Invesco

Invesco Senior Secured Loans

US Loan Market **Snapshot**

Monthly US loan market update: September 2019 (covering August 2019)

A reescalation of US-China trade tensions and softening global economic data weighed on market sentiment throughout August. These developments fueled further rate cut expectations, prolonging the rotation of retail flows out of loans. Countering these headwinds to loan demand, CLO formation provided a steady bid for loans as managers continued to nearly keep pace with last year's record CLO volume. Additionally, new loan issuance was muted as is seasonally typical, helping to balance the technicals as the market had little incremental supply to absorb. In fact, the size of the loan market contracted for the second straight month as repayments exceeded new issuance. Against this backdrop, the senior secured loan market gave back its July price gains, returning -0.27% overall in August.[1] Despite $26.9 billion of retail outflows witnessed thus far in 2019, the asset class has continued to deliver strong returns, as year-to-date returns of 6.30% are the strongest of the past 10 years.[1,3]

Loans underperformed during the month, lagging longer duration assets which benefitted from the continued downward shift in interest rate expectations. High yield bonds gained 0.39% and investment grade returned 3.03%[2] while the 10 year Treasury soared 4.67% as yields plummeted 52 basis points to 1.50%. The percentage of loans trading above par dropped to 20.6% as prices declined.[3] From a quality perspective, "BBs" (0.09%) bested "Bs" (-0.41%) and "CCCs" (-1.81%) during the month as the market clearly reflected a higher quality bias.[4] The average price in the loan market was $96.64 at the end of August.[5] At the current average price, senior secured loans are providing a 6.13% yield inclusive of the forward LIBOR curve.[5]

Fundamentals

- Economic data was mixed in August, as solid consumption data contrasted with weaker PMIs and durable goods orders. Meanwhile, loan issuers posted positive, albeit muted, earnings growth of 2% in the second quarter.[4] Earnings growth has decelerated since 2018, but broadly remains supportive of loan market fundamentals.
- The trailing 12 month default rate held steady at 1.29%.[4]

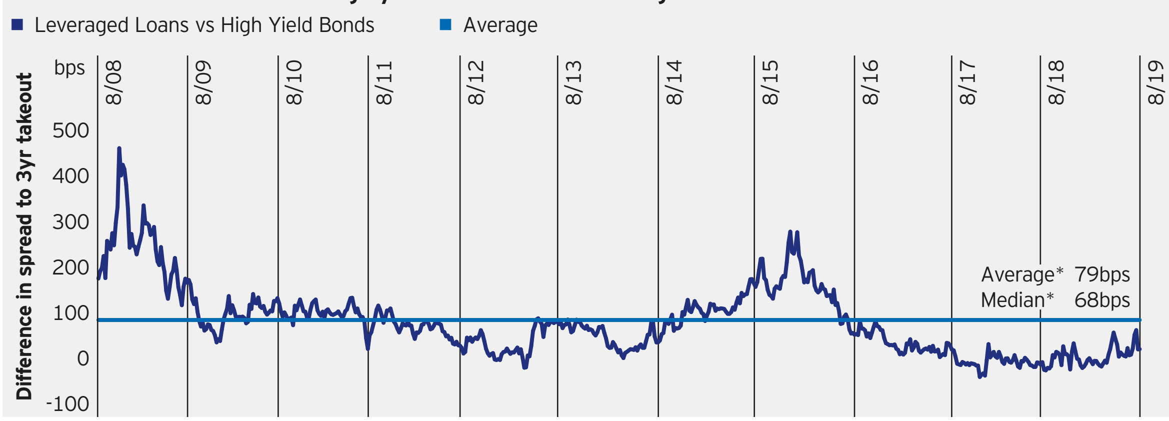
Technicals

- Retail outflows continued in August; however, limited new supply and steady demand from new CLOs maintained a stable technical dynamic.
- Gross CLO volume was slower than prior months, but solid at $11.0 billion in August, with $7.6 billion of issuance net of resets and refinancings.[3]
- Retail mutual funds and ETFs reported withdrawals of $2.8 billion in August, the eleventh consecutive month of redemptions.[3]
- New issuance volume was in line with July's total, at $29.3 billion during the month. Excluding refinancing and repricing activity, net issuance was $15.0 billion. This new supply was more than offset by substantial paydown activity of $49.8 billion in August.[3]

Relative value/market opportunity

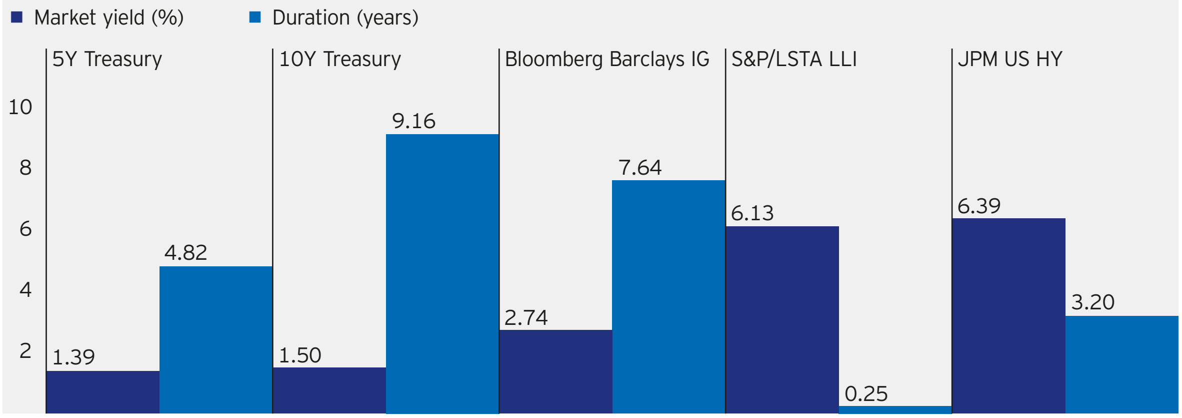
Interest rate expectations have declined amid mounting risks to the economic outlook, prompting investors to bid high yield bonds to historically tight levels relative to senior secured loans. The rationale driving the demand for bonds is that fixed rate assets are better positioned for falling rates than floating rate loans. However, this thinking undervalues the critical long-term return drivers for loans:
i) the relatively high absolute coupon rates which are comprised of LIBOR plus credit spread, and
ii) loans' advantageous position within the capital structure which mitigates the risk of credit loss.
These features have historically contributed to loans' lower price volatility relative to other credit risk assets. Even as interest rates decline, loans' overall coupons will remain strong. The income provided by loans tends to be relatively stable when rates decline (typically during periods of macroeconomic weakness), as this often coincides with spread widening. Additionally, loans provide investors with better structural protection from economic weakness / issuer distress than the unsecured debt market, indicating that the current period of rising economic uncertainty is not an opportune time to trade down in the capital structure, particularly given the absence of incremental yield for doing so.

Yield differential between US high yield bonds and US leveraged loans



Source: J.P. Morgan Leveraged Loan Index versus J.P. Morgan US High Yield Bond Index as of Aug. 31, 2019.
(*) Historical data includes periods Feb. 1, 2007 to Aug. 31, 2019.

Loans offered investors a high level of current income with short duration



Source: Bloomberg L.P., Barclays, JP Morgan, and S&P LCD as of Aug. 31, 2019. **Past performance is not a guarantee of future results.** An investment cannot be made directly in an index.

Relative yield

	$ Price	Yield to worst (%)	Spread to worst	At forward Libor	Duration (years)
5 Year Treasuries	99-11	1.39	–	–	4.82
10 Year Treasuries	101-05	1.50	–	–	9.16
Bloomberg Barclays US Agg. Index	107.12	2.13	T + 0.59	–	5.75
Bloomberg Barclays IG Index	110.14	2.74	T + 1.15	–	7.64
JPM US HY Bond Index	100.42	6.39	T + 4.86	–	3.20
S&P/LSTA Leveraged Loan Index	**96.64**	**L + 4.82**	**T + 4.70**	**6.13%**	**0.25**

Source: S&P LCD, Barclays, JP Morgan and Bloomberg L.P. as of Aug. 31, 2019. Loan "spread to worst" and "at forward Libor" incorporate LIBOR forward curve as of Aug. 31, 2019.

1 S&P/LSTA Leveraged Loan Index as of Aug. 31, 2019.
2 S&P/LSTA Leveraged Loan Index and Bloomberg as of Aug. 31, 2019. High yield represented by BAML US High Yield Index; investment grade represented by the BAML Investment Grade Index.
3 JP Morgan as of Aug. 31, 2019.
4 S&P LCD as of Aug. 31, 2019.
5 S&P LCD and Invesco as of Aug. 31, 2019.

Important information

All data provided by Invesco unless otherwise noted. All data is US dollar and as of Aug. 31, 2019, unless otherwise noted. By accepting this document, you consent to communicate with us in English, unless you inform us otherwise.

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