US Loan Market Snapshot

Monthly US loan market update: March 2017

Loans delivered positive returns for a 12th consecutive month, returning 0.50% in the month of February and 1.06% year to date.[1] Similar to recent months, robust demand for loans continued to outpace comparatively light new primary loan supply. Because of this favorable technical backdrop and stable borrower fundamentals, loans remained well bid even as issuers utilized the strong market environment to re-price and refinance existing loans. The ongoing re-pricing wave again characterized the loan market in February, with another $92.4 billion of re-pricing and refinancing activity completed during the month.[2] Despite the resulting spread compression, loans continue to provide solid volatility adjusted returns for investors.

Loans and other risk assets gained during the month on generally firm earnings reporting and more encouraging economic data which emboldened the narrative that growth, and thus interest rates, are likely to trend higher as the year unfolds. Yet, after months of increasing, the 10 year Treasury yield actually dipped 6 bps to 2.39% in February, alleviating recent pressure on long duration assets. The 10 year Treasury returned 0.86% and the High Grade Bond Index returned 1.13%, while high yield bonds continued to outperform loans, with the High Yield Bond Index returning 1.56%. Like loans, the high yield market has benefitted from a positive earnings season, economic optimism, and strong demand amid limited new supply, however its returns have been less impacted by re-pricing activity than loans due to the more restrictive call protection features typical of bonds.[3]

The lower yielding, higher quality "BB" (0.39%) and "B" (0.44%) ratings categories continued to underperform the "CCC's" (2.09%[1]), although retail-related issuers did weigh on returns in the lower end of the ratings spectrum. The average price in the loan market was $98.55 at the end of February with 72% of the market trading at or above par.[1] At the current average price, senior secured loans are providing a 6.07% yield.[1]

Fundamentals

- US GDP growth for the fourth quarter was affirmed at 1.9%.
- The core CPI inflation rate increased to 2.3% while payroll growth remained robust, adding to the case that economic fundamentals are supportive of another policy rate hike in the near future.
- There were no new defaults in February, causing the trailing 12 month default rate to decline to a 13 month low of 1.41%.[1]

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

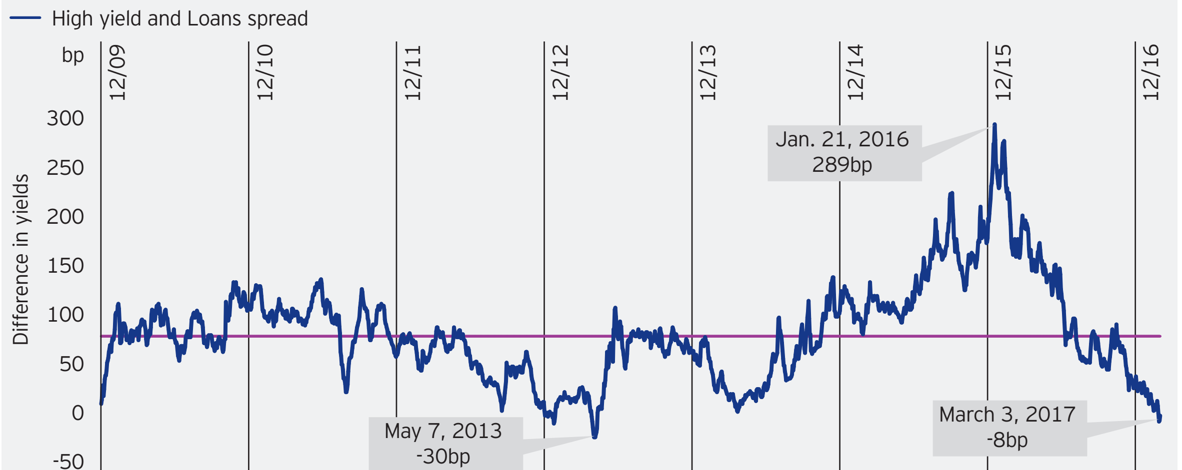
Technicals

- Technical conditions remained favorable for loans in February as demand comprised of inflows and repayments continued to outstrip supply.
- New CLO formation accelerated from January's lackluster pace, with $25.5 billion of gross volume and $8.7 billion of issuance net of refinancings.[2] Managers sought to lock in increasingly attractive funding costs amid strong demand for CLO liabilities.
- Retail mutual funds and ETF's continued to record robust inflows for an 8th consecutive month, collecting $3 billion in February, with weekly inflows averaging over $900 million. Year-to-date inflows are $7.5 billion.[2]
- New issuance volume was $102.5 billion in February, although 90% of that total was refinancing and re-pricing activity which extended the recent trend of spread compression.

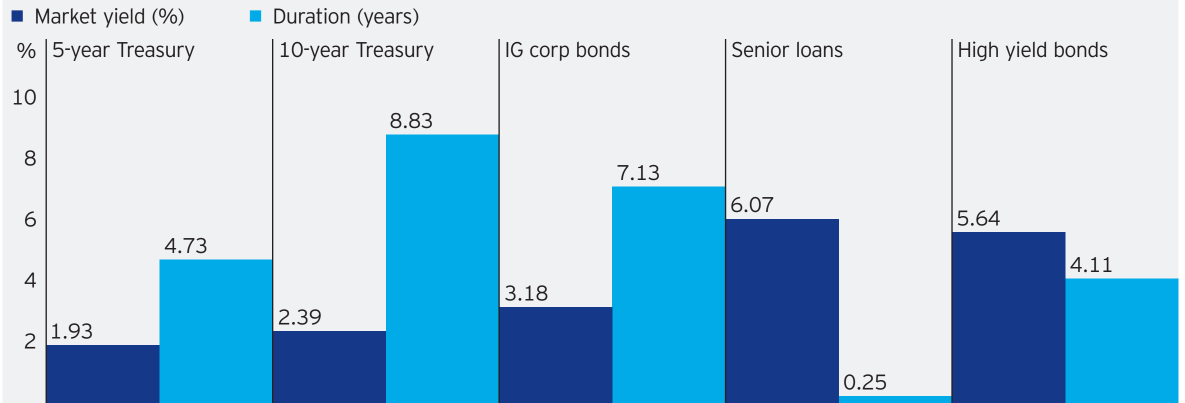
Relative value/market opportunity

While months of heightened re-pricing activity has lowered spreads on roughly 21% of the leveraged loan universe in the past six months[2], loan yields remain attractive relative to other credit products. Following the rally in high yield bonds in recent months, loans are currently offering an equivalent yield to high yield bonds, making loans historically attractive on a relative value basis. Unlike bonds, loan investors benefit from a senior secured claim over borrowers' assets and coupon payments that adjust higher along with market rates. This combination both mitigates loans' downside risk in the event of a default while positioning loans well for the expected rise in interest rates this year from a total return perspective. With LIBOR now above the 100 bps threshold, the vast majority of loans exceed their LIBOR floor.[1]

Senior secured loans currently offering similar yields as unsecured bonds



Source: J.P. Morgan, as of Feb. 28, 2017. High yield represented by the J.P. Morgan US HY Bond Index; Loans represented by the J.P. Morgan Leveraged Loan Index.



Source: Bloomberg L.P., BAML, S&P LCD as of Feb. 28, 2017. 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	99-23	1.93			4.73
10-year Treasury	98-24	2.39			8.83
Bloomberg Barclays US Agg Index	103.03	2.57	T + 0.62		5.95
Bloomberg Barclays IG Index	104.84	3.18	T + 1.15		7.13
ML US HY Index	101.60	5.64	T + 3.94		4.11
S&P/LSTA Leveraged Loan Index	**98.55**	**L+4.41**	**T+ 4.55**	**6.07%**	**90 Days**

Source: Bloomberg L.P., BAML and S&P LCD as of Feb. 28, 2017. Loan yields incorporate LIBOR forward curve as of Feb. 28, 2017. Loan "spread to worst" and "At Forward LIBOR" incorporate LIBOR forward curve as of Feb. 28, 2017.

1 S&P LCD (Leveraged Commentary and Data) as of Feb. 28, 2017; Total returns and other data stated are for the S&P LSTA Leveraged Loan Index.
2 J.P. Morgan as of Feb. 28, 2017.
3 HY Bonds: BAML HY Master Index, High Grade Bonds: BAML High Grade Corp; data as of Feb. 28, 2017. Returns stated are total returns.

Important information

All data provided by Invesco unless otherwise noted. All data is US dollar and as of Feb. 28, 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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