European Loan Market Snapshot

European monthly loan market update: April 2016 (covering March 2016)

Returns

- The Credit Suisse Western European Leveraged Loan Index ("CS WELLI") posted a total return of 2.06% in March (see Figure 1) with 0.42% of interest bolstered by 1.63% of capital appreciation.[1] The March performance more than offset January and February's negative monthly returns, resulting in a positive 0.78% year-to-date return.[1]
- Sentiment improved considerably in March, largely due to the European Central Bank's (ECB) announcement of strong stimulus measures. The resulting demand driven rally was further fuelled by noticeable spread tightening in the adjacent European High Yield Bond and US Loan and High Yield Bond markets. Further, March also experienced a resurgence in European Collateralized Loan Obligation (CLO) formation and continued institutional loan flows leading the asset class to its highest monthly total return since January 2012.[1,2]
- Despite the improved market tone and rampant demand for existing inventory in the secondary loan market, asset managers, on the whole, remained selective on new primary deals brought to market. For example, well priced and highly rated (BB or stronger single B) cross border deals were significantly oversubscribed, resulting in under allocations in the primary, which meant those loans traded above re-offer in the secondary market. On the other hand, arrangers offering deals with aggressive structures struggled to find traction and were forced to flex pricing wider and materially increase upfront discounts (as much as 5 percentage points). Even then, asset managers preferred to err on the side of caution rather than chase yield – this discipline bodes well for the quality of future new loan issuance.
- The appetite for risk resulted in demand for lower quality loans, a complete reversal of the trend seen over the last eight months.[3] As an illustration, CCC rated loans outperformed single B and BB rated loan by returning 7.73% versus, single B's 2.44% and BB's 2.10.[1] On a year-to-date basis, CCC rated loans have now outperformed BB and B.[1]
- At an industry level, the positive sentiment was felt across the board with all sectors registering positive total returns in the month. Energy was the biggest contributor registering 9.63% total return in March thanks to the increase in oil prices, although the sector remains negative over the last 12 months (-27.99%).[1]

Fundamentals

- The ECBs new policy action announced in March was designed to ease financial conditions across the Eurozone. This should provide impetus to the Eurozone's already blossoming domestic picture, including stronger employment growth. However, external factors like rising oil prices and weak global growth cannot be ignored and continue to pose a threat to a significant acceleration of the growth rate of Europe's GDP. On balance, we have seen a continuation of the modest GDP growth for the Eurozone.

- Stable macroeconomics, more conservative balance sheets and low funding rates have kept the default picture in check. There were no new defaults in March 2016. Accordingly, the trailing 12 month default rate on the CS WELLI was 0.58% at the end of the month.[1]

Technicals

- Primary institutional loan issuance reached €2.6 billion over 9 deals in March. While this was an increase on the slow February issuance, it is still considerably below the same period last year (€6.1 billion). However, thanks to a blockbuster March, year-to- date volume of €10.7 billion is only 9% less than the same three month period in 2015.[3]
- Notable loan market deals in syndication in the period included:
  - €885 million senior secured loan cross border facilities to support Western Digital's acquisition of Sandisk, the US based data storage solutions company. The tranche is priced at E+5.25% with a 0.75% EURIBOR Floor and issued at €0.9750.[3]
  - €200 million senior secured loan facility to support Electra's acquisition of Photobox, the UK-based digital consumer services business for personalized products and gifts with a focus on online digital photo printing services. The tranche priced at L+5.00%. Issue price is not disclosed.[3]
  - €230 million senior secured loan facilities to support Astorg's acquisition of Parkeon the French based provider of parking meters. The tranche priced at E+5.75% and issued at €0.9500.[3]
- CLO formation in March totaled €1.8 billion issued (5 deals), up from the €1.3 billion (4 deals) issued in the same month last year. Although CLO liabilities remained high, they have tightened from February levels and along with CLO manager's ability to source cheap assets in February resulted the restart of CLO issuance. Year-to-date volumes stand at €2.6 billion (7 deals), €0.5 billion less than the same period in 2015.[3] We expect to see some catch up in CLO formation following the recent ECB actions but have revised our full year expectations to €10 billion, down from the previous forecast of €13-15 billion (versus €13.6 billion in 2015) on the basis that CLO liabilities remain high and are unlikely to tighten as quickly as asset prices and further, that regulatory hurdles (risk retention requirements) remain a barrier to entry for repeat issuers as well as for many would-be issuers.

Valuations

- The average lagging 3 month new issue institutional loan spread was EURIBOR + 4.97%, 6 basis points (bps) higher than February. All-in-Yields were up slightly (0.03%) to 5.85%, thanks to a combination of the aforementioned higher spread, high upfront discount of 98.03 as well as increases in the amount of EURIBOR floors (37% vs 35% in February). For new issue single-B rated tranches the All-in-Rolling-3-month Yield-to-Maturity reached 6.04%. Despite better economics credit metrics remained relatively conservative for new deals and flat on February levels with first lien leverage and total leverage amounting to 4.6 times and 4.8 times respectively, well below the peak levels from 2006 and 2007.
- The Credit Suisse Western European High Yield Bond Index total return was positive 3.59% in March (See Figure 1), considerably outperforming the loan market meaning that high yield bonds have now overtaken loan returns on a year-to-date basis. At the end of March, Spread-to-3 year take out for senior secured loans was 5.95% versus European High Yield Bond Spread-to-Worst of 5.93%.[3]

Figure 1

Total return (EUR, in %)	**Q1 15**	**Q2 15**	**Q3 15**	**Q4 15**	**2015**	**Jan-16**	**Feb-16**	**Mar-16**	**LTM cumulative**	**YTD cumulative**
Credit Suisse Western Europe Leveraged Loan Index (EUR-HDG)	2.22	1.14	0.00	-0.25	3.14	-0.32	-0.93	2.06	1.68	0.78
Credit Suisse Western Europe HY Index (EUR-HDG)	2.97	-0.47	-2.07	0.99	1.36	-1.24	-0.60	3.59	0.11	1.70
Bloomberg Europe 500 Index	16.34	-3.22	-8.20	5.64	9.19	-6.32	-2.47	1.74	-12.75	-7.04
FTSE All-Share Index	4.76	-1.54	-5.64	4.02	1.25	-3.07	0.84	1.96	-3.68	-0.35
10-Year UK Government Bond	0.43	-3.02	2.23	-1.22	-1.65	3.26	1.90	-1.74	1.25	3.39
10-Year Euro Government Bond	4.09	-5.27	2.39	-0.23	0.72	3.63	2.17	-0.43	2.01	5.42

Source: Credit Suisse, as at 31, March 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 represented by senior secured loans, as at 31 March 2016
2 J.P. Morgan European High Yield Fund Flows: Weekly Update as at 31 March 2016
3 Standard & Poor's, Loan Market Commentary and Data (LCD) as at 31 March 2016

Important information

All data provided by Invesco, as at 31 March 2016, 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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