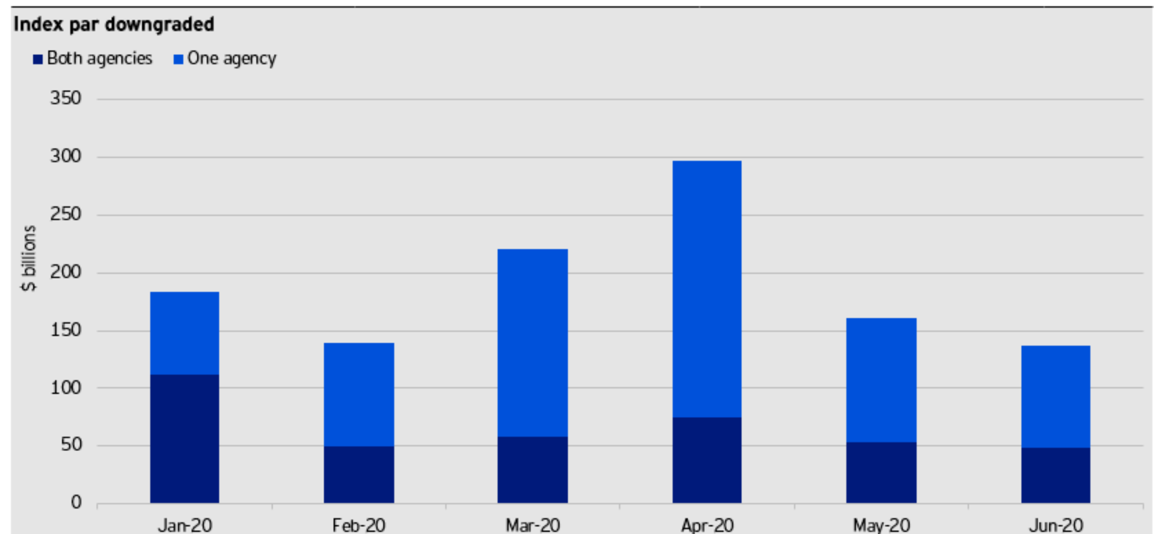
US Loan Market Snapshot

Monthly US loan market update: June 2020

Loan prices continued to recover in June, gaining 1.14% during the month and improving year-to-date returns to -4.61%.[1] Early in the month, price gains were fueled by optimism regarding both the reopening of economic activity and vaccine development, anchored in the US Federal Reserve's (the Fed) credible pledges to provide policy support. However, the gains eased towards month-end as a renewed surge in COVID-19 cases in many parts of the US caused several states to pause or reverse reopening efforts. Evidence of improving economic activity resulting from initial stages of reopening clashed with the uncertainty brought on by the reacceleration of infections caused by those reopenings. This tension between the health of the economy and the health of the population is likely to remain a key theme in the near-term.

Loans outperformed high yield bonds (0.92%) in June, but underperformed investment grade (2.55%).[2] The percentage of loans trading below $80 declined from 12% to 8%, and now stands far below the peak of 57% reached on March 23, 2020.[3] For a second consecutive month, the lower end of the quality spectrum outperformed in June; "BBs" (0.24%) underperformed "Bs" (1.19%) and "CCCs" (4.26%), though "CCCs" remain a clear laggard since the onset of COVID-19.[1] Relatedly, the rapidly unfolding ratings downgrade cycle, which has been key contributor to loan market instability since the pandemic began, has slowed markedly since peaking in April.[4] The average price in the loan market was $91.37 at the end of June.[3] At the current average price, senior secured loans are providing a 7.14% yield inclusive of the forward LIBOR curve.[3]

Some signs of easing in downgrade volumes (S&P + Moody's ratings)



Sources: LCD, an offering of S&P Global Market Intelligence; Bloomberg, and Morgan Stanley Research as of June 29, 2020.

Fundamentals

- Economic data showed significant month-over-month improvement in June as portions of the economy came back online. However, high frequency data sets indicate a slowing of this improvement in states which have been forced to slow reopenings as infection counts rise.
- The trailing 12-month default rate ended June at 3.23%, with 9 new issuers joining the list of defaults during the month.[5] The $23.1 billion of defaults across 27 issuers in Q2 2020 was the highest quarterly total since Q1 2009.[5]

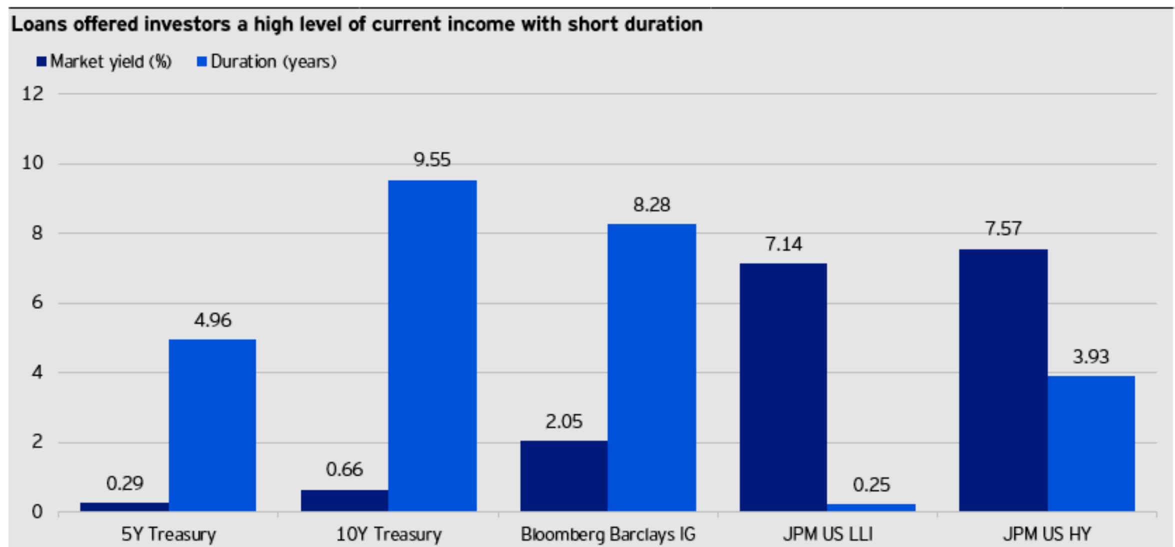
Technicals

- Loan technicals were supportive during the month as gradually improving institutional and CLO demand helped absorb modestly increased supply.
- New CLO issuance continued to gradually increase; $8.2 billion of issuance in June was up versus $6.0 billion in May.[3] Issuance continued to be driven by securitizations of open warehouse exposures and relied on creative deal structures, including shorter than typical reinvestment periods. Though CLO liabilities continued to tighten in June, CLO arbitrage for equity investors remains challenging.
- Retail mutual funds and ETFs reported outflows of $0.6 billion during the month, a continued moderation of the outflow trend witnessed in recent months.[3]
- New issue activity increased in June with 22 deals pricing for a total of $28.8 billion, the busiest month since the onset of COVID-19.[3] Net of refinancing, volume was $15.3 billion.[3] Speculative-grade issuers continued to lean more heavily on the high yield bond market for both secured and unsecured financing needs.

Relative value/market opportunity

The resurgence of COVID infections in June has further muddled the near-term economic recovery outlook. Early hopes for a "V" shaped recovery in activity may ultimately look more like a "U" or "W" depending on how effectively the US can collectively regain control over the virus moving forward. Given these developments, support signals from policy makers at the Fed and in Congress will continue to play an outsized role in market sentiment. Thus far, full throated policy support measures have been well received by the investor community. The Fed has slashed interest rates, dramatically expanded its balance sheet, and intervened in credit markets through purchases of fixed income credit ETFs and corporate bonds. Perhaps more importantly, the Fed has signaled an open-ended commitment to backstop liquidity and support economic recovery with further measures if necessary. Meanwhile, Congress has appropriated fiscal stimulus amounting to 13.4% of GDP to-date. Ongoing discussions for additional relief center on a potential infrastructure spending bill and an extension of enhanced unemployment benefits, among other measures.

Investors' continued confidence in policy relief will remain a critical factor in the functioning of credit markets as the COVID-19 headwind remains and defaults continue to accrue throughout the second half of 2020. In this delicate environment, senior secured loans continue to offer investors a compelling combination of potential robust yield, price upside, and structural downside mitigation afforded by loans' senior ranking in companies' capital structures.



Source: Barclays, JP Morgan and Bloomberg L.P. as of June 30, 2020. **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	Duration (years)
5 Year Treasuries	99-26	0.29	–	4.96
10 Year Treasuries	99-22	0.66	–	9.55
Bloomberg Barclays US Agg. Index	110.44	1.25	T + 0.80	6.04
Bloomberg Barclays IG Index	113.05	2.05	T + 1.43	8.28
JPM US HY Bond Index	96.50	7.57	T + 7.22	3.93
JPM US Leveraged Loan Index	**91.37**	**7.14**	**T + 6.90**	**0.25**

Source: Barclays, JP Morgan and Bloomberg L.P. as of June 30, 2020. Loan "yield to worst" and "spread to worst" incorporate the LIBOR forward curve.

1 S&P/LSTA Leveraged Loan Index as of June 30, 2020.
2 S&P/LSTA Leveraged Loan Index and Bloomberg as of June 30, 2020. High yield represented by BAML US High Yield Index; investment grade represented by the BAML Investment Grade Index.
3 JP Morgan as of June 30, 2020.
4 Morgan Stanley as of June 30, 2020.
5 S&P LCD as of June 30, 2020.

About risk

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.
Many senior loans are illiquid, meaning that the investors may not be able to sell them quickly at a fair price and/or that the redemptions may be delayed due to illiquidity of the senior loans. The market for illiquid securities is more volatile than the market for liquid securities. The market for senior loans could be disrupted in the event of an economic downturn or a substantial increase or decrease in interest rates. Senior loans, like most other debt obligations, are subject to the risk of default.

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