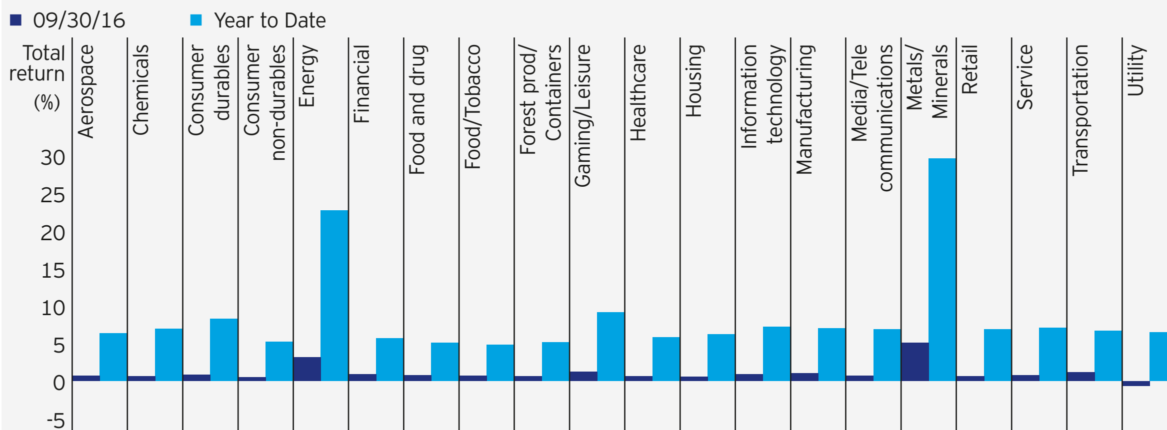
Invesco Senior Secured Loans

US Loan Market
Snapshot

Monthly US loan market update: October 2016

The loan market returned 0.86% in September – the third consecutive month with returns in excess of the coupon as stable fundamentals and strong technicals continued to push prices towards par and above par. The year-to-date return of 7.72% is the highest return for the first nine months of the year since 2012.[1] Global markets continued to experience relatively low volatility, but recent statements from the US Federal Reserve (Fed) indicate that the case for future rate hikes in the near term has improved. The potential for increasing rates weighed on longer duration fixed income and equities as loans outperformed the S&P 500 (0.02%), the High Grade Bond Index (-0.29%), 10 year Treasuries (-0.22%), and high yield bonds (0.65%).[2] As in the previous two months of the quarter, the "risk-on" tone persisted leading to outperformance in the commodity related sectors and the riskier end of the ratings spectrum. Higher quality "BB" (0.61%) and "B " (0.97%) ratings categories underperformed the "CCC's" (1.98%) and "D' s" (1.97%). [1] The "risk-on" sentiment and commodity price rally has disproportionally benefited the high yield bond asset class (15.32% year-to-date return[2]) due to its greater underlying commodity exposure but this has caused the spread differential between the two asset classes to tighten well inside of the historical average.[3]

Commodity related sectors continued to outperform in September and for the year-to-date period



Source: Credit Suisse Leveraged Loan Index as of Sept. 30, 2016. Past performance is not a guarantee of future results.

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

Technical factors continued to favor issuers as demand firmed across the different constituents in the loan asset class. Institutional demand remained robust, the pace of CLO issuance increased from last month, and inflows from retail mutual funds and ETF's continued to gain traction. Net new issue supply remained light as the majority of new issue activity was dedicated to re-pricing existing deals or refinancing to extend maturities. We remain encouraged that despite the accommodating capital market conditions and limited new supply, the loan market continues to behave with prudence – pushing for improved economics on deals perceived to underprice risk.

The average price in the loan market was $95.42 at the end of September – with 52.3% of the market trading at or above par and a small percentage of stressed and distressed outliers weighing on the broader average.[1] At the current average price, senior secured loans are providing a 5.95% yield. [1]

Fundamentals

- Estimated US GDP growth for the second quarter was revised up to 1.4% from last month's estimate of 1.1% and Q2' s growth accelerated from the 0.8% experienced in the first quarter of this year.
- There were no new defaults in September – lowering the trailing 12 month default rate to 1.95%. [1] With only three months left in the year and the strong rebound in commodity prices, the loan market could end the year modestly below the historical average of 3.1%. [1]

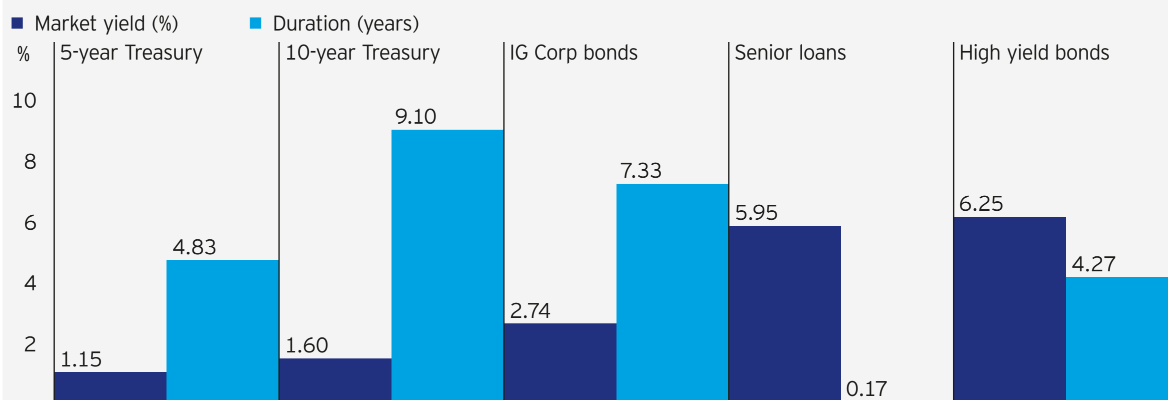
Technicals

- New issuance volume of $57.3 billion in September was the second highest monthly total this year; but net new issuance was only $20.5 billion with the remainder dedicated to re-pricing and refinancing transactions. The pace of net new issuance accelerated versus last month and the pipeline for new deals coming to the market has grown as well. Total year-to-date volume (excluding repricings and refinancings) totals $117.9 billion versus $137.9 billion for the same period last year.[3]
- Retail mutual funds and ETF's had an inflow of $1.4 billion in September – the third consecutive monthly inflow. Inflows have been positive for nine consecutive weeks totaling $2.1 billion during that span. September's inflow was the largest since March of 2014. Year-to-date outflows total -$4.2 billion versus -$12.1 billion for the same period last year.[3]
- CLO volume swelled to $12.7 billion in September, the highest total this year. Year-to-date CLO issuance has totaled $54.2 billion versus $89.8 billion during the first nine months of last year.[3]

Relative value/market opportunity

Loans continue to be well positioned, providing investors with a relatively high level of current income with insulation from rising rates due to its floating rate structure. The increasing likelihood of a rate hike, along with looming money-market fund reforms has resulted in a gradual increase in USD LIBOR. At its current level of 85 bps, it has surpassed the LIBOR floor set on 33.28% of loans converting those loans back into truly floating rate instruments. The average floor in the market remains at 98 bps.[1] Loans also look more attractive from a relative value perspective than they were earlier this year with the yield differential between loans and high yield bonds compressing. Loans are now offering a similar yield to high yield bonds despite their senior, secured status, with limited exposure to rising rates.

Loans continued to offer investors a high level of current income with short duration



Source: Bloomberg L.P., BAML, S&P LCD as of Sept. 30, 2016. Investment grade corporate bonds represented by a subset of Barclays U.S. Aggregate Index; the senior secured loan asset class is represented by S&P/LSTA Leveraged Loan Index; and high yield bonds represented by BAML High Yield Master Index. Past performance cannot guarantee comparable future results. An investment cannot be made directly in an index. Diversification does not guarantee a profit or eliminate the risk of loss.

	$ Price	Yield (%)	Spread to worst	At forward Libor	Duration (years)
5-Year Treasury	99-28	1.15%			4.83
10-Year Treasury	99-04	1.60%			9.10
Barclays US Agg Index	106.72	1.96%	T + 0.72		5.51
Barclays IG Index	108.46	2.74%	T + 1.33		7.33
ML US HY Index	99.23	6.25%	T + 5.10		4.27
S&P/LSTA Leveraged Loan Index	**95.42**	**L + 5.14%**	**T + 5.07**	**5.95%**	**45-60 Days**

Source: Bloomberg L.P., BAML and S&P LCD as of Sept. 30, 2016. Loan yields incorporate LIBOR forward curve as of Sept. 30, 2016. Loan "spread to worst" and "At Forward LIBOR" incorporate LIBOR forward curve as of Sept. 30, 2016.

1 S&P LCD (Leveraged Commentary and Data) as of Sept. 30, 2016; Total returns, yields, average price and average floor stated are for the S&P LSTA Leveraged Loan Index. Historical average default rate is for period January 1998 to September 2016.
2 HY Bonds: BAML HY Master Index, High Grade Bonds: BAML High Grade Corp; data as of Sept. 30, 2016. Returns stated are total returns.
3 J.P. Morgan as of Sept. 30, 2016. Difference in yield to 3 year takeout between high yield bonds and leveraged loans is 56 basis points as of Sept. 30, 2016 versus 8 year average of 100 basis points.

Important Information

All data provided by Invesco unless otherwise noted. All data is US dollar and as of Sept. 30, 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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