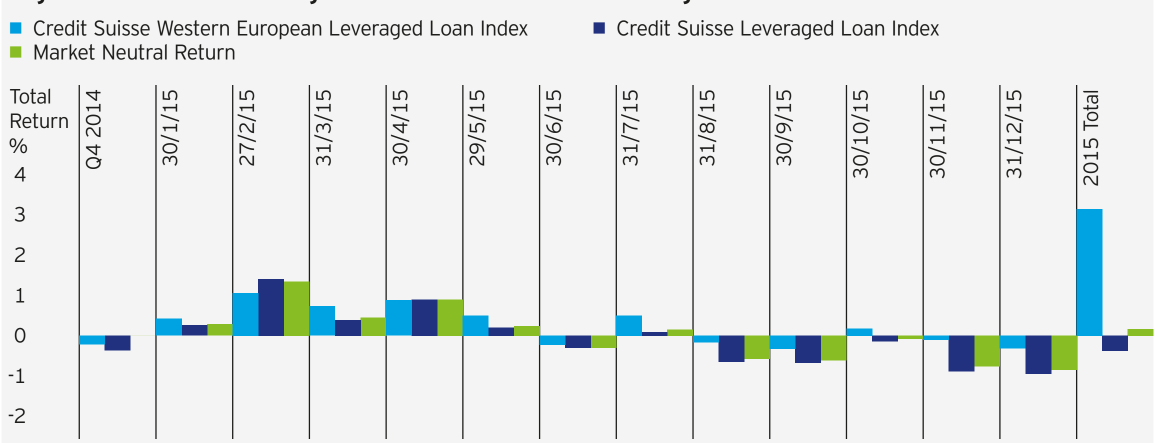
Global senior secured loan market outlook – 2015 recap and 2016 outlook

The Credit Suisse Leveraged Loan Index and Credit Suisse Western European Leveraged Loan Index returned -0.38% and +3.14% respectively in 2015. Both markets started the year strongly, driven by common themes of improving fundamentals, a stabilization in commodity prices, and strong technical support. Beyond the first half of the year – as headlines surrounding Greece, China, and falling commodity prices reintroduced volatility into the broader capital markets – global loan investors were rewarded by the diversification benefits of investing across the US and European markets with the Western Europe Loan index outperforming the US index by nearly 300 bps. As shown in the chart below, even with the dispersion in returns between the US and European loan markets, loans overall experienced relatively low volatility.

A global allocation to leveraged loans benefited investors during 2015



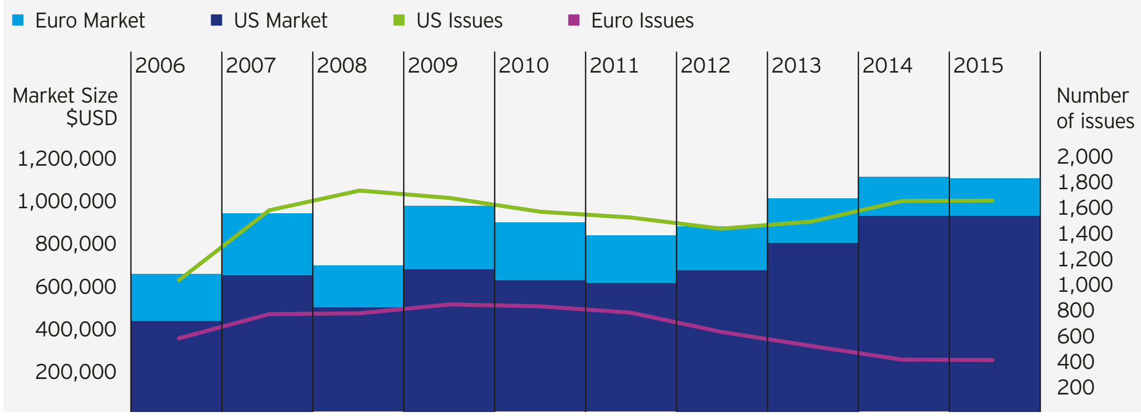
Source: Credit Suisse, as of Dec. 31, 2015. Market neutral return is the weighted average return of the Credit Suisse Leveraged Loan Index and the Credit Suisse Western European Leveraged Loan Index.

On the surface, both US and European loan markets were impacted by common themes- (1) a supportive macroeconomic environment resulted in below average default rates, (2) pockets of weakness- especially in commodity related sectors (3) a bifurcation in performance across the risk spectrum with higher quality outperforming lower quality[1], and (4) elevated new issue and secondary market spreads provided attractive opportunities. However, different structural underpinnings and diverging economic policies have reduced the correlation across markets.[1] We expect these structural differences to persist into 2016.

From a technical perspective, the US and European loan markets operate with different investor bases and are subject to different supply/demand dynamics. Notably Europe lacks a retail mutual loan fund investor base with market demand being driven by relatively stable sources of capital – Collateralized Loan Obligation (CLO) creations, institutional funds, and separately managed accounts. Outflows from retail mutual loan funds have been a headwind in the US market for the last two years. Additionally, the US market opportunity is significantly larger with the CS Leveraged Loan Index totaling $922 billion and the CS Western Europe Leveraged Loan Index totaling €163 billion.

1 Credit Suisse Leveraged Loan Index, as of Dec. 31, 2015

The global leveraged loan market is greater than $1 trillion USD



Source: Credit Suisse Western Europe Leveraged Loan Index and Credit Suisse Leveraged Loan Index, as of Dec. 31, 2015

In both markets, we anticipate a continuation of supportive technicals. In the European loan market we expect demand from institutional accounts to remain robust as investors look to benefit from loans senior position in the capital structure, short duration, and limited commodity exposure. Our outlook is for CLO volumes to remain in line with 2015 totals of €13.6 billion. In the US market we expect technicals to remain supportive with CLO issuances normalizing in the $50-$70 billion range- below the last few years near record pace- but more in line with historical averages and strong institutional demand. Outflows from US retail mutual loan funds have been elevated since early 2014 but are small in comparison to the demand from CLO's and institutional accounts. The loan asset class has reported outflows from retail mutual funds of $20.3 billion in 2015 and $23.8 billion in 2014.[2]

From a fundamental perspective — both markets have benefited from a benign default environment and our outlook for a continuation of below average defaults is consistent across both markets. Despite both markets' limited exposure to commodities (US: 4.3%, Europe: 2.3%)[1], the volatility in those sectors, along with a few other pockets of weakness had a pronounced effect on the overall returns. Looking forward, we expect the European economy to benefit from the tailwinds of accommodating central bank policies, low oil prices and currency depreciation. In the US, the Federal Reserve has embarked on its first interest rate hike. We view this as a vote of confidence in the fundamental underpinnings of the economy.

Our view is that the European market has a greater chance of outperformance in the short term given the accommodative central bank policies and lower commodity exposure.[3] We believe that there is potential for short term weakness in the US market driven by contagion from other risk assets and continued outflows from retail accounts. Longer term, loans in both markets remain well positioned to provide a relatively high level of current income, with short duration, and potential for price appreciation, in our view. Investing in loans across both US and European market offers the following potential benefits - a larger opportunity set, geographic diversification, enhanced sector and issuer diversification, and divergent earnings drivers. For both the US and European loan markets, we expect returns for the asset class of 5-5.5%[3] in 2016, largely driven by the coupon. We believe there is potential for upside to our estimate from capital appreciation, but we are hesitant to expect price appreciation due to the general "risk off tone". While the Loan market remains a credit driven investment opportunity, the ability to create additional alpha on a portfolio basis resulting from a defined market allocation approach will help to complement other sources of excess return capture.

1 CS Western Europe Leveraged Loan Index and CS Leveraged Loan Index Dec. 31, 2015
2 J.P. Morgan, as of Dec. 31, 2015
3 This is an objective and not guaranteed.

Important information

All data provided by Invesco unless otherwise noted. Data as of Dec. 31, 2015, 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

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