European Loan Market Snapshot

Monthly European loan market update: August 2020

The Credit Suisse Western European Leveraged Loan Index ("CS WELLI" or "Index") returned 1.20% in August, comprised of principal return of 0.87% and interest return of 0.34%.[1]

Throughout the month, global markets have pushed higher. In aggregate, developed nations' stock markets jumped by 6.6% in August, its largest August move since 1986.[2] This was aided by fresh sparks of fiscal and monetary stimulus as well as Q2 earnings, which beat expectations. Furthermore, improved economic forecasts added momentum. For instance, forecasts for German 2020 GDP (Europe's largest economy) were increased to -5.8% from -6.3% given a faster-than-expected rebound in economic activity, which compares favorably to fears of double-digit declines earmarked in the spring.

Similarly, the leveraged loan market equally rallied on market optimism as well as the better-than-expected Q2 earnings. The CS WELLI was up by 0.9 points during the month, closing at an average price of €94.13.[1]

Primary loan markets stayed surprisingly active during the traditional August holiday period. New issue volume during the month came in at over €1.5 billion (bn) – more than double compared to the same time period last year – supported by the launch of the jumbo, cross-border (multi-currency) transaction of Swiss Telco UPC acquiring its competitor Sunrise Communications, which included $1.3bn and €0.4bn term loans.

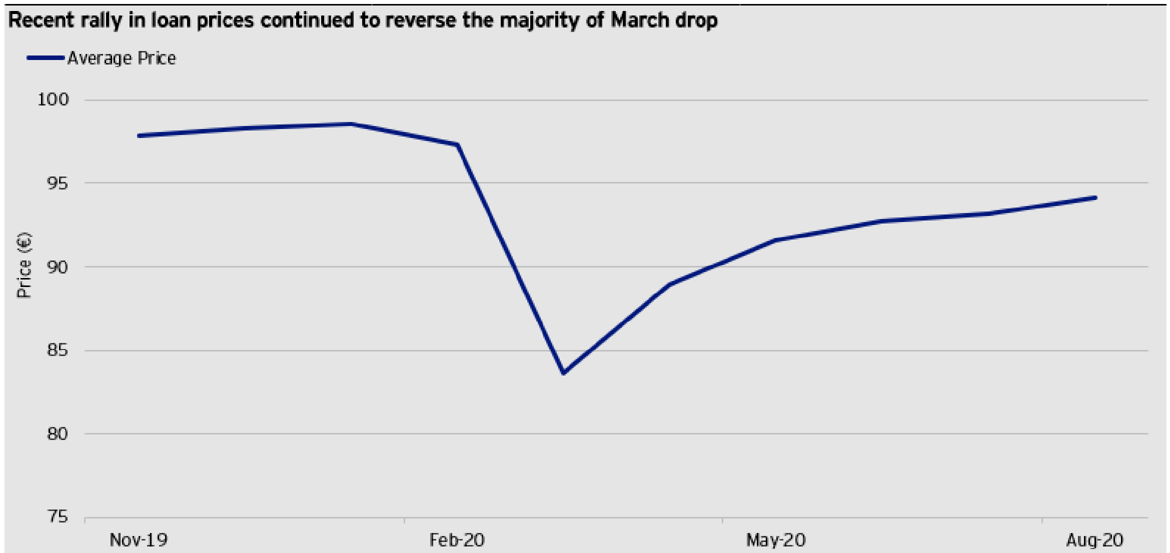
The CLO market on the stayed relatively quiet during August, with €0.5bn of new issuance, bringing year-to-date (YTD) volume to €14bn – down by 44% as compared to the same period last year.[3] AAA spreads have stabilized around the 140 basis points (bps) level – up circa 50bps for the year, but more than 150bps tighter compared to the levels reached in March-April. While creation of new CLO warehouses remains muted, it is likely that there remain numerous pre-pandemic warehouses – many of which are expected to launch soon, which could create potential demand for the asset class.

Discussions with dealers suggest a comparatively healthy leveraged loan pipeline to develop and to start materializing from early September.

As we close out the summer, we outline a YTD recap below. Much has happened during the first seven months of 2020:

- Prices crumbled as the COVID-19 pandemic struck but have recovered surprisingly quickly.
- Primary issuance has bounced back with even more challenged credit stories able to successfully clear the market.
- Initial credit ratings downgrades have stabilized.
- Overall uncertainty remains elevated, but (cautious) optimism has improved, moreover given improved COVID-19 vaccine prospects.

The CS WELLI's nominal value (size of the market) at the end of the month was approximately €314 billion, a 0.9% increase YTD.[1]



Source: Credit Suisse Western European Index (EUR-hedged), as of August 31, 2020. An investment cannot be made directly in an index.

Returns

- Within the CS WELLI, the best performing industries were Energy, which returned 5.61%, followed by Consumer Durables (3.58%) and Retail (2.19%).[1] There was no industry that delivered negative returns during the month.[1] Gaming/Leisure, the bottom performer, returned 0.05%.[1]
- 'B' rated loans performed best this month, with a total return of 1.13%, as compared to 0.99% for 'CCC' rated loans and 0.60% for 'BB' rated loans.[1]
- At month end, the average price of the CS WELLI was €94.13, up by €0.90 during the month.[1] The CS WELLI's three-year discount margin was 5.64% (a 34bps decrease during the month).[1] For comparison, the Credit Suisse Western European High Yield Index returned 1.35% for the month and had a spread-to-worst yield of 5.46%.[4]

Fundamentals

- After a record cumulative gain of 41 points over May-July, the Euro area ("EA") composite PMI declined by 3 points to 51.9 (although remained in expansion mode) in August, which was below expectations (55). The decline was skewed towards the Service sector, with the manufacturing PMI little changed from July. The readings suggest that the positive rebound from the unwinding of lockdown measures introduced over March-April has eased, and that the pace of sequential growth has moderated as the gap in the level of activity relative to pre-COVID narrows, which is consistent with high-frequency activity indicators.
- Although the EA flash PMIs disappointed in August, other surveys suggest that the recovery continued during the summer. The German IFO, French INSEE, and Belgian BNB business indicators, which rely on larger samples than the flash PMI, all increased in August.
- Fiscal policies remain supportive of the recovery. The temporary work support schemes are set to be extended (Spain, an exception, end its programs this year), which will help household incomes. Governments are still adding new fiscal stimulus measures, including France and Italy (€100bn and €25bn, respectively). Local fiscal efforts are underpinned by the €750 billion EU Recovery Fund, which is on track for ratification in September.
- Following a slow start, UK output has grown significantly, with the flash PMIs rising sharply in August and retail sales surpassing their pre-virus peak in July. The end of furlough is set for October and a sharp increase in the country's unemployment rate is anticipated thereafter, which will be the catalyst for additional fiscal and monetary easing. Brexit negotiations resume on 7 September. Some progress has been made on a number of important issues, including fisheries, the governance of the deal, and the implementation of the Northern Ireland Protocol; however, the "level playing field" remains unresolved.

- Risks are aplenty: a ramp-up in US elections activity; Chinese/US trade tensions; and geopolitical risks around the globe (Turkey/Greece, for example). EA risks center on national political agendas, with Italy in the limelight as regional elections approach in September. The EU Recovery Fund has given the Italian Prime Minister Conte breathing room and diminishes the risk of an early parliamentary election in the near term.
- New COVID-19 cases have risen throughout the summer period, with daily infections in Spain and France, for example, near their mid-April peaks. Importantly, fatality rates are lower than March and April figures, most likely due to more testing, a lower average age of the infected, and better treatment. Therefore, governments have not implemented strict lockdowns to abate the virus, instead relying on social distancing, mandatory wearing of face masks, and local containment measures. Given the lower fatality rates, the hurdle for a return to nationwide lockdowns is probably set high.
- The last twelve-month default rate for the S&P European Leveraged Loan Index (based on principal amount) is 2.01%.[5] The historical average annual default rate is 3.36%.[5]

Index returns (%)	2013	2014	2015	2016	2017	2018	2019	June 2020	July 2020	August 2020	YTD 2020
Credit Suisse Western European Leveraged Loan Index (EUR-HDG)	8.73	1.96	3.14	6.52	3.30	0.55	5.03	1.57	0.82	1.20	-1.85
Credit Suisse Western European HY Index (EUR-HDG)	9.10	4.31	1.36	9.63	6.28	-3.85	11.05	2.34	1.84	1.35	-2.73

Source: Credit Suisse, as of August 31, 2020. **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) in EUR as of August 31, 2020. Past performance is not a guide to future returns.
2 MSCI World Index as of August 31, 2020. The MSCI World Index captures large and mid cap representation across 23 Developed Markets (DM) countries.
3 Barclays Credit Research as of August 31, 2020.
4 Credit Suisse Western European High Yield Index in EUR as of August 31, 2020.
5 S&P European Leveraged Loan Index, average default rates covering June 1, 2007 through August 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

All data provided by Invesco, as at August 31, 2020 in Euro unless otherwise noted. Please note index returns represent total returns in respective base currencies.

This document has been prepared only for those persons to whom Invesco has provided it for informational purposes only. This document is not an offering of a financial product and is not intended for and should not be distributed to retail clients who are resident in jurisdiction where its distribution is not authorized or is unlawful.. Circulation, disclosure, or dissemination of all or any part of this document to any person without the consent of Invesco is prohibited.

This document may contain statements that are not purely historical in nature but are "forward-looking statements," which are based on certain assumptions of future events. Forward-looking statements are based on information available on the date hereof, and Invesco does not assume any duty to update any forward-looking statement. Actual events may differ from those assumed. There can be no assurance that forward-looking statements, including any projected returns, will materialize or that actual market conditions and/or performance results will not be materially different or worse than those presented.

The information in this document has been prepared without taking into account any investor's investment objectives, financial situation or particular needs. Before acting on the information the investor should consider its appropriateness having regard to their investment objectives, financial situation and needs.

You should note that this information:

- may contain references to amounts which are not in local currencies;
- may contain financial information which is not prepared in accordance with the laws or practices of your country of residence;
- may not address risks associated with investment in foreign currency denominated investments; and
- does not address local tax issues.

All material presented is compiled from sources believed to be reliable and current, but accuracy cannot be guaranteed. Investment involves risk. Please review all financial material carefully before investing. The opinions expressed are based on current market conditions and are subject to change without notice. These opinions may differ from those of other Invesco investment professionals.

The distribution and offering of this document in certain jurisdictions may be restricted by law. Persons into whose possession this marketing material may come are required to inform themselves about and to comply with any relevant restrictions. This does not constitute an offer or solictation by anyone in any jurisdiction in which such an offer is not authorised or to any person to whom it is unlawful to make such an offer or solicitation.