Invesco

Invesco Senior Secured Loans

# European Loan Market Snapshot

## Monthly European loan market update: May 2017 (covering April 2017)

### Returns

- The Credit Suisse Western European Leveraged Loan Index ("CS WELLI") returned 0.29% during April, of which interest income of 0.33% was slightly offset by principal depreciation of 0.04%.[1]
- Despite numerous potentially negative events throughout the month, such as the elections in France, tensions over North Korea and volatile oil and commodity prices, fixed income markets continued to tighten in general, helped by continuing positive macroeconomic data and technical conditions. The loan market remained disciplined, with demand from CLOs and institutional funds abundant. Importantly, there were examples of primary deals with initial pricing seen as too aggressive by investors, requiring increased margins in order for them to be syndicated. Upfront discounts on primary issuances continue to be offered to entice investors. These pricing-to-clear dynamics reflect a maturing loan market with an investor base of various risk appetites: we are witnessing price discovery rather than aggressive deals simply being pulled.
- Consumer Non-durables was the highest returning sector for April, with a total return of 1.13%, continuing the positive momentum observed last month. Aerospace related loans were the month's industry laggard with a total-return of negative 0.25% – the sole negative-returning sector in April. Returns by credit rating were broadly comparable across the board: +0.30% for BB, +0.28% for B and +0.24% for CCC's rated loans.[1]
- The average price of loans in the European market ended April at €98.48, with a spread-to-three years of 4.23%.[1,2]

### Fundamentals

- April's Euro area composite Purchasing Managers' Index reading of 56.8 is a new cyclical high – an increase of 0.4 points from March – and the highest level since April 2011. The increase was broad based with positive momentum seen across output, orders and employment measures. Manufacturing sentiment stabilized in Germany while improvement was seen in Italy, France and Spain, where the employment index showed the best improvement.
- Preliminary Euro area flash 1Q17 GDP grew by 0.5% quarter-over-quarter, an unchanged pace from 4Q16. The UK economy began to show signs of post-'Brexit' slowing with flash 1Q17 GDP growth at 0.3% down from 0.7% in 4Q16. Barclays, commented that "after seven years of stagnation … [there are] signs of a significant rebound in European [Q1] earnings."

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

- Eurozone core CPI inflation came in at 1.2% for April a large uptick from the 0.7% seen in March, albeit compounded by volatility in travel prices around Easter.
- As expected, April's European Central Bank's Governing Council ("GC") announced no changes to monetary policy or to forward guidance. President Draghi commented that macroeconomic conditions are improving and inflation is only gradually trending to the GC target rate (2%) which ensures continued QE. The GC did note that risks to growth projections were "moving towards a more balanced configuration".
- The European loan default rate remained relatively flat from March to April. Accordingly, the trailing 12 month default rate on the CS WELLI was 2.30% at the end of the month.[1]

## Technicals

- New institutional loan volume for the month was €5.7 billion a 36% increase relative to the same month last year. €2.7 billion was related to re-financings and re-pricings and the balance, net new institutional supply. Year-to-date volume stands at €36.2 billion or 1.4 times greater than the same period last year.[3]
- Notable loan deals in syndication in the period included:
  - €850 million facility for Misys to finance the acquisition of D+H. Misys is a UK headquartered developer of financial software products. The euro tranche priced at Euribor+325 with a 1% floor. Issue price was 99.50% of par.[3]
  - €265 million refinancing for Duran, the German based manufacture of borosilicate glass. The euro tranche priced at Euribor+400 with a 0% floor. Issue price was 99.75% of par.[3]
- Four CLOs priced during the month totaling €1.6 billion in value. Year-to-date, eleven CLOs have priced with a total value of €4.4 billion, equal to the same period last year.[3] CLO liability-spread tightening was seen in single-A, BBB and single-B CLO tranches. Tightening in loan spreads continues to put pressure on CLO arbitrage. We continue to expect CLO formation to abate in 2017 to €12.5–€17.5 billion, with CLO's becoming less of a factor in shaping aggregate loan demand.

## Valuations

- Primary:
  - The average lagging three month all-in-yield on primary deals was 3.97% (compared to 4.03% last month). The month-over-month change in yield was due to a reduction in margin (declined by 3bps). Lagging three-month senior and total-leverage declined by circa 0.2x to 4.5x and 4.8x respectively. Positively, this brings average total-leverage under 5.0x.[3]
- Secondary:
  - At month end, European loans were providing a spread-to-three year takeout of 4.23% (compared to 4.57% at the prior month's end and 5.67% at the same time last year). In comparison, the spread-to-worst for European high yield bonds was 4.07% (compared to 4.34% at the prior month's end and 5.45% at the same time last year).[1]

**Figure 1**

| Total return (EUR, in %) | 2015 | 1Q 16 | 2Q 16 | 3Q 16 | 4Q 16 | 2016 | Feb-17 | Mar-17 | Apr-17 | 2017 cumulative |
|---|---|---|---|---|---|---|---|---|---|---|
| Credit Suisse Western Europe Leveraged Loan Index (EUR-HDG) | 3.14 | 0.78 | 1.49 | 2.80 | 1.31 | 6.52 | 0.46 | -0.29 | 0.29 | 1.48 |
| Credit Suisse Western Europe HY Index (EUR-HDG) | 1.36 | 1.70 | 1.75 | 3.67 | 2.20 | 9.63 | 1.21 | 0.06 | 1.09 | 3.08 |

Source: Credit Suisse, as at 30 April 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 April 2017
2 Average loan price includes all loans January 1998 through April 2017.
3 Standard & Poor's, Loan Market Commentary and Data (LCD) as at 30 April 2017

## Important information

All data provided by Invesco, as at 30 April, 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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