US Loan Market Snapshot

Monthly US loan market update: January 2017

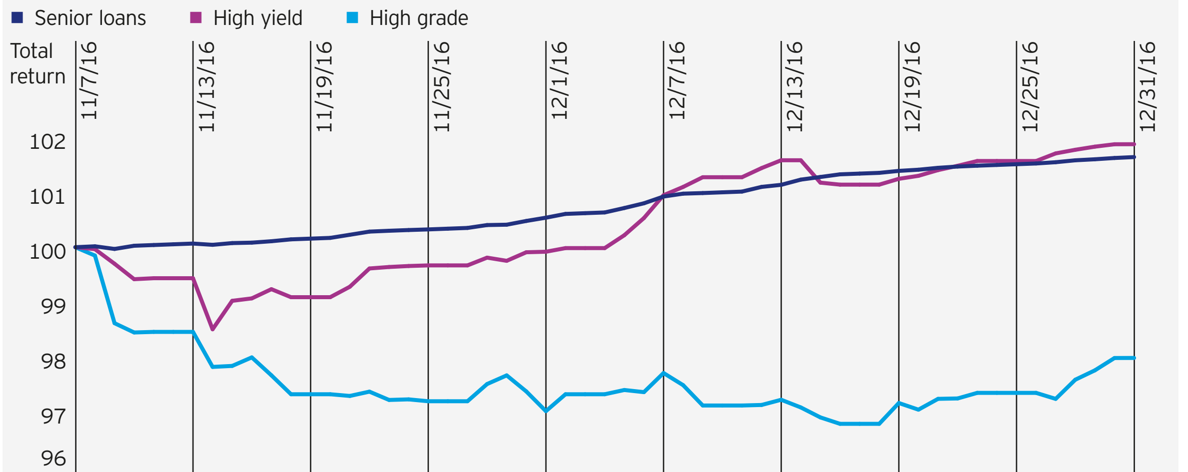
The US loan market finished the year on a positive note, returning 1.16% in the month of December and bringing 2016's return to 10.16%.[2] Favorable credit fundamentals and surging demand for the asset class drove steady loan price appreciation throughout much of the year, including December. As evidenced by December's retail fund inflows at levels not recorded since 2013, the technical bid for loans strengthened in the waning months of 2016 as the outlook for interest rates steepened – a development for which loans are well positioned relative to longer duration assets due to the floating rate nature of their coupon payments.

As expected, the Federal Reserve lifted interest rates in December by 25 basis points for the second time since the 2008 financial crisis amid increasingly supportive economic conditions. More notably, policymakers guided to a steeper path of rate increases in 2017 than had been previously anticipated, a reflection of their expectation for inflationary pressures to accelerate. This caused yields to continue rising, as the 10 year Treasury yield increased by 6 bps to 2.44% in December, briefly reaching as high as 2.60% - a level not seen since September 2014. In this environment of increasing rates, loans continued to broadly outperform longer duration fixed income with the 10 year Treasury returning -0.37%, the High Grade Bond Index returning 0.62%, and the High Yield Bond Index returning 1.97%.[1] Returns in the high yield bond market exceeded that of loans in the month as high yield disproportionately benefitted from the ongoing recovery in energy prices and the improved risk appetite permeating capital markets.

As was the case for much of the year, higher quality "BB" (0.82%) and "B" (1.09%) ratings categories performed well in December, but lagged the "CCC's" (4.32%) and "D's" (3.14%).[2] The average price in the loan market was $98.49 at the end of December with 68% of the market trading at or above par and a small percentage of stressed and distressed outliers weighing on the broader average.[2] At the current average price, senior secured loans are providing a 5.91% yield.[2]

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

Loans have exhibited muted volatility compared to other credit products since interest rates have come into sharper focus post-election



Source: S&P LCD, BAML as of Dec. 31, 2016. Senior Loans represented by the S&P/LSTA Leveraged Loan Index, US High Yield Bonds by BAML HY Master Index, High Grade Bonds by BAML High Grade Corp. Returns represented are total returns in USD and are indexed to 100 since the US Presidential election. Past performance cannot guarantee comparable future results. An investment cannot be made directly in an index.

Fundamentals

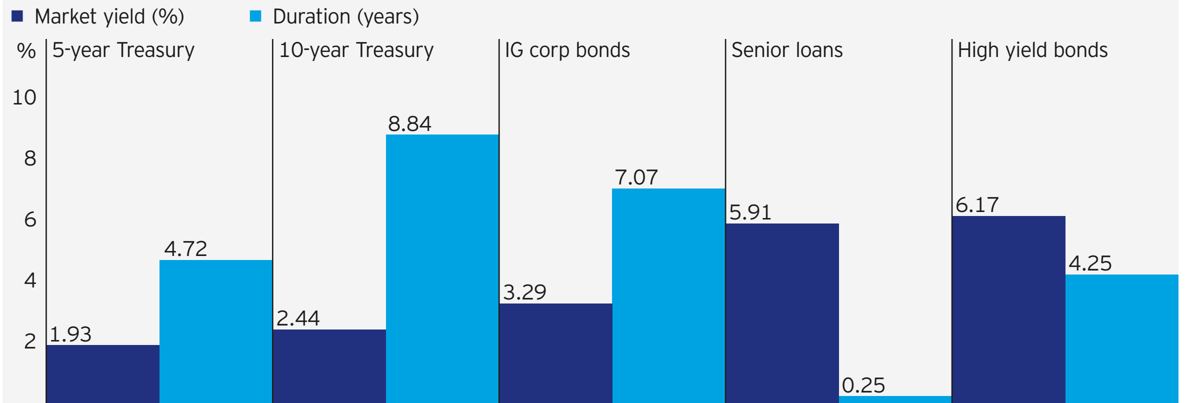
- US GDP growth for the third quarter was upwardly revised again to 3.5% from the initial 2.9% estimate due primarily to stronger readings of consumption and business investment.
- The unemployment rate in the US continued falling to 4.6% in December as firms hired workers at a steady pace.
- There was one new default in December, TwentyEighty, as the trailing 12 month default rate fell to a ten-month low of 1.58%, below the historical average of 3.1%.[2]

Technicals

- Technical conditions remained supportive in December, providing a strong bid for loan assets and contributing to the muted overall volatility for the asset class.
- CLO issuance of $17.2 billion followed robust months of issuance in September, October, and November. 2016 finished with $111.7 billion of CLO volume versus $109.6 billion in 2015.[3]
- Retail mutual funds and ETF's recorded the strongest inflows of the year with $5.7 billion in December, a sixth consecutive month of inflows. Notably, the first three weeks of the month recorded inflows of $1.8 billion, $1.5 billion, and $1.5 billion, the largest weekly totals since 2013. 2016 retail flows were $6.9 billion, a large reversal from the outflows of 2014 and 2015.[3]
- New issuance volume of $69.7 billion in December was considerable, although 78% of that total was refinancing and repricing activity which extended the recent trend of spread compression. Total new issue volume for the year was $485 billion and $169 billion net of refinancings and re-pricings versus $326 billion gross and $190 billion net in 2015.

Relative value/market opportunity

The Federal Reserve's latest guidance implies three policy rate hikes in each of the next three years, indicating that the recent ascent of the yield curve is likely to continue in 2017. Facing this prospect, borrowers in the senior secured loan market are broadly in healthy position with respect to interest expense levels. Balance sheets have been well managed to absorb an increase in debt service costs, particularly following refinancing and repricing activity in the back half of 2016 that has extended maturities and lowered coupon payments. Given the backdrop for rates, we believe loans remain an opportune allocation to help mitigate interest rate volatility that traditionally impacts longer duration assets which has played out since November. LIBOR is currently 99 bps - at the 100 bps threshold, 94.8% of loans will meet or exceed their LIBOR floor, thus converting back into truly floating rate instruments.[3]



Source: Bloomberg L.P., BAML, S&P LCD as of Dec. 31, 2016. Investment grade corporate bonds represented by a subset of the BBG BARC 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	100-10	1.93			4.72
10-year Treasury	96-03	2.44			8.84
Bloomberg Barclays US Agg Index	102.70	2.61	T + 0.62		5.89
Bloomberg Barclays IG Index	104.11	3.29	T + 1.22		7.07
ML US HY Index	99.60	6.17	T + 4.39		4.25
S&P/LSTA Leveraged Loan Index	**98.49**	**L+4.65**	**T+ 4.46**	**5.91%**	**90 Days**

Source: Bloomberg L.P., BAML and S&P LCD as of Dec. 31, 2016. Loan yields incorporate LIBOR forward curve as of Dec. 31, 2016. Loan "spread to worst" and "At Forward LIBOR" incorporate LIBOR forward curve as of Dec. 31, 2016.

1 HY Bonds: BAML HY Master Index, High Grade Bonds: BAML High Grade Corp; data as of Dec. 31, 2016. Returns stated are total returns.
2 S&P LCD (Leveraged Commentary and Data) as of Dec. 31, 2016; Total returns and other data stated are for the S&P LSTA Leveraged Loan Index. Historic average default rate is for period January 1998 to December 2016.
3 J.P. Morgan as of Dec 31, 2016.

Important information

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