European Loan Market Snapshot

Monthly European loan market update: August 2018 (covering July 2018)

The Credit Suisse Western European Leveraged Loan Index ("CS WELLI") returned 0.51% in July (interest income of 0.38% and 0.14% of principal) – the second highest monthly return for 2018 (behind January). Year-to-date ("YTD") total returns are 1.42%.[1]

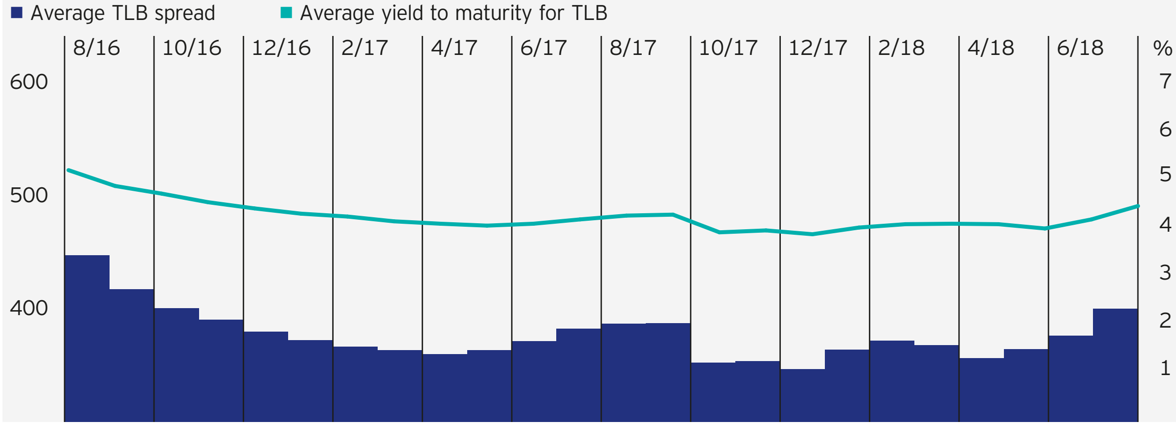
Market sentiment improved across most risk-assets throughout the month. Commodities were the notable exception, reflecting some caution related to a cooling Chinese economy, potential impact of US-led tariffs, and escalating trade war implications. July ended with a solid start to the earnings season in Europe and the US. European Banks were helped by rising bond yields across the region (the STOXX Europe 600 Banks Index returned 4.3% in July.)[2] German Bund monthly total-returns were -0.60% (+1.0% YTD) and European Sovereign monthly total-returns were -0.30% (YTD +0.20%). Euro area growth has improved from the first quarter.

Total institutional loan supply in July was €7.3 billion, which is €3.7 billion (34%) less than the same period last year. However, a year-over-year comparison is not a fair representation of market dynamics as deal purpose continues to be dominated by M&A activity and, in contrast, refinancing and recapitalizations have diminished significantly. On an M&A volume basis, new loan activity in July was €6.2 billion compared to €4.2 billion last year (85% of total issuance this July compared to only 38% last year). Similarly, on a YTD basis, M&A activity stands at €43.5 billion compared to €22 billion for the same period last year. Total YTD issuance is in line with last year at €58 billion.[3]

The M&A supply trend continues to be supportive for higher spreads (and original issue discounts), more protective documentation for lenders, and recently where demanded, addition of second-lien debt in the capital structure to appease potential senior lenders. During July, no new issue transactions flexed spreads tighter. Furthermore, in general, deal size continues to grow, with the average size of LBO-related loans reaching €689 million, greater than the previous high-water mark of €559 million experienced during 2007.[3] In terms of demand, both ramping CLO warehouses and institutional investors are stepping in to take advantage of attractive yields ahead of a likely summer slow-down in the primary loan market.

The CS WELLI reached almost €260 billion in nominal value (growing 20% YTD), with the average rating improving to 'Split BB' from 'B' since December 2017.[1]

Average TLB Primary Spread and YTM (Rolling 3-months)



Source: S&P Global Market Intelligence Europe Monthly July 2018. Based on the TLB spread at launch, the OID, and EURIBOR floor (if any).

Returns

- The CS WELLI sector returns were led by Media/Telecommunications (+0.96%) and Energy (+0.80%), offset by Aerospace (-1.30%) and Retail (-0.16%). BB and B rated loans returned 0.52% and 0.44%, respectively.[1]
- The average price of loans in the European market ended the month at €98.61, an increase of €0.28 from last month, while the three-year discount margin was 3.95%.[1] In comparison, the spread-to-worst for European high yield bonds was 3.89%, with July returns of 1.39% and year-to-date returns of 0.00%.[4]

Fundamentals

- The ECB's Governing Council (GC) did not announce any changes this month to its monetary policy or risk assessment of the Euro area's outlook, which "remains broadly balanced." The message remained one of gradualism and policy accommodation, as well as "prudence, patience and persistence" to bring underlying inflation, still close to 1.0%, gradually towards target. A dovish President Draghi signaled that the GC remained concerned about protectionism, but were encouraged by the Juncker/Trump talks (regarding tariffs) and the promise of further negotiations. Forward guidance results in Euribor remaining below zero and is expected to remain so until late 2019 at the earliest.
- The first estimate of Euro area 2Q GDP was 0.35% quarter-on-quarter, slightly lower than expectations of 0.40%. The slowdown was broad across countries, with growth easing in France (0.2%), Spain (0.6%), and Italy (0.2%). First half 2018 underperformance has been attributable to slower external demand versus a strong 2017 and some likely temporary drivers (such as rising oil prices, volatile weather, and strikes). Consensus calls for a pickup in growth during the second half of the year. Recent survey-level data remained upbeat, with the main downside risks identified as trade war escalation and uncertainty in Italy. July core inflation increased by two-tenths to +1.1% year-over-year (versus +1.0% expected).
- There were no defaults in July. The last twelve-month default rate for the S&P European Leveraged Loan Index (based on principal amount) is 0.12%, well below the historical average annual default rate of 3.94%.[5]

Technicals

- European CLOs accelerated supply in July totaled €4.5 billion with eleven new deals.[3] CLO primary AAA spreads inched towards the 90 area on the increased supply.[6] Spreads widened across tranches, with large moves experienced at lower rated tranches. With equity arbitrage still attractive, supply is likely to continue.

Index returns (%)	2013	2014	2015	2016	2017	May 2018	June 2018	July 2018	YTD 2018
Credit Suisse Western Europe Leveraged Loan Index (EUR-HDG)	8.73	1.96	3.14	6.52	3.30	0.03	-0.49	0.51	1.42
Credit Suisse Western Europe HY Index (EUR-HDG)	9.10	4.31	1.36	9.63	6.28	-0.88	-0.31	1.39	0.00

Source: Credit Suisse, as of July 31, 2018. Past performance is not a guide to future returns. An investment cannot be made directly in an index.

Investment Risks

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested. 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 low. 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 the investment grade bonds, junk bonds involve greater risk of default or price changes due to changes in the issuer's credit quality. Diversification does not guarantee profit or eliminate the risk of loss.

1 Credit Suisse Western European Leveraged Loan Index (CS WELLI) as of July 31, 2018. May not sum due to rounding.
2 STOXX Europe 600 Banks Price EUR as of July 31, 2018.
3 Standard and Poor's, Loan Market Commentary and Data (LCD) as of July 31, 2018.
4 Credit Suisse Western European High Yield Index as of July 31, 2018.
5 S&P European Leveraged Loan Index, average default rates covering June 1, 2007 through July 31, 2018.
6 Spreads refers to that over EURIBOR.

Important information

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

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