Invesco

Invesco Senior Secured Loans

European Loan Market Snapshot

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

Returns

- The Credit Suisse Western European Leveraged Loan Index ("CS WELLI") returned 0.48% during July, of which interest income was 0.35% and principal return of 0.13%.[1]
- Sustained issuance of new (primary) senior loans was a key theme for July. Total issuance was €11.2 billion – more than twice the volume for the same month last year – of which €4.8 billion (42%) related to new borrowers (versus refinancing/recapitalizations of existing inventory) the second highest month this year (June was the highest). This is the second best start to new issuance on record behind 2007. Year-to-date new issuance is close to €61 billion, more than 2016 total volume and 1.5 times than 2015. Continued new borrowers coming to market is key in obtaining a balance between supply and demand and appropriate credit structures and economics. As supply increased in June and July, all-in-yields for new issuance improved to 4.05% (from 3.94% in May) whilst leverage ratios remained relatively static, increasing to 4.6x from 4.4x. The observed increase in all-in-yields is a welcome change from the compression trend seen earlier in the year.
- The Energy sector return of 6.01% was the largest gainer in the CS WELLI for the month, reversing the -6.59% return in June – not a surprise given the volatility in the oil markets. The sole negative returning sector in the CS WELLI was Aerospace which returned -0.32%. In terms of performance by credit quality, BB rated loans outperformed (+0.35%) all other ratings categories as investors continue to require higher spreads (yields) in their portfolios and for CLO arbitrage to be attractive. Single B rated loans returned 0.32%. CCC's returned 2.50% a significant rebound from the June return of -0.29%.[1]
- The average price of loans in the European market ended July at €99.07, with a spread-to-three year of 3.92%.[1]

Fundamentals

- Consistent with the economic data and surveys, market forecasts are for the Euro area economic growth to remain robust but slow in the third and fourth quarters of 2017. On an annual basis, market expectations are for GDP growth to exceed 2.0% year-on-year in 2017 from 1.7% in 2016.
- Given the continuing positive macro data, it is not surprising that the market focus continues to be on the ECB and any signs of an easing in policy.

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

- The stable macro-economic landscape and solid fundamentals generally seen across European leveraged corporate borrowers, suggests a continuation of a benign default environment in Europe. There were no new defaults during the month of July. Accordingly, the last twelve month default rate for the CS WELLI remained unchanged at 1.8% at the end of July 2017, well below the historical average annual default rate of 3.32% (CS WELLI defaults covering the period 1 January 2003 through 31 July 2017).[1]

Technicals

- New institutional loan volume for the month was €11.2 billion, 2.1 times the volume of July 2016 volume. Of this gross new issuance volume, €4.8 billion (42%) was new deals coming to the market. Year-to-date institutional issuance reached €60.8 billion, 3.0 times more than in the first seven months of 2016.[2]
- Notable loan deals in syndication in the period included:
  - €1,750 billion facilities to support refinancing of Techem, the Macquire owned, German provider of energy billing and management services business. The euro tranche priced at Euribor+300% with a 0% floor, with an issue price of par.[2]
  - £820 million facilities to support refinancing of Sky Bet , the CVC owned, leading operator in the UK's online bettering and gaming market. The sterling facilities priced at Libor+4.25% with a 0% floor, with an issue price of par.[2] The Euro tranche priced at Euribor+350% with a 0% floor, with an issue price of par.[2]
- CLO generation accelerated with €2.3 billion of formation, materially above the €1.4 billion average in the first six months of the year due to a combination of price resets of existing deals as well as new non-refinancing deals priced as managers made the most of the abundant new deal volume. CLO liability spreads ground slightly tighter in the quarter but CLO's still require close to a blended margin of E+3.50–3.75% from the underlying senior loans in order to generate compelling equity returns. Year-to-date CLO formation reached €10.5 billion, €0.7 billion more than in the first seven months of 2016.

Valuations

- Primary:
  - The average lagging three month all-in-yield on primary deals was 4.05%. Lagging three-month senior leverage slightly increased from 4.4x at the end of June 2017 to 4.6x at the end of July 2017.[2]
- Secondary:
  - At month end, European loans were providing a spread-to-three year takeout of 3.92% (compared to 4.03% at the prior month's end and 5.60% at the same time last year). In comparison, the spread-to-worst for European high yield bonds was 3.55% (compared to 3.71% at the prior month's end and 5.46% at the same time last year).[1]

Figure 1

Total return (EUR, in %)	2015	1Q 16	2Q 16	3Q 16	4Q 16	2016	1Q 17	2Q17	May-17	Jun-17	Jul-17	2017 YTD
Credit Suisse Western Europe Leveraged Loan Index (EUR-HDG)	3.14	0.78	1.49	2.80	1.31	6.52	1.18	0.88	0.52	0.06	0.48	2.55
Credit Suisse Western Europe HY Index (EUR-HDG)	1.36	1.70	1.75	3.67	2.20	9.63	1.97	2.08	0.89	0.08	0.81	4.94

Source: Credit Suisse, as at 31 July 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 31 July 2017
2 Standard & Poor's, Loan Market Commentary and Data (LCD) as at 31 July 2017

Important information

All data provided by Invesco, as at 31 July, 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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