Invesco Senior Secured Loans

European Loan Market Snapshot

Monthly European loan market update: July 2017 (covering June 2017)

Returns

- The Credit Suisse Western European Leveraged Loan Index ("CS WELLI") returned 0.06% during June, of which interest income was 0.34% and principal return of -0.28%.[1]
- Fixed income markets, in general, continued to exhibit low volatility for the most part of June. The European Central Bank (ECB) forum at Sintra caused some market volatility towards the end of the June, with president Draghi's comments interpreted as being more hawkish on inflation and monetary policy outlooks. The market took this to be a hint of easing of the status quo policy of "the ECB will do whatever it takes". Unsurprisingly, the immediate reaction was for (long) duration assets to underperform. While these assets did recover following softening (backtracking) dialogue from the ECB, this clearly foreshadows what may happen when monetary policy does tighten. When the tapering scenario eventually plays out, short duration assets, such as senior secured loans ("SSL"), should benefit.
- In June the loan market was weaker following a material and much needed increase in new deal supply. Market participants opted to focus on new primary opportunities rather than sourcing loans in the secondary market, which were often priced above par. Accordingly, as demand eased in the secondary market, bids for loans decreased, which was the main driver (rather than the Sintra meeting) of the June's return.
- The Energy sector return of -6.59% was the biggest laggard in the CS WELLI, not a surprise given the observed volatility in the oil markets. The Transportation sector also detracted 0.22% from the CS WELLI. In terms of performance by credit quality, single B rated loans outperformed (0.26%) all other ratings categories as investors still require higher spreads to make their portfolios attractive and for CLO arbitrage to be attractive. BB's returned -0.05%, and –CCC's returned 0.29%.[1]
- The average price of loans in the European market ended June at €98.83, with a spread-to-three year of 4.03%.[1]

Average loan price includes all loans January 1997 through June 2017.

Fundamentals

- Outside of pockets of weakness, such as in the UK, the Eurozone continues to post soft and hard data consistent with modest GDP growth (0.7-0.8% in 2Q 2017). Solid momentum continues with strong manufacturing new orders, employment growth and easing price pressures. Positively, this momentum is spread over the Eurozone, with Spain a particular hotspot. Contrarily, in the UK economic data is pointing to a subdued second quarter GDP print, with a loss of momentum into the third quarter.
- Off the back of the continuing positive trajectory in macro data, it is not surprising the focus continues to be the ECB and any signs of an easing in policy. The market is not pricing three month Euribor becoming positive until late 2019.
- The stable macro-economic landscape and solid fundamentals seen, generally, across European leveraged corporate borrowers, suggests a continuation of a benign default environment in Europe. There were no new defaults during the month of June or the second quarter of 2017. One issuer default rolled out of the trailing twelve month default rate, thus accordingly, the last twelve month default rate for the CS WELLI decreased to 1.8% at the end of June 2017 as compared to 2.40% at the end of May 2017, both periods well below the historical average annual default rate of 3.3% (CS WELLI defaults covering the period 1 Jan. 2003 through 30 June 2017).[1]

Technicals

- New institutional loan volume for the month was €7.4 billion, 2.4 times the volume of June 2016 volume. Of this gross new issuance volume, €5.3 billion (71%) was new deals coming to the market. This is was largest supply of net new supply since June 2008. Year-to-date institutional issuance reached €49.4 billion, 2.2 times more than in the first half of 2016.[2]
- Notable loan deals in syndication in the period included:
  - CHF equivalent €375 billion facility to support CVC's buyout of luxury watch maker Breitling, price talk is Euribor+3.75-4.00% with a 0% floor, issue price of €0.9950.[2]
  - €455 million facility to support Apax's buyout of chemical cleaning company Safetyclean. Price talk is Euribor+3.50-3.75% with a 0% floor, issue price of €0.9950.[2]
- CLO generation continued at a good pace with €1.6 billion of formation, slightly above the €1.3 billion average in the first five months of the year. CLO liability spreads remained relatively stable in the period but asset yields continued to move tighter. Year-to-date CLO formation reached €8.3 billion, €1.1 billion more than in the first half of 2016.

Valuations

- Primary:
  - The average lagging three month all-in-yield on primary deals was 3.97%. Lagging three-month senior leverage slightly decreased from 4.4x at the end of May 2017 to 4.3x at the end of June 2017.[2]
- Secondary:
  - At month end, European loans were providing a spread-to-three year takeout of 4.03% (compared to 4.04% at the prior month's end and 5.90% at the same time last year). In comparison, the spread-to-worst for European high yield bonds was 3.71% (compared to 3.82% at the prior month's end and 6.13% at the same time last year).[1]

Figure 1

Total return (EUR, in %)	2015	1Q 16	2Q 16	3Q 16	4Q 16	2016	Apr-17	May-17	Jun-17	2Q 17	2017 cumulative
Credit Suisse Western Europe Leveraged Loan Index (EUR-HDG)	3.14	0.78	1.49	2.80	1.31	6.52	0.29	0.52	0.06	0.88	2.06
Credit Suisse Western Europe HY Index (EUR-HDG)	1.36	1.70	1.75	3.67	2.20	9.63	1.09	0.89	0.08	2.08	4.09

Source: Credit Suisse, as at 30 June 2017. 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 at 30 June 2017
2 Standard & Poor's, Loan Market Commentary and Data (LCD) as at 30 June 2017

Important information

All data provided by Invesco, as at 30 June, 2017 unless otherwise noted.

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 law. 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 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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