Invesco Senior Secured Loans

European Loan Market **Snapshot**

Monthly European loan market update: August 2016 (covering July 2016)

Returns

- The Credit Suisse Western European Leveraged Loan Index ("CS WELLI") posted a total return of 1.16% in July (see Figure 1) with 0.39% of interest bolstered by 0.77% of price appreciation.[1]
- Broad market sentiment turned positive from the first week of July as investors weighed the impact of Brexit against the implications of current and potential European Central Bank (ECB) and Bank of England stimulus.
- The European senior secured loan (SSL) market benefited from the general demand for risk assets thanks to institutional inflows, as well as substantial demand from newly issued Collateralized Loan Obligations (CLOs) and ramping CLO warehouses.
- The European SSL market benefited from generally buoyant demand for risk assets stemming from both institutional inflows and substantive new CLO formation. A total of €2.56 billion of CLOs were issued in July which marks a monthly record in the current CLO 2.0 format.[2] Further, this new CLO issuance milestone was also on the heels of a record topping 2016 first quarter. We attribute the notable increase in issuance to two main factors: (1) tightening CLO liability spreads due to strong demand and (2) steady supply of loans in the primary market, offering spreads and original issue discounts (OIDs) that met arbitrage hurdles. Loan primary issuance was €4.7 billion in July, the highest month since January 2016.[2] This was due to the combination of a catch up effect from a slower June (Brexit) as much so as resilient Merger & Acquisition activity levers. Market participants believe this positive loan issuance trend will continue post the August break.
- While all risk categories rallied, the higher end of the credit ratings spectrum outperformed. CLO managers typically show an inordinate appetite for higher quality loans as they look to meet fairly regimented portfolio average rating tests. BB and single B rated loans returned 1.55% and 1.26% respectively.[1] CCC rated loans returned a more modest 0.57%.[1]
- At an industry level, only two sectors posted negative returns; consumer durables (-0.76%) due to the weak macroeconomic data and expectations following Brexit and Energy (-0.78%) due to softer oil prices.[1]

Fundamentals

- In the UK, post-Brexit data and surveys have been weak and indicate a significant slowdown in GDP growth. In this light, the Bank of England (BoE) has indicated they are likely to action in the form of a rate cut and potentially further measures such as quantitative easing in August. We note that management teams of borrowers have indicated minimal impact on earnings from Brexit so far, but caveat their responses, indicating it is too early for the full impact to be included in results.
- On the continent, macroeconomic data has fared better showing no material impact from the UK decision to leave the EU. Despite no immediate need for incremental measures, the ECB's existing corporate sector purchase programme (CSPP) has acted as a strong ballast for risk assets to broad negative headlines. This has been bolstered by repeated rhetoric that the ECB stands, ready and willing, to do more if needed.
- There were no new defaults in July 2016. Accordingly, the trailing 12 month default rate on the CS WELLI was 0% at the end of the month.[1]

Technicals

- Primary institutional loan issuance reached €4.7 billion over 15 deals in July, a 5.5% decline on the same month last year. As a result, year-to-date new issue volume of €27.5 billion (102 deals), was slightly (3%) more than the same seven months in 2015.[2]
- Notable loan deals in syndication in the period included:
  - €828 million SSL facilities to support Partner's Group acquisition of Foncia, the French headquartered provider of services for the residential real estate market such as leasing management. The tranche is priced at E+4.25% and is sued at €0.9975.[2]
  - $350 million (€160 million euro denominated) cross border SSL facilities to support the repayment of a portfolio of Coveris' North American and UK asset-backed revolving facilities. The Sun Capital controlled company is headquartered in Luxembourg and is a global manufacturer of plastic and other packaging products. The tranche is priced at L+3.50% with a 1.00% floor and issued at €0.9951.[2]
  - €670 million equivalent SSL facilities to support Coherent's acquisition of RoFIN-SINAR, the laser technology firm. Coherent is a publically listed company which manufactures and sells a variety of laser based photonic products. The tranche priced at E+3.75% and is sued at €0.9925.[2]
- CLO formation in July totaled €2.10 billion issued (5 deals), around 3% more than the €2.03 billion (5 deals) issued in the same month last year. The CLO liability spread environment remains benign with AAA's in particular in high demand from both domestic and international players. The market is now testing multi year lows with discount margins of 1.20% in the higher rated tranches of the CLO structure, a level that gives considerable room for the arbitrage if loan spreads remain stable. The BB rated CLO tranches tested discount margins of 8.00% around Brexit but are now rapidly tightening with recent secondary levels already inside discount margins of 7.00%.[2]
- Based on our understanding of open warehouses and current spread levels on liabilities, we expect around €13 billion of CLO issuance this year, in line with the €13.6 billion seen in 2015.[2]

Valuations

- The average lagging three month new issue institutional loan spread was EURIBOR + 4.65%, 8 basis points (bps) lower than June. All-in-Yields were down (0.31%) to 5.17% due to both the lower spread as well as a lower Original Issue Discount (OID) and less loans with Floors (down from 42% to 32%). Yields of on primary single-B rated tranches were 5.2%. Credit metrics remained relatively conservative for new deals and were in-line with June levels with first lien leverage and total leverage amounting to 4.3 times and 4.7 times respectively. Interest coverage remains at a healthy 3.8 times.[2]
- The Credit Suisse Western European High Yield Bond Index total return was 2.21% in July (See Figure 1), outperforming the European loan market; high yield bonds have now returned 5.77% on a year-to-date basis. At the end of the month of July, the Spread-to-3-year take out for SSLs was 5.60% versus European High Yield bond Spread-to-Worst of 5.46%.[2]

Figure 1

Total return (EUR, in %)	Q1 15	Q2 15	Q3 15	Q4 15	2015	Q1 16	Q2 16	May-16	June-16	July-16	LTM cumulative	YTD cumulative
Credit Suisse Western Europe Leveraged Loan Index (EUR-HDG)	2.22	1.14	0.00	-0.25	3.14	0.78	1.49	0.74	-0.60	1.16	2.70	3.46
Credit Suisse Western Europe HY Index (EUR-HDG)	2.97	-0.47	-2.07	0.99	1.36	1.70	1.75	0.36	-0.46	2.21	3.89	5.75

Source: Credit Suisse, as at 31 July 2016. 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 31 July 2016
2 Standard & Poor's, Loan Market Commentary and Data (LCD) as at 31 July 2016

Important information

All data provided by Invesco 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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