P/LSTA Leveraged Loan Index	**97.54**	**L + 4.92%**	**T + 4.75**	**5.74%**	**45-60 Days**

Source: Source: Bloomberg L.P., BAML and S&P LCD as of October 31, 2016. Loan yields incorporate LIBOR forward curve as of October 31, 2016. Loan "spread to worst" and "At Forward LIBOR" incorporate LIBOR forward curve as of October 31, 2016.

1 S&P LCD (Leveraged Commentary and Data) as of October 31, 2016; Total returns, yields, and average price stated are for the S&P LSTA Leveraged Loan Index. Historic average default rate is for period January 1998 to October 2016.
2 HY Bonds: BAML HY Master Index, High Grade Bonds: BAML High Grade Corp; data as of October 31, 2016. Returns stated are total returns.
3 J.P. Morgan as of October 31, 2016.
4 Loans represented by the S&P LSTA Leveraged Loan Index, as of October 31, 2016

Important information

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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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