US Loan Market Snapshot

Monthly Loan Market Update: April 2017

Despite market volatility over the past two weeks, senior secured loans ended the month relatively flat, returning 0.08% in March and 1.15% year to date.[1] The softer tone for loans versus recent months was contagion from a pullback in high yield where oil price volatility and significant high yield outflows drove declines. The weakness in longer duration credit also coincided with rate concerns heading into a mid-month US Federal Reserve (Fed) meeting and the subsequent failure of healthcare legislation, generating speculation over the Trump administration's ability to deliver on other agenda items such as tax reform. Despite a more cautious sentiment taking hold, the wave of loan repricings and refinancings continued to come to market, and another $89.2 billion of activity was completed during the month.

The modest retreat in loan prices brought the percentage of loans trading above par down to 66.6% from 72% at the end of last month. Declines in high yield served as the catalyst, as oil price volatility and concerns about increasing interest rates in the first weeks of March contributed to the largest high yield outflows since December 2015. Positive for loans, the Fed increased interest rates by 25 basis points at its meeting in mid-March as expected, and it did not alter its forward guidance of two additional hikes this year.

In a month characterized by a re-appearance of volatility, loans outperformed its peer asset classes. The 10 year Treasury returned –0.12%, the High Grade Bond Index returned –0.12%, and the High Yield Bond Index returned –0.21%. The 10 year Treasury yield held flat at 2.39%, despite rising to 2.62% intra-month.[2] Unlike in past months, loans' lower yielding, higher quality "BB" (0.12%) and "B" (0.16%) ratings categories outperformed the "CCC's" (–0.43%)[1], as lower quality commodity related issuers experienced relatively more pressure. The average price in the loan market was $98.30 at the end of March.[1] At the current average price, senior secured loans are providing a 6.10% yield.[1]

Fundamentals

- The Q4 (GDP) report showed a second consecutive quarter of corporate profit growth, following six quarters of declines. Other measures of economy-wide corporate earnings health, including the reporting of S&P 500 companies' EPS (+6.3% year over year) and the EBITDA of high yield issuers (+4.7% year over year), underscored the improvement in corporate fundamentals.[3]
- Numerous economic indicators including durable goods orders, inflation, jobless claims, and business sentiment indices continue to show improving economic conditions that were supportive of another policy rate hike during the month.
- There were two new defaults in March, Ocean Rig and Answers Corp. This caused the trailing 12 month default rate to edge higher from 1.41% to 1.49%.[1] However, despite these defaults, market participants are optimistic of low defaults throughout the year. J.P. Morgan, in its April 4th report, reduced its 2017 loan default forecast from 2% to 1.5% amid the increasingly benign credit environment that we are seeing in the market today.

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

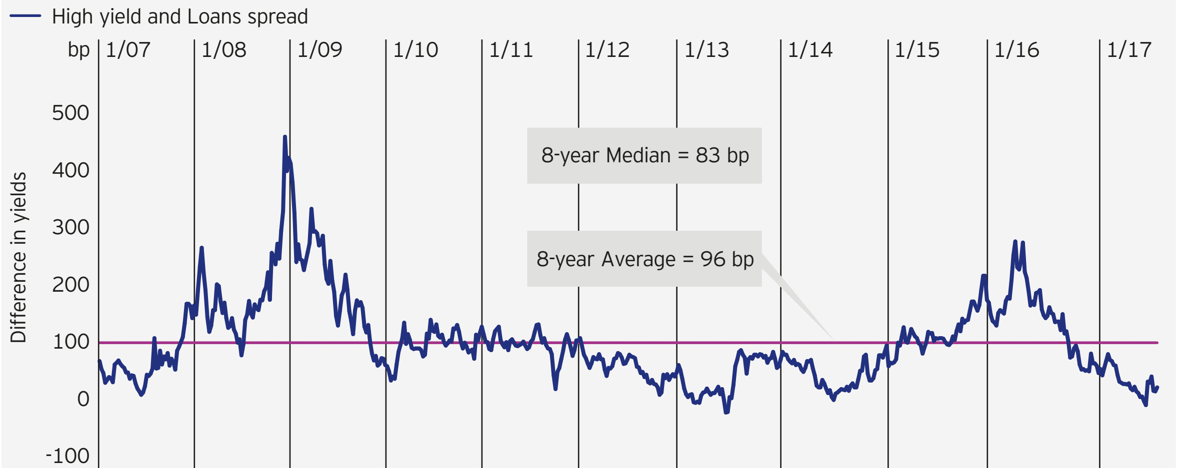
Technicals

- Technical conditions continue to pressure loan spreads given the continuing demand for assets amid comparatively light supply.
- New CLO formation matched February's pace, with $28.7 billion of gross volume and $7.9 billion of issuance net of refinancings.[3] Year-to-date CLO issuance is $64.3 billion (gross) and $17.3 billion (net).
- Retail mutual funds and ETF's continued to attract inflows, collecting $3.4 billion in March.[3] Year-to-date inflows are $12.7 billion.
- New issuance volume was again robust at $111.2 billion in March, although 80% of that total was refinancing and re-pricing activity. In terms of gross issuance, the first three months of 2017 have been among the four most active months on record, with 81% of that issuance earmarked for debt refinancing.

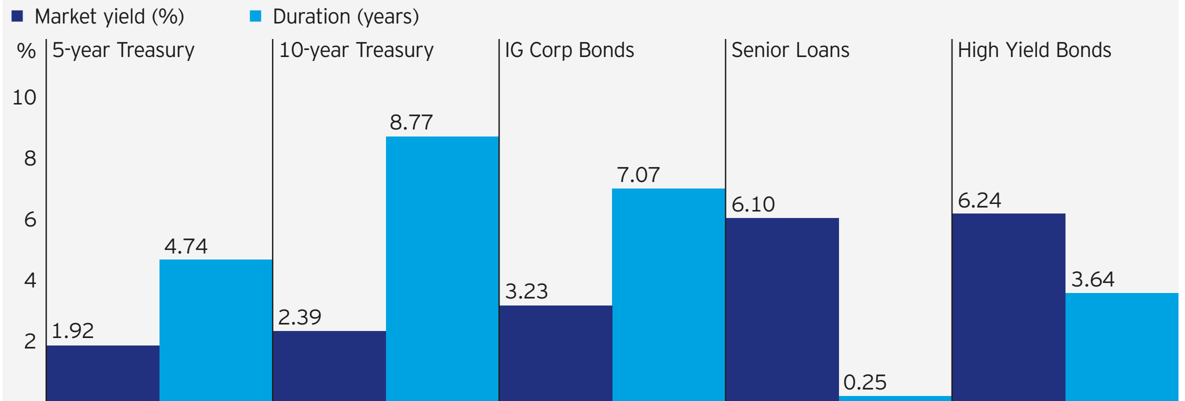
Relative value/market opportunity

March was the latest demonstration of how loans provide investors with both solid coupon income and a muted volatility profile due to their defensive positioning within the capital structure. As other investable credit products were whipsawed by commodities as well as shifting expectations around interest rates and the prospect for fiscal expansion, loans experienced only modest price declines, which were more than offset by current income. Although high yield bonds pulled back during the month, the yield differential between loans and unsecured bonds remains historically narrow, making loans attractive on a relative value basis. While the latest Fed meeting was interpreted as dovish by the broader market, interest rates are expected to continue rising through 2017, a direct benefit to loan investors as the vast majority of loans already exceed their LIBOR floors.[1]

Senior secured loans currently offering similar yields as unsecured bonds



Source: J.P. Morgan, as of March 31, 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., J.P. Morgan, S&P LCD as of March 31, 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 JPM US HY 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 to worst (%)	Spread to worst	At forward Libor	Duration (years)
5-year Treasury	99-25	1.92			4.74
10-year Treasury	98-25	2.39			8.77
Bloomberg Barclays US Agg Index	102.65	2.61	T + 0.60		6.00
Bloomberg Barclays IG Index	104.16	3.23	T + 1.15		7.07
JPM US HY Index	101.86	6.24	T + 4.56		3.64
S&P/LSTA Leveraged Loan Index	**98.30**	**L+4.38**	**T+ 4.61**	**6.10%**	**90 Days**

Source: Source: Bloomberg L.P., J.P. Morgan and S&P LCD as of March 31, 2017. Loan yields incorporate LIBOR forward curve as of March 31, 2017. Loan "spread to worst" and "At Forward LIBOR" incorporate LIBOR forward curve as of March 31, 2017. Past performance is no guarantee of future results.

1 S&P LCD (Leveraged Commentary and Data) as of March 31, 2017; Total returns and other data stated are for the S&P LSTA Leveraged Loan Index.
2 HY Bonds: BAML HY Master Index, High Grade Bonds: BAML High Grade Corp; data as of March 31, 2017. Returns stated are total returns.
3 J.P. Morgan as of March 31, 2017.

Important information

All data provided by Invesco unless otherwise noted. All data is US dollar and as of March 31, 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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