European Loan Market **Snapshot**

Monthly European loan market update: January 2017 (covering December 2016)

Returns

- The Credit Suisse Western European Leveraged Loan Index ("CS WELLI") returned 0.63% during the month of December, representing interest income of positive 0.39% and principal return of 0.25%. The full year 2016 return for the CS WELLI was positive 6.52%.[1]
- The main drivers of the December return were consistent with the themes seen throughout 2016 with Oil & Gas loans rebounding and riskiest assets outperforming in the index. For example, the Energy industry (4.34% of the CS WELLI) returned positive 5.97% in December (33.08% for the full year 2016). Similarly, CCC-rated assets (3.88% of the CS WELLI) returned positive 6.32% during December (37.57% for the full year 2016). For completeness, we note that most of the Oil & Gas borrowers have loans rated CCC or below, and therefore contributed to the outperformance at the riskier end of the spectrum. In contrast, BB-rated assets returned positive 0.35% in December (5.30% for full year 2016) and B-rated assets returned positive 0.38% during December (6.35% for full year 2016).[1]
- New issuance momentum seen in the last few months continued into December. There was a mix of new and existing borrowers making good use of the strong European credit market. New institutional loan volume for the month of December was €3.8 billion (compared to €1.0 billion for the same period last year), bringing the 2016 total European new-issue loan volume to €57.0 billion (compared to €39.6 billion for 2015). Digging into the full year numbers, positively net new supply of loans increased 11% in 2016 thanks to M&A and LBO activity. We also saw an increase in the number of repricings and recapitalisations, representing 46% of new institutional loan issuance in 2016 (up from 31% last year).[2]
- The strong new issuance continued to be met with high demand for new loan assets by investors. This meant that loans of new borrowers were easily absorbed by the market and existing borrowers were able to reprice their outstanding loans (reduction in margin) during December. We attribute the strong demand for loan assets to be due to (1) The general demand for risk assets as the default environment remains low, (2) The desire to reduce duration as investors focus more on the factors that may indicate a risk of the European Central Bank's (ECB) tapering later in 2017 or early 2018 (inflation), and (3) The halo effect from the ECB's monetary support through their Asset Purchase Program ("APP").

Fundamentals

- On 8 December 2016, the ECB's Governing Council ("GC") decided to leave rates unchanged at their historically low levels. Furthermore, the GC also decided to extend its Asset Purchase Program from March 2017 to December 2017 (9 month extension) while decreasing the monthly pace of purchases from €80 billion to €60 billion. While the extension clearly illustrates continued support for the European economy, which should bode well for economic growth, the reduction of the monthly purchase guidance may also reflect that the ECB is preparing the markets for tapering in 2017 and going into 2018.

Average loan price includes all loans January 1997 through December 2016.

- Consensus estimates for 4Q 2016 GDP in the Eurozone are 0.4% quarter-over-quarter ("QoQ"), representing a slight acceleration from 3Q 2016 GDP of 0.3% QoQ. The positive GDP expectation has been bolstered by steady consumer and government spending and growing exports, while imports and gross fixed investment growth has slowed slightly.
- Recent macro-economic data released for the Eurozone have been positive, including an upward revision to the composite Purchasing Manager Index ("PMI") from 53.9 to 54.4, indicating strong and improving confidence from European corporates (measures over 50 illustrate confidence). In particular, the German and French PMIs increased nicely month-over-month ("MoM"), while the periphery countries were more mixed – flat or slight decreases MoM, albeit still in positive territory (i.e. over 50).
- There were no new defaults in December 2016. Accordingly, the trailing 12 month default rate on the CS WELLI was 0.50% at the end of the month.[1]

Technicals[2]

- New institutional loan volume for the month of December was €3.8 billion (compared to €1.0 billion for the same period last year), bringing the 2016 total European new-issue loan volume to €57.0 billion (compared to €39.6 billion for 2015).
- Notable loan deals in syndication in the period included:
  - €730 million of new senior secured loan (SSL) facilities to support the Eslan's (formerly Vedici) acquisition of Medipole-Partenaires, along with a €530 million refinancing of Elsan's existing debt (€1.3 billion combined deal size). The acquisition will make Elsan the largest private hospital operator in France. The new tranche priced at E+3.75% (0% Euribor floor) and issued at par.
  - €2.1 billion cross-border SSL facilities (€/$) to support the refinancing of Obethur's existing debt and help fund the acquisition of Morpho. Obethur offers payment technology, including smart (credit/debit) cards, identity protection and authentication services globally. The tranche priced at E/L+3.75% (0% Euribor/Libor floor) and issued at 99.50.
  - €110 million SSL incremental facility for Verisure (Dream Secured), to refinance revolver drawings. The company also repriced their existing €1.4 billion of SSL facilities (€1.5 billion combined debt size). The new tranche priced at E+3.25% (0.50% Euribor floor) and issued at par.
- CLO formation in December totaled €1.3 billion, down from €2.0 billion in November 2016, and similar to the same period last year. Total 2016 CLO issuance reached €16.8 billion, €3.2 billion more than 2015, while the number of CLO transactions also increased (41 CLOs printed in 2016 versus 33 in 2015).[2] CLO demand from native and foreign investors remains robust, resulting in spread compression across the whole capital structure. Recent prints saw CLO AAA tranches price as low as Euribor + 91 basis points (bps) and BBs are edging towards the low 600bps mark (after having crossed 800 at some points during the year).
- Based on our understanding of currently open warehouses, we expect around €15-20 billion of CLO issuance in 2017, roughly in line with the 2016 level.

Valuations

- Primary:
  - The average lagging 3 month new issue institutional loan spread was EURIBOR +3.80%, 9bps lower than in November. All-in-yields on these new primary issuances decreased 14bps to 4.33% in December as the slightly lower spread was combined with a lower original issue discount ("OID"), as illustrated by the average issue price of 99.71. The tightening of the margin and the OID, however, was partially offset by an increase of the contribution of the base rate (Euribor) floor (61 bps contribution), as 94.7% of all new loans come with a floor (35.6bps average). In comparison, the lagging 3 month average yield on single-B rated primary tranches was 4.50%, unchanged from the prior month.[2]
  - Credit metrics remain healthy for new European primary deals. Average lagging 3 month leverage was unchanged in December, with first lien leverage of 4.5 times, secured leverage of 4.7 times and total leverage of 5.1 times. Interest coverage and fixed charge coverage ratios remain strong at 3.7 times and 2.6 times, respectively (average for 2016). Importantly, European new primary deals continue to come with large equity cushions (49% average for 2016).[2]
- Secondary:
  - At the end of 2016, the average secondary market price of loans in the CS WELLI was 97.58, with a spread of 4.01% and the Spread-to-three year takeout was 5.22%[1]
  - In comparison, the average secondary price of high yield bonds was 100.35, with an average coupon of 5.66% and a Spread-to-Worst of 4.56%.[3]

Figure 1
Total return (EUR, in %)

	Q4 15	2015	Q1 16	Q2 16	Q3 16	Sept-16	Oct-16	Nov-16	Dec-16	Q4 16	2016 Full Year
Credit Suisse Western Europe Leveraged Loan Index (EUR-HDG)	-0.25	3.14	0.78	1.49	2.80	0.74	0.50	0.18	0.63	1.31	6.52
Credit Suisse Western Europe HY Index (EUR-HDG)	0.99	1.36	1.70	1.75	3.67	-0.42	0.78	-0.40	1.82	2.20	9.63

Source: Credit Suisse, as at Dec. 30, 2016. 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 Dec. 30, 2016. All returns stated are total returns in EURO.
2 Standard & Poor's, Loan Market Commentary and Data (LCD) as at Dec. 31, 2016
3 Credit Suisse Western European High Yield Index — All Denominations (hedged to EUR) Dec. 30, 2016

Important Information

All data provided by Invesco as at Dec. 31, 2016, 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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