US Loan Market
Snapshot

Monthly US loan market update: February 2017

The US loan market began the year on a steady note, returning 0.56% in the month of January.[1] Re-pricing activity dominated the loan market throughout the month as issuers continued to capitalize on strong demand for assets as an opportunity to lower spreads. The $67 billion of re-pricing volume during the month brought the six month total to $167 billion.[2] Despite the wave of re-pricings and a more restrained risk appetite across markets amid the transfer of power in Washington, loans delivered solid returns underpinned by strong coupon income and firm prices.

Loans[1] again outperformed long duration assets as cues from both Federal Reserve chairwoman Janet Yellen and the Trump administration continued pointing to a period of higher interest rates on the horizon. The 10 year Treasury yield held roughly flat at 2.45% in January as the 10 year Treasury returned 0.05% and the High Grade Bond Index returned 0.41%. Returns in the high yield bond market exceeded loans in the month, with the High Yield Bond Index returning 1.34%.[3]

As cash continued to flow into the loan market, the lower yielding, higher quality "BB" (0.14%) and "B" (0.54%) ratings categories were outpaced by the "CCC's" (3.32%) and "D's" (3.80%)[1] as has been the case in recent months. From an industry perspective, the two performance outliers were energy (5.95%) and retailers (-0.73%). The average price in the loan market was $98.39 at the end of January with 68% of the market trading at or above par.[1] At the current average price, senior secured loans are providing a 5.93% yield.[1]

Fundamentals

- US GDP growth for the fourth quarter was 1.9%, down from the 3.5% pace in the third quarter, as steady personal consumption was offset by the strong dollar's impact on trade. Note that final sales, or GDP excluding the contribution from trade and inventories, grew 2.5%, faster than last quarter's 2.1% pace.
- The trailing 12 month default rate declined to an 11 month low of 1.56% in January as the relatively large default of Avaya ($3.2 billion) was offset by several defaults rolling out of the measurement period.[1]

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

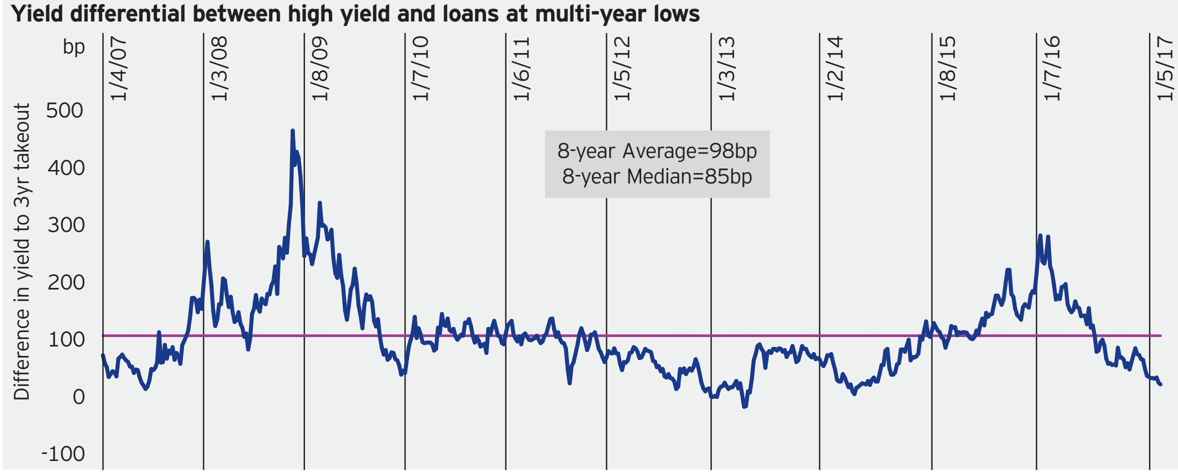
Technicals

- Technical conditions remained supportive in January. Demand coming from inflows and repayments, including the repayment of Avago's $6.6 billion term loan B and $7.1 billion term loan A, continued to outstrip supply.
- CLO issuance was lighter in January than in recent months, with $8.7 billion of gross volume and only $826 million of issuance net of refinancings.[2] Spread compression and relatively light net new issue made conditions for CLO creation less attractive than in the final months of 2016.
- Retail mutual funds and ETF's continued to record robust inflows, collecting $3.3 billion in the first month of the year.[2]
- New issuance volume of $116.7 billion in January was a record total, although 72% of that total was refinancing and repricing activity which extended the recent trend of spread compression.

Relative value/market opportunity

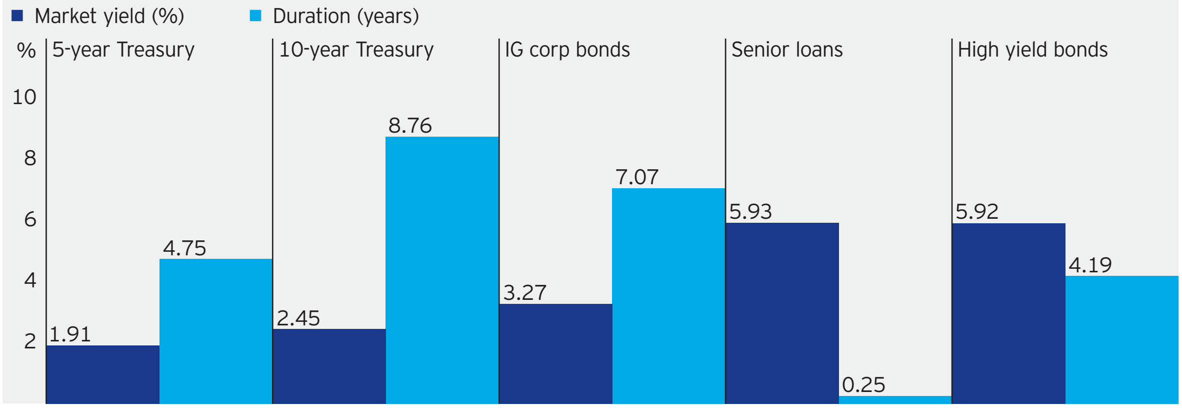
Although recent re-pricing activity has resulted in spread compression, loans continued to provide attractive relative value, especially in light of the ongoing rally in high yield bonds. As shown in the chart below, the yield differential between high yield bonds and loans is increasingly narrow from a historical perspective. Given the outlook for interest rates to rise further amid permitting economic conditions, we believe loans are positioned to provide low volatility exposure to credit with an attractive yield profile. With LIBOR now above the 100 bps threshold, 96.4% of loans exceed their LIBOR floor, and thus are truly floating rate instruments.[1]

Yield differential between high yield and loans at multi-year lows



Source: J.P. Morgan, as of Jan. 31, 2017. High yield represented by the J.P. Morgan US HY Bond Index; Loans represented by the J.P. Morgan Leveraged Loan Index.

Loans continued to offer investors a high level of current income with short duration



Source: Bloomberg L.P., BAML, S&P LCD as of Jan. 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 BAML High Yield Master 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 (%)	Spread to worst	At forward Libor	Duration (years)
5-year Treasury	96-26	1.91			4.75
10-year Treasury	96-02	2.45			8.76
Bloomberg Barclays US Agg Index	102.61	2.61	T + 0.62		5.95
Bloomberg Barclays IG Index	104.06	3.27	T + 1.20		7.07
ML US HY Index	100.53	5.92	T + 4.17		4.19
S&P/LSTA Leveraged Loan Index	**98.39**	**L+4.57**	**T+ 4.47**	**5.93%**	**90 Days**

Source: Bloomberg L.P., BAML and S&P LCD as of Jan. 31, 2017. Loan yields incorporate LIBOR forward curve as of Jan. 31, 2017. Loan "spread to worst" and "At Forward LIBOR" incorporate LIBOR forward curve as of Jan. 31, 2017.

Important information

All data provided by Invesco unless otherwise noted. All data is US dollar and as of Jan. 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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1 S&P LCD (Leveraged Commentary and Data) as of Jan. 31, 2017; Total returns, yields, average price and other data stated are for the S&P LSTA Leveraged Loan Index.

2 J.P. Morgan as of Jan. 31, 2017.

3 HY Bonds: BAML HY Master Index, High Grade Bonds: BAML High Grade Corp; data as of Jan. 31, 2017. Returns stated are total returns.

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