Invesco Senior Secured Loans

US Loan Market Snapshot

Monthly US loan market update: February 2018

Senior secured loans began the year on a strong note, returning 0.96% in January[1]. Loan prices were a beneficiary of the positive macro backdrop and rising interest rate expectations. Unlike much of 2017 when coupon income primarily drove loan returns, price growth was a more significant component of total return in January. From a sector standpoint, retail and metals & mining delivered the largest gains.

Gross supply declined in January to $49.3 billion, the quietest month since last July. The majority of issuance continued to be repricing and refinancing activity. Meanwhile, solid overall demand continued to be driven by CLO issuance, the forward pipeline for which remains well stocked. Retail recorded its first monthly inflow since July. This technical dynamic, in addition to the fundamental market tailwinds, pushed the percentage of loans trading above par up to 78%.

The loan market continued its streak of outperformance versus other fixed income asset classes. The High Yield Bond Index returned 0.64% and the High Grade Bond Index returned -0.92%[2], each exhibiting sensitivity to rising rates. The 10 year Treasury declined -2.45% as yields increased by 30 basis points to 2.71%. Loans' lower yielding, higher quality "BB" (0.74%) and "B " (1.02%) ratings categories underperformed "CCC's" (2.30%)[3]. The average price in the loan market was $98.69 at the end of January[4]. At the current average price, senior secured loans are providing a 6.37% yield[5].

Fundamentals

- The Q4 U.S. GDP estimate was 2.6%, resulting in a 2017 growth rate of 2.3%.
- There were two new defaults in January – Fieldwood Energy and Philadelphia Energy Solutions. However, the trailing 12 month default rate declined to 1.95% as last year's Avaya default dropped out of the calculation[6].

Technicals

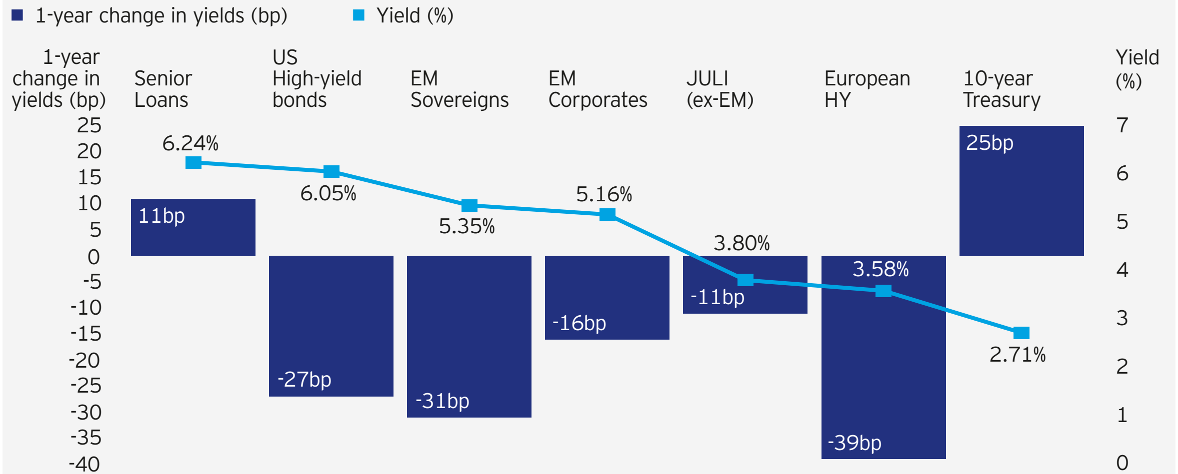
- Technical conditions were tight in January as modest new issuance was offset by paydown activity and steady demand for the asset class.
- Gross CLO volume was $21.1 billion in January, with $8.4 billion of issuance net of resets and refinancings[7].
- U.S. Retail mutual funds and ETF's reported a $338 million inflow for the month, reversing several consecutive months of outflows[8].
- New issuance volume was $49.3 billion in January, and $15.6 billion excluding refinancing and repricing activity.

1 S&P/LSTA Leveraged Loan Index January 31, 2018
2 BAML High Grade Corporate Bond Index, BAML HY Master Index January 31, 2018 3 S&P LCD January 31, 2018
4 S&P LCD January 31, 2018
5 S&P LCD and Invesco as of January 31, 2018
6 S&P LCD January 31, 2018
7 JP Morgan January 31, 2018
8 JP Morgan January 31, 2018

Relative value/market opportunity

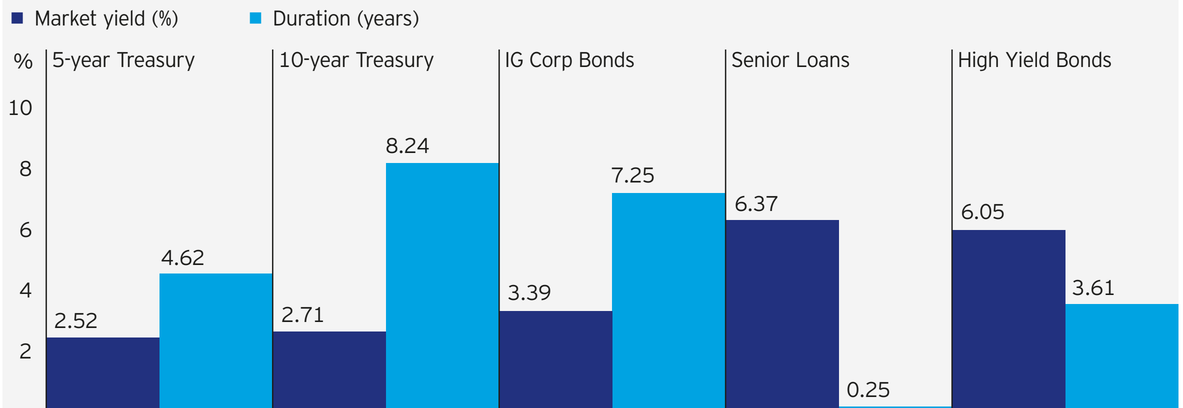
With rising rates back at the forefront of investor sentiment, loans have been outperforming high yield in recent months. After gaining in early January in sync with the broader risk rally, high yield then succumbed to rising Treasury yields, a consequence of their longer duration. January high yield bond returns peaked at 0.93% late in January before selling off 0.26% in the closing days to deliver a 0.64% monthly return. While rising rates will remain a challenge for high yield bonds, they have historically served as a tailwind for loans given the floating rate coupon. Additionally, bond yields remain near 3-year lows as prices have been buoyed by positive corporate and economic fundamentals and higher oil prices. As a result, the yield differential between loans and unsecured bonds continues to be historically tight. Investors may thus own less volatile, more defensively positioned loans at a similar yield to unsecured bonds, while curtailing interest rate risk. With 3-month LIBOR up to 1.78%, the rise in loans' base rate has offset much of the spread compression stemming from repricings. The Fed's latest statement indicated a strong likelihood of another rate increase in March, for which loans are well positioned.

Loan yields increasingly attractive relative to other fixed income alternatives



Source: J.P. Morgan, as of January 31, 2018. Senior Loans are represented but the JP Morgan Leveraged Loan Index; US High-yield bonds are represented by the JP Morgan Domestic High Yield Index; EM Sovereigns are represented by the JP Morgan EMBI Global Diversified Blended Index; EM Corporates are represented by JP Morgan CEMBI Div Broad Composite Index; JULI (ex-EM) is represented by the JP Morgan JULI Ex EM Index; European HY is represented by the JP Morgan European Currency High Yield Index; and the 10-year Treasury is represented by iteslf. Past performance cannot guarantee comparable future results.

Loans offered investors a high level of current income with short duration



Source: Bloomberg, Barclays, JPM, S&P LCD January 31, 2018

	$ Price	Yield to worst (%)	Spread to worst	At forward Libor	Duration (years)
5-year Treasury	99-11	2.52			4.62
10-year Treasury	96-03	2.71			8.24
Bloomberg Barclays US Agg Index	101.61	2.97	T + 0.45		6.07
Bloomberg Barclays IG Index	104.36	3.39	T + 0.84		7.25
J.P. Morgan US HY Bond Index	102.20	6.05	T + 3.72		3.61
S&P/LSTA Leveraged Loan Index	**98.69**	**L + 3.75**	**T + 4.08**	**6.37%**	**90 Days**

Source: Standard & Poor's LCD, Barclays, JPM and Bloomberg L.P. as of January 31, 2018. Loan "spread to worst" and "at forward Libor" incorporate LIBOR forward curve as of January 31, 2018.

Important information

All data provided by Invesco unless otherwise noted. All data is US dollar and as of 31 January 2018, unless otherwise noted.

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