



Investment Perspective

Bank Loans



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Current Bank Loan Themes

Current Income and Positive Optionality to the Yield Curve

Earlier this year we provided our outlook for key themes and performance expectations in the bank loan market for 2010. As we are now midway through the year, we wanted to provide an update on several of these themes and address recent performance against the backdrop of renewed capital markets volatility on sovereign events in Europe and concerns about a slow-down in the economic recovery in the U.S. Prior to these issues the bank loan market had performed in-line with our expectations having posted positive returns of 6.2%¹ on the S&P/LSTA Index through early May. We had also seen an improvement in credit quality as evidenced by steady declines in the trailing twelve month default rate to roughly 5%² through the same period. Since then, the market has retreated three points to close out the first half of 2010 at a dollar price of \$.898³. While the price decline has rolled-back almost half of this year's returns, we are encouraged by the market's performance relative to other asset classes and see the roll-back as a renewed buying opportunity based on the following re-affirmed themes:

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| 1a. Current Income | LIBOR ⁴ + 378 bp ⁵ |
| 1b. Total Return & Option on Future Rate Increases | LIBOR + 668 bp ⁵ |
| 2. Still Trading Cheap to Historic Levels: | Price ⁶ = \$.898 ³ |
| 3. Relative Value to Other Credit Products: | Swaps ⁷ = T + 702 bp |

Each of these concepts are discussed in more detail below along with risks to our thesis and Invesco's positive view of investing in the asset class at this time.

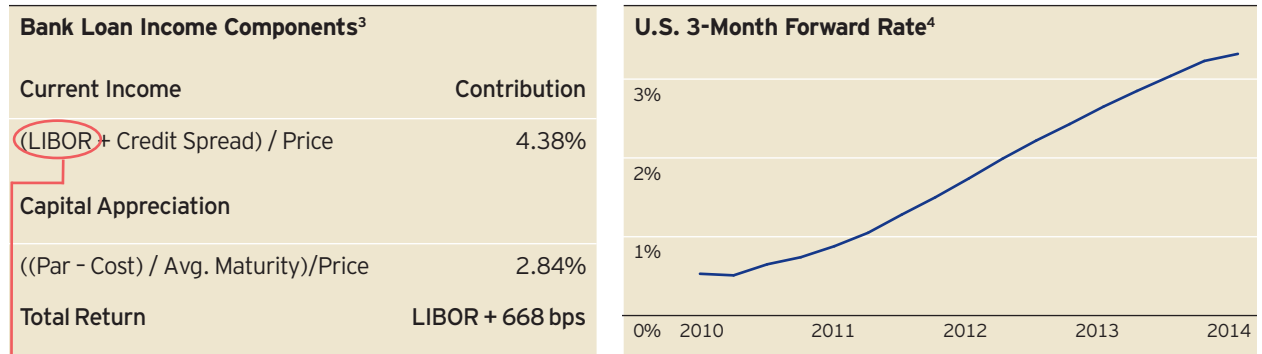
1. Source: Standard and Poor's LCD Daily Play Book - May 5, 2010.
2. Source: Standard and Poor's Leveraged Commentary and Data.
3. Source: S&P/LSTA Leveraged Loan Index June 2010 Review.
4. LIBOR or (London Interbank Offered Rate) is a floating base rate of interest that resets on a 30, 60 or 90 day basis. For purposes of this commentary we use the 90 day rate which is the defacto standard for bank loans.
5. Based on the S&P/LSTA Leveraged Loan Index and a 4 year maturity.
6. Based on the S&P/LSTA Leveraged Loan Index.
7. Floating to Fixed Swap vs 4 Year Treasuries.

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All data as of June 2010, unless otherwise stated. Source: Invesco, unless otherwise stated. All references to Invesco refer to Invesco Senior Secured Management, Inc.

Current income and yield curve optionality

With the average price of the S&P/LSTA Index at \$.898¹ the bank loan market trades to an all-in four year annualized yield to maturity of LIBOR + 668 bp. At today's LIBOR rates this equates to a 7.20%² annual yield but this does not take into account the forward LIBOR curve. Recall that the LIBOR component of bank loan interest payments is reset when the contracts roll – typically between 30 and 90 days – so investors benefit from any future increases in interest rates with little or no corresponding price exposure. This is one of the unique features of the bank loan asset class and provides investors with a positive option on rising interest rates. While the benefit of this has likely been delayed as the FED has retrenched an accommodative monetary posture against concerns of a slowing economic recovery, we still believe interest rates must eventually move upward. We concede that a prospective upward move in rates is now pushed back and is likely to be less pronounced vs. our last commentary but still look toward the forward LIBOR curve as a barometer for expectations. If we apply the forward LIBOR curve, then the expected annual yield on the bank loan asset class jumps to 8.94% over the average maturity of the market.



Impact of Forward LIBOR on Current Income ⁴								
Date	Forward LIBOR	+	Spread	=	Current Income	÷ Price	=	Total Current Income
7/16/10	0.53%	+	3.40%	=	3.93%	0.898	=	4.38%
10/18/10	0.51%	+	3.40%	=	3.91%	0.898	=	4.35%
1/18/11	0.65%	+	3.40%	=	4.05%	0.898	=	4.51%
4/18/11	0.74%	+	3.40%	=	4.14%	0.898	=	4.61%
7/18/11	0.88%	+	3.40%	=	4.28%	0.898	=	4.77%
10/17/11	1.05%	+	3.40%	=	4.45%	0.898	=	4.96%
1/17/12	1.28%	+	3.40%	=	4.68%	0.898	=	5.21%
4/16/12	1.50%	+	3.40%	=	4.90%	0.898	=	5.46%
7/16/12	1.74%	+	3.40%	=	5.14%	0.898	=	5.72%
10/16/12	1.99%	+	3.40%	=	5.39%	0.898	=	6.00%
1/16/13	2.22%	+	3.40%	=	5.62%	0.898	=	6.26%
4/16/13	2.43%	+	3.40%	=	5.83%	0.898	=	6.49%
7/16/13	2.65%	+	3.40%	=	6.05%	0.898	=	6.74%
10/16/13	2.85%	+	3.40%	=	6.25%	0.898	=	6.96%
1/16/14	3.04%	+	3.40%	=	6.44%	0.898	=	7.17%
4/16/14	3.23%	+	3.40%	=	6.63%	0.898	=	7.38%
7/16/14	3.32%	+	3.40%	=	6.72%	0.898	=	7.48%

1. Source: S&P/LSTA Leveraged Loan Index June 2010 Review.

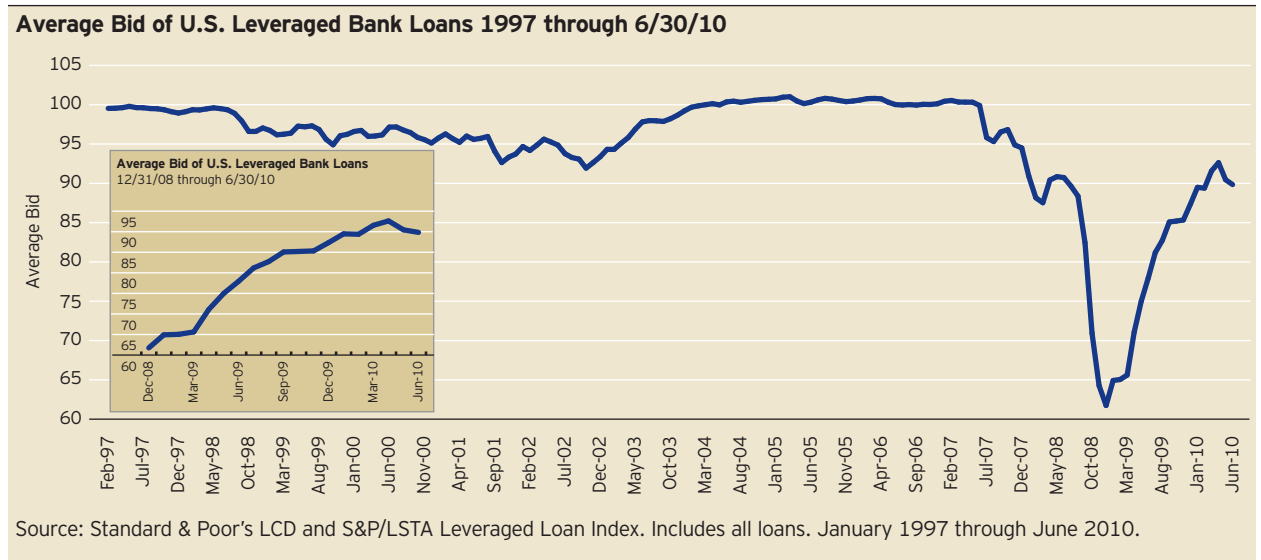
2. Source: Bloomberg.

3. Source: Bloomberg as of 7/14/10.

4. Source: Standard & Poors/Bloomberg as of 7/14/10.

Still trading cheap to historical levels

While loan prices have made a significant recovery from all time lows set in December of 2008, the market has yet to return to its historical trading range at or near par. We attribute much of this to technical factors which now feature as a more permanent part of our market place with ebbs and flows reflective of a broader buyer base (cross-over accounts/non CLOs) and a more delicate balance between supply and demand factors. The impact of these technical factors was in strong evidence during the first half of the year: from January 1st through May 1st pre-payment rates were running at an annualized pace of 20%¹ and new issue was initially unable to keep pace - this pushed secondary prices on the S&P/LSTA Index to a post-Lehman high of \$.928¹ during the first week of May and had some market participants calling for a "near par" market by year end. Prices on the index have since rolled back to \$.898¹ but we attribute this to an interim technical correction on the contagion effects of sovereign problems in Europe and concerns about slower economic growth here in the U.S. Since we have not seen any concurrent deterioration in credit fundamentals and are still looking for positive, albeit slower, economic growth for the remainder of 2010 we expect prices to resume a move back toward par once technical factors normalize.



The case for a resumed pull toward par in the back half of 2010 is underpinned by solid credit performance and expectations that we will continue to see pre-payment activity. Expectations for solid credit performance are supported by declining corporate default rates, a theme we highlighted in our last commentary. The trailing 12-month default rate dropped to an 18 month low of 4.02%² as of June 30th and June represented the first month in 2.5 years where there were no new defaults. There has also been a positive swing to 1.33:1² in the upgrade to downgrade ratio on S&P's rated universe of corporate credits which further supports our view that we are now well into a fundamental recovery. Based on this and our view that corporate profits should maintain a stable bias over the next 12 months, we concur with market forecasts which call for the default rate to stay at or near the 4% level into 2011. This means that credit losses should have less of an impact on returns in 2010 and the early part of 2011 and underscores that the market remains cheap relative to historic norms. Using the S&P/LSTA Index as a proxy for the market, today's gross yields are 254 bp wider than historical averages. If we risk adjust this excess yield to account for prospective credit losses at a 4% default rate there is still a solid 225 bp pick-up to historical levels:

S&P/LSTA Performing Loan Index*				
Date	Price	YTM	Credit Losses	Net Yield
6-30-10	\$.898 ¹	L + 668 bp	Forecast 120 bp	L + 547 bp
Jan '97 to Dec '09	\$.953	L + 413 bp	90 bp	L + 322 bp

* Note that we use the S&P/LSTA Performing Index as a Proxy for the market as this data set reaches back to 1997. The broader index which is more widely quoted and the basis for all other current figures in this commentary only reaches back to 2006.

1. Source: S&P/LSTA Leveraged Loan Index June 2010 Review.
 2. Source: Standard and Poor's Leveraged Commentary and Data.

Relative value to other credit products

The risk return of Bank Loans coupled with a floating base rate that helps to hedge duration risk creates a compelling relative value story when compared to other corporate asset classes. This story becomes even more commanding against the backdrop of an improving credit environment where risk assets would typically outperform. In short, Bank Loans will see positive current income gains on any future interest rate increases and minimal price exposure since LIBOR adjusts up and risk based credit spreads are usually inversely correlated to rate movements.

	Yield	Swapped Yield	Yield At Forward LIBOR
5 Year Treasuries	1.80%		
10 Year Treasuries	3.04%		
I.G. Credit	4.33%		
H.Y. Bonds	8.90%		
Bank Loans	L + 6.68%	T + 7.02%	8.94%

Source: Bloomberg/Invesco as of 6/30/10.

Are bank loans too good to be true?

Market visibility had steadily improved through the first four months of 2010 before being disrupted by sovereign events in Europe. In our view this disruption is not unique to bank loans and has been driven more by market psychology and technical factors than by specific fundamental events. That said, it has become increasingly clear that bank loans are no longer an “uncorrelated” asset class and that near term performance can be influenced by a combination of market driven, technical and fundamental factors. While we concede that visibility may not be as good today as it was earlier in the year, we still believe that the market is poised for positive returns during the back half of 2010 and offer several observations below to support this view.

■ Technical factors:

- The market saw a net increase in supply for May/June but this now appears to be equalizing. The forward calendar of new deals stood at \$16.2¹ billion as of 6/30/10 down several billion from second quarter averages. Our conversations with underwriters suggest that the new deal pipeline should go quiet for the rest of the summer so the calendar should be covered by pre-payments which are running at an average of \$2.5² billion per week.
- Inflows to Loan Participation funds remain positive and stand at \$6.18³ billion for 2010 based on the latest Lipper data. There is also evidence of new institutional investors coming into the market based on public search activity.
- Recent new issue has found good support from cross-over buyers once all-in yields price above 7% - these issues have also traded well in the secondary and most remain above Original Issue Discount levels.
- TRS desks continue to ramp up and are providing leveraged investors with funding well below L + 150 bp (positive arbitrage). This is likely to create new demand albeit we acknowledge that de-leveraging had been a major source of volatility in 2008.
- Performance across the CLO space continues to materially improve and we have seen three new/re-pack deals get done in the first half. Based on this we expect some, albeit modest, new issue in 2010.

■ Fundamentals:

- Notwithstanding concerns over Europe and slower growth here in the U.S., the risk of a double dip recession remains low. As a result we see corporate earnings performance remaining in-line with recent results albeit concede that year-over-year growth may be more difficult to achieve in Q3 and Q4.

1. Source: Standard and Poor's Leveraged Commentary and Data.
2. Source: Standard and Poor's Leveraged Commentary and Data.
3. Source: Lipper as of 6/30/10.

Sequential U.S. GDP Growth		Sequential Performance for Large Public Loan Issuers		
			Revenue	EBITDA
Q4 '08	-5.4%	Q4 '08	-6.47%	-14.63%
Q1 '09	-6.4%	Q1 '09	-6.53%	-3.72%
Q2 '09	-0.7%	Q2 '09	5.04%	16.91%
Q3 '09	2.2%	Q3 '09	5.12%	9.99%
Q4 '09	5.6%	Q4 '09	3.99%	5.03%
Q1 '10	2.7%	Q1 '10	-0.63%	5.16%
Source: Bloomberg		Source: Bloomberg		

To conclude, we believe that performance in the bank loan market should improve as we move through the remainder of the year. Taking this in tandem with both absolute and relative return profiles and the added benefit of a positive option on the interest rate yield curve supports a pure-play allocation into the bank loan asset class.

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