# European Loan Market Snapshot

## Monthly European loan market update: January 2019 (covering December 2018)

The Credit Suisse Western European Leveraged Loan Index ("CS WELLI") returned -1.26% in December, comprised of principal return of -1.63% and interest return of 0.37%. The total return for 2018 is 0.55%.[1]

December was a volatile month. Trade/tariff tensions, US central-bank policy, global economic slowdown fears, Brexit, and Italian politics all contributed to a general rotation out of global risk assets (e.g., Nikkei -10.0% in the mon th, NASDAQ -9.4%, DAX -6.2%[2]) and into traditional safe havens such as precious metals (Gold +5.0%) and government debt (Italian BTPs +3.1%, Gilts +2.4%, German Bunds +0.5%, US Treasuries +2.3%). Oil also experienced dramatic declines with both WTI and Brent dropping approximately -10.0%. We believe European credit fundamentals remain constructive and that the CS WELLI's December returns were technically driven overall.

Significant outflows in the US leveraged finance market – partially triggered by increasing concerns over a US economic slowdown – required selling of assets to fund redemptions, which subsequently caused a broad base remarking of loans lower in both the US and European markets. Themes outlined in November's European loan market update remain in play. In particular, European borrowers (often with large total outstanding debt) with USD-denominated loans added additional negative pressure on the CS WELLI's monthly performance. Borrowers with loans and high yield bonds in their capital structures experienced additional pressure, as bond declines pulled related loans lower. European loan remarking was further amplified by the usual end-of-year thin liquidity, especially given the limited European CLO bid and the risk-off tone generated by the volatility observed across other risk assets (in particular, global equity markets).

The CS WELLI's nominal value (size of the market) at the end of the month was €283 billion, a 30% percent increase for the year.[1] The new-deal pipeline for the start of 2019 is reported to be building, although recent volatility will likely push timing out until markets have stabilized. Encouragingly, margins for upcoming deals are likely to be higher given secondary market opportunities and repricings in the near term are unlikely.

## Returns

- All sectors within the CS WELLI had negative total returns for the month. The Consumer Non-durables sector was the best performer, returning -0.25% whilst the Consumer Durables sector performed the worst at -3.48%. The median sector return was -0.99%. [1]
- By ratings, B rated loans (approximately 57% of the CS WELLI) returned -1.28%, CCC rated loans (approximately 2% of the CS WELL) returned -1.44%, and BB rated loans (approximately 26% of the CS WELLI) returned -1.63%.[1] The underperformance of BB rated loans (typically the largest and most liquid loans) further highlights how market weakness was heavily influenced by beta and not fundamentally driven.
- At month-end, the average price of the CS WELLI was €96.54, the lowest level since June 2016.[1] The average price declined -€1.52 over the month of December, which is the largest monthly decline since September 2011.[1] The CS WELLI's three-year discount margin is 4.73% (+58bps during the month).[1] For comparison, the Credit Suisse European High Yield Index monthly total return was -0.95%, bringing the calendar year 2018 return to -3.85% and spread-to-worst to 5.68%.[3]

## Fundamentals

- Whilst the Euro area's economy remains in good shape, the data rebound expected in the second half of 2018 has so far been underwhelming. We expect Q4 to be stronger, but political risks have dampened expectations. A risk-off sentiment has recently dominated the European market, with the latest developments on Brexit and the Italian budget playing a major role. A flight to quality was mostly supportive to core bond yields, with 10-year Bund yields trading below 0.4%. Economic data out of the Euro area continued to be soft, with weak German industrial production weighing negatively on growth in the third quarter. This was, however, in large part due to new emissions testing on cars, which should be temporary, and we expect a rebound in growth in the fourth quarter.
- Euro area core inflation rebounded to 1.1% in October while headline picked up to 2.2% on the back of higher food and energy prices. Core CPI is expected to pick up slightly in 4Q towards 1.2%, while energy inflation is anticipated to start moving lower towards year end.
- The short end of the interest rate curve remains anchored as the ECB continues to signal that rates will remain low well past the end of QE (December). Euribor remains negative. The ECB is likely to hike rates by 15bps in 4Q 2019. Reinvestments are expected to continue after QE stops at year-end 2018.
- 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 0.11%, well below the historical average annual default rate of 3.79%.[4]

## Technicals

- European CLO YTD volume was €27.3 billion - a record high year during the 2.0 era - with over 66 transactions completed during the year.[5]

| Index returns (%) | 2013 | 2014 | 2015 | 2016 | 2017 | Oct 2018 | Nov 2018 | Dec 2018 | YTD 2018 |
|---|---|---|---|---|---|---|---|---|---|
| Credit Suisse Western European Leveraged Loan Index (EUR-HDG) | 8.73 | 1.96 | 3.14 | 6.52 | 3.30 | 0.20 | -0.72 | -1.26 | 0.55 |
| Credit Suisse Western European HY Index (EUR-HDG) | 9.10 | 4.31 | 1.36 | 9.63 | 6.28 | -1.36 | -1.82 | -1.82 | -2.94 |

Source: Credit Suisse, as of Dec. 31, 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 Dec. 31, 2018.
2 Deutsche Boerse AG German Stock Index (DAX) as of Dec. 31, 2018. The DAX is a total return index of 30 selected German blue chip stocks traded on the Frankfurt Stock Exchange.
3 Credit Suisse Western European High Yield Index as of Dec. 31, 2018.
4 S&P European Leveraged Loan Index, average default rates covering June 1, 2007 through Dec. 31, 2018.
5 Standard and Poor's (S&P) / LCD as of Dec. 31, 2018.

## Important information

All data provided by Invesco, as at Dec. 31, 2018 in Euro unless otherwise noted. Please note index returns represent total returns in respective base currencies.

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