Invesco Senior Secured Loans

US Loan Market
Snapshot

Monthly US loan market update: October 2019 (covering September 2019)

The senior secured loan market gained 0.47% in September, bringing year-to-date returns to 6.79%.[1] Following a sleepy summer for new issuance, supply picked up in September as an array of new primary loan deals came to market. Despite the influx of supply, mild retail outflows, moderating CLO demand, and menacing geopolitical headlines (e.g. attack on Saudi oil production, Congressional impeachment inquiry, US Federal Reserve (Fed) intervention in repo markets), loan prices were approximately flat during the month, again demonstrating the resilience of the asset class. Beneath the calm, there was a clear bifurcation in the performance of higher and lower quality assets. Higher quality loans continued to outperform as budding cyclical concerns and idiosyncratic, issuer-specific pitfalls quelled the overall risk appetite among investors.

Loans outperformed during the month, besting longer duration assets which wilted in response to a modest reversal of declining interest rate expectations. High yield bonds gained 0.32%; however, investment grade returned -0.62%[2] and the 10 year Treasury lost 1.41% as yields rose 17 basis points to 1.67%. The percentage of loans trading above par rose to 34.1% as prices inched up in the higher quality end of the spectrum.[3] "BBs" (0.62%) and "Bs" (0.55%) definitively outpaced "CCCs" (-1.36%) during the month as investor buying maintained a higher quality bias.[4] The average price in the loan market was $96.63 at the end of September.[5] At the current average price, senior secured loans are providing a 6.37% yield inclusive of the forward LIBOR curve.[5]

Fundamentals

- Economic data remained mixed in September; decent consumption, labor market, and inflation data contrasted with weaker manufacturing sentiment and business investment, indicative of the uneven effect of ongoing trade tensions between the US and China.
- The trailing 12 month default rate held steady at 1.29%, as no new defaults occurred during the third quarter.[4]

Technicals

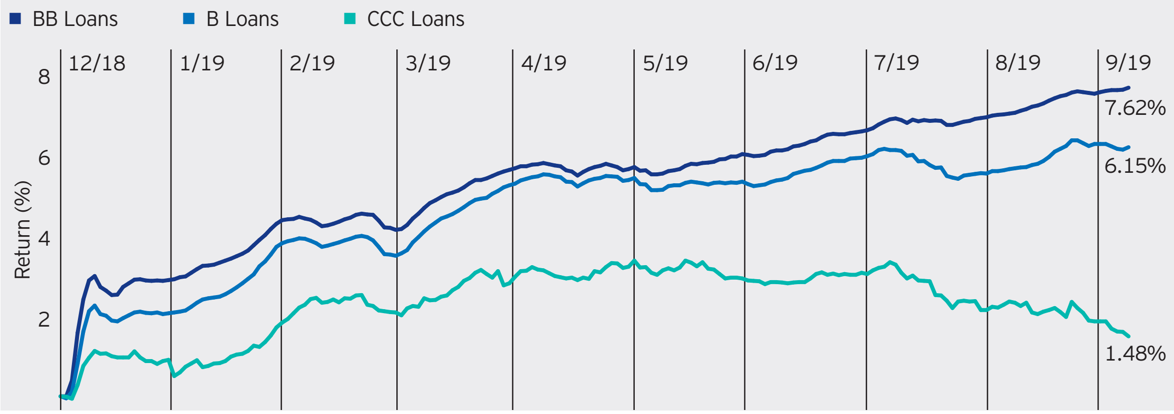
- Technicals loosened in September as new supply increased, while retail outflows moderated and the pace of new CLO creation remained below levels seen in the first half of the year.
- Against this more balanced technical backdrop, the aforementioned flight to quality also impacted new issue market dynamics. Higher quality deals generally flexed pricing tighter during the month, while lower quality deals met strong lender resistance to aggressive covenant proposals and were frequently forced to flex pricing wider. This served as further evidence of lenders' prudence towards higher risk transaction structures.
- Gross CLO volume was solid, although slower than earlier in 2019, at $11.2 billion in September, with $8.7 billion of issuance net of resets and refinancings.[3]
- Retail mutual funds and ETFs reported withdrawals of $0.7 billion in September, the twelfth consecutive month of redemptions, albeit at a far slower pace than prior months.[3]
- New issuance activity increased to $35.1 billion during the month, largely comprised of refinancing efforts. Excluding refinancing and repricing activity, net issuance was $14.4 billion.[3]

Relative value/market opportunity

Declining interest rate expectations have formed a headwind to loan demand throughout 2019 as mounting risks to the economic outlook forced a more dovish tone from the Fed. However, future rate expectations temporarily retraced higher following the Fed's meeting in September which included another 25 basis point cut and updated views on the path of rates. The guidance signaled an openness among policymakers to ease further, but also suggested a shallower path for rate cuts than investors had priced into the yield curve. As the LIBOR curve edged higher in response, the loan market recorded a weekly inflow from rate-sensitive retail accounts for the first time in months while ETFs attracted $813 million during the month.

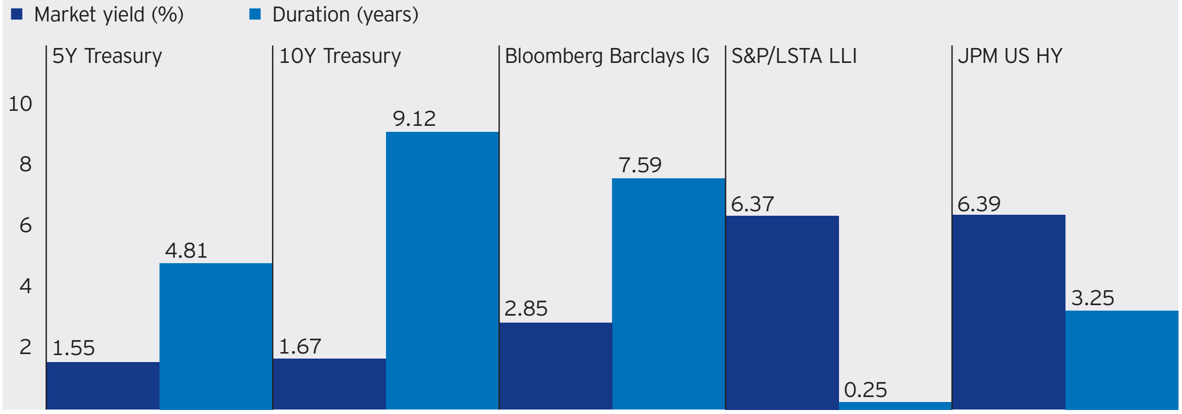
It is likely that the Fed will further reduce rates at its next meeting in October. But as this episode shows, rate expectations will continue to evolve with varying impact to loan demand, so rate considerations alone should not inform investors' view of the loan asset class. Far more critical to the long term performance of the asset class is loans' advantageous position within the capital structure which mitigates the risk of credit loss. Throughout the year, investors have expressed a preference for higher quality issuers within the loan market, benefitting managers which had positioned conservatively early in the year. For investors wary of signs that the economic cycle has slowed, this preference should extend to asset class selection as well, with loans providing structurally better downside protection than unsecured credit products and offering a similar yield profile.

Higher quality loans have significantly outperformed



Source: Credit Suisse Leveraged Loan Index as of Sept. 30, 2019. Past performance is not indicative of future returns.

Loans offered investors a high level of current income with short duration



Source: Bloomberg L.P., Barclays, JP Morgan, and S&P LCD as of Sept. 30, 2019. **Past performance is not a guarantee of future results.** An investment cannot be made directly in an index.

Relative yield

	$ Price	Yield to worst (%)	Spread to worst	At forward Libor	Duration (years)
5 Year Treasuries	99-25	1.55	–	–	4.81
10 Year Treasuries	99-20	1.67	–	–	9.12
Bloomberg Barclays US Agg. Index	106.24	2.26	T + 0.60	–	5.78
Bloomberg Barclays IG Index	108.96	2.85	T + 1.11	–	7.59
JPM US HY Bond Index	100.40	6.39	T + 4.75	–	3.25
S&P/LSTA Leveraged Loan Index	**96.63**	**L + 4.84**	**T + 4.81**	**6.37%**	**0.25**

Source: S&P LCD, Barclays, JP Morgan and Bloomberg L.P. as of Sept. 30, 2019. Loan "spread to worst" and "at forward Libor" incorporate LIBOR forward curve as of Sept. 30, 2019.

1 S&P/LSTA Leveraged Loan Index as of Sept. 30, 2019.
2 S&P/LSTA Leveraged Loan Index and Bloomberg as of Sept. 30, 2019. High yield represented by BAML US High Yield Index; investment grade represented by the BAML Investment Grade Index.
3 JP Morgan as of Sept. 30, 2019.
4 S&P LCD as of Sept. 30, 2019.
5 S&P LCD and Invesco as of Sept. 30, 2019.

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