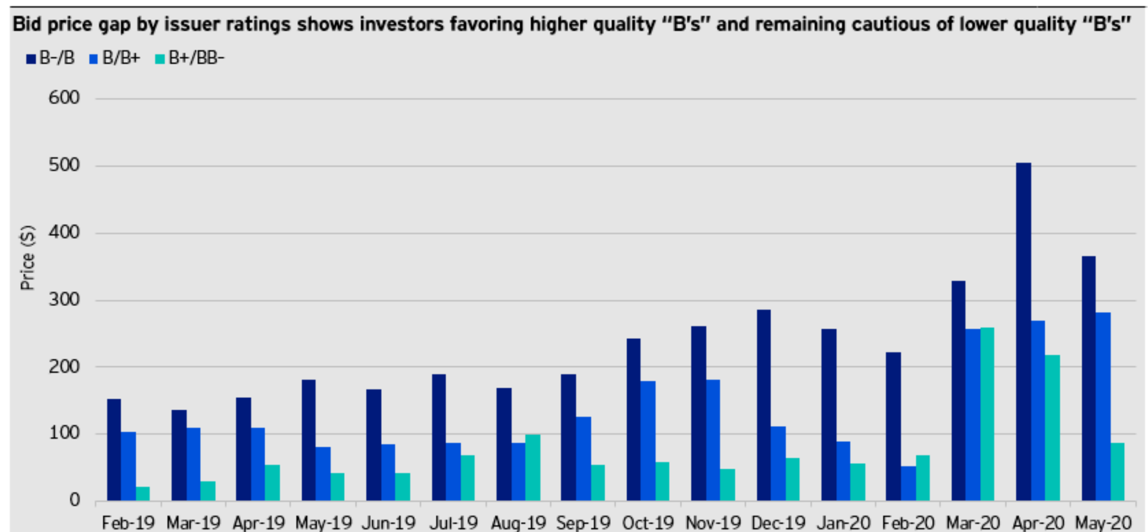
Invesco Senior Secured Loans

US Loan Market
Snapshot

Monthly US loan market update: May 2020

Loans continued to recover in May, gaining 3.80% during the month and improving year-to-date returns to -5.68%.[1] Encouraged by the initial stages of reopening, positive tidings on vaccine development, and additional policy support measures, investors wagered that economic activity has likely bottomed and a gradual rebound is underway. After sinking $20.46 from late February to late March, loan prices have now retraced $13.33, or 65%, of that loss.[2]

Loans underperformed high yield bonds (4.63%) in May, but outperformed investment grade (1.22%).[3] The percentage of loans trading below $80 declined from 17% to 12%, and now stands well below the peak of 57% reached on March 23, 2020.[2] This follows a comparatively stronger rally at the lower end of the quality spectrum in May; "BBs" (2.65%) underperformed "Bs" (4.57%) and "CCCs" (5.21%), though "CCCs" remain a clear laggard since the onset of COVID-19 with year-to-date losses of -15.58%.[1] At a more granular level, investors became increasingly discerning of risk within "Bs"; as shown below, the bid differential between B+/BB- compressed in May to more normalized levels while the differential between B-/B remained elevated.[1] The average price in the loan market was $90.33 at the end of May.[2] At the current average price, senior secured loans are providing a 7.56% yield inclusive of the forward LIBOR curve.[2]



Sources: LCD, an offering of S&P Global Market Intelligence; S&P/LSTA Leveraged Loan Index as of May 31, 2020. An investment cannot be made directly in an index.

Fundamentals

- Economic data remained extremely bleak, portending a significant contraction in Q2. However, market participants were more focused on the direction than the level this month; high frequency data sets tracking metrics such as traffic congestion and restaurant dining have reflected a gradual uptick in activity as restrictions are eased.
- The trailing 12-month default rate rose to 3.29% during the month, with 8 new issuers joining the list of recently defaulting issuers: Hertz, Akorn, J.C. Penny, Intelsat, Outerstuff, Fieldwood Energy, SkillSoft, and J. Crew.[4]

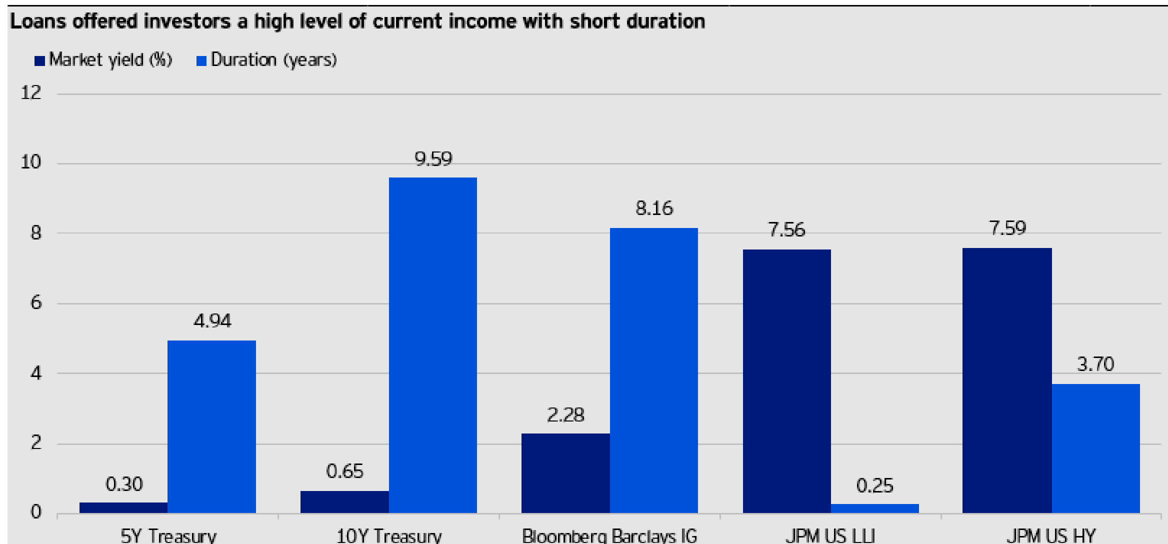
Technicals

- Loan technicals remained supportive during the month as institutional and CLO demand showed signs of life while new issue supply was sparse.
- New CLO issuance of $6.0 billion was an improvement versus the prior month as the new issue market continued to open to managers.[2] However, many of the new issues have been securitizations of open warehouse exposures. Although CLO liabilities tightened in the month of May alongside most credit products, on a historical basis they remain relatively wide and continue to challenge CLO arbitrage for equity investors.
- Retail mutual funds and ETFs reported outflows of $1.2 billion during the month, a continued moderation of the outflow trend in March.[2]
- The new issue market has been slow to resume; 16 deals priced in May for a total of $9.4 billion, slightly ahead of last month.[2] Net of refinancing, volume was $6.9 billion.[2] 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

Credit markets continued to rebound in May as the fear of "left tail" outcomes from COVID-19 disruption eased. While credit assets have seen a substantial pickup in investor interest in April and May, the inflows have gone primarily into high yield bonds instead of loans. Compared to the $1.2 billion retail fund outflow in loans, high yield retail funds recorded a $15.3 billion inflow in May.[2] This is not because the credit fundamentals are meaningfully different; in fact, loans offer better structural downside protection and have seen fewer defaults, due in part to less Energy sector exposure.[2] Rather, the difference in flows is driven by the US Federal Reserve's (Fed) more explicit intervention in high yield bond markets. The Fed began directly purchasing bond ETFs this month via its Secondary Market Corporate Credit Facility and has signaled it will purchase the debt of recent "fallen angels," which is more relevant to the bond market as those issuers typically do not have outstanding loans. The impact of other programs, such as the Main Street Lending Facilities, remains to be seen but should provide similar benefits bond and loan issuers.

In addition to the comparatively more direct central bank support for bonds, fixed rate assets have gained favor amid a declining interest rate environment. In light of these factors, issuers have preferred the bond market for secured and unsecured financing needs since the start of COVID-19, producing more than $80 billion of new issuance since late March including $47.3 billion in May.[2] However, despite the recent declines in base rates, loans continue to offer a comparable yield to high yield bonds while also providing better structural protection against loss given default as well as negligible duration risk.



Source: Barclays, JP Morgan and Bloomberg L.P. as of May 31, 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	99-23	0.30	–	4.94
10 Year Treasuries	99-23	0.65	–	9.59
Bloomberg Barclays US Agg. Index	110.10	1.34	T + 0.89	6.01
Bloomberg Barclays IG Index	111.49	2.28	T + 1.66	8.16
JPM US HY Bond Index	96.56	7.59	T + 7.18	3.70
JPM US Leveraged Loan Index	**90.14**	**7.56**	**T + 7.27**	**0.25**

Source: Barclays, JP Morgan and Bloomberg L.P. as of May 31, 2020. Loan "yield to worst" and "spread to worst" incorporate the LIBOR forward curve.

1 S&P/LSTA Leveraged Loan Index as of May 31, 2020.
2 JP Morgan as of May 31, 2020.
3 S&P/LSTA Leveraged Loan Index and Bloomberg as of May 31, 2020. High yield represented by BAML US High Yield Index; investment grade represented by the BAML Investment Grade Index.
4 S&P LCD as of May 31, 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.

Important information

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